



27 June 2014

FRC  
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Response to Consultation Document:  
**Proposed Revisions to the UK Corporate Governance Code**

The Financial Reporting and Analysis Committee (FRAC) of the CFA Society of the UK (CFA UK) welcomes the opportunity to respond to the Financial Reporting Council's (FRC) Consultation Document on Proposed Revisions to the UK Corporate Governance Code.

CFA UK represents more than 10,000 investment professionals working across the financial sector including asset managers, buy-side analysts, sell-side analysts and credit rating analysts, among others. For advocacy purposes in the field of financial reporting, these members are represented by the Financial Reporting and Analysis Committee.

**Executive Summary**

We are not sure what a viability statement will add to disclosures of principal risks and uncertainties and the going concern statements. What we would like to see is a frank discussion of the risks that might cause a business to run into difficulties, e.g. to have to refinance, stop paying dividends, or undertake major restructuring. In addition we would like the board to explain how it plans to tackle these risks, for instance via a recovery plan. This could be the "bottom line" to the principal risks section, drawing attention to the most serious threats to earnings and cash flows and discussing the company's financial resilience. Transparency about assumptions and stress testing would be welcome.

We are also unsure whether setting a period is the most relevant piece of information as the timing of threats to an organisation's survival is typically unpredictable and often beyond its control, e.g. when an oil well explodes or wholesale funding markets close.

Separately, on the subject of remuneration, we are keen to emphasise the importance of deferral (rather than clawback) of bonuses and share-based elements in performance-related pay to foster a longer-term culture.



## **Main response**

### **1. Do you agree with the proposed changes in Section D of the Code?**

The proposed rewording of the main principle would appear to de-emphasise the importance of performance-related pay. We are comfortable with the current wording, which says that a significant proportion of pay should be related to corporate and individual performance, provided that this performance is measured over a reasonable time period i.e. more than 12 months.

### **2. Do you agree with the proposed changes relating to clawback arrangements?**

The deletion of the sentence regarding clawbacks in schedule A would appear to water down the code. Although clawback circumstances need not be made public, investors would expect the board to specify these circumstances. Furthermore, we think the deferral of payments would be more practical than clawing back payments already made. In some cases the money may have already been spent.

### **3. Do you agree with the proposed change relating to AGM results? Is the intention of the proposed wording sufficiently clear?**

What constitutes a significant proportion is open to interpretation. Perhaps a specific threshold in percentage terms is more appropriate. We welcome the move to encourage boards to engage with dissenting shareholders, and for this not to be limited to pay.

### **4. Do you agree with the proposed amendments to the Schedule?**

Provided there are clawback measures in place, and/or an executive must wait for several years after leaving a company for their share options to fully vest, there should be no need to require an executive to continue holding shares after leaving the company. Indeed it might well be a conflict of interest if they have moved to a competitor.

### **5. Do you agree with the changes to the Code relating to principal risks and monitoring the risk management system?**

Provision C.2.1 appears satisfactory. C.2.2 seems more problematic as long-term forecasting is inherently unreliable. The requirement to specify a forecast period is unlikely to yield much useful information for investors as companies, guided by their auditors, are likely to converge on a consensual figure (e.g. two or three years). Investors understand that companies cannot predict the future and are more interested in C.2.1 than they are in crystal ball gazing.

### **6. Do you agree that companies should make two separate statements? If so, does the proposed wording make the distinction between the two statements sufficiently clear?**

We are not sure it will be sufficiently clear what the difference is between the two statements, other than potentially a different time period, given that both the going concern statement and the viability statement are based on solvency/liquidity tests. The classification of risks into two separate timing categories seems somewhat arbitrary as, by their very nature, the timing of risks is unknown. As per Q5, investors want a frank



discussion of the risks a business faces and how the company aims to tackle them, which should be covered in the principal risks report. Ultimately, factors such as financial leverage will play a key role in determining if a business can survive cyclical risks. Therefore, reporting on stress testing, recovery plans and financial resilience may be useful, if it includes granular, entity-specific information. For example, we would like to see explicit disclosure of material operational risks such as upcoming regulatory changes, patent expiries, or major contract terminations. Equally we would like clear disclosure of financial risks such as debt covenant thresholds.

Ultimately we acknowledge it is up to investors to make their own assessment of the gravity of potential risks. We accept that there can be no guarantee of survival.

**7. Do you agree with the way proposed Provision C.2.2 addresses the issues of the basis of the assessment, the time period it covers and the degree of certainty attached?**

Only if the disclosures are frank and have detail about assumptions and stress-testing will investor understanding be enhanced.

**8. Do you have any comments on the draft guidance in Appendix B on the going concern basis of accounting and / or the viability statement?**

Based on the answers to the previous questions, the scope and content of the viability statement needs some revision if it is to add anything to disclosures of principal risks and mitigating action on those.

**9. Should the FRC provide further guidance on the location of the viability statement?**

Investors would like to visit one place in an annual report to look for a discussion of the risks a business faces and how the company plans to tackle them. So any viability statement should be with the principal risks e.g. as a "bottom line".

**10. Should the recommendation that companies report on actions being taken to address significant failings or weaknesses be retained? If so, would further guidance be helpful?**

Yes it should be retained. Companies should be encouraged to be transparent and not hide behind the excuse of confidentiality.

**11. Should the option of giving companies the possibility of putting the full corporate governance statement on their website be considered further? If so, are there any elements of the corporate governance statement that should always be included in the annual report?**

While the corporate governance disclosures may not be of interest to all investors, it does no harm to leave them in the annual report for the benefit of those who do read them and are accustomed to finding them there. There may be scope for having the remuneration policy statement on the website, so long as it does not change. Changes should always be disclosed in the annual report.



**12. Are there any disclosure requirements in the Code that could be dropped entirely?**

While investors would appreciate less cluttered annual reports they are also reluctant to give up any disclosures. There may be scope for some perennial, unchanged information to go on the website only, with the proviso that all changes must be highlighted and explained.

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We look forward to discussing the issues raised in this response.

Yours sincerely,



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Chair, Financial Reporting and Analysis Committee  
CFA Society of the UK



Will Goodhart,  
Chief Executive  
CFA Society of the UK

**About CFA UK and CFA Institute**

The CFA Society of the UK (CFA UK) represents the interests of more than 10,000 leading members of the UK investment profession. The society, which was founded in 1955, is one of the largest member societies of CFA Institute and is committed to leading the development of the investment profession through the promotion of the highest ethical standards and through the provision of continuing education, advocacy, information and career support on behalf of its members. Most CFA UK members have earned the Chartered Financial Analyst® (CFA®) designation, or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.

CFA Institute is the global association for investment professionals. It administers the CFA and CIPM curriculum and exam programs worldwide; publishes research; conducts professional development programs; and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry. CFA Institute has more than 100,000 members in 140 countries, of which more than 90,000 hold the Chartered Financial Analyst (CFA) designation.