

From the Chief Executive
David Wilson FCIS FSA



Chris Hodge

Financial Reporting Council

Submitted by email to

codereview@frc.org.uk

[16 Park Crescent
London W1B 1AH

Telephone: +44 (0) 20 7580 4741
Facsimile: +44 (0) 20 7323 1132
www.icsa.org.uk

1 October 2009

ICSA response to the FRC's Review of the Effectiveness of the Combined Code (the "Code"): Progress Report and Second Consultation

Dear Chris

As with our last submission dated 28 May 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 would first like to say that in broad terms we very much welcome the content of the interim responses from both the FRC and Sir David Walker and are pleased that the main tenets of our submissions earlier this year to both consultations are broadly in line with the position taken in these interim reports (whether as draft recommendations from Sir David Walker, or as matters for further consideration in the FRC Progress Report).

In particular we are pleased to see:

- support for the continuation of the comply or explain model
- support for the unitary board model
- recognition of the importance of boardroom behaviour as a backdrop to any governance model (arguably the missing component)
- an acceptance that risk should be dealt with more appropriately at board level
- recognition that the time commitment of directors should be re-assessed
- recognition that the board must be properly supported in its delivery of good decision-making

We are also pleased to see resonance with our thinking on director induction and training, performance evaluation and remuneration.

As requested we do not propose to repeat the points we made in our earlier submission in May, but we would stress that the detail therein is still our favoured position for listed companies as a whole. Where you seek further consideration of issues in relation to a section of the Code which we addressed in May, we would refer you back to our earlier comments as applicable.

We would also like to confirm our support for your guiding principles and our willingness to work with the FRC on additional guidance in relation to boardroom behaviours. You will be aware of our report to Sir David Walker on this subject. The process of formulating this response has reaffirmed our view that much of the material you are currently considering would be appropriately dealt with in this way.

Under each of your consultation headings we first consider the extent to which the draft Walker recommendations should be applied to listed companies as a whole. We then address certain of the FRC's 'items for consideration' which we did not address in our initial response in May.

When we state our view that a particular Walker recommendation should be considered best practice by all listed companies, this does not necessarily mean the particular recommendation should feature in the Code itself, and it will often be more appropriately dealt with in associated guidance.

Where we state that further consideration of a recommendation's application should be limited to BOFIs, please note that we are not commenting on the suitability or otherwise of the particular recommendation for BOFIs (rather it is a comment on its unsuitability for a wider application). We consider the determination of the recommendations' suitability for BOFIs to be a matter for the banks and other financial institutions, in conjunction with their shareholders and regulators.

The numeric references in brackets below refer back to the paragraph numbers of our earlier submission to the FRC.

A. The responsibilities of the chairman and the non-executive directors

3. NEDs on BOFI boards should be expected to give greater time commitment than has been normal in the past. A minimum expected time commitment of 30 to 36 days in a major bank board should be clearly indicated in letters of appointment and will in some cases limit the capacity of the NED to retain or assume board responsibilities elsewhere.

Further consideration of the application of the specifics of this recommendation should be limited to BOFIs (although in any context there may be practical difficulties in tracking/auditing time spent – time commitment is perhaps better dealt with as part of the board evaluation process).

This is because, while we do agree, as we stated in our earlier submission, that many NEDs, across all types of companies, need to make a greater commitment to their role, for smaller or less complex listed companies a stipulated minimum of 30 - 36 days will often be too much. If set at this level for all listed companies, it will mean that executives holding or contemplating non-executive positions in other companies could be absent from their employing companies for 1.5 - 2 months of the year. This would reduce the ability and enthusiasm of companies to allow their own executives to take up non-executive positions (a valuable contribution to the pool of NEDs). (3.2)

6. As part of their role as members of the unitary board of a BOFI, NEDs should be ready, able and encouraged to challenge and test proposals on strategy put forward by the executive. They should satisfy themselves that board discussion and decision-taking on risk matters is based on accurate and appropriately comprehensive information and draws, as far as they believe it to be relevant or necessary, on external analysis and input.

This should be best practice for all companies. It is in this area that development of a guidance note on boardroom behaviours could particularly add value.

7. The chairman should be expected to commit a substantial proportion of his or her time, probably not less than two-thirds, to the business of the entity, with clear understanding from the outset that, in the event of need, the BOFI chairmanship role would have priority over any other business time commitment.

