

Governance and stewardship themes raised by CMIT

This note is produced by CMIT to support high level dialogue between chairs and institutional investors, on the best approach to a governance and stewardship architecture that can enhance the attractiveness and competitiveness of UK capital markets. In early 2023, CMIT and FRC exchanged letters on five main governance and stewardship themes identified by CMIT for the FRC's consideration in advance of the review of Corporate Governance and Stewardship codes. A summary of the key points is set out below:

1. Quality of engagement between Boards and shareholders

- A range of factors is putting under pressure the quality of engagement between boards of UK listed companies and their shareholders. While there are different views, there is appetite from all parties for improved engagement.
- A structured dialogue between Chairs and investors, and identification of best practice principles for board and investor communications, would provide useful input to the reviews of Corporate Governance and Stewardship codes.

2. Voting transparency

- Greater visibility around shareholder voting & rationale for voting, would identify key areas of difference between companies and investors, as well as enable considered view of where a level playing field for UK listed issuers versus peers listed elsewhere is needed.
- FCA is undertaking work on shareholder voting as part of its response to the Taskforce on Pension Scheme Voting Implementation, and FRC has commissioned research on the role and influence of proxy advisors and ESG rating agencies which is to be published in May.
- CMIT has suggested the Review of the Stewardship Code should consider how to create voting transparency, including potential new requirements for signatories and proxy agencies.
- There is agreement that the voluntary "Best Practice Principles for Shareholder Voting Research" issued by the BPP Group should be reviewed and updated as a tool for improvement.

3. Restoring the intent of 'comply or explain'

- Over time the 'comply or explain' (CoE) regime has in practice become 'comply or else' as investors and issuers and their advisers take a standardised approach to compliance with and disclosure against the Code (given the pressure to process votes).
- Repositioning the regime would support genuine flexibility for issuers to depart from the Code without judgement providing cogent explanations are given. FRC analysis has found that quality of Board disclosures relating to departures from the Code is also an issue here.

4. Recasting the remuneration regime

- Remuneration approaches should support UK competitiveness, prevent 'rewards for failure' and maintain high standards of corporate governance.
- In practice, the UK can be overly restrictive when set against other jurisdictions globally, preventing companies from adopting remuneration approaches they judge most suited to their business. This may act as a deterrent to listing in the UK and as a talent drain from the UK.
- While UK remuneration regulation is the remit of the Department for Business & Trade, other influencing factors might be usefully explored, including the impacts of governance rules / proxy voting guidance and remuneration reporting requirements.

5. ESG

- Overlapping taxonomies and ESG ratings are driving a standardisation of approach that does not reflect the particular circumstances of individual companies. Work is underway in this area, inc. finalisation of ISSB's standards and discussions on a Code of Practice for ESG Data providers.
- Greater transparency around rating methodologies would assist companies in reporting justifiable differences in their approach to ESG and consideration by companies of those ESG factors most material to them.
- FRC also notes here the importance of clarity on materiality of issues considered by company Boards and committees, and has started a project to look at materiality in the context of company reporting.