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Armstrong Bonham Carter's response to the Financial Reporting Council's consultation on the Revised UK Corporate Governance Code March 2010

Armstrong Bonham Carter (ABC) is delighted to provide some views on the proposed revisions to the Combined Code of Corporate Governance which is to be renamed the UK Corporate Governance Code (Code) as requested by the Financial Reporting Council (FRC).

ABC agrees with the FRC in its introduction when it asserts that the underlying good governance principles are accountability, transparency, objectivity and focus on the sustainable success of an entity over the long term. ABC would also agree with the comments that the chairman made in his preface but notes that whilst this latest iteration of the Code and its predecessors has done much to improve accountability, there has not been equivalent progress on transparency. All of Section C1 Corporate Reporting and, in particular, the new provision (C.1.2) will improve the current level of transparency but this section does not go far enough. Indeed, ABC would suggest that in point C.1.2 directors should be required to comply with the recommendations of the Accounting Standards Board's report on narrative reporting (published in October 2009) which proposes a much greater step forward in transparency.

This is essential in our view, as ABC has found that without proper transparency, the outside observer will find it impossible to evaluate the effectiveness of a board. Without improvement investors will be unable to engage more effectively unless they demand access to sufficient information, which in turn, may be judged to be price-sensitive. As a result of this, the institutional investors will be constrained from looking after their clients properly.

Second and of equal significance, ABC has found that without the discipline of real transparency, Boards allow opacity to drift into the Board and become less than rigorous in the leadership of their companies.

Third, ABC has also found that the Code in its efforts to be principle-based rather than prescriptive nurtures a degree of opacity. This may well be attractive if the minimum standards are achieved, but ABC is of the view that the existing and former versions of the Code lack a clear definition of what is an effective board. This has led to a wide range of definitions and records of board effectiveness, some of which (under proper scrutiny) would prove hard to justify whether shareholders interests are being managed at all. But companies have, to date, been able to conceal this if necessary (as there has been little requirement for comprehensive transparency either from the Code, legally or by investors).

If the FRC could further improve the level of transparency in reporting and define clearly what an effective board is, then, ABC believes there would be, not just an improvement in Board effectiveness across all Boards, but that all investors (both institutional and private) would be armed with the means of understanding the effectiveness of the Boards and thus be able to fully engage with them. Indeed without this, initiatives such as the Stewardship Code are likely to have limited impact.

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ABC has provided (as attached) a detailed breakdown of comments on each main and supporting principle and each provision for each Section and the Appendix of the new Code. However, ABC would like to highlight the following comments:

- (i) If the chairman is responsible for the effectiveness of the Board, then there is a potential conflict of interest if an external resource or internal resource were to be responsible for the evaluation. ABC would suggest that the Senior Independent Director is responsible for, at least, the periodic externally managed board review or even the annual board review.

- (ii) ABC is concerned if any director or chairman is subject to an annual vote. First in the absence of a definition of board effectiveness it would be hard for directors or the chairman to know how they would be assessed and thus how to perform. Second, and in particular, as the Code suggests the Board is responsible for the long term success of a company and not just the short term - how could an annual election take appropriate account of the long term record?

- (iii) On Risk, ABC believes the risk management systems should be subject to an annual review along with the internal controls and both should be subject to an externally managed review so as to ensure these systems match best practice within their industry or sector. ABC also believes risk appetites need to be disclosed so that shareholders understand that the extent of their capital is at risk. But whilst this term is commonly used, ABC is unaware of a widely accepted definition of this appetite.

- (iv) On remuneration, it remains unclear to ABC exactly how Remuneration Committees can demonstrate that they have set levels of remuneration for their executive directors that are 'no more than necessary' as suggested by the Code.

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Consultation on the Revised UK Corporate Governance Code

<u>Number</u>	<u>Change Description</u>	<u>ABC Comment</u>
Section A: Leadership	All suggested changes	All seems sensible
A.1	Main principle and supporting principles	Better definition of an effective board but ABC feels more is required particularly on aim, appreciation, strategy, plans and targets
A.1.1	No issue	No issue
A.1.2	Board committees	No issue
A.1.3	No change	No issue
A.2	Division of responsibilities	No issue
A.3	Main principle	No issues
	Supporting principle	Lack of comprehensive definition of board effectiveness means the suggested chairman's responsibilities are misleading
A.3.1	chairman's independence	No issue
A.4	NEDs	NEDs should be responsible for shareholders to ensure that through their efforts the board is effective. Thus to understand their role, the Code needs to fully define board effectiveness. The Supporting principles play down the vital role they hold in developing strategy in a rigorous manner
A.4.1	SID	No issue
A.4.2	No executive directors' appraisal of the chairman	As the chairman's job is to ensure the board is effective, Surely the SID should be responsible for the board performance evaluation? This would match current best practice
A.4.3	No change	No issue
Section B: Effectiveness		
B.1	The Composition of the Board-Main principle, Supporting principles	Good No issues

