



Mr Chris Hodge
Corporate Governance Unit
Financial Reporting Council
Fifth Floor
Aldwych House
71-91 Aldwych
London WC2B 4HN

5 March 2010

Dear Mr Hodge,

RE: Response to FRC consultation on annual re-election of directors / chairman, on behalf of members of the LLM course Corporate Governance in the UK and US at University College London*

Thank you for the opportunity to respond to this consultation, which is written on behalf of current graduate students at University College London studying the course Corporate Governance in the UK and US as part of UCL's Masters in Laws (LLM) degree.

UCL is a world-leading academic institution, having been rated 4th in the latest Times Higher Education-QS World University Rankings. The Faculty of Laws in particular was rated joint 1st in the most recent UK government Research Assessment Exercise. Competition for places on our degree programmes is consequently fierce, and all entrants to graduate studies at UCL Laws have already attained an outstanding level of higher educational achievement prior to commencing their degree here. LLM students at UCL have the opportunity to specialise in a variety of areas of law, with many choosing to focus on corporate law courses including the particular option that I offer in corporate governance.

Over the past 5 months, we have had the opportunity in this course to study recent regulatory developments in corporate governance in considerable detail, including the FRC's current review of the UK Corporate Governance Code and also Sir David Walker's recent recommendations on corporate governance in UK banks and other financial institutions. In our submission to you we have chosen to focus specifically on the FRC's proposal for annual re-election of board members, whether of all the directors or else the chairman individually. The following views represent the collective opinion of participating members of the class following detailed discussion of the key issues as we see them.

Overall position on the issue of annual re-election of directors / chairman

We acknowledge the potential benefits of both proposals for reforming the directorial re-election process. As regards the proposal for annual re-election of all directors, we believe that it is unlikely (absent some significant event such as a takeover) to lead to continual or even regular replacement of boards or individual directors, given the general tendency of institutional shareholders ultimately to support incumbent appointees. Nevertheless, we recognise the advantage of this proposal in terms of encouraging individual board members more regularly to 'put their case' to shareholders for continued support, which could have the dual effect of: (1) increasing shareholders' knowledge of and familiarity with individual board members; and (2) engendering a regular flow of fresh ideas from individual board members as part of the annual re-evaluation process, thereby enhancing the cognitive diversity of the board as a whole.

* Mr Steven Slade, Miss Folake Fawehinmi, Miss Nikoletta Kleftouri, Mr Glenn Donnelly, Mr Joseph Segilia, Mr Chrispas Nyombi, Miss Ying Xu, Mr Folajimi Alli-Balogun, Miss Giedre Berberausaite, and Dr Marc Moore.

We likewise see some arguable advantages in the proposal for annual re-election of the chairman individually, particularly in view of the chairman's centrality to the overall functioning and effectiveness of the board, and the inevitable power and influence that this responsibility entails.

On the whole, however, we are of the view that the arguments against both of the above proposals are overwhelming. We therefore believe that the most desirable option would be to reject both of the above proposals, and to preserve the existing governance norm of triannual directorial election on a rotational staggered basis. Alternatively, we would advocate a non-binding 'approval' resolution by shareholders each year in respect of every continuing board member. Our reasons for reaching these conclusions are as follows:

1. Annual directorial re-election prone to engender skewed time horizons

We are of the view that the FRC's first suggestion for reform of the directorial re-election process, namely to recommend annual re-election of all board members, arguably risks exacerbating current pressures on directors to adopt short-term time horizons. If the board's tenure is to be reviewed by shareholders at the end of each year, there is a risk that directors will be pressurised to take measures (e.g. excessively risky expansion or acquisitions) that enhance the company's immediate share price performance while neglecting longer-term issues of sustainability. In addition to impeding the consistency and continuity of long-term planning, such a development would moreover undermine measures by the FRC to increase directors' awareness of the company's appetite for risk and the sustainability of its strategies in the longer term. There is arguably not enough evidence at present to suggest that institutional shareholders can be relied on, when considering the re-election of directors, to make informed decisions on a company's long-term business strategy on a consistent and systematic basis. While we acknowledge that external stock market influences (especially the importance attached by analysts to quarterly earnings reports) might arguably produce the same skewed incentives regardless of a company's internal re-election process, we nevertheless feel that annual re-election of the board would be likely to exacerbate rather than mitigate this problem. The current governance norm of gradual, periodic changes to board composition is on the whole beneficial for companies and consequently should not be regarded as a drawback of the existing system.