This recommendation is too prescriptive to be applied to listed companies as a whole. As in '3' above, while all chairmen should be encouraged to give the appropriate time commitment, a stipulation of two-thirds of their time will be out of proportion to the requirements of many listed companies. It would also prevent any chair from chairing more than one company - a restriction that has just been lifted in respect of FTSE 100 companies. There will be some chairmen ideally suited to chairing and able to do an excellent job at more than one non-BOFI company.

8. The chairman of a BOFI board should bring a combination of relevant financial industry experience and a track record of successful leadership capability in a significant board position. Where this desirable combination is only incompletely achievable, the board should give particular weight to convincing leadership experience since financial industry experience without established leadership skills is unlikely to suffice.

This recommendation is too prescriptive to be applied to listed companies as a whole. It should be left to the board of a listed company to decide what skills it is looking for in a new chairman, and which of these skills are the most important.

9. The chairman is responsible for leadership of the board, ensuring its effectiveness in all aspects of its role and setting its agenda so that fully adequate time is available for substantive discussion on strategic issues. The chairman should facilitate, encourage and expect the informed and critical contribution of the directors in particular in discussion and decision-taking on matters of risk and strategy and should promote effective communication between executive and non-executive directors. The chairman is responsible for ensuring that the directors receive all information that is relevant to discharge of their obligations in accurate, timely and clear form.

This should be best practice for all companies. As in '6', this could be further expanded on by ICSA in a guidance note on boardroom behaviours.

11. The role of the senior independent director (SID) should be to provide a sounding board for the chairman, for the evaluation of the chairman and to serve as a trusted intermediary for the NEDs as and when necessary. The SID should be accessible to shareholders in the event that communication with the chairman becomes difficult or inappropriate.

This should be best practice for all companies (and is usually the case already). Again, this could be covered in guidance on boardroom behaviours.

FRC issues for further consideration: While we think that there should be a reference in the Code to the importance of behaviours, we do not think further clarifications of the roles and expected behaviours of the chairman, SID or NEDs should be made in the Code as this could be over prescriptive. Rather, these clarifications would be usefully dealt with in non-binding guidance on boardroom behaviours. A further suggestion is to draw out, in the non-binding guidance,

the specific responsibilities of these positions as they appear already in the Code, so that they are more easily accessible, for example to a new chairman, at a glance.

Similarly, time commitments should be not prescribed in the Code, but guidance could remind companies of the importance of addressing this with their directors, and ensuring there is an appropriate understanding.

B. Board balance and composition

4. The FSA's ongoing supervisory process should give closer attention to both the overall balance of the board in relation to the risk strategy of the business and take into account not only the relevant experience and other qualities of individual directors but also their access to an induction and development programme to provide an appropriate level of knowledge and understanding as required to equip them to engage proactively in board deliberation, above all on risk strategy.

Not applicable to listed companies as a whole. As a general comment on this recommendation we do not support giving more importance to any one aspect of board responsibility (here risk strategy is given special emphasis).

5. The FSA's interview process for NEDs proposed for major BOFI boards should involve questioning and assessment by one or more senior advisers with relevant industry experience at or close to board level of a similarly large and complex entity who might be engaged by the FSA for the purpose, possibly on a part-time panel basis.

Not applicable to listed companies as a whole.

FRC issues for further consideration: We consider there is adequate reference in the Code on the need for relevant experience among non-executives collectively. This is covered by the requirement for the board to have an appropriate balance of skills and experience and for the maintenance of this balance to be a responsibility of the nomination committee. The latter should be aware of the importance of refreshing the board at relatively regular intervals.

On independence, we would recommend dropping the "nine year rule". It has proved itself to be too arbitrary a measure which can result in the loss of non-executives otherwise making a valuable contribution. It is sufficient for the board to have a requirement to determine whether directors remain independent in character, judgment and circumstance.

C. Frequency of director re-election

10. The chairman of a BOFI board should be proposed for election on an annual basis.

We do not support prescribing this for all listed companies for the reason given below in our comment on annual re-election of directors.

36. If the non-binding resolution on a remuneration committee report attracts less than 75 per cent of the total votes cast, the chairman of the committee should stand for re-election in the following year irrespective of his or her normal appointment term.

We think this should be applied to all companies. In spite of the time lag, we consider this to be a good counter balance against the perceived weakness of the advisory vote status of the remuneration report vote. It would provide a welcome and equitable opportunity to shareholders to take action should they consider that insufficient action has been taken by the remuneration committee in the year following weak support for a remuneration committee report. However, it must be made clear that votes cast do not include votes withheld.

