Introduction

On 16 July 2018, the Financial Reporting Council (FRC) published the 2018 UK Corporate Governance Code (the 2018 Code). This finalises the ‘fundamental review’ of the Code consulted on by the FRC from the end of last year. This, coupled with The Companies (Miscellaneous Reporting) Regulations 2018, updating the Companies Act 2006 marks the culmination of the Government’s suite of governance reforms which aim to build trust in business.¹

Since 2017 there has been a tangible shift in sentiment by shareholders and many companies, that engagement with stakeholders is key to a company’s long term success. This update to the Code, along with the addition of the concept of company purpose, greater emphasis on culture and broad diversity in many ways embeds and spreads good practice that already exists in some companies.

As with all previous updates to the Code, the real test will be how companies take forward the new requirements. There is a risk that companies will follow the letter, rather than the spirit of the 2018 Code, resulting in boilerplate disclosure that will not provide useful information for investors and stakeholders nor meet the Government’s intentions.

This paper:

- Provides an analysis of the 2018 Code, highlighting the key issues and the resulting considerations for premium listed companies;
- Covers the new secondary legislation which impacts the reporting of a wide range of companies including private companies meeting certain size thresholds; and
- Contains an analysis of the changes between the 2016 and 2018 Codes in the appendix.

The FRC has also updated the Guidance on Board Effectiveness (the Guidance) which provides more details on some of the areas covered in the 2018 Code. This is useful Guidance with questions for boards to consider and adds a practical dimension to each section. The FRC will consult on an update to the UK Stewardship Code, later this year.

¹ A summary of the UK Government’s August 2017 proposals to reform corporate governance can be found in The long and winding road to corporate governance reform.
Structure of the 2018 Code

The Supporting Principles from the 2016 Code have been incorporated into Principles or Provisions, moved to the Guidance or, in some cases, removed altogether in an effort to simplify the Code and shift the focus to application of the main Principles, rather than prescriptive compliance with the Provisions.

The FRC emphasises that as per Listing Rule 9.8.6 (5), companies must report how they have applied the Principles of the Code ‘in a manner that would enable shareholders to evaluate how these have been applied’, rather than simply focusing on Listing Rule 9.8.6 (6) which deals with ‘comply or explain’ aspects of the Provisions. In doing so ‘companies should demonstrate how the governance of the company contributes to its long-term sustainable success and achieves wider objectives’. In order to assist shareholders in assessing the quality of a company’s governance arrangements and the board’s activities, the Corporate Governance statement should also relate coherently to other parts of the annual report, particularly the strategic report. The FRC also states that high quality reporting will include signposting and cross-referencing to other relevant parts of the annual report.

The FRC has highlighted the 2018 Code should be used as a positive opportunity by companies to explain their governance practices, not a burden. It has acknowledged that this shift also requires change from investors and proxy advisers. As such they have stressed that investors and proxy advisers should consider a company’s individual circumstances when considering departures from the Code. The FRC has an engagement programme in place with these groups in order to emphasise this change and to promote constructive engagement.

The 2018 Code has five sections:

A. Leadership
B. Effectiveness
C. Accountability
D. Remuneration
E. Relations with shareholders

This is a change from the previous structure used in the 2016 Code:
The majority of updates are in the first three sections (1-3, which broadly correspond with A and B of the 2016 Code). Section E ‘Relations with shareholders’ has now been integrated throughout the 2018 Code. See the Appendix for a more detailed overview of the changes between the 2016 and 2018 Codes.

**When will companies comply with the 2018 Code?**

The 2018 Code will apply to accounting periods beginning on or after 1 January 2019 with, 2 exceptions:

- Provision 4 in relation to significant votes at shareholder meetings which companies will be expected to report on during 2019.
- Similarly, companies who are proposing new remuneration policies in 2019 are expected to do so with the 2018 Code and Guidance in mind.

We are currently conducting a review of annual reporting in the FTSE 350 that we will publish in September 2018. In it we will highlight companies that are already beginning to take into account considerations from the 2018 Code, in particular around the engagement of stakeholders. Some companies may choose to adopt certain Principles and Provisions early.

**What are the key issues raised in the 2018 Code?**

While the Code has been restructured, much of the content of the 2016 Code remains, alongside some new additions. The 2018 Code elevates the importance of stakeholders, however, in response to concerns raised about the fundamentals of shareholder primacy as set out in company law, the FRC have emphasised that they are not overriding or interpreting the law.

The FRC received an unprecedented response rate to the consultation on the Code that resulted in a number of changes both to the draft Code they consulted on (the Draft 2018 Code) and the 2016 Code.

**Chair tenure**

The most contentious issue within the draft 2018 Code was to require the Chair to be independent on an ongoing basis. The FRC was pragmatic in this regard instead clarifying their intention to limit the term of chair appointments. The new wording in Principle F that the chair should demonstrate ‘objective judgement throughout their tenure’ has, in our view, struck the right balance.

Provision 19 states that ‘The chair should not remain in post beyond nine years from the date of their first appointment to the board. To facilitate effective succession planning...this period can be extended for a limited time, particularly in those cases where the chair was an existing non-executive director on appointment.’ The nine year ‘term’ is designed to aid refreshment while the added flexibility to extend the appointment takes into account situations where individuals serve on the board before becoming chair (commonly as Senior Independent Director). The FRC allowed this flexibility because of responses from companies that there would be a disincentive for individuals moving from a non-executive director role to chair at the same company and as such they would lose talent.

**Independence**

The draft 2018 Code ‘hardened’ the criteria around independence for non-executive directors. The FRC have since updated the wording to reference that the items could impair or be seen to impair independence and importantly highlights that the factors in Provision 10 are not the only factors to consider when assessing if a director is independent. However there is a more explicit reference to companies explaining why they consider a director is independent should they meet one of the indicators. This is sensible given boards need to think more broadly than the criteria in the Code when determining independence.

The 2018 Code also includes a new Provision (Provision 7) which asks the board to take action to identify and manage conflicts of interest. This includes some of the same considerations as for
independence, but applies to the whole board, regardless of independence or executive nature of role.

**Role of the nomination committee**

The 2018 Code also introduces changes for nomination committees. Boards are expected to disclose more information on their composition, the board evaluation and how the board engaged with the evaluator. In doing so the FRC has sought to emphasise the importance of the evaluator having direct contact with the board and individual directors rather than using a questionnaire approach. The nomination committee’s responsibilities and reporting requirements have been expanded to include reporting on its approach to succession planning and overseeing a diverse pipeline of talent both to the board and senior management positions.

In line with the recommendations from the Hampton-Alexander review, nomination committees will have to disclose the gender balance of senior management (i.e. executive committee) and their direct reports. Companies have for some time under legislation been disclosing the gender balance of their directors, senior management (different definition to that used by the FRC) and employees. The FRC recognises this potential duplication but believes a focus on this issue by nomination committees will lead to more consistency in the data reported and consequently more balanced assessments on whether the attempts to improve gender equality are succeeding. Companies can avoid duplication through the use of signposting or alignment of definitions.

Principle J highlights that appointments and succession planning should be based on merit and - within that context - aim to promote diversity across a broader range of areas than the 2016 Code, ‘gender, social and ethnic backgrounds, cognitive and personal strength’. This is to take on board recommendations from the Hampton-Alexander and Parker Reviews. Disclosure on the board’s policy on diversity (previously required under Provision B2.4) has also been strengthened. As previously, companies are still required to disclose their policy on diversity and inclusion, its objectives, how it has been implemented and progress on achieving the objectives. In addition companies now have to draw the link between the policy and company strategy.

The FRC also made some minor changes to the wording contained in the draft 2018 Code to ensure that the final wording is better aligned to the requirements in DTR 7.2.8 AR which introduced similar disclosures arising from the UK implementation of the EU Non-Financial Reporting Directive.

The 2018 Code also focuses on board refreshment. In part this is covered through chair tenure discussed above, but it also covers directors more widely. Principle K requires companies not only to consider the combination of skills and knowledge of the board but also to give consideration to ‘the length of service of the board as a whole and membership regularly refreshed.’ This will help prevent ‘cliff edge’ situations where a large proportion of the board reaches the 9 year tenure ‘limit’ at the same time. The annual board evaluation should also consider board composition which should aid this process. However, the feedback statement from the FRC implies that they will consider follow up work with regards to board refreshment and diversity.

