UK FINANCE

Prudential, Reporting and Tax

A response to the

FRC's consultation on UK Corporate Governance Code

September 2023

Introduction

1. UK Finance is the collective voice for the banking and finance industry. Representing around 300 firms, we act to enhance competitiveness, support customers, and facilitate innovation.

2. We welcome the opportunity to comment on the FRC's consultation on revisions to the UK Corporate Governance Code ('the Code') published in May 2023.

3. Approximately 25 of our members, many listed and others who voluntarily apply or are informed by the FRC's Code have contributed to this industry response. These members include the UK's eight systemic firms, listed mid-tier firms, larger building societies and UK subsidiaries of foreign globally systemically important banks. Almost half of the contributing firms are subject to US Sarbanes-Oxley (US SOX) legislation and related requirements either directly or, indirectly through their foreign parent.

4. As an industry, we are not only subject to the Code, but also provide banking and financial services to, and are investors in probably all the companies subject to the Code and the UK Government's new corporate reporting proposals. Therefore, as well as considering the implementation of these combined proposals, we have a strong interest in ensuring that the combined package delivers high quality corporate reporting and governance whilst maintaining the competitiveness of the UK market. This will inevitably entail certain trade-offs. Our members also have considerable experience from complying with the generally higher standards applicable to the financial services sector, as many are also subject to US SOX regime. We have drawn on this knowledge and experience to help consider the impact of the Code revisions on UK Plc. Our objective is to help the FRC in ensuring comprehensive good quality implementation whist ensuring the UK remains a competitive location for businesses to locate and to access capital markets.

UK Finance & FRC roundtable:

5. We found the recent roundtable meeting to discuss the proposed changes to the Code insightful and it was helpful to hear the FRC's views on some of our feedback. We have summarised below the four key points discussed in detail:

   - **Comply or explain**: we discussed the difficulties caused by the external perception that the Code is based on the principle of 'comply or else', that this was not the intention of the FRC and that in many cases disclosure of the reasons for a company not complying with the Code provides more helpful disclosure than boilerplate compliant disclosure. We believe that the concept of 'comply or explain' is fundamental to the Code's success and that the FRC should use this revision of the Code to strongly reinforce that an insightful disclosure of the reasons for not providing a Code disclosure can be the better option.

   - **Timing**: we discussed the volume of work that companies will need to complete to comply with the new requirements and that the proposed effective date of 1 January 2025 presented challenges to both companies and the FRC (in terms of producing its Guidance). There is a

significant risk that the proposed effective date will result in a poor implementation of the revised Code, damaging the UK's global standing and competitiveness. We firmly believe companies need more time to plan and subsequently dry-run processes in a considered manner. This will lead to better corporate governance and disclosures, further enhancing the Code's global reputation.

- **Group exemption**: we briefly discussed the scope of the Code. Companies that have only listed debt, including subsidiaries of premium listed companies, do not currently have to comply with the Code. We agreed that there was no value in subsidiaries each separately complying with the Code. The FCA is currently reviewing the categories of listed entities and it is important that the wording of the scope of the revised Code in combination with any changes to the Listing Rules made by the FCA does not have the unintended consequence of subsidiaries coming into scope of the Code.
- **Controls & Audit & Assurance Policy (AAP):** We believe that the corporate reporting reforms being implemented through the UK government's secondary legislation and the FRC's Code will provide greater value to investors if they are aligned. In particular, we believe that the scope of the directors' declaration on reporting controls should be limited to those that are relevant to disclosures within the scope of the annual report and accounts.

Key messages

UK competitiveness

6. **Our members are still concerned about UK competitiveness**: We reiterate the comments on UK competitiveness that we made to the UK government's proposals to improve the UK's audit, corporate reporting, and governance, as set out in the White Paper 'Restoring trust in audit and corporate governance'.

7. **Trust in UK corporate governance:** We acknowledge that the failure of significant companies can have material social and economic consequences. So, in the wake of a handful of recent high-profile corporate failures, we support the UK government's and the FRC's policy objective to enhance certain disclosure and corporate governance requirements. However, we do not believe that there has been a pervasive breakdown in public trust in the way that the UK's largest companies are run, governed and scrutinised.

8. **FRC' s current Code is the gold standard**: Arguably, the FRC's current Code is regarded as the gold standard that is copied by many jurisdictions around the world. It does not need all the proposed changes. The UK already has an enviably strong international reputation for high quality corporate reporting and governance, albeit we agree there will always be room for improvement and evolution. This is acknowledged in the executive summary of the White Paper as "*The UK is consistently placed as one of the leading destinations for foreign investment in Europe and around the world….This includes the UK's internationally-respected system of audit and corporate reporting, which is mirrored by many countries around the globe…The UK has long had a hard-earned reputation for high standards of corporate governance and robust practice for investors and others stakeholders*".

9. **Proportionality and cost benefit analysis**: It is important that any reform addressing the issues identified through the various reviews is proportionate, appropriately balancing benefit and cost and adopting a holistic and consistent approach across various UK authorities. This must be a significant consideration as the UK makes its way out of the Covid-19 and Ukraine war related economic challenges and sets its global agenda in a post-Brexit environment.

10. **Maintaining attractiveness of UK markets:** The proposed measures should be designed to further enhance the already internationally pre-eminent UK corporate governance framework and not disincentivise companies from establishing and developing businesses in the UK. If implemented

without due consideration and evaluation, the combined proposals of the UK government and the FRC could result in new and potentially burdensome requirements on both current and prospective UK-listed companies, undermining the recent governmental efforts to increase the attractiveness of the UK markets through the UK Listings Review. It could also render boards less effective by deterring senior executives from working in the UK or making it difficult to recruit non-executive directors of appropriate quality. Finally, excessive, and overly complex reporting and governance could deter investors and stakeholders, or by rendering boards excessively risk adverse, harm innovation, constrain market forces or in extremis, create situations where companies deliberately operate under the thresholds to avoid the burden of compliance.

11. **Consistency across regulatory developments:** It is essential that certain criteria are met across the package as the UK government and the FRC implements their respective corporate reporting and governance reform: notably quality, proportionality and consistency with other UK and international requirements and frameworks, with the ultimate goal that the UK continues to be 'a world-class destination for investment'. While we agree that the UK benefits from having, and being seen to have, the highest standards of corporate reporting and governance, we also see a need to guard against implementing changes with little or no incremental benefit, that merely duplicate existing requirements or that introduce inconsistencies. For example, the FCA is currently reviewing the Listing Rules and is proposing to create a single listing category for shares in commercial companies. The Code is currently applicable only to premium listed companies. Whilst the FCA proposals appear to support the retention of discrete listing categories for entities with other types of instruments, any changes to the Listing Rules should not inadvertently bring the Code into scope for wholly owned subsidiaries of premium listed companies, including subsidiaries with a listing only in respect of debt instruments. This could be achieved by adopting a group-based approach in line with the UK government's corporate reporting secondary legislation. Many of our members use separate entities for debt issuance and it would be a disproportionate burden and inappropriate for these entities to be within the scope of the Code.

