HERBERT SMITH FREEHILLS

Corporate briefing

Consolidated corporate update

This consolidated corporate update summarises the major developments in UK corporate law and regulation which have occurred over the last six months and which will be of relevance to UK listed companies.

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On the horizon: the most material developments expected in the next 6-12 months

Reform of Companies House – transforming Companies House from a largely passive recipient of information into an active gatekeeper – see item A1 below.

Failure to prevent fraud offence and identification principle – amendments have been tabled to the Economic Crime and Corporate Transparency Bill that will introduce a new failure to prevent fraud offence and significantly reform the identification principle – see item A2 below.

UK listing regime reform – radically reforming the nature and structure of the UK listing regime – see item D1 below.

Reform of the prospectus regime – overhaul of the prospectus regime, in particular for further issuances by companies that are already listed – see item E1 below.

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A. Company law

1. Reform of Companies House

The Economic Crime and Corporate Transparency Bill (ECCT Bill), first laid in Parliament in September 2022, is currently having its third reading in the House of Lords. The ECCT Bill contains, among other things, draft amendments to the Companies Act 2006 to facilitate the reform of Companies House. The ECCT Bill is expected to become law later this year. We expect it to be brought into force at a later date, so that Companies House can fully prepare for the reforms.

For an overview of the ECCT Bill proposals, see our one-page snapshot here.

House of Commons

In January 2023, the ECCT Bill completed its journey through the House of Commons. Various amendments were made to the draft ECCT Bill, including:

- **Discrepancy reporting** – The government will be given power to make regulations requiring any person carrying on business in the UK to report to Companies House discrepancies between: (i) information they receive from a customer or prospective customer; and (ii) information made publicly available by Companies House.
- **Overseas companies** – The government will be given power to make regulations requiring an overseas company that has registered a UK establishment/branch with Companies House to supply a UK address for service and an email address to Companies House. The address for service will be made publicly available (but the email address will not).
- **Register of overseas entities that own UK property** – Companies House will be given the power to remove information from the new register of overseas entities that own UK property, either of its own volition or on request.

House of Lords

The ECCT Bill began its passage through the House of Lords in January 2023 and is now having its third reading. A version of the Bill as amended by the House of Lords has been published, which includes several key additions:

- **New failure to prevent fraud corporate offence** – See item A2 below.
- **Criminal offences relating to the register of members** – A new duty will be imposed on members to notify to companies the information required to be included on the register of members (being the member's full name and a service address) and any changes to that information. Companies will also be able to serve a notice on members requiring them to provide the information. Failure to supply the information or the making of a false statement will be a criminal offence.
- **Nominee shareholders** – Nominee shareholders will be required to declare whose control their shares are held under.
- **Sanctions and director disqualification** – The Sanctions and Anti-Money Laundering Act 2018 will be amended so that individuals may be disqualified from being directors for breaches of the UK sanctions regime.

2. Failure to prevent fraud offence and the identification principle

New failure to prevent fraud offence

The government tabled amendments to the ECCT Bill in April 2023 that will introduce a new failure to prevent fraud offence for corporates.

Under the proposed new offence, an organisation will be strictly liable if:

- a specified fraud offence is committed by an employee, agent or subsidiary; and
- the organisation did not have reasonable fraud prevention procedures in place.

A list of the specified fraud and false accounting offences is set out in the legislation, and includes, for example, cheating the public revenue, false accounting and false statements by company directors. The Secretary of State will be given power to amend the list of specified offences by regulations.

The offence will:

- apply to all large companies, LLPs and partnerships (including those incorporated outside the UK); and
- be punishable by an unlimited fine.

The government will issue statutory guidance on reasonable prevention procedures.

For further information, see our briefing here.

Proposed amendments to the "directing mind and will" of a company

The government is also proposing to significantly reform the so-called "identification" principle for certain economic crimes through an amendment to the ECCT Bill. The government's intention is to make it easier to prosecute companies for the in-scope economic crime offences – particularly large companies with complex management structures.

A company may currently be criminally liable for the acts of its officers or employees. However, under the common law "identification" principle, for many offences – including fraud – that will only be the case if a prosecutor can identify an individual(s) whose conduct, and state of mind, can be attributed to the company, such that they represent the company's "directing mind and will". Particularly in large organisations, senior people who have decision making powers in respect of substantial areas of business are often not considered sufficiently controlling to hold the company liable.

