Feature

Covid 19 and the UK CG Code

Alex Cameron and **David Archer** examine the principles in the UK Corporate Governance Code (the Code) and make practical suggestions for areas that are likely to require particular attention from boards at this time.

This is an unprecedented and worrying time for businesses and their boards. As the virus pandemic took hold, the country was put in lockdown and every business had to respond. Suddenly the corporate environment entered the 'emergency room' where executives and non-executives alike were required to make radical decisions to ensure the survival of their business. This has been a shocking and exhausting phase for many board members.

However, it is neither possible nor desirable to stay in this emergency room indefinitely. As the country tries, step-by-step, to emerge from lockdown the future has not yet become much clearer and further shocks to the corporate world are likely in the months ahead. Living with the virus will be essential until a vaccine is widely available. For boards exhausted by recent events, this is not a sprint, but neither is it a marathon - there is no clear finish line to cross.

Even in this situation board members' responsibilities have not changed, and the principles outlined in the Code still hold true. But with a radically different corporate environment and boards meeting by video conference, it is time to examine the principles in the Code and interpret them in the light of recent events. Let's examine each of the Code's five sections and explore areas that are likely to require particular attention from boards at this time.

Section 1 – Board leadership and company purpose

More than ever the board is focused on the sustainability of the business and the challenge has rarely been so critical. In a situation with high levels of uncertainty, boards need to focus their attention at three different time horizons. These are not serial questions but activities that have to be addressed in parallel as the board navigates the future:

1. Is the business set up to financially survive in the short term?
2. Is the business able to adapt and evolve in the mid-term (12 - 18 months) to a world living with the virus?
3. 3. Is the business able to assess and if necessary, radically change its offer, to develop a longer-term sustainable business to fit a very different environment?

The stakeholders of the business will each have particular concerns, and it's not a time for the board to make assumptions about the needs of any particular group. Stakeholders need to be listened to and carefully managed. With face-to-face communication curtailed, board members will have to give greater priority to stakeholder engagement, and in particular, staff engagement to provide the visible leadership that this group needs.

Boards need confidence that workforce policies and procedures are aligned with the new reality and with any changes to legal and financial frameworks. And, most importantly from the board's perspective, is the reputation of the business protected through this period. Has the business been seen as a 'good citizen' and is its contribution to the wider society evident and aligned with the company values?

Section 2 – Division of responsibility

The board itself is not isolated from the change occurring all around it. Sadly, board members may be affected by serious illness - especially considering the demographic of the average board and the vulnerability of older males to coronavirus complications. This means that boards will need to appoint deputies who can take accountability for particular roles if a board member becomes incapacitated. And the board should be aware of and amend if required the quorate rules for the board and its committees. These and other changes should be incorporated swiftly into updated terms of reference for all parts of the governance system.

The role of the Chair in board meetings is more essential than ever, to ensure that tough issues are fully debated by the board within the limitations of video technology. There will also be a greater need for one-to-one meetings between the Chair and individual board members to check that the CEO and other executives are able to carry out their roles effectively, and that stress levels are being actively managed. This may be a time when the SID can share some of the load - and act as a deputy if illness strikes.

The Chair needs to be rigorous in clarifying the decisions made by the board in video meetings, and to focus on taking the right decisions at the right time. In addition, the non-execs need to ensure that they can meet virtually as a group, reflecting on their contribution and checking that they are not becoming too 'executive' in response to the crisis. Non-executives need to understand more clearly than ever, the limits of their role and when help for executives is truly helpful.

The Company Secretary role becomes more important as a vehicle to keep board members informed and updated on legislative and regulatory change, and to ensure that the board has access to appropriate legal advice, eg employment and insolvency regulations. The CoSec needs to ensure that the board is not weighed down by complex, extensive board packs - and that electronic board tools are used by all.

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Section 3 – Composition, Succession Evaluation

Exceptional times require exceptional leaders and an innovative mindset. Ensuring that the right skill and experience mix is available to the board is a priority. As well as ensuring that deputies are in place as already discussed, the board may need to:

- Protect critical skills and individuals that are irreplaceable just now.
- Make changes to the non-exec group if some do not have the appetite or the relevant experience to help the business navigate the future.
- Extend some board appointments beyond current tenure if necessary - inducting new board members may be particularly challenging at this time.
- Look to co-opt individuals onto the board or particular committees for limited periods to inject new expertise or new thinking.

This is an agenda that will require an active and engaged Nominations Committee, meeting more regularly than is normal on most boards.

Section 4 – Audit risk and internal control

Clearly, this situation demonstrates the importance of the board owning and actively reviewing the principal risks of the business. This is not simply an Audit and Risk Committee responsibility, it's for the whole board. If boards do not understand the importance of this issue now, they never will! However, as the situation develops, the principal risks (and the risk register) should be kept in active review by the board to ensure that management and mitigation plans are in place.

Plans need to be in place to deal with year-end and the external auditor's access to the business. In particular the board needs to reflect on its obligation to provide a 'fair and balanced assessment of the company's position and prospects'. This will be more complex and potentially a harder task than the board has had to carry out in the past. It will take honest debate and some time to get the wording in a form that all board members support.

The year-end reporting cycle is an area where the board also needs to be aware of changing requirements from the regulator. This is an area where we can expect new guidelines from the FCA to apply to the 2020/21 reporting year. This is a time to listen to regulators carefully and for boards to take legal advice to fully understand their changing responsibilities.

Section 5 – Remuneration

In a similar manner to the extraordinary agenda for the Nominations Committee, the Remuneration Committee needs to meet to review remuneration policy in the light of the impact of the lockdown on the business. LTIP and other incentive plans will need to be reviewed and possibly changed to protect the financial and reputational impact. This is a time for a board to use their discretion with bonus schemes and not just follow the consequences of a pre-defined mathematical formula.

Remuneration has been an area of increasing scrutiny by shareholders and other corporate stakeholders in recent years. It is to be expected that remuneration policies will be under the spotlight in a changed corporate landscape where all sectors are impacted by the consequences of the pandemic. Society will now have greater awareness and concern about global risks than ever before. Boards can expect greater levels of shareholder activism as the pandemic crisis abates, especially regarding global issues such as climate change. Remuneration is a likely place for this public and media scrutiny.

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In conclusion

The impact of this pandemic will be a tough and long-lasting. Boards exist to protect the long-term health of the business on behalf of shareholders and other stakeholders and in the pandemic, this means ensuring that the right tactical changes occur to protect the business now, while in parallel, exploring more radical strategies for the future. This is probably more than a board strategy day!

How board members behave in the crisis will define the executive/non-executive relationship for some time in the future - people have long memories. Stress levels will be high for all board members and the impact of high stress and exhaustion need to be recognised and managed.

In this period of continuing uncertainty, board members need a common structure and good guidance to help navigate such uncharted waters. The principles of the Code remain one of the most valuable of guides for a board - even if they need to be re-interpreted in the ways we have discussed above to ensure their continued relevance in these extraordinary times.

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