2. Annual directorial re-election prone to divert officers' time and energy from core strategic matters

One further potential adverse outcome of annual directorial re-election, in our view, is the increased time and resources which will be dedicated by directors to 'defending' themselves in annual re-election processes. This will result in a significant diversion of directorial time and energy from core strategic matters, especially in the case of executive directors with full-time managerial responsibilities.

3. Annual directorial re-election prone to exacerbate informational deficiencies

To the extent that the annual re-election process does result in regular board changes, there will be a frequent need for newly-appointed directors to familiarise themselves quickly with company affairs in order to be able to make a meaningful and constructive contribution to boardroom affairs. This may result in more time being spent by directors learning about the relevant company and industry, which in the case of complex organisations such as banks or other financial institutions will be a formidable task. As against this, it may be argued that the existing statutory power enjoyed by shareholders in General Meeting (under section 168 of the Companies Act 2006) to dismiss directors without cause is prone to produce the same outcome in any event. However, it should be acknowledged that the costs to the company (and, indirectly, its shareholders) of invoking the statutory power of dismissal can be extremely high (even with the limited period of contractual notice allowed under the Companies Act), and refusal to elect at the end of the year would appear to us to be a considerably cheaper (and therefore more readily-available) remedy to perceived board underperformance. As such, we may witness increased problems of discontinuity, displacement, and loss of firm-specific knowledge by directors.

4. Annual re-election of chairman risks undermining the board's collective responsibility

A fundamental principle of corporate governance in the UK is the collective responsibility of the board of directors, who consequently 'stand or fall together'. This principle is important in ensuring (at least theoretically) the 'equalisation' of decision-making influence between all members of the board, on the basis that with collectively-shared responsibility comes collectively-shared power. However by earmarking one particular member of the board (the chairman) for annual re-election, there arises the risk that this individual will be made the scapegoat for underperformance of the board as a whole. Further, by rendering only the chairman, but not the CEO, subject to annual re-election, a company arguably risks making the chairman answerable for strategic managerial decisions which should more appropriately be regarded as within the CEO's remit. This would not only be inequitable, but would also make the position of chairman extremely unattractive to potential candidates. Certainly, we would predict, a significant increase in the average remuneration of company chairmen would be necessary in order to encourage talented individuals to continue taking up this position within UK listed companies.

5. Annual re-election of chairman risks increasing chairman's dependence on CEO

To the extent that annual re-election of the chairman alone leads to greater frequency of replacement of chairs, there is a risk that the chairman's independence vis-à-vis the CEO will be undermined by rendering newly-appointed chairs more dependent on incumbent CEOs for information and familiarity with company affairs following their initial appointment. One cannot underestimate the importance of having a chairman who knows the company's business and who is known, trusted and respected by his board peers (indeed, Sir David Walker makes this point emphatically). The proposal for annual re-election of company chairs risks undermining the chairman's influence and standing vis-a-vis other board members, which could have the unwanted effect of increasing the executive directors' relative power on the board. The ability of the chairman to command the respect of his peers is crucial for the purpose of encouraging constructive relations between executive and non-executive directors, in order to help promote a culture of openness and debate on the board. Insofar as more frequent replacement of chairs risks undermining this attribute of chairmen, then annual re-election should not be recommended in our view.

Conclusions

For the above reasons, we are opposed to both of the FRC's proposals for reform of the directorial re-election process. At the same time, though, we recognise that there are advantages in encouraging more regular evaluation by shareholders of directorial appointees. As a more practicable alternative to annual re-election of directors or chairs, therefore, we would suggest that the FRC considers recommending a non-binding 'approval' resolution by a company's shareholders each year for all continuing members of the board. We believe that this would encourage greater constructive dialogue between directors and shareholders in and around the Annual General Meeting, but in a manner that does not inflict undue disturbance to the board's longer-term planning function. If the above suggestion proves to be impracticable or otherwise undesirable in the opinion of the FRC, then we would advocate preserving the current Code norm of rotating directorial re-elections on a triannual basis.

We hope that our comments are helpful to you. Please do not hesitate to contact us if you wish to discuss any of the above matters in greater detail.

Yours sincerely,

Dr Marc Moore

on behalf of Mr Steven Slade, Miss Folake Fawehinmi, Miss Nikoletta Kleftouri, Mr Glenn Donnelly, Mr Joseph Segilia, Mr Chrispas Nyombi, Miss Ying Xu, Mr Folajimi Alli-Balogun, Miss Giedre Berberausaite, and myself.