UK Corporate Governance Reform: What next?
The Department for Business, Energy and Industrial Strategy (BEIS) published their eagerly anticipated Green Paper on Corporate Governance Reform on 29 November 2016. Whilst some may have been expecting more concrete proposals, particularly given the Government’s commitment to give workers and consumers representation on company boards, the Green Paper was “designed to stimulate a debate on a range of options for strengthening the UK’s corporate governance framework, including options for increasing shareholder influence over executive pay and strengthening the employee, customer and supplier voice at boardroom level.”

As business and the business environment is changing rapidly – driven by technology, globalisation and public opinion – it is right that we pause to consider whether the UK’s corporate governance framework is delivering the right outcomes, and how public trust in business could be enhanced. It is important that the corporate governance framework continues to be fit for purpose, but, in our view, any changes need to be considered carefully so that we build on its strengths.

An open debate with all stakeholders is needed and the Green Paper is a good start particularly as the “Government does not have preferred options at this stage” but wants “to use responses to the Green Paper to help us understand the strengths and weaknesses of the different options and build a better evidence base before deciding which of them to develop further.”

This is emphasised by the Rt Hon Greg Clark MP, the Secretary of State for Business, Energy and Industrial Strategy, who, in his foreword, said that “The Green Paper seeks views on three areas where we want to consider options for updating our corporate governance framework ... This Green Paper is designed to frame a discussion, so that we can move quickly to consider whether changes are appropriate at this time. Where there is a view that change is appropriate it may not be the case that regulation by Government is needed to secure it. One of the strengths of our system of corporate governance has been the use of non-legislative standards by business itself.”

The consultation period closed on 17 February 2017 and BEIS is now assessing the responses, including a response from EY. It is clear that the Government’s consultation “has been a catalyst to focus the minds of both investors and businesses” and has attracted a significant volume of input and varied views. While we await the outcome with interest, in this article we will look at the background and context to the Green Paper and the possible next steps. We also, for information, recap on the public policy formation process more generally.

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1 Foreword from the Secretary of State, Corporate Governance Reform, Green Paper

The background and context to the Green Paper
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In July 2016, at the launch of her campaign to be the leader of the Conservative Party, Theresa May, outlined how to make Britain a country that works for everyone and, perhaps not surprisingly giving mounting public concern at the quantum of executive pay and high profile corporate governance failings, one of her pledges related to the reform of UK corporate governance:

“And I want to see changes in the way that big business is governed. The people who run big businesses are supposed to be accountable to outsiders, to non-executive directors, who are supposed to ask the difficult questions, think about the long-term and defend the interests of shareholders. In practice, they are drawn from the same, narrow social and professional circles as the executive team and – as we have seen time and time again – the scrutiny they provide is just not good enough. So if I’m Prime Minister, we’re going to change that system – and we’re going to have not just consumers represented on company boards, but employees as well.”

A few month later, as Prime Minister, Theresa May announced her Government’s plans for corporate governance reforms at the Conservative Party Conference. The focus was again being on accountability, but this time it was more targeted on the bad apples, and worker and consumer representation on boards:

“But we must acknowledge that the way a small number of businesses behave fuels the frustration people feel.”

Fast forward to November 2016, and in a speech to the CBI Conference the Prime Minister announced that:

“There will be a green paper later this autumn that addresses executive pay and accountability to shareholders, and how we can ensure the employee voice is heard in the boardroom. This will be a genuine consultation – we want to work with the grain of business and to draw from what works. But it will also be a consultation that will deliver results.”

3 The Rt. Hon Theresa May MP, ‘We can make Britain a country that works for everyone’, 11 July 2016

4 The Rt. Hon Theresa May MP, Speech to Conservative Party Conference, 4 October 2016
That there is a clear and strong commitment at the top of Government to reform corporate governance is in no doubt and we should expect to see action being taken. The three areas of focus for the Green Paper are:

1. **Executive pay:**
   - Do shareholders need stronger powers to hold companies to account on executive pay and performance?
   - Does more need to be done to encourage institutional and retail investors make full use of their existing and any new voting powers on pay?
   - Do steps need to be taken to improve the effectiveness of remuneration committees and advisers, in particular to encourage them to engage more effectively with shareholder and employee views before developing pay policy?
   - Should a new pay ratio reporting requirement be introduced?
   - Should the existing, qualified requirements to disclosure performance targets that trigger annual bonus payments be strengthened (without compromising confidentiality)?
   - How could long-term incentive plans be better aligned with the long-term interests of quoted companies and shareholders and should holding periods be increased from a minimum of three to five years for share options awarded to executives?

