



**Gartmore Investment  
Management Limited**

Gartmore House  
8 Fenchurch Place  
London EC3M 4PB  
Telephone +44 (0) 20 7782 2000  
Fax +44 (0) 20 7782 2075  
Telex 896873 GIM G

[www.gartmore.com](http://www.gartmore.com)

C Hodge  
Corporate Governance Unit  
Financial reporting Council  
5th Floor, 71-91 Aldwych  
London  
WC2B 4HN

Email: [codereview@frc.org.uk](mailto:codereview@frc.org.uk)

30th September 2009

Dear Mr Hodge

## **Re: FRC Review of the Effectiveness of the Combined Code**

Gartmore is an independent, specialist asset management firm whose focus is the provision of investment products to a broad range of institutional and retail investors. Gartmore has offices strategically located in London, Tokyo, Boston, Madrid and Frankfurt. Interests in Gartmore Investment Management Limited are held by private equity funds affiliated with Hellman & Friedman LLC, and members of Gartmore's fund management and executive teams and a number of employees. Assets under management total some £20.329bn.

Gartmore endorses the view of the FRC that it is appropriate to review the workings of the Code in the light of the failings in the financial system made plentifully evident in hindsight. We agree with summary of the feedback given on p3 of the consultation document that the quality of corporate governance 'ultimately depends on behaviour not process' and that consequently a 'soft law' approach is the most effective way of facilitating a move towards best practice and to allow for developments in what represents best practice.

In his review Sir David Walker has produced a list of thirty nine recommendations which concern regulation, company governance, remuneration and the role of institutional shareholders in engaging with companies which are intended to apply to Banks & Other Financial Institutions. Gartmore considers that many of Sir David's recommendations could equally apply to other quoted companies and as far as possible would wish to see a single Combined Code applied by all listed companies. In so far as particular requirements are necessary for BOFIs, these should be as few as possible. While some of the governance recommendations could be considered over-prescriptive (such as the suggestions on the time requirements for NEDs and chairmen), we consider that the broad thrust of the recommendations is in the right direction and we do not wish to comment on them individually.

Rather we wish to respond on the role of institutional shareholders and on changes to the governance code that should improve the interaction between companies and their shareholders.

In the introduction to the FRC consultation document, the FRC draws attention to the need for companies and investors to act 'in the spirit not just the letter, of the code and "comply or explain"'. Gartmore would endorse this sentiment. However, we fear that too often the written statements in the annual accounts on governance and remuneration issues are produced in a safety first standardised language drafted with more legal input than effort to explain.

Gartmore considers that there is an opportunity for companies embrace more fully the spirit of explanation required by the Code and for the review to assist this process. This could be done by enhanced reporting and enhanced accountability through increased frequency of election for the chairs of the company and committees

Gartmore considers that there are opportunities for making the annual report and accounts more useful for all shareholders which include:

- Fuller and more nuanced discussion of risk and strategy in the business review.
- A proper assessment of board effectiveness and the work of the nomination committee
- Greater assurance on the financial statements through enhanced disclosure and more nuanced discussion of the audit process

Changes should be made to the Combined Code to promote greater discussion at board level of the board's effectiveness and shareholders should be given greater clarity in the annual report by the company's nomination committee or equivalent body. The nomination committee report should show

- The conclusions of the annual review of board effectiveness, including whether the review had an external element and proposed actions which follow from the review including arrangements for induction, familiarisation and training of directors and the resources made available to them for independent advice
- A summary of the soundings taken by the company from its shareholders
- A review of any recruitment activity undertaken at board and senior executive level
- Arrangements which have been made for executive succession
- Arrangements made for regular renewal of the Chairman and NEDs

Changes should be made to the Combined Code to encourage more openness about the role of the audit process. Encouragement should be given to statutory auditors, through a safe-harbour mechanism, to provide a more qualitative commentary on elements in the annual accounts through an enhanced True & Fair Valuation report, more frequent reporting of matters of emphasis reporting, and comments on assumptions used and on internal controls.

Too often the annual audit committee disclosure is little more than a summary of its terms of reference whereas the role of the committee would be strengthened if the report was more forthcoming about its activities and how it had discharged its responsibilities

- Reviewing the effectiveness and independence of the statutory auditor
- Approving the appointment, remuneration and engagement terms of the statutory auditor
- Approving the use of the auditor for non-audit services
- Reviewing the effectiveness of the internal controls environment
- Reviewing the annual and interim accounts

## **Enhancing Accountability**

Gartmore supports the ISC proposal to increase access to the board by requiring committee chairs to stand for annual re-election.

