DEVELOPMENTS IN THE LONDON LISTING MARKETS: QCA AND UK CORPORATE GOVERNANCE CODES

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In this article, we focus on recent updates to the corporate governance regimes for public companies under both the UK Corporate Governance Code (the "UK CGC") and the Quoted Companies Alliance ("QCA") Corporate Governance Code (the "QCA Code").

Our previous articles relating to developments in the London listing markets can be found **here**.

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CORPORATE GOVERNANCE

The QCA Code and the UK CGC received updates in November 2023 and January 2024, respectively. There has been no shortage of commentators pointing out apparent corporate governance failings recently, with companies such as Boeing, Carillion and (notably) the Post Office, all coming under their spotlights. Set against that, there has also been considerable pressure on the London markets to remain an attractive venue for companies to list, meaning the changes adopted come at an interesting time.

WHAT IS GOOD CORPORATE GOVERNANCE?

Good governance should ensure sound decision making in the interests of lasting value creation (whilst protecting minority interests). It should eliminate inertia by ensuring the right people are in the right roles, working collaboratively to deliver for all shareholders over the medium- to long-term. It should be about asking the right questions and having the right systems and controls in place to allow people to do so, without fear of reprisal for whistleblowing.

WHY IS GOOD CORPORATE GOVERNANCE NECESSARY AND HOW IS IT MODERATED?

Good corporate governance mitigates the risks that a company faces as it seeks to create sustainable growth over the medium- to long-term.

The UK CGC applies to larger companies with a Premium listing on the London Stock Exchange ("LSE") (whether incorporated in the UK or elsewhere),[1] whilst the QCA Code is generally followed by small to mid-sized companies, such as those listed on AIM. Each code is principle-based (applied on a "comply or explain" basis), and the QCA Code draws many of its fundamental themes from the more extensive UK CGC.

> "The UK CGC applies to larger companies with a Premium listing on the London Stock Exchange."

UK CGC

INTRODUCTION

The Financial Reporting Council (the "FRC") published the updated UK CGC on 22 January 2024. It will apply to financial years beginning on or after 1 January 2025, though provision 29, which introduces new reporting obligations, will only take hold from the 2027 reporting season. The FRC published separate non-mandatory guidance on the UK CGC on 29 January 2024 which is designed to help companies apply the UK CGC.

The revised UK CGC has allayed fears in the City that the changes proposed last year would be overly prescriptive and aims to balance the need to uphold high standards of governance with ensuring the competitiveness of UK listed companies and UK capital markets.

The UK CGC is split into five sections: board leadership and company purpose; division of responsibilities; composition, succession and evaluation; audit, risk and internal control; and remuneration. Each section contains a set of principles of good corporate governance, which are each expanded on by specific provisions derived from the Financial Conduct Authority's Listing Rules.

CHANGES TO UK CGC

The recent updates can be broken down into the following sections:

> "It will apply to financial years beginning on or after 1 January 2025."

Section 1 – board leadership and company purpose

Provision	Commentary
New: Principle C: Governance reporting should focus on board decisions and their outcomes in the context of the company's strategy and objectives. Where the board reports on departures from the UK CGC's provisions, it should provide a clear explanation.	There is a renewed emphasis on the application of the UK CGC's principles on a comply or explain basis.

Provision	Commentary
Provison 2: This has been updated to include that boards should not only assess and monitor culture, but also how the desired culture has been embedded.	There is now an onus on boards to reflect upon whether their assessments and recommended actions have actually been implemented.

Section 3 – Composition, succession and evaluation

Principle J: This has been amended to promote diversity, inclusion and equal opportunity, without referencing specific groups.	The list of diversity characteristics has been removed to indicate that diversity policies can be wide ranging.
Provision 23: This has been amended to reflect the fact that companies may have additional initiatives in place alongside their diversity and inclusion policy.	This demonstrates recognition that the UK CGC should be applied on a company specific basis and is not trying to be a 'one size fits all' mantra. Generally, references to 'board evaluation' have changed to 'board performance review' which alludes to a more objective review process.

