HERBERT SMITH FREEHILLS

Corporate Briefing

Consolidated Corporate Update

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London

This half-yearly update briefing 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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A. Corporate Law and Regulation

1. Consultation on the governance of companies approaching insolvency

In August 2018, the Department for Business, Energy and Industrial Strategy (BEIS) published its response to the March 2018 Insolvency and Corporate Governance consultation paper. The response includes feedback on the Insolvency Service's 2016 Consultation Paper on the Corporate Insolvency Framework.

No new legislation or regulation is proposed at this stage but further consultation in these corporate governance areas is planned:

- **Group structures** – the Government and the Financial Reporting Council (FRC) will work to underline the importance of boards understanding how governance applies throughout the group;
- **Shareholder responsibilities** – the Government and the FRC plan to incorporate stewardship within mandates given to asset managers and establish a new mechanism for institutional investors to escalate concerns;
- **Dividends** – the dividend payment framework may be strengthened. The Government has asked the Investment Association to review the practice of companies "avoiding" a shareholder vote on dividends by only declaring interim dividends;
- **Directors' duties** – the Government plans to strengthen access to training and guidance for directors and will consider whether training for directors of large companies should be mandatory; and
- **Supply chain protection** – the Government has issued a call for evidence to gather data and information on how to create a responsible payment culture for small businesses. It also intends to prohibit the enforcement of termination clauses in supply contracts triggered purely by the entry of a party into an insolvency process.

The Government will also proceed with some of the proposals in the consultation paper around the sale of distressed businesses and reversal of value extraction schemes. In particular it will:

- propose measures to extend the liability of the directors of a holding company which sells a financially distressed subsidiary. Under the proposals, if the directors do not give due consideration to the interests of the stakeholders of the subsidiary when it is sold, they may be subject to disqualification action and a compensation order if the subsidiary enters into insolvency proceedings within 12 months of the sale; and
- proceed with proposals for a moratorium to help distressed businesses to be rescued and a new restructuring plan procedure to bind dissenting creditors.

2. GC100 publishes guidance on directors' duties under section 172 of the Companies Act 2006

In October 2018, the GC100 published its guidance on directors' duties under section 172 of the Companies Act 2006. The guidance forms part of the package of measures introduced by the Government in recent months to improve the UK's corporate governance framework.

The guidance aims to provide practical help to directors on the performance of their duty under section 172, with a particular focus on the consideration of the stakeholder factors listed in section 172(1). It contains:

- a short summary of suggestions for directors to consider;
- examples of practical steps that directors can take in order to comply with their section 172 duty, including a focus on training, information, strategy and culture;
- a summary of the key legal background to the section 172 duty; and
- an example scenario of how directors could discharge their duties in a specific business situation.

The guidance emphasises that there is no one size fits all approach, and says that the suggestions in it reflect different ways in which different businesses have sought to ensure they achieve their goals responsibly and, at the same time, address their specific company law duties in relation to stakeholder considerations.

3. Government response to consultation on reform of limited partnerships

BEIS published a response paper in December 2018 to its consultation on proposed reforms to limited partnership law, which aims to strengthen the current legal framework and limit the risk of limited partnerships being used for illicit activities.

The key reforms to limited partnership law that the Government intends to take forward are:

- **Additional registration requirements** – those registering limited partnerships will have to provide evidence that they are registered with an anti-money laundering (AML) supervising body. In practice, this would mean that individuals would not be able to register a limited partnership and registration would have to be made by a supervised entity such as a company formation agent, law firm or accountancy firm;
- **Principal place of business** – limited partnerships will be required to maintain some connection to the UK, for example a place of business or the services of an agent that is registered with a UK AML supervisory body and which has agreed to provide its address as a service address for the limited partnership; and
- **Reporting and transparency requirements** – additional information will have to be provided when registering a limited partnership, including contact information for all limited and general partners. Limited partnerships will also be required to file an annual confirmation statement at least every 12 months, confirming that the information held on the public register remains correct.

The Government says that it will develop the primary legislation required to effect the proposals set out in the response paper and legislate as soon as Parliamentary time allows.

4. Liability for acts of overseas subsidiary – Court of Appeal holds English court does not have jurisdiction

The Court of Appeal held in July 2018 that the English court does not have jurisdiction to hear claims by individuals against two companies in the Unilever group, one domiciled in the UK and the other in Kenya. The claims related to alleged injuries suffered by the individuals on the Kenyan subsidiary's tea plantation at the hands of third parties during post-election violence in 2007.

The individuals alleged that the defendants owed a duty to protect them from the risks of such violence and breached that duty. At first instance the High Court declined jurisdiction on the basis that the test for the imposition of a duty of care was not met, as the damage suffered was not foreseeable and it would not be fair, just and reasonable to impose a duty. The Court of Appeal upheld the decision but on different grounds. It found that there was a lack of proximity between the claimants and the UK company. Consequently, it held that there was no "anchor" defendant for proceedings in England and that the English court therefore had no jurisdiction to hear the claims against the Kenyan company either.

