



Consultation on the Revised UK Corporate Governance Code

PIRC response

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Introduction

We welcome the opportunity to respond to the consultation on the review of progress. Pensions & Investment Research Consultants Ltd (PIRC) has been an independent adviser to pension funds and other institutional investors for over 20 years. PIRC's clients have combined assets in excess of £1.5 trillion and include some of the largest pension funds, investment management companies and insurance companies in the UK and overseas. Together, they comprise a diverse group of institutional investors with long-term liabilities and broad fiduciary duties.

PIRC undertakes company research on corporate governance and corporate social responsibility issues at public companies, and provides advice to clients on proxy voting strategies and other active shareholder initiatives. Our comments are based on two decades of practical experience, which inform our views on the strengths and weaknesses of disclosures, governance structures, and the interaction of statute, regulation and codes of practice.

Proposed changes to the name and structure of the Code

PIRC believes that the suggested new title of 'the UK Corporate Governance Code' provides a much clearer summary of the content and function of the document and we strongly support it.

We have no concerns about the proposed structural changes to the Code. We provide brief comments on the removal of former Section E at the end of this submission.

Annual election of all directors vs annual election of the chair

PIRC considers that this is the most significant question raised in the consultation and, as you will be aware from previous submissions, we favour annual election for all directors. As we set out in our submission of October 2009, a small number of UK-listed companies already have annual elections in place and do not appear to face any particular problems.

However, we are aware of the perception that many UK companies are opposed to the idea of annual elections and therefore we have sought to engage with them over this issue to ascertain more detailed views. In January this year PIRC sent a letter to the FTSE350 setting out our view in favour of annual elections, but also inviting a response from companies. In recent weeks we have received a steady stream of replies. To state the obvious, there is a wide spectrum of opinion on this issue on the part of companies. Some are overtly hostile to the proposal, others are clearly comfortable with it, and some are actively considering implementing annual elections.

Based on the responses we have received from companies, the principal objection to

annual elections is the possibility that this could, in an extreme case, result in the entire board being voted off. This is a concern which should not be lightly dismissed, but we believe that there are strong counterarguments.

First, the actual level of shareholder opposition to directors remains very small. In the whole of 2009, a year in which shareholders were in a more combative mood than usual, the average vote against a director of a FTSE All Share company was 2%. It would take a very significant shift in shareholder voting behaviour for the vast majority of boards to face losing a single director, let alone all of them. Second, as the recent Mitchells & Butler case demonstrates, if investors really want to dislodge board members there are ways to do so without annual elections even being in place.

Notably we have picked up little evidence from companies' responses that they believe annual elections could result in an unduly short-termist outlook on the part of directors, and this seems to us to be an unlikely outcome. As previous voting behaviour suggests, it seems improbable that the vast majority of directors will face repeated pressure from shareholders over their re-election. And it requires a further leap to make predictions about how, if at all, this would affect board members' decision-making.

Where a director *does* face a serious threat of being ousted there are likely to have been significant previous events, and votes against their re-election may well be a reasonable response on the part of shareholders. We must recognise that the provision of a vote on the appointment of directors is to provide accountability to shareholders, and on occasion this means it will be used to seek their removal. Ultimately then any argument against annual elections is in essence an attempt to mitigate the effectiveness of this particular form of accountability.

Remuneration

We would reiterate two points we have made in a number of previous submissions.

First, the guidance (expressed as a supporting principle in the current consultation) that companies should be sensitive to pay and conditions elsewhere in the company is, in our view, ignored by most companies. In addition what little commentary there is in relation to this guidance is typically boilerplate reporting. Therefore we strongly urge the FRC to consider further guidance on how companies might provide evidence of how they are applying this guidance.

Second, we continue to favour greater disclosure of directors' pension entitlement. This is an area in which preferential treatment for directors compared to other employees is not uncommon and where performance-linkage is effectively non-existent. Yet companies vary dramatically in the amount of information provided to shareholders, and typically make no effort to explain preferential arrangements (which would seem to run counter to the principle of being sensitive to pay and

conditions of others). We believe it would be very simple to include an extra sentence or two in the Code promoting fuller disclosure and explanation.

We are also surprised that the FRC has not sought to incorporate in some way the Walker Review recommendation 37:

The remuneration committee report should state whether any executive board member or "high end" employee has the right or opportunity to receive enhanced benefits, whether while in continued employment or on termination, resignation, retirement or in the wake of any other event such as a change of control, beyond those already disclosed in the directors' remuneration report and whether the committee has exercised its discretion during the year to enhance such benefits either generally or for any member of this group.

We see no reason why this should not apply to all companies.

Removal of former Section E

PIRC is very supportive of the creation of the proposed Stewardship Code and of the decision to hand responsibility for this to the FRC. In light of the creation of a separate Stewardship Code we understand the rationale for removing the former Section E of the former Combined Code. We are comfortable with this, provided that the Stewardship Code is put on an equal footing.

We understand the resource constraints the Council faces in this area, but PIRC feels it is essential that the FRC either undertakes or facilitates some form of monitoring of compliance with the Stewardship Code. We will set out our thoughts more fully in our response to the separate consultation on the Stewardship Code.

The role of governance advisers

Whilst this issue does not fall within the remit of the current review of the Code, we think that the FRC may wish to consider the role of governance advisers as monitors at some stage. As you will be aware, PIRC recently developed and published a set of best practice principles that we believe provide a reasonable framework for companies which operate in this field¹.

We believe that these could form the basis of a document equivalent to the Corporate Governance Code and the Stewardship Code.

¹ Available here: <http://pirc.co.uk/publidoc.html>
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Further information

PIRC would be happy to discuss the points we have made in our submission in more detail. Please contact:

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