The proposed amendment to the ECCT Bill places the identification doctrine on a statutory footing for economic crimes and will impose criminal liability on body corporates and partnerships for economic crime offences committed by their "senior managers". The proposed definition of senior manager in the ECCT Bill (which replicates the definition in the Corporate Manslaughter and Corporate Homicide Act 2007) looks at what the senior manager's roles and responsibilities are within the organisation, rather than their job title. It includes a person who plays a significant role in the making of decisions about the whole, or a substantial part, of the activities of the body corporate.

The new statutory attribution test would apply only to the specific economic crimes set out in a schedule to the ECCT Bill. In addition to the common law offences of cheating the public revenue and conspiracy to defraud, these include:

- fraudulent trading under the Companies Act 2006;
- misleading statements and impressions under the Financial Services Act 2012;
- theft, false accounting and false statements by directors under the Theft Act 1968; and
- fraud under the Fraud Act 2006.

If convicted, a company may be subject to an unlimited fine (in addition to any sentences imposed upon the individuals who are also found guilty of the same offence(s)).

For further information, see our briefing here.

3. Directors' duties – High Court refusal of derivative action

In a significant decision for boards seeking to grapple with how to respond to the impact of climate change on their company's business, in May 2023 the High Court refused permission for ClientEarth, a minority shareholder in Shell plc, to continue a derivative action on behalf of the company against its directors (the Directors) under s.261(1) of the Companies Act 2006 (CA 2006).

The underlying claim brought by ClientEarth alleged that the Directors had breached their statutory duties owed to Shell as a result of acts and omissions relating to: (i) Shell's Energy Transition Strategy published and updated between April 2021-2022; and (ii) the Directors' response to an order made by the Hague District Court on 26 May 2021 that Shell must reduce its global net carbon emissions by 45% by 2030 compared to 2019 levels. Specifically, ClientEarth alleged that the Directors had breached the duty to act in the best interests of the company (s.172 CA 2006) and the duty to act with reasonable care, skill and diligence (s.174 CA 2006).

As a shareholder seeking to bring a derivative claim in the name of the company, ClientEarth was required to apply for permission to proceed with the action. However, the court ruled that ClientEarth failed to meet the initial threshold of establishing a *prima facie* case for granting permission, and so dismissed the application in accordance with s.261(2)(a) CA 2006.

The judgment provides comfort to boards that the court will be slow to allow shareholders with small or *de minimis* shareholdings to use the derivative claim procedure under CA 2006 as a way to challenge strategic or long-term decisions made in good faith in relation to addressing the risks posed by climate change. The court:

- is extremely reluctant to interfere in company management decisions.
- rejected attempts to formulate new and absolute duties in respect of climate change.
- will look at the motivation behind an action and will be unlikely to grant permission if it takes the view that there is an ulterior motive and/or the derivative mechanism is being used for a collateral purpose, such as to publicise and advance the shareholder's own policy agenda, rather than to secure the directors' compliance with their duties for the benefit of members as a whole.
- is unlikely to grant mandatory injunctive relief in such cases (even if the claim is successful).

The judgment may not bring an end to these proceedings. The application was considered on the papers, and ClientEarth has been granted an oral hearing at which the High Court will reconsider the dismissal of the lawsuit.

4. Repeal of retained EU law

On 10 May 2023, the government published a written statement announcing that it had tabled an amendment to the Retained EU Law (Revocation and Reform) Act 2023 (which was then in draft form) that removed the provision in the Act which would have revoked almost all retained EU law at the end of 2023. The Act then received Royal Assent in that form on 29 June 2023.

The Act as first published would have automatically revoked the majority of retained EU law on 31 December 2023, unless specifically preserved (the so-called "sunset"). The amendment put through by the government replaced the general sunset for all retained EU law with a list of the specific retained EU laws it intends to revoke. See also item E2 below on powers for the government to repeal the UK Market Abuse Regulation and UK Prospectus Regulation.

The government also published a policy paper which sets out some more detailed proposals for post-Brexit reform. These proposals set out how the government would seek to improve regulation post-Brexit (see also item F2 below). The policy paper largely focused on employment law issues including:

- simplifying the rules that apply under the TUPE Regulations when a business transfers to a new owner;
- limiting the length of non-compete clauses in employment contracts to three months; and
- reducing the rules on recording working hours and other administrative requirements under the Working Time Regulations.