Provision 15 expands the focus on ‘overboarding’ which is another consideration for the board when determining composition. The 2018 Code is explicit that full time executive directors should not take on more than one non-executive director role in a FTSE 100 company or other significant appointment. The 2018 Code is also now more explicit that candidates for directorships need to disclose to the company what other time commitments they have.

When we wrote our report *Nomination committees - coming out of the shadows* we highlighted the ways in which some companies were taking a proactive approach to talent management. It seems that, despite the FRC’s report on succession planning published shortly after, most companies have not taken the opportunity to develop how their nomination committee operates. These new updates

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2 Where a director takes on a number of roles to the extent that he/she is overextended and not able to fulfil their role effectively.
should help refocus on the nomination committee and the important role it plays. We encourage companies to revisit our report and make use of its practical recommendations when thinking about these disclosures.

**Stakeholder and workforce engagement**

The wording in Provision 5 in the draft 2018 Code about workforce engagement has been clarified to include reference to wider stakeholders and the importance of the board understanding their views and then goes on to require specific engagement with the workforce. They are required to report on how the interests of stakeholders, and matters set out in section 172 of the Companies Act 2006 have been considered in board discussions and decision making. This is designed to support the new requirements in the new legislation and requires more information than the legislation itself.

The FRC also clarified that a combination of the three mechanisms (a director from the workforce, a formal workforce advisory panel or a designated non-executive director) or an alternative mechanism outside of the three in the provision would all be appropriate. The wording was updated in order to offer companies the necessary flexibility to determine which mechanism would work best for their circumstance.

‘Workforce’ is not defined in the Code. The Guidance on Board Effectiveness (Paragraph 50) explains that communication and engagement will involve those with formal contracts of employment – of all kinds, including zero hour contacts – as well as other members of the workforce who are effected by the board’s decisions. This may bring in other groups not employed directly by the company.

Given the global nature of many premium listed companies in the UK, it will also be interesting to see how companies with a geographically diverse workforce, apply these new provisions relating to the workforce. It will likely be a challenge especially given the different cultures and languages that may be involved.

**Purpose and culture**

The 2018 Code introduces the concept of purpose for the first time and also emphasises the board’s role in culture, which is now elevated from having previously only been mentioned in the Preface.

Principle B requires the board to establish the company’s purpose, and Provision 2 introduces board assessment and monitoring of culture, ensuring it is aligned to the purpose, values and strategy as well as the approach taken to reward. This link of purpose and values to reward extends to Remuneration (section 5), with both the board and the remuneration committee to have different roles, looking not only at executive directors, but also senior management and the whole company.

The 2018 Code also asks that policies and practices more widely align with the company’s values, requiring that companies allow the workforce to raise any matters of concern (not only in relation to financial reporting). A link is now made between whistleblowing arrangements (and regular monitoring by the board) and the board’s role in ensuring that behaviours align with culture.

**Audit, risk and internal control**

While the draft 2018 Code left section 4 on audit, risk and internal control largely unchanged from the 2016 Code, the FRC has made some amendments and clarifications following the consultation. The main change in this section is introducing a requirement for companies to carry out a robust assessment of emerging risks as well as the previously required principal risks, explain what procedures are in place to identify emerging risks, and explain how these are being managed or mitigated. While in practice robust discussions of principal risks by boards would likely capture emerging risks, very few companies currently disclose information on their emerging risks.

The section includes updates with regards to the work of the audit committee including:
Greater emphasis placed on ensuring the integrity of the narrative statements (Principle M). This is a responsibility of the whole board, but will have ramifications for the audit committee.

The 2018 Code tightens certain aspects on the audit committee’s role and relationship with the external auditor, including greater specificity on the committee’s role in conducting the tender process (rather than simply making recommendations) and in approving non-audit services (specifically ‘considering the impact this may have on independence’) (Provision 25).

Where there is no internal audit function, audit committees will now need to include in the annual report ‘an explanation for the absence, how internal assurance is achieved, and how this affects the work of external audit’ (Provision 26). This is much stronger language than previously included. This will need some careful and early consideration by the Audit Committee as it may prompt some Committees to request new processes or resources for internal assurance.

The Companies (Miscellaneous Reporting) Regulations 2018

In July 2018, Parliament approved the statutory instrument updating the 2006 Companies Act. The legislation covers:

- a section 172 (1) statement;
- employee engagement and stakeholder interests;
- a statement of corporate governance arrangement; and
- a CEO pay ratio.

Below we outline a high level overview of the requirements, the scope and considerations for premium listed companies who meet the scope criteria.

**UK subsidiary reporting in relation to s172(1) statement, employee engagement and stakeholder interests and a corporate governance statement**

It is worth noting that where there are UK subsidiaries of groups (whether or not listed) that meet the qualifying thresholds noted in the scope section of the table below, they will need to meet the new reporting requirements. There are no exemptions which would allow a parent or holding company to fulfil the reporting obligations for the subsidiaries. This is because under UK company law, the duty of directors is owed to their company and in the government’s words “Directors of subsidiaries are not puppets of their parent companies […].” Companies are advised to refer to the FAQs issued by BEIS for further detail on this matter.

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<th>Requirement</th>
<th>Scope</th>
<th>Considerations for companies</th>
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| 1. Section 172(1) statement | A statement in the Strategic Report to set out how directors have had regard to the matters set out in Section 172 (1) (a)-(f). This is now called a ‘section 172(1) statement’. For companies that are unquoted, the section 172(1) statement must also be made available on a website and updated each year. | All companies that prepare a Strategic Report unless they qualify as medium-sized. At a high level, this means all public companies and any company which meet any two of the below fall in scope:  
- Turnover £36m or more  
- Balance sheet £18m or more  
- 250 employees or more  
- The 2018 Code (Provision 5) also requires companies to disclose how their interests and the matters set out in section 172 of the Companies Act 2006 have been considered in board discussions and influenced the board’s decision-making.  
- Consider how to explain the impact of these different stakeholder groups on the Boards' decisions. |
### 2. Employee engagement and stakeholder interests

The Directors’ Report must:

a. Detail how directors have engaged with employees, and the effect of their regard for employee interests on principal decisions taken by the company.

b. Include information about actions taken during the year to keep employees informed, regularly consulted, involved in performance through share schemes or other means and aware of financial and economic factors affecting the company.

All companies with 250 UK employees or more.

- Many companies will have processes for employee engagement but these may not involve directors. Companies may need to reconsider the operations of their engagement processes such that directors gain the necessary exposure to employees.
- The challenge for companies will be in articulating how this engagement has impacted board decisions.
- Companies should note the following nuances:
  - Whereas the legislation refers to employees, the 2018 Code refers to ‘workforce’ and therefore premium listed companies will need to think beyond the legal definition of an employee.
  - The legislation refers to UK employees however the Code's reference to workforce is not geographically bound.

The Directors’ Report must summarise how directors have had regard for suppliers, customers and others, and the effect of that regard on principal decisions taken by the company.

Any two of the below:
- Turnover £36m or more
- Balance sheet £18m or more
- 250 employees or more

- Different in nature to the above as they are not required to detail how they have engaged suppliers, customers and others but they will need to explain how they have had regard to these groups.

### 3. Statement of corporate governance arrangements (considerations from the perspective of a premium listed company)

A statement of corporate governance arrangements must be made in the Directors’ Report detailing which corporate governance code the company applies (and how the code is applied, including explanations for

All UK companies with either:
- More than 2,000 employees globally; or
- Turnover above £200m AND a balance sheet of over £2bn.

- As noted above, there are no exemptions for subsidiaries if they meet the qualifying thresholds. Therefore, a subsidiary of a premium listed company
any departure from application), and if no code is applied, why and what governance arrangements are in place.

For companies that are unquoted, this statement must be made available on the website and updated each year.