This was the second Court of Appeal decision in 2018 in which a UK incorporated company and its overseas subsidiary have successfully challenged the jurisdiction of the English court to hear claims arising out of the operations of the subsidiary company abroad. Our discussion of the first decision, *Okpabi and others v Royal Dutch Shell plc and another* [2018] EWCA Civ 191, can be found here. However, this remains a developing area of the law and it will be interesting to see whether the claimants appeal to the UK Supreme Court.

For further information on the Court of Appeal decision in *AAA and others v Unilever PLC and Unilever Tea Kenya Limited* [2018] EWCA Civ 1532 see the detailed post published by our disputes team on the Herbert Smith Freehills Litigation Notes blog.

5. Regulations banning provisions prohibiting assignment of receivables entered into force

The Business Contract Terms (Assignment of Receivables) Regulations 2018 (SI 2018/1254) have been made and apply to contracts entered into on or after 31 December 2018.

Under the Regulations, a contractual term will have no effect to the extent that it:

- prohibits the assignment of a receivable;
- prevents the assignee of a receivable from determining its validity or value; or
- hinders the assignee's ability to enforce the receivable.

A receivable is defined as a right (whether or not earned by performance) to be paid any amount under a contract for the supply of goods, services or intangible assets.

The prohibition will not apply to 'excluded contracts', which include:

- contracts for prescribed financial services;
- contracts which concern interests in land;
- contracts for or in connection with the sale of a business, including transitional services agreements, provided the contract contains a statement that it is a contract of that nature; and
- contracts under which the supplier is a "large enterprise", broadly defined as a company or limited liability partnership which is not classed as small or medium-sized under the Companies Act 2006 or corresponding LLP legislation. The size of the supplier is assessed at the time the receivable is assigned rather than at the time the contract is entered into.

6. Updated ICSA guidance note on access to register of members

In November 2018 the Institute of Chartered Secretaries and Administrators (ICSA) updated its guidance note on access to the register of members and the proper purpose test.

When a company receives a request for access to its register of members, it must, within five working days, either comply with the request or apply to court for a direction that the request is not for a proper purpose (section 117 of the Companies Act 2006). The Companies Act does not define "proper purpose" and the

ICSA guidance note sets out examples of what could constitute a proper purpose and what is likely to be an improper purpose. It also discusses how to deal with requests for access more generally.

The 2018 edition of the guidance note has been updated to reflect the Court of Appeal decisions in *Fox-Davies v Burberry plc* [2017] EWCA Civ 1129 and *Burry & Knight Ltd v Knight* [2014] EWCA Civ 604 and provides additional guidance on determining "proper purpose" in light of those decisions. The guidance is available via the ICSA website.

B. Mergers and Acquisitions

Consultation on government powers to intervene on national security grounds

In July 2018 the UK Government published a National Security and Investment White Paper in which it has consulted on powers that would enable it to intervene in any M&A transaction that may give rise to national security risks.

The White Paper follows the Government's call for views on options for longer term reforms in a Green Paper published in October 2017. The Green Paper also contained proposals for short term reforms, which were implemented in June 2018 and which lowered the jurisdictional thresholds under the merger control regime for transactions in the military or dual use, quantum technology or computing hardware sectors.

The key features of the proposals in the White Paper, which focuses only on national security rather than on any wider public interest test, are:

- **Regime will apply in addition to existing regime** – the proposed regime will be distinct from the merger control regime under the Enterprise Act. Transactions that are caught by both regimes are likely to face dual regulatory processes. The existing public interest regime under the UK merger control rules, covering media plurality and financial security, will remain unchanged;
- **Transactions within scope** – the regime will apply to an acquisition of control or significant influence over assets, such as IP rights, as well as businesses. The regime is not confined to infrastructure or sectors traditionally seen as carrying national security risks but instead will apply across the whole economy. There will be no turnover or share of supply tests which must be met in order for the regime to apply;
- **Voluntary notifications of transactions** – notification of transactions will be voluntary. However, whilst there is no proposal to introduce a mandatory notification regime ahead of transactions that might give rise to national security risks, the Government will have the right to call in transactions where parties choose not to notify them;
- **Screening for national security concerns** – the Government will publish a detailed Statement of Policy Intent to describe where and how it considers national security concerns are most likely to arise. A draft of the Statement of Policy Intent has been published alongside the White Paper. It will be a Cabinet-level minister who makes the national security assessment; and
- **Remedies for transactions that raise concerns** – the Government will be able to approve a transaction, with or without conditions, or block it or order it to be unwound.

The consultation closed in October 2018.

C. Listing Regime

1. Minor changes to the Listing and Transparency Rules

The Financial Conduct Authority (FCA) published its latest Handbook Notice (No. 57) which describes a number of changes to the FCA Handbook, including two minor technical changes to the Listing and Transparency Rules. The amendments took effect from 27 July 2018 and are set out in the Listing Rules and Disclosure Guidance and Transparency Rules (Miscellaneous Amendments) Instrument 2018 (FCA 2018/41).

