

## **CIS' response to the Review of the impact of The Combined Code: July 2007**

### **Introduction**

Co-operative Insurance Society Limited ("CIS") welcomes the opportunity to comment on our experiences as investors in respect of the implementation of the Combined Code. This is further to CIS's previous submissions to the preceding consultations on The Combined Code 2003 and 2006.

#### ***1. Does the Code support better board performance over time?***

We support the Code's emphasis on the Chairman's key role in ensuring individual director contribution in respect of the performance of the board. The Chairman should ensure that independent non-executive directors can demonstrate and undertake independent oversight of the actions and decisions of executive management. If this function is working effectively, there should be no danger of a breakdown in the cohesiveness of the board but if there is, it is for the Chairman to address this.

We would welcome disclosure relating to how both individual directors, and the board as a whole, are assessed. For example, is there any independent consultation or benchmarking process used in relation to determining board performance? We would also be interested in the methodology used and whether an independent audit of the process is undertaken. CIS does look at board performance reviews as part of our overall assessment of companies. It is frequently difficult to take a view due to the lack of disclosure on board performance matters. One notable exception to this is the disclosure by Speedyhire Plc, in its annual report and accounts for the year ended 31 March 2007. Within the Corporate Governance statement, the Company reports on the independent evaluation of the Board's processes and procedures undertaken by Lintstock during the year. Not only is there a detailed list provided of the key areas evaluated by Lintstock, the Company also discloses the outcome of the evaluation process and lists the key areas that were identified for improvement. The outcomes of board performance evaluations, and with this level of detail, are very rarely provided to investors.

Whilst engagement with companies gives us valuable insight into the performance of the board we are unable to engage with all companies every year and so information such as this would be helpful in taking a view on how the board operates.

We believe that compliance with the Combined Code, fostering adherence to best practice in corporate governance, should be embedded into the culture of an organisation. This should therefore avoid unnecessary time and attention of the board being diverted away from strategic priorities and leadership activities. However, where there are material issues of concern around corporate governance, the necessary time should be spent to resolve or address those issues. It is for the Board to determine what priority is given within board meetings to such matters, with the Chairman providing leadership on this, and managing the discussions.

## **2. Is the “comply or explain” approach working effectively?**

CIS supports the non-prescriptive ‘comply or explain’ approach to corporate governance. Moving towards legislative enforcement would not be considered a positive step in our opinion. For instance, the heavy-handed approach of Sarbanes-Oxley Act appears to be detrimental to the spirit of independence, disclosure and shareholder relations.

However, we still encounter explanations of non-compliance that are limited, and anodyne statements plague the annual report and accounts of many companies that we analyse. Justifications and explanations needs to be convincing. In some cases, a key issue such as the Chairman undertaking his role in an executive capacity, which is clearly a cause for concern, is skimmed over without due consideration. Another example of non-compliance that we often encounter is where a non-executive has served the board for over nine years. We would expect to see a comprehensive justification if the company states the individual concerned is considered independent, notwithstanding their length of tenure on the board. For instance, opinion on the value he/she brings to the board, or the unique skills that they have which necessitate them remaining on the board would bring more weight to justifications. An explanation of the balance between longer serving directors and newly appointed non-executives on the board would also aid understanding in this area. Frequently, explanations are absent or brief with only a reference to the fact that the board considers the individual to be independent, notwithstanding that their independence is clearly compromised when considering the independence criteria detailed in The Combined Code, Provisions A.3.1.

In the case of companies who have a director acting in a temporary capacity as both the Chief Executive and the Chairman, we would like to see an approximate time scale for this arrangement. Failing a time scale, some indication that a recruitment process or succession planning system has been activated would give us a clearer view of the necessity for such an arrangement.

## **3. What impact has the code had on smaller companies?**

The Combined Code in its current format gives leeway to smaller companies and allows flexibility on compliance in key areas such as the number of independent non-executives on the board. Our engagement with smaller companies is often very productive and smaller companies are increasingly willing to initiate changes to bring themselves in line with the Code’s provisions. The Code gives us a point of reference for engagement and we are encouraged by the results of our engagement with smaller companies and their willingness to listen and take action should be applauded. However, we consider that there is sufficient flexibility within the Code for smaller companies, and any further leeway may detract from the spirit of the Code.

**4. Do disclosures on the Combined Code in annual reports provide useful information to shareholders at proportionate cost to companies? If not, in what respects and how do you believe they should be modified?**

Whilst disclosures on the Combined Code provide a helpful means for us to assess companies, we are concerned by the boiler-plated nature of some disclosure. We would appreciate more reporting on the characteristics and experiences of individual companies, rather than statements of the same structure, which do nothing to aid the understanding of companies by investors. There is a trend for larger companies to have larger report and accounts documents, and whilst we understand that there are certain statements that must be included within the reporting document, the adage of quality over quantity should be borne in mind.