

# **Corporate Governance Disclosures by Listed Issuers**

November 2020

## Key messages

We set and oversee a number of rules relating to corporate governance. The specific rules that apply depend on a variety of factors and are not restricted to the 'comply or explain' statement on compliance with the Provisions of the UK Corporate Governance Code (the Code) required by LR 9.

We have recently reviewed disclosures relating to corporate governance from a sample of issuers across different listing segments and categories. We found several areas where we felt that the corporate governance disclosures required under our rules could be improved:

- We would encourage premium listed issuers to consider carefully whether, when stating how they have applied the Principles of the Code under LR 9, they have done so in a manner which enables shareholders to evaluate how the Principles have been applied rather than merely stating they have been applied.
- We would also encourage premium listed issuers to consider including specific details of how the company has applied the Principles in that accounting period, using examples and cross-references where appropriate.
- For the premium listed population sampled in our review we felt that in certain cases, disclosures appeared to be boilerplate, in that they did not change from year to year. Such disclosures could be rendered less boilerplate by including examples and/or cross references to disclosures elsewhere in the annual report evidencing good corporate governance.
- The quality of Board Diversity Reporting across our sample of entities across all the relevant listing categories could have been better, for the reasons set out in section 4 below.

Of particular concern were our observations that:

- some closed-ended investment funds which had executive directors may have erroneously been using the exemption in LR 15.6.6R
- a number of companies in our sample of standard listed issuers either provided little or no information to meet the disclosure requirements of DTR 7.2.5R and DTR 7.2.7R concerning certain of their systems, bodies and committees and
- standard listed issuers who state they have applied the Provisions of the Code 'as far as is relevant' without providing any further detail do not appear to meet the requirements set out in DTR 7.2.3R (1)

We will use the results of this review to inform our decisions about future surveillance and monitoring efforts in this area. We encourage issuers to consider their compliance with the relevant rules and to make improvements where appropriate.

## Introduction

In early 2020 we completed a review of listed companies' compliance with certain FCA rules relating to corporate governance.<sup>1</sup> We reviewed a sample of annual reports across several years for issuers across different listing segments and categories. We have set out here some reminders about those rules and ways in which disclosures relating to corporate governance could be improved, based on observations from our review. These are arranged both by listing category and segment, where appropriate, as well as some comments directed at all listed issuers to whom the relevant rules apply.

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<sup>1</sup> While the review sampled annual financial reports for accounting periods ending in 2016, 2017, 2018 and considered compliance with the 2016 UK Corporate Governance Code ("the 2016 Code"), our observations and suggestions are nonetheless relevant on a forward-looking basis for compliance with the 2018 UK Corporate Governance Code ("the 2018 Code").

It is important to note that a range of rules apply depending on the issuer's listing segment, security type, company type and country of incorporation and that the rules overseen by the FCA are not restricted to the comply or explain statement regarding compliance with the Provisions of the Code required by LR 9.

## **Background**

Corporate governance has been defined as 'the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place.'<sup>2</sup>

In our role as the UK's securities regulator, we operate the UK listing regime which requires listed issuers to comply with a number of relevant requirements including those within the Listing Rules (LR) and parts of the Disclosure Guidance and Transparency Rules (DTR).

The main FCA rules relating to corporate governance reporting in the listing regime are set out within DTR 7.2 and LR 9.8.6R. The scope of these rules is defined by a number of provisions, principally DTR 1B.1, LR 9.1.1R, LR 9.8.6R, LR 9.8.7R, LR 9.8.7AR, LR 14.3.24R, LR 15.4.1R, LR 15.6.6R, LR 16.4.1R, LR 16.4.2R and LR 18.4.3R (2).

The Code applies to all companies with a premium listing, whether incorporated in the UK or elsewhere. Such companies are required under LR 9.8.6R (6) to state in their annual financial report whether they have complied with the relevant Provisions of the Code or explain why they have not done so. Under LR 9.8.6R (5) they are also required to state how they have applied the Principles set out in the Code in a manner that would enable shareholders to evaluate how the Principles have been applied. They are also required to make statements reflecting certain Provisions of the Code, for example as required by LR 9.8.6R (3).

The most recent version of the Code was published in July 2018 by the Financial Reporting Council (FRC), which sets the Code for accounting periods beginning on or after 1 January 2019. The FRC is responsible for promoting high-quality corporate governance and reporting to foster investment.