<table>
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<tr>
<th>Exemptions apply for those who already report on their corporate governance (e.g., premium and standard listed companies), and CICs and charitable companies.</th>
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| (applying the UK Corporate Governance Code) which meets these thresholds will be required to prepare a corporate governance statement. This requires careful consideration as for many listed groups the cascade of governance processes in the business often follows segmental, divisional or business unit lines rather than legal entity structures.

- In principle, a subsidiary could state it did not apply a code because its parent applied the UK Corporate Governance Code and this was applied throughout the group. However it still must explain how the UK Corporate Governance Code actually applies to governance arrangements in the subsidiary and its directors. The alternative could be to apply a separate Code which was more relevant e.g., the Wates Principles for private companies.

4. CEO pay ratio

A ‘pay ratios table’ of executive pay to the first quartile, median and third quartile of employee pay. Where a company is a parent, the ratio information must relate to the group. There are three options for how to calculate the pay and benefits.

<table>
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<tr>
<th>Quoted companies with more than 250 UK employees.</th>
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| Narrative on changes to ratio and context.

These calculations are complex and will require careful planning by companies well in advance of reporting.

There are a number of other amendments to Directors’ Remuneration Report requirements, including enhanced reporting on the impact of a share price change on executive pay awards.

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<tr>
<th>Quoted companies.</th>
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Conclusion

Companies need to begin planning how to comply with the 2018 Code and secondary legislation. This will mean work for company secretarial teams in ensuring compliance with a reordered Code. Many of the changes may require new processes that will then be reported on. Despite the fact companies will not report against the 2018 Code or new legislation until their annual reports issued in 2020, they will need to implement these processes in 2019 if aiming to be in compliance for the full year.

The FRC has also challenged investors to engage more constructively with companies on departures from the Code. With the Stewardship Code next in line to be updated it will be interesting to see how the FRC reflect this ambition.

The FRC plan to ‘escalate’ the monitoring of practice and reporting in relation to the 2018 Code. They will also be working with stakeholders to help embed the Code and have established an outreach programme with investors and proxies to support the implementation of the Code. The outcomes of the conversations between the FRC and investors and their advisors will likely impact the way in which companies approach compliance with the Code.

The FRC will shortly be publishing their updated Strategic Report Guidance that was consulted on in August 2017. They also intend to update the Guidance on Audit Committees and the Guidance on Risk Management, Internal Controls in line with the updates to the Code. In the wake of the collapse of Carillion, the FRC are waiting for the outcomes of the various enquiries before determining whether further change relating to internal control and viability statements is needed.

Please do get in touch with us if you have any questions you would like to discuss how the changes might impact you.
For further information, please contact us:

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Appendix: Code updates and additions

This is designed to help reconcile and understand how the 2018 and 2016 Codes differ. Some of the provisions in the 2016 Code were deleted or moved to the Guidance on Board Effectiveness, these are not covered here.

In this table, blue boxes contain Principles, and white boxes contain Provisions.

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<tr>
<th>New or updated Principle or Provision</th>
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<tr>
<td><strong>Section 1 - Board leadership and company purpose</strong></td>
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| ▶ Principle A: ‘A successful company is led by an effective and entrepreneurial board, whose role is to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society.’ | ▶ The key addition is ‘contributing to wider society’.  
Incorporates from the 2016 Code:  
▶ Main Principle A.1: ‘Every company should be headed by an effective board which is collectively responsible for the long-term success of the company.’  
▶ Supporting Principles A.1: ‘The board’s role is to provide entrepreneurial leadership of the company.’ |
| ▶ Principle B: ‘The board should establish the company’s purpose, values and strategy, and satisfy itself that these and its culture are aligned. All directors must act with integrity, lead by example and promote the desired culture.’ | ▶ The focus on purpose is new.  
▶ The consideration of culture and values has been elevated from the Preface, where the 2016 Code previously stated: ‘One of the key roles for the board includes establishing the culture, values and ethics of the company. [...] The directors should lead by example and ensure that good standards of behaviour permeate throughout all levels of the organisation.’ There had also been a reference to culture in the board in Supporting Principles A3.  
Incorporates from the 2016 Code:  
▶ Supporting Principles A.1: ‘The board should set the company’s values and standards and ensure that its obligations to its shareholders and others are understood and met.’ |
| ▶ Principle C: ‘The board should ensure that the necessary resources are in place for the company to meet its objectives and measure performance against them. The board should also establish a framework of prudent and effective controls, which enable risk to be assessed and managed.’ | ▶ Incorporates 2016 Code Supporting Principles A.1: ‘The board’s role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed. The board should set the company’s strategic aims, ensure that the necessary financial and human resources are in place for the company to meet its objectives and review management performance.’ |
| ▶ Principle D: ‘In order for the company to meet its responsibilities to shareholders and stakeholders, the board should ensure effective engagement with, and encourage participation from, these parties.’ | ▶ While the 2016 Code only mentioned the importance of stakeholder engagement in the Preface, the 2018 Code elevates stakeholder consideration and engagement into a Principle. This stakeholder focus is woven throughout the 2018 Code.  
Incorporates from the 2016 Code: |
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<td>Main Principle E.1: ‘[...] The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.’</td>
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<td>Provision E.1.2: ‘The board should [...] ensure that the members of the board, and in particular the non-executive directors, develop an understanding of the views of major shareholders about the company [...]’</td>
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| Principle E: ‘The board should ensure that workforce policies and practices are consistent with the company’s values and support its long-term sustainable success. The workforce should be able to raise any matters of concern.’ | This is an entirely new Principle.  
Previously Supporting Principles D.1 stated that the remuneration committee ‘should be sensitive to pay and employment conditions elsewhere in the group’. This responsibility is much expanded and has been elevated to a consideration for the whole board.  
This Principle also makes the importance of workforce concerns more prominent (previously only mentioned in a Provision, C.3.5) by making it a Principle and a board level responsibility. |
| Provision 1: ‘The board should assess the basis on which the company generates and preserves value over the long-term. It should describe in the annual report how opportunities and risks to the future success of the business have been considered and addressed, the sustainability of the company’s business model and how its governance contributes to the delivery of its strategy.’ | Adapts 2016 Code Provision C.1.2: ‘The directors should include in the annual report an explanation of the basis on which the company generates or preserves value over the longer term (the business model) and the strategy for delivering the objectives of the company.’  
Greater focus on how governance is linked to strategy. |
| Provision 2: ‘The board should assess and monitor culture. 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 annual report should explain the board’s activities and any action taken. In addition it should include an explanation of the company’s approach to investing in and rewarding its workforce.’ | This is a new Provision which aligns with the expanded focus on purpose, culture and values in Principle B (in the 2018 Code). There is a clear emphasis on the board’s role to assess and monitor culture throughout the company, and report on it. |
| Provision 3: ‘In addition to formal general meetings, the chair should seek regular engagement with major shareholders in order to understand their views on governance and performance against the strategy. Committee chairs should seek engagement with shareholders on significant matters related to their areas of responsibility. The chair should ensure that the board as a whole has a clear understanding of the views of shareholders.’ | The main change is that the 2018 Code introduces a specific requirement on Committee chairs seeking engagement with shareholders, whereas the 2016 Code called for them to be available to answer questions at the AGM.  
The 2016 Code had a section dedicated to relations with shareholders which has been removed. But its main features have been incorporated throughout the Code. This provision incorporates some of the below elements:  
Provision B.4.1: ‘As part of [induction], directors should avail themselves of opportunities to meet major shareholders.’ |
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<td>Supporting Principles D.2: 'The chairman of the board should ensure that the committee chairman maintains contact as required with its principal shareholders about remuneration.'</td>
<td>▶ Main Principle E.1: 'There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.'</td>
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<td>▶ Provision E.1.2: 'The board should state in the annual report the steps they have taken to ensure that the members of the board, and in particular the non-executive directors, develop an understanding of the views of major shareholders about the company[.]'</td>
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<td>Provision E.1.2: 'The board should state in the annual report the steps they have taken to ensure that the members of the board, and in particular the non-executive directors, develop an understanding of the views of major shareholders about the company[.]'</td>
<td>▶ Principle E.2: 'The board should use general meetings to communicate with investors and to encourage their participation.'</td>
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<td>▶ Provision 4: ‘When 20 per cent or more of votes have been cast against the board recommendation for a resolution, the company should explain, when announcing voting results, what actions it intends to take to consult shareholders in order to understand the reasons behind the result. An update on the views received from shareholders and action taken should be published no later than six months after the shareholder meeting. The board should then provide a final summary in the annual report, and, if applicable, in the explanatory notes to resolutions at the next shareholder meeting, on what impact the feedback has had on the decisions the board has taken and any actions or resolutions now proposed.’</td>
<td>▶ Incorporates 2016 Code Provision E.2.2: ‘When, in the opinion of the board, a significant proportion of votes have been cast against a resolution at any general meeting, the company should explain when announcing the results of voting what actions it intends to take to understand the reasons behind the vote result.’</td>
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<td>Incorporates 2016 Code Provision E.2.2: ‘When, in the opinion of the board, a significant proportion of votes have been cast against a resolution at any general meeting, the company should explain when announcing the results of voting what actions it intends to take to understand the reasons behind the vote result.’</td>
<td>▶ The new Provision goes further than E2.2 of the 2016 Code to outline more specific follow-up steps in terms of reporting back on the engagement. It also specifies a 20 per cent threshold.</td>
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<td>▶ Provision 5: 'The board should understand the views of the company’s other key stakeholders and describe in the annual report how their interests and the matters set out in section 172 of the Companies Act 2006 have been considered in board discussions and decision-making. The board should keep engagement mechanisms under review so that they remain effective.'</td>
<td>▶ This is new and aligns with new secondary legislation affecting UK incorporated companies for accounting periods beginning 1 January 2019.</td>
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<td>▶ Note: ‘The Companies (Miscellaneous Reporting) Regulations 2018 require directors to explain how they have had regard to various matters in</td>
<td>▶ The Guidance on Board Effectiveness includes helpful information on how boards may gather views from the workforce.3</td>
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3 In September 2017, ICSA: The Governance Institute and the Investment Association also published guidance on bringing the stakeholder voice into the boardroom.
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<td>performing their duty to promote the success of the company in section 172 of the Companies Act 2006. The Financial Reporting Council's Guidance on the Strategic Report supports reporting on the legislative requirement.'</td>
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| As a reminder, the matters set out in section 172 are:  
(a) the likely consequences of any decision in the long term  
(b) the interests of the company’s employees  
(c) the need to foster the company’s business relationships with suppliers, customers and others  
(d) the impact of the company's operations on the community and the environment  
(e) the desirability of the company maintaining a reputation for high standards of business conduct, and  
(f) the need to act fairly as between members of the company. |  