The changes were consulted on in FCA Quarterly Consultation Paper No 19 (CP17/39) (and have been adopted in the form proposed):

- **Premium Listing Principle 6** – this Listing Principle provided that a premium listed company must communicate information to holders and potential holders of its listed equity shares in such a way as to avoid the "creation of a false market" in those listed equity shares. This has been amended to expressly refer to the "continuation" as well as the creation of a false market. The FCA says that this is to clarify the meaning of the Principle (and to reinstate its original wording before the principles were reworked a few years ago) rather than any change of substance; and
- **Diversity reporting** – DTR 7.2 has been amended to clarify that the disclosures relating to the company's board diversity policy (required to be made under DTR 7.2.8AR) must be either included in the company's corporate governance statement or set out in a separate report which is published with the annual report or on the company's website.

2. Market Abuse Regulation updated ESMA Q&A

The European Securities and Markets Authority (ESMA) has published two updated editions of its Q&A on the Market Abuse Regulation (MAR).

The first update (in October 2018) contained three new Q&A relating to credit institutions or financial institutions delaying disclosure of inside information in order to preserve the stability of the financial system pursuant to Article 17(5) of MAR (which is separate from the general provisions regarding delaying disclosure in Article 17(4)).

The second update (in November 2018) contained one new Q&A (Q7.10) relating to the prohibition in Article 19(11) of MAR on PDMRs of an issuer conducting transactions in shares or other financial instruments of the issuer during a closed period. The Q&A makes clear that the prohibition does not apply to transactions by an issuer itself, such as a share buyback, even if it is a PDMR who takes the decision to proceed with the transaction. The Q&A confirms the analysis set out in the Q&A on MAR published by the City of London Law Society and Law Society. However, care should still be taken in relation to transactions carried out by an issuer during a closed period, as it remains subject to the prohibition on insider dealing contained in Article 14 of MAR.

The Q&As do not have any official regulatory status but are intended to assist in the consistent interpretation of MAR and, in practice, national regulators will refer to the Q&As when considering MAR compliance.

3. AIM Corporate Governance Code requirements and rules for Nomads

Corporate Governance Code requirements

The London Stock Exchange (LSE) published a new edition of Inside AIM in July 2018 which was intended to assist AIM companies prepare for the entry into force of the new corporate governance requirements in the AIM rules (Rule 28) on 28 September 2018.

AIM companies now have to state on their website which recognised corporate governance code they apply and comply or explain against their chosen code. Previously AIM companies could state that they did not follow a governance code. The new edition addressed some of the common questions received from nominated advisors in relation to this new requirement.

AIM Rule changes for Nomads

The LSE also published revised AIM Rules for Nominated Advisers (Nomads), which came into force on 30 July 2018. The revisions to the Rules relate to the eligibility of firms seeking approval to act as Nomads and the LSE's supervisory powers over Nomads. The amendments to the Rules follow a consultation by the LSE published in April 2018. As well as the final Rules, the LSE has published a blackline showing the changes to the Rules and feedback on the consultation.

4. AIM Disciplinary Notices

The LSE has published AIM Disciplinary Notices in relation to breaches of Rules 10 (principles of disclosure), 11 (general disclosure of price sensitive information) and 31 (AIM company and directors' responsibility for compliance). It:

- censured MBL Group plc in August 2018 for breaching AIM Rule 11 by failing to notify, without delay, price sensitive information it became aware of in relation to the significant deterioration in the financial performance of certain subsidiaries it was preparing to sell. MBL Group plc also breached AIM Rule 10 by issuing a trading update which stated that the relevant subsidiaries remained "profitable and cash generative", without making any reference to the overall deterioration of their financial performance, and AIM Rule 31 by failing to seek advice from its Nomad when appropriate to do so and failing to ensure it had sufficient procedures, resources and controls to ensure it could comply with the AIM Rules;

- privately censured two AIM companies in August 2018. The first company had breached AIM Rules 10 and 31 by making public relevant information via social media before disclosing it via an RIS and failing to have sufficient procedures, resources and controls to monitor its social media updates in line with the AIM Rules. The second company breached AIM Rules 11 and 31 by failing to keep its existing Nomad informed as to its progress in appointing a successor Nomad and consequently failing to manage its disclosure obligations; and
- fined and censured Bushveld Minerals Limited in December 2018, a mineral development company, for breach of AIM Rules 11 and 31 by failing to notify information without delay and failing to provide its Nomad with information in circumstances that it knew (or ought to have known) that it was information the Nomad had reasonably requested and required to fulfil its responsibilities. The fine was originally £700,000 but was reduced to £499,000 for early settlement.

These censures are a reminder that AIM companies must ensure that they properly consider the disclosure implications of relevant information available. The private censure also serves as a reminder that the disclosure obligations of AIM companies under the AIM Rules are in addition to those which they owe under MAR.