LR 9 does not apply to companies with a standard listing, however certain standard listed companies are subject to, or required by the Listing Rules to comply with, DTR 7.2, which concerns corporate governance statements.

## **Results**

Our review revealed a number of areas where we felt that the corporate governance disclosures required under our rules could be improved and we have set out further details below in relation to:

1. All premium listed issuers
2. Premium listed closed-ended investment funds
3. Standard listed issuers
4. Reporting with respect to diversity concerning the board

### **1. All premium listed issuers**

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<sup>2</sup> definition taken from the first version of the UK Corporate Governance Code, as published in 1992, by the Cadbury Committee (the Combined Code), which is quoted in the 2018 Code which says it remains true today.

### *Scope of LR 9.8.6R*

LR 9.8.6R applies to all premium listed issuers.

### *Statement re application of the Principles of the Code*

LR 9.8.6R (5) requires premium listed issuers to make 'a statement of how the listed company has applied the Principles set out in the Code, in a manner that would enable shareholders to evaluate how the Principles have been applied' and they are also subject to LR 9.8.6R (6) which, in summary, requires a statement as to whether or not the listed company has complied with all the relevant Provisions set out in the Code and the company's reasons for any non-compliance.

We would encourage companies to consider carefully whether, in making their statement of how they have applied the Principles, they have done so in a manner which enables shareholders to evaluate how the Principles have been applied rather than merely stating that they have been applied. For example, our review found that it was sometimes challenging to evaluate how certain premium listed issuers had applied aspects of what are now Principles A - H regarding Board Leadership, Company Purpose, Division of Responsibilities and the responsibilities of the Chair. In particular, in certain cases:

- we found it difficult to understand from the statement how issuers had applied Principle F (formerly Principle A.3) relating to the Chairman's responsibility for leadership of the board. However, we were pleased to note that the annual reports of a high proportion of our sample (80%) contained a personal introduction from the Chair.
- we found it difficult to understand from the statement how issuers had applied Principle H (formerly Principle A.4) relating to non-executive directors providing constructive challenge. Non-executive directors play a valuable role in providing constructive challenge, strategic guidance and bringing external perspectives, so explaining how this Principle has been applied is important.

### *Compliance with all relevant Provisions of the Code*

It should be noted that LR 9.8.6R (6) requires the inclusion in the annual financial report of a statement as to whether the listed company has complied throughout the accounting period with all relevant Provisions set out in the Code. Bearing in mind the requirements of LR 9.8.6R (5), we would encourage companies to consider including specific details of how the company has applied the Principles in that accounting period, using examples and cross-references where appropriate.

### *'Boilerplate' disclosures*

For the population sampled in our review we felt that in certain cases, disclosures appeared to be 'boilerplate', in that they did not change from year to year. For example, for our sample of Premium Listed issuers we compared the corporate governance report for the years ended 2016 and 2018. We were surprised to find that in many cases there was a significant proportion of the report that had not substantively changed between the two years. Such disclosures could be rendered less 'boilerplate' by including examples and / or cross references to disclosures elsewhere in the annual report evidencing good corporate governance.

### *Other points to note*

We would also refer readers of this section to our comments in:

- Section 3 below headed 'Standard listed issuers', which concerns DTR 7.2, and is relevant for premium listed issuers required to comply with DTR 7.2
- Section 4 below headed 'Reporting with respect to diversity concerning the board and board appointments'

and to the comments of the FRC's Chief Executive in January 2020, following its [Review](#) of the Code (under Conclusion below).

## **2. Premium listed closed-ended investment funds**

During our review, we noted the potential misapplication of the exemption in LR 15.6.6R regarding corporate governance reporting against the remuneration Principles of the Code. In particular, we were concerned that some closed-ended investment funds which had executive directors may have erroneously been using this exemption, potentially risking inadequate scrutiny of executive pay. We are reminding funds that this exemption will only be available where the fund does not have any executive directors.

## **3. Standard listed issuers**

### *Scope of DTR 7.2*

DTR 7.2 applies to UK incorporated companies which have transferable securities admitted to trading on an EU regulated market. At the end of the Transition Period, DTR 7.2 will continue to apply to UK incorporated companies which have transferable securities admitted to trading on a UK regulated market. In addition, within the standard listed segment LR 14.3.24R and LR 18.4.3R(2) extend the application of DTR 7.2 for certain overseas companies which have shares or GDRs admitted to the Official List.

