

Chris Hodge
Financial Reporting Council
Submitted by email to

codereview@frc.org.uk

5 March 2010

ICSA response to the FRC's Consultation on the Revised UK Corporate Governance Code

Dear Chris

As with our previous submissions dated 28 May and 1 October 2009, this response has been informed by consultation with a specially constituted working group of company secretaries and the ICSA Company Secretaries Forum which has 30 members, with strong representation from the FTSE 100.

We are pleased to be able to confirm that overall we welcome the draft Code and the approach that has been taken. The only item of content on which we have serious reservations about the direction the Code is taking relates to director re-election which we deal with below.

1. Proposed changes to the structure of the Code

We welcome the clarity of meaning in the proposed naming of the Code as 'The UK Corporate Governance Code'. While understanding that the FRC does not have jurisdiction in Ireland, we are supportive of discussions with the Irish Stock Exchange (ISE) to find a solution which reflects the fact that the rules of the ISE require Irish companies to comply or explain against the Code, including giving consideration to the suggestion made by certain of our Irish membership who work within major Irish companies that the Code be named 'The UK and Ireland Corporate Governance Code'.

We welcome all the structural changes and particularly support:

- the prominence given, in the introductory sections, to:
 - (a) the importance of board behaviour to good governance; and
 - (b) the change in emphasis such that non-compliance with a provision should be more acceptable in the future, where a reasoned explanation is provided



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- the additional and upgraded main principles in Sections A, B and C which we believe will support improved boardroom behaviours and transparency for shareholders through the related disclosure and communication
- your objective to reduce boilerplate reporting

2. Proposed changes to the content of the Code

In this section of our response we have only commented on those areas of the draft Code where we take a differing view, or suggest a revision to the wording. Where we make no comment it is an indication of support for, or acceptance of, the position reached in the draft.

Governance and the Code

The definition of corporate governance on page 11 reads:

"..Corporate governance is therefore about what the board of a company does and is to be distinguished from the day to day operational management of the company by full-time executives."

While good corporate governance is a board imperative, by virtue of the board sitting at the apex of the company, we feel that the proposed wording inadequately reflects the need for appropriate decision-making governance practices to be cascaded throughout the organisation. By way of example, the governance of all risk within organisations cannot be carried out solely by the board and the governance structure should include the cascading of delegated authorities to managers at all levels.

It is suggested that the definition should be altered to read:

"..Corporate governance is therefore about what the board of a company does, and how it expects important decisions to be made throughout the organisation; and is to be distinguished from the day to day operational management of the company by full-time executives."

Chairman's Preface

Under paragraph 7, where you state 'it is hoped' that chairmen will choose to report personally how the principles in the new Sections A and B have been applied, we would recommend strengthening this to 'it is expected'.

A.4.1

We consider that the new wording on the role of the SID, that he is 'to provide a sounding board for the chairman and to serve as an intermediary for the other directors when necessary' could be interpreted too easily in a way that makes it over-prescriptive. We believe that the chairman should not be so constrained in his choice and that, in cases of severe internal dissent, the chairman may want to deal with the matter directly with the other directors. At the very least, varying circumstances may require different approaches and we suggest it would be better to deal with the role of the SID in the guidance being prepared by ICSA rather than in a Code provision.

B.1, Supporting principles

In the second paragraph the draft Code states that:

“The board should include a strong presence of executive and non-executive directors...such that no individual or small group of individuals can dominate the board’s decision taking.”

We suggest replacing ‘a strong presence’ with ‘an appropriate combination’. The sentence would still convey the message about the importance of avoiding a dominant force, but would not raise the subjective question of what is meant by a ‘strong’ presence.

B.1.1

Although we recognise that the new main principle in B1 is helpful in providing a clearer context for provision B.1.1 on independence, we reiterate our preference for the reference to nine years to be deleted. The arguments are outlined in our October submission (see Section B, penultimate paragraph). In essence we view this criterion as an arbitrary measure, with no automatic relevance to the determination of independence, likely to result in unfortunate pressure from box-tickers. We do appreciate the importance of regular board refreshment, but this is dealt with adequately in B.2.

B.7.1

On director re-election, our strongly preferred route is to maintain the status quo of triennial elections, for the reasons given in our October submission. This view is held almost unanimously by the members of the ICSA Company Secretaries Forum and, in many cases, also reflects the unanimous views of their respective boards.

We believe that this is consistent with the addition of “long-term” in Main Principle 1 and the FRC’s desire, evident from many other proposed amendments to the Code, for improved board knowledge of the business and its risks, which can only be gained through continuity of personnel and length of each director’s tenure.