D. Prospectus Regime

EU Prospectus Regulation – further provisions in force and progress towards full implementation

The EU Prospectus Regulation (EU 2017/1129) will replace the current prospectus regime under the Prospectus Directive in its entirety. Most of the provisions will be directly effective in Member States two years following publication, that is, in July 2019. However, two specific exemptions from the requirement to publish a prospectus on an admission of securities to trading on a regulated market came into force in July 2017 and two other specific exemptions from the requirement to publish a prospectus for offer of securities to the public came into force in July 2018. The provisions that came into force in 2018 exempt offers below €1 million and give Member States discretion to exempt offers below €8 million, which the UK has elected to do.

Under the terms of the Prospectus Regulation, the European Securities and Markets Authority (ESMA) was mandated to develop:

- specific technical advice and delegated regulations in relation to, among other things, the format and content of prospectuses and the scrutiny and approval process of prospectuses;
- regulatory technical standards (RTS) in relation to, among other things, the content of the key financial information for the prospectus summary; and
- guidelines in relation to risk factors.

Consultations, reports and draft regulations are being issued by ESMA in all of these areas and will continue to be finalised ahead of implementation in July 2019, including:

- in July 2018, ESMA published its Final Report (ESMA31-62-1002) on draft RTS, which includes consideration of key financial information in the summary, dissemination of advertisements, and supplementary prospectuses. The Final Report, including the draft RTS, has been sent to the European Commission for endorsement and will become fully applicable by July 2019;
- also in July 2018, ESMA published a consultation paper on guidelines on risk factors (ESMA31-62-996) and draft technical advice on the minimum content for prospectus exemption (ESMA31-62-962) which considers the document that should be published when an issuer seeks to offer or admit securities to trading in connection with a takeover without publishing a prospectus. The consultation on the

Guidelines and the Draft Technical Advice closed in October 2018. ESMA will publish its final reports by 31 March 2019; and

- in November 2018, the European Commission published a draft Regulation on the format, content, scrutiny and approval of prospectuses. Feedback on the draft regulation was due by 26 December 2018 and it is expected to be published in final form in March 2019.

The Prospectus Regulation will be directly applicable in EU Member States from July 2019 (in relation to any no-deal Brexit, see section G.2).

E. Corporate Reporting

1. Stakeholder reporting Regulations in force

Regulations in force

The Regulations which create a range of new corporate governance reporting requirements for UK-incorporated companies now apply in relation to financial years beginning on or after 1st January 2019. The Companies (Miscellaneous Reporting) Regulations (SI 2018/860) cover a range of areas including:

- performance of the directors' section 172 Companies Act 2006 duty;
- employee engagement;
- governance arrangements; and
- CEO pay ratios.

Our detailed briefing on these new corporate governance reporting requirements has been updated to reflect the final form Regulations.

BEIS guidance

BEIS has published updated Q&A on the new corporate governance reporting requirements. BEIS's first edition of the Q&A included coverage of the scope of the Regulations, timing and what information companies should include to meet the requirements. Key new points in the updated Q&A include:

- **Section 172(1) statement** – a new Q&A states that, where decisions and policies affecting employees, the environment and suppliers are made at a group level, and the parent provides a full explanation in its section 172(1) statement, it may be acceptable for the subsidiary to provide less detail in its own report. The subsidiary will still need to explain how its directors have applied or reflected the group policies;
- **Governance arrangements for large private companies** – the Regulations require very large UK-incorporated companies to state which corporate governance code, if any, they applied in the financial year and how that corporate governance code was applied. The new Q&A says that the Government hopes that the Wates Corporate Governance Principles for Large Private Companies will be widely adopted (see section F.2); and
- **Directors' remuneration policy** – the Regulations introduce a requirement to disclose the possible impact of a growth in the share price on executive remuneration that is linked to performance targets. The Q&A confirms that this disclosure should be included in any new directors' remuneration policy introduced by a quoted company on or after 1 January 2019 (in contrast to all the other new requirements, where the first actual reporting will start in 2020).

2. Energy consumption and climate change reporting

Changes have been introduced to energy consumption and climate change reporting by the Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations (SI 2018/1155). The changes apply for financial years beginning on or after 1 April 2019. Subject to a de minimis exemption:

- **UK-incorporated quoted companies** must disclose in their directors' report a figure, in kWh, which is the aggregate of the annual quantity of energy from activities for which the company is responsible worldwide and the annual quantity of energy consumed; the proportion of that figure that relates to energy consumed in the UK; and, where the company has taken any measures for the purpose of improving the company's energy efficiency, a description of the principal measures taken. This is in addition to existing reporting requirements on group greenhouse gas emissions; and

- **Unquoted companies and UK-incorporated LLPs** which are "large" for accounting purposes under the Companies Act 2006 will have to report on emissions and energy consumption. The disclosures are similar, but not identical, to those for quoted companies.

