

Hermes' response to the FRC's Consultation on Proposed Changes to the Combined Code, December 2007

Hermes is one of the largest pension fund managers in the City of London and is the principal manager of the BT Pension Scheme on behalf of whom we are responding. We also respond to consultations such as this one on behalf of many other clients, including Ireland's National Pension Reserve Fund, Denmark's PKA, the Netherland's PNO Media Stichting Pensioenfond and Canada's Public Sector Pension Investment Board. We have some £35 billion assets under management and over £45 billion assets under advice¹.

Hermes welcomes the opportunity again to comment on the development of the Combined Code. We strongly believe that the Code promotes better board performance over time and that both companies and their owners benefit from boards complying with the Code or carefully and honestly explaining their reasons for non-adherence to it. Through better board performance we believe that the Code can assist in the creation of shareholder value as well as reducing the risk of value destruction.

Institutional investors benefit from judging carefully companies' Code disclosures to evaluate whether their compliance or otherwise with its provisions are of benefit to the company and its shareowners. It is important that fund managers take their responsibilities in this area seriously such that explanations can form part of active dialogue between companies and their owners.

We therefore welcome the FRC's commitment to revise the preamble to the Code. We believe that this new preamble should bolster the point that good governance promotes value-enhancement and that this value creation and protection is the underlying aim of the Code. It could also reinforce the importance of investors taking their responsibility to comply with the Institutional Shareholders' Committee's *The Responsibilities of Institutional Investors and Agents - Statement of Principles*, in particular to make reasoned judgements about reasons given for departures from the Code and to avoid box-ticking. Such a preamble might provide a better context for the drafting of governance disclosures, and also for the assessment of them.

Proposed Amendments to the Combined Code

Chairing more than one FTSE 100 company

We agree with the proposed change, removing the restriction on an individual being appointed to the chair of more than one FTSE 100 company. We do not think that any further qualifications need to be added to the provision.

Nevertheless, we believe that both directors and chairs need to apply due consideration to the time commitments that they are likely to have, particularly in the event of crises at any of the companies of which they are a director. We would note that this applies not only to a second FTSE 100 chair role but also to other major commitments. Boards should also be mindful of the possible effect of the chair's other commitments on his or her ability to perform effectively. We regard this as a specific instance of the usual requirement that boards actively consider the time commitment of all directors to ensure that they are and will remain effective in their role.

Any decisions should be made following a robust process which is properly explained in the annual report of each affected company.

Company chairman sitting on audit committee for smaller companies

We accept the proposed change to enable the chairman of a smaller company, if independent on appointment, to be a member of the audit committee in addition to the minimum of two independent non-executive directors.

We believe that that this change will make it easier for some companies to comply with the Code. There may be some other benefits to smaller companies, such as better performance of their audit committees, without increased costs.

We welcome this increased flexibility in the Code which reflects the approach which we have, in practice, been applying.

Other Revisions to the Combined Code

Revised preamble

We welcome, as described above, the opportunity that the revised preamble to the Code will provide the FRC to emphasise important points about how the Code should be viewed, in particular emphasising that value creation and protection is the purpose of good governance. We would be happy to assist in its redrafting if this would be of assistance to the FRC.

Overlap with FSA Corporate Governance Rules

We agree with the FRC's intentions in this area.

Timing

The proposed timing is sensible.

¹At 31st December 2007