Section 4 – Audit, risk and internal control

Principle O: This has been amended to make the board responsible not only for establishing, but also for maintaining the effectiveness of, the risk management and internal control framework.	
Provision 25 and Provision 26: These have been updated to reflect the Minimum Standard: Audit Committees and the External Audit (the "Standard").[2]	The Standard sets out the suggested relationship between a company and external auditors, including considerations such as carrying out the tender process, approving remuneration and setting terms of engagement. Some provisions have been removed from the UK CGC and are now included directly in the Standard. It is expected the Standard will become applicable to all companies on the single commercial company listing category ("ESCC") once the new Listing Rules are adopted.

New: Provision 29: The board should monitor the company's risk management and internal control framework and, at least annually, carry out a review of its effectiveness. The monitoring and review should cover all material controls, including financial, operational, reporting and compliance controls. The board should provide in the annual report: • a description of how the board has monitored and reviewed the effectiveness of the framework; • a declaration of effectiveness of the material controls as at the balance sheet date; and • a description of any material controls which have not operated effectively as at the balance sheet date, the action taken, or proposed, to improve them and any action taken to address previously reported issues.	This new provision asks companies to take a view on the effectiveness of the controls most material to the long-term sustainability of their company.

Section 5 – Remuneration

Provision 37: This has been amended to include that directors' contracts and/or other agreements or documents which cover director remuneration should include malus and clawback.[3]	The FRC has clarified that this provision should focus on executive directors and not all those that are on applicable incentive schemes.
New: Provision 38: This asks companies to include in their annual report a description of their malus and clawback provisions, including: • the circumstances in which malus and clawback provisions could be used; • a description of the period for malus and clawback and why the selected period is best suited to the organisation; and	Where companies have to express scenarios where malus and clawback are relevant, it increases accountability for decision makers both prospectively (i.e., it would encourage an appropriate level of engagement with (for example) an acquisition)), and retrospectively (i.e., it would encourage a certain level of enquiry of things that had gone wrong).

- whether the provisions were used in the last reporting period. If so, a clear explanation of the reason should be provided in the annual report.

QCA CODE

INTRODUCTION

In November 2023 the QCA released its updated corporate governance code, its first update since 2018. The QCA Code acts as a framework for good corporate governance for small to mid-sized companies quoted on AIM and the Aquis Stock Exchange. As a voluntary code, it is used by nearly 900 companies, with 93% of AIM quoted companies having adopted the QCA Code as of 2023. Over 25% of Standard listed companies currently use the QCA Code, but these companies will adopt the UK CGC on the creation of the ESCC. The revised code will apply to companies with accounting periods commencing on or after 1 April 2024.

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The revised QCA Code was implemented following a consultation which found that stakeholders wanted a code which placed greater emphasis on corporate purpose, environmental and social impacts, risk management, the function and make-up of the board and corporate communications, but which maintained its core principles-based structure.

CHANGES TO THE QCA CODE

This table sets out the updated principles coming into force later this year, and brief commentary on these.

"The revised code will apply to companies with accounting periods commencing on or after 1 April 2024."

Principle (with 2023 updates in bold)	Implication / commentary
Principle 1 (numbering unchanged from the 2018 QCA Code) Establish a **purpose**, strategy and business model which promote long-term value for shareholders.	There must now be a clear articulation of the company's corporate purpose which goes beyond that of an expression of its strategy and business model.

Principle (with 2023 updates in bold)	Implication / commentary
Principle 2 (previously Principle 8 in the 2018 QCA Code) Promote a corporate culture that is based on ethical values and behaviours.	The desired corporate culture should support the company's purpose, strategy, and business model and should be visible throughout the company's operations.
Principle 3 (previously Principle 2) Seek to understand and meet shareholder needs and expectations.	The board should ensure proactive engagement with shareholders on governance matters. This should be led by the chair, but board members of all levels should engage with this process.
Principle 4 (previously Principle 3) Take into account wider stakeholder interests, including social **and environmental** responsibilities, and their implications for long-term success.	Stakeholder interests have been expanded to include consideration of the company's societal and environmental impacts – including those relating to or stemming from climate change. Employee whistleblowing procedures should also be given more prominence in forming the culture of the company. The expansion of "social" interests to recognition of the workforce as key stakeholders in the company acknowledges the advantages that a committed employee base at all levels brings in delivering longer-term shareholder value. Disclosures should describe the environmental and social issues that the board has identified as being material to the company in achieving its purpose and set out any relevant associated KPIs.
Principle 5 (previously Principle 4) Embed effective risk management, **internal controls and assurance activities**, considering both opportunities and threats, throughout the organisation.	There is now greater emphasis on identifying and managing climate change related risk, as well as clear separation between a company's assurance practices and its board.

