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FRC guidance: improving ‘comply or explain’ reporting

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Following its review of corporate governance reporting late last year, the Financial Reporting Council (‘FRC’) has recently published additional guidance intended to help companies improve the quality of their ‘comply or explain’ reporting on adherence to the Provisions of the UK Corporate Governance Code (‘Code’). This follows concerns raised during the review, that companies are using boilerplate wording lacking in clarity and substance, particularly when disclosing departures from the Code.

The FRC encourages companies to embrace the full flexibility offered by the Code and to develop governance processes that are suitable for their circumstances; noting that in some cases temporary departures from the Code may be unavoidable. However, the FRC encourages companies to be clear and transparent when explaining any deviations from the Code and to make it easy for the reader to find this information in the annual report.

In respect of remuneration matters, the guidance notes the following areas where there is a perceived lack of transparency in reporting:

Provision 36: post-employment shareholdings

- The guidance clarifies the FRC’s opinion that continued application of a post-vesting holding period alone is not sufficient to constitute a formal policy on post-employment shareholding and thus demonstrate compliance with the Code. The remuneration report should reference a formal policy that requires directors to hold owned shares post-employment in addition to the continued application of any post-vesting holding period.

Provision 38: aligning executive pensions with the workforce

- As a new requirement in the 2018 Code, the FRC anticipated that it would be difficult for all companies to comply with this Provision immediately. Code compliance can only be declared where the pension contribution rate for all executive directors is in line with (or below) that of the workforce. Where pensions are not yet aligned with the workforce rate, companies should provide an explanation, which should include a timeline for alignment with the Provision.

- **Provisions 40 & 41: engagement with shareholders and the workforce**

  Provision 40 states that companies should ‘promote effective engagement with shareholders and the workforce’ on executive remuneration; whilst Provision 41 requires companies to provide a description of the engagement that has taken place.

  Effective engagement should be a two-sided process. Reporting on compliance with Provision 40 should cover the method of engagement, the parties involved and, in the case of the workforce, what explanation was given as to how executive remuneration aligns with the wider company pay policy and the views of the workforce on it. In the case of engagement with shareholders, the reporting should cover what impact, if any, this engagement has had on the remuneration policy.

Ellason commentary

Explanations are key to the ‘comply or explain’ nature of the Code. Companies need to provide clear and meaningful explanations to reassure shareholders and other stakeholders as to how high standards of governance are being maintained, notwithstanding any departure (temporary or otherwise) from the Code. The helpful guidance from the FRC on this topic is welcome. With the heightened focus on stakeholder alignment brought on by the pandemic, we are already seeing enhanced reporting on broader workforce matters and how this wider context has influenced the decision making of remuneration committees. As companies further expand their channels of communication and engagement with the workforce, how committees have engaged with employees on executive remuneration will become an increasing area of focus.

Please do not hesitate to contact any of the Ellason team should you wish to discuss this issue further.