3. FRC publishes new guidance on the strategic report

The FRC has published the final form of its new Guidance on the Strategic Report. This completely replaces the FRC's previous Guidance on the Strategic Report which was issued in 2014. The FRC consulted on a draft of the new Guidance in August 2017, but subsequently announced that it was delaying publication of the final form in order to reflect the reporting changes being introduced as part of the government's corporate governance reforms (see section E.1 above). The Guidance has been substantially changed since the 2014 edition, in particular:

- to reflect the new non-financial information content requirements for the strategic report that were introduced into the Companies Act 2006 to implement the EU Non-Financial Reporting Directive which has been in force for financial years beginning 1 January 2017 onwards;
- to give greater emphasis to the link between directors' duties under section 172 of the Companies Act 2006 and the purpose of the strategic report, which is to inform members and help them to assess how the directors have performed their section 172 duty; and
- to cover the new reporting requirements relating to the section 172 duty in the Companies (Miscellaneous Reporting) Regulations 2018 (see section E.1 above).

4. GC100 and Investor Group guidance on directors' remuneration reporting

The GC100 and Investor Group has published an updated version of its Directors' Remuneration Reporting Guidance.

The guidance, which addresses the key elements of the directors' remuneration reporting requirements, has been reviewed and updated in response to the amendments to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 made by the Companies (Miscellaneous Reporting) Regulations 2018 (see section E.1 above). The primary areas that have been amended or are new include the exercise of discretion in the award of directors' remuneration; considerations surrounding share price appreciation; and reporting of pay ratios.

5. Climate-related financial disclosures

Financial Stability Board Task Force

The Financial Stability Board (FSB) is an international body with a mandate to promote financial stability. Its Task Force on Climate-related Financial Disclosure (TCFD) published Recommendations in 2017 aimed at helping companies understand what financial markets want from sustainability reports. In September 2018 the TCFD published a 2018 status report on climate-related financial disclosures which summarises the extent to which companies included information aligned with the TCFD's Recommendations in their financial filings and sustainability reports for the 2017 financial year and provides guidance to companies to help them implement the Recommendations. The TCFD highlights the need for continued efforts to support implementation of its Recommendations. A further status report will be issued by the TCFD in June 2019.

FCA and PRA papers

The FCA has issued a Discussion Paper on Climate Change and Green Finance (DP18/8), which considers, amongst other things, the impact of the physical effects of climate change and transition to a low carbon economy on financial markets and reporting of climate change-related matters by listed companies. Views are sought by 31 January 2019.

The FCA intends to consult on guidance to issuers about how the current regulatory regime might be interpreted to apply to climate change-related risks. This proposed guidance will reflect the FCA's view that existing disclosure obligations already require the reporting of the implications of climate change on a business where it is material to the company's prospects. The FCA also seeks views on whether premium listed companies and other issuers should be required to provide a statement to investors explaining whether or not they have followed the TCFD Recommendations (see above) in preparing their climate change disclosures.

Separately, the Prudential Regulation Authority (PRA) has published a consultation paper (CP23/18) seeking views on a draft supervisory statement on the PRA's expectations about banks' and insurers' approaches to managing the financial risks from climate change.

6. BHRRC report on FTSE 100 Modern Slavery Act statements

The Business & Human Rights Resource Centre (BHRRC) has published an analysis of Modern Slavery Act statements published by FTSE 100 companies.

The BHRRC report reviews compliance with the minimum requirements for statements set out in the Modern Slavery Act (that is, approval by the board, signature by a director and a link to the statement on the company's homepage). It also reviews reporting against the six suggested content areas for a statement set out in the Act, highlighting examples of good practice as well as suggesting areas where reporting could be improved, with reference to the relevant parts of the Government Guidance, Transparency in Supply Chains: A practical guide (which was recently revised to update the Useful Information and Resources Appendix).

7. Consultation on ethnicity pay gap reporting

The Government has published a consultation paper on ethnicity pay reporting, alongside a "One Year On" Review of progress. These follow on from the 2017 McGregor-Smith Review of race in the workplace.

The 2017 McGregor-Smith Review recommended mandatory reporting of ethnicity pay data but the Government's preferred response in 2017 was to encourage voluntary reporting and monitor progress. The One Year On Review says that only 11% of employees reported that their organisation collected data on ethnicity pay. Given the limited voluntary progress made in the last 12 months, the Government is now proposing that there should be a mandatory duty to report on ethnicity pay gap data. Both the Equality and Human Rights Commission and the House of Commons' Business, Energy and Industrial Strategy Committee have recommended consultation on a mandatory duty.

The consultation invites views on a number of questions, including what information should be reported by employers to allow for meaningful and proportionate action to be taken without adding undue costs to business. The consultation closes on 11 January 2019.

F. Corporate Governance

1. 2018 UK Corporate Governance Code published by the FRC

The 2018 UK Corporate Governance Code applies to all premium listed companies for financial years beginning on or after 1 January 2019.

The 2018 Code is a complete rewrite of the 2016 Code and has a range of new requirements for both corporate behaviour and reporting — we published a detailed briefing on it, available here.

Key new requirements in the 2018 Code compared to the 2016 Code are:

- an enhanced focus on culture and aligning the company's strategy and values with culture;
- a requirement to have a board-monitored whistleblowing mechanism;
- new stakeholder engagement and section 172 Companies Act 2006 disclosure requirements;
- a requirement for the board to have a mechanism for workforce engagement;
- a provision that the chair should not normally remain in post for longer than nine years from the date of their appointment to the board;
- greater focus on gender, social and ethnic diversity in succession planning for both the board and senior managers, including diversity reporting requirements;

- a provision that vesting and holding periods for long-term incentives should be at least five years; and
- the removal of certain concessions for smaller companies (those outside the FTSE 350).

