TRAVERS SMITH

New UK Corporate Governance Code: Directors of FTSE 350 companies to face annual re-election

On 28 May 2010, the Financial Reporting Council published a new edition of the UK Corporate Governance Code (the "Code"). This new edition will apply to listed companies for financial years beginning on or after 29 June 2010. The Code sets out standards of recommended practice for listed companies and operates on a "comply or explain" basis.

The changes introduced by this new edition of the Code are designed to respond to what have been perceived to be shortcomings in the pre-financial crisis era of corporate governance. The key focus is on increased board effectiveness and accountability to shareholders, and this is evidenced in new recommended standards relating to board diversity (the need to get the right mix of skills and experience), the board's approach to risk management and the importance of proper debate and challenge in the boardroom. Perhaps the most controversial, and certainly the most discussed, example of the focus on increased effectiveness and accountability is the introduction of a recommendation that all directors of FTSE 350 companies be put up for re-election every year. The introduction of this provision has received particular criticism from the Institute of Directors.

The key changes to the Code are as follows:

- **Annual re-election:** all directors of FTSE 350 companies should be put up for re-election every year
- **Improvement of risk-management and internal control:** the board will need to take responsibility for determining the nature and extent of the significant risks that it is prepared to take to achieve its strategic objectives
- **Performance related pay:** a significant proportion of executive remuneration should be linked to the long term success of the company as well as to the individual success of a given executive director
- **Productive boardroom debate and challenge:** in order to prompt more effective debate and reasoned challenge in the boardroom, there are new principles relating to: (i) the leadership of the chairman and his responsibility for leading the board and ensuring the board's effectiveness in all aspects its role; and also (ii) the responsibility of the non-executive directors to constructively challenge, and help develop proposals on, strategy
- **Board composition and diversity:** to promote board effectiveness, there are principles relating to the composition of the board (and its committees), which stipulate that the directors constituting a board should together have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their duties effectively; furthermore, in order to ensure that board appointments are made on merit, there are principles setting out the need for formal, rigorous and transparent procedures for the appointment of new directors.

We are preparing a more detailed briefing note on the detail of these changes together with a discussion of the impact that they may have in practice, which we will be mailing to you in due course.

The need for prescribed standards of responsible shareholder engagement is also receiving attention from the Financial Reporting Council. It is intended that the increased focus on board effectiveness and accountability to shareholders that these amendments to the Code are designed to engender amongst boards will be met by, and will work in tandem with, the increase in responsible shareholder engagement that will follow the introduction of the Stewardship Code, which the Financial Reporting Council is intending to publish in final form at the end of June 2010.

For further information, please get in touch with your usual Travers Smith contact or Spencer Summerfield.

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