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FRC Review Of The Effectiveness Of The Combined Code
Progress Report And Second Consultation

Dear Chris,

Thank you for giving the Institute of Directors (IoD) the opportunity to comment on your consultative document, published on 28 July 2009. Issues surrounding corporate governance are of considerable interest to the IoD and its membership. We are therefore pleased to present our views on each of the recommendations that are proposed by your review.

About the IoD

Founded in 1903, and granted a Royal charter in 1906, the IoD is an independent, non-party political organisation of 50,000 individual members. Its aim is to serve, support, represent and set standards for directors to enable them to fulfil their leadership responsibilities in creating wealth for the benefit of business and society as a whole. The membership is drawn from right across the business spectrum. 92% of FTSE 100 companies have IoD members on their boards, but the majority of members, some 70%, comprise directors of small and medium-sized enterprises, ranging from long-established businesses to start-up companies.

Introductory comments

Our detailed views on the effectiveness of the Combined Code have already been submitted as part of your consultation of March-May 2009. We do not wish to excessively replicate the views of that earlier consultation. In this document, we focus on the recommendations of the recent Walker Review, and consider their potential applicability to the Combined Code and the work of the FRC.

The ostensible focus of the Walker Review is on the corporate governance of Banks and Other Financial Institutions (BOFIs). However, the potential impact of its recommendations extend well beyond the financial sector. As you state in your Progress Report (p.2), the Walker Review will be a “particularly important” input into the FRC Review of the Combined Code. Furthermore, the Walker Review itself envisages that most of its recommendations will be incorporated as “guidance and provisions in the Combined Code” (p.10).

Our initial observation is that the Walker Review (hereafter referred to as the Review) provides an informed and reasoned response to a number of important corporate governance issues. To its credit, it has not been unduly influenced by populist demands to overthrow the overall UK model of corporate governance (which is based on a distinctive mixture of hard and soft law) in favour of a heavily regulated approach.

Equally, the Review has recognised – given the magnitude of recent governance failures – that an unthinking defence of the status quo is untenable. Reflecting this, it has made a number of significant recommendations for reform.

However, a number of the Review's recommendations – although potentially relevant to systemically important financial institutions – would not be desirable governance standards for non-financial companies. As a result, we would not support such proposals being adopted into the Combined Code (which applies to companies in all industry sectors).

In our view, the Combined Code should consist of high level best practice principles for all listed companies. It should not be carved-up on a sectoral basis. A move towards incorporating sectoral provisions into the Code would represent an excessively prescriptive approach to the overall corporate governance framework, and an unwarranted presumption on behalf of regulators regarding how specific industries and sectors should structure their activities.

The key factor that distinguishes the necessary governance framework of systemically important financial institutions is the need to protect the taxpayer. As has been clear during the financial crisis, major financial institutions are "too important to fail", and must ultimately be underpinned by the government. There is hence a need to exert tighter control over the risk profiles of financial institutions than would be appropriate elsewhere in the economy.

Consequently, the additional governance safeguards applied to systemically important financial institutions should primarily be a matter for the financial regulator. Finance-specific governance proposals should be incorporated into the financial regulatory and supervisory framework, and not into the Combined Code.

This does not necessarily preclude the use of a "soft law" approach to financial regulation by the financial regulator, e.g. by allowing BOFIs to either "comply or explain" with respect to certain governance recommendations, rather than simply "comply". But this should be undertaken as part of a framework that is separate from the Combined Code (and the FRC).

In contrast, non-financial companies are subject to the discipline of the market, and do not require the same degree of state-led risk control. Outside of the financial sector, the purpose of a governance framework is not to eradicate any possibility of business failure. Indeed, business failure is an unavoidable aspect of the 'creative destruction' process that underpins a dynamic modern economy. An appropriate governance framework is that which maximises the creation of value in the economy as a whole, not that which eliminates the potential failure of individual enterprises.

IoD response to the Walker Review's individual recommendations and applicability to the Combined Code:

Recommendation 1
To ensure that NEDs have the knowledge and understanding of the business to enable them to contribute effectively, a BOFI board should provide thematic business awareness sessions on a regular basis and each NED should be provided with a substantive personalised approach to induction, training and development to be reviewed annually with the chairman.

A major theme of the Review is the need to improve corporate governance through changes to behaviour rather than through the imposition of new rules and regulations. An improved framework for director training and professional development would appear to offer a direct way of influencing such behaviour. However, this recommendation provides only a tentative proposal in this area.

For example, the Review does not consider the potential benefits to behaviour of a shift in the professional status of directors towards a structure more akin to a traditional profession, with training and continuing professional development (CPD) requirements, and an ethical framework within which to operate. There is also no consideration of the role that a more formal professional structure can play in promoting diversity on boards[1].

Related to this, there is also no mention of the Chartered Director qualification, despite the fact that its potential contribution to corporate governance is recognised by an overwhelming number of UK regulatory, investor and business organisations[2]. Although the Chartered Director qualification is not necessarily a complete solution to the issue of director level training (particularly in terms of developing industry-specific knowledge), it offers a baseline framework through which to promulgate norms and standards of appropriate boardroom knowledge and behaviour.

Regardless of whether the Chartered Director route is followed, a more formal approach to board training is needed. As a part of the annual appraisal process by the chairman and each director, there should be a discussion and resolution around training needs on an individual basis. Directors should keep a record of CPD hours and the type of training undertaken. The board's individual and collective training activities could even be disclosed to external stakeholders.

In summary, we believe that the Review could have given significant impetus to the professionalism of boards by inclusion of a more prescriptive statement of what is expected from director training and ongoing professional development[3].

Recommendation 2
A BOFI board should provide for dedicated support for NEDs on any matter relevant to the business on which they require advice separate from or additional to that available in the normal board process.

We agree with this recommendation. It is similar to the proposal that we made in our submission to the Walker Review, although we specifically stressed the role of the company secretary: "The non-executive directors of large, complex companies should have greater access to significant in-house administrative support, coordinated by the company secretary". The recommendation is equally applicable to large unlisted companies in non-financial sectors, and could be included the Combined Code.

There are currently two provisions in the Combined Code that are relevant to this issue. Provision A.5.2 states that "The board should ensure that directors, especially non-executive directors, have access to independent professional advice at the company's expense where they judge it necessary to discharge their responsibilities as directors. Committees should be provided with sufficient resources to undertake their duties". In addition, provision A.5.3. states that "All directors should have access to the advice and services of the company secretary".

In our view, these provisions should be brought together and strengthened within the Code in order to define a more formal responsibility for the company secretary vis-à-vis the support of non-executive directors. Non-executives of large, complex listed companies should have access to significant administrative support and/or research assistance through the company secretary's office. This may include permanent office accommodation, allocated members of staff and a designated budget.

To support this objective, best practice should dictate that the company secretary of a listed company should jointly report to the Chairman (as well as the CEO). If the company secretary reports solely to the

[1] A recent study by Dr Robert Blackburn of Cambridge University (*Gender Inequality at Work in Industrial Countries*) found that women had made significant progress in reaching senior levels in the traditional professions. This contrasts with the lack of gender diversity that still exists on company boards (less than 12% in the FTSE 100). The more formal structure of a "profession" may have the effect of creating more of a level playing field for the participation of different groups in society