



FINANCIAL REPORTING COUNCIL

REVIEW OF THE 2003 COMBINED CODE

**CONSULTATION ON POSSIBLE AMENDMENTS TO
THE COMBINED CODE**

JANUARY 2006

1. The FRC is consulting on the following changes to the Combined Code:
 - A. amending provision B.2.1 to allow the chairman to sit on the remuneration committee where he or she was considered independent at the time of appointment;
 - B. amending section D.2 to provide shareholders voting by proxy with the option of withholding their vote, and to require the publication of details of proxies lodged at the AGM where votes are taken on a show of hands;
 - C. for those provisions that require companies to “make information available” (provisions A.4.1, B.2.1 and C.3.3), enabling the requirement to be met by placing the information on the company’s website; and
 - D. setting out in Schedule C the disclosure requirements in the Listing Rules in order to ensure companies are able to find details of all relevant requirements in one place.
2. Comments are invited on the proposals in this consultation document and the draft amendments to the Combined Code. Comments are also invited on the draft Regulatory Impact Assessment, which identifies the potential costs and benefits associated with these proposals, and which is available at:
www.frc.org.uk/corporate/combinedcode.cfm
3. The deadline for comments is **21 April 2006**. The intention is that any changes to the Combined Code would take effect for financial years beginning on or after 1 November 2006.
4. Comments should be sent by e-mail to codereview@frc.org.uk or by post to:

Chris Hodge
Corporate Governance Unit
Financial Reporting Council
Fifth Floor
Aldwych House
71-91 Aldwych
London WC2B 4HN

***Note:** Unless otherwise stated, responses will be regarded as being on the public record. Consultees should indicate specifically whether their responses should be treated as confidential (standard disclaimers in responses received by e-mail will be disregarded for this purpose).*

A: THE COMPOSITION OF THE REMUNERATION COMMITTEE

5. Provision B.2.1 of the Combined Code currently states: “The board should establish a remuneration committee of at least three, or in the case of smaller companies two, members, who should all be independent non-executive directors”. As the company chairman is not considered to be an independent non-executive director for the purposes of this provision, this means that if a company wishes the chairman to be a member of the committee it needs to provide an explanation to shareholders in the annual report.

6. A sizeable percentage of companies currently choose to explain rather than comply with this provision. According to Grant Thornton, the chairman sits on the remuneration committee of nearly 30% of FTSE350 companies¹, and the figure is believed to be higher outside the FTSE350. Anecdotal evidence suggests that at many other companies the chairman, although not a committee member, is routinely invited to attend meetings.

7. It has been proposed that the provision should be amended to allow the company chairman to sit as a full member of the committee where he or she was considered independent at the time of appointment. It has been argued that allowing the chairman to sit on the remuneration committee would ensure that performance incentives and other elements of the remuneration policy were properly aligned with the company’s strategic objectives.

8. If the Code were to be amended, it is proposed that the chairman would sit on the committee in addition to the current recommended minimum number of independent directors (three for FTSE350 companies, two for all others), rather than instead of one of those directors. It is also proposed that the chairman of the company should not chair the committee. Principle B.2 of the Code – that no director should be involved in deciding his or her own remuneration – would also continue to apply. Draft amendments to the Code are set out below.

9. Views are invited on:

- whether any change should be made to the Code; and if so
- whether the company chairman should sit on the remuneration committee in addition to the minimum number of independent non-executive director members, or instead of one of them;

¹ ‘Fourth FTSE350 Corporate Governance Review’, Grant Thornton, November 2005.

- whether the company chairman should only sit on the remuneration committee if he or she were considered to be independent at the time of appointment as chairman;
- whether the company chairman should also be able to chair the remuneration committee; and
- the draft amendments to provision B.2.1 as set out below.

Current wording of provision B.2.1

The board should establish a remuneration committee of at least three, or in the case of smaller companies two, members, who should all be independent non-executive directors. The remuneration committee should make available its terms of reference, explaining its role and the authority delegated to it by the board. Where remuneration consultants are appointed, a statement should be made available of whether they have any other connection with the company.

