**Corporate governance**

This element explains the rules relating to the composition and functioning of boards of directors of listed companies.

**Introduction**

Rules exist that relate to the **composition** and **functioning** of boards of directors of listed companies.

These rules are embodied in UKLR 6, DTR 7 and in the UK Corporate Governance Code.

The UK Corporate Governance Code 2024 sets out a number of specific corporate governance requirements. It is maintained by the Financial Reporting Council (the ‘**FRC**’), which consults on any amendments and periodically review it.

**DTR 7.2 and Corporate Governance Statements**

Under DTR 7.2, issuers are required to produce a corporate governance statement which must be included either (1) in the directors' report or (2) in a separate report published together with the annual report or (3) in a document widely available on the company's website to which reference is made in the directors' report.

DTR 7.2.2 requires that the corporate governance statement contains a reference to the corporate governance code to which the company is subject. For companies with a listing on the main market of the LSE, this will be the UK Corporate Governance Code.

DTR 7.2.3 requires that, where it departs from the code, the company must explain both which parts of the code it departs from and the reasons for doing so (this is known as the 'comply or explain' principle).

DTR 7.2 also sets out a number of other matters which must be disclosed in the corporate governance statement (for example, certain information about how the company is controlled).

**The relationship between the UK Corporate Governance Code and the LPDT Rules**

The UK Corporate Governance Code sets out a number of specific corporate governance requirements. Unlike DTR 7.2, the UK Corporate Governance Code does not form part of the LPDT Rules and does not have the force of law. All listed companies (or those who are to be listed) need to take into account the detailed contents of the UK Corporate Governance Code. This is because each company must make a 'comply or explain' statement in its annual financial report explaining how it has applied the Principles, and whether or not it has complied with the Provisions, of the UK Corporate Governance Code and, if not, the extent to which it has not complied and the reasons why (UKLR 6.6.6 (5) and (6)).

The 'comply or explain regime' offers companies a degree of flexibility, permitting companies to choose bespoke governance arrangements most suitable to their particular circumstances. When departing from the Code, companies should explain how their chosen alternative arrangement is more appropriate and beneficial in upholding high standards of governance.

The FCA has given guidance to the effect that, where there is an overlap between the corporate governance requirements in DTR 7.2 and the UK Corporate Governance Code, compliance with therelevant UK Corporate Governance Code provision will satisfy the corresponding provision in DTR 7.2. For example: Under DTR 7.2.4, a listed company which produces a 'comply or explain' statement under UKLR 6.6.6 (6) will satisfy the requirements of DTR 7.2.2 and 7.2.3.

**The relationship between the UK Corporate Governance Code and the LPDT Rules**

You should be aware, however, that not all of the provisions of DTR 7.2 overlap with the UK Corporate Governance Code and DTR 7.2 stipulates that, in its corporate governance statement, a company must report on how it has applied these additional obligations.

All listed companies will need to have regard to DTR 7.2 as regards corporate governance and the UK Corporate Governance Code. A company preparing itself for listing should aim to be in full compliance with both the UK Corporate Governance Code and DTR 7 by the time it lists or within the next 6-12 months so that it meets the standards expected by potential investors.

**Scope of the UK Corporate Governance Code**

The UK Corporate Governance Code covers a variety of matters including:

- Board leadership and company purpose

- Division of responsibilities

- Audit, risk and internal control

- Remuneration

- Composition, succession and evaluation

**Provisions of the UK Corporate Governance Code 2024**

The UK Corporate Governance Code 2024 contains 18 principles of good governance and 41 provisions split into five sections.

**Example:**

**Principle B:** The board should establish the company’s purpose, values and strategy, and satisfy itself that these and its culture are all aligned. All directors must act with integrity, lead by example and promote the desired culture. The board should establish the company’s purpose, values and strategy, and lead by example and promote the desired culture.

**Provision 2:** The board should assess and monitor culture and how the desired culture has been embedded. Where it is not satisfied that policy, practices or behaviour throughout the business are aligned with the company’s purpose, values and strategy, it should seek assurance that management has taken corrective action.

**The UK Corporate Governance Code and preparation to list**

A company applying to list should aim to ensure that it is in compliance with the UK Corporate Governance Code by the time it lists on the Official List or within the next 6-12 months. This will require a number of issues to be addressed and structures to be put in place prior to listing.