We believe that the preparation of the further reports from the audit and nomination committees would be of benefit to companies by encouraging them to think through the associated issues on a formal basis. We consider that the proposal to require the annual re-election of committee chairs would strengthen the sensitivity of the board in dealing with shareholders and would strengthen the hand of non-executive directors in their dealings with executives as the committee chairs would need to take even greater responsibility for the areas under their guidance.

### **Role of Institutional Investors**

Gartmore recognises that responsible fund managers should, on behalf of their clients and underlying beneficiaries, exercise the rights attached to holding shares, in particular the right to vote on significant company business at the annual general meeting. Gartmore also recognises that these rights have generated 'soft power' by which institutional shareholders engage in dialogue with the senior management of companies and thereby influence the direction that companies take. Gartmore seeks to play this responsible role and to comply with the ISC statement on the Responsibilities of Institutional Shareholder and Agents.

Nevertheless, Gartmore does not believe that increasing the role and duties of institutional shareholders will inevitably result in the better performance of companies for the following reasons:

- Institutional shareholders do not uniquely possess foresight in the direction of markets either for shares or products which would ensure that all their interventions are successful and collectively their interventions are as likely to confirm existing trends as to warn against them
- Institutional shareholders are at an informational disadvantage compared to incumbent management by not being insiders and if made insiders are at the disadvantage that their ability to influence by buying or selling is removed.

The role of the institutional shareholder is more analogous to that given the sovereign in Walter Bagehot's *The English Constitution* – 'the right to be consulted, the right to encourage, the right to warn'.

Gartmore welcomes the Walker review proposals for the development of a code based on the *ISC Statement of Principles – the Responsibilities of Institutional Shareholders & Agents* to incorporate those sections of the Combined Code which refer to institutional investors and for these Principles of Stewardship to form part of the remit of the FRC (Walker Recommendations 16-18). Gartmore also welcomes the proposal that fund managers should signify on their web sites how they seek to discharge their stewardship responsibilities (Walker Recommendation 19). However, because we harbour doubts that the case for the efficacy of such principles has been clearly established or clear cut evidence provided of the beneficial impact of such a model of interaction with companies, in the review, Gartmore does not consider that the review has made the case that the Stewardship principles should yet form part of the FSA authorisation process (Walker Recommendation 20). Similarly we doubt that an annual review of the principles would

be required and suggest that it might be more appropriate if the Principles of Stewardship are reviewed on the same cycle as the Combined Code (Walker Recommendation 18).

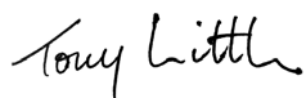
While Gartmore has no objections in principle to the concept of a Memorandum of Understanding to govern collective engagement by shareholders, we have in the past engaged with companies in conjunction with other shareholders without the need for such an Understanding and do not yet see the advantage to be gained by such formalisation. Of greater concern is the remaining doubt generated by the efforts of the Takeover Panel to clarify the circumstances limiting engagement and the relationship of their clarification to the EU directive on acquisitions (Walker Recommendation 21).

Gartmore recognises a responsibility to disclose to clients how it has acted on their behalf and believes that this responsibility extends to proxy voting and engagement. However, we do not believe that it has been established that there is a duty to disclose to the wider public. We have received very few requests for disclosure of proxy voting from individuals or bodies who are not clients. We did not consider that the review had made a case for its recommendation on public disclosure (Walker Recommendation 22) and would be concerned if a requirement was imposed analogous to the SEC requirement on mutual funds which generates large volumes of information but little understanding of the actions of the funds concerned.

Walker Recommendations 14 & 15 require the board and the FSA, as appropriate, to investigate, understand and where necessary react to changes in the composition of the share register with the implication that the reason for significant share sales should be understood. These recommendations imply an onus on institutional shareholders to be willing to disclose to the company or the FSA the reasons for its transactions. Gartmore is willing to accept such a responsibility.

If you wish for any further information, we would be only too happy to assist.

Yours sincerely

A handwritten signature in black ink, reading "Tony Little". The signature is written in a cursive, flowing style.

Tony Little  
**Head of Corporate Governance**