Possible amendments

The board should establish a remuneration committee of at least three, or in the case of smaller companies two, ~~members, who should all be~~ independent non-executive directors. *In addition the company chairman may also be a member of, but not chair, the committee if he or she was considered independent on appointment as chairman.* The remuneration committee should make available its terms of reference, explaining its role and the authority delegated to it by the board. Where remuneration consultants are appointed, a statement should be made available of whether they have any other connection with the company.

B: VOTES WITHHELD

10. In January 2004 Paul Myners produced a report for the Shareholding Voting Working Group on impediments to voting UK shares². In that report he recommended that companies should include a 'vote withheld' box on proxy voting forms and publish the total number of votes withheld as well as votes for and against when declaring the results, and that the FRC should review provision D.2.1 of the Code in the light of this recommendation. It was argued that the facility to indicate a conscious withholding of votes was a valuable mechanism enabling shareholders to communicate reservations about a particular resolution whilst not going as far as voting against the resolution. The FRC is consulting on whether the Combined Code should be amended to reflect this recommendation.

11. It should be emphasised that the provision of a 'vote withheld' option would not affect the current legal position where only 'for' and 'against' votes are taken into account when deciding whether or not a resolution is carried. If the Code were to be amended as proposed companies would be advised to check their Articles of Association, although it is not anticipated that changes would normally be needed.

12. It is increasingly becoming general practice for companies to provide a 'vote withheld' option. According to RREV, for 92% of company meetings of the FTSE100 in 2005 and where results were disclosed either publicly or to RREV, voting forms had an abstention/vote withheld option³. The CREST electronic proxy form already includes a 'vote withheld' option.

13. In his January 2004 report Paul Myners stated that where a shareholder decides to withhold their vote "it is essential that the reasons for the decision are clearly explained to the company if the full impact of the decision is to be apparent". This is consistent with the guidance to investors in the Institutional Shareholders Committee's Statement of Principles. If the Code were to be amended as proposed, the FRC would encourage investors to advise the company in advance of their intention to withhold their vote and to explain the reasons for doing so.

² 'Review of the impediments to voting UK shares', a report by Paul Myners to the Shareholder Voting Working Group, January 2004.

³ Data quoted in 'Review of the impediments to voting UK shares – an update on progress', a report by Paul Myners to the Shareholder Voting Working Group, November 2005.

14. The January 2004 report also recommended that “companies should disclose on their web sites and in summary in annual reports, the results of polls at general meetings and, where a poll is not called, the level of proxies lodged on each resolution”. This recommendation is being implemented in respect of disclosure of the results of polls on websites through draft clause 315 of the Company Law Reform Bill which is currently with Parliament. The Bill does not address resolutions which are voted on a show of hands, and the Code could be amended to recommend that companies adopt similar practices in relation to those resolutions.

15. Views are invited on:

- whether the Code should be amended to require companies to include a ‘vote withheld’ option on proxy appointment forms for the AGM;
- whether the Code should be amended to address the publication of details of proxies lodged at the AGM where votes are taken on a show of hands; and
- the draft amendments to the Code as set out below.

Current wording

Provision D.2.1

The company should count all proxy votes and, except where a poll is called, should indicate the level of proxies lodged on each resolution, and the balance for and against the resolution and the number of abstentions, after it has been dealt with on a show of hands. The company should ensure that votes cast are properly received and recorded.

Provision D.2.2

The company should propose a separate resolution at the AGM on each substantially separate issue and should in particular propose a resolution at the AGM relating to the report and accounts.

Possible amendments

Reverse the order of provisions D.2.1 and D.2.2.

Add new wording to current provision D.2.2:

The company should propose a separate resolution at the AGM on each substantially separate issue and should in particular propose a resolution at the AGM relating to the report and accounts *For each resolution, proxy appointment forms should provide shareholders with the option to direct their proxy to vote either for or against the resolution or to withhold their vote.*

Replace existing provision D.2.1 with:

The company should ensure that all valid proxy appointments received for the AGM are properly recorded and counted. For each resolution, after a vote has been taken, except where a poll is called, the company should ensure that the following information is given at the meeting and subsequently made available on a website:

- *the number of shares in respect of which proxy appointments have been validly made ;*
- *the number of votes for the resolution;*
- *the number of votes against the resolution; and*
- *the number of shares in respect of which the vote was directed to be withheld.*

C: MAKING INFORMATION AVAILABLE

16. The Combined Code contains a number of provisions which state that companies should make certain information available in order to comply with the provision. These include requirements to make available:

- the terms of reference of the nomination, remuneration and audit committees (provisions A.4.1, B.2.1 and C.3.3 respectively); and
- where remuneration consultants are appointed, a statement of whether they have any other connection with the company (provision B.2.1).