2. **Strengthening the employee, customer and wider stakeholder voice:**
   - How to strengthen the way in which the interests of employees, customer and wider stakeholders are taken into account at board level in large UK companies?
   - What type of company should be the focus for any steps to strengthen the stakeholder voice – should there be an employee number or other size threshold?
   - Should the reform be taken forward as a legislative, code-based or voluntary approach?

3. **Corporate governance in large, privately-held businesses:**
   - What is the case for strengthening the corporate governance framework of the UK’s largest, privately-held businesses and what are the benefits and risk?
   - Should a size threshold be set, would a legislative or voluntary approach be preferable and how could compliance be monitored?
   - Should non-financial reporting requirements be applied on the basis of a size threshold rather than legal form?

The Green Paper recognises that legislation may not be the best or only way to effect a positive change (e.g., it consults on strengthening the employee, consumer and wider stakeholder voice more generally rather than making a worker or consumer representative a board director). This is reiterated in the FRC’s response to BEIS, which outlines the regulator’s views on how change could be effected through the UK Corporate Governance Code, a new code for private companies and new powers and an increased scope, albeit underpinned by statute.
So what might we expect and when might we expect it?
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Although the Consultation Principles 2016 suggest the Government response should be published by 16 May 2017, as discussed previously, this is good practice only and BEIS may take longer to assess the responses received, policy implications and develop proposals.

Our first indication of the Government’s direction of travel could, however, still come in mid-May. If the Government decides to proceed with primary legislation, a corporate reform Bill should be included in the Queen’s Speech for the 2017-18 session, which sets out the Government’s legislative agenda. If a Bill were to be announced, it could be laid before Parliament at any time before May 2018. Hence, if the Government was to publish a White Paper in May or June with a three month consultation period, we might not see a Bill laid before Parliament until the end of 2017 or early 2018 and it would probably not become law until mid-2018 at the earliest (particularly as Bills may take up to, or even over, a year to complete all stages in both the House of Commons and House of Lords and become law).

So what is the likely direction of travel?

The Companies Act 2006 (the Act) provides the Secretary of State for BEIS with the power to amend parts of the Act through secondary legislative, and make more detailed regulations. For example, executive pay requirements for UK incorporated listed companies are also set out in regulations made under the Act5. Hence, given the legislative agenda and the pressures on Parliamentary time in the run up to Brexit, the more likely scenario is that the Government will propose secondary legislation to make targeted amendments to the Act and related secondary legislation. In particular, we could see changes to the Act and The Strategic Report Regulations to require directors to report on how they have discharged their responsibilities under Section 172 of the Act, and changes to the executive pay regulations to enhance the transparency of reporting (for example, by reporting pay ratios) and, hopefully, simplify executive pay and how it is reported.

The support in the Green Paper for the ‘comply or explain’ basis of the Code also suggests that the Government will favour non-legislative options. Particularly given the enthusiastic response from the FRC, it seems likely that the Government will task the FRC with implementing large parts of the policy agenda, including enhancing companies’ engagement with stakeholders, widening the role of remuneration committees and a corporate governance code for private companies. As the FRC notes, though, this is likely to need legislative underpinning and changes to the FRC’s scope and powers that were not included in the Green Paper.

The FRC has already announced plans for “a fundamental review of the UK Corporate Governance Code” which will “take account of work done by the FRC on corporate culture and succession planning…”

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Whether we see a Government response to the Green Paper or a White Paper is still uncertain but we should expect to see — and be ready to engage with — further debate and consultation on the likely amendments to primary and secondary legislation to reform elements of UK corporate governance.

Meanwhile, the FRC has already announced plans for “a fundamental review of the UK Corporate Governance Code” which will “take account of work done by the FRC on corporate culture and succession planning, and the issues raised in the Government’s Green Paper and the BEIS Select Committee inquiry.”