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B.1.1	Director's independence	No issues
B.2	Appointments to the Board-Main and supporting	Concerned about the opacity of 'appropriate'-a merit based approach focusing on the required skills, knowledge and experience to ensure the Company achieves its aim should be sufficient
B.2.1	No change	No issues
B.2.2	Skills, experience, independence and knowledge	I would have assumed that knowledge was included in experience
B.2.3	No change	No issues
B.2.4	No change	No issues
B.3	Commitment	What is 'sufficient'?-should be more than just attending all board and committee meetings!
B.3.1	No change	No issues
B.3.2	No change	No issues
B.3.3	No change	No issues
B.4	Development-Main and supporting	Agree
B.4.1	Induction	No issue
B.4.2	Personalised training	Agree
B.5	Information and Support-main and supporting	No issues
B.5.1	No change	No issues
B.5.2	No change	No issues
B.6	Evaluation-main and supporting	How do you test the rigour of an internally managed board review?
B.6.1	No change	No issues
B.6.2	External facilitation	Should be externally managed reporting to the SID otherwise there is a potential conflict of interest
B.6.3	No change	No issues
B.7	Main principle	No issue
B.7.1- 1st option	All directors should be subject to annual election	Not easy to establish suitable short term benchmarks for board effectiveness and will take away from directors' efforts on the longer term performance
B.7.2-1st option	Reasons for re-election	Boiler plating extensively used with little real rationale provided, thus hard to assess the validity of the recommendation by the fellow directors. Hence the

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		need for clear definition of board effectiveness
B.7.2-2 nd option	chairman subject to annual re-election	Again, risk of excessive short term focus on board and chairman's performance. First, that it is hard to define appropriate measures of success without clear definition of board effectiveness and second, will distract the chairman from long term board performance
B.7.2-2 nd option	Reasons for re-election	As above
Section C: Accountability	Main and supporting principle - Corporate reporting	Not enough information is provided on prospects - more information required on Aim/appreciation/strategy, annual plans and targets to fully evaluate a board. Current levels of transparency are not good enough
C.1.1	Responsibilities for reports and accounts	No issues
C.1.2	Business model and financial strategy	A good step in the right direction but not enough- ASB paper for October 09 is better but still not enough. (See covering note on transparency)
C.1.3	Going Concern reporting	No issues
C.2	Board responsibility for defining risk appetite and tolerance	But what is a risk appetite and tolerance? Should shareholders be aware of this appetite and thus should it be disclosed? How can shareholders engage properly with a board if they are unaware of the extent of the risk the Board is prepared to accept?
C.2.1	Board responsible for appropriate risk management systems	Agreed but how will this be evidenced other than by a boiler plate comment? These should be subject to an annual review like internal controls
C.2.2	Review of effectiveness of internal controls	No issues
C.3	Main principle-Formal and	As above, what is transparent

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	transparent arrangements for applying reporting, risk management and internal control principles	about risk appetite?
C.3.1	Audit committee establishment and composition	No issues
C.3.2	Main role and responsibility of Audit committee	No issues
C.3.3	Terms of reference availability and report of the Audit committee	No issues
C.3.4	Whistle Blowing process	No issues
C.3.5	Effectiveness of Internal Audit	This review should be subject to some external benchmarking
C.3.6	Audit committee's responsibility for relationship with external auditor	No issues
C.3.7	Assessment of Auditor's objectivity and independence	No issues
Section D: Remuneration	Remuneration-Main and supporting principles	Need some evidence that the 'no more than necessary' test is being passed. When is a target stretching?
D.1.1	See schedule A	No issues
D.1.2	Executive director's retention of NED fees	No issues
D.1.3	No performance element for NED fees	NEDs should receive and retain part of their fees in shares.
D.1.4	Termination Terms	Hard to reconcile employment contractual obligations with the investors' perception that poor performance is being rewarded
D.1.5	One year notice periods	No issues
D.2	Procedure for developing policy on executive remuneration-main and supporting principles	As above how is 'no more than necessary' evidenced?
D.2.1	Remcom establishment and composition	No issues
D.2.2	Setting remuneration for EDs, chairman and senior management	No issues
D.2.3	Remuneration of NEDs	To avoid NEDs setting their own fees, a sub-committee of the Board-chairman/CEO and EDs should, with advice

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		of the Remuneration consultants, set the fees
D.2.4	Shareholders should approve long term incentive schemes	No issues
Section E: Communication		
E.1	Dialogue with Shareholders- Main and Supporting principles	This requires disclosure of objectives which is consistently not done by listed companies. Agree that all directors should be aware of investors' attitudes
E.1.1	Chairman, SID and NEDs meeting with shareholders	Nice idea but very rarely practiced due to lack of investor demand
E.1.2	Understanding the views of shareholders	Boiler plate reporting unless companies are required to report on investor attitudes
E.2	Use of the AGM-Main principle	For communication to be effective, shareholders should be empowered-e.g. remuneration vote should be binding, not advisory. AGM's are of questionable value for both boards and shareholders. They need re-vamping
E.2.1	Voting	See cover note
E.2.2	Recording of votes	No issues
E.2.3	Attendance of all directors	No issues
E.2.4	Notice of AGM	No issue
Schedule A	Design of performance-related remuneration	Agreed