17 February 2010

Our ref: ICAEW Rep 07/10

Your ref: Code Review

Mr Chris Hodge
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Financial Reporting Council
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By email: codereview@frc.org.uk

Dear Chris

CONSULTATION ON THE REVISED UK CORPORATE GOVERNANCE CODE

We welcome the opportunity to comment on the *Consultation on the Revised UK Corporate Governance Code* published by the Financial Reporting Council (FRC) in December 2009.

ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the FRC. As a world leading professional accountancy body, we provide leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

ICAEW has participated in consultations throughout the development of the Combined Code and plays an active role in corporate governance thinking in the UK and internationally.

This response has been drafted after consultation with the ICAEW Corporate Governance Committee which includes representatives from the business and investment communities. We have also received input from our Special Interest Group representing non-executive directors (NEDs) in particular in respect of those areas which would impact NEDs most directly. We have highlighted some general observations below in response to the main consultation issues.

The new structure and preamble to the UK Corporate Governance Code (Code): do they appropriately reinforce the message about the way the Code should be viewed and applied?

In our opinion the Chairman's preface strikes the right balance. It is a useful reminder of the limitations of the Code and the continuing need for high quality leadership and in highlighting the effort involved in running boards. The emphasis on good communication is particularly relevant and a welcome introduction. The statement that the Chairman's Preface is an integral part of the Code is a useful addition and helpful to users of the Code.

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Paragraph 7 is especially useful in encouraging chairmen to report personally in their annual statements how the principles relating to the role and effectiveness of the board have been applied. This may assist in producing clearer and more meaningful disclosures and explanations and may be a counterbalance to the over-use of boiler-plate formulaic disclosures. We suggest that the use of the word ‘fungus’ in relation to boiler-plating is reconsidered: a reference to ‘prolific growth of boiler-plating in corporate reporting’ may be more appropriate.

The separate section on ‘Comply or Explain’ is also useful in reminding both boards and shareholders what their key responsibilities are and encourages both companies and investors away from mechanistic approaches to compliance and governance reporting. This is both encouraging and helpful and is useful in setting out responsibilities clearly and reinforces the need for satisfactory engagement. We understand and agree that changing the terminology from ‘comply or explain’ to ‘apply or explain’ would not effect a change in behaviour and respect the decision to maintain the current terminology.

In relation to institutional investors we will separately respond to the FRC’s consultation on a Stewardship Code for institutional investors issued on 19 January 2010. This will be critical to the overall success of the revised Code and ultimately the governance reviews undertaken in 2009.

Paragraph 5 in the ‘Comply or Explain’ section dealing with smaller listed companies is particularly welcome and the direction to other relevant codes is both useful and helpful.

The existing structure is logical and gives users of the Code greater guidance on the principles. In particular the dividing of ‘Leadership’ and ‘Effectiveness’ is a very effective way of making distinct points and directing more and considered thought to separate principles. As a result, the disclosures are more likely to be fuller and more meaningful.

In our opinion the proposed structural changes succeed in the intention to reinforce distinct messages about the way the Code should be viewed and applied.

We understand the logic of deleting existing Schedule B on the liability of non-executive directors. However, we urge that when the Higgs Guidance has been reviewed by the Higgs review steering group and updated by the Institute of Chartered Secretaries and Administrators (ICSA) that the appropriate cross references are available on the FRC website so that users (especially overseas ones) can find information that they may need quickly and from one website. Redirection on the FRC’s website for overseas companies and for smaller listed companies to other relevant websites and codes would be extremely useful. While we agree with the FRC that guidance in respect of the liability of NEDs is available elsewhere, we urge the FRC to ensure that the review of the Higgs Guidance specifically considers the increase in concerns held by NEDs in this area.

We acknowledge that the FRC does not bear responsibility for the ‘annotated codes’ that are produced by other bodies, such as the annotated codes in respect of building societies and mutual insurers. We are aware, however, that there has often been delay in the revision of annotated codes by the relevant bodies which has led to inconsistent practices. We ask the FRC to encourage, where possible, the timely revision of these codes.

Proposed changes to the content of the Code

We agree with the proposal made as a result of the work of the Treasury Select Committee to include a provision requiring disclosure of the company’s business model and overall financial strategy. Reference has already been made to the increase in boiler-plating and we are anxious that this provision does not add further to this. We feel that there is a risk that bland statements may be used by companies that will obfuscate rather than clarify the issues surrounding the performance of the company. Additional guidance in respect of this proposed provision would be welcome.

We understand the rationale behind the amended wording of Principle C.2. We would like to draw attention to the work undertaken in recent years to establish technical definitions for the terms ‘risk appetite’ and ‘risk tolerance’ in the financial services sector. These terms have taken some time for financial institutions to understand, interpret and accept, and it should not be assumed that non-financial institutions will necessarily adopt these terms in a uniform manner – potentially leading to large inconsistencies in the way in which this principle is applied. While we understand and support the rationale behind the change, we recommend that where technical terms have been adopted that are in everyday use in some sectors and not in others, care is taken to ensure that all companies are able to interpret these terms in a meaningful and uniform manner. The work involved in achieving this may complicate the limited review of the Turnbull Guidance that the FRC is planning and, given our past role in developing and updating that guidance, we would be pleased to provide further input and support to your review.

The two proposed options on re-election of directors (Provisions B.7.1 and B.7.2)

We understand that there is strong support for the annual election of the chairman of the board. However, we urge the FRC to give full consideration to the utility of annual elections of company chairmen and the potential implications that may flow from such a change. As we have previously commented, we are not convinced that the annual re-election of the chairman is, in and of itself, a progressive or necessary proposal. There is a slight but nonetheless real concern that the proposed development to annually re-elect chairmen may weaken the principles of collegiality and joint and several liability that underpin current arrangements. In addition, it could be argued that annual re-election of the chairman could be contrary to the long-term interests of all shareholders. It may also potentially reduce the impact and usefulness of the new provision to have board evaluations facilitated externally at least every three years.

We do not support the routine annual re-election of all directors or the annual re-election of the chairs of the main board committees. We believe that annual re-elections of the whole board could be counter-productive and potentially damaging to the continuity of boards.

Both the annual election of the chairman of the board and the annual election of all directors are comparatively short-termist measures which seem to be at odds with the need to embed a long-term approach to the success of the business which many of the other proposed amendments seek to achieve.

Whether companies should be able to take advantage of the flexibility allowed under section 7.2 of the Disclosure and Transparency Rules (DTRs) to allow them the choice of whether to put the corporate governance statement on the website or include it in the annual report

We welcome the fact that the FRC does not propose to remove any of the current disclosure requirements in the Code.

Companies should be free to take advantage of the flexibility allowed under section 7.2 of the DTRs to be able to choose whether to put their full corporate governance statement on the website or include it in their annual report.

With annual reports becoming longer and more complex, permitting companies the flexibility of including full information on websites and edited versions in the full accounts would be a progressive move.

Any cost implications of any of the changes proposed

There will be additional costs incurred in obtaining an external board evaluation at least every three years for many companies. While we welcome the proposal to have an external board evaluation at least every three years, we particularily welcome the work being undertaken by the Institute of Directors and ICSA on best practice guidance on the undertaking of externally facilitated board evaluations.

We hope that our comments are useful. Please contact me or Vanessa Jones (Corporate Governance Manager) should you wish to discuss any of the points raised in this response in more detail.

Yours sincerely

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