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BRIEFING NOTE ON THE NEW FRC CODE AND 'GUIDANCE'

RE: BOARD PERFORMANCE REVIEWS AND THEIR REPORTING

First of all, it should be understood that there is little new in the revised Code about board evaluation, other than an insistence that it now be called "Board Performance Review".

There is, however, fresh FRC guidance, not referred to or even footnoted in the Code itself at all, but published separately a week later.

The FRC itself says that this guidance "is not part of the Code and should not be seen as a requirement of the FRC. It is aimed at contributing helpful context to a Board's consideration of how they might go about complying with the Code."

This FRC guidance is, happily, excellent: practical and useful, not seeking to be straining ahead with the latest notions of best practice but rooted in some existing good practice. Although not 'mandatory', we are content to be compliant with it as well as the Code.

The following are notable:

- The boards of non-FTSE 350 companies are encouraged - but not compelled - to undertake external reviews;
- Examples are given of when a review may be appropriate outside the triennial cycle (e.g. change of chair and poor company performance);
- Advice is offered that solely questionnaire-based reviews are unlikely to add sufficient value; and that observation of meetings be undertaken.
- Reviews should try to include views from beyond the boardroom, e.g. shareholders, senior executives who regularly interact with the board, auditors and other advisors, and the workforce.

However, and this is where it gets more laborious (and slightly unsatisfactory) for those who delve further, there is also contained in the FRC's own guidance a new if glancing reference to the CGI (i.e. formerly ICSA) guidance on "Reporting on Board Effectiveness: Guidance for listed companies", which the FRC says - rather carefully - that companies '*are encouraged* to *consider*' [note, not apply or follow, hence my italics].

(No reference is made by the FRC or by the CGI to the fact that the latter organisation has been offering board evaluation services for many years, and so is (arguably) somewhat conflicted in this particular space.)

The reason for this new reference to the CGI's own guidance lies probably in the failure of the Government directly to take up the recommendations of the CGI's work in to this area (published in early 2021 as the "Review of the effectiveness of independent board evaluation in the UK listed sector') which - through what was then BEIS - it had originally commissioned. The FRC has been persuaded to give the CGI's recommendations in this area some renewed traction, by these indirect means, without actually asking companies to follow it.

However, taking it on its merits, when one consults this further CGI guidance, we are told in the Foreword:

"This document should be read in conjunction with… the Code of Practice for board reviewers; and the Principles of Good Practice for listed companies using external board reviewers."

So it is clear that for those who wish to have the full picture, we are now dealing with a daisy chain of documents, each with rather different official status.

The CGI guidance does not quite set out how a review should be conducted but it does go so far as to stipulate how firms should be selected, as well as what should go in the annual report (as detailed below), which is quite a reach beyond current practice.

Therefore, I will pick up on a selection of the points in the only 'external' document in this area which the FRC itself actually mentions - "Reporting on Board Effectiveness: Guidance for listed companies" – and offer some commentary from us.

In doing so, I will try to focus on those areas that relate most closely to companies themselves rather than just their advisers, and on disclosures of the board performance review in the annual report in particular. As will be seen, a few touch on much wider issues, some of them quite sensitive.

- Point 5 of this CGI guidance states the "the annual report should identify… who was the independent board member identified as the reviewer's escalation point".

This is formally a new concept - let alone as a reporting matter - but in practical terms, this would normally be the SID, as a matter of course, and especially useful if there were a problem with the chair.

It is of course axiomatic that, however the engagement began, a reviewer should establish and/or maintain multiple sources of contact, for just such an eventuality.

However, what if the SID (or anyone else) proved to be 'the problem' or 'elephant in the room' when they had been identified at the start as the escalation point? By definition, it is often impossible to say for certain at the outset of a project where it will lead.

- Point 9 states: "Where the reviewer provides other services to the company, the annual report should state the payment for board review as a percentage of the total paid to the provider for all services".

Given the comparatively lower cost of board review services compared with many others (such as search services), in such a case where this arises (comparatively rare) the percentage for board review will tend to appear artificially low (and thus presumably a 'bad thing') by this measure, compared with its actual, critical importance at the intersection of so many different workstreams and threads in a board's life.

Is this the intention behind this idea? If so, it seems to be a sledgehammer to crack a nut, and unnecessarily restrictive in its effect in narrowing the market of providers. If not, it is poorly conceived, as it will have such unintended consequences.