Companies should review existing policies and procedures to identify gaps and areas that require change before the start of their first financial year to which the 2018 Code applies. Companies will then report against compliance with the 2018 Code when they produce their annual report and accounts during the course of 2020.

The FRC published frequently asked questions on the 2018 edition of the UK Corporate Governance Code in November 2018.

2. Final Governance Principles for large private companies published

The FRC has published the final-form Wates Corporate Governance Principles for Large Private Companies.

In January 2018, the Government announced that the Wates Group, chaired by James Wates CBE, would develop a set of corporate governance principles for large privately-owned businesses. A consultation draft of the Wates Principles was published in June 2018.

The feedback statement accompanying the final-form Principles explains that, in light of responses to the consultation, a number of changes have been made to the Principles and some significant changes have been made to the supporting guidance.

The six Principles cover purpose and leadership; board composition; director responsibilities; opportunity and risk; remuneration; and stakeholder relationships and engagement. The Principles adopt an "apply and explain" approach, that is, companies are expected to apply the Principles and, for each one, provide a supporting statement that gives an understanding of how their corporate governance processes operate and achieve the desired outcomes.

The Principles will provide very large private companies with a framework when complying with the corporate governance reporting requirements in the Companies (Miscellaneous Reporting) Regulation 2018, which apply to accounting periods beginning on or after 1 January 2019 (see section E.1).

3. Kingman Review of the Financial Reporting Council

In December 2018, Sir John Kingman published his Independent Review of the Financial Reporting Council.

The Government asked Sir John to lead a review of the FRC in April 2018 looking at a range of areas including the structure of the FRC, its culture and processes, its powers, how accountable it is and its impact, resources and capacity.

The Review discusses the strengths and weaknesses of the FRC and the constraints on its effectiveness. It sets out 83 recommendations, including that the FRC be replaced with an independent statutory regulator, accountable to Parliament, called the Audit, Reporting and Governance Authority. Other recommendations of particular relevance to corporates include:

- **Corporate governance** – the Review recommends a fundamental review of the Stewardship Code and the framework for viability statements and suggests that they be abolished if they cannot be made more effective;
- **Corporate reporting** – the Review recommends extending the FRC's corporate reporting review work to cover the entire annual report, including the corporate governance statement and directors' remuneration report; and
- **Enforcement** – the FRC currently has no authority to act against company directors unless they are a member of a professional accountancy body. The Review recommends developing an effective enforcement regime that holds all relevant directors to account for their duties to prepare and approve true and fair accounts and to deal openly and honestly with auditors. The Review also recommends that the new regulator should have more extensive powers, including the power to remove an auditor and to recommend that shareholders consider a change of CEO, CFO, chair or audit committee chair.

Most of the Review's recommendations require primary legislation from the Government to implement. However, the FRC and Government are encouraged to identify and agree a set of measures that can be implemented in the short term, ahead of such primary legislation being passed by Parliament.

4. Competition and Markets Authority Review of Statutory Audit Market

The Competition and Markets Authority (CMA) published an update paper on its statutory audit services market study in December 2018. The CMA launched its audit market study in October 2018 to consider whether the audit market is working as well as it should.

The CMA's provisional findings are that there remain concerns about the quality of audits. In particular, concerns arise in relation to the way companies select their auditor, the lack of choice of auditors (with many companies selecting only "big four" auditors), and the provision by auditors of non-audit services. In light of this, the CMA proposes a range of remedies, including:

- **Joint audits** – FTSE 350 audits should be carried out jointly by two firms, at least one of which should be from outside the big four. The CMA also recommends peer review of audits;
- **Auditor appointment** – there should be regulatory scrutiny of audit committees, both during the tendering process for selecting an auditor and throughout the audit engagement; and
- **Non-audit services** – an audit firm's audit and non-audit businesses should be split into clearly defined separate entities, with separate management, accounts and remuneration.

The CMA is also concerned about the resilience of the sector and the damaging impact on competition and choice if one of the big four audit firms were to fail. It therefore also proposes measures seeking to avoid the big four becoming the big three.

The CMA considers that legislation is more appropriate than a CMA Order to implement the proposed remedies and says that the Government will need to consider the recommendations made by other reviews of the audit sector, including the Kingman Review (see F.3 above).

The CMA invites comments on its study by 21 January 2019, following which it will publish its recommendations to the Government.

5. Updated institutional investor voting guidelines

Institutional Shareholder Services Inc. (ISS) has published updates to its benchmark proxy voting policies for 2019 and Glass Lewis has published its 2019 proxy paper guidelines for the UK.

