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October 9, 2009

Response from RiskMetrics Group to Financial Reporting Council Second Consultation Document:
“Review of the Effectiveness of the Combined Code”

Introduction

RiskMetrics Group specialises in financial services and is recognised as the standard in financial risk management. We work to make risk transparent and leverage our expertise in corporate governance, compliance, accounting, legal, transactional, and sustainability risks. Our clients include most major asset managers, pension funds, banks and hedge funds.

RiskMetrics Group welcomes the opportunity to respond to the Second Consultation Document ‘*Review of the Effectiveness of the Combined Code*’ issued by the Financial Reporting Council in July 2009.

In addition to providing a response for sections 1 and 2, we have also included some additional feedback based on our day-to-day experience of interpreting and applying the Code. This is found at the end of our response under section 3.

Yours sincerely

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FRC - Review of the Effectiveness of the Combined Code

SECTION 1: THE CONTENT OF THE COMBINED CODE_

The responsibilities of the Chairman and the non-executive directors

Specific issues for further consideration requested by the FRC consultation include:

- *Whether it would be helpful to give further clarification of the role, key responsibilities and expected behaviours of the chairman, the senior independent director and/ or the non-executive directors, either in the Code or in non-binding guidance.*
- *Whether it would be helpful to provide further guidance on the time commitment expected of the chairman, senior independent director and / or non-executive directors.*

RMG Response

RMG believes that it would be helpful for the Code to provide further clarification of the role, responsibilities and behaviour of the chairman, the SID and the NEDs.

The chairman is viewed among many shareholders to be ultimately responsible for adherence to governance best practice guidance and overall board performance. Accepting that a chairman has a prominent and important function on the board which may require him/her to devote substantial time to board and business matters, the issue of over-boarding may need to be reconsidered by re-introducing limitations on outside board appointments through the Combined Code.

There is no doubt that direct experience and industry knowledge as well as leadership skills are the optimal combination for chairmen and non-executive directors (NEDs). In addition, RMG believes that more time needs to be devoted by NEDs to board and company matters. Alongside this it is considered essential that such directors not only have appropriate skills and knowledge but also continue to demonstrate insight and understanding of the business. In turn, the role of the NED should be seen to be a 'real' job that requires specific time dedicated to fulfilling such responsibilities.

It may be that companies will need to pay for such greater commitment and to attract top talent. RMG accepts that this may lead to initial widespread NED remuneration increases but these must be balanced so that such amounts are not considered material enough to compromise independence. However, contrary to the statement regarding a potential increase in NEDs fees, it is considered that the current level of remuneration for the post of chairman at the largest companies remains appropriate and should not be increased significantly unless appropriate justification is provided. Any significant increase may confuse the position with that of an executive.

Whilst RMG agrees that the time commitment required going forward may limit the capacity of the NED to retain or assume board responsibilities elsewhere and the issue of over-boarding may need to be scrutinised more closely, companies may also find it problematic in appointing NEDs who hold CEO or executive positions at other companies as they may not be able to dedicate the appropriate time needed to effectively fulfill the NED role on financial boards. This could severely impact the pool of talent available.

RMG does not consider Recommendation 11 of the Walker review to be significantly different from the current Combined Code. We would propose that this recommendation be expanded such that it provides for a more proactive obligation on the SID to meet with shareholders, rather than in response to dissatisfaction with the chairman, since the lines of communication with the SID may hamper the expression of such dissatisfaction unless there is positive outreach from the SID to shareholders.

Board Balance and Composition

Specific issues for further consideration requested by the FRC consultation include:

- *Whether the Combined Code gives sufficient emphasis to the need for relevant experience among the non-executive directors collectively.*
- *Whether the independence criteria and the way they have been applied by boards of companies and investors have unnecessarily restricted the pool of potential non-executive directors, and in particular whether the so-called “nine year rule” has resulted in a loss of continuity and valuable experience.*
- *Whether the recommendation that the boards of FTSE 350 companies should comprise at least 50% independent non-executive directors has resulted in fewer executive directors sitting on boards and/or boards becoming larger.*
- *Whether more guidance is needed, in the Code or elsewhere, on succession planning and the need to ensure that board composition is aligned with the present and future needs of the business.*

RMG Response

RMG encourages that the Code further emphasise the need for relevant experience among NEDs individually as well as collectively, whilst still requiring appropriate independent representation on the board and its committees. The Code should require companies to clearly disclose why they consider the board to have relevant experience, or the appropriate mix of experience and how it will benefit the company and its business. Companies should also explain the knowledge and experience held by individual directors and the qualities that they bring to the business at the time of their (re-)election. Disclosure of this kind is often limited and therefore restricts the level of insight given to shareholders outside the scope of standard governance compliance such as independence of the individual.

