



Catherine Horton
Financial Reporting Council
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By email only: codereview@frc.org.uk

28 February 2018

Dear Ms Horton,

Re: BVCA response to consultation on Proposed Revisions to the UK Corporate Governance Code (December 2017)

1. We are writing on behalf of the British Private Equity and Venture Capital Association (“BVCA”), which is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of over 650 firms, the BVCA represents the vast majority of all UK based private equity and venture capital firms, as well as their professional advisers. Our members have invested over £27 billion in nearly 3,800 UK-based companies over the last five years. Companies backed by private equity and venture capital in the UK employ around 448,000 people, and 87% of UK investments in 2016 were directed at small and medium-sized businesses.
2. As you will be aware, private equity / venture capital firms are long-term investors, typically investing in unquoted companies for around three to seven years. This is a commitment to building lasting and sustainable value in business.
3. The private companies in which our members invest tend to share certain characteristics. Namely, that they are controlled by one or more private equity / venture capital funds (which in turn are managed or advised by regulated entities) and that they have a limited number of other shareholders who are, or have been, actively involved in the business. As such, these companies are typically well equipped to design and implement appropriate corporate governance frameworks. Private equity / venture capital firms are very focussed on effective governance and strengthening existing corporate governance arrangements is something private equity / venture capital firms strive to do. From the perspective of our members, it is very important that corporate governance reform does not simply turn governance into a formulaic ‘one-size fits all’ type of exercise and that any standardisation of governance practices does not dilute existing practices in this area or discourage innovation.
4. We welcome the opportunity to comment on the Proposed Revisions to the UK Corporate Governance Code (“the Code”). We appreciate that the Code is aimed at publicly listed companies, whereas our members invest primarily in private companies on the basis indicated in paragraphs 2 and 3. Nevertheless, we consider it appropriate to comment on certain of the Proposed Revisions given the influence the Code may have on any future corporate governance reform in relation to private companies and, in particular, on the



proposed corporate governance principles for large privately owned companies. We would therefore ask the FRC to consider our comments on the Proposed Revisions in light of that general context.

5. The remaining part of this submission sets out our responses to each of the questions raised in relation to the UK Corporate Governance Code and Guidance on Board Effectiveness. Please note that, whilst certain of our members may be signed up to the UK Stewardship Code, we feel that there are other bodies which are better placed to comment on the questions posed in relation to it so have not addressed it in this submission.

Q1 Do you have any concerns in relation to the proposed Code application date?

6. In our view, the proposals in relation to board composition and independence are likely to take time for companies to comply with and we believe that the proposed application date should take account of this. Please see our response to question 7 for more details on this.

Q2 Do you have any comments on the revised Guidance?

7. We have two general comments on the revised Guidance.
8. The first relates to stakeholder engagement and disclosure. We strongly support the concepts of engagement with stakeholders and meaningful disclosure on corporate governance matters. However, we do have a general concern that, when taken together, the new Code, revised Guidance on Board Effectiveness and the draft Guidance on the Strategic Report have the potential to confuse directors as to how their section 172 (Companies Act 2006) duty should be interpreted. The section 172 duty to “promote the success of the company” is owed to the “members as a whole” and not to other stakeholders. In particular, we are of the view that attempting to increase the protection of stakeholders through corporate governance is unlikely to be as effective as addressing specific concerns appropriately through direct regulation of the matters in question. We commented on these points in more detail in paragraphs 7 and 8 of our response to the FRC’s draft amendments to the Guidance on the Strategic Report in October 2017¹ and in paragraph 45 of our response to the BEIS Green Paper on Corporate Governance Reform in February 2017².
9. We believe that it would be helpful to clarify in the introduction to the Code and the relevant Guidance that there has not been a shift away from the enlightened shareholder value model towards a pluralistic model (albeit that stakeholder interests should be a factor in the decision making process itself).
10. Our second comment relates to the prescriptiveness of certain aspects of the revised Guidance. For example, paragraph 17 could make clearer that there are several ways in which the “conditions for sound decision making” may be created, paragraph 20 seems unnecessarily prescriptive, and paragraph 21 is onerous and may not be appropriate to many of the ‘lower level’ decisions which boards have to make. Our overriding concern is to ensure

¹ [BVCA Response to Draft Amendments to the Guidance on the Strategic Report](#) (October 2017)

² [BVCA Response to BEIS Green Paper on Corporate Governance Reform](#) (February 2017)



that the revised Guidance does not have the effect of discouraging entrepreneurship and making the UK seem a less attractive place to do business through the removal of flexibility and the creation of overly onerous processes. This is brought into sharper focus in light of Brexit and applies equally to both public and private companies.

Q3 Do you agree that the proposed methods in Provision 3 are sufficient to achieve meaningful engagement?