Provision 5 (cont.): ‘For engagement with the workforce, one or a combination of the following methods should be used:  
o a director appointed from the workforce;  
o a formal workforce advisory panel;  
o or a designated non-executive director.  
If the board has not chosen one or more of these methods, it should explain what alternative arrangements are in place and why it considers that they are effective.’  

Note: ‘See the Guidance on Board Effectiveness Section 1 for a description of ‘workforce’ in this context’  

Provision 6: ‘There should be a means for the workforce to raise concerns in confidence and – if they wish – anonymously. The board should routinely review this and the reports arising from its operation. It should ensure that arrangements are in place for the proportionate and independent investigation of such matters and for follow-up action.’  

The 2016 Code Provision C.3.5 stated: ‘The audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters.’  

Provision 6 aligns with Principle E, by raising this consideration to the whole board. It also aligns the specific reference in the 2016 Code to ‘improprieties in matters of financial reporting or other matters’, making this a wider consideration that connects to consistency with values to allow the workforce to raise wider concerns.  

Provision 7: ‘The board should take action to identify and manage conflicts of interest, including those resulting from significant shareholdings, and ensure that the influence of third parties does not compromise or override independent judgement.’  

This is a new Provision. It takes some of the circumstances which the board needs to take into account when determining which directors it considers to be independent, and asks that any conflicts of interest on the whole board (whether independent non-executive director or not) be identified and managed.  

Provision 8: ‘Where directors have concerns about the operation of the board or the management of the company that cannot be resolved, their concerns’  

Incorporates 2016 Code Provision A.4.3: ‘Where directors have concerns which cannot be resolved about the running of the
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<td>should be recorded in the board minutes. On resignation, a non-executive director should provide a written statement to the chair, for circulation to the board, if they have any such concerns.'</td>
<td>company or a proposed action, they should ensure that their concerns are recorded in the board minutes. On resignation, a non-executive director should provide a written statement to the chairman, for circulation to the board, if they have any such concerns.'</td>
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**Section 2 – Division of Responsibilities**

- **Principle F:** 'The chair leads the board and is responsible for its overall effectiveness in directing the company. They should demonstrate objective judgement throughout their tenure and promote a culture of openness and debate. In addition, the chair facilitates constructive board relations and the effective contribution of all non-executive directors, and ensures that directors receive accurate, timely and clear information.'
  
  Incorporates from the 2016 Code:
  - Main Principle A.3: 'The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role.'
  - Supporting Principles A.3: 'The chairman should also promote a culture of openness and debate by facilitating the effective contribution of non-executive directors in particular and ensuring constructive relations between executive and non-executive directors. The chairman is responsible for ensuring that the directors receive accurate, timely and clear information.'

- **Principle G:** 'The board should include an appropriate combination of executive and non-executive (and, in particular, independent non-executive) directors, such that no one individual or small group of individuals dominates the board's decision-making. There should be a clear division of responsibilities between the leadership of the board and the executive leadership of the company's business.'
  
  Incorporates from the 2016 Code:
  - Main Principle A.2: 'There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision.'
  - Supporting Principles B.1: 'The board should include an appropriate combination of executive and non-executive directors (and, in particular, independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision taking.'

- **Principle H:** 'Non-executive directors should have sufficient time to meet their board responsibilities. They should provide constructive challenge, strategic guidance, offer specialist advice and hold management to account.'
  
  Incorporates from the 2016 Code:
  - Main Principle A.4: 'As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy.'
  - Main Principle B.3: 'All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively.'

- **Principle I:** 'The board, supported by the company secretary, should ensure that it has the policies, processes, information, time and resources it needs in order to function effectively and efficiently.'
  
  Incorporates from the 2016 Code:
  - Main Principle B.5: 'The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties.'
  - Supporting Principle B.5: 'Under the direction of the chairman, the company secretary's responsibilities include ensuring good information flows within the board and its...
New or updated Principle or Provision | Key differences from 2016 Code and other notes
--- | ---
> Provision 9: 'The chair should be independent on appointment when assessed against the circumstances set out in Provision 10. The roles of chair and chief executive should not be exercised by the same individual. A chief executive should not become chair of the same company. If, exceptionally, this is proposed by the board, major shareholders should be consulted ahead of appointment. The board should set out its reasons to all shareholders at the time of the appointment and also publish these on the company website.' | > This incorporates two provisions of from the 2016 Code. Interestingly, compliance against chair independence on appointment previously only needed to be reported for the year that the appointment was made. Given that this footnote is no longer included in the 2018 Code, it implies that it ought to be re-reported every year.

Incorporates from the 2016 Code:
> Provision A.2.1 'The roles of chairman and chief executive should not be exercised by the same individual. The division of responsibilities between the chairman and chief executive should be clearly established, set out in writing and agreed by the board.'
> Provision A.3.1 'The chairman should on appointment meet the independence criteria set out in B.1.1 below. A chief executive should not go on to be chairman of the same company. If exceptionally a board decides that a chief executive should become chairman, the board should consult major shareholders in advance and should set out its reasons to shareholders at the time of the appointment and in the next annual report.'

Incorporates Provision B.1.1 from the 2016 Code: 'The board should identify in the annual report each non-executive director it considers to be independent. Circumstances which are likely to impair, or could appear to impair a non-executive director’s independence include, but are not limited to, whether a director:
- is or has been an employee of the company or group within the last five years;
- has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;
- has received or receives additional remuneration from the company apart from a director’s fee, participates in the company’s share option or a performance-related pay scheme, or is a member of the company’s pension scheme;
- has close family ties with any of the company’s advisers, directors or senior employees;
- holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
- represents a significant shareholder; or
- holds a significant shareholding; or
- has been an employee of the company or group within the last five years;
- has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a

This provision is substantially similar to 2016 Code Provision B.1.1.