B. Mergers and acquisitions

1. Changes to the Takeover Code

The Takeover Panel published two response papers on 4 April 2023 on the offer timetable in a competitive situation (RS 2022/3) and on miscellaneous amendments to the Code (RS 2022/4). The amendments to the Code took effect on 22 May 2023, and apply to all transactions from that date, including transactions that were already live.

The amendments are broadly as proposed in the consultation papers PCP 2022/3 and PCP 2022/4. The Takeover Panel has also made minor consequential amendments to some of its Practice Statements to reflect the rule changes.

The offer timetable in a competitive situation (RS 2022/3)

In the new rules, the Panel has clarified how the offer timetable applies in certain competitive situations where one of the bidders is proceeding by way of scheme and official authorisations or regulatory clearances are required by one or both of the bidders:

- **Official authorisation or regulatory clearance required** – Where one or more official authorisations or regulatory clearances cannot be obtained in the normal 60-day timetable for contractual offers, the Panel will not normally introduce an auction procedure under Rule 32.5 until after the last condition relating to a relevant official authorisation or regulatory clearance has been satisfied or waived by each of the bidders.
- **Bidder wishing to complete its offer prior to the introduction of an auction procedure** – Where one bid is proceeding faster than another (in terms of obtaining the requisite clearances) and the faster bidder does not wish to wait for the other bidder to obtain its clearances and the subsequent Panel auction procedure before completing its bid:
    - If the faster bidder is proceeding by way of contractual offer, it can make an acceleration statement and bring forward the unconditional date of its offer (provided it is willing to waive any outstanding conditions etc as required by Rule 31.5). Otherwise, its Day 60 will effectively be suspended (such that its offer will not lapse on its acceptance condition on the 60th day after publication of its offer document).

    - If the faster bidder is proceeding by way of scheme (which has been approved by target shareholders) and the target board (with the agreement of the faster bidder) wishes to complete the scheme prior to the Panel auction procedure, the target board should consult the Panel as to whether the sanction of the scheme would, without an additional shareholder vote, be restricted by Rule 21.1 on frustrating action (although the Panel will generally agree to disapply Rule 21.1 in these circumstances).

- **Setting Day 60 where there is a competing offer and scheme** – Where one competing offer is by way of scheme and the other by way of a contractual offer, Day 60 on the contractual offer will normally be set for a date after the shareholder meetings and before the court sanction hearing in relation to the scheme.

Miscellaneous Code amendments (RS 2022/4)

This response statement contains a variety of minor amendments to the Code including the following:

- **Companies in financial difficulty** – The Panel will have greater flexibility to grant a derogation or waiver from the Code in exceptional circumstances, for example to facilitate a rescue of a company which is in serious financial difficulty.
- **Rumour or speculation following a DTR 5 disclosure** – Where a potential offeror is actively considering an offer, and there is rumour or speculation, or an untoward movement in the target's share price, the potential offeror will have to make an announcement under Rule 2.2 of the Code, even if the rumour or speculation, or share price movement, is caused by a public statement such as a disclosure under DTR 5.
- **Recommendations by the target board** – The target board must make a recommendation to shareholders (and to holders of convertible securities, options and subscription rights) as to the action that they should take, and where there are alternative offers, the target board circular must state which alternative (if any) the directors intend to elect for in respect of their own shares (and why). Examples of language which a target board could use are set out in Appendix C of RS 2022/4.

2. Takeover Panel consultation on frustrating action

The Takeover Panel published a consultation paper on possible amendments to Rule 21 on frustrating action on 15 May 2023 (PCP 2023/1). Rule 21.1 of the Takeover Code restricts the board of an offeree company from taking any action which may result in an offer or bona fide possible offer being frustrated, unless the target obtains shareholder approval, or the Panel gives its consent, for the action.

Overall, the Panel says it thinks Rule 21.1 operates satisfactorily and so it does not propose fundamental amendments to the Rule. However, it is proposing to:

- give companies more flexibility for actions which are either in the ordinary course of business for the particular company (such as buying or selling assets) or are not material;
- include in the Notes on the Rule and in a new Practice Statement further guidance on when certain actions by a target board, for example employee incentivisation arrangements or share buybacks, will be considered either not to be material or to be in the ordinary course; and
- to apply the prohibition on frustrating action to a bidder on a reverse takeover.