RMG does not necessarily believe that the current balance of board provision has resulted in fewer executives sitting on boards. A number of companies have made such appointments and provided appropriate justification whilst maintaining an adequate level of board balance. Shareholders have supported such appointments on their merits.

RMG acknowledges that the assessment of NEDs against the current criteria of independence under the Code allows companies to conclude that an individual director remains independent even when one or more of the criteria appears to be compromised. However, a number of companies interpret this to mean that their assessment is final without providing any justification for their conclusions. The Combined Code guidance operates within a ‘comply or explain’ framework, but this should not be mistaken to mean either ‘comply or else’ or ‘explain and accept’.

RMG appreciates the difficulty of ‘outsiders’ knowing if a NED is truly independent of mind, character and judgement and therefore supports the concept that the board, who are the most informed, should provide the first assessment. However, this must be supported by a clearly disclosed explanation of the factors considered and the basis for its conclusion to shareholders. Shareholders are by definition unable to observe the board in session and thus must draw conclusions as to the likely ability of a NED to act in a truly independent manner based on the evidence presented. A more extensive and candid exposition by the board of the considerations it has made in arriving at its designation of independence for a NED would aid shareholders in reaching informed conclusions.

In all cases the information presented should be sufficient to identify the potential for a ‘conflict’ to exist. The impact on independence may vary depending on the severity of the ‘conflict’ and the potential frequency with which it could arise.

The majority of institutional investors do not consider absolute tenure as the primary factor in considering a director's independence. RMG has been using pragmatic judgement in line with the NAPF Policy in assessing a director's independence due to tenure. RMG believes the discussion of tenure centres on the Cadbury guidance which states that a NED should be independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement.

Therefore, RMG believes tenure should be primarily considered based on concurrent relationships with the management of a company. However, it is also agreed that with the passage of time, independence is naturally compromised. As a result, the tenure should differentiate between **absolute tenure** and **concurrent tenure**; the latter to ensure that the relationship between NEDs and Executive Directors, including the Board chairman, is assessed in accordance with the underlying principle first proposed by Cadbury with regard to the length of concurrent board membership.

Absolute tenure

RMG proposes that this threshold should be extended to **15** years from the date of first election. This issue may be amplified if no statement on performance evaluation or succession planning is provided by the company (either in the annual report or through engagement).

Concurrent tenure

RMG proposes that concurrent tenure arises where a NED has served on the Board concurrently with the **board chairman** or any **executive director** for at least **9** successive years from the date of his/her first election and no statement or explanation on performance evaluation or succession planning is provided by the company (either in the annual report or through engagement).

In all cases where the independence of a NED becomes questionable, it is important that the following factors are taken into consideration:

- **Any explanation provided by a company (either in the annual report or through engagement) to justify why the board considers that the NED remains independent;**
- **Evidence of a performance evaluation (either in the annual report or through engagement) that explains why the company considers the NED remains independent;**
- **Evidence of the company's succession policy and any commitment of future refreshment of the Board (either in the annual report or through engagement).**

In order to support this type of consideration, RMG encourages the code to provide more guidance to companies on the importance of succession planning and the board evaluation process (as has been highlighted in latter part of our response). More guidance on this matter may also encourage companies to be better pre-prepared to take actions should exceptional circumstances arise.

This disclosure would also benefit shareholders in ensuring a better understanding of a company's future intentions for moving towards compliance in cases where it is either not considered in their immediate best strategic interests to do so, or where they are unable to do so due to specific circumstances. This in turn would allow shareholders to better understand the difficulties faced by companies and enable them to take a pragmatic approach in such cases of non-compliance with the letter of the Code.

Frequency of director re-election

Views are invited by the FRC consultation from companies and investors on whether changes to voting would increase accountability to shareholders and which, if any, of the following options they would support as recommendations for possible inclusion in the Code:

- *Annual re-election of the company chairman.*
- *Annual re-election of the chairs of the main board committees.*
- *Annual re-election of all directors.*
- *Binding or advisory votes on specific issues, or on the corporate governance statement as a whole.*

RMG Response

RMG supports the principle of increased accountability to shareholders; however, we would caution against automatic/routine annual re-elections as this may be considered to promote board instability and short-termism when, in fact, alignment with long-term shareholder interests is what is being sought.