12. **Overall adverse impact on UK competitiveness**: While we generally support the overarching principles and objectives of the UK government's corporate reporting and aspects of the FRC's Code proposals, we are concerned that the proposals, taken together, could significantly reduce the attractiveness of the UK as a location for business.

Scope

13. **Many uncertainties**: Whilst we agree with the broad scope of the revised Code, several requirements require further clarification. Primarily, this is in relation to the requirement for directors to assess and make a declaration in the annual report on the ongoing effectiveness of the risk and control framework building on the current requirement of ensuring a risk and control framework has been effectively implemented. We set out our specific concerns below.

14. **Risk-based control assessment by boards**: Assessing the effectiveness of the risk and control environment and the basis of that assessment during the reporting period should build on the existing requirement to establish a risk and control framework. It should be proportionate and principles-based, using the judgement of senior executive management and audit committee and not be based on a fixed set of mandatory rules. The setting of the risk and control framework, the level of risk appetite, the identification of key controls and the nature of the control assessment must be an informed risk-based judgement by firms' boards.

15. **Internal assurance and reviews should be appropriate under the Code and the related Audit and Assurance Policy in the SI**: The current Code's flexibility of approach should be retained to avoid a

establishing *a de facto* set of fixed standards. For example, various methods of control assessment are valid and should be acceptable, including internal self-assessment, independent internal assurance, third line of defence review, as well as limited external assurance and reasonable external assurance. It would be reasonable to expect that, with the additional obligations placed on directors under the proposed Code, they would request that existing assurance be expanded, or the scope of assurance be increased, by internal auditors, external auditors, or other assurance providers. The Code should explicitly state that internal independent assurance or self-assessment will often be appropriate and in many cases will reinforce the embedding of a strong risk and control culture. Externally facilitated assurance can provide comfort but should not always be seen as the best form of assurance, nor as an alternative to appropriate internal risk management.

16. **Balance sheet date reporting**: The Code should explicitly state that the assessment is aligned with the balance sheet date based on the assessment undertaken during the year, in line with other annual report and accounts processes. Only control deficiencies identified as material weaknesses (subject to an agreed definition for a material weakness or an alternative phrase as discussed below) that are unresolved at the end of the reporting period should be considered for disclosure. In our view, publication of all resolved and remediated issues would provide a misleading view on the effectiveness of the risk and control environment.

17. **Post balance sheet date assessment**: Expanding the scope of assessment to the period between the balance sheet date and the signing of the annual report and accounts would not be appropriate. It will be costly and inefficient to put in place additional controls that can identify an issue that arises across different risk types identified in the post reporting date period.

18. **Avoid conflict with other regulatory requirements**: Financial institutions are already subject to a significant volume of regulatory rules in relation to risks and controls through other regulators, including the PRA, FCA, SEC, as acknowledged by the FRC. Therefore, it is essential that there is no conflict with or near duplication of existing requirements to reduce operational burden and cost This should be addressed in the Code or at least in the forthcoming guidance.

Clarity and Guidance

19. **Material weakness definition**: We do not believe that the term "material weakness" should be used within the FRC's proposed Code, to reduce the risk of confusion arising between a material weakness as defined by US SOX and a material weakness as defined by the Code. To ensure consistency of reporting, the Code must provide an unambiguous definition of matters that need to be publicly disclosed with examples of options available to confirm the effectiveness of controls. This is particularly important given that the Code proposes disclosure of control weaknesses for operational, compliance and broader reporting processes, as well as financial reporting and would ensure a move towards consistency and certainty and demonstrate that the proposals are also proportionate. We do not believe that current wording in the consultation achieved this. As recently seen with Credit Suisse, the publication of a "material weaknesses" under the US SOX regime can have a significant impact on a company. The current wording in the consultation can be interpreted in many ways which raises a significant risk of inconsistency across companies, potentially generating uncertainty in the minds of users.

20. **Annual report disclosures only**: The scope or definition of narrative reporting that audit committees are responsible for monitoring in relation to the Code should be limited to the annual report disclosures only.

21. **Guidance and examples**: The forthcoming guidance on the risk and control framework is a critical document and we are concerned that it will not be available until after the FRC has published the revised Code. Having the opportunity to review and comment on the guidance prior to publication of the Code can only help companies with their implementation. The FRC will also be providing guidance on the other new reporting requirements included in the UK Government's secondary legislation package. To map out a timeline for implementation of these changes alongside the Code revisions, companies will need early sight of any planned guidance to scope the work required. Until the guidance is available, it will be difficult for firms, particularly smaller and those not already subject to similar requirements from other regulators, to conduct any form of gap analysis and determine the amount of resource needed for implementation. The Guidance should include clear non-biased examples and alternative options on how the risk and control assessment can be achieved rather than leading companies in one direction or no direction. Where relevant, the examples should refer to exiting frameworks used elsewhere or by other regulators.

Timelines and good quality implementation

22. **Packed FRC agenda and squeezed implementation:** To facilitate a high-quality implementation of these requirements, we believe that companies should be able to design, implement and 'dry-run' the requirements with appropriate rigour for a full calendar year. Given the FRC's expected timing of the proposed Code, the associated Guidance from the FRC for the new Code and the UK government's related corporate reporting secondary legislation, laid before Parliament only recently, we believe that an effective date of 1 January 2026 would be more appropriate. The proposed condensed timeline will pose a significant pressure and costs on smaller companies that do not already report under regimes such as US SOX and have fewer resources with which to meet the significant new requirements. Previous control frameworks such as US SOX, which has a narrower scope than the proposed Code, took several years to fully implement.

23. **Time to review guidance**: Preparers, their auditors and other relevant stakeholders should have the opportunity to review and comment on the detailed guidance associated with the risk and control assessment as well as the linked new corporate reporting prior to implementation.

24. **Poor-quality outcome could undermine confidence in the UK corporate sector**: In some sectors such as banking, the risk and control framework is already well embedded but implementing the revised Code will still represent significant incremental effort. However, for other companies, the risk and control framework is significantly less mature and so these proposals will be a major undertaking. An overly ambitious implementation date could lead to a poor-quality outcome undermining confidence in the UK corporate sector.

25. **Enforcement of the new corporate reporting and revised Code proposals**: The UK government has recently indicated that it will not be going ahead before the general election with its primary legislation proposals to establish Audit, Reporting and Governance Authority (ARGA). Given that the FRC does not have the enforcement powers that are expected to be given to ARGA, this could cause confusion, both in terms of the directors' responsibilities for the revised Code and, in how the government's new corporate reporting proposals will be enforced.

