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9 October 2009

Ref: EY2009

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Dear Mr Hodge

## FRC's second review of the Combined Code for 2009

### INTRODUCTION

1. Ernst & Young LLP welcomes the opportunity to comment on the *Review of the Effectiveness of the Combined Code, Progress Report and Second Consultation 2009* ("the Consultation") issued by the Financial Reporting Council ("FRC"). This has prompted us to revisit our response to your earlier review, dated 29 May 2009, and amplify some of our remarks.
2. In our earlier comments we explained why the Combined Code ("the Code") was, in our opinion, fit for purpose and should therefore be left unaltered. Our view remains unchanged.

### OVERALL COMMENTS

3. As we said at the time, altering the Code to reflect the circumstances of the financial crisis would, in effect, be tampering with a set of principles which have successfully helped to promote good governance across most business sectors in the UK. We added that key issues faced by the banking sector (involving but not solely attributable to corporate governance matters) are in many respects unique to that sector and are being addressed accordingly by the government and FSA. We took the view that regulatory change will be developed for and applied to the banking sector in the not too distant future, in response to the review led by Sir David Walker, *A review of corporate governance in UK banks and other financial industry entities*, 16 July 2009.



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4. We believe that Sir David Walker's recommendations, once finalised, will offer banks and other financial institutions (BOFIs) highly appropriate corporate governance principles, as long as they remain proportionate and carefully targeted towards BOFIs. In our view this is more likely to be achieved if the recommendations are maintained and promulgated by the FSA. Some could be incorporated as principles into non-binding guidance. Others might be better served as rules enforced by the FSA or Stock Exchange.
5. The alternative, as suggested in the Consultation, would require the FRC to patch-in or append Walker's recommendations to the Code. In our view this could lead to: i) a two-tier Code with different principles applying to different companies, creating additional cost, complexity and potential confusion for stakeholders; or ii) an enlarged Code which requires companies to over-govern themselves, with measures that may be excessive for their risk profiles and business models.
6. If either approach is taken, we are concerned that it might jeopardise the overall effectiveness of the Code for all sectors. For example, companies which find requirements of the Code disproportionately high might be deterred from following it and explaining the reasons why. Similarly, if a two-tier Code were to exist, those companies which are expected to comply or explain against the "lower tier" (which makes comparatively less governance requirements) may feel compelled by stakeholders to comply with the "upper tier", or at least offer an explanation as to why they have chosen not to *go the extra mile*. This would be, in effect, a requirement to "explain *and* comply", counter to the overarching principle of the Code.
7. Finally, if a decision is taken to build Walker's recommendations into the Code, we encourage the FRC to consider how this would sit alongside the UK's *Statutory Code for Regulators 2007*. This requires that 'regulators should consider the impact that their regulatory interventions may have on economic progress, including through consideration of the costs, effectiveness and perceptions of fairness of regulation'.

## CONCLUSION

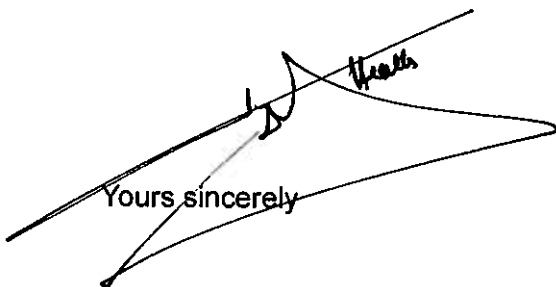
8. We have reviewed Walker's recommendations and believe that once they are finalised, they have the potential to provide BOFIs with an effective set of corporate governance principles. However, in our opinion they stand the best chance of success if they are targeted and used proportionately, which means limiting their scope to BOFIs.
9. Since the FSA has the closest proximity (in regulatory terms) to this relatively small sector, it would seem better placed than most to help make sure the final recommendations have the desired effect. We say this because we want the Walker Review to make a change for the better, a view we have already expressed in our response to the Review which we would be happy to share with the FRC.
10. We are grateful to the FRC for publishing this consultation and we hope you have found our comments helpful. If you would find it useful, colleagues in our firm are available to discuss further any of the points we have raised.



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11. We wish you every success with the rest of the consultation process and encourage you to publish all non-confidential responses, including this one, shortly after the closing date. We look forward to reading the results.



Yours sincerely

Robin Heath  
UK Managing Partner  
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