A company will still need to consult the Panel about any proposed action that may be restricted by the Rule.

The Panel is also proposing a number of amendments to Rules 21.3 and 21.4 to reduce the administrative burden on the parties to an offer where a request for information is made under Rule 21.3 (equality of information to competing offerors) and to enhance the target's ability to protect its commercially sensitive information.

The consultation closes on 21 July 2023 and final amendments to the Code are expected to be published in Autumn 2023 (to come into effect approximately one month after publication).

3. Updated government guidance on the National Security and Investment Act 2021

In April 2023, the government published updated Market Guidance on the National Security and Investment Act 2021 (NSI Act).

The additions and clarifications in the latest version of the Market Guidance include:

- additional guidance in relation to issues such as acquisitions involving parties who are in material financial distress, the timing of a notification, the stages of the NSI Act review process, and the government's powers to provide financial assistance to businesses and other parties affected by a final order under the NSI Act; and
- for the 17 specified sectors where notification is mandatory, some more detail on how to engage with government if there is significant uncertainty about whether an acquisition is notifiable.

C. Private capital

1. PERG annual report and updated good practice guidance

The Private Equity Reporting Group (PERG) published its latest annual report in February 2023 on the private equity industry's compliance with the Guidelines for Disclosure and Transparency in Private Equity (known as the Walker Guidelines). PERG has also published a 2023 guide to good practice reporting by portfolio companies.

Under the Guidelines, portfolio companies in scope are expected to include additional disclosures in their annual report and accounts on areas such as the private equity funds that own the company, the composition of the board, key performance indicators (KPIs) and a description of the principal risks and uncertainties facing the business.

The key findings in PERG's annual report include:

- 60% of the portfolio companies sampled prepared disclosures to at least a good standard, compared to 67% in 2021;
- 52% of companies included in their annual report a statement of compliance with the Guidelines, compared with 62% in 2021; and
- there has not been a notable increase in the quality of disclosure on non-financial KPIs, with many companies lacking the level of detail required for a deeper understanding of why they are the company's strategic priorities.

The Guidelines are currently being reviewed to take into account changes in the broader narrative reporting landscape for both private and listed companies, the increased focus on climate change, and to enhance the level of understanding of the Guidelines amongst the private equity industry's stakeholders.

2. Updated BVCA documents for early stage venture capital investment

The British Private Equity & Venture Capital Association (BVCA) published updated versions of its model documents for early stage investments in February 2023.

It says that its aim is to produce industry-standard legal documentation in the UK and it encourages all parties to adopt these documents as the starting point for their investments so that investors and companies can then focus on deal-specific matters.

The suite of documents, which has been drafted for use on a Series A funding round and envisages a significant investment being made in whole or in part by fund investors, comprises a subscription agreement, shareholders' agreement and articles of association.

D. Listing regime

1. UK listing regime reform

In May 2023, the Financial Conduct Authority (FCA) proposed a revolutionary restructuring of the UK listing regime. Its consultation paper (CP 23/10) sets out a blueprint for the new "UK listing". While the genesis of the rule changes is the desire to attract more companies to London, they will have a significant impact on existing listed companies.

In a change from the FCA's previously announced reform approach, it has abandoned the idea of a split between mandatory and supplementary continuing obligations in favour of a true single segment with one set of continuing obligations for normal commercial companies. As part of the new UK listing regime:

- shareholder votes will no longer be required for significant/Class 1 transactions;
- shareholder votes will no longer be required for related party transactions;
- a modified sponsor regime will remain a cornerstone of investor and market protection; and
- there will be significant changes to the eligibility requirements for new prospective IPO candidates, moving to a disclosure-based rather than rules-based regime.

The FCA has said that following this consultation (which closed on 28 June 2023) it expects to publish a second paper containing draft rules in Autumn 2023, and plans to accelerate its final rule making processes. We expect the new rules to be implemented in early 2024. For existing listed companies, transitional provisions will be made in due course.