17. The footnotes to these three provisions state that the requirement to make the information available would be met by making it available on request and by including the information on the company's website. Data provided by PIRC in its response to the review shows that a significant majority of companies are now making information on committee terms of reference available on their website – 95% of FTSE100 companies, 82% of FTSE250 companies and 66% of smaller listed companies.

18. As a minor deregulatory measure, the Combined Code could be amended to recommend only that the information be made available on an appropriate website, and not for the company also to make the information available on request. Draft amendments to the Code are set out below.

19. Views are invited on this proposal. The FRC is particularly interested in the views of private shareholders and their representatives. It would also be helpful if companies were able to indicate how frequently, if at all, they receive requests for this information.

Current wording

Footnotes to provisions A.4.1, B.2.1 and C.3.3

The requirement to make the information available would be met by making it available on request and by including the information on the company's website.

Schedule C

The following information should be made available (which may be met by making it available on request and placing the information available on the company's website):

- the terms of reference of the nomination, remuneration and audit committees, explaining their role and the authority delegated to them by the board (A.4.1, B.2.1 and C.3.3);
- the terms and conditions of appointment of non-executive directors (A.4.4) (see footnote 10 on page 9); and
- where remuneration consultants are appointed, a statement of whether they have any other connection with the company (B.2.1).

Possible amendments

Footnotes to provisions A.4.1, B.2.1 and C.3.3

The requirement to make the information available would be met by ~~making it available on request and by~~ including the information on the company's website.

Schedule C

The following information should be made available (which may be met by ~~making it available on request and~~ placing the information ~~available~~ on the company's website:

- the terms of reference of the nomination, remuneration and audit committees, explaining their role and the authority delegated to them by the board (A.4.1, B.2.1 and C.3.3);
- the terms and conditions of appointment of non-executive directors (A.4.4) (see footnote 10 on page 9); and
- where remuneration consultants are appointed, a statement of whether they have any other connection with the company (B.2.1).

D: LISTING RULES REQUIREMENTS IN SCHEDULE C

20. Schedule C of the Combined Code summarises the disclosure recommendations contained in the Code. It also includes a reference to the requirements in the Listing Rules for listed companies to include a 'comply or explain' statement on how the Code has been applied in the annual report.

21. It is proposed to replace the current reference to the Listing Rules with the relevant extract from the Listing Rules. This will mean that companies will be able to find details of all the disclosure recommendations relating to the Combined Code in one place. Views are invited on this proposal.

Current wording

The Listing Rules require a statement to be included in the annual report relating to compliance with the Code, as described in the preamble. For ease of reference, the specific requirements in the Code for disclosure are set out below:

Possible amendments

Replace with:

Paragraph 9.8.6 of the Listing Rules states that in the case of a listed company incorporated in the United Kingdom, the following items must be included in its annual report and accounts:

a statement of how the listed company has applied the principles set out in Section 1 of the Combined Code, in a manner that would enable shareholders to evaluate how the principles have been applied; [a new footnote 23 could be added here - see below]

a statement as to whether the listed company has

- complied throughout the accounting period with all relevant provisions set out in Section 1 of the Combined Code; or*
- not complied throughout the accounting period with all relevant provisions set out in Section 1 of the Combined Code and if so, setting out:*

- (i) *those provisions, if any, it has not complied with;*
- (ii) *in the case of provisions whose requirements are of a continuing nature, the period within which, if any, it did not comply with some or all of those provisions; and*
- (iii) *the company's reasons for non-compliance.*

In addition the Code includes specific requirements for disclosure which are set out below:

[Possible new footnote 23 linked to the paragraph relating to disclosure of how the Code principles have been applied:]

As noted in the preamble, the form and content of this part of the statement are not prescribed, the intention being that companies should have a free hand to explain their governance policies in the light of the principles, including any special circumstances applying to them which have led to a particular approach.