FRC issues for consideration: Our membership has mixed views on whether annual re-election would enhance or detract from good governance at their companies. Therefore we believe it should not be a Code requirement, but left to companies to decide, and market practice to emerge, in the light of circumstances.

We do not support the idea of an advisory vote on the corporate governance statement. Governance reporting should be integral to the entire narrative of the accounts, and we do not want to encourage a restrictive style of reporting in a single section of the accounts.

D. Board information, development and support

1. To ensure that NEDs have the knowledge and understanding of the business to enable them to contribute effectively, a BOFI board should provide thematic business awareness sessions on a regular basis and each NED should be provided with a substantive personalised approach to induction, training and development to be reviewed annually with the chairman.

This should be best practice for all listed companies. (4.1)

2. A BOFI board should provide for dedicated support for NEDs on any matter relevant to the business on which they require advice separate from or additional to that available in the normal board process.

This should be applied to all listed companies provided that the method by which a board chooses to adopt the recommendation does not of itself undermine the unitary nature of the board. The point is that the secretariat should provide an effective and adequate resource to enable each and every director to carry out their role (some executive directors will also need extra support in areas outside their particular operational expertise). We previously stated that the NEDs need extra support and still support this position, however we also believe how NED support is managed should be left as an internal matter. We note that Sir David Walker makes a similar point in his review (page 44).

To ensure that NEDs are suitably supported we refer you to our earlier suggestion that the board should have a formal opportunity to evaluate the secretariat for its effectiveness and sufficiency of resource as part of the board evaluation process. (3.3, 3.4)

E. Board evaluation

12. The board should undertake a formal and rigorous evaluation of its performance with external facilitation of the process every second or third year. The statement on this evaluation should be a separate section of the annual report describing the work of the board, the nomination or corporate governance committee as appropriate. Where an external facilitator is used, this should be indicated in the statement, together with an indication whether there is any other business relationship with the company.

We support this for all listed companies. We support external facilitation (or at the very least a third party review of the internal practice) at least every third year, and go further with the suggestion that full board and committee evaluations (as opposed to individual director evaluation) should not be required to be carried out every year. (4.2) In the recommendation itself we would suggest replacing the rather open 'every second or third year', with 'at least every third year'.

13. The evaluation statement should include such meaningful, high-level information as the board considers necessary to assist shareholders understanding of the main features

of the evaluation process. The board should disclose that there is an ongoing process for identifying the skills and experience required to address and challenge adequately the key risks and decisions that confront the board, and for evaluating the contributions and commitment of individual directors. The statement should also provide an indication of the nature and extent of communication by the chairman with major shareholders.

This should apply to all listed companies. Such an evaluation statement is best practice already.

FRC issues for consideration: We do not like the terminology “assurance statement” as it has legal connotations. The Code simply needs to be expanded slightly to encourage boards to give details of the areas of focus of an evaluation and any resultant areas for development. Clearly companies should be able to retain the right to use their judgement as regards which outcomes to make public. Companies should however be required to disclose who facilitated the external evaluation.

F. Risk management and internal control

23. The board of a BOFI should establish a board risk committee separately from the audit committee with responsibility for oversight and advice to the board on the current risk exposures of the entity and future risk strategy. In preparing advice to the board on its overall risk appetite and tolerance, the board risk committee should take account of the current and prospective macro-economic and financial environment drawing on financial stability assessments such as those published by the Bank of England and other authoritative sources that may be relevant for the risk policies of the firm.

Consideration of a requirement for risk committees should not be extended beyond BOFIs (a distinction which makes sense in the light of the greater complexity of risks that are a part of their core business models and the impact of possible systemic failure). We are adamant that the setting of the company's risk appetite and profile should be a matter for the board and dealt with at the highest level, including at BOFIs, and that the board should have a stated policy in this area (see our earlier submission). However, we do not think a risk committee is necessarily the best way to achieve this and certainly it will not be appropriate for all listed companies. In fact, we have some concerns about risk committees as there is a danger of a silo effect which is the precise problem we are trying to avoid - all directors should be part of high level risk debates. In any event the decision about whether to have a risk committee is a matter for the board and the latter should be free to decide for itself whether the establishment of a separate risk committee is appropriate. (2.1)

A separate risk committee also works against the potential benefits to be derived from smaller boards (more committees normally require more directors).

Where an audit committee continues to act also as a risk committee there should be acknowledgement that audit oversight is backward facing, whereas risk oversight is forward looking and that there needs to be a clear demarcation on agendas where audit finishes and risk starts.