In our view, this is an important step towards improving the competitiveness of the UK market from a regulatory perspective and should have the dual benefits of making the UK a more attractive listing destination and improving the competitiveness of UK listed companies in international M&A processes. However, challenges remain, in particular as regards the depth of liquidity, perceptions on valuation gaps, extent and quality of research coverage and consistency of investor appetite for IPOs in the UK (especially from UK investors). These will also need to be addressed if the UK is to materially improve its competitive position as a listing venue. In addition, the loss of established protections, particularly around related party transactions, will concern some investors and, taken together with the other relaxations on eligibility (which are being modified to a disclosure-based approach) and on the separate prospectus and secondary issuance reforms (which will enable significant undocumented capital raises), will decisively place the emphasis on investors to manage risk. The FCA will also need to have the powers and capacity to ensure the new disclosure-based regime is adhered to, as well as deal with rule breaches and ensure that the high standards of market conduct that attract investors to the London market are retained. All eyes will now turn to investors for their responses to the proposals, given that the FCA has gone down a radical route.

Our full briefing on the proposals is available here.

2. Financial Services and Markets Act 2023 receives Royal Assent

See item E2 below.

3. Primary Market Bulletin 44

The FCA published market guidance for issuers on a range of topics in Primary Market Bulletin 44 (PMB 44) in March 2023.

Multimedia in RIS announcements

The FCA believes that the inclusion of multimedia content in regulatory announcements creates a risk of harm to market users due to a potential reduction in clarity, particularly if it makes it less clear to the reader what is regulated information and inside information. It also said that there is a risk that announcements containing multimedia content could breach its rules, including the requirement in DTR 6.3.5 for an issuer to communicate regulated information in unedited full text, and UK Market Abuse Regulation (UK MAR) Article 17(1), which says that issuers should not combine the disclosure of inside information with marketing.

New diversity disclosures

The FCA reminded issuers of its expectations in relation to its new diversity and inclusion reporting requirements, including setting out some steps it considers will help companies get ready to make the relevant disclosures. The FCA also set out its supervisory strategy for monitoring and enforcing compliance with the new rules, stating it may ask companies to take corrective action where necessary, such as enhancing their disclosures in subsequent annual financial reports.

Prospectus for scheme of arrangement

In August 2020, the FCA published for consultation a proposed new technical note on when a prospectus is required where securities are issued pursuant to a scheme of arrangement. In particular the draft note said that if a shareholder is being asked to make a choice between different forms of consideration, for example where a scheme includes a mix and match facility which offers shareholders a choice between shares and cash, in the FCA's view, a prospectus should be produced.

In PMB 44 the FCA says that, having considered the consultation responses, it will not publish the proposed technical note. The FCA notes that respondents to the draft note disagreed with its view and recognises that the question of whether a prospectus is required is a question of law and ultimately is for the courts to decide.

E. Capital markets

1. Reform of the prospectus regime

In May 2023, the FCA published a series of engagement papers on the new prospectus and public offers regime in the UK, as trailed by the government in December 2022.

Responses to the engagement papers will inform the new prospectus rules that will be made by the FCA using new powers under the Financial Services and Markets Act 2023 (see item E2 below). The FCA asks for responses to the questions raised by the engagement papers by 29 September 2023 and then plans to consult on specific rule proposals in 2024.

The matters on which the FCA is currently seeking views are:

- **Admission to trading on a regulated market** (Engagement Paper 1) – The FCA says that the requirement for a prospectus on an IPO will remain and it will continue to need to contain sufficient detail to meet the “necessary information” test. It is asking for views on when exemptions to this requirement should apply, the required content and format of a prospectus in this context, and the responsibility for, and approval of, such a prospectus.
- **Further issuances of equity on regulated markets** (Engagement Paper 2) – The FCA says there will be no requirement for a listed company to publish a prospectus when it issues further equity securities unless there is a clear need for one. It asks whether there should be a threshold (set by reference to the percentage of existing share capital that the issuance represents) above which a prospectus would be required and what document (if any) should be required if/where a prospectus is not required.
- **Protected forward-looking statements (PFLS)** (Engagement Paper 3) – The FCA seeks views on how PFLS, which will be subject to the lower recklessness liability standard, should be defined. It also asks whether the FCA should set certain minimum criteria for the production of PFLS, how they should be presented and labelled in prospectuses, and whether sustainability-related disclosures should be PFLS.