Accepting that the chairman is viewed as ultimately responsible for adherence to governance best practice guidance and overall board performance, accountability of the chairman through annual re-election is the most direct route. However, this is where the aforementioned concerns over stability and short-termism would be most acute.

The following alternatives to the chairman's automatic annual re-election may be considered:

- (1) The requirement for a higher threshold of support (e.g.75%) for the re-election of the chairman;
- (2) Consistent with the concept used for Recommendation 36 of the Walker review, automatic re-election in the year following significant shareholder dissent (approval does not exceed at least 75%) of **any** resolution proposed by the board at the previous AGM. The latter can be used as reconfirmation of support of the chairman's leadership notwithstanding opposition to a particular resolution. This concept may also extend to the committee chairs on matter which directly concern their committees directly; or
- (3) The adoption of a Corporate Governance Statement presented at the general meeting, either as a point on the agenda for discussion only (as is the case in the Netherlands), or perhaps as a formal voting agenda item used as an advisory vote or even as a mandatory vote, is a viable proposal. Although this would enable shareholders to voice their opinion of a company's corporate governance practices without the need to direct their disapproval at other agenda items which may, or may not be, directly related to the issue in question, RMG observes that this offers less direct accountability than is the case with subjecting the Chairman to shareholder approval on the basis of the company's governance record.

When looking at levels of 'support' in the foregoing options, it should be noted that as an abstain/withhold vote is a valid vote option on a UK proxy card and is used by shareholders as a way of demonstrating 'disapproval without consequence', the 75% approval threshold should be assessed against the total number of votes cast (including abstain/withhold votes).

Board information, development and support

Views are invited by the FRC consultation on whether it would be helpful to provide more guidance on some or all of these issues raised, either in the Combined Code or in non-binding guidance.

RMG Response

The Combined Code currently does provide some guidance on training of NEDs but it is felt that this could be more specific and prescriptively required. RMG supports the principles prescribed in Recommendation 1 of the Walker review and would suggest that the proposed session include presentations by the executive management team and below-board business managers or other internal experts. As part of the training and development RMG would encourage that this extends to attendance at industry conferences or participation of accredited courses. RMG also believes that the ongoing verification that NEDs continue to have appreciation, knowledge and understanding of both company matters and the issues as they relate to the wider industry is important. This could be achieved through annual continued professional development (CPD) requirements for NEDs, similar to those applied in the legal and accountancy professions.

RMG considers that time spent with experts within the organisation in order to better understand the complexities faced by various parts of the business at root-level can be extremely beneficial. RMG encourages the Code to require any or all of the training and development received by an NED to be disclosed to shareholders with accounts of the activities run by the board and their individual attendance records.

RMG supports the concept that the board should provide dedicated support for NEDs on any matter on which they require advice separate from that available in the normal board process and believes that the 'installation of a dedicated resource under the group secretary' as proposed in the Walker review is appropriate and that NEDs should also 'make regular use of advice from sources outside the company'. We believe that the latter should be under the unfettered discretion of the chairman and the committee chairs. All such external consultancy engagements should be disclosed to shareholders.

Board evaluation

Specific issues for further consideration requested by the FRC consultation include:

- *Whether the Code should be amended to recommend that board evaluations should be externally facilitated at least every two or three years for some or all companies.*
- *Whether the recommendation that the effectiveness of all the main board committees should be evaluated every year should be relaxed in some way, for example to recommend a rolling cycle of committee reviews. Some commentators considered that after the initial evaluation there was limited value in subsequent annual reviews.*
- *How disclosures in the annual report might be made more informative, either in relation to the process that was followed and/ or the outcomes of the effectiveness review.*

RMG Response

RMG supports the Code being amended to recommend that board evaluations should be externally facilitated at least every two or three years for all companies. RMG does see value in yearly internal evaluation of all the main board committees. Feedback received from companies supports the value of such regular internal evaluations.

RMG supports the Combined Code principle of board evaluations and the recommendation regarding meaningful information. RMG agrees with the consensus view that disclosure on board evaluation is presently little more than boilerplate in nature. There is a tendency for disclosure on this subject to centre on recounting the evaluation process with little meaningful information on the outcome of the evaluation itself and actions taken by the board in response. This denies shareholders potentially useful information, particularly in areas such as when the independence of a director is in question, or when non-compliance with the letter of the Code arises around board and committee composition. In such cases, disclosure in this area can be extremely beneficial so that factors other than strict adherence to code provisions can be considered.

