

# The **co-operative** asset management

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Via e-mail to: [codereview@frc.org.uk](mailto:codereview@frc.org.uk)

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Dear Chris,

## **Consultation on the Revised UK Corporate Governance Code Submission from The Co-operative Asset Management.**

The Co-operative Asset Management (TCAM) welcomes the opportunity to respond to the FRC's consultation on the revised UK Corporate Governance Code (the Code).

### **About TCAM**

TCAM considers that sound corporate governance in the companies in which it invests is of central importance to create and sustain long-term shareholder value. TCAM considers that it is the responsibility of institutional investors, such as ourselves, to act as owners of the companies in which they invest. We seek to maximise value from our investments by using our influence as shareholders, through engagement and the use of our voting rights, to further good corporate governance in investee companies.

### **Structure of the Code**

#### Section A

We support proposals to change the name of the 'Combined Code of Corporate Governance' to 'The UK Corporate Governance Code'.

We broadly support the division of Section A of the Code into Section A - "Leadership" and Section B - "Effectiveness".

#### Preamble

We support the tone of the preamble and feel it will be constructive for overseas companies who will soon be required to report for the first time in respect of the Code under the Listing Rules.

#### Section E

We disagree with the removal of this section and have no concerns with duplicating recommendations for institutional shareholders in both the Stewardship Code and the UK Corporate Governance Code, given the importance we place on institutional

investors acting as owners. We are currently preparing our response to the FRC's consultation on a new Stewardship Code for institutional investors.

## **Proposed changes to the content of the Code**

Main principles

### Section A

#### A.1

We particularly support the reference to directors' fiduciary and statutory duties in the Supporting Principles of A.1 in light of section 172 of the Companies Act (2006) which highlights that directors should have regard to (amongst other matters):

- the likely consequences of any decision in the long term;
- the need to foster the company's business relationships with suppliers, customers and others; and
- the impact of the company's operations on the community and the environment.

#### A.3

A key role to ensuring that the full knowledge and experience of board members is brought to bear on a given problem is the surfacing of relevant information by the chairman. This can be particularly challenging where there are board members with different styles of communication, yet it is boards with a wide array of backgrounds and perspectives and particularly gender balanced boards that are more likely to have a breadth of opinions to enable opportunities to be captured and risks mitigated. We therefore recommend a slight alteration to the text so that the supporting principle reads "... promote a culture of openness and debate by facilitating, with consideration given to different styles of communication, the effective contribution all directors, in particular non-executive directors, and ensuring constructive relations ...."

### Section B

#### B.1

In respect of the composition of the board we view gender balance as the most relevant example of diversity.

The value of broader representation on boards has long been recognised by academic studies.

A 2007 Catalyst study on board diversity and financial performance found that those companies with the highest proportion of women on their board of directors outperformed those with the lowest percentage of women 42% to 66% on the basis of three financial indicators (return on equity, return on sales and return on invested capital).<sup>1</sup> A study by Francoeur et al. in 2007 found that "firms operating in complex environments do generate positive and significant abnormal returns when they have

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<sup>1</sup> Catalyst, "The Bottom Line: Corporate Performance and Women's Representation on Boards," 2007.

a high proportion of women officers,”<sup>2</sup> whereas Adams and Ferriera found that firms facing greater variability in stock returns have lower female representation among board members.<sup>3</sup> Drawing upon the work of Catalyst, Kirshnan and Parsons found that the improved profitability of companies with greater proportions of women in their management structures is not a result of accounting manipulations, or earnings management, but rather that earnings quality is higher.<sup>4</sup> In addition to financial outperformance, there are potentially several other benefits associated with support for diversity, such as increased workforce morale, productivity, teamwork and support for organizational goals and values.

This value is now also being recognised by regulators. In 2002, for example, Norway passed a law requiring that 40 percent of board members be women. Spain and the Netherlands recently passed comparable laws (set to take effect in 2015), while France, Belgium, Germany and Sweden are considering similar legislation.

More recently, in the United States the Securities and Exchange Commission adopted a new rule on proxy disclosure that included, amongst other changes, a requirement that companies disclose whether, and if so how, their nominating committees consider the related issue of diversity in identifying board nominees.

We therefore wondered if consideration could be given to the impact of gender balance in this section. This could be achieved through altering the text of the main principle to add backgrounds and perspectives to the list of factors relevant to board composition, noting at the end the particular relevance of gender balance.