Principle (with 2023 updates in bold)	Implication / commentary
Principle 6 (previously Principle 5) **Establish and** maintain the board as a well-functioning, balanced team led by the chair.	Diversity characteristics should now be explicitly referred to as evidence of a board having the necessary mix of experience, skills, and capabilities to execute the company's strategy. Investors are especially mindful of levels of board independence where there is a founder and/or executive chair. To offset any concerns, companies should now explain in greater detail how non-executive directors are considered to be independent and any instances where their independence could be called into question. The QCA Code also now suggests that all directors should be re-elected on an annual basis.
Principle 7 (a combination of the previous Principle 6 and Principle 9) Maintain **appropriate** governance structures and ensure that **individually and collectively** the directors have the necessary up-to-date experience, skills and capabilities.	Can be read as an acknowledgement that companies change their size, strategy and business model over time and that the governance structures, processes and policies should evolve over time in parallel.
Principle 8 (previously Principle 7) Evaluate board performance based on clear and relevant objectives, seeking continuous improvement.	The board should regularly review its performance as a unit, as well as that of its committees and individual directors, including relevant discussion on succession planning.
Principle 9 (new) **Establish a remuneration policy which is supportive of long-term value creation and the company's purpose, strategy and culture.**	The QCA Code now contains explicit recommendations previously contained in the QCA's Remuneration Committee guide. A new core principle for directors' remuneration has been established, requiring relevant companies to establish a remuneration policy which aligns with long-term value creation and corporate purpose. Shareholders must now have a director's remuneration report submitted to them annually for their approval for at least an advisory vote and any new, or significant changes to, employee share schemes and long-term incentive plans must go to a shareholder vote.

Principle (with 2023 updates in bold)	Implication / commentary
Principle 10 (numbering unchanged) Communicate how the company is governed and is performing by maintaining a dialogue with shareholders and other **key** stakeholders.	Boards should ensure that corporate disclosures, in particular through annual reporting, are appropriate to satisfy the reporting needs of investors, including, but not limited to, sustainability matters.

CONCLUSION

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The changes to both codes are reasonably limited. Both emphasise the importance of key decision makers having the appropriate level of expertise, independence and varied perspective to ensure the right signals are communicated from the top of the governance chain downwards.

They also both reinforce the idea that corporate governance regimes in the UK are to be applied on a "comply or explain basis" despite complaints from some quarters that it is at risk of becoming a "comply, or else!" system.[4]

The FRC has arguably reacted to calls to avoid increasing the burden on companies at a time when new London listings have been outweighed by delistings and has dropped certain of its original proposals such as a requirement for external auditors to review a company's controls (as is required in the US) and limits on the number of roles that non-executive directors may hold. Further the FRC has effectively confirmed that it is for the board to decide what constitutes effective internal controls.

"The revised QCA Code reflects the general consensus that environmental and sustainability matters are at the heart of good corporate governance."

The revised QCA Code reflects the general consensus that environmental and sustainability matters are at the heart of good corporate governance. A greater variety of stakeholders must now be considered which necessitates deeper self-scrutiny by decision makers; reinforcing the idea of good corporate governance as providing longer-term value creation.

Though there is still little direction from the QCA as to the quality of disclosure and who monitors compliance, the fundamental purpose of alternative listing regimes (being to give growing companies with tighter purse-strings access to capital without imposing cumbersome reporting and governance requirements) has been maintained.

FOOTNOTES

[1] It is expected to apply to both Premium and Standard segment companies once these segments are merged into the single commercial company listing category (anticipated later in 2024)
[2] This FRC standard was published in May 2023 but is yet to become mandatory for relevant companies, currently being those with a Premium Listing or on the FTSE 350.
[3] Malus is the part of a deferred bonus which has not yet been paid out and can be 'reclaimed' because, for example, an acquisition's due diligence is not carried out thoroughly. Clawback is applied to a bonus that has already been paid out. It can be reclaimed by the employer in, for example, cases of gross negligence or non-compliance.
[4] Julia Hoggett (CEO of the London Stock Exchange)

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