The FRC has stated that “the review will build on the Code’s globally recognised strengths developed over the past 25 years while considering the appropriate balance between its principles and provisions and the growing demands on the corporate governance framework.” So we should also expect, later in 2017, an FRC consultation on its proposals to amend the UK Corporate Governance Code.

“Twenty-five years after Sir Adrian Cadbury’s report the UK remains in a good position globally, with high levels of trust and confidence among investors. Corporate governance must be such as to maintain that trust. It is clear that the Government expects businesses to help deliver fair outcomes across all of society as well as to investors. The FRC’s policy proposals and those of the over 400 submission to the consultation should help attract goodwill and capital from across the globe. At a time when geopolitics and world economics look less certain, that will be ever more important.”

A recap on the public policy formation process at a macro-level
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What is a Green Paper?
A Green Paper is a type of public consultation that is designed to create debate and discussion on issues, and possible policy options (including both legislative and non-legislative options), at an early stage in their development. A Green Paper may be the first step in the formation of public policy but this is not necessarily the case if the Government has more fully formed policy proposals – in which case it could move straight to a White Paper (see below) – or opt for a consultation document.

Importantly, a Green Paper is exploratory and does not commit the Government to take action but is drafted broadly to encourage input from stakeholders to help the Government decide whether or not to take action and, if so, what policy response would be appropriate in the circumstances. If the Government decides on a legislative response, the feedback to a Green Paper will help shape the proposals and the evidence base for the related impact assessments. A Green Paper could also be the last the public hears about a particular debate, particularly if there is a change of Government.

What follows a Green Paper?
After responses to a Green Paper have been analysed, the Government will publish a summary of views it received, the names of the respondents and possibly the individual responses. This summary of responses could be published as part of, alongside or possibly before, the substantive Government response which sets out the decisions made. If the Government decides to use other public policy levers, including tasking regulators, such as the Financial Reporting Council (FRC), to implement changes through regulation, rather than legislation, it could publish a Government ‘response’ to conclude the process (see, for example, the October 2010 HM Treasury/BIS Financing business growth: The Government response to Financing a private sector recovery).

The Cabinet Office’s Consultation Principles 2016 set out good practice for public consultations. Under Principle H, departments should publish a response to a consultation that explains the responses that have been received from consultees (including the number received) and how they have informed the policy. Under Principle J, Government responses should also be published “in a timely manner” i.e. “within 12 weeks of the consultation” closing or an explanation why this is not possible should be published. However, the Principles do not have legal force and departments can and do use discretion. For example, a BEIS consultation on the UK implementation of the Non-Financial Reporting Directive closed on 15 April 2016 but the Government response was not published until 8 November 2016.

What is a White Paper?
A White Paper sets out the Government’s intended policy initiatives and, where appropriate, proposals for legislation. A White Paper may follow a Green Paper and include a summary of feedback received and its impact on policy but, as noted above, where the Government has a more fully formed policy it could be published in its own right as the start of process. A White Paper may invite further feedback on aspects of the proposals and it may include draft legislation (see, for example, the 2011 White Paper: A new approach to financial regulation: the blueprint for reform, which included a draft Bill). However, a White Paper could simply set out the Government’s policy (see, for example, The United Kingdom exit from and new relationship with the European Union White Paper).

What follows a White Paper?
If the Government decides to issue primary legislation (i.e., an Act of Parliament), the department will need to secure time in the Government’s legislative programme for the Bill – either by bidding successfully to the Parliamentary Business and Legislative (PBL) Committee for a slot and being included in the Queen’s speech or being separately programmed by the PBL Committee. The department leading the work will create a dedicated Bill team. Instructions to draft a Bill will be issued to Parliamentary Counsel by the Bill team, who will translate the intended policy outcomes into instructions to legislate. Draft clauses drafted by Parliamentary Counsel will be reviewed by the department’s own legal advisers until the department approves the Bill. There then follows a number of operational procedures including a write round, whereby the Bill team informs other Government departments and possibly the devolved administrations of their intentions to legislate and provides an opportunity to comment. A full impact analysis – detailing the issue being addressed, the policy options considered, the policy objectives and intended effects, recurring and transitional costs and benefits and reasons for the
choice – will be drafted by the Bill team and sent to the Regulatory Policy Committee (RPC) for their opinion. The RPC “is the independent advisory body set up to provide external, transparent, real time scrutiny on the quality of evidence and analysis supporting regulatory changes affecting business and civil society.” The RPC gives “Ministers opinions in advance, to help ensure decisions on legislative proposals are based on a robust evidence base, which provides businesses and the public with confidence that the government’s claims on regulatory reform are credible”. The RPC can find an impact assessment fit for purpose, fit for purpose subject to improvements or not fit for purpose – in which case the department will need to revise and resubmit.