Responsible Executive

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Answers to specific questions

1. Do you agree that the changes to Principle D in Section 1 of the Code will deliver more outcomes-based reporting?

   Strategy, stewardship, and oversight as well as outcomes: The move towards outcomes-based reporting is a positive step. However, Board governance effectiveness cannot always be proven by evidenced outcomes. Boards spend considerable amount of time on stewardship, challenge and oversight which do not necessarily have separately identifiable outcomes. Strategy does not have short term outcomes either and it can be difficult to evaluate and describe the impact of the adoption of a given strategy as against available alternatives. These facets should be recognised in the Code.

2. Do you think the board should report on the company's climate ambitions and transition planning, in the context of its strategy, as well as the surrounding governance

   Boards should report on climate ambitions and transition planning: We agree that boards should report on the company's climate ambitions and transition planning. To ensure both the success of the company and delivery of the company's climate change ambitions, boards need to ensure that the company's ambitions and plans are aligned to its strategy, supporting the Government's stated 2050 net-zero commitment for the UK economy. Ideally companies will identify and develop commercial opportunities linked to their climate change strategy which reinforces this approach and meets the needs of all stakeholders. We propose the following amendment to Provision 1 proposals to clarify that reporting should cover both embedding and delivery of climate ambitions and transition planning:

   "It should describe in the annual report how opportunities and risks to the future success of the business have been considered and addressed, the sustainability of the company's business model and how material environmental and social matters are embedded in, and taken into account in the delivery of, its strategy, including its climate and transition planning."

   Proposed updates to the code centre around expanding the responsibilities of Board Audit Committee to include: "monitoring the integrity of narrative reporting, including sustainability matters and reviewing any significant reporting judgements". As the remit of Board sub-committees increase in this space, it seems appropriate for the Board to also report on these matters given their importance to a broad set of stakeholders.

   Relevance and materiality: There are a broad range of climate-related topics. It is for individual boards to determine which are relevant and material to the company.

   Eliminate conflict with other regulatory requirements: We consider that the inclusion of detailed reporting requirements on climate change and transition risks in the Code is unnecessary in light of regulatory disclosure requirements elsewhere, including in the UK Listing Rules, UK law and International Sustainability Standards Board Standards (once promulgated in the UK), to reduce the potential for conflict.

3. Do you have any comments on the other changes proposed to Section 1?

   Culture: Given the embedded nature of culture, we suggest that Principle B is changed as follows:

   "The board should establish the company's purpose, values, culture and strategy and satisfy itself that these are all aligned."

   We welcome the more explicit link of purpose, values, culture and strategy to Board's responsibilities and workforce practices and policies. But it is important that this link is not just a compliance exercise and is instead reflected in actions and companies' operations. We understand that reward in provision 2 might have been removed to avoid duplication but given the importance of reward and incentives to achieve delivery against purpose and strategy, we suggest retaining the explicit link between purpose, performance and reward.

   Overlap in the financial services sector: the consultation on the proposed revisions to the Code is taking place at the same time as the FCA and PRA review of the Senior Managers' Certification Regime (SMCR). In UK Finance's response to HMT/ FCA on the SMCR Call for Evidence, we queried whether there should be a review of NEDs duties in SMCR vs the Corporate Governance Code, given the overlap. Prior to the SMCR, a number of executive roles in banks around the world were already caught by high individual regulatory bars e.g. Chief Accounting Officers, or by Professional Standards Bodies (Accountants). Arguably, the SMCR

brought other accountable executives into a similar net and levelled the playing field across the business and functions of financial services.

Engagement: In principle 3 the amendments require the chair to engage with shareholders on strategy matters, with similar comments on engagement in other sections. In practice it can be difficult, especially for smaller companies but even larger ones from our membership, however willing, to achieve any meaningful level of contact with shareholders in the normal course of events. We suggest that the wording be changed to 'seek engagement' to reflect these difficulties and that attention should also be given to expectations of investors under the Stewardship Code in parallel with this.

4. Do you agree with the proposed change to Code Principle K (in Section 3 of the Code), which makes the issue of significant external commitments an explicit part of board performance reviews?

Sufficient time for the role: As noted in question 1, we support the Code becoming more outcomes-based. The proposed change on "directors' commitments" is focussed on the 'inputs' and we believe that it would be better for boards to assess whether each director devotes sufficient time to their role and is effective in discharging their board responsibilities. The proposal should be revised to focus on directors' discharge of responsibilities regardless of other commitments. We noted that, particularly for NEDs, commitments might include a variety of corporate roles, charitable involvements and other obligations, which might take up a considerable amount of their time, but would not be identified by the approach suggested.

Financial services: Within financial services, prudential requirements in CRD IV already limit the number of roles board members may hold so we do not *per se* object to the proposed changes to bring other sectors to the same level.

Investor expectations: Investors also tend to set their own expectations on number of positions, albeit there may not be alignment across companies, probably reflecting that the time commitment of a NED or a chair on every listed company is not equivalent. Therefore, the FRC should leave to market forces to resolve as relevant the appropriate numbers based on each company's business model and organisational structure.

Rely on chair and the board instead: Alternatively, taking account of these different considerations, the approach could be to rely on boards and particularly the chair to judge and take the right course of action.

5. Do you agree with the proposed change to Code Provision 15, which is designed to encourage greater transparency on directors' commitments to other organisations?

Too prescriptive: We consider that the proposals are overly prescriptive and that the current requirements are sufficient (para 15 already indicates that the reasons for permitting significant appointments should be explained in the annual report and external appointments are listed in the annual report or website).

Boilerplate disclosures: The proposed disclosures will not add value and be boilerplate as it will be extremely challenging to articulate time availability succinctly. If the FRC believes this can be achieved, we would appreciate guidance on what it considers a good disclosure might look like. Generally, we believe that companies should be trusted to monitor this internally, for example, through performance reviews (as per Q4) and identify where there is a real concern as to a director's ability to discharge their responsibilities relating to time commitment, potentially with a description of this process given in the entity's board reporting.

Guidance on significant, appointments, commitments: Guidance is required on the definition of 'significant'. We also note that as drafted this proposal increases transparency on 'significant appointments', but not necessarily all commitments to other organisations. This could lead to directors taking more appointments that do not meet the definition of significant to avoid disclosure.

Equivalence of working days and calendar days for NEDs: When describing how each director has sufficient time to undertake their role effectively, it may be helpful to clarify the baseline for review, including expected number of days for NEDs

Location of disclosure: We welcome the lack of prescription of location for this information.

6. Do you consider that the proposals outlined effectively strengthen and support existing regulations in this area, without introducing duplication?

