

From the Office of the Chairman

Richard L Oliver FREng

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Sir Christopher Hogg
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Sir David Walker
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Dear Chris and David,

We have separately talked on many occasions about how to improve our governance without damaging the very real progress we have seen in the UK over recent years. I thought for completion I should just record a few issues for the record prior to the October 1st date!

In general I think the Combined Code is not broken and the most important issue in all of this is the behaviour and selection of people.

We have also discussed the issue of separating or aggregating listed banks and other financial institutions (BOFIs) and Non-BOFI companies. I have reluctantly come to the conclusion that for some issues they should stay separate.

Risk

Whilst noting the recommendations in the Walker report concerning the creation of risk committees and appointment of chief risk officers, my view is that requiring non-banking listed companies to take such steps would be disproportionate and inappropriate for many non-BOFI companies. The management of risk is an integral part of running a company and all directors should have an involvement in reviewing and deciding the acceptable level of risk for company as a natural part of the operation of the board. As you know, I believe that in large non-BOFI companies there may well be a need for a non-financial risk committee in addition to Audit but this should be left for the Board to judge. There may be merit in bringing some of the Turnbull Guidance into the combined code to emphasise this role and recommending good practice in

discharging this responsibility. We continue to work on bringing non-financial issues and data to the same quality level as financial data. This will take a few years to fully achieve.

Re-election

Where a company has either lost or received a significant vote against on an AGM remuneration policy resolution, boards have usually taken action subsequently to address the issues raised. However, it is important that the UK's corporate structure should be effective and seen to be so, and having a situation where technically a board can ignore a shareholder vote leaves the structure open to criticism. Therefore, I believe it would be sensible to amend the Code in line with the recommendation that if a remuneration report receives less than 75% backing from shareholders the chairman of the remuneration committee should stand for re-election the following year.

I have no problem personally with annual re-election of Chairmen!

Responsibilities of Directors

I certainly agree that there has been a significant increase in the burden of both expectation and workload on non-executive director in recent years. Also, it is clear that directors need to do more than just attend board meetings to be effective in discharging their duties. However, there is a real danger that we will severely restrict the group of people we are able to recruit to serve as non-executive directors if we demand too much in terms of their time. Boards need a balanced membership, and that has to include individuals who hold senior executive positions in other companies. I fear that stipulating an expected minimum time commitment – especially one as high as 30–35 days - would simply mean that this will not be possible.

Board Balance and Composition

I certainly agree that to be effective a board needs the right people in terms of relevant experience and a broad range of skills and expertise. This is what I called context at our meetings. Relevant skills and experience is critical but once this core requirement is achieved there should be scope for broadening the membership of a board – as with many things balance is what is really important. Also, it is important to recognise that you can never sit back and think you have achieved the right board composition. Board membership is dynamic, and if managed properly a chairman and the nomination committee will always need to be thinking about succession and plan moves well in advance. It is all too easy to get caught out on the timing of critical appointments. For something as involved as succession planning you can't have tick box governance. Instead, I suggest companies should be subject to an enhanced requirement to report on succession planning process, the objectives agreed by a nominations committee and subsequent reporting on outcomes.

Board Information, Development and Support

I note with interest that the Walker Review propose that boards should have 'thematic business awareness sessions' as, following feedback from our board effectiveness evaluation process, we

have created a programme of what we have termed 'deep dives'. This involves setting time aside during the board's annual programme to undertake an in-depth analysis of a particular aspect of the company's business – typically a large programme or project. It's early days yet but I think this has been a positive development for our board in developing understanding and analysis of our businesses. I believe that, whilst it is difficult to include such matters in a 'comply or explain' code, it would be useful for the FRC to sponsor the production of best practice guidance on information, development and support for directors.

Shareholders

It seems that it would be helpful to be clear about obligations as well as rights and generally more engagement would be constructive.

Evaluation

The Walker Review recommends that boards undertake externally facilitated performance evaluation processes. I'm aware there has been much debate over the merits of external evaluation relative to an internal process. Since 2004 the BAE Systems board has used an external facilitator for its annual performance evaluations and have found it to be a valuable exercise. Having found a facilitator that board members are comfortable with, we have used her to analyse how we work as a board and individually, and have used the feedback to improve our effectiveness. Overall, I think it has helped us move on from basic process issues (board arrangements etc) to bigger issues such as succession planning and how we develop group strategy. In the last few years we have reported to shareholders on board objectives agreed through the annual evaluation. On the basis of our experience I strongly support the Walker Review recommendation on board evaluation.

Reporting

A general comment I would offer on the existing code is that it has too many detailed disclosure requirements that add very little value. This leads to anodyne 'boiler plate' disclosure lacking in individual ownership or buy in. To improve disclosure I would suggest reducing the number of provisions that require annual reporting and encourage reporting on key governance issues such as board balance, succession planning, risk management and performance evaluation. There should be a requirement for reporting on objectives and outcomes, and not just process. Finally, I suggest that in order to achieve more effective ownership, the report should be approved by the board as a whole and signed by the chairman.

May I wish you the greatest of success and grant you great wisdom as you conclude your processes!

Yours sincerely,



DICK SOLYER