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Preparing for the new UK Corporate Governance Code

In January 2024 the Financial Reporting Council ("FRC") published the UK Corporate Governance Code 2024 ("Code"), which was followed shortly afterwards by the associated guidance ("Guidance"). We reviewed the changes to the Code and the associated Guidance in earlier editions of indigoINSIGHT here and here.

In this indigoINSIGHT, we look at the practical steps that boards and governance professionals might consider in preparation for the implementation of the new Code.

What is the UK Corporate Governance Code and when will the changes take effect?

The Code constitutes a set of principles of good corporate governance and is aimed at companies listed on the London Stock Exchange's main market. The changes will apply to financial years beginning on or after 1 January 2025, except for Provision 29, which relates to risk management and the internal control framework and will apply to financial years beginning on or after 1 January 2026.

Getting ready for the key changes

Boards and governance professionals have an opportunity in advance of the introduction of the amended Code to consider and decide how to adapt their governance arrangements to take account of the new expectations. A one-size-fits-all approach is never appropriate so boards should take time to reflect on how

best to address the changes, whether any of them are not wholly appropriate for their organisation and whether the option of explaining areas of non-compliance with some of the Code's provisions should be adopted instead.

<u>Section 1 - Board leadership and company purpose</u>

New Principle C places a slightly different emphasis on governance reporting, steering companies away from tick box narratives about process towards sharing more insightful information on outcomes. Thought should be given as to how, when decisions are made, a common understanding of the intended or expected outcomes and timeframes (which could be very long-term) will be reached. This understanding can then be used to measure and report against actual outcomes. Boards will no doubt find it helpful for proposals to specifically address what outcomes and timelines are anticipated, and agreed expectations should be recorded in board meeting minutes. Maintaining a log of decisions taken and their expected outcomes will make it easier to schedule periodic reviews of actual experience versus what was intended at the time the decision was made.

Under amended Provision 2, boards are now required to not only assess and monitor culture but also how it has been embedded within the organisation. Boards will want to think about what additional assurance they might need to satisfy themselves that the desired culture really does exist in practice.

<u>Section 3 – Composition, succession and evaluation</u>

Amended Principle J now promotes diversity, inclusion and equal opportunity, without referencing specific groups. The previous list of diversity factors has gone, signalling that boards should think more broadly about diversity policies. Diversity and equality challenges will differ from one organisation to another and boards should understand both what the key challenges are and how they can improve progress in this area. Visible leadership can make a huge difference here, particularly with the greater focus now on diversity below board level.

Amended Provision 23 has updated the nomination committee's reporting requirements to include information on diversity and inclusion initiatives rather than just policy. Similar to the Provision 2 changes on culture above, the Code expects an understanding to be developed of what is actually happening within the business, not just the theory. It will be helpful for nomination committees to familiarise themselves with what initiatives are in place or planned. Site visits, conversations with colleagues and appropriate KPIs can be good ways of providing real insight into how effective different forums, schemes and training are in practice.

<u>Section 4 – Audit, risk and internal control</u>

Principle O has been amended. The board's responsibility for determining the nature and extent of the principal risks that are acceptable to the business in its pursuit of long-term strategic objectives remains unchanged. However, in place of the previous wording which required the board to establish procedures and have oversight of risk and control matters, the board will now be directly responsible under the Code for establishing and maintaining an effective risk management and internal control framework.

New Provision 29 stipulates that the board's risk management and internal controls monitoring and review must cover all material controls, including financial, operational, reporting and compliance controls. The effectiveness of those controls will need to be reviewed annually to support the new declaration that the board will be expected to make (effective for financial years starting 2026). These new requirements are the most significant of the changes made to the Code but the two year period available before they are introduced should enable good preparation.

A good starting point will be to map current controls against principal risks, noting that the Code clearly now expects the board to look beyond financial controls and cover non-financial issues as well.

The audit committee will have a key role to play here to support the board in meeting these new expectations. With amendments to Provision 25 and Provision 26 reflecting the key roles and responsibilities of the audit committee as set out in the FRC's separate standard document: Minimum Standard: Audit Committees and the External Audit, now would be a good time to review the audit committee's remit and terms of reference to ensure they embrace these new Code requirements.

Section 5 – Remuneration

Provision 37 has been amended to require inclusion of malus and clawback provisions in all directors' contracts and other agreements that cover their remuneration. This new requirement moves the existing practice of including those provisions in individual incentive documentation to a more all-embracing position. To prepare for this change, boards should ensure that their company's arrangements are clarified within the remuneration policy and that appropriate amendments are made to directors' contracts. Responsibility for determining how and when malus and clawback provisions are applied should already be within the terms of reference of the remuneration committee but do take the opportunity to check this point.

Finally, a new Provision 38 introduces some new malus and clawback reporting requirements, including the scenarios in which malus and clawback provisions might be used and why the period selected for malus and clawback to apply was deemed to best suit the business. The remuneration committee should take the opportunity to review their policy on these points.

What do boards need to do now?

The clock is now ticking for boards to fully understand the key changes and take action to review and update their governance arrangements where necessary. Cutting through the narrative and getting to the heart of the new requirements may seem daunting but, by acting now, boards can successfully identify any gaps and devise an action plan to address them to ensure compliance in good time.

The full Code can be read here, along with the associated Guidance. If you have any questions or would like to discuss your board's readiness for the changes and how we can help, please contact one of our directors:

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