

30 July 2007

Email: codereview@frc.org.uk

Chris Hodge
Corporate Governance Unit
Financial Reporting Council
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Dear Chris

Financial Reporting Council assesses the impact of the Combined Code

IMA represents the UK-based investment management industry. Our members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of nearly £3 trillion of funds (based in the UK, Europe and elsewhere), including authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, our members represent 99% of funds under management in UK-authorised investment funds (i.e. unit trusts and open-ended investment companies).

In managing assets for both retail and institutional investors, IMA members are major investors in companies whose securities are traded on regulated markets. Therefore, we have an interest in the Combined Code from the perspective of our members as institutional investors.

The initial consultation on the draft strategic framework and plan for 2007/2008 proposed that the FRC undertook a formal review of the Combined Code in the current financial year. We did not consider that the Code needed to be reviewed at this stage – it was last comprehensively overhauled in 2003 and further changes, albeit limited, were made in 2006 for reporting years beginning on or after 1 November 2006. We understand that others had a similar view and we appreciate that the FRC has responded to the wishes of its stakeholders and as opposed to reviewing the Code, is undertaking an assessment of its impact. We also welcome the FRC's statement in the introduction of the document, "there should be no presumption that the review will lead to revisions being made¹". Recently there have been many changes to corporate reports and the rate of change is continuing. There has been the introduction of IFRS, revised Turnbull guidance, the enhanced business review, and new requirements under the Transparency Obligations Directive and the

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Companies Act 2006. We consider that these changes should be given the opportunity to bed down before further amendments are considered to the Code in that both companies and investors would appreciate a period of stability in corporate reporting. That said, we set out a couple of points of detail on the text of the Code in our answers to the specific questions in the attached annex on the progress in implementing the Code. In essence we consider that the standards of UK governance are high and that the Code is working well. As our members operate across international borders, we would prefer the FRC engaging with international regulators to promulgate UK best practice as opposed to further refining standards operated in the UK.

Please do contact me if you would like clarification on any of the points in this letter or the attached, or if you would like to discuss any issues further.

Yours sincerely




Liz Murrall, Senior Adviser – Corporate Governance

ANNEX

IMA RESPONSE TO THE FRC'S ASSESSMENT OF THE IMPACT OF THE COMBINED CODE

IMA's answers to the specific questions raised are set out below.

Q.1 Does the Combined Code support better board performance over time?

IMA considers that the principles and provisions in the Code essentially support better board performance over time. In particular, since the last major revision of the Code in 2003 our members have noticed improvements in, and better disclosure of, board practices and procedures. Furthermore, as noted in the document, to ensure that the non-executives monitor effectively in a way that is compatible with the Board's cohesiveness and that the Board's priorities do not become too subordinated to adhering to the letter rather than the spirit of the Code requires strong leadership by the Chair working with the CEO². We agree it would appear that these challenges are being overcome.

Q.2. Is the Comply or Explain approach working effectively?

The document explains that the FRC wants to assess any frustrations with the comply or explain approach. IMA strongly supports the "comply or explain" principle in the Combined Code. This recognises that a one size fits all approach to corporate governance does not work and provides for more flexible and effective market led regulation. That said, we have certain reservations as set out below.

- First, certain of our members have commented that there can be a reticence for certain companies to "explain" non-compliance with the Code leading them to comply when this may not be in the best interests of the company. This may be driven in part by the fact that certain parties have commented that companies believe that investors treat "comply or explain" as "comply or else". We do not believe that this is the case in that in the main both investors and companies have a mutual commitment to the principle of "comply or explain". We believe that a "comply or else" approach undermines the overall objectives of the Code and should be discouraged.
- Secondly, the 'comply or explain' approach can only work if companies respect the obligation and give sound reasons for non-compliance. However, there is a risk, and some have commented it is beginning to happen, that disclosures and explanations become standardised over time and thus limit their usefulness to our members as users. In particular, our members are concerned at the size of annual reports. Although this is mainly a product of the disclosures required by IFRS and other regulatory requirements, any disclosures required under the Combined Code should be tailored to the specific circumstances of the company. Meaningful disclosures facilitate engagement, reduce the amount of time and resources required of investors and companies, and lessen the perception of a "comply or else" approach as investors cast fewer votes against management and fewer conscious abstentions. Companies should be encouraged to guard against standardised disclosures.

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- Lastly, although undoubtedly disclosures and explanations have improved since the Code was last revised not all companies provide adequate explanations for non-compliance and some consider any explanation will suffice. For example, Code Provision A2.2 states “if exceptionally a board decides that a chief executive should become chairman, the board should consult major shareholders in advance and should set out its reasons to shareholders at the time of the appointment and in the next annual report”. In this respect, certain of our members have noted that the “exceptional circumstances” have not always been convincing or clear.

Q.3 What impact has the Code had on smaller companies?

IMA considers that smaller listed companies should be able to address any particular issues and possible areas of non-compliance with the Code under the comply or explain principle. Thus they are free not to comply with individual provisions in the Code provided they explain why not. It is then for individual investors to decide on the merits of the explanation, and whether they want to take it up with the company concerned. Although due to limited resources, smaller companies may not always be as proactive in engaging with institutional investors on corporate governance, our members are sensitive to the constraints that smaller companies operate under.

Q.4. Do disclosures on the Combined Code in annual reports provide useful information to shareholders at proportionate cost to companies?

IMA is not in a position to be able to comment on the cost to companies of providing the disclosures required. Our observations on the disclosures in relation to the Combined Code are set out above under Question 2. In particular, we note that certain explanations are beginning to become standardised and not all companies necessarily provide adequate explanations for non-compliance.

As regards particular issues on the text, the Code aims to address the obligations of listed companies which, in accordance with the Listing Rules, are required to report on their compliance. However, paragraph 7 of the Preamble and Section E addresses the role of institutional shareholders and their agents. A number of our members consider that in seeking to address institutional shareholders and their agents, the Code is moving away from its mandate. In addition, it is not clear how companies could ensure the obligations in E3 are effected in practice - institutional shareholders own the companies and our members do not believe that it is for those companies to hold them to account.

Furthermore, we would support a relaxation of Code provision A.4.3 to permit an individual to serve as chairperson two FTSE 100 companies at the same time. We consider that this provision is too prescriptive and restrictive. This change would represent some fine tuning and apart from this, we do not consider that the Code should be amended or re-written. Recently there have been many changes to corporate reports and the rate of change is continuing. We consider that these changes should be given the opportunity to bed down before further amendments are considered to the Code in that both companies and investors would appreciate a period of stability in corporate reporting.