



Governance for Owners

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Dear Mr Hodge

Financial Reporting Council Consultation on the Revised UK Corporate Governance Code

Thank you for the opportunity to submit comments in relation to your review of the UK Corporate Governance Code. By way of background, and to put our comments in context, Governance for Owners (GO) is an independent partnership dedicated to adding long-term value to clients' equity holdings through relational investing and active share ownership.

As we have expressed in previous submissions, we are strong supporters of the Combined Code as the market standard of sound corporate governance practice in the UK. We view "comply or explain" as integral to the effective functioning of the Code, as it enables companies and shareholders to agree mutually acceptable compromises when necessary. A "soft law" approach, we believe, is both more cost effective and more readily adaptable to evolving market conditions. We are pleased, therefore, that you have concluded that the Code "remains broadly fit for purpose."

In terms of overall tone, we strongly agree with the emphasis in the introductory section on board behaviour and adherence with the spirit of the Code. Through our extensive analysis of, and interactions with, boards as active owners, we can attest that while conformance with structural and procedural rules is important, behaviour is the most critical determinant of board effectiveness.

In furtherance of the above, we believe that it would be helpful for the Code to elaborate how to bring about desirable behaviour in the boardroom. For example, guidance could be provided on such matters as the facilitation role and style of the chairman and the deliberation and decision-making processes of the board.

We also found helpful your guidance that chairmen "report personally in their annual statements how the principles relating to the role and effectiveness of the board have been applied." We feel that a personal touch and candour in communication will go a long way toward rebuilding trust between boards and investors and achieving the

“virtuous upward spiral in attitudes to the Code” critical to its continued durability and effectiveness.

We support changing the name of the Combined Code to the UK Corporate Governance Code and agree that it will promote understanding of its standard-bearer status in the UK, particularly among foreign investors and companies. We also welcome the changes made to the overall structure of the Code and believe that the proposed Code has accorded priority to most of the essential matters. However, as detailed below, the restructuring of the Code has resulted in certain sections appearing to be disjointed.

We are highly supportive of the emphasis in A.1 that boards are collectively responsible for the *long-term* success of the company and, correspondingly, in D.1 that remuneration arrangements should also promote the *long-term* success of the company. While these are not new concepts, the proposed language provides a helpful reminder to boards, management, shareholders, and other involved parties.

We welcome your decision to elevate three supporting principles – relating to the roles of the chairman (A.3) and non-executive directors (A.4) and time commitment (B.3) – to main principles. However, we would recommend amendments to the proposed language. With respect to the supporting principle in A.3, we would suggest that the phrase “discussion on strategic issues” be replaced by “full consideration of strategic issues,” as the latter stresses both the opportunity for debate as well as thoroughness and thoughtfulness of discussion. Furthermore, the supporting principles in A.4 do not appear to follow the main principle (i.e., they do not pertain to challenging or developing proposals on strategy), and the code provisions appear somewhat at odds with the main principle.

We very much support the balanced emphasis in B.1 on director skills, experience, independence, and knowledge. We therefore find it somewhat puzzling and incongruent that the corresponding code provisions focus only on director independence. We would suggest that the code provisions – in either B.1 or B.4 – include a requirement for boards to discuss in the annual report the skills, experience, and knowledge of their members, particularly efforts made by the company to enhance director competence.

We are in agreement with your intention to ensure that boards recruit directors from a broad pool of talent. The proposed language in the supporting principles of B.2, however, focuses on not restricting the size of the present talent pool. If you believe that boards should *expand* the pool from which directors are recruited – as many investors do – a different phraseology would be required.

In our view, one topic deserving much greater attention is the board’s role in succession planning. Effective succession planning underpins the ability of the board to discharge one of its most important responsibilities, the hiring and – when necessary – firing of the chief executive. In recent years, we have witnessed in the UK several high-profile examples where poor succession management by the board led to serious disruptions in the transition of board and management leadership and, more critically, impacted the running of the business. Accordingly, we believe that

succession planning should be elevated – perhaps into a main principle – rather than subsumed under a general discussion of appointments to the board in B.2. Given that succession planning appears to be an area of weakness for many boards, we believe that the Code should elaborate the key elements of effective succession planning – such as the role of the chairman, general approaches, and timing – and require boards to report their involvement and activities in this area.

We strongly agree with the emphasis in B.4 on director knowledge and, in this regard, on the importance of directors having access to company operations and staff as well as a personalized approach to training and development. In our view, a key contributor to board independence is a high level of familiarity with the company, as such knowledge puts non-executive directors in a strong position to constructively challenge management. Further, we believe that knowledge gained through interactive, experiential activities – such as site visits – will likely yield deeper understanding and insights than information acquired through passive absorption, such as by perusing written reports. As investors, we regularly visit the facilities of our investee companies to strengthen our understanding of the business. Our only suggestion in this area is that an affirmative obligation be imposed on individual directors to proactively acquire the requisite knowledge, rather than waiting for it to be supplied by the chairman or management.

We support the proposed code provision in B.6 advocating the use of external facilitators in board evaluation and agree that every three years is the appropriate frequency. We believe that external facilitators can help to surface critical people and behavioural issues that could otherwise remain undetected if other mechanisms, such as surveys or internally-conducted interviews, were employed. Furthermore, external facilitators can assist in disseminating good boardroom practices. Boards, however, should avoid appointing external facilitators who may have a natural incentive to increase board turnover.

From the perspective of investors, it would be extremely helpful for boards to disclose – pursuant to B.6.1 – not only how an evaluation was conducted but also the overall findings and remedial actions taken. While some boards discuss candidly the shortcomings surfaced in board evaluation and the corrective measures adopted, many boards continue to utilise boilerplate language to communicate evaluation findings.

Given the ability of shareholders in UK companies to requisition a general meeting at any time to remove underperforming directors, we generally believe that the standard three-year board term strikes the appropriate balance between board continuity and shareholder protection. However, due to the heightened responsibilities of board, audit committee, and remuneration committee chairmen, we believe consideration should be given to annual re-election of the individuals occupying these roles.

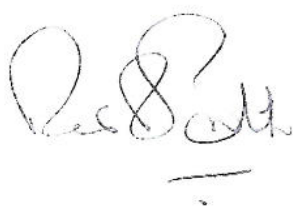
While we welcome the increased emphasis on risk management in C.2, we believe that the Code should provide further guidance on when supplementary risk management mechanisms – such as a separate risk committee – would be appropriate. Furthermore, the code provisions should include a requirement for boards to report on risk management oversight (beyond internal controls).

We agree fully with the proposed changes to Schedule A highlighting the importance of risk-adjusted bonus awards and compatibility between remuneration incentives and risk policies and systems.

Regarding the medium of disclosure, we would prefer that the requirements of the Code be reported in the annual report, with supporting information – such as terms of reference – be made available on the company's website.

We hope you find these comments helpful. Please contact us if you would like to discuss any of the points made above.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Peter Butler". The signature is fluid and cursive, with a horizontal line underneath.

Peter Butler
Chief Executive and Founding Partner

A handwritten signature in black ink, appearing to read "Simon Wong". The signature is fluid and cursive, with a horizontal line underneath.

Simon Wong
Partner