24. In support of board-level risk governance, a BOFI board should be served by a CRO who should participate in the risk management and oversight process at the highest level on an enterprise-wide basis and have a status of total independence from individual business units. Alongside an internal reporting line to the CEO or FD, the CRO should report to the board risk committee, with direct access to the chairman of the committee in the event of need. The tenure and independence of the CRO should be underpinned by a provision that removal from office would require the prior agreement of the board. The remuneration of the CRO should be subject to approval by the chairman or chairman of the board remuneration committee.

A requirement for a CRO should not extend beyond BOFIs as reporting structures should not be unnecessarily mandated. It should be left to companies to decide whether to appoint a CRO and to determine his reporting line. As stated in our earlier submission, we are however supportive of the CRO/risk manager having direct access to the board, and for his appointment or dismissal to be a matter for the whole board. (2.1, 4.4)

25. The board risk committee should have access to and, in the normal course, expect to draw on external input to its work as a means of taking full account of relevant experience elsewhere and in challenging its analysis and assessment.

As stated above, we are not in favour of all companies being required to have a risk committee. In any event, the principle underlying this recommendation that the committee should have the right to external advice should apply to all board committees, not just risk committees.

26. In respect of a proposed strategic transaction involving acquisition or disposal, it should as a matter of good practice be for the board risk committee to oversee a due diligence appraisal of the proposition, drawing on external advice where appropriate and available, before the board takes a decision whether to proceed.

We do not think this should be applied at all as we consider acquisition risk to be a board issue, and such a due diligence appraisal to be the role of management. The non-executive role is oversight and, when detailed work on such oversight is appropriately delegated, it is better for the relevant committee to be appointed at the time depending on the transaction involved and on particular NEDs' likely availability.

27. The board risk committee (or board) risk report should be included as a separate report within the annual report and accounts. The report should describe the strategy of the entity in a risk management context, including information on the key exposures inherent in the strategy and the associated risk tolerance of the entity and should provide at least high level information on the scope and outcome of the stress-testing programme. An indication should be given of the membership of the committee, of the frequency of its meetings, whether external advice was taken and, if so, its source.

We agree that the board's disclosure of its risk policy should be best practice for all companies. However, we refer you to our previous comments in respect of its contents. (2.2, 2.4) (As noted above, we do not support a requirement for risk committee.)

G. Remuneration

28. The remit of the remuneration committee should be extended where necessary to cover all aspects of remuneration policy on a firm-wide basis with particular emphasis on the risk dimension.

We agree this should be best practice for all companies but beyond the senior remuneration policy, the remit should be able to be limited to aspects of the remuneration policy which could influence the group's risk profile. We refer you to our earlier submission. (4.3)

29. The terms of reference of the remuneration committee should be extended to oversight of remuneration policy and remuneration packages in respect of all executives for whom total remuneration in the previous year or, given the incentive structure proposed, for the current year exceeds or might be expected to exceed the median compensation of executive board members on the same basis.

We consider that the principles of this recommendation should be applied widely, but the threshold, we believe, should be one set by the board, but not at a level

higher than the lowest paid (full-time) executive director. We refer you to our earlier submission. (4.3)

30. In relation to executives whose total remuneration is expected to exceed that of the median of executive board members, the remuneration committee report should confirm that the committee is satisfied with the way in which performance objectives are linked to the related compensation structures for this group and explain the principles underlying the performance objectives and the related compensation structure if not in line with those for executive board members.

This should be best practice for all companies. (4.3)

31. The remuneration committee report should disclose for "high end" executives whose total remuneration exceeds the executive board median total remuneration, in bands, indicating numbers of executives in each band and, within each band, the main elements of salary, bonus, long-term award and pension contribution.

This recommendation should be limited to further consideration by BOFIs as it deals with a situation most often occurring in that sector and we consider that the expense of producing the information is unnecessary for companies whose collapse would not threaten the economy as a whole. We would however support a requirement to disclose the remuneration policy in respect of those below board level should it diverge considerably from the policy applied to the board.

32. Major FSA-authorized BOFIs that are UK-domiciled subsidiaries of non-resident entities should include in their reporting arrangements with the FSA disclosure of the remuneration of "high end" executives broadly as recommended for UK-listed entities but with detail appropriate to their governance structure and circumstances agreed on a case by case basis with the FSA. Disclosure of "high end" remuneration on the agreed basis should be included in the annual report of the entity that is required to be filed at Companies House.

