

## **NAPF Comments on the proposed changes to the Combined Code**

The NAPF welcomes the opportunity to comment on the proposed changes to the Combined Code. Overall we believe this review has led to significant changes to the way in which companies and investors are asked to apply it. If its provisions are widely adopted we should see a material change in corporate governance in the UK. The NAPF intends to update its Policy to take account of the new Code.

### ***Responses***

The FRC intends to change the name of the Code to “The UK Corporate Governance Code”.

*NAPF: agreed.*

The FRC proposes significant structural changes to Section A of the Code with the intention of giving more prominence to some of the factors that underpin an effective board.

*NAPF: we welcome this emphasis on board effectiveness, which should lead to greater confidence on the part of investors in company boards.*

Other proposed structural changes include updating the structure and content of the Preamble to the Code

*NAPF: we think the revised Preamble provides valuable context for the Code as a whole. We suggest it could usefully be referred to in company corporate governance reports.*

The FRC proposes to remove the former Section E, which was addressed to institutional shareholders, subject to sufficient progress being made by the time the revised Code is issued on implementation of a Stewardship Code for institutional investors.

*NAPF: We agree with the approach, but note that some investors would like to see some ongoing reference to the role of institutional shareholders in the Code. It should be possible to accommodate that suggestion.*

The FRC also proposes to delete the previous Schedule B on the liability of non-executive directors.

*NAPF: agreed*

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

As part of the proposed changes to Section A of the Code three supporting principles have been upgraded to main principle.

*NAPF: agreed. The increased emphasis on the role of the chairman is particularly welcome.*

In addition former Main Principle A.5 on information and development has been divided into two separate principles.

*NAPF: agreed.*

Two proposed new main principles have been added in response to issues raised during the review. The first is new Principle B.1 which states that the board should have the appropriate balance of skills, experience, independence and knowledge of the company. The second proposed new principle makes explicit the board's responsibility for overseeing risk management and setting the company's risk appetite and tolerance.

*NAPF: agreed*

In addition, drafting changes have been proposed to the main principle on the role of the board to clarify that the board is responsible for the longterm success of the company (Principle A.1). The supporting principles on the level and composition of remuneration have also been amended to make explicit reference to the long-term success of the company (new Principle D.1). Finally, the supporting principles on appointments to the board (new Principle B.2) have been amended to encourage boards to consider candidates from a broad talent pool and to incorporate the existing principle that there should be progressive refreshing of the board.

*NAPF: agreed*

## **Changes to the provisions**

The FRC proposes a small number of new provisions, which will be subject to the "comply or explain" requirement in the Listing Rules. These are:

- The chairman should agree and regularly review a personalized approach to training and development with each director (new Provision B.4.2).
- Evaluation of the board should be externally facilitated at least every three years, and any other connections between external consultants and the company disclosed (new Provision B.6.2)
- The board should satisfy itself that appropriate systems are in place to identify, evaluate and manage the significant risks faced by the company (new Provision C.2.1)
- The annual report should include an explanation of the company's business model and overall financial strategy (new Provision C.1.2)

*NAPF: agreed. We regard all of the above as best practice and their inclusion will encourage the adoption of higher standards of conduct and disclosure.*

Some changes to the wording of other provisions are also proposed:

- Additional wording is proposed in the provision on the role of the senior independent director to reflect Sir David Walker's recommendation on this subject (new Provision A.4.1)
- The FRC also proposes to amend the provisions relating to the reelection of directors (new Provisions B.7.1 and B.7.2).

*NAPF: In our last submission to the FRC we stated that on balance member's favoured annual elections. Our latest sample of member views points towards a balance in favour of retaining the status quo and reserving annual re-elections for specific circumstances, such as after a major capital-raising. There seems to be little appetite for the halfway house of the chairman and committee chairmen standing each year.*

The FRC proposes some changes to the provisions relating to remuneration in the new Section D and Schedule A to reflect developments in good practice and the recommendations made by the European Commission and Sir David Walker.

*NAPF: agreed. We also remain of the view that senior executive remuneration is generally too complicated to be effective. We would add that recent evidence is that policy is changed too often for it to be seen as genuinely long term.*

A number of changes have also been proposed to the new Section E on relations with shareholders (now titled "Communication"). These include: amending the heading of the new Section E.1 to clarify that engagement with private shareholders, who might also form a major part of the share register in some companies, is encouraged; amending the new Provision E.1.1 to clarify that compliance can be achieved without needing to set up separate meetings for non-executive directors; and clarifying the new Provision E.2.2 on votes taken on a show of hands.

*NAPF: agreed. We note concerns that a show of hands may seem to be preferable to a poll and would wish to see companies encouraged to adopt all poll voting.*

Finally, there are a small number of other minor drafting amendments that the FRC considers do not change the meaning of the Code. These have been indicated in the text.

*NAPF: we agree with the broad approach being adopted. We suggest that any simplification to the corporate governance report should be considered in the context of the wider aim to make annual reports more relevant and accessible to a wide range of investors.*