Align with Listing Rules: UK Finance and members are strong advocates of diversity and inclusion, but we would suggest ensuring close alignment with related Listing Rules and other market benchmarks requirements from a consistency perspective. There is already an issue with different requirements using

differing definitions of 'senior manager', for instance. It might also be sensible to clarify whether an Internal Audit Director is defined as a senior manager, in the same way as the proposals provide for the Company Secretary, given that the Code requires them to report to the Audit Committee Chair, rather than the CEO, falling outside the definition as drafted.

7. Do you support the changes to Principle I moving away from a list of diversity characteristics to the proposed approach which aims to capture wider characteristics of diversity?

We agree with the proposals and support the idea that diversity should not be a compliance exercise or that some characteristics are 'more important' than others. We welcome the focus on cognitive and personal strengths as this moves more towards the concept and value of diversity of thought.

We do not believe that the proposed terminology of protected/non-protected characteristics will add any incremental value to the current list, which should be amended to make it clear that the list is not exhaustive.

8. Do you support the changes to Provision 24 and do they offer a transparent approach to reporting on succession planning and senior appointments?

- **Succession planning:** We support the requirement for the Nomination Committee to provide an explanation of how the Committee oversees the succession planning process as this provides clarity on the approach adopted. It may be helpful to clarify in guidance what a 'diverse pipeline' means for the sake of consistency.

- **Publication of confidential information**: We do not support disclosure of granular aspects of succession plans, recognising that executive succession plans are confidential, while non-executive succession plans tend to be less specific given their very nature, and hence subject to change. This may be a more significant issue in smaller companies, where the number of executive roles under consideration may be smaller and therefore the potential candidates more readily identifiable.

9. Do you support the proposed adoption of the CGI recommendations as set out above, and are there particular areas you would like to see covered in guidance in addition to those set out by CGI?

We support the proposed adoption of the CGI guidance.

10. Do you agree that all Code companies should prepare an Audit and Assurance Policy, on a 'comply or explain' basis?

- **Align the Code with the secondary legislation on ARA only being in scope**: The secondary legislation focusses primarily on assurance over the content of the annual report and accounts, rather than any other public reporting an entity might publish; it would be helpful for the FRC to be consistent and indicate as such in the Code.

- **Group exemption:** The Code requirement for companies to prepare an AAP should be aligned with the statutory instrument. In particular, if a Code company is a subsidiary undertaking of a company that prepares a group AAP it should not itself be required to prepare an AAP. In these circumstances, the company should not have to 'explain' why it has not prepared the AAP, given that using the 'explain' option is often effectively viewed as non-compliance. Footnote 11 in Section 4 of the revised Code should be amended accordingly.

- **Transparency over assurance arrangements**: it is important to establish a framework explaining where directors believe assurance gaps may exist and how these are addressed. This allows focus on the more important elements of the Annual Report and Accounts (ARA) where additional comfort is considered relevant for stakeholder communication. We agree that this decision rests with the Board and audit committee, allowing companies to choose assurance arrangements, including providers, most suitable to their requirements, in both the short and long-term, providing clarity to users of the ARA and other disclosures on the robustness of the disclosures. However, there should not be a presumption that formal audit or external assurance is a pre-requisite for good reporting. We have some concerns with the current requirements of the AAP which focus primarily on external audit assurance which could potentially imply assurance from internal audit is of less importance.

- **Publication of assurance reports:** As part of the AAP, there is a requirement that companies publish summaries of all external assurance reports that they receive. While we agree that it is appropriate for

formal assurance of a limited or reasonable nature to be disclosed, we do not believe this requirement should apply to private assurance engagements.

11. Do you agree that amending Provisions 25 and 26 and referring Code companies to the Minimum Standard for Audit Committees is an effective way of removing duplication?

We agree with removal of duplication, noting that the Minimum Standards for Audit Committees have been published, as cross referencing is an efficient way to simplify the guidance. However, we note that:

- The Draft minimum standard does not focus on internal audit or internal controls but these are covered in a separate section of the Corporate Governance Code.
- this requirement should apply only to companies that have listed equity. Whilst this is currently the case (as the current Code applies only to companies with premium listings), the FCA is currently considering removing the distinction between premium listings and standard listings. We do not believe that companies that have only listed debt should be required to comply with the Minimum Standard as a result of the Code – the Minimum Standard itself applies only to FTSE 350 companies.

12. Do you agree that the remit of audit committees should be expanded to include narrative reporting, including sustainability reporting, and where appropriate ESG metrics, where such matters are not reserved for the board?

Scope of reporting: Overall we understand that the remit of Audit Committee is increasing, but we believe its remit should only cover specific reporting contained in the ARA and the general control environment of the company. We believe the scope of 'Reporting' in the Code proposals is too broad. All supplementary information should not automatically fall within the remit of the audit committee, it should be left to individual boards to determine what is relevant for their company. It would also be helpful to ensure that this remit is consistent with the scope of the AAP described in Question 10 response above.

Over-reach: We recommend that FRC leave it to standard setters to set the framework for and for individual boards to determine what is material for inclusion in the ARA. For example, recent changes to the Companies Act have seen the inclusion of Task Force on Climate-related Financial Disclosures (TCFD) into the Strategic Report of the ARA. Similarly new International Sustainability Standards Board (ISSB) disclosure standards will be connected to the ARA.

Responsibility for sustainability reporting: We agree that a board committee composed of independent non-executive directors should oversee sustainability reporting and other narrative reporting. However, flexibility and proportionality are important, and the Code should avoid being prescriptive. For example, as drafted, the Code would not allow for companies who have set up sustainability / ESG committees or other committees that may be better placed to provide this oversight. However, we agree that the ultimate responsibility to assess whether the annual report and accounts as a whole is a coherent depiction of the company's activities must sit in one place, and that can only be the Audit Committee,

Sustainability reporting metrics, targets and assurance: the Audit Committee or other equivalent Board Committee should:

- Be responsible for the oversight of the reporting and disclosure against the sustainability strategy and progress against metrics and targets – leveraging the Finance and Risk or equivalent control framework delivering internal reporting and external disclosures to the same standard as the general-purpose financial reports.
- be aware that disclosure standards are increasingly focused on the connections between sustainability risks and opportunities with the sustainability-related financial disclosures and financial statements, provided at the same time as the financial statements as part of general-purpose financial reports. for example, as posited by ISSB's first two standards, published in June 2023. On that basis increasing the Audit Committee's (or another suitable Board committee's) remit to include narrative reporting, including sustainability reporting and ESG metrics (where appropriate) would facilitate appropriate oversight of this connectivity being established and maintained.
- consider implications of assurance. Narrative reporting of sustainability matters is increasingly subject to external audit and assurance. The Audit Committee is generally expected to provide this oversight, leveraging their existing financial reporting assurance remit as well as the requirements of the UK government's' proposed statutory instrument covering AAP.

