

(Submitted by email to codereview@frc.org.uk)

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Dear Sirs

Response to Review of the Effectiveness of the Combined Code Call for Evidence

We welcome the opportunity to respond to the current review of the effectiveness of the Combined Code.

The present financial crisis is quite rightly prompting a thorough re-evaluation of many aspects of political, regulatory and corporate attitudes generally. We acknowledge that it is right that the Code should also be re-appraised. However, whilst it is both timely and imperative that all those associated with corporate governance should take an active role in re-assessing and testing all aspects of the Combined Code, we believe that the Code with its 'comply or explain' principles based approach continues to provide the optimum mechanism for translating into practice the basic principles of good corporate governance. It ultimately enables boards to work better in the long-term interests of the company. In our view the Code has, in general, raised corporate governance standards.

Given that jurisdictions which have adopted different regulatory approaches to corporate governance have suffered similar failures, we believe that this is indicative of the fact that many of the issues that have emerged are not linked to the effectiveness of the Code per se.

GSK, like many other broad based industrial companies, does not believe that the current governance model is broken. We adopted a risk-based approach to management many years ago. As a pharmaceutical company we operate in a highly regulated environment where failure could impact peoples' health. The finance industry may not have been fully aware of the risks it was taking, but we do not believe that this is necessarily reflective of UK plc generally.

We believe that it is important for boards to include members who have relevant sector or industry experience, such as former CEOs or senior executives. Each such appointment would need to be carefully assessed to establish the scope for potential conflicts of interest and whether these could be managed without impeding the director's participation in board activities. However, relevant industry expertise greatly benefits board deliberations and enables the non-executive team to challenge from a position of strength proposals from management on industry specific issues. From GSK's perspective, we have already identified the need for board members

with scientific knowledge to bring an independent perspective to debate on scientific issues. In our view this has proved beneficial.

We are concerned to learn that PIRC has suggested the need for a "fundamental reform" of corporate governance. We do not believe that this is necessary. More particularly we do not believe that their proposal for employee representation on boards is worthy of further consideration. Boards should comprise individuals who can bring specialist knowledge and expertise to board deliberations in the long-term interests of shareholders. An employee director would not necessarily be best placed to take this view and would most likely be primarily concerned with the best interests of employees. There are other ways for companies to ensure they hear the voice of their employees which would be more effective than appointing them onto the board. Neither do we support PIRC's proposal for the FRC to be rolled into the Financial Services Authority. The FRC's expertise and independence in overseeing and managing corporate governance is balanced and measured. It operates on a principles-based perspective rather than a rules basis. It is more appropriate for assessing and measuring companies' adherence to a principles based Code. Now is not the time for reflex actions. It is important for a period of reflection before implementing fundamental change which will impact UK listed companies during a period of economic strain.

Please find attached our responses to both the specific questions raised in your call for evidence and the more general areas of the Code upon which you have stated that you would particularly welcome views.

Should you have any queries please do not hesitate to contact either me or Victoria Whyte, (Deputy Company Secretary) (020 8047 4509).

Yours faithfully



Simon Bicknell
Company Secretary

Specific Questions:

1. Which parts of the Code have worked well? Do any of them need further reinforcement?

We believe that the Code is currently working well.

It is evident that, since the Code first came into being, in a number of ways shareholder oversight, facilitated through the Code and its 'comply or explain' principle, has proved very effective; improving openness on governance issues, generally highlighting and eradicating rewards for failure, and helping alignment of pay and performance. It has also embedded the move to a clear division of responsibilities at the top of companies with the separation of the roles of CEO and Chairman, and the need for effective internal controls.

Our comments on possible further reinforcement to parts of the Code are detailed within our various responses below.

2. Have any parts of the Code inadvertently reduced the effectiveness of the board?

We do not believe that the Code has reduced the effectiveness of boards.

The Code was never intended to ensure the effectiveness of boards rather to create a framework around which boards would operate to try to ensure good governance. The failures in one sector should not be seen as a failure in the Code per se.

The 'comply or explain' philosophy means that one Code can work for a variety of different companies enabling companies to tailor their approach to governance to suit their own needs, provided that they can, and do, 'explain' any departures from the Code.