Changes in the 2019 edition of ISS's UK benchmark proxy voting policies include:

- **External auditor** – where the lead audit partner has been linked with a significant auditing controversy at another company, this will be raised for investor attention (even if no issues of concern have been identified at the company being assessed); and
- **Director re-election** – ISS will consider recommending a vote against the re-election of an individual director where egregious actions relating to the director’s service on another board raise substantial doubt about that individual’s ability to effectively oversee management and to serve the best interests of shareholders at any company.

Changes in the 2019 edition of Glass Lewis's UK proxy guidelines include:

- **Board and committee responsiveness** – the guidelines explain how the board and board committees respond to shareholder dissent (including where 20% of more of shareholders vote against a resolution) will be analysed and that committee chairs and committee members may be held accountable for a failure to adequately address shareholder dissent;
- **Board skills and diversity** – the guidelines state that assessment of board skills forms an integral part of Glass Lewis's analysis of director election proposals and it expects FTSE 100 companies (excluding investment trusts) to provide meaningful disclosure in this area, including a robust assessment of the board’s profile in terms of diversity and skills; and
- **Environmental and social risk oversight** – Glass Lewis’s approach to reviewing how boards are overseeing environmental and social issues has been codified in the 2019 guidelines.

6. IA updated Principles of Remuneration and letter to remuneration committee chairs

The Investment Association (IA) has published its annual letter to Remuneration Committee Chairs as well as its updated Principles of Remuneration.

The Principles have been updated to be clearer and sharper and to take account of the 2018 UK Corporate Governance Code and developing best practice. Areas to note include:

- **Malus and clawback** – remuneration committees should consider the most appropriate trigger events to allow a company to forfeit a bonus or recover sums already paid, extending beyond the current market standard triggers of gross misconduct or misstatement of results; and
- **Shareholding requirements and post-employment holding periods** – the Principles outline which shares can count towards the shareholding guidelines and the expectation of investors on post-employment holding periods.

For 2019, key issues highlighted by the IA in their letter to remuneration committee chairs include:

- IA members will be voting against remuneration committee chairs and individual members of the committee where they feel that the committee's decisions have failed to meet investor expectations; and
- companies should report their pay ratios in 2019 (using Option A in the Companies (Miscellaneous Reporting) Regulations 2018) even though only legally required to report against them in the 2020 Annual Report.

G. Brexit

1. 'Deal' – Withdrawal Agreement and future UK/EU27 relationship

The Government published a Draft Withdrawal Agreement on 14 November 2018 which sets out the terms of the negotiated deal and the arrangements for the UK's withdrawal from the EU on 29 March 2019, when the UK will cease to be a Member State. The Government also published the accompanying Political Declaration on the Future Relationship on 22 November 2018. Both the Withdrawal Agreement and the Declaration were approved by the European Council on 25 November 2018. The UK Government must now put the deal (or some variation of it) before Parliament but the timing of the vote and whether there will be any changes to the deal are currently the subject of debate. If, once put forward, Parliament votes down the proposed deal, the Government must present its plan on how it will proceed in a motion. Parliament will have a vote on those plans giving MPs the opportunity to express a view on what should happen next by way of amendment to the motion. Those amendments will not be legally binding but will be politically significant.

If Parliament approves the deal, the UK Government will put forward the Withdrawal Agreement and Implementation Bill, which will implement the Withdrawal Agreement into UK law. On the EU 27 side, the Withdrawal Agreement will be adopted under Article 50 of the Treaty of the European Union and will form part of EU law under Article 216(2) of the Treaty on the Functioning of the EU, in the same way as any other international agreement to which the EU is a party.

If a Brexit deal is approved, whilst the UK will cease to be a Member State of the EU on 29 March 2018, a transitional period will follow through to at least 31 December 2020. During the transitional period, EU law will continue to apply in and to the UK and the UK will continue to trade as part of the Single Market. In particular:

- directly applicable EU legislation, such as the Market Abuse Regulation (EU 2014/596), Audit Regulation (EU 2014/537) and Prospectus Regulation (EU 2017/1129), will continue to apply in the UK until at least 31 December 2020 and the Shareholder Rights Directive (2017/828) will need to be implemented in the UK by June 2019;
- there will not be any immediate changes to the Companies Act 2006 or the Accounting Regulations in March 2019;
- issues relating to groups of companies and reciprocal recognition may be dealt with in any future relationship agreement between the UK and the EU27; and

- any attempts post Brexit to remove certain regulatory burdens on business which were previously derived from EU legislation may be impacted by any such future relationship/trade deal.