- **Evolution of controls standards around non-financial and sustainability reporting:** Non-financial and sustainability reporting is still developing, and the processes, systems and control frameworks are not as sophisticated or mature as financial reporting. This is also true of the assurance processes presently

available in these areas, including those from firms outside the major audit firms. A single attestation may lead users to mistakenly believe that control standards are equivalent across all aspects of reporting, and potentially restrict the emergence of useful forms of information as these areas mature.

13. Do you agree that the proposed amendments to the Code strike the right balance in terms of strengthening risk management and internal controls systems in a proportionate way?

Appropriate and reasonable principles: The principles underlying the proposed amendments are appropriate and reasonable, as they provide improved accountability and transparency, while avoiding disproportionate burdens on business, allowing flexibility for companies to tailor their arrangements to their own circumstances. We propose that where flexibility and discretion can currently be applied by the Board, that this remains allowing firms to apply appropriate sound judgement in relation to the management and reporting of the risk management framework, where it is complemented by independent internal oversight and assurance.

Concerns on practical implementation: Even with flexibility, we have concerns on the practical implementation that may mean the Code may not strike the right balance. We would welcome clarification on the following points:

- **Scope of reporting**: see response to question 12 above relating to supplementary information.

- **Period of reporting**: The period over which the board's declaration applies should not extend beyond the balance sheet date up to the point of signing the financial statements. We do not believe it is practical to attest to the operating effectiveness of controls up to the date of signing the ARA. See response to Q14 for further details.

- **Disclosure of control failures**: Clarification on the reporting or disclosure of control failures is required, as this may introduce hair-trigger reporting at the point of identification of a control failure which does not allow board the opportunity to resolve them in a timely manner. We believe it is necessary to consider company's ability to respond to issues. This issue might be addressed if more guidance was given on the intent of this disclosure requirement

- **Interim reporting requirements:** We believe that the requirements should be limited to the annual reporting cycle. This needs to be clarified within the Code to alleviate 'scope creep' through market expectation. There could be an additional burden on companies and their directors, seeking confirmations of control effectiveness at each reporting period (for the larger banks caught by the Code, this could be quarterly), to avoid a situation where a control issue is reported at year end as part of the ARA but was in existence at the time of interim reporting. Making the attestation aligned to the balance sheet (and hence ARA production) would ease the burden but it does not need to detract from the intent or ability of reporting on the continuous operation of those internal controls.

- **Group relief**: For the proposed changes to the Code to be proportionate, they need to strike the right balance between benefit and cost. To avoid disproportionate burdens on business, we strongly recommend the FRC confirm that subsidiaries and intermediate groups should not be required to prepare an AAP if the ultimate parent is a PIE or Code company that prepares a group AAP.

- **Natural evolution of the control environment over non-financial reporting:** On climate and ESG reporting, our view is that the proposals do not consider the current industry wide limitations with climate data. Due to lack of granular customer level climate data, there is currently reliance on third party data sources and judgements need to be applied to estimate data where this is not available. There are currently no standard estimation methodologies for some types of exposure or guidance on judgements made which would be needed to drive consistency across different companies. External assurance methodologies and tolerance levels will need adjusting to deal with these specificities related to climate and ESG data. We feel it may be more appropriate for a phased approach (or that controls are brought into the scope of the Code in blocks) for the implementation given we know it is a multi-year journey to get to the same level of control environment as financial reporting and metrics. And while we understand the Code is based on an comply or explain basis, providing explanations for this could be seen as non-compliance rather a natural evolution of the control environment.

- **Clear definition of standard terms:** The banking sector tends to have a common risk language across the industry as would other sectors. Therefore, we would encourage the FRC to not introduce new lexicons

where possible, but to align to existing or common industry definitions. The banking regulator already has clearly expressed expectation for the control environments to be operated by firms, and it would be helpful if the FRC's expectations harmonised with these. As the threshold is different for each company, for individual companies and sectors, the FRC could leave the definition of what constitutes a material control with their boards, so that resource and focus is concentrated in the relevant areas.

- **Disclosure of material weakness**: Explicit clarification is needed to understand the scope of disclosing 'Material control weaknesses'. Financial institutions are a critical part of the national infrastructure and require the flexibility to decide what disclosures will cause harm to the bank or their customers e.g., disclosure of material weaknesses in cyber controls could lead to an increase in cyber-attacks, or other material weaknesses could generate a run on the bank, produce significant banking sector uncertainty or create significant issues with customers and shareholders, if made public.

- **'Comply or explain' conundrum**: We support the 'comply or explain' nature of the Code in principle and note the FRC's efforts to reinforce this in the consultation. However, there is a disconnect between the FRC's vision of "comply or explain" and the real-world experiences of listed companies. Members report that this has sometimes translated into a "comply or else" situation, where some investors, governance analysts and proxy agencies approach compliance with the Governance Code as a box-ticking exercise without scope for flexibility, and companies feel compelled to follow guidelines rigidly to avoid negative consequences or an adverse 'score'. Companies need to be able to demonstrate and articulate their reasons for departing from the Code, how they link to the business strategy, and how the risks of divergence have been minimised. This is key to securing the attractiveness of the UK as an international destination for business. The current misalignment between this intended flexibility of "comply or explain" and the actual rigidity experienced by companies needs to be acknowledged and effectively addressed by the FRC, including the role of voting proxy agencies, whether based in the UK or overseas. The assessment of corporate compliance with the Code and subsequent reporting by voting proxy agencies play a pivotal role in shaping the perception of compliance. Ensuring that 'explain' through insightful disclosure of the reasons for not providing a Code disclosure can be the better option will become even more important given the new reporting requirements that the Code and the UK government are seeking to introduce. We would recommend a change in emphasis to 'explain compliance' rather than 'comply **o**r else' that effectively exists under the current Code.

- **Capacity**: We anticipate that firms seeking to recruit staff with appropriate experience will struggle in the short-term, due to the limited pool of candidates and the widespread demand for these people across UK PLC which will result from the reforms. We have also been warned by audit firms that their capacity to provide assistance is likely to be constrained by their resource levels.

14. Should the board's declaration be based on continuous monitoring throughout the reporting period up to the date of the annual report, or should it be based on the date of the balance sheet?

Continuous and dynamic monitoring but 'as at' reporting: We generally support the FRC proposal that the board's monitoring could be continuous and dynamic, relative to board defined appetite of the framework elements, acknowledging that this may in some cases force disclosure (see below). We suggest this is a cyclical activity, in the same way that a firm's approach to internal audit assurance will be cyclical, with the formal annual declaration aligned to the balance sheet date in line with other elements in the annual report. The declaration provided within the ARA should explicitly state that it is 'as of' the balance sheet date. There will be practical impediments to the board being able to assert that controls are effective days immediately prior to publication of the annual report, among them, the difficulty of sourcing sufficient evidence to support the assertion.