The comments in this section are aimed at UK and overseas standard listed issuers who are required to comply with DTR 7.2. However, they are also relevant for premium listed issuers who are required to comply with DTR 7.2.

### *Corporate governance statements*

An issuer which is subject to, or required by the Listing Rules to comply with, DTR 7.2 must include a corporate governance statement in its directors' report (or alternatively, in a separate report, or in a document published on the issuer's website, in accordance with DTR 7.2.9R).

This statement must contain, inter alia, a description of the main features of the issuer's internal control and risk management systems in relation to the financial reporting process (DTR 7.2.5R) and a description of the composition and operation of the issuer's administrative, management and supervisory bodies and their committees (DTR 7.2.7R). These descriptions contain important governance information, which should be clearly disclosed, and we are concerned that a number of companies in our sample either provided little or no information concerning these systems, bodies and committees.

Under DTR 7.2.2R the corporate governance statement must contain a reference to, where applicable, (1) the corporate governance code to which the issuer is subject, (2) the corporate governance code which the issuer may have voluntarily decided to apply and (3) all relevant information about the corporate governance practices applied over and above the requirements of national law.

Our review identified disclosures by standard listed issuers to the effect that voluntary adopters of the 2016 Code had applied it as far as was relevant.

We remind standard listed issuers which voluntarily apply the Code that they must explain which parts of the Code (if any) they depart from and their reasons for doing so, in accordance with DTR 7.2.3R (1) (b). We consider that standard listed issuers who make statements that they have applied the Provisions of the Code 'as far as is relevant' without providing any further detail do not appear to meet the requirements set out in DTR 7.2.3R (1).

We would also refer standard listed issuers who report against the Code to note the comments of the FRC's Chief Executive (under the heading "Conclusion" below).

#### **4. Reporting with respect to diversity concerning the board and board appointments (Board Diversity Reporting)**

Overall, we felt that the quality of Board Diversity Reporting across our sample of entities across all the relevant listing categories could have been better.

##### *Premium listed issuers*

In some cases we found it difficult to evaluate how premium listed issuers had applied what are now Principles J and L with respect to Board Diversity Reporting. Also, we felt descriptions of the work of the nomination committee, particularly on diversity and inclusion (formerly Provision B.2.4, now Provision 23) could have been better.

##### *Standard listed issuers*

Within our sample of standard listed issuers we found that reporting on the diversity policy applied to the issuer's administrative, management and supervisory bodies (Diversity Policy), as required by DTR 7.2.8AR could have been far better. For example, we found neither a statement explaining why they did not apply any Diversity Policy nor any description of a Diversity Policy in the majority of this sample. This may prevent readers of the corporate governance statement from reaching any conclusions about such issuers' approach to diversity in respect of the issuer's administrative, management and supervisory bodies.

We would also encourage standard listed issuers to consider whether to adopt a Diversity Policy if they have not already done so. We also note that certain premium listed issuers are also required to comply with DTR 7.2.8AR.

Notwithstanding the above comments, we recognise that not all listed companies are required to comply with diversity reporting either under DTR 7.2.8AR or the Code.

#### **Conclusion**

Based on our review, there is room for improvement in the corporate governance disclosures across all categories of listed issuers. Issuers should bear in mind not only that the quality of their disclosures will aid compliance with the relevant FCA rules, but also in achieving the purpose of those rules which is that shareholders can effectively assess the quality of the company's governance arrangements, and the board's activities and contributions.

We fully support and endorse the comments of the FRC's Chief Executive following its [Review](#) of the Code that 'Concentrating on achieving box-ticking compliance, at the expense of effective governance and reporting, is paying lip service to the spirit of the Code and does a disservice to the interests of shareholders and wider stakeholders, including the public. Where companies depart from the Provisions of the Code they need to provide compelling explanations for why non-compliance is the right approach for their particular company.'

We are aware that the FRC is currently undertaking its own assessment of the quality of reporting against the Code.

The FCA, in its role as the UK's securities regulator, oversees and enforces a variety of rules relating to corporate governance. We will be working together with the FRC to consider areas for improvement and will use the results of our review of corporate governance disclosures to inform our decisions about the deployment of future surveillance and monitoring efforts in this area. We encourage issuers to consider their compliance with the relevant rules and to make improvements where appropriate.