Not applicable to listed companies generally.

33. Deferral of incentive payments should provide the primary risk adjustment mechanism to align rewards with sustainable performance for executive board members and executives whose remuneration exceeds the median for executive board members. Incentives should be balanced so that at least one-half of variable remuneration offered in respect of a financial year is in the form of a long-term incentive scheme with vesting subject to a performance condition with half of the award vesting after not less than three years and of the remainder after five years. Short-term bonus awards should be paid over a three year period with not more than one-third in the first year. Clawback should be used as the means to reclaim amounts in limited circumstances of misstatement and misconduct.

While supporting the principles behind this recommendation, we think that the detail therein of precise vesting periods is too prescriptive to be applied widely, and that it should be left to companies to decide such matters in the context of their business models. The evidence we have is that clawback appears good in theory but that a meaningful formulation is difficult to develop; companies often only feel able to take from future awards rather than require awards which have already been paid out to be returned.

34. Executive board members and executives whose total remuneration exceeds that of the median of executive board members should be expected to maintain a shareholding or retain a portion of vested awards in an amount at least equal to their total compensation on a historic or expected basis, to be built up over a period at the discretion of the remuneration committee. Vesting of stock for this group should not normally be accelerated on cessation of employment other than on compassionate grounds.

Again, while supporting the principles, this recommendation is too prescriptive to be applied widely. Even in a BOFI context we would recommend linking the shareholding requirement to basic salary (and not compensation), and not introducing a new concept of 'compassionate grounds' when good/bad leaver provisions are already defined terms found in share scheme rules.

35. The remuneration committee should seek advice from the board risk committee on an arm's-length basis on specific risk adjustments to be applied to performance objectives set in the context of incentive packages; in the event of any difference of view, appropriate risk adjustments should be decided by the chairman and NEDs on the board.

This level of prescription should not be applied widely.

37. The remuneration committee report should state whether any executive board member or senior executive has the right or opportunity to receive enhanced pension benefits beyond those already disclosed and whether the committee has exercised its discretion during the year to enhance pension benefits either generally or for any member of this group.

This should be best practice for all companies.

38. The remuneration consultants involved in preparation of the draft code of conduct should form a professional body which would assume ownership of the definitive version of the code when consultation on the present draft is complete. The proposed professional body should provide access to the code through a website with an indication of the consulting firms committed to it; and provide for review and adaptation of the code as required in the light of experience.

We support this development, but would recommend that its constitution require an independent non-executive element on the governing body.

39. The code and an indication of those committed to it should also be lodged on the FRC website. In making an advisory appointment, remuneration committees should employ a consultant who has committed to the code.

We agree, and can see some benefit in the FRC taking a more proactive role in overseeing the code of conduct.

FRC issues for consideration: We have reviewed the EU Recommendation on the remuneration of directors of listed companies in the non-financial sector (the 'EU Recommendation'), issued in April 2009. (We assume the Walker Review will consider the recommendation for the financial services sector.) They are only recommendations and therefore not mandatory, and are not themselves the result of a formal consultation. Further, they were written in the context of the entire EU and their provisions should only be embraced if there is a demonstrable need for enhancements of the current position (we do not want to be making adjustments just to meet the particular wording of the recommendations, if the substance does not represent a meaningful improvement).

The Walker review of remuneration practice for BOFI companies and the new FSA remuneration code for banks reflect the widely held view, which we share, that an enhanced level of remuneration provision is appropriate for BOFIs because it is in that sector that the greatest risk lies. The non-BOFI market carries far lower systemic risk and needs to be considered separately.

In an annex to this response is our detailed review of the provisions of the EU Recommendation for the non-financial services market. Our review has concluded that there are no changes required to the Code in respect of non-BOFI companies.

This is not because we disagree with the provisions of the EU Recommendation. In fact we find most of them sensible. It is rather because the majority of the provisions are already included in UK practice. This may be as part of the Combined Code, the Companies Act, the directors' remuneration report requirements, the Listing Rules or the ABI guidelines on remuneration (which are reflected in the remuneration policies of most listed companies).

We also have an institutional investor base which considers remuneration issues carefully and monitors practices closely.

Since the provisions of the EU Recommendation are largely already addressed as stated above in the UK, we would not support amendment to the Code to include explicit reference to those areas which are not already covered by it. It seems to us to be highly undesirable to put in place any duplicating provisions. Furthermore, any expansion of the Code results in increased work and expense for companies to 'comply or explain' and arguably may result in more boilerplate compliance and a consequent diminution of governance standards.