Disadvantages and the practical consequences: Having considered the potential benefits of the proposals, as discussed above, we have also considered the possible disadvantages and the practical consequences of the proposals. These are:

- **Level of disclosure and commerciality**: We would be cautious on the level of disclosure of outcomes of continuous monitoring (for example the effectiveness of specific controls) given commercial sensitivity, and we would also question the value and overall purpose of the more detailed reporting requirements. We would appreciate further engagement on the more detailed guidance being drafted to help shape the requirements and ensure that disclosures are comprehensible and beneficial to users.

- **Operational burden and costs**: There is a risk that continuous monitoring requirements will lead to a significant operational burden and cost for firms to provide assurance and testing in order to evidence the effectiveness of internal controls across a broader spectrum of reporting throughout the year.

- **"Not US SOX":** We acknowledge that the FRC has reiterated that the premise of the Code is not the same as US SOX, where companies are already subject to an annual review of internal controls over financial reporting (ICFR). However, the ICFR approach should be explored as an appropriate starting point before expanding control frameworks and attestation across all reporting areas. For companies covered by US SOX, users of the financial information have assurance that at year end that the external auditors have checked all material aspects relating to financial reporting. But this level of assurance on internal controls would not be possible on a continuous basis and ultimately could give false comfort. Nor would it be possible over other areas of internal controls such as non-financial reporting and operational and compliance controls given the relative lack of maturity of these aspects compared with financial reporting. For companies not already subject to these requirements there should not be an assumption that the US SOX framework forms the most suitable approach. This should be assessed on the particular circumstances of the company including its complexity, risk profile and the maturity of its pre-existing systems.

- **Impact on UK competitiveness**: Given that the costs could be disproportionate, it would be good to see it tested through a cost benefit analysis. Given the difficulty of constructing a gap analysis based on the information published so far, it is difficult for firms to evaluate the additional costs, although we appreciate that the FRC may have access to a different approach. We believe that, as drafted, the proposals will create such a burden that it significantly reduces the appeal of investing in businesses in the UK, including both investing in stock and setting up a business. It will also be easier to achieve buy-in from boards, investors and other stakeholders if the benefits are clearly visible.

15. Where controls are referenced in the Code, should 'financial' be changed to 'reporting' to capture controls on narrative as well as financial reporting, or should reporting be limited to controls over financial reporting?

Controls over financial reporting; See under "Not US SOX" in response to Q14 above.

Scope including new corporate reporting requirements: There is an assumption that the Code's scope refers to the annual report, including any narrative disclosures and the Government's new corporate reporting proposals (Resilience Statement; AAP; Material Fraud Statement). This should be clarified in the final Code to avoid confusion as there are other external reports which are published either voluntarily or pursuant to legislation or regulation.

Maturity of non-financial reporting: There is a significant difference in maturity between processes, controls and governance between financial reporting and non-financial reporting. We are concerned that a 'common' attestation may give a false level of confidence over non-financial reporting, even if the level of assurance is clearly disclosed in the AAP, where this is either required by the UK government's new corporate reporting proposals or published voluntarily. Recent developments in reporting show a growing importance of non-financial reporting to various stakeholder groups. This is being accelerated by the trend for increased ESG disclosures within annual reports. To provide comfort to stakeholders over these key disclosures, a broader reporting focus is essential. However, the wording in the Code revision proposals do not provide clarity on the nature of reporting.

Divergence from SOX: Whilst the FRC has posited that the Code's control framework is not aligned with US SOX requirements which only relates to financial reporting, our members subject to US SOX highlight that, practically speaking, there should not be an automatic assumption that the controls over narrative disclosures meet US SOX standard and it should be clear that other valid assessment methods can be adopted.

16. To what extent should the guidance set out examples of methodologies or frameworks for the review of the effectiveness of risk management and internal controls systems?

Examples of best practice should be included in the guidance: As highlighted by the FRC, financial services and banking industry has well established processes for reviewing the effectiveness of their control and risk management systems so would not necessarily require additional guidance. However, we consider that good practice examples of methodologies and frameworks would support effective implementation of the Code. Given that the proposals look to build on the existing Code, it would be useful to see examples of how existing methodologies and frameworks could evolve from current state to meet the requirements of the new proposals and what this may look like in terms of reporting outputs and formats.

Proportionate, principles-based and aligned with other regulatory requirements: Whilst we expect FRC guidance to be principles based, we caution that it should not be too prescriptive, otherwise it will limit firms' ability to adapt to requirements relevant for their business model and complexity, and potentially to address future developments in the reporting landscape. From banking industry perspective, we would welcome the

opportunity to comment on the contents of future guidance to provide insight based on our own extensive experience, to ensure that any guidance is proportionate, suits a variety of different business models and considers that some companies are already subject to similar requirements by their own industry regulators. It is essential that such companies or sectors are not subject to competing requests or overly burdensome requirements on top of existing heavy regulatory control reporting requirements such as US SOX and the SMCR for the banking industry and the extensive corporate reporting obligations placed on premium listed issuers in the UK. Direct reference to existing standards and practice in the UK, whilst not limiting the flexibility and discretion available to companies, would be more valuable.

Group considerations: We also believe guidance is required to provide clarity on reporting at group level of weaknesses noted in a lower-level entity and how to assess implications at intermediate Group levels.

17. Do you have any proposals regarding the definitional issues, e.g., what constitutes an effective risk management and internal controls system or a material weakness?

Scope of the revised Code: There are various factors in the Code proposals that make defining "material weakness" difficult:

- The need to cover reporting (financial and non-financial), operating and compliance controls
- the varying size of companies in scope and the different sectors they operate in
- the intersection with the UK government's new corporate reporting requirements (see response to Question 18)

Whilst we appreciate that the FRC would want to create a defined standard that can be used across all facets discussed above, it may be difficult to create a definition that effectively captures the items 'material' to all firms in all sectors and for all the different areas in scope. Therefore, some elements should be left with the boards of companies to define as relevant for their sector, size, and business model.

Divergence from US SOX: The FRC is clear that its proposals are not intended to be UK SOX, however the language appears to be deliberately drawn from US SOX, and we believe this will be misleading for users given the differences. As noted in response to Q15, the US SOX attestation of controls is limited to financial reporting controls (the Code goes further) and the attestation is made as of the balance sheet date (the proposed Code appears to suggest continuous reporting). We could agree with the alignment of 'material weakness' definition across financial reporting controls, but not for other controls where, in some areas, the understanding of materiality is still nascent and developing. We are concerned that the use of identical terminology across other controls, would make it difficult to report material weaknesses on non-financial reporting operating and compliance controls without creating confusion for US readers as to whether this is a US SOX problem or not. We therefore propose that the FRC should have a different terminology for a 'material weakness' to clearly distinguish from US SOX reporting. Should FRC persist with using material weakness, we strongly recommend delineating application between internal controls over financial reporting and other controls.