The FCA is also interested in views (Engagement Paper 4) on where the current UK prospectus regime could be improved in the context of wholesale debt capital markets.

For more details on the plans for prospectus regime reform, read our full briefing here.

2. Financial Services and Markets Act 2023 receives Royal Assent

The Financial Services and Markets Act 2023 received Royal Assent on 29 June 2023. The Act forms part of the government's Future Regulatory Framework Review (FRF Review), which was established to determine how the UK's financial services regulatory framework should be amended post-Brexit.

The Act will, when the relevant sections are brought into force, revoke the UK Market Abuse Regulation and the UK Prospectus Regulation – both of which are part of retained EU law post-Brexit. The FCA will then have the power to set the detailed rules on when a prospectus is required and what it should contain, and the definition and disclosure of inside information. See item E1 above for more information.

F. Corporate reporting

1. Consultation on extension of payment practices reporting requirements

The Department for Business and Trade (DBT) published a consultation paper on its proposals to extend and strengthen the Reporting on Payment Practices and Performance Regulations 2017 and the Limited Liability Partnerships (Reporting on Payment Practices and Performance) Regulations 2017 in January 2023. The consultation closed on 28 April 2023.

The Regulations, which have applied since financial years beginning on or after 6 April 2017, require entities within scope to produce a report on their invoice payment practices every six months and to submit that report to a government-hosted website for publication.

The consultation sought views on:

- the extension of the Regulations beyond 6 April 2024;
- imposing an additional requirement to disclose the total value of payments that have not been paid within the agreed terms in the reporting period;
- imposing a new requirement to include a summary of a group's payment practices in its annual report;
- clarification around reporting in relation to supply chain finance; and
- additional requirements to report separately on disputed invoices and, in the construction sector, standard retention terms.

2. Call for evidence on non-financial reporting

In May 2023 as part of its plans for post-Brexit regulatory reform, the DBT, working with the Financial Reporting Council (FRC), launched a call for evidence on the non-financial reporting requirements that UK companies have to comply with.

The call for evidence recognises that reporting requirements for companies have expanded over time, increasing the size and complexity of annual reports. Through an online survey, the DBT asks a series of questions relating to:

- the costs and utility of current non-financial annual reporting;
- opportunities to streamline existing annual reporting requirements;
- reporting requirements outside the annual report, including modern slavery statements and gender pay gap reports; and
- the thresholds and definitions used to determine whether companies and LLPs must comply with certain reporting requirements.

The call for evidence also reiterates the government's plans – announced in its Green Finance Strategy in March 2023 – to introduce requirements in two areas:

- **Sustainability reporting** – In June 2023, the International Sustainability Standards Board (ISSB) issued final versions of its sustainability-related disclosure standards in a step towards creating a unified global framework for sustainability reporting. IFRS S1 established general requirements for disclosures of sustainability-related financial information, and IFRS S2 established specific requirements in relation to climate-related disclosures. The government has previously stated it intends to implement the ISSB standards and will consult on doing so in Summer 2023. For more information, see our blog post here; and
- **Transition plans** – It will consult on the introduction of requirements for the UK's largest companies to disclose their transition plans, drawing on the outputs of the government's UK Transition Plan Taskforce (TPT). The TPT's call for evidence closed in July 2022 and it is reviewing the responses received. It plans to publish its disclosure framework and implementation guidance in Autumn 2023, with sector guidance to follow later.

The DBT's call for evidence closes on 16 August 2023. It plans to use the information collected to develop detailed proposals for public consultation next year, and then look to legislate for any changes.

G. Corporate governance

1. Corporate Governance Code consultation

The FRC published a consultation paper on changes to the UK Corporate Governance Code in May 2023.

The majority of the proposed changes implement reforms outlined by the government in May 2022 following its consultation on audit and governance reform.

