The Law Society

Combined Code review

Response of the Company Law Committee of the Law Society of England and Wales

The Law Society of England and Wales is the representative body of over 120,000 solicitors in England and Wales. The Society negotiates on behalf of the profession and makes representations to regulators and Government in both the domestic and European arena. This response has been prepared on behalf of the Law Society by members of the Company Law Committee. The committee is made up of senior and specialist corporate lawyers.

Guiding principles

We support the guiding principles underpinning the Review, as set out on page 6 of the Review.

The responsibilities of the chairman and the non-executive directors

It is for companies to assess the correct balance between experience and independence when selecting a NED. We do not see this as requiring a Code change, though boards might be reminded that it is for them to determine the independence of a particular director taking all material factors into account and that they should not apply the guidance in the Code in a mechanistic fashion.

In relation to the Walker Recommendations, we do not feel it is necessary for the Code to be so prescriptive in relation to the wider listed company arena. We do not think guidance on role and time commitment in the Code will be helpful, given the diversity of companies and roles.

We note that BOFIs may well sit under an unregulated listed company but we do not think that this justifies wider Code changes.

Board balance and composition

The requirement for boards of FTSE 350 companies to comprise at least 50% NEDs has, we believe, resulted in boards becoming larger. However companies should be less hidebound about the need to comply where they can give a satisfactory explanation for the reasons for their divergence from the Code.

We do think that non-BOFI listed companies need NEDs. Given the acknowledged need to maintain and improve corporate governance standards, it surely runs entirely counter to this to suggest that not having NEDs with the absence which that would entail of 'independent' checks at board level could provide a workable model.

We are not clear what more could be included in the Code on succession plans. The supporting principles to main principle A4 seem sufficient.

Frequency of director re-election

Whilst we do not think that significant issues would be caused in practice by annual re-election of some specific directors or all directors, we do not believe that it would be particularly helpful except in specific situations (and companies do, as noted, sometimes offer up all their board for re-election at present). Walker Recommendation 36 has some logical appeal, but we believe that generally, in cases where companies have received signals of shareholders dissatisfaction through their voting on a remuneration report, they have acted on that before their next AGM and so we are not sure that more regular election of directors would serve any purpose. Perhaps, greater analysis is required in this area.

There are a significant number of tools in the Companies Act 2006 allowing members to generate debate on particular issues (by allowing them to requisition meetings, propose resolutions or business, require the circulation of statements, have their questions answered at AGM or raise audit concerns). Those options, when combined with the possibility of informal consultation, might suggest that a general requirement to propose an advisory vote on the corporate governance report is unfocussed and unnecessary.

Board information, development and support

We agree that the board should have thematic business awareness sessions. We believe that it would be helpful if the full board attended such sessions and not just NEDs.

We are not supportive of creating a dedicated support structure for NEDs by divorcing the secretariat from the executive function as we do not believe that it would improve the effectiveness of the secretariat.

On neither of these issues, nor on Walker Recommendation 9, do we believe that change to the Code is required.

Board evaluation

We do not think that it is appropriate to recommend external facilitation of board evaluations. We think that it is for the boards themselves to determine how best to carry out the evaluations.

We support the concept of a rolling cycle of committee reviews in place of the requirement of annual evaluation, but in that case companies may wish to interrupt the rolling order and carry out fresh evaluations of all of them where there has been significant change, for example following a merger.

Assurance statement – we do not think that it would be helpful to impose on companies a requirement for them to produce an “assurance statement”. We think that it is important that

additional requirements should only be imposed on companies where there is considered to be a real demand for the information. All disclosure requirements impose additional burdens on companies in terms of time and expense and we risk making the UK main market unattractive for listing if the requirements become too onerous.

Risk management and internal control

We believe that non-BOFI companies should be free to decide for themselves whether to have a separate risk committee from the audit committee. In many cases there may be greater benefits to retaining risk within the terms of reference of the audit committee.

We do not believe that there are issues with the legal framework in this area.

Remuneration

We believe that the underlying issues on risk and remuneration relationship are less significant for non-BOFI companies. Such issues clearly can arise - for example, in the FSA enforcement notice following the FSA's investigation into Shell's over-statement of its reserves the SEC's concerns about the use of reserves targets in score cards affecting variable pay were noted - but we do not see any compelling reason why non-BOFI companies should have any curtailment on devising their own remuneration structures.

We think the Review should consider the extent to which the remuneration Committee is responsible for reviewing remuneration structures below board level and perhaps for providing guidance on pay for staff whose remuneration should be disconnected with corporate performance such as, perhaps, compliance functions.

We are not sure what direct role could be given to shareholders in relation to the setting of remuneration. We think that such a role would be difficult to create other than through the establishment of an independent committee - which role is fulfilled by the remuneration Committee.

Comply or apply?

We do not believe that the change from 'comply or explain' to 'apply or explain' is significant. There is a fine semantic distinction between "comply" and "apply" in this context.

Stewardship agenda

We do not consider that the possible development of some form of stewardship concept for long-term shareholders which is floated in the Walker Report should be reflected in the Code.

We note the clarifications provided by the FSA and the Takeover Panel in relation to collective negotiation by groups of shareholders. Those clarifications are helpful but we do not understand what is intended by the suggested Memorandum of Understanding. Concerted action by shareholders may lead to a requirement for them to make announcements in relation to their combined holdings under the Disclosure and Transparency Rules and to issues in relation to trading in knowledge of their discussions.

The creation of a secure network of 'special' long investors does not sit easily with the general principle of transparency or with UK corporate law. It is also important that the principle of equal treatment for shareholders is not sacrificed. We query to what extent shareholders would have the depth of knowledge or time to play a meaningful role in the active management of investee companies.

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