RMG believes that the Code could provide clarification on the type of disclosure expected from companies and how the information should be received by shareholders. Boards should be open-minded as to the purpose of disclosure and view it as a constructive process rather than merely an exposure of any failings. Boards should provide meaningful disclosure of the areas evaluated, the conclusions of such evaluations and the actions taken in response to such conclusions. It is the latter that is the only proof of effectiveness.

Risk management and internal control

Specific issues for further consideration requested by the FRC consultation include:

- *Whether the board's responsibility for strategic risks and setting risk appetite – as set out in the Turnbull Guidance - should be made more explicit in the Code, and whether the current balance between the Code and the Guidance is the right one.*
- *Whether there is a need for all or parts of the Turnbull Guidance to be reviewed.*
- *To what extent the particular mechanisms recommended for banks and financial institutions would also be appropriate for other listed companies. For example, there were mixed views among commentators about whether separate risk committees were necessary for companies with less complex business models.*
- *How reporting on risk might be improved, for example by rationalizing existing disclosure requirements or providing guidance on good communications tools.*

RMG Response

RMG is strongly supportive of the Walker recommendations on risk, in particular the establishment of a CRO role with reporting lines to the risk committee and the board. This would clearly enable the board's fundamental role in setting of a risk strategy and oversight, with the CRO taking the day-to-day responsibility for the execution and monitoring thereof. There is also merit in the CRO being invited to attend board meetings so that he can acquire a better understanding and appreciation of all factors affecting risk strategy.

RMG believes that there should perhaps be some flexibility regarding the separate risk committee for smaller financial institutions. However, this flexibility should not provide exceptions to the appropriate management of risk and accompanying disclosures. RMG believes that this principle should be applicable to non-financial companies; however it does not feel it necessary to require a separate committee.

RMG considers that transparency is the key to effective risk management and that disclosure of risk strategy/profile is positive; however, this should not lead to the demonisation of a high risk profile if that is consistent with the stated strategy of the institution.

The Code should be more explicit in clarifying the board's responsibility for setting strategic risks and setting risk appetite. In addition, in order to promote accountability, RMG believes that consideration should be given to requiring a statement in the 'Risk Report' from the CRO and risk committee confirming that the company has managed its business in accordance with its stated risk profile and strategy throughout the reporting year. The challenge will be in establishing a basis for meaningful comparative analysis of the risk profiles of different institutions in the absence of common standards for the benchmarking of risk.

RMG generally believes that such requirements and accompanying disclosures should be clearly set out in the Code.

Remuneration

Specific issues for further consideration requested by the FRC consultation include:

- *Whether to revise the Code to ensure consistency with the European Commission's Recommendations and, where appropriate, the FSA's proposed code of remuneration practice for financial institutions and the recommendations of the Walker Review.*
- *Whether any other changes to the Code, or additional guidance, are required to reflect developments in best practice.*
- *Whether shareholders should be given a more direct role in setting remuneration and, if so, how this might be achieved.*

RMG Response

RMG believes that consistency with the European Commission's recommendations is helpful provided that where the standards of governance prescribed in the UK are higher, these are maintained. RMG does not oppose the provisions contained in the FSA's proposed code of remuneration practice for financial institutions and the recommendations of the Walker Review and believes that the Code should support those principles for the broader corporate market. However, careful consideration should be applied to each provision or recommendation to decide if it is appropriate for non-financial companies to follow the same guidance.

RMG considers the current Code to provide limited guidance regarding remuneration best practice. Most shareholders and companies consider that best practice guidance in this area is issued by the NAPF and ABI. RMG would encourage the Code to either support or leverage this guidance.

RMG does not believe that the majority of shareholders need or desire a more direct role in setting remuneration. RMG considers this function is best left in the hands of a remuneration committee that effectively engages with shareholders when necessary. Although it is acknowledged in the preamble that a vote on individual remuneration packages has been suggested, RMG feels that this is unnecessary as it may suggest micro-management by shareholders. A potential alternative that has been seen on very few occasions is to propose two remuneration-related items: the first would provide shareholders with an opportunity to approve a company's remuneration policy; the second a mechanism for shareholders to hold companies accountable for its application (e.g. appropriate use of discretion or approval of awards prior to grants) in any given year.