The changes proposed include:

- **Internal controls** – Rather than adopting a statutory reporting and assurance regime (similar to the US Sarbanes-Oxley regime), the proposed changes will require the board to include in the annual report:
  - a declaration on whether the board can reasonably conclude that the company's risk management and internal control systems are effective;
  - an explanation of the basis for that declaration; and
  - a description of any material weaknesses identified when reviewing the effectiveness of those systems**.**
- **Enhanced audit committee role** – Audit committees will be given responsibility for the oversight of narrative as well as financial reporting – this includes environmental and sustainability reporting, an area of increased focus for the Governance Code. The role of audit committees in the oversight of the external audit process and relations with external auditors will be expanded. The FRC has also published a Minimum Standard for Audit Committees of FTSE 350 companies (May 2023) in relation to external audit which took effect immediately. Under the proposed changes to the Governance Code, the Minimum Standard would apply to all Governance Code companies (though on a "comply or explain" basis only for non-FTSE 350 companies). For further information on the Standard, see our blog post here.
- **Environmental, social and governance considerations** – In addition to giving the audit committee oversight of ESG reporting, the proposed changes would increase the focus on ESG matters (including climate matters and transition planning) and how they are taken into account when considering a company's strategy. The FRC says that it considered, but decided not to introduce, a requirement for companies to have a board sustainability committee.
- **Directors' time commitments** – The current provisions in relation to directors' time commitments would be enhanced, with greater disclosure required in relation to directors' other commitments and more focus on time commitments as part of the board performance review.
- **Comply or explain reporting** – The FRC is proposing to introduce a new principle that seeks to improve "comply or explain" reporting as well as reporting on the impact and outcomes of governance practices.

Alongside the consultation on changes to the Governance Code, the FRC will review the supporting guidance in the Guidance on Audit Committees, the Guidance on Board Effectiveness and the Guidance on Risk Management, Internal Control and Related Financial and Business Reporting. The FRC has highlighted some of the changes it intends to make to this guidance and invites comments on these changes as part of this consultation process.

The consultation closes on 13 September 2023. The FRC's intention is that the new Governance Code will apply to financial years beginning on or after 1 January 2025.

Our full briefing on the proposals is available here.

2. New targets set for ethnic diversity in companies

The Parker Review published its 2023 Update Report in March on the progress made against the targets for ethnic diversity on UK boards and has also set new targets for UK companies.

The Parker Review was asked by the government in 2015 to explore how to increase ethnic and cultural diversity on the boards of UK companies. It recommended that FTSE 100 companies should have at least one ethnic minority director on the board by December 2021 and FTSE 250 companies should have at least one ethnic minority director on the board by December 2024.

The 2023 Update Report notes that as at December 2022:

- 96% of all FTSE 100 companies had met the target and 18% of all FTSE 100 director positions were held by an ethnic minority director;
- in the FTSE 250, with two years still to go until the deadline to meet the target, 67% of the 224 companies that responded had at least one ethnic minority director (equating to 60% of all FTSE 250 companies); and

- 49 FTSE 100 companies and 28 FTSE 250 companies had more than one ethnic minority director.

The Parker Review recognises that the composition and diversity of the board may only have a limited impact on the wider culture at the company. It also acknowledges that there are some very significant entities in the UK economy which are not part of the FTSE index. With this in mind, the Parker Review has set the following new targets:

- by December 2023, FTSE 350 companies should set themselves a target, to be met by December 2027, for the percentage of their senior management that self-identify as being from an ethnic minority (and report that target in their annual report published in 2024); and
- by December 2027, the top 50 private companies should have at least one director who self-identifies as being from an ethnic minority on their board. By December 2024, they should also have set themselves a target, to be met by December 2027, for the percentage of their senior management who self-identify as being from an ethnic minority. The definition of top 50 private companies is the same as that used by the FTSE Women Leaders Review.

3. FTSE Women Leaders Review 2023 Report published

The FTSE Women Leaders Review published its second report on improving gender balance in FTSE leadership in February 2023.

The 2023 report notes:

- the voluntary target of 40% of FTSE 350 board positions being held by women by the end of 2025 has already been met – the figure by the end of 2022 was 40.2% of all FTSE 350 board positions;
- the FTSE 350 is on track to hit the target of 40% of all leadership positions being held by women by the end of 2025, with the percentage standing at 33.5% at the end of 2022 (up from 31.5% at the end of 2021);
- 64 FTSE 100 and 144 FTSE 250 companies have at least one woman in one of the four key leaderships roles (chair, SID, CEO or CFO); and
- 44 of the top 50 private companies in the UK submitted data to the Review, which indicated that the level of women representation in leadership positions amongst these companies is comparable to the level amongst the FTSE 350, but that the situation for board positions lagged behind the FTSE 350 (at 31.8%).