Note that with the deletion of Provision B.2.3 (which said that non-executive director terms beyond six years should be subject to particularly rigorous review), a nine year term will, we expect, become the de facto tenure period in practice.

Incorporates Provision B.1.1 from the 2016 Code: 'The board should identify in the annual report each non-executive director it considers to be independent. The board should determine whether the director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director’s judgement. The board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination, including if the director:
- has been an employee of the company or group within the last five years;
- has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a

This provision is substantially similar to 2016 Code Provision B.1.1.

Note that with the deletion of Provision B.2.3 (which said that non-executive director terms beyond six years should be subject to particularly rigorous review), a nine year term will, we expect, become the de facto tenure period in practice.
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| o has served on the board for more than nine years from the date of their first appointment. Where any of these or other relevant circumstances apply, and the board nonetheless considers that the non-executive director is independent, a clear explanation should be provided.‘ | body that has such a relationship with the company;  
→ has received or receives additional remuneration from the company apart from a director’s fee, participates in the company’s share option or a performance-related pay scheme, or is a member of the company’s pension scheme;  
→ has close family ties with any of the company's advisers, directors or senior employees;  
→ holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;  
→ represents a significant shareholder; or  
→ has served on the board for more than nine years from the date of their first election.‘ |
| ▶ Provision 11: ‘At least half the board, excluding the chair, should be non-executive directors whom the board considers to be independent.’ | Incorporates 2016 Code Provision B.1.2: ‘Except for smaller companies [one that is below the FTSE 350 throughout the year immediately prior to the reporting year], at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent. A smaller company should have at least two independent non-executive directors.’ Note: ▶ The exemption for smaller companies has now been removed, so that all will have to report compliance or explain. |
| ▶ Provision 12: ‘The board should appoint one of the independent non-executive directors to be the senior independent director to provide a sounding board for the chair and serve as an intermediary for the other directors and shareholders. Led by the senior independent director, the non-executive directors should meet without the chair present at least annually to appraise the chair’s performance, and on other occasions as necessary.’ | Incorporates from the 2016 Code: ▶ Provision A.4.1: ‘The board should appoint one of the independent non-executive directors to be the senior independent director to provide a sounding board for the chairman and to serve as an intermediary for the other directors when necessary. The senior independent director should be available to shareholders if they have concerns which contact through the normal channels of chairman, chief executive or other executive directors has failed to resolve or for which such contact is inappropriate.’ ▶ Provision A.4.2: ‘Led by the senior independent director, the non-executive directors should meet without the chairman present at least annually to appraise the chairman's performance and on such other occasions as are deemed appropriate.’ |
| ▶ Provision 13: ‘Non-executive directors have a prime role in appointing and removing executive directors. Non-executive directors should scrutinise and hold to account the performance of management and individual executive directors against agreed performance objectives. The chair should hold | Incorporates from the 2016 Code: ▶ Supporting Principles A.4: ‘Non-executive directors should scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance. […] They are responsible for
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| meetings with the non-executive directors without the executive directors present.’ | determining appropriate levels of remuneration of executive directors and have a prime role in appointing and, where necessary, removing executive directors, and in succession planning.’  
  - Provision A.4.2: ‘The chairman should hold meetings with the non-executive directors without the executives present.’ |
| Provision 14: ‘The responsibilities of the chair, chief executive, senior independent director, board and committees should be clear, set out in writing, agreed by the board and made publicly available. The annual report should set out the number of meetings of the board and its committees, and the individual attendance by directors.’ | Incorporates 2016 Code Provision A.1.2: ‘The annual report should identify the chairman, the deputy chairman (where there is one), the chief executive, the senior independent director and the chairmen and members of the board committees. It should also set out the number of meetings of the board and those committees and individual attendance by directors.’ |
| Provision 15: ‘When making new appointments, the board should take into account other demands on directors’ time. Prior to appointment, significant commitments should be disclosed with an indication of the time involved. Additional external appointments should not be undertaken without prior approval of the board, with the reasons for permitting significant appointments explained in the annual report. Full-time executive directors should not take on more than one non-executive directorship in a FTSE 100 company or other significant appointment.’ | Whilst incorporating elements of the 2016 Code, this provision has been expanded with a greater focus on the issue of ‘overboarding’.  
  - Incorporates from the 2016 Code:  
  - Main Principle B.3: ‘All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively.’  
  - Provision B.3.3: ‘The board should not agree to a full time executive director taking on more than one non-executive directorship in a FTSE 100 company nor the chairmanship of such a company.’ |
| Provision 16: ‘All directors should have access to the advice of the company secretary, who is responsible for advising the board on all governance matters. Both the appointment and removal of the company secretary should be a matter for the whole board.’ | Incorporates 2016 Code Provision B.5.2: ‘All directors should have access to the advice and services of the company secretary, who is responsible to the board for ensuring that board procedures are complied with. Both the appointment and removal of the company secretary should be a matter for the board as a whole.’ |

**Section 3 - Composition, Succession and Evaluation**

| Principle J: ‘Appointments to the board should be subject to a formal, rigorous and transparent procedure, and an effective succession plan should be maintained for board and senior management [note 1]. Both appointments and succession plans should be based on merit and objective criteria [note 2] and, within this context, should promote diversity of gender, social and ethnic backgrounds, cognitive and personal strengths.’ | The 2018 Code asks boards to intensify their efforts in promoting and creating diversity in its broadest sense. The breadth of diversity considerations has been expanded from the 2016 Code.  
  - Incorporates from the 2016 Code:  
  - Main Principle B.2: ‘There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.’  
  - Supporting Principles B.2: ‘The search for board candidates should be conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender. The board should satisfy itself that...’ |
| Note 1: ‘senior management’ has been defined as the executive committee or the first layer of management below board level, including the company secretary. |  