SECTION 2: THE IMPLEMENTATION OF THE COMBINED CODE

The quality of disclosure by companies

Specific issues for further consideration requested by the FRC consultation include:

- *The extent to which it would be possible and desirable to rationalise the disclosure requirements set out in the Code. We would particularly welcome the views of investors on what information is of most value to them, and the views of companies on what information is most costly to produce.*
- *Whether it would be appropriate for the FRC or the FSA to undertake greater monitoring and enforcement of “comply or explain” statements, and if so what form this might take.*

Views are invited on these issues, and on whether there are any other actions that the FRC might take to encourage more informative disclosure.

RMG Response

RMG believes that the Code currently provides appropriate guidance on the structure and processes which companies are required to follow. However, disclosure which results from the undertaking of such processes is often limited. An area that has been highlighted in our response to Section 1 discusses the boiler-plate nature of disclosure surrounding the board evaluation process. Furthermore disclosure is often limited when assessing the company's remuneration arrangements in a number of areas.

Remuneration structures have grown ever more complex and shareholders are often unable to derive a clear picture of the correlation between the amount payable to executives and the corresponding shareholder return relative to performance targets, which is the single most important ‘data point’ for them. Emphasis should be placed on a justification of relative outcomes for executives and shareholders. Any disclosure mandate which provides a clearer picture of this relationship would be a significant step forward. It would be preferable if companies were to provide an explanation detailing how remuneration is clearly linked to the strategic objectives, targets and key performance indicators set out in the Company's Business Review. Remuneration committees should ensure that the performance measures chosen are aligned with business strategy and motivate executives appropriately, without promoting or rewarding disproportionate risk taking.

Companies should also closely examine the behaviour and the design of remuneration packages, particularly the attitude of executives to risk, which should become a factor considered, explained and disclosed in conjunction with a company's remuneration policy as a whole.

In respect of the annual bonus arrangements, many companies has fail to provide any clear retrospective disclosure of the performance metrics used under this plan. Although it is acknowledged that due to commercial sensitivity companies may not be able to disclose the specific targets set, it would provide greater insight for shareholders if companies clearly disclose the performance metrics used, their relative weightings and their vesting schedule. Furthermore, shareholders expect to see a full disclosure in the remuneration report of the extent to which the relevant targets were actually met, which is rarely the case.

RMG is supportive of the FRC being primarily responsible for greater monitoring and enforcement of “comply or explain” statement.

Engagement between boards and shareholders

Specific issues for further consideration requested by the FRC consultation include:

- *The framework proposed by Sir David Walker, and the appropriate role for the FRC.*
- *What role, if any, it would be appropriate for the FRC to play in encouraging collective engagement.*
- *Whether further guidance on best practice for companies, investors or proxy voting services would be helpful, either in the Combined Code or elsewhere, and whether the practices currently recommended in Sections D and E of the Code continue to represent best practice.*
- *What other steps might be taken, by the FRC or others, to encourage both companies and investors to be more proactive about regular engagement and with a longer term focus than the annual results presentations.*

RMG Response

RMG is supportive of the narrative contained in the pre-amble in the section. RMG supports the principle of open engagement between companies and shareholders (shareholder bodies). In all cases engagement works best when both parties are transparent and open and are willing to receive explanations and provide feedback.

One way of overcoming this problem is for companies to use shareholders first as a sounding board for intended changes it wishes to pursue before subsequently submitting proposals to shareholders for formal approval at general meetings. This will ensure that companies have the option to take into consideration shareholder feedback in a timely manner without 'last minute' surprises and embarrassment as a result of shareholder opposition displayed at a general meeting.

This works best when shareholders are forthcoming with clear opinions and companies are willing to embrace and act on such feedback. At times companies need to be more open to shareholder feedback and if necessary 'go back to the drawing board' instead of pursuing proposals known not to be supported by its shareholders. When shareholders approach companies to engage on any concerns that they may have, companies should not see such engagement or accompanying adverse feedback to be intrusive or 'shareholders being difficult'.

It is also important that when companies do undertake company-led engagement initiatives, they present the 'whole picture' and not just specific areas they require shareholders to support. Many companies undertake a consultation process with shareholders regarding proposed changes to their remuneration arrangements. However, on many occasions where shareholders have devoted much time to the proposals presented to them, they then find that upon publication of the annual report the company failed to transparently explain other aspects of their remuneration policy and subsequent practices (the unwarranted use of discretion) which may not be acceptable to shareholders.