## B.2

We welcome the reference in supporting principle B.2 to potential restrictions of the pool of talent. One key difficulty is that structural blocks are generally very difficult for members of over-represented groups to spot. We therefore suggest that the words “or inadvertently” are inserted so that the text reads: “objective criteria that do not inappropriately or inadvertently restrict the talent pool”.

Provision B.2.2 highlights the balance of skills, experience, independence and knowledge on the board and we feel that there should be reference to gender balance made here for the reasons given above.

## B.3

In respect of Main Principle B.3 we take into account the number of additional board level positions a director holds when taking a view on the re-election of directors. Consequently we welcome the provision.

A number of FTSE 100 companies include reputation, environmental, social and governance risks as part of their induction program for directors joining the board. We consider this good practice to mitigate risks and would welcome reference to this in one of the supporting principles of provisions underpinning Main Principle B.4.

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<sup>2</sup> Francoeur et al. “Gender Diversity in Corporate Governance and Top Management.” *Journal of Business Ethics* (2008) 81:83-85.

<sup>3</sup> Renee N. Adams and Daniel Ferriera, “Gender Diversity in the Boardroom,” August 2004.

<sup>4</sup> Gopal V. Krishnan and Linda M. Parsons, “Getting to the Bottom Line: An exploration of Gender and Earnings Quality,” George Mason University, no date.

#### B.4

We support the additional supporting principle “To function effectively all directors need appropriate knowledge of the company and access to its operations and staff.” Further to this we believe non-executives should be able and actively encouraged to gain direct experience of the company’s main activities free of inappropriate executive supervision.

#### B.6

We support the reference in Provision B.6.2 in respect of external board evaluation and consider there should be disclosure in the Annual Report and Accounts on the matters arising from such an evaluation. We further welcome the reference to potential conflicts of interests arising from the use of consultants who have other connections with the company. We have concerns in respect of the three year recommendation that a lot can happen in a three year time period and would be more comfortable with a shorter time frame recommendation. However, we remain mindful of the potential interference on board proceedings by the frequent presence of external facilitations.

#### B.7

As per our response to the Walker Review we strongly support the annual re-election of all directors alongside the proposal to include accompanying papers providing sufficient biographical detail on non-executives to allow shareholders to take an informed view at the time of re-election.

A small number of companies in the FTSE100 are in the vanguard of putting forward all their directors for annual re-election and do not appear to have suffered negative consequences. We believe annual re-election will reinforce accountability for directors' actions.

### Section C

We feel the duties of directors, outlined in the Companies Act (2006), to stakeholders in addition to shareholders extend to reporting considerations. We therefore suggest supplementing Section C with a new provision that outlines a requirement to report on relations with other stakeholders. This reporting would be in line with the previously references section 172 of the Companies Act (2006) and would help investors understand any reputation risks to the company stemming from stakeholders and the measures being taken to mitigate these risks.

In respect of C.2.2., we believe that explicit mention of risks to reputation relating to the environment, and social stakeholders should be included in the risk management and internal controls systems. Many leading companies already report on this as part of their Principal Risks and Uncertainties section of the Annual Report and Accounts.

Provision C.3.1 references that at least one member of the audit committee has recent and relevant financial experience. We feel this number should be increased to add credibility and enhance the ability of the audit committee to scrutinise. Furthermore, we believe that the recent and relevant financial experience should be detailed in the biographies of non-executives so that shareholder can make an informed decision as to the re-election of audit committee members.

## Section D

### D.1

We welcome the reference to linking performance-related elements of executive remuneration to the long-term success of the company. Furthermore, we welcome the inclusion in Schedule A of non-financial performance measures. In the course of our engagement with companies and remuneration consultants we often press for the inclusion of non-financial measures that encompass environmental, social and governance factors or praise the increasing number of companies who have already taken this step, primarily in their annual bonus.

We would welcome reference to the use of a underpinning performance measures in incentive schemes, as well as the avoidance of distorting metrics, to assist in producing balanced, risk-adjusted outcomes.

In addition, we are of the view that remuneration incentives must have a fundamental link to risk policies and systems to mitigate the potential for perverse incentivisation.

We are supportive of both hard and soft clawback provisions in circumstances of mis-statement and misconduct.

## Section E

### E.2

Whilst we understand the Companies Act (2006) permits the show of hands, poll voting is now legally mandated in many countries and is our preferred method of canvassing opinion from shareholders. Nearly 70% of FTSE 100 companies have voluntarily adopted full poll voting and we would like to see this extended to all listed companies. Furthermore, we encourage companies to develop transparent means of announcing or publishing results after the meeting.

Thank you once again for inviting The Co-operative Asset Management to participate in this consultation.

Yours sincerely,



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