It could be argued that the Code may have inadvertently reduced the effectiveness of investors who take a false sense of security from reading a company's compliance rather than choosing to understand sufficiently how their asset managers are discharging their Code responsibilities. However, we have no evidence that this is the case based on our own engagement with investors. Our investors take seriously their obligations and seek to ensure that they have properly understood how the company operates.

3. Are there any aspects of good governance practice not currently addressed by the Code or its related guidance that should be?

No. We believe that the Code is fit for purpose.

The clarity which came with the creation of the Code was welcomed by companies. It provides a bar against which companies can be measured and evaluated. However over time, a plethora of guidelines and codes have been developed by investors and other groups. These often seek to go further than the Code and unfortunately place additional often conflicting requirements on companies. We do not believe that the Code needs to change. Rather if institutions are content that the Code provides the right checks and balances on corporate governance then it would be helpful if these competing codes and guidance notes could be withdrawn. This would reduce the burden on companies to keep abreast of the numerous alternative codes and guidelines and help focus their attention on the Code.

Remuneration policies can provide an insight into an overall governance mindset. The current crisis has indicated a need for additional remuneration checks and balances within financial institutions. Within certain UK banks individuals appear to have been incentivised to chase performance, without having full regard to their company's long-term interests and appropriate risk profile. Much attention is therefore currently being focussed on what additional safeguards should be introduced around remuneration. The European Commission has recently adopted recommendations on remuneration in the financial services sector and for directors' pay. PIRC have made recommendations for additional disclosure, and the G20 proposed that there should be global standards for the remuneration of banking executives. These and other recommendations should be considered and resolved before any change is made to the Code. It is also vital that remuneration policy is always set in relation to the achievement of a company's strategic objectives and in the context of its own risks. This could be further stressed in the Code.

In the context of the above, the FRC might also wish to take the opportunity to remind companies, via the Code or in related guidance, of their Companies Act obligations that if remuneration risk exists which represents a principal risk to the business then that risk would need to be disclosed in the enhanced business review sections of their annual reports.

4. Is the 'comply or explain' mechanism operating effectively and, if not, how might its operation be improved?

Yes, we believe that the mechanism is operating effectively.

Section 2 of the Code currently states that *"Institutional shareholders should enter into a dialogue with companies based on the mutual understanding of objectives"*. Frustration can arise when a company feels that it is having a 'one way' conversation. It is important that when shareholders accept an invitation to be consulted on an issue, they reciprocate by unambiguously stating their view and clarifying matters if this view changes.

It has been suggested that shareholders are, in part, to blame for the current crisis, having not been sufficiently attentive or having been unwilling or unable to fulfil their duties, we recognise that investors can walk a fine line between stewardship and activism. They can often appear to be in a 'no win' situation in such matters, being severely criticised in some quarters when they do intervene against a company's management. Fund managers can also sometimes be unwilling to 'go nuclear' for a perceived but unfounded fear of somehow being cut off from their otherwise good ongoing working relationship with a particular company. We nevertheless believe that the Code should emphasise the need for shareholders to engage early privately on issues about which they have concerns.

We endorse the stance being taken by the International Corporate Governance Network (ICGN) that any proposed change in this area should come from shareholders themselves through the reform of the internal governance of the institutional shareholder community.

As you will be aware, ICGN has issued a Statement of Principles on Institutional Shareholder Responsibilities, which goes further than the Code. ICGN is advocating better oversight from each institutional shareholder's board of directors or other governing body, and transparency and accountability (through the disclosure of

advisers, consultants, policies and mandates) for all those in the chain of investment. They believe that asset managers and others in a similar agency position should also develop clear decision making procedures/policies with regard to the governance of investee companies and for voting of clients' shares. We also believe that there could be greater coordination between some fund managers and their corporate governance functions.

General Points:

5. The composition and effectiveness of the board as a whole.

Some boards and individual directors may well behave differently when they are being closely observed by investors. For this reason it is vital that the 'comply or explain' mechanism of the Code should always be effectively enforced by shareholders. Ultimately, however, boardroom behaviour will stem from the personal integrity of the individuals on the board. This is a key prerequisite when a nominations committee is considering prospective board candidates.