Threshold for reporting control weakness: The proposal appears to set a low threshold, being a fault or failure when the framework "does not operate as expected". We do not believe this threshold to be appropriate. Escalation to Board would generally indicate a significant issue, but issues are commonly escalated before they become critical and while this points to some level of "not as expected". we do not consider this to be *prima facie* material. We feel there are unintended consequences of this wording where organisations with more mature control environments may look to move away from setting expectations at levels higher than 'satisfactory', to avoid instances of controls not operating as intended (but still being satisfactory). The definition of the terms 'reasonable' and 'adverse' need greater clarity. We suggest reference to risk appetite and internal risk and controls systems, which firms can map to their own use of the terms.

Maturity of systems: While financial institutions generally have well developed systems of enterprise risk management which would facilitate the recording, classification and reporting of control failures and weaknesses, amongst other operational risk events, we are aware that the majority of smaller companies outside the financial sector would not be as advanced in this area. Therefore, the infrastructure required to support control reporting would potentially be a new build, rather than an adaption of existing processes. This needs to be considered in developing expectations and setting timeframes.

Publication of outcomes: We consider the need to publish outcomes as unhelpful, for example does private reporting to Board require publishing and separately does a commissioned preliminary investigation need to

be reported? Without significant context such disclosure could be potentially misleading and tend to penalise diligent application of the rules.

18. Are there any other areas in relation to risk management and internal controls which you would like to see covered in guidance?

Material risk mitigation or risk elimination? The proposed statement on internal controls 'effectiveness' risks the declaration being interpreted as a statement that, since the board believes that the systems have been effective, and risks have been eliminated. This leaves the company exposed to an increased likelihood of legal action in a situation where subsequent events develop in a way that could not reasonably have been foreseen at the time the declaration was made. The terminology in the proposals could be clarified, requiring the board to describe how the systems are 'appropriate' or 'proportionate' considering the **material** risks faced by the company and identified by the board. This would sufficiently demonstrate no expectation for the elimination of all risk. It is likely that company's legal advisers will wish to have input on the extent to which such statements should be subject to caveats.

Risk management and Internal controls: See our response above to Q17.

Level of assurance and auditor attestation: It is important for the FRC to be clear that there is no formal requirement for auditor sign off with respect to the declaration made by directors relating to risk management and internal controls. We expect this to be a function of the AAP. We do not see the changes to the Code as a need for audit firms to perform more work to support their external audit engagement work either. We are concerned that a number of audit firms are creating an expectation that companies need to engage their assurance services to perform additional work to support attestation.

Use of Internal Audit: We believe that in many instances an Internal Audit function would be better placed to perform assurance over the monitoring of controls on an ongoing basis and embedding this focus on assurance within the fabric of the business, and potentially delivering a more informed evaluation for the related cost. External assurance may be of greater value where it reflects an assertion of the quality of internal assurance.

Smaller listed non- PIEs: as they currently stand, smaller listed companies thar do not meet the UK government's revised PIE definition (£750 million turnover & 750 employees) fall outside the scope of the SI, except potentially for the AAP and Resilience statement (going concern and future prospects in the Code) which have a link to the FRC's Code. We consider it odd that the risks which the Distribution and Material Fraud Statements in the SI were intended to address might be more of an issue with smaller listed companies than larger. Would these companies be expected to apply these latter SI provisions without there being a requirement, thereby creating uncertainty and additional burden and costs?

19. Do you agree that current Provision 30, which requires companies to state whether they are adopting a going concern basis of accounting, should be retained to keep this reporting together with reporting on prospects in the next Provision, and to achieve consistency across the Code for all companies (not just PIEs)?

Global consistency of going concern basis: One of the Government's new corporate reporting requirements, the Resilience statement, includes going concern and future prospects. Provision 30 of the Code maintains the link to IFRS requirements (IAS 1: Presentation of Financial Statements, paragraph 25) and to the UK gtovernment's proposals, as any entity preparing its financial statements under IFRS is required to make an assessment of its ability to continue as a going concern and disclose that fact in the financial statements. It is therefore a requirement for all entities not just PIEs. We therefore believe it is appropriate to retain the current Provision 30 and apply to all Code companies to ensure global consistency. However, it would be helpful if the FRC could consider the potential for duplication between the IAS 1 requirements, which must be included in the audited financial statements, and the Code disclosures which are presented in the 'front half'.

Link to Government's new Resilience statement disclosures: As majority of annual reports are prepared on a going concern basis, there is a danger that current disclosures have become a boiler-plate disclosure, although there has been pressure from audit firms to resist this tendency. The revised UK government proposals would hopefully support consistency across Code companies and sets the expectation of disclosing more detail on the going concern assessment than required under current accounting standards. It would

also be advisable to ensure that the requirements addressed to companies in the Code are consistent with those in Auditing Standards.

20. Do you agree that all Code companies should continue to report on their future prospects?

Broader reporting of future prospects but with proportionality: We consider that all companies, not just PIEs, should provide disclosures on future prospects proportionately based on their business model, size, level of public interest, as relevant for investors and other stakeholders. We also believe it is appropriate for the FRC to retain this provision to avoid entities that are not PIEs but follow the Code falling out of scope. It seems reasonable to expect such entities to continue to make disclosures around their future prospects, but care should be taken to not introduce the additional risk of mis-managing expectations.

Reverse stress tests: We agree that the Resilience statement disclosures should be proportionate and consider that it would be sensible for companies to disclose their processes around reverse stress testing and to disclose that reverse stress test scenarios considered by the board.

Time horizons avoiding boiler plate: The medium-term section of the statement would incorporate the existing viability statement requirements to provide an assessment of the company's prospects and resilience, and to address matters which may threaten the company's ability to continue in operation and meet its financial liabilities as they fall due. We welcome the removal of mandated period of 5 years and instead require judgment around the length of period relevant for the entity and sector. We see the longer term, beyond the medium term, as the area where the existing viability statement evolves and being the additional period over which entities will need to form as assessment. While the content of the long-term section will not be prescribed, we would recommend guidance from the FRC to limit the use of boiler plate language.

21. Do you agree that the proposed revisions to the Code provide sufficient flexibility for non-PIE Code companies to report on their future prospects?

Comply or explain provides flexibility but further guidance is needed: We agree that the "comply or explain" basis gives sufficient flexibility to non-PIE Code companies, subject to our comments in response to Q13. But the proposed Code itself is unhelpful in that it does not really allow companies to understand the most important expectations of the new regime, which will require a revision to the FRC's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting before it can be assessed.