The 2023 report also contains data going back to 2011, setting out the significant progress that has been made in the last 12 years on improving gender diversity in FTSE leadership.

4. Proxy advisor and investor group policy and voting guidelines

Investment Association's updated Share Capital Management Guidelines

In February 2023, the Investment Association (IA) published an updated version of its Share Capital Management Guidelines, which set out the expectations of the IA's members as institutional investors on various aspects of share capital management.

The Guidelines (which apply to premium listed companies, with standard-listed and AIM companies encouraged to adopt them) have been updated to reflect the recommendations of the UK Secondary Capital Raising Review (SCRR).

The SCRR recommended that:

- companies should continue to be able to seek annual allotment and pre-emption rights disapplication authorities from their shareholders of up to two thirds of their issued share capital, but with the authority extending not just to rights issues but to all forms of fully pre-emptive offers, as well as to any follow-on offer (which is designed to enable retail and other existing shareholders who did not participate in a non-pre-emptive placing to subscribe for shares); and
- the Statement of Principles on the disapplication of pre-emption rights published by the Pre-Emption Group (PEG) be updated – a revised Statement of Principles was published in November 2022.

The Institutional Voting Information Service (IVIS), which is part of the IA, will red-top any company that:

- seeks a routine disapplication of pre-emption rights in excess of 24% of the issued share capital allowed for by the Statement of Principles; or

- seeks a disapplication of pre-emption rights up to 24% but does not follow the Statement of Principles, for example if it does not confirm that it will follow the shareholder protections set out in the Statement.

Investment Association's statement on shareholder priorities for 2023

The IA published a statement on its Shareholder Priorities for 2023 in February 2023, which sets out the expectations of investors in listed companies for 2023.

It also sets out how IVIS will analyse these issues for financial years ending on or after 31 December 2022, including what its “colour-top” approach will be for each issue at listed companies’ AGMs.

The four key areas of focus for 2023 are:

- **Climate change** – IVIS will continue to amber-top all companies that do not make disclosures against all four pillars of the Task Force on Climate-related Financial Disclosures (TCFD) Recommendations.
- **Diversity** – IVIS is increasing its diversity targets for FTSE 350 companies in 2023. It will:
    - red-top FTSE 350 companies where women represent 35% or less of the board, or 30% or less of the Executive Committee and their direct reports; and
    - red-top FTSE Small Cap companies where women represent 25% or less of the board, or 25% or less of the Executive Committee.

  IVIS is not changing its approach to ethnic diversity for 2023, and so will continue to red-top FTSE 100 companies that have not met the Parker Review target of one director from a minority ethnic group, and amber-top FTSE 250 companies that do not disclose either the ethnic diversity of their board or a credible action plan to achieve the Parker Review targets by 2024.
- **Stakeholder engagement** – Investors were generally pleased with the way that boards responded to the needs of various stakeholders during the pandemic. Company disclosures should include the impact of the increases in the cost of living and inflationary pressures on employees (particularly lower paid employees), consumers and suppliers.
- **Audit quality** – The IA continues to expect companies to demonstrate how they have judged the quality of the audit they have received.

PLSA Stewardship & Voting Guidelines 2023

The Pensions and Lifetime Savings Association (PLSA) published its Stewardship & Voting Guidelines 2023 in March 2023. The guidelines set out the PLSA’s views on key issues and its voting recommendations on those issues.

Key areas covered by the 2023 guidelines include:

- **Climate change** – Climate change continues to be an area of focus. In particular, the PLSA notes that growing attention is being paid to transition plans, which should be underpinned by credible targets, with clear interim milestones and accountability mechanisms;
- **Diversity** – The guidelines note the recent updates from the FTSE Women Leaders Review and the Parker Review, and the new requirements of the Listing Rules to report against diversity targets. The PLSA expects disclosure in relation to any obstacles or delays to achieving diversity goals and details of how the background of directors standing for re-election help shape the board’s diversity;
- **Workforce** – A new section addresses how companies should approach issues such as employee wellbeing (including mental health support), workforce diversity and tackling modern slavery; and
- **Executive remuneration** – The PLSA reiterates its call for restraint when setting executive remuneration in light of the on-going cost of living crisis and the economic pressures being experienced by the wider workforce.

Appendix 1 to the guidelines summarises the PLSA’s voting recommendations on the issues covered.

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