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*Note: The text above is based on the provided document and has been formatted for readability.*
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<td>Note 2: Which protect against discrimination for those with protected characteristics within the meaning of the Equalities Act 2010.</td>
<td>plans are in place for orderly succession for appointments to the board and to senior management, so as to maintain an appropriate balance of skills and experience within the company and on the board and to ensure progressive refreshing of the board.</td>
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| Principle K: ‘The board and its committees should have a combination of skills, experience and knowledge. Consideration should be given to the length of service of the board as a whole and membership regularly refreshed.’ | When considering board composition, greater emphasis is now made of the length of service of directors. Incorporates from the 2016 Code:  
- Main Principle B.1: ‘The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.’  
- Main Principle B.7: ‘All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.’ |
| Principle L: ‘Annual evaluation of the board should consider its composition, diversity and how effectively members work together to achieve objectives. Individual evaluation should demonstrate whether each director continues to contribute effectively.’ | Incorporates from the 2016 Code:  
- Main Principle B.6: ‘The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.’  
- Supporting Principles B.6: ‘Individual evaluation should aim to show whether each director continues to contribute effectively and to demonstrate commitment to the role (including commitment of time for board and committee meetings and any other duties).’ |
| Provision 17: ‘The board should establish a nomination committee that should lead the process for appointments, ensure plans are in place for orderly succession to both the board and senior management positions, and oversee the development of a diverse pipeline for succession. A majority of members of the committee 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.’ | There is now an emphasis on building diversity throughout the workforce and a key change is that the role of the nomination committee is expanded beyond board succession and appointments to providing oversight of talent development in the executive pipeline. Incorporates from the 2016 Code:  
- Supporting Principles B.2: ‘The board should satisfy itself that plans are in place for orderly succession for appointments to the board and to senior management, so as to maintain an appropriate balance of skills and experience within the company and on the board and to ensure progressive refreshing of the board.’  
- Provision B.2.1: ‘There should be a nomination committee which should lead the process for board appointments and make recommendations to the board.’ |
<p>| Provision 18: ‘All directors should be subject to annual re-election. The board should set out in the papers accompanying the resolutions to elect each director the specific reasons why their contribution is, | Although incorporating pre-existing Principles and Provisions from the 2016 Code, setting out why director contribution is |</p>
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<td>and continues to be, important to the company’s long-term sustainable success.’</td>
<td>‘important to the company’s long-term sustainable success’ is new.</td>
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<td>No distinction is made between FTSE 350 companies and others applying the Code.</td>
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<td>Incorporates from the 2016 Code:</td>
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<td>Main Principle B.7: ‘All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.’</td>
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<td>Provision B.7.1 (but now covers all directors): ‘All directors of FTSE 350 companies should be subject to annual election by shareholders. All other directors should be subject to election by shareholders at the first annual general meeting after their appointment, and to re-election thereafter at intervals of no more than three years. Non-executive directors who have served longer than nine years should be subject to annual re-election. The names of directors submitted for election or re-election should be accompanied by sufficient biographical details and any other relevant information to enable shareholders to take an informed decision on their election.’</td>
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<td>Provision B.7.2 ‘The board should set out to shareholders in the papers accompanying a resolution to elect a non-executive director why they believe an individual should be elected. The chairman should confirm to shareholders when proposing re-election that, following formal performance evaluation, the individual’s performance continues to be effective and to demonstrate commitment to the role.’</td>
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<td>Provision 19: ‘The chair should not remain in post beyond nine years from the date of their first appointment to the board. To facilitate effective succession planning and the development of a diverse board, this period can be extended for a limited time, particularly in those cases where the chair was an existing non-executive director on appointment. A clear explanation should be provided.’</td>
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<td>This is an entirely new Provision.</td>
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<td>See ‘What are the key issues raised in 2018 Code?’ in the body of this paper, for more detail on this.</td>
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<td>Provision 20: ‘Open advertising and/or an external search consultancy should generally be used for the appointment of the chair and non-executive directors. If an external search consultancy is engaged it should be identified in the annual report alongside a statement about any other connection it has with the company or individual directors.’</td>
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<td>Incorporates 2016 Code Provision B.2.4: ‘[...] An explanation should be given if neither an external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director. Where an external search consultancy has been used, it should be identified in the annual report and a statement made as to whether it has any other connection with the company.’</td>
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<td><strong>Provision 21:</strong> 'There should be a formal and rigorous annual evaluation of the performance of the board, its committees, the chair and individual directors. The chair should consider having a regular externally facilitated board evaluation. This should happen at least every three years. The external evaluator should be identified in the annual report and a statement made about other connection it has with the company or individual directors.'</td>
<td>The new Provision now applies to all companies applying the Code, not just FTSE 350 companies. Incorporates from the 2016 Code: Main Principle B.6 references to evaluating the performance of committees and individual directors, where 2018 Code Principle L does not specify. Provision B.6.2: ‘Evaluation of the board of FTSE 350 companies should be externally facilitated at least every three years. The external facilitator should be identified in the annual report and a statement made as to whether they have any other connection with the company.’</td>
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<td><strong>Provision 22:</strong> 'The chair should act on the results of the evaluation by recognising the strengths and addressing any weaknesses of the board. Each director should engage with the process and take appropriate action when development needs have been identified.'</td>
<td>Incorporates from the 2016 Code: Supporting Principles B.4: ‘The chairman should ensure that the directors continually update their skills and the knowledge and familiarity with the company required to fulfil their role both on the board and on board committees. The company should provide the necessary resources for developing and updating its directors’ knowledge and capabilities. To function effectively all directors need appropriate knowledge of the company and access to its operations and staff.’ Provision B.4.2: ‘The chairman should regularly review and agree with each director their training and development needs.’ Supporting Principles B.6: ‘[...] The chairman should act on the results of the performance evaluation by recognising the strengths and addressing the weaknesses of the board and, where appropriate, proposing new members be appointed to the board or seeking the resignation of directors. [...]’</td>
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| **Provision 23:** 'The annual report should describe the work of the nomination committee, including: o the process used in relation to appointments, its approach to succession planning and how both support developing a diverse pipeline; o how the board evaluation has been conducted, the nature and extent of an external evaluator’s contact with the board and individual directors, the outcomes and actions taken and how it has or will influence board composition; o the policy on diversity and inclusion, its objectives and linkage to company strategy, how it has been implemented and progress on achieving the objectives; and o the gender balance of those in the senior management [note] and their direct reports.' | This Provision shifts the focus from the nomination committee reporting on processes and policies to actions and outcomes. For example: reporting on actions taken to increase diversity and inclusion and their outcomes; reporting on outcomes of the board evaluation and actions to be taken, etc. It also implements the Hampton-Alexander Review recommendation that ‘the FRC should amend the UK Corporate Governance Code so that all FTSE 350 companies disclose in their Annual Reports the gender balance on the Executive Committee and Direct Reports to the Executive Committee’ and goes further by not limiting to the FTSE 350. A requirement for disclosure of ethnic diversity or other types of diversity in the
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| Note: ‘senior management’ has been defined as the executive committee or the first layer of management below board level, including the company secretary. | pipeline has not been included, but the Provision requires much greater disclosures on diversity and inclusion overall, with a continued focus on actions and outcomes. Incorporates from the 2016 Code:  
|  | Provision B.2.4: ‘A separate section of the annual report should describe the work of the nomination committee, including the process it has used in relation to board appointments. This section should include a description of the board’s policy on diversity, including gender, any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives. [...]’. However the 2018 Code asks for a link to be made between the diversity policy and the strategy of the company. |