Although we recognise that in the consultation document we are being asked to make a positive selection, there is simply insufficient consensus amongst our membership positively to support either annual re-election of the entire board, or of the chairman. If constrained by the options you propose, it may be a solution to offer companies a choice in the Code of either adopting annual re-election of the entire board or annual re-election of the chairman (while offering a choice is somehow more palatable, we do note that in practice this has the same effect as a single provision requiring annual re-election of the chairman, since a provision requiring annual re-election of the chairman would automatically be complied with should a company choose to adopt annual re-election of the entire board instead). We also note that Sir David Walker recommended chairman annual re-election for BOFIs, in preference to entire board re-election.

However, as stated above, our strong preference is for the status quo to be maintained. Many of our members simply do not believe that a strong enough case has been made on either basis to justify a new provision in

the Code on annual re-election, which they believe for many boards is likely to drive short-term decision-making. There are after all many effective routes available for shareholders who are unhappy with the performance of specific directors eg discussions via the chairman and/or the SID, as well as, in the final resort, the relatively low shareholding thresholds required to requisition resolutions, or other matters to be raised, as part of the business of the shareholders' meeting.

In view of these rights, many of our consultees consider it to be inappropriate to require annual re-election. The votes cast for and against a routine re-election of directors or a chairman could fluctuate year by year for no real reason, not indicating any governance weakness. Thus, even as a signalling mechanism, the process would be deficient. However, such fluctuations would be open to negative interpretation by journalists and box-tickers.

We understand the argument that the FRC's proposal in B.7.1 would be a provision, with which companies could choose not to comply (subject to advancing a reasoned explanation). It is usually the case, however, that a provision would reflect a consensus view of best practice for the majority of companies (even if there were reasons for a minority of companies reasonably and justifiably not to comply). On this issue we face the unusual situation of strongly opposing views being held by different companies over which model would best enhance good governance and, see no evidence of the broad consensus necessary, in our view, for a new provision on director re-election.

There may be examples where a small number of very large companies have moved to annual re-election, but this does not mean there is a consensus that this is appropriate for all companies. If this practice gains any momentum, it should be allowed to develop naturally and should not be forced by inclusion in the revised Code.

C.2

The main principle in the draft Code currently reads:

"The board is responsible for defining the company's risk appetite and tolerance".

We prefer 'determining' to 'defining'.

D.1.3

In the third sentence of this paragraph, we suggest repeating the phrase 'or other performance related elements' so that these awards also require shareholder approval.

The amended paragraph would read:

"Remuneration for non-executive directors should not include share options or other performance-related elements. If, exceptionally, options are granted or performance-related elements awarded, shareholder approval should be sought in advance. Any shares acquired by the exercise of options should be held until at least one year after the non-executive director leaves the board."

Further, with reference to the last sentence in the above quote, we question whether the company should be held accountable, through the Code, for the actions of a director once the director has left the board.

E.1

In the supporting principle we suggest replacing 'understand' with 'are made aware of', such that the sentence would read:

"Whilst recognising that most shareholder contact is with the chief executive and finance director, the chairman should ensure that all directors are made aware of their major shareholders' issues and concerns."

E.1.1

We think that the meaning of the phrase 'existing meetings' is unclear. We would suggest amending the third sentence as follows:

"Non-executive directors should be offered the opportunity to attend the regular meetings that take place with major shareholders and should expect to attend meetings if requested by major shareholders."

Schedule A

In Paragraph 5 we question whether non-financial performance metrics sit well with long-term incentive schemes because they are less likely to remain relevant over long periods, during which time there may well be changes of strategy, whereas financial performance metrics are more enduring (it is always an objective to achieve a good return on equity). We therefore suggest this reference should be omitted from the Code and be left instead to the ABI and NAPF to consider in any update to their remuneration guidelines.

The question has also been raised whether 'risk adjusting' the criteria for paying bonuses has much meaning outside of the financial services industry. We understand that a number of remuneration consultants regard this as exceedingly challenging, in practical terms, to implement beyond that sector.

3. Disclosure requirements

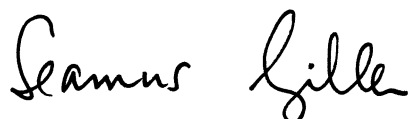
We do not think companies should be given a choice of whether to put the corporate governance statement on the website or in the annual report. We believe that singling out this section in this way risks downgrading its importance. (We are generally supportive of course of e-communications in terms of users being able to access the annual report in its entirety on a website.)

4. Costs and benefits

While it is recognised that there will be increased costs for some companies in relation to the requirements for triennial external board evaluation and possibly the annual re-election of all directors, our membership has not raised any serious cost concerns with us during the review of your proposals.

We would be glad to expand on any of these points should you like to discuss any of them further.

Yours sincerely

A handwritten signature in black ink that reads "Seamus Gillen". The signature is written in a cursive, flowing style.

Seamus Gillen
Director of Policy