2. 'No-deal' – statutory instruments and notes

If no Brexit deal is approved by 29 March 2019, the UK will (unless an alternative approach is decided upon) cease to be a Member State of the EU and under the European Union (Withdrawal) Act 2018, the European Communities Act 1972 will be repealed and existing EU law then in force will be imported into UK law (with necessary amendments). The Government has published a number of statutory instruments to make the changes to legislation required in the event of a 'no-deal' Brexit. Areas covered by some of the statutory instruments include:

- **Companies Act** – various statutory instruments will amend the Companies Act including:
  - the draft Companies, Limited Liability Partnerships and Partnerships (Amendment etc.) (EU Exit) Regulations 2018 will make a range of miscellaneous amendments in relation to EEA companies with a UK establishment or branch and revoke the Companies (Cross-Border Mergers) Regulations 2007; and the draft European Public Limited-Liability Company (Amendment etc.) (EU Exit) Regulations 2018 will create a new corporate form (UK Societas);
  - the draft Accounts and Reports (Amendment) (EU Exit) Regulations 2018 will amend preparation and filing of accounts provisions to remove the preferred treatment for EEA companies and limit the scope of certain exemptions to UK companies with UK parents; and
  - the Competition and Markets Authority will be granted the power under the draft Competition (Amendment etc.) (EU Exit) Regulations 2019 to review mergers that affect the UK market (even where the transaction is also being reviewed by the European Commission), where the UK jurisdictional thresholds are met. Transitional provisions for in flight proceedings and investigations are also covered;
- **Audit** – the draft Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2018 will make amendments so that the framework for the regulatory oversight and professional recognition of statutory auditors and third country auditors in the UK continues to work effectively;
- **Prospectus Regulation** – the Financial Services (Implementation of Legislation) Bill (HL Bill 143) will empower the UK Government to implement certain EU legislation which is "in flight" on exit day, including the Prospectus Regulation;
- **Market abuse and inside information** – the draft Market Abuse (Amendment) (EU Exit) Regulations 2018 will address deficiencies in the market abuse regime arising from Brexit. The Regulations will amend retained EU law relating to market abuse, including the EU Market Abuse Regulation (MAR), other supplementary EU legislation made under MAR and the UK legislation which complements MAR, to ensure that the relevant legislation continues to operate effectively at the point at which the UK leaves the EU;
- **Listing Regime** – the draft Official Listing of Securities, Prospectus and Transparency (Amendment) (EU Exit) Regulations 2019 will make amendments to retained EU law related to the Prospectus and Transparency Directives to ensure that they continue to operate effectively once the UK leaves the EU. These Regulations will underpin the proposed changes to the Listing Rules, Prospectus Rules, Disclosure Guidance and Transparency Rules on which the FCA is consulting (see item G.3 below);
- **FCA/PRA** – the draft Financial Regulators' Powers (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018 will provide that binding technical standards and rules made by the UK regulators will continue to operate effectively after Brexit (including by the FCA and Prudential Regulation Authority);
- **Contract** – the draft Law Applicable to Contractual Obligations and Non-Contractual Obligations (Amendment etc.) (EU Exit) Regulations 2018 are intended to ensure that EU rules that determine the law applicable to contractual and non-contractual obligations continue to operate effectively in domestic law after Brexit. These draft Regulations will incorporate the substantive rules in Rome I and Rome II into UK domestic law so that the rules will continue to apply (as amended) in the UK post-Brexit;

- **Enforcement of judgements** – the Government has deposited an instrument acceding to the Hague Convention so that, with effect from 1 April 2019, the Hague Convention will govern jurisdiction and enforcement of judgements as between the UK and the other signatories to it. The Government has also published the Civil Jurisdiction and Judgments (Hague Convention on Choice of Court Agreements 2005) (EU Exit) Regulations (SI 2018/1124) which set out how the Hague Convention will apply to contracts entered into both prior to and following Brexit (including contracts entered into during the 'gap' period between 29 March and 1 April 2019); and
- **Competition** – the Competition and Markets Authority will be granted the power under the draft Competition (Amendment etc.) (EU Exit) Regulations 2019 to review mergers that affect the UK market (even where the transaction is also being reviewed by the European Commission), where the UK jurisdictional thresholds are met. Transitional provisions for in flight proceedings and investigations are also covered.

The Government has also published a number of technical notices which provide guidance in the context of a 'no deal' Brexit on actions for businesses and on the UK Government's plans to afford assistance to affected businesses and individuals, including ones on structuring your business, accounting and audit and enforcement of judgements.

3. 'No deal' – FCA consultation papers

The FCA published two consultation papers (CP18/28 and CP18/29), which set out some of its proposals in the event of a no-deal Brexit on 29 March 2019 (the consultations closed in December 2018 and will be reported on in Q1 2019). For listed companies, the proposed changes that will be of most interest are amendments to the Listing Rules, the Prospectus Rules and the Disclosure Guidance and Transparency Rules to reflect the Treasury proposal that, after Brexit, the UK's primary markets regime should apply to all issuers that have securities admitted to trading on a regulated market, or admitted to listing, in the UK, or that are making a public offer in the UK, irrespective of the country in which the issuer is incorporated.

4. Takeover Panel consultation paper

The Takeover Panel published a consultation paper (PCP 2018/2) on the changes required to be made to the Takeover Code as a result of Brexit.

The changes are not significant, the key one being the removal of the regime for shared jurisdiction of a bid. Following Brexit, the Takeover Panel will have full jurisdiction of a UK-incorporated company that has its securities listed in another EEA Member State (and not in the UK) but no jurisdiction over an EEA company that has its securities admitted to trading on a UK regulated market (and not in its own Member State).

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