Notwithstanding these comments, there are two areas in which we do not agree with the provisions of the EU Recommendation:

- We do not agree that at least one member of the remuneration committee must have knowledge of and experience in the field of remuneration policy unless this definition would be met by an independent non-executive director who has previous or current senior executive experience. If anything we prefer the FSA's approach in their new code of practice of requiring the balance of skills to include an understanding of risk implications. It would not be helpful for boards to be further constrained by having to ensure one of their independent NEDs had direct remuneration experience.
- We consider it a matter for companies to decide whether in their business model it makes sense for the remuneration committee to use different remuneration consultants to the human resources department. Both courses of action have merits. There is already transparency as the decision has to be declared under the Combined Code B2.1

Finally, a number of the provisions refer to decisions being made in the long term interests of the company (eg 3.2 and 5.2) and we consider this to be covered by S172 of the Companies Act 2006: duty to promote the success of the company. The introduction to the Code and/or any associated guidance on boardroom behaviours might usefully refer to such statutory duties as the bedrock of governance in any company (without reciting them in any detail).

H. The quality of disclosure by companies

Companies have not raised concerns with us about the cost of governance reporting.

We do not see a need for the FRC or the FSA to undertake greater monitoring and enforcement of "comply or explain" statements. This is principally a matter for investors and the market (and for BOFIs probably their regulators).

I. Engagement between boards and shareholders

We are very supportive of ongoing consultation between the investor community and companies to improve both communication and engagement. It is our belief that institutions which wish to engage with companies should also be expected to sign up to the ISC's Statement of Principles and to disclose against them on a comply or explain basis. Due to the well-acknowledged diversity among long and short term investors, sign up should be encouraged, but remain voluntary.

In relation to recommendations that we consider applicable to BOFIs only, we think it desirable that these should be incorporated within some existing code or rules. If it were determined that these BOFI-specific provisions should be subject to the 'comply or explain' regime of the Combined Code, there should be no objection to them being appended to or included within the Code (as a specific section). If it were considered that they should in fact be mandatory requirements for BOFIs, we think they would not sit well alongside existing Combined Code provisions that permit departure when an appropriate explanation is acceptable.

However, while we accept that the inherent complexity of the financial sector merits some more exacting regulation and guiding principles, we are generally not supportive of the idea of further expanding within the Code a sliding scale of different principles for different sized companies. Generally speaking, if a principle is deemed to promote good governance, the aim should be that all companies should consider applying the principle. All companies then have the opportunity to explain should it not make sense for the particular principle to be applied to them.

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, appearing to be 'David Wilson', with a long, sweeping horizontal stroke extending to the right.

David Wilson FCIS FSA
Chief Executive

APPENDIX TO SECTION G

Position paper on the extent to which the EU Recommendation on Executive Pay should be taken account of in the Combined Code Review

SECTION II REMUNERATION POLICY

3. Structure of the policy on directors' remuneration

3.1. Where the remuneration policy includes variable components of remuneration, companies should set limits on the variable component(s). The non-variable component of remuneration should be sufficient to allow the company to withhold variable components of remuneration when performance criteria are not met.

Listing Rule 13.8.11 requires companies to state in shareholders' circulars for the approval of option schemes or incentive plans the limits on the cash or securities or other benefits under the scheme. Combined Code Schedule A para 1 states (for annual bonuses) 'performance conditions should be relevant, stretching and designed to enhance shareholder value. Upper limits should be set and disclosed.'

We regard the second sentence as overly prescriptive (for non-BOFI companies. We understand that a similar provision is included in the new FSA remuneration code for banks). There are circumstances where it may be appropriate to pay a lower basic salary supplemented by variable pay and companies should retain the discretion to do this.

Remuneration committees will in any case consider the balance of fixed to variable pay under Combined Code main principle B.1, provision B.1.1 and Schedule A. The CA 2006 remuneration' report requirements (in the Large and Medium-Sized Companies (Accounts and Reports) Regulations 2008 Sch 8, para. 3) also require a company to explain the relative importance of those elements of remuneration that are and those which are not related to performance.

3.2. Award of variable components of remuneration should be subject to predetermined and measurable performance criteria.

Performance criteria should promote the long-term sustainability of the company and include non-financial criteria that are relevant to the company's long term value creation, such as compliance with applicable rules and procedures.