PIEs and non-PIEs: The UK government's new corporate reporting requirements suggests PIEs set out information on the company's decision whether to adopt the going concern basis of accounting in the relevant period, as part of their resilience statement, similar to Provision 30 in the current Code. However, as there are many companies which follow the Code that do not meet the PIE definition, the FRC proposes retaining current Provision 30 on going concern (Provision 31 in the new Code) without change and an amended Provision 31 on viability statements (Provision 32 in the new Code). Companies which have complied with the going concern element of the Resilience Statement requirement (see below) will also be compliant with this Provision. For Code companies which report on future prospects without following the whole Resilience Statement requirements, we propose that retaining the Provision on going concern and the amended Provision 31 (Provision 32 in the new Code) will support additional narrative on longer term future prospects.

FRC guidance on important information in the ARA: we would like to see the FRC offer guidance on what elements of the Code would be more helpful or should be focussed on by entities who are adopting the Code on a voluntary basis (i.e., non-PIE Code companies) and / or for the first time eg newly listed companies. In the same way investors are seeking better information from the banking industry in their ARAs, our members, as lenders and investors, would be keen to see other sectors and smaller companies (their customers or potential customers) being encouraged to focus on the following key areas:

- **Controls over material disclosures**
- **Going concern and Resilience**
- **Director level governance, appointment, and term**

22. Do the proposed revisions strengthen the links between remuneration policy and corporate performance?

UK competitiveness: Whilst good corporate governance standards contribute to investor confidence in capital markets, overly prescriptive standards and excessively onerous disclosure burdens can decrease the attractiveness of a market as a business and investment environment. The Code provisions regarding remuneration disclosure already play a part in the current negative attitudes towards UK listing. Therefore,

any changes should be proportionate, as arguably the Code already represents the full height of a proportionate and sound regime.

Financial services perspective: For financial services (FS) firms, and larger firms in particular, the proposed changes to the Code are unlikely to strengthen the link between remuneration policy and corporate performance given their close alignment to the PRA and FCA's respective remuneration codes which have held firms subject to them to a higher standard than other market participants for a number of years. The proposed changes would largely reflect existing practice across the sector.

ESG metrics: We welcome he enhanced focus on ESG metrics as this explicitly expands the scope of corporate performance. It is important that companies have flexibility on the choice of metrics that form part of the executive director incentives to ensure that these support the delivery of long-term sustainable value and strategy for individual companies and their stakeholders. However, the drafting of the Code should take care to focus on executive metrics on the sustainability (E and S) pillars, as the company's governance is largely a matter for the board.

Principal Q: This principle has been amended to refer to the remuneration committee (RemCo) exercising independent judgement on remuneration matters, rather than the directors. As NED fees are required to be set by the board (provision 36), not the RemCo, is this consistent?

23. Do you agree that the proposed reporting changes around malus and clawback will result in an improvement in transparency?

Learnings from FS sector and consistency across sectors: We agree that proposed reporting changes around malus and clawback will improve transparency. However, we note that although FS firms subject to the remuneration code are required to operate robust malus and clawback policies since 2016 and typically disclose both the terms of those policies and their operation in material cases, although there is no obligation to do so. The proposals would drive consistency across the market, create similar transparency and provide investors with more insight into how and when these policies operate. Rather than having a standard five (or one year) disclosure format, we recommend that the Code sets expectations of disclosure requirements only when an application of malus or clawback occurs during a financial year. This will help improve the quality and relevance of remuneration-related disclosures.

Proportionality and balancing transparency and confidentiality: Care should also be taken to ensure that requirements are not overly prescriptive. A proportionate approach can be taken such that firms are not required to disclose immaterial individual adjustments or compromise their data privacy obligations where the subject of malus and / or clawback could be publicly identifiable and balance between transparency and disclosing confidential information or damage reputations:

- **Executive directors**: are already the subject of detailed remuneration disclosures so we agree that it is proportionate for details of malus and / or clawback applied to them during the year, or in prior years, to be disclosed
- **Other employees:** given the complexity of the decision-making process and the right to privacy, we do not consider that it is appropriate, or practical, to disclose details of the operation of malus and / or clawback provisions at an individual or collective level.
- **Confidentiality:** For the most material matters which otherwise necessitate disclosure in the ARA, we think it should be sufficient to note that malus and / or clawback has been applied without disclosing the quantum or the individuals subject to adjustment.
- **Clarification on 'over 5 years':** It would be useful to clarify whether the 'use over the last 5 years' is current executive directors or at any point in time.

24. Do you agree with the proposed changes to Provisions 40 and 41?

By simplifying the requirements and taking a more purpose-led approach, the changes to Provisions 40 and 41 will drive a richer and more thoughtful approach to reporting across the market. We specifically agree with the removal of Provision 41, as apart from duplication with the Pay Gaps report, there are complexities with referring to pay gaps as these reflect many factors such as the profile of the organisation, rather than equal pay gaps.

The expanded wording around ESG may help companies to focus on linking remuneration to ESG.

25. Should the reference to pay gaps and pay ratios be removed, or strengthened?

As set out in the new Principle P, the appropriateness of a company's remuneration outcomes should be explained by their alignment to its performance, purpose, culture and values and the successful delivery of its long-term strategy rather than the discussion of pay ratios / gaps within its workforce. These types of ratios are already specifically addressed by most firms under mandatory Gender Pay Gap disclosures and in most larger banks, there is voluntary ethnicity pay gap reporting. We therefore support the removal of the requirement to specifically consider ratios in this way.

26. Are there any areas of the Code which you consider require amendment or additional guidance, in support of the Government's White Paper on artificial intelligence?

Evolution of broader AI regulation and current lack of need for incorporation in the Code: There may be a role for the Board to play in the oversight of use cases of artificial intelligence (AI) in the business and to ensure these are implemented in a responsible way, having regard to agreed principles. However, AI regulation principles in the UK continue to evolve and until they settle, we do not think it would be appropriate to codify the board's role regarding AI in the Code. The UK government is keen to present the UK as a leader in the AI space, so it is expected that UK related governance provisions will be finalised and become binding in due course. At that time there may be stronger argument for the Code to reflect the board's role in governing AI use in companies. We do not consider that the Code needs to be amended in respect of AI as it is currently a processing methodology or just one of different source of evidence that companies will be able to use. Companies may use AI to inform them about what is going on in respect of a particular area or business, or evaluate certain transactions, and we do not see this changing the overall essence of corporate governance.

Lack of appropriate skills and experience to be able to oversee the use of AI in its business: Despite the above comments, there is a need to ensure the board has the appropriate skills and experience to be able to oversee the use of AI in its business. The Code is not specifically prescriptive regarding the skills and experience the board should collectively possess and it is thought that the current provision in section B, para 22 of the Code *'To safeguard high quality decision making in a complex world, boards will need to attract candidates who bring new experience and skills to the table.'* is sufficient. However, in terms of actual practice, we highlight a 2022 member survey by Institute of Directors that revealed that 80% of boards did not have a process in place to audit their use of AI. The Directors indicated that they did not know what questions to ask. Over 86% of businesses already use some form of AI without the board necessarily being aware of this.