11. We agree that the methods specified in Provision 3 are sufficient to achieve meaningful engagement with a company's workforce. However, we believe that Provision 3 could usefully express that companies can choose to achieve this engagement through a combination of these methods (as is indicated to be acceptable in paragraph 35 of the revised Guidance on Board Effectiveness).
12. We also believe that the use of the term "normally" could (contrary to the spirit of the Guidance) discourage companies from considering other methods of engagement. This could hamper innovation, particularly where private companies are concerned, which we believe is necessary to enable methods of engagement to be tailored, appropriate, and meaningful in the context of the company concerned. For example, different forms of engagement may be required for different constituencies within the "workforce". We would also welcome guidance on the scope of the term "workforce" itself or, if this is deemed to be too fact specific, which categories of individual / counterparty are not within scope - for example, outsourced service suppliers.

Q4 Do you consider that we should include more specific reference to the UN SDGs or other NGO principles, either in the Code or in the Guidance?

13. No, we do not think that there is any need for more specific references to be made to the UN SDGs or other NGO principles in the Code or the Guidance. We believe that flexibility should be maintained so that companies can approach this area in the manner that makes most sense in the context in which they operate.

Q5 Do you agree that 20 per cent is 'significant' and that an update should be published no later than six months after the vote?

14. As mentioned in the introduction, our interest in the Code is primarily due to the potential impact on our members of the substantive provisions of the Code to the extent these are replicated in, or otherwise influence, any corporate governance principles that may be adopted in relation to private companies. We therefore do not think it is appropriate for us to answer this question as the requirement for a shareholder vote is not (and as we understand, is not planned to be) applicable to private companies.

Q6 Do you agree with the removal of the exemption for companies below the FTSE 350 to have an independent board evaluation every three years? If not, please provide information relating to the potential costs and other burdens involved.

15. There may be significant similarities in companies below the FTSE 350 and many of the privately held companies in which our members invest (although there are, of course, companies that are privately held which are as large as those in the FTSE 100). To the extent



a removal of this exception for companies below the FTSE 350 is an indication of the guidance that may be put in place for large privately held companies, we do not agree with the removal of the exception. Our members, as investors, appreciate the need for the performance of boards to be considered on a regular basis, but consider this to be an issue for individual companies and shareholders to address. They consider it part of their role to implement a governance structure that is self-regulating and with an emphasis on creating the right culture to ensure the effectiveness of the arrangements put in place. The introduction of a prescriptive independent board evaluation process would, in our view, add a disproportionate reporting and compliance burden to private companies.

Q7 Do you agree that nine years, as applied to non-executive directors and chairs, is an appropriate time period to be considered independent?

16. We are concerned about the impact that the proposed changes to the Code in relation to the determination of independence of non-executive directors and chairs might have on public companies that were private equity-backed prior to IPO. In particular, the move away from giving the board the discretion to determine whether the test for independence is met, even if one of the specified indicators of non-independence is present, to the more prescriptive nature of Provision 15, will likely make it more difficult for certain directors to be treated as independent, even where it is in the interests of the company that they should and, on the basis of all other considerations, would be. Examples of individuals who might be caught are: (i) a former chief executive or executive chair who was in office before the group was taken public; (ii) anyone who participated in an equity or other incentive scheme pre-IPO (which the chair in most private equity backed businesses would); (iii) anybody who is a participant in the company's pension scheme (which could be the case where the individual has never worked for the appointing company, but his or her former employer was acquired by it); and (iv) anyone who is a director or chair of other investee companies of a private equity fund which also has directors on the board. For these reasons, we believe that the current approach to determining independence should be retained, namely that it should remain a question of judgment for the board as to whether the test of independence is met. In the event that the FRC does proceed with this proposal as currently set out in Provision 15, it would be helpful for the wording used in Provision 15 to be clarified. For example, what 'significant links' and 'close family ties' means.
17. We are also concerned by the changes around board composition. Specifically the new requirement that the majority of the board, including the chair, must be independent (rather than the current formulation of at least half the board excluding the chair). In our view this change does not recognise the fact that the chair has a very different and much more involved role than that of the other non-executive directors. The Code has tacitly accepted this point for many years and therefore only required a chair's independence to be tested on appointment. The proposed change will in our view lead to many unnecessary changes to chairs and has potential to reduce their tenure unnecessarily. We do not understand the basis for making this change now and believe that the existing approach should therefore be maintained.
18. More generally, for reasons of proportionality, we do not believe that it would be appropriate for an independence requirement to be imposed in relation to boards of privately owned companies.



Q8 Do you agree that it is not necessary to provide for a maximum period of tenure?

19. Please see our response to question 0.

Q9 Do you agree that the overall changes proposed in Section 3 of revised Code will lead to more action to build diversity in the boardroom, in the executive pipeline and in the company as a whole?

20. Our members are very supportive of initiatives that aim to build diversity (of all types) at board level and more generally within the more senior levels of a company's staff in their pursuit of best in class governance and we believe that the changes proposed in Section 3 will be helpful in a public company context.