We would also stress the importance of ensuring that a board includes non-executive directors with personal experience from within its business sector or industry. A former CEO or retired senior executive would bring practical experience and insight into board deliberations. Careful attention would obviously need to be given to ensure the likelihood of any conflicts arising were minimised or managed.

The Code already clearly sets out that Chairman should ensure that the Board continually update and refresh their skills and their knowledge and familiarity with the Company to fulfil their roles both on the Board and on its committees. It requires the Chairman, in conjunction with the Company Secretary, to take responsibility for ensuring that this happens. We therefore do not agree with recent calls that have been made for mandatory directors' training and continuing professional development.

6. The respective roles of the chairman, the executive leadership of the company and the non-executive directors.

Dominant management has proven to be a key theme in a number of recent cases of failure or fraud. Boards should bear this in mind to ensure that they always act to support the role of the chairman in his efforts to balance the non-executive and executive elements of the board so as to maximise the effectiveness of the board as a whole. In this regard, the chairman's role is obviously pivotal in identifying issues for consideration and debate by the board as a whole.

It is also important that the non-executive directors should have full confidence in the skills and judgement of the executive directors and the executive management team.

7. The board's role in relation to risk management.

The Code already clearly sets out that it is the board (rather than its committees) that should maintain and review a sound system of internal control to safeguard shareholders' investment and the company's assets. The FRC may wish to give this greater prominence in the guidance that accompanies the Code.

The Code also already recognises that risk is matter for the whole board and not one for which responsibility can simply be abrogated to non-executive directors with their very finite time constraints or to the executive team.

The Code requires boards to demonstrate that they have informed themselves of the prevailing risks and satisfied themselves that the systems in place to eliminate and/or manage risks are sufficiently sound to safeguard the company's assets. The directors, and particularly the non-executive directors, have a duty to ask probing questions.

The board's role is not to take decisions about management of a company's business, rather, it exists to appoint the chief executive officer (CEO) and to critically appraise the business plan of the company and the strategy for its execution as proposed by the CEO and the executive team. The board's role is to monitor the company's performance against that plan and the strategic objectives. Boards need to avoid straying into areas of management, so as to be able to continue to see the 'wood for the trees'. More importantly boards must avoid delegating to board committees the responsibility for matters that should be reserved for the attention of the board as a whole.

8. The role of the remuneration committee.

GSK believes that the current requirements of the Code for remuneration are appropriate and clearly set out the principles that should be followed to avoid imbalance. As mentioned previously, the European Commission and the G20 have recently made recommendations on reform or further regulation of directors' and executive pay. These and other recommendations should be considered and evaluated before any change is made to the Code.

We believe that the Code should explicitly stress the need for the remuneration committee to work closely with the audit committee in assessing the impact of remuneration risk on the business. In setting pay, the remuneration committee should ensure it fully understands (through careful modelling of potential payouts over a meaningful time frame and in a variety of business scenarios) the extent to which complex pay arrangements will be effective in promoting the long-term success of the business.

9. The quality of support and information available to the board and its committees.

The Code already states that the board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. It requires the Chairman to take responsibility for ensuring that this objective is fulfilled. It is difficult to see what further clarity could be given. We do not believe that the Code could be made much clearer on this point.

Further there have been proposals that Secretariats should be made independent to assist non-executive directors in this respect. We believe that a fully integrated Secretariat can provide most value by ensuring the provision of accurate and balanced information to the board. A well run Secretariat links the executive with the non executive directors and ensures that the information that is presented to the board is appropriate and not ambiguous. A separate and isolated independent Secretariat would not necessarily be able to assess and assist the Chairman in carrying out his obligation under the Code.

10. The content and effectiveness of Section 2 of the Code, which is addressed to institutional shareholders and encourages them to enter into a dialogue with companies based on a mutual understanding of objectives and make considered use of their votes.

Although we do not believe there is need for fundamental change there are a few areas where improvement could be made. In principle we believe the Code is and continues to be fit for purpose.