RMG concludes that effective pro-active engagement is centred upon open and transparent discussion by both parties and a willingness to listen and address any concerns exchanged.

RMG is supportive of a governance and engagement policy statement appearing with the same prominence as traditional investment policy statements on institutional investor websites, in literature etc. This would reinforce good governance as an integral part of investment policy. Whether statements should be made relative to a single code of best practice as a benchmark is more open to debate. However, it is noted that the ISC Statement of Principles as a framework has already received considerable industry support. Whether this will help address the 'free-rider' issue is debatable but being required to report will provide a greater degree of transparency for beneficial owners regarding the governance and engagement policies of asset managers (or lack thereof) which can, in turn, be more effectively monitored. As also previously stated, the 'explain' approach required of companies could be an appropriate model for shareholder reporting.

Regarding the appropriate custodian of a governance code for investors, we note the respective cases to be made for the FRC, as the independent regulator responsible for promoting confidence in corporate governance; for the ISC, as author of the Statement of Principles (though obviously not independent and, not a regulator); and the FSA, as the regulator of the investment industry. Perhaps the situation can be reviewed as analogous to the requirement for companies to report against Combined Code provisions, imposed by the FSA via listing requirements, with the principles and their monitoring under the guardianship of the FRC.

RMG does not consider it is necessary to be prescriptive regarding the mode of collective engagement considering that the FSA has cleared the way for collective engagement by its recent announcement that it would not fall foul of its market abuse and holdings disclosure provisions. A number of investor representative bodies and networks already exist which are able to facilitate and administer collective engagement.

RMG supports the principle of shareholders working together but this should not be seen as shareholders acting in concert.

RMG supports the requirement that institutional investors should disclose a governance and engagement policy statement. RMG is supportive of institutional investors being required to report regularly on the implementation of both voting and engagement activity. As background, some European market commentators criticise the US N-PX filings format for providing a large volume of undifferentiated data whilst not providing sufficient context about why certain voting decisions were taken, which were the most important and the extent to which engagement was undertaken to address issues of concern.

RMG therefore suggests that ISC members could develop models of good practice rather than a regulator being overly prescriptive about specific formats. RMG believes that areas which could be included are on broadly two levels. At a basic level there should be a formal overview report reflecting the voting universe and the percentage of votes opposing management proposals. At a more detailed level, for underlying clients only, a report should be produced which includes individual voting and engagement records.

SECTION 3: Ambiguities in the Combined Code

One area of the Code that is ambiguous in nature concerns the classification of the board chairman.

The Code (A.2.2) suggests that the chairman should on appointment meet the independence criteria as set out in the Code (A.3.1). This is supported by the footnote in A.3.1 which clarifies that '*A.2.2 states that the chairman should, on appointment, meet the independence criteria set out in this provision, but thereafter the test of independence is not appropriate in relation to the chairman*'.

This provision originates from the Higgs review which argued that '*Once appointed, the chairman will have a much greater degree of involvement with the executive team than the non-executive directors. Applying a test of independence at this stage is neither appropriate nor necessary*' (Higgs Report 2003: 5.9).

This principle is supported by the Code provision (A.3.2) which excludes the chairman from the assessment of board balance. Consistent with this approach, the chairman is not considered to be part of the majority independent denominator when assessing the composition of a nominations committee.

The classification of the chairman becomes more ambiguous when considering his classification on the remuneration and audit committees. The amendment to the 2008 Code allows the chairman to be

a member of the remuneration committee, and for smaller companies, the audit committee provided that the chairman was considered independent on appointment.

Supporting the argument that as a formal member, the chairman brings considerable value to the role of the remuneration and audit committee, shareholders understand the spirit of this provision to allow the chairman to be a formal member provided that he/she was considered independent upon appointment and, other than any conflicts that may arise due to his role as chairman of the board, continues to fulfill the test of independence should this be applied. This ensures that the independence of such committee is not compromised.

However, this approach is not accepted by some companies who argue that, as written, this flexibility only requires the chairman to have been assessed as independent at the time of appointment and excludes any issue since that time that may have compromised one or more of the criteria of independence.

RMG encourages the FRC to review this and provide clearer guidance in this area as we would expect the test of independence to continue to be relevant, aside from the fact that the individual is board chairman.

Another area of ambiguity concerns the specification of the composition of the remuneration committee, which, unlike the guidance provided for the audit committee, does not clearly states that the committee should be fully independent. This once again creates differing interpretations and merits clarification.