Schedule A, para 1 of the Code states;

'performance conditions should be relevant, stretching and designed to enhance shareholder value'

The ABI guidelines provide

'Share-based incentives should align the interests of executive directors with that of shareholders and link reward to performance over the longer term. Vesting should therefore be based on performance conditions measured over a period appropriate to the strategic objectives of the company. This will not be less than, and may exceed, three years.'

All directors are required by law, under s172 (1) (a) CA 2006 to promote the success of the company having regard to the likely consequences of any decision in the long term.

3.3. Where a variable component of remuneration is awarded, a major part of the variable component should be deferred for a minimum period of time. The part of the variable component subject to deferment should be determined in relation to the relative weight of the variable component compared to the non-variable component of remuneration.

The Code provides at Schedule A, para 2

'In normal circumstances, shares granted or other forms of deferred remuneration should not vest, and options should not be exercisable, in less than 3 years.'

See also above reference to ABI guidelines.

3.4. Contractual arrangements with executive or managing directors should include provisions that permit the company to reclaim variable components of remuneration that were awarded on the basis of data which subsequently proved to be manifestly misstated.

The ABI guidelines on remuneration provide in section I:

'Where performance achievements are subsequently found to have been significantly mis-stated so that bonuses and other incentives should not have been paid, effective avenues of redress should be considered.'

Note that this refers to 'effective avenues of redress'. To go further would create legal and practical problems (eg definition of 'manifestly misstated', difficulty of clawing back what has already been paid and perhaps spent.)

The provision has been included in the FSA remuneration code for BOFIs, but it is there that the greatest risk lies. Extending it to the general market would not justify the practical and legal issues, (and expense) which could well ensue.

3.5. Termination payments should not exceed a fixed amount or fixed number of years of annual remuneration, which should, in general, not be higher than two years of the non-variable component of remuneration or the equivalent thereof. Termination payments should not be paid if the termination is due to inadequate performance.

The Joint ABI/NAPF statement on termination payments states the following with regard to length of notice:

'3.5 The Combined Code states that under normal circumstances directors should be retained on contracts of one year or less. However we believe that a one-year notice period should not be seen as a floor, and we would strongly encourage boards to consider contracts with shorter notice periods. Compensation for risks run by senior executives is already implicit in the absolute level of remuneration, which mitigates the need for substantial contractual protection.

3.6 If it is necessary to offer executives longer notice periods, for example for incoming executives at companies in difficulties, we would expect the length of the contract to be justified. In that case the termination provisions attached should be fully disclosed and the length of the contract should reduce on a rolling basis in line with the recommendations contained in this Guidance.'

The statement provides for the following regarding rewards for failure:

'4.1 It is unacceptable that poor performance by senior executives, which detracts from the value of an enterprise and threatens the livelihood of employees, can result in excessive payments to departing directors. Boards have a responsibility to ensure that this does not occur. '

The Code states at B.1.5

'The remuneration committee should carefully consider what compensation commitments....their directors' terms of appointment would entail in the event of early termination. The aim should be to avoid rewarding poor performance. They should take a robust line on reducing compensation to reflect departing directors' obligations to mitigate loss.'

4. Share-based remuneration

4.1. Shares should not vest for at least three years after their award. Share options or any other right to acquire shares or to be remunerated on the basis of share price movements should not be exercisable for at least three years after their award.

As already noted, the Code provides at Schedule A, para 2

'In normal circumstances, shares granted or other forms of deferred remuneration should not vest, and options should not be exercisable, in less than 3 years.'

4.2. Vesting of shares and the right to exercise share options or any other right to acquire shares or to be remunerated on the basis of share price movements, should be subject to predetermined and measurable performance criteria.

The ABI guidelines state:

'4.2 Challenging performance conditions should:

- relate to overall corporate performance;
- demonstrate the achievement of a level of financial performance which is demanding and stretching in the context of the prospects for the company and the prevailing economic environment in which it operates;
- be measured relative to an appropriate defined peer group or other relevant benchmark; and
- be disclosed and transparent. '

4.3. After vesting, directors should retain a number of shares, until the end of their mandate, subject to the need to finance any costs related to acquisition of the shares. The number of shares to be retained should be fixed, for example twice the value of total annual remuneration (the non-variable plus the variable components).

The Combined Code states at Schedule A, para 2

'Directors should be encouraged to hold their shares for a further period after vesting or exercise, subject to the need to finance any costs of acquisition and associated tax liabilities.'