### Section 4 - Audit, risk and internal control

| Principle M: ‘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.’ | This Principle places a new emphasis on the board satisfying itself not only of the integrity of the financial statements, but also the narrative statements. Incorporates from the 2016 Code:  
|  | Main Principle C.3: ‘The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles and for maintaining an appropriate relationship with the company’s auditors.’  
|  | Provision C.3.4: ‘Where requested by the board, the audit committee should provide advice on whether the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company’s position and performance, business model and strategy.’  
|  | The note also incorporates Supporting Principles C.1: ‘The board’s responsibility to present a fair, balanced and understandable assessment extends to interim and other price-sensitive public reports and reports to regulators as well as to information required to be presented by statutory instruments.’  
<p>|  | The board should establish arrangements that will enable it to ensure that the information presented is fair, balanced and understandable.’ |
| Principle N: ‘The board should present a fair, balanced and understandable assessment of the company’s position and prospects.’ | Incorporates 2016 Code Main Principle C.1: ‘The board should present a fair, balanced and understandable assessment of the company's position and prospects.’ |</p>
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| ▶ **Principle O**: ‘The board should establish procedures to manage risk, oversee the internal control framework, and determine the nature and extent of the principal risks the company is willing to take in order to achieve its long-term strategic objectives.’ | ▶ Greater focus on ‘establishing procedures’ and ‘oversight’ rather than ‘determining’ and ‘maintaining’.  
▶ Incorporates 2016 Code Main Principle C.2: ‘The board is responsible for determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.’ |
| ▶ **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 [note]. 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.’  
Note: A smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year. | ▶ The exemption allowing chairs of non-FTSE 350 companies to be members of the audit committee has been removed.  
▶ Incorporates 2016 Code Provision C.3.1: ‘The board should establish an audit committee of at least three, or in the case of smaller companies two, independent non-executive directors. In smaller companies the company chairman may be a member of, but not chair, the committee in addition to the independent non-executive directors, provided he or she was considered independent on appointment as chairman. The board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience. The audit committee as a whole shall have competence relevant to the sector in which the company operates.’ |
| ▶ **Provision 25**: ‘The main roles and responsibilities of the audit committee should include:  
- monitoring the integrity of the financial statements of the company and any formal announcements relating to the company’s financial performance, and reviewing significant financial reporting judgements contained in them;  
- providing advice (where requested by the board) on whether the annual report and accounts, taken as a whole, is fair, balanced and understandable, and provides the information necessary for shareholders to assess the company’s position and performance, business model and strategy;  
- reviewing the company’s internal financial controls and internal control and risk management systems, unless expressly addressed by a separate board risk committee composed of independent non-executive directors, or by the board itself;  
- monitoring and reviewing the effectiveness of the company’s internal audit function or, where there is not one, considering annually whether there is a need for one and making a recommendation to the board;’ | ▶ This provision is more explicit about the audit committee’s role in conducting the tender process and in approving non-audit services (specifically ‘considering the impact this may have on independence’), rather than simply developing and implementing the non-audit services policy.  
Incorporates:  
▶ Main Principle C.3 [see alongside Principle M]  
▶ **Provision C.3.2**: ‘The main role and responsibilities of the audit committee should be set out in written terms of reference and should include:  
- to monitor the integrity of the financial statements of the company and any formal announcements relating to the company’s financial performance, reviewing significant financial reporting judgements contained in them;  
- to review the company’s internal financial controls and, unless expressly addressed by a separate board risk committee composed of independent directors, or by the board itself, to review the company’s internal control and risk management systems;’ |
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<td>o conducting the tender process and making recommendations to the board, about the appointment, reappointment and removal of the external auditor, and approving the remuneration and terms of engagement of the external auditor;</td>
<td>• to monitor and review the effectiveness of the company’s internal audit function;</td>
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<td>o reviewing and monitoring the external auditor’s independence and objectivity;</td>
<td>• to make recommendations to the board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;</td>
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<td>o reviewing the effectiveness of the external audit process, taking into consideration relevant UK professional and regulatory requirements;</td>
<td>• to review and monitor the external auditor’s independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;</td>
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<td>o developing and implementing policy on the engagement of the external auditor to supply non-audit services, ensuring there is prior approval of non-audit services, considering the impact this may have on independence, taking into account the relevant regulations and ethical guidance in this regard, and reporting to the board on any improvement or action required; and</td>
<td>• to develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm; and to report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken; and</td>
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<td>o reporting to the board on how it has discharged its responsibilities.’</td>
<td>• to report to the board on how it has discharged its responsibilities.’</td>
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<td>• to monitor and review the effectiveness of the company’s internal audit function;</td>
<td>▶ Provision C.3.4: ‘Where requested by the board, the audit committee should provide advice on whether the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company’s position and performance, business model and strategy.’</td>
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<td>• to make recommendations to the board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;</td>
<td>▶ Provision C.3.7: ‘The audit committee should have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditors. If the board does not accept the audit committee’s recommendation, it should include in the annual report, and in any papers recommending appointment or re-appointment, a statement from the audit committee explaining the recommendation and should set out reasons why the board has taken a different position.’</td>
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<td>Greater emphasis on explaining how internal assurance is achieved if there is no internal audit function.</td>
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<td>Incorporates from the 2016 Code:</td>
<td>▶ Provision C.3.7 [see alongside Provision 25]</td>
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<td>▶ Provision C.3.8: ‘A separate section of the annual report should describe the work of the</td>
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Provision 26: The annual report should describe the work of the audit committee, including:

- the significant issues that the audit committee considered relating to the financial statements, and how these issues were addressed;
- an explanation of how it has assessed the independence and effectiveness of the
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<td>external audit process and the approach taken to the appointment or reappointment of the external auditor, information on the length of tenure of the current audit firm, when a tender was last conducted and advance notice of any retendering plans;</td>
<td>committee in discharging its responsibilities. The report should include:</td>
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<td>o in the case of a board not accepting the audit committee's recommendation on the external auditor appointment, reappointment or removal, a statement from the audit committee explaining its recommendation and the reasons why the board has taken a different position (this should also be supplied in any papers recommending appointment or reappointment);</td>
<td>1. the significant issues that the committee considered in relation to the financial statements, and how these issues were addressed;</td>
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<td>o where there is no internal audit function, an explanation for the absence, how internal assurance is achieved, and how this affects the work of external audit; and</td>
<td>2. an explanation of how it has assessed the effectiveness of the external audit process and the approach taken to the appointment or reappointment of the external auditor, information on the length of tenure of the current audit firm, when a tender was last conducted and advance notice of any retendering plans; and</td>
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<td>o an explanation of how auditor independence and objectivity are safeguarded, if the external auditor provides non-audit services.</td>
<td>3. if the external auditor provides non-audit services, an explanation of how auditor objectivity and independence are safeguarded.</td>
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<td>▶ Provision 27: The directors should explain in the annual report their responsibility for preparing the annual report and accounts, and state that they consider the annual report and accounts, taken as a whole, is fair, balanced and understandable, and provides the information necessary for shareholders to assess the company's position, performance, business model and strategy.</td>
<td>Incorporates 2016 Code Provision C.1.1: ‘The directors should explain in the annual report their responsibility for preparing the annual report and accounts, and state that they consider the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company’s position and performance, business model and strategy. There should be a statement by the auditor about their reporting responsibilities.’</td>
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<td>▶ Provision 28: ‘The board should carry out a robust assessment of the company’s emerging and principal risks [note]. The board should confirm in the annual report that it has completed this assessment, including a description of its principal risks, what procedures are in place to identify emerging risks, and an explanation of how these are being managed or mitigated.’</td>
<td>New focus on assessing the company’s emerging risks, and disclosing what procedures are in place to identify them.</td>
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<td>Note: ‘Principal risks should include, but are not necessarily limited to, those that could result in events or circumstances that might threaten the company’s business model, future performance, solvency or liquidity and reputation. In deciding which risks are principal risks companies should consider the potential impact and probability of the related events or circumstances, and the timescale over which they may occur.’</td>
<td>The note makes more explicit what the FRC expects to be disclosed as a principal risk and how the assessment ought to be made.</td>
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<td>▶ Provision 29: ‘The board should monitor the company’s risk management and internal control systems and, at least annually, carry out a review of</td>
<td>Incorporates 2016 Code Provision C.2.1: ‘The directors should confirm in the annual report that they have carried out a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity. The directors should describe those risks and explain how they are being managed or mitigated.’</td>
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<td></td>
<td>Incorporates 2016 Code Provision C.2.3 ‘The board should monitor the company’s risk management and internal control systems</td>
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### New or updated Principle or Provision

**their effectiveness and report on that review in the annual report. The monitoring and review should cover all material controls, including financial, operational and compliance controls.**

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<td>and, at least annually, carry out a review of their effectiveness, and report on that review in the annual report. The monitoring and review should cover all material controls, including financial, operational and compliance controls.</td>
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- **Provision 30:** ‘In annual and half-yearly financial statements, the board should state whether it considers it appropriate to adopt the going concern basis of accounting in preparing them, and identify any material uncertainties to the company’s ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements.’

  - **Incorporates 2016 Code Provision C.1.3:** ‘In annual and half-yearly financial statements, the directors should state whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and identify any material uncertainties to the company’s ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements.’

- **Provision 31:** ‘Taking account of the company’s current position and principal risks, the board should explain in the annual report how it has assessed the prospects of the company, over what period it has done so and why it considers that period to be appropriate. The board should state whether it has a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, drawing attention to any qualifications or assumptions as necessary.’

  - **Incorporates 2016 Code Provision C.2.2:** ‘Taking account of the company’s current position and principal risks, the directors should explain in the annual report how they have assessed the prospects of the company, over what period they have done so and why they consider that period to be appropriate. The directors should state whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, drawing attention to any qualifications or assumptions as necessary.’

### Section 5 – Remuneration

‘Schedule A: The design of performance-related remuneration for executive directors’ of the 2016 Code has been integrated into Section 5, which now includes a range of considerations for the Committee (e.g., Provision 40).

- **Principle P:** ‘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.’

  - **Incorporates from the 2016 Code:**

    - Main Principle D.1: ‘Executive directors’ remuneration should be designed to promote the long-term success of the company. Performance-related elements should be transparent, stretching and rigorously applied.’

- **Principle Q:** ‘A formal and transparent procedure for developing policy on executive remuneration and determining director and senior management [note] remuneration should be established. Performance-related elements should be clear, stretching, rigorously applied and aligned to the successful delivery of the strategy. No director should be involved in deciding their own remuneration outcome.’

  - **Incorporates from the 2016 Code:**

    - Main Principle D.2: ‘There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration’

- **Note:** ‘Senior management’ has been defined as the executive committee or the first layer of management below board level, including the company secretary.

