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Will the new UK CG Code make a difference?

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David Archer & Alex Cameron

In this feature, **Alex Cameron** and **David Archer** of **Socia** argue that the new UK Corporate Governance Code recently published by the FRC is not a subtle tweak of the current provisions, but a more radical review as the FRC tries to respond to a number of often conflicting demands for improved governance.

Feature

Will the new UK CG Code make a difference?

Alex Cameron and **David Archer** argue that the new UK Corporate Governance Code (the Code) recently published by the FRC (see page 3 of this issue) is not a subtle tweak of the current provisions, but a more radical review as the FRC tries to respond to a number of often conflicting demands for improved governance.

The FRC is clear that the revisions to the Code aim to address the public's reduction in trust of our corporations. In particular, to respond to press, public and government comment on issues such as executive pay, workers' representation, and the role of corporations in sustainability and climate change.

Compared with previous versions, the principles and provisions in the updated Code along with its associated guidance are certainly more ambitious in their objectives.

In trying to meet this ambition, the new version emphasises a wider perspective for boards, acknowledging that 'companies do not exist in isolation'. In order to succeed businesses are encouraged to develop 'relationships with a wide range of stakeholders … based on respect, trust and mutual benefit.'

These statements set the tone of the new Code. The FRC is taking a much broader view of corporate governance with even greater emphasis on boards looking to the long-term.

This longer-term approach now encompasses the corporate role in providing employment, creating prosperity and operating sustainably, and this emphasis runs through much of the new language in the 17 principles of the Code.

The FRC also wanted the new Code to be more concise. This is achieved by a set of principles that, although more ambitious in their aims, are slimmed down and more focused than in previous versions. The core of the Code is the provisions that sit below the principles.

Here again the emphasis has been on slimming down the text. But in the end, this has been achieved by putting more into the guidance notes. These additional notes are now extensive, often adding significant interpretations to the provisions. It is in the guidance notes that we find an explanation of how this revised Code addresses its greater ambition.

The Code still emphasises the 'comply or explain' approach which, in the past, has allowed it to be applied to a wide range of businesses in very different corporate environments. But with a wider ambition for the Code, this could imply that the guidance notes are 'optional advice' – or at least will be seen as such by boards less interested in a wider governance agenda.

Adherence to the principles of the Code appears quite possible without any meaningful reference to the new spirit of the guidance. A possible consequence is that a board could comply by the letter of the principles but not really address the ambition that they support. For example: Principle:1A in its statement of the functions of a board includes the need to 'generate value for shareholders and contribute to wider society'. But the associated provisions only talk about 'the sustainability of the company's business model … and the delivery of strategy' which a board could choose to interpret much more narrowly.

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Much has been made of the move by the Code into the area of corporate culture. The revisions certainly make more mention of culture and of directors' responsibility to ensure that behaviour throughout the organisation is aligned to company values.

The provisions also explicitly state that the board should engage more closely with the workforce. It is now encouraged to gather workforce views via either a director appointed from the workforce, a formal workforce advisory panel, or a designated non-exec. As currently specified, this area demonstrates a weakness in the Code when you stretch its remit too far.

The principles and provisions are hard to disagree with, but it will be difficult to see how boards can really engage in this area without appearing to get overly involved in the details of the executive leadership role. This could cause tensions in the boardroom.

All-in-all, the new version of the Code represents a set of changes with ambitious intent, but can a slimmed down set of provisions with beefed up guidance notes have the desired results?

The UK Corporate Governance Code has built a strong reputation and should be changed with great care. These are our initial reactions to the changes and we are sure that the FRC will listen to feedback. The consultation doesn't close until the end of February 2018. You can have your say by replying to codereview@frc.org.uk