See ABI guideline, Section III, final main provision:

'Shareholders encourage companies to require executive directors and senior executives to build up meaningful shareholdings in the companies for which they work. '

4.4. Remuneration of non-executive or supervisory directors should not include share options.

This is already in Code B.1.3 'Remuneration for non-executive directors should not include share options'.

5. Disclosure of the policy on directors' remuneration

5.1. The remuneration statement, mentioned in point 3.1 of Recommendation 2004/913/EC, should be clear and easily understandable.

Remuneration disclosure in the UK is largely governed by Statute – see the directors' remuneration report requirements contained in the Large and Medium-Sized Companies (Accounts and Reports) Regulations 2008, Sch. 8 (see also Sch,5) which prescribe in detail the content of the Report, which must be voted on annually by shareholders. The following areas are covered specifically or are implicit in accepted current practice.

5.2. In addition to the information set out in point 3.3. of Recommendation 2004/913/EC, the remuneration statement should include the following:

(a) an explanation how the choice of performance criteria contributes to the long term interests of the company, in accordance with point 3.2. of this Recommendation;

(b) an explanation of the methods, applied in order to determine whether performance criteria have been fulfilled;

(c) sufficient information on deferment periods with regard to variable components of remuneration, as referred to in point 3.3. of this Recommendation;

(d) sufficient information on the policy regarding termination payments, as referred to in point 3.4. of this Recommendation;

(e) sufficient information with regard to vesting periods for share-based remuneration, as referred to in point 4.1. of this Recommendation;

(f) sufficient information on the policy regarding retention of shares after vesting, as referred to in point 4.3. of this Recommendation;

(g) sufficient information on the composition of peer groups of companies the remuneration policy of which has been examined in relation to the establishment of the remuneration policy of the company concerned.

6. Shareholders' vote

6.1. Shareholders, in particular institutional shareholders, should be encouraged to attend general meetings where appropriate and make considered use of their votes regarding directors' remuneration, while taking into account the principles included in this Recommendation, Recommendation 2004/913/EC and Recommendation 2005/162/EC.

This is already covered in the Code at Section 2, E.3.

SECTION III THE REMUNERATION COMMITTEE

7. Creation and composition

7.1. At least one of the members of the remuneration committee should have knowledge of and experience in the field of remuneration policy.

We do not feel it is necessary to state this specifically, since the Code encompasses issues of the board's balance of skills and experience, board training and development and board evaluation. Directors serving on remuneration committees are almost certain to have this knowledge and experience owing to their general business and board experience. Arguably this provision devalues the stated required level of expertise of the committee.

8. Role

8.1. The remuneration committee should periodically review the remuneration policy for executive or managing directors, including the policy regarding share-based remuneration, and its implementation.

This is already common practice.

9. Operation

9.1. The remuneration committee should exercise independent judgement and integrity when exercising its functions.

S. 173 CA 2006 requires all directors to exercise independent judgement.

The Code, at B.2.1 requires that the remuneration committee comprise independent non-executive directors.

9.2. When using the services of a consultant with a view to obtaining information on market standards for remuneration systems, the remuneration committee should ensure that the consultant concerned does not at the same time advise the human resources department or executive or managing directors of the company concerned.

The Code states at B.2.1

'Where remuneration consultants are appointed, a statement should be made available of whether they have any other connection with the company'.

There is therefore transparency on this issue and shareholders have an opportunity to raise any issues of concern or even vote against the remuneration report and the AGM.

We think the proposed provision is unnecessarily restrictive and prescriptive, as it may be that it is easier and more cost effective if the remuneration consultants also work with the HR department.

9.3. In exercising its functions, the remuneration committee should ensure that remuneration of individual executive or managing directors is proportionate to the remuneration of other executive or managing directors and other staff members of the company.

The Combined Code states in the supporting principle at B.1 that the remuneration committee 'should be sensitive to pay and employment conditions elsewhere in the group, especially when determining annual salary increases.'

Under s.417 CA 2006, the enhanced business review for quoted companies requires companies to comment (to the extent necessary to understand the business) on policies with regard to employees and the effectiveness of those policies.

9.4. The remuneration committee should report on the exercise of its functions to the shareholders and be present at the annual general meeting for this purpose.

The committee's report is covered by the directors' remuneration report requirements, as noted earlier.

Code provision D.2.3 states

'The Chairman should arrange for the chairmen of the audit, remuneration and nomination committees to be available to answer questions at the AGM and for all directors to attend.'