- Point 10 then deals with the idea that "the annual report should state whether or not the reviewer is independently accredited or otherwise complies with the CGI Code of Practice for independent board reviewers and explain any consideration of conflict of interest. Please refer to paragraphs 1-3 of the Principles of Good Practice for listed companies using external board reviewers also published by the Institute for further information."

Aside from this further cross reference to yet another CGI document, this suggests that even experienced reviewers should now be invited to undergo independent accreditation under the auspices of the CGI, until recently ICSA, which - as noted - offers board evaluation services itself.

It is clear, of course, that they have the option *not* to do this, whether because such accreditation is practically redundant (in the case of experienced reviewers) or viewed as inappropriate anyway (due to the CGI's own self-promoted role as accreditor while itself being conflicted as a supplier of services).

A current source of uncertainty then becomes what reviewers themselves may need to do to comply with the Code of Practice, when asked by clients who wish to pursue this.

They are not actually invited to be signatories, it seems: "Organisations applying the Code should report against it on an 'apply and explain' basis." However, beyond signalling that they do so apply it on their own website, it is

not clear quite what explanations are needed, unless they do *not* wish to apply elements of it.

However, companies themselves in choosing (if they wish) to use the Code of Practice in their pre-selection of reviewers, will also need to bear this in mind, unless this is just a tick box entry requirement.

For in the cause of helping sift and select possible reviewers, another burden could fall in part on the companies concerned to spend time assessing and even disclosing the assessed level of compliance/appliance of the Code of Practice by their advisers, and themselves 'explaining' any divergences.

- Point 16 states: "Where the company has concluded that changes to the board composition are needed it should indicate, as a minimum, what specific needs those changes are intended to address…"

In practical terms, this requirement could well come in to conflict with commercial considerations and price sensitivity when applied to anyone who is not merely a non-executive director.

In truth, such a disclosure could likely never be made about the CEO, the CFO, and probably also not the Chair (except in obvious cases of rotation/time limitations).

While there is some ground given on making disclosures that 'raise commercial or other sensitivities', this is a case of letting the best be the enemy of the good, in terms of sound regulation – it does not easily survive contact with reality.

- Finally, boards will also be asked (at Point 18) to allow the reviewer "the opportunity to comment on the process followed and the findings contained in the annual report and disclosures, and agree any opinions attributed to the reviewer. The annual report should state whether this has been the case, and if not, explain why".

The disclosures are fully the property and province of the company and its board. While any direct, personal quotations and/or separate verbal appraisals from a reviewer should be cleared, if made at all, the accurate reporting of simple text from a reviewer's final report would usually not need such a heavyhanded check and balance.

Further, this guidance as drafted could be taken to allow scope for the reviewer to compose his or her own gloss on the disclosure itself, and expect it to be included, as a kind of 'sign-off' on the whole process and its subsequent disclosure. Urgent clarification on this is needed.

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CONCLUSION

What a trail of breadcrumbs!

Apart from the Code itself, we should – having adjusted the damp towel around our heads - firstly remind ourselves that none of the bits of guidance is 'mandatory', only 'encouraged'.

However, we still must face the fact that we now have the new Code (simple and clear in this particular area), the suggested but still not compulsory FRC Guidance (ditto), and a one line referral to the - belt and braces - CGI guidance on reporting board reviews, with a further injunction (from the CGI, not the FRC) to consider this alongside two other CGI documents.

Funnily enough, the more one follows the trail of paper, the more prescriptive (not less) the successive sets of guidance appear to become, despite protestations that this is not the intention, nor of course an accurate reflection of their true status.

What will the reaction of already stretched company secretaries be, one wonders, as well as boards and their reviewers?

The failure to keep this simple, and confined to what the FRC will put its own name to, could well spell a recipe for confusion and some sclerosis about what is really needed, and - unless remedied - a likely 'patchwork quilt' of compliance.

The tighter and leaner any 'guidance', the more likely it will be to move the dial because of near-total compliance. The flabbier and more diffused, and of uncertain status, the less effective it will tend to be.

The FRC has attempted to square the circle (to a degree) by keeping its own Code and guidance much neater than the several carriages of 'other stuff' it has nevertheless allowed to be hitched to the engine in this particular area, but it has still been tempted (unnecessarily) by the CGI to point towards some ideas that are unnecessary and/or even counter-productive.

All told, and only through the microcosm of company board effectiveness, it is not obviously in keeping with the Government's wider desire to shake up and simplify the listings rules and generally to aim for lean and agile regulation, to nurture our UK public markets.

As a result, some of the CGI sub-guidance will probably be quietly ignored, while the important, more official elements – from the Code to the FRC's own guidance – can be taken forward with much more enthusiasm.