For example:

•the board should have an appropriate combination of executive and non-executive directors (**Principle G**);

•at least half the board, excluding the chair, should be non-executive directors whom the board considers to be independent (**Provision 11**) and guidance as to the meaning of ‘independent’ is in **Provision 10;**

•the roles of chair and chief executive should be separate (**Provision 9)**;

•as part of their role as members of the board, non-executive directors should: provide constructive challenge, provide strategic guidance; offer specialist advice; and hold management to account (**Principle H**); and

•appointments to the board should be subject to a formal, rigorous and transparent procedure, and an effective succession plan for the board and senior management should be maintained. Both appointments and succession plans should be based on merit and objective criteria. They should promote diversity, inclusion and equal opportunity (**Principle J**).

**Committees to be established**

**•A nomination committee (Provision 17)** should established - a majority of the members of which should be independent non‑executive directors. The chair of the board should not chair the committee when it is dealing with the appointment of their successor.

**•**Remuneration policies and practices should be designed to support strategy and promote long-term sustainable success. Executive remuneration should be aligned to company purpose and values, and be clearly linked to the successful delivery of the company’s long term strategy (**Principle P**) and a formal and transparent procedure for developing policy on executive remuneration and determining director and senior management remuneration should be established (**Principle Q**).

**•A remuneration committee** should be appointed.Provision 32 recommends that the remuneration committee should consist of at least three, or in the case of smaller companies two, members who should all be independent non-executive directors.

**•**Under **Provision 33** the remuneration committee should have delegated responsibility for determining the policy for executive director remuneration and setting remuneration for the chair, executive directors and senior management. It should review workforce remuneration and related policies and the alignment of incentives and rewards with culture, taking these into account when setting the policy for executive director remuneration.

**Committees to be established (continued)**

•The board should establish formal and transparent policies and procedures to ensure the independence and effectiveness of internal and external audit functions and satisfy itself on the integrity of financial and narrative statements (**Principle M**).

•An **audit committee** should be established (**Provision 24**). The board should establish an audit committee of independent non-executive directors, with a minimum membership of three, or in the case of smaller companies, two. The chair of the board should not be a member. The board should satisfy itself that at least one member has recent and relevant financial experience. The committee as a whole shall have competence relevant to the sector in which the company operates

•The main roles and responsibilities of the audit committee which include monitoring the integrity of the financial statements of the company and any financial announcements are set out in Provision 25.

**Principle M and DTR 7.1**

The provisions of Principle M overlap with DTR 7.1.

DTR 7.1.1 requires companies incorporated in the UK with shares admitted to trading on a regulated market (for example, the Main Market of the London Stock Exchange) to have an audit committee which complies with the provisions of DTR 7.1.3.

DTR 7.1.1A requires that:

•the majority of the members of the audit committee must be independent;

•at least one member must have competence in accounting and/or auditing; and

•the members must have competence relevant to the sector in which the company is operating.

DTR 7.1.5 requires issuers to make a statement disclosing which body carries out the functions required by DTR 7.1 and how that body is composed.

In the FCA’s view, compliance with the UK Corporate Governance Code will result in compliance with DTR 7.1.1 to DTR 7.1.5 (DTR 7.1.7).

**Principle M and DTR 7.1**

As can be seen, the key difference between **DTR** **7.1** and the corresponding provisions of the UK **Corporate Governance Code** is that **the provisions of DTR 7.1 are mandatory** (and are not subject to ‘comply or explain’ process).

Therefore, a listed company **must** appoint an audit committee which complies with the provisions of DTR 7.1.

A listed company is required to put the appointment of its statutory auditor out to tender at least every 10 years.

**Stewardship Code**

The FRC is also responsible for the Stewardship Code, which it sees as complementary to the UK Corporate Governance Code.

The Stewardship Code sets out good practice for institutional investors (such as pension funds, insurance companies etc) when dealing with UK listed companies.

Institutional investors, who are signatories to the Stewardship Code, apply its principles on a “comply or explain” basis.

**Summary**

* The UK Corporate Governance Code (maintained by the FRC) contains a range of recommendations regarding corporate governance.
* Listed companies must give an annual “comply or explain” disclosure in relation to their compliance with the UK Corporate Governance Code.
* Among other things, a company seeking to list will need to put in place Remuneration, Nomination and Audit committees, ensure that the roles of the Chair and CEO are separated and ensure that at least half of the board (excluding the chair) consists of independent NEDs.
* DTR 7 contains a number of corporate governance requirements which are compulsory (it is not possible to explain non-compliance with these).