21. There are already a number of initiatives that aim to achieve similar objectives in the private equity and venture capital industry, which are supported by both the BVCA and its members as individuals. We believe that all stakeholders should leverage their influence to help companies continuously improve in this area, but do not believe that, in the private company context, applying prescriptive reporting requirements or methodologies will necessarily lead to the best outcomes for the wide range of organisations that would be in scope. We believe that a principles based approach and a degree of flexibility is needed to ensure that private companies address this issue in the manner and on the timescale which is most appropriate for them.

Q10 Do you agree with extending the Hampton-Alexander recommendation beyond the FTSE 350? If not, please provide information relating to the potential costs and other burdens involved.

22. Our understanding is that the reference to Hampton-Alexander in the question is to the final four bullet points of Provision 23 of the Code, rather than to the entirety of the Hampton-Alexander Review. On this basis, we are supportive of such enhanced transparency extending beyond the FTSE 350.

23. However, whilst our members are very supportive of initiatives that aim to build diversity (of all types) at board level and more generally within the more senior levels of a company's staff, to the extent that the question is asking about an extension of the entirety of the Hampton-Alexander recommendation to companies below the FTSE 350 (and potentially to large privately held companies), we do not agree with such an extension for the reasons set out in paragraph 9 above.

Q11 What are your views on encouraging companies to report on levels of ethnicity in executive pipelines? Please provide information relating to the practical implications, potential costs and other burdens involved, and to which companies it should apply.

24. In line with our responses to questions 9 and 10 above, we are generally supportive of initiatives which seek to encourage transparency in respect of diversity and therefore support this proposal in principle. We believe that there are a number of items to be considered in its practical implementation, including the following:



- If this were extended to private companies, consideration would need to be given to its scope to ensure that this is a proportionate measure, given the significant administrative burden it will necessarily entail and the impact this will have on resources, particularly on smaller companies that may not have a large HR and corporate reporting team. In terms of costs, we anticipate that increased reporting of this nature in private companies could necessitate the hiring of an additional employee to collate and review the data and potentially external adviser costs in reviewing the data and the reporting derived from it.
- Clarification would be required as to what is meant by “ethnicity”.
- Data protection laws, in particular the General Data Protection Regulation, will constrain the level of disclosure if the data might identify a particular individual (e.g. where the employee pool is small).
- Employees can only be requested to provide data for diversity monitoring purposes voluntarily so any report will only be as useful as the extent of the underlying data provided.

25. We do not think that any new requirement should be introduced until these and other related issues have been resolved.

Q12 Do you agree with retaining the requirements included in the current Code, even though there is some duplication with the Listing Rules, the Disclosure and Transparency Rules or Companies Act?

26. No. We would suggest that duplication should be avoided.

27. As regards the Government’s plans to introduce secondary legislation to require all companies of a significant size to explain how their directors comply with section 172, Provision 0 could cross refer to the relevant legislative provision from time to time to avoid companies needing to comply with two sets of similar, but (potentially) not identical rules.

Q13 Do you support the removal to the Guidance of the requirement currently retained in C.3.3 of the current Code? If not, please give reasons.

28. Yes.

Q14 Do you agree with the wider remit for the remuneration committee and what are your views on the most effective way to discharge this new responsibility, and how might this operate in practice?

29. As a general comment, we would note that our members (in their capacity as investors) are typically very focussed on remuneration issues and, in particular, ensuring the alignment of interests to support the long-term growth of the business in question. Normally, a key element of this is ownership of an equity stake in the business – this model often extends beyond the executive management team and sometimes flows down to more junior employees. This typically leads to business specific and appropriate non-executive director oversight of remuneration (in its broadest sense).



30. However, if prescriptive guidance based on the wide remit set out in Provision 33 (covering wider workforce remuneration and workforce policies and practices) were to apply to privately owned companies, we would be concerned that this: (i) would not be necessary in light of the above; and/or (ii) may have a detrimental impact in so far as this could lead to a 'race to the bottom', rather than encouraging free thinking in this area; and/or (iii) may lead to an overly burdened board that has less time to focus on 'board level' matters.

Q15 Can you suggest other ways in which the Code could support executive remuneration that drives long-term sustainable performance?

31. As discussed above, we believe that flexibility is paramount in this area, and therefore that prescriptive requirements should be kept to an absolute minimum (and, in the private company context, should not be necessary at all).

Q16 Do you think the changes proposed will give meaningful impetus to boards in exercising discretion?

32. Our interest in the Code is primarily due to the potential impact on our members of the substantive provisions of the Code to the extent these are replicated in, or otherwise influence, any corporate governance principles that may be adopted in relation to private companies. We do not believe that an extension of the regime applicable to the exercise of discretion would be appropriate in the private company context and we therefore do not think it is appropriate for us to answer this question.
33. The BVCA would, of course, be pleased to discuss this submission further. If you wish to do so, please contact Gurpreet Manku (gmanku@bvca.co.uk).

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Amy Mahon'.

Amy Mahon
Chair, BVCA Legal & Accounting Committee