### What is a pre-legislative scrutiny?

The Government has the option to publish a draft Bill for consultation and pre-legislative scrutiny – this is particularly helpful for complex Bills (such as the Financial Services Bill) as it gives stakeholders and Parliamentarians an opportunity to engage and recommend changes, which can be considered before the Bill is laid before Parliament – hopefully easing its passage.

As noted above, a draft Bill may be published as part of a White Paper or it may be published separately – either for information or consultation. Where a draft Bill is published with a White Paper, consultees will submit responses to the relevant department in the usual way.

Most draft Bills are either scrutinised by a Parliamentary Select Committee (for example, the House of Commons Science and Technology Committee is examining the draft Spaceflight Bill) or a Joint Bill Committee, which is appointed for the specific draft Bill with its members being appointed by both Houses (see, for example, the Joint Committee on the Draft Investigatory Powers Bill). Committees may call for written evidence from the public (which has to adhere to a number of procedural requirements) and may call witnesses to give oral evidence (either experts in the field, stakeholders and/or consultees who have submitted written evidence that the Committees wishes to explore in more detail). The Committee will publish a report to the Government on the draft Bill and the Government will issue a response before or at the same time the Bill is laid before Parliament.

Interestingly, a general corporate inquiry was launched by the Business Energy and Industrial Strategy Committee in September 2016, preceding the Green Paper. This inquiry has yet to report.

### How is the formal Bill process?

Before a Bill can be laid before Parliament it – and its supporting documents – has to be approved by the PBL, which will decide whether the Bill starts in the House of Lords or House of Commons. Regardless of where a Bill starts, it will follow a similar process through both Houses, i.e.:

- **First reading** – the name of the Bill is read out, a number is allocated, the date of the second reading is set and the Bill is ordered to be printed.
- **Second reading** – the first debate on principles and key issues.
- **Committee stage** – a line by line examination of a Bill over a specified period (in the Lords this is usually the full House sitting as a Committee).
- **Report stage** – review of amended Bill and opportunity for further amendments.
- **Third reading** – the final vote on the Bill.
- **Agreement of Houses** to amendments, followed by Royal Assent.

As regards timing, a Bill used to have to complete its journey in a Parliamentary session (e.g. in around a year at maximum) or was lost. However, Bills can now be carried over into another session (the first carried over Bill being the Financial Services and Markets Bill).

### How is secondary legislation made?

Secondary legislation – i.e. statutory instruments (SIs) such as Regulations – is made under powers conferred by an Act of Parliament. It is drafted by a department’s lawyers and is ‘made’ when signed by the relevant Minister of State. The Government may publish a draft Statutory Instrument (SI) for consultation (see, for example, the Technical consultation on draft regulations for the Apprenticeship Levy) as part of or separate from a White Paper or other consultation document but this is not always the case.

SIs are either subject to:

- **Affirmative resolution** – the SI is either laid before each House in draft and has to be approved by both Houses or laid after it has been made but cannot continue in force unless approved (usually within a 28 or 40 day period).
- **Negative resolution** – the SI is either laid before each House in draft or laid after it has been made and both Houses have a 40 day period (including the date of laying) to disprove or annul. The Joint Committee on Statutory Instruments and the House of Lords Committee on the Merits of Statutory Instruments (there is no House of Commons equivalent) will review each SI – the former focusing on the legal issues and the latter on the policy issues. However, ordinarily, both Houses can only approve, disapprove or annul SIs but not amend. SIs are also not subject to the programming restrictions of Bills.

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Assuming a Bill begins its journey in the House of Commons.

[Diagram of Bill process]
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