- **Principle R:** ‘Directors should exercise independent judgement and discretion when authorising...

  - **This principle emphasising the need for the remuneration committee to exercise...**
July 2018

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<td>remuneration outcomes, taking account of company and individual performance, and wider circumstances.</td>
<td>independent judgement and discretion is new. The FRC is keen for directors to be empowered to override formulaic remuneration outcomes, for example, when the link to performance is missing.</td>
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- **Provision 32:** ‘The board should establish a remuneration committee of independent non-executive directors, with a minimum membership of three, or in the case of smaller companies, two [note]. In addition, the chair of the board can only be a member if they were independent on appointment and cannot chair the committee. Before appointment as chair of the remuneration committee, the appointee should have served on a remuneration committee for at least 12 months.’

  - **Note:** A smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year.

- **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 [also note 1]. It should review workforce [see note 2] 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.’

  - **Note 1:** ‘Senior management’ has been defined as the executive committee or the first layer of management below board level, including the company secretary.
  - **Note 2:** ‘See Guidance on Board Effectiveness Section 5 for a description of the workforce in this context.’

- **Provision 34:** ‘The remuneration of non-executive directors should be determined in accordance with the Articles of Association or, alternatively, by the board. Levels of remuneration for the chair and all non-executive directors should reflect the time commitment and responsibilities of the role. Remuneration for all non-executive directors should

  - **Incorporates from the 2016 Code:**
    - **Provision D.2.1:** ‘The board should establish a remuneration committee of at least three, or in the case of smaller companies’ two, independent non-executive directors. In addition the company chairman may also be a member of, but not chair, the committee if he or she was considered independent on appointment as chairman. The remuneration committee should make available its terms of reference, explaining its role and the authority delegated to it by the board. […]’

  - **Incorporates from the 2016 Code:**
    - **Provision D.1.3:** ‘Levels of remuneration for non-executive directors should reflect the time commitment and responsibilities of the role. Remuneration for non-executive directors should not include share options or other performance-related elements. […]’
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<td>not include share options or other performance-related elements.'</td>
<td>Provision D.2.3: ‘The board itself or, where required by the Articles of Association, the shareholders should determine the remuneration of the non-executive directors within the limits set in the Articles of Association. Where permitted by the Articles, the board may however delegate this responsibility to a committee, which might include the chief executive.’</td>
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| Provision 35: ‘Where a remuneration consultant is appointed, this should be the responsibility of the remuneration committee. The consultant should be identified in the annual report alongside a statement about any other connection it has with the company or individual directors. Independent judgement should be exercised when evaluating the advice of external third parties and when receiving views from executive directors and senior management.’ Note: ‘senior management’ has been defined as the executive committee or the first layer of management below board level, including the company secretary. | Incorporates from the 2016 Code:  
- Supporting Principles D.2: ‘The remuneration committee should take care to recognise and manage conflicts of interest when receiving views from executive directors or senior management, or consulting the chief executive about its proposals. The remuneration committee should also be responsible for appointing any consultants in respect of executive director remuneration. [...]’  
- Provision D.2.1: ‘The board should establish a remuneration committee of at least three, or in the case of smaller companies’ two, independent non-executive directors. In addition the company chairman may also be a member of, but not chair, the committee if he or she was considered independent on appointment as chairman. The remuneration committee should make available its terms of reference, explaining its role and the authority delegated to it by the board.’ |
| Provision 36: ‘Remuneration schemes should promote long-term shareholdings by executive directors that support alignment with long-term shareholder interests. In normal circumstances, share awards granted for this purpose should be released for sale on a phased basis and be subject to a total vesting and holding period of five years or more. The remuneration committee should develop a formal policy for post-employment shareholding requirements encompassing both unvested and vested shares.’ | Recommended minimum vesting and post-vesting holding periods for executive share awards have been extended from three to five years.  
- The inclusion of post-employment periods is also new, and the shareholding requirements cover both unvested and vested shares. |
| Provision 37: ‘Remuneration schemes and policies should enable the use of discretion to override formulaic outcomes. They should also include provisions that would enable the company to recover and/or withhold sums or share awards, and specify the circumstances in which it would be appropriate to do so.’ | The term ‘discretion’ was not used in the 2016 Code and the first part of Provision 37 is new. This aligns with 2018 Code Principle R.  
- Incorporates 2016 Code Provision D.1.1: ‘In designing schemes of performance-related remuneration for executive directors, the remuneration committee should follow the provisions in Schedule A to this Code. Schemes should include provisions that would enable the company to recover sums paid or withhold the payment of any sum, and...’ |
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<td>Provision 38: ‘Only basic salary should be pensionable. The pension contribution rates for executive directors, or payments in lieu, should be aligned with those available to the workforce. The pension consequences and associated costs of basic salary increases and any other changes in pensionable remuneration, or contribution rates, particularly for directors close to retirement, should be carefully considered when compared with workforce arrangements.’</td>
<td>The requirement to align pension arrangements to those of the wider workforce is new. Incorporates 2016 Code Provision D.1.4: ‘The remuneration committee should carefully consider what compensation commitments (including pension contributions and all other elements) their directors’ terms of appointment would entail in the event of early termination. [...]’</td>
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<td>Provision 39: ‘Notice or contract periods should be one year or less. If it is necessary to offer longer periods to new directors recruited from outside the company, such periods should reduce to one year or less after the initial period. The remuneration committee should ensure compensation commitments in directors’ terms of appointment do not reward poor performance. They should be robust in reducing compensation to reflect departing directors’ obligations to mitigate loss.’</td>
<td>Incorporates from the 2016 Code: Provision D.1.4: ‘The remuneration committee should carefully consider what compensation commitments (including pension contributions and all other elements) their directors’ terms of appointment would entail in the event of early termination. The aim should be to avoid rewarding poor performance. They should take a robust line on reducing compensation to reflect departing directors’ obligations to mitigate loss.’ Provision D.1.5: ‘Notice or contract periods should be set at one year or less. If it is necessary to offer longer notice or contract periods to new directors recruited from outside, such periods should reduce to one year or less after the initial period.’</td>
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| Provision 40: ‘When determining executive director remuneration policy and practices, the remuneration committee should address the following:  
  o **clarity** - remuneration arrangements should be transparent and promote effective engagement with shareholders and the workforce;  
  o **simplicity** - remuneration structures should avoid complexity and their rationale and operation should be easy to understand;  
  o **risk** - remuneration arrangements should ensure reputational and other risks from excessive rewards, and behavioural risks that can arise from target-based incentive plans, are identified and mitigated;  
  o **predictability** - the range of possible values of rewards to individual directors and any other limits or discretions should be identified and explained at the time of approving the policy;  
  o **proportionality** - the link between individual awards, the delivery of strategy and the long-term performance of the company should be clear. Outcomes should not reward poor performance; and | These considerations are new and link to the new or enhanced focus in the Code on long term success, purpose, culture and values. |
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<td>o alignment to culture - incentive schemes should drive behaviours consistent with company purpose, values and strategy.</td>
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<td>► Provision 41: ‘There should be a description of the work of the remuneration committee in the annual report, including:</td>
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<td>o an explanation of the strategic rationale for executive directors' remuneration policies, structures and any performance metrics;</td>
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<td>o reasons why the remuneration is appropriate using internal and external measures, including pay ratios and pay gaps;</td>
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<td>o a description, with examples, of how the remuneration committee has addressed the factors in Provision 40;</td>
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<td>o whether the remuneration policy operated as intended in terms of company performance and quantum, and, if not, what changes are necessary;</td>
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<td>o what engagement has taken place with shareholders and the impact this has had on remuneration policy and outcomes;</td>
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<td>o what engagement with the workforce has taken place to explain how executive remuneration aligns with wider company pay policy; and</td>
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<td>o to what extent discretion has been applied to remuneration outcomes and the reasons why.’</td>
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<td>► There are expanded disclosure requirements compared to the 2016 Code including the company's approach to investing in, developing and rewarding the workforce as well as the Remuneration Committee's engagement with the workforce. The Provision incorporates some of the reporting developments brought in by The Companies (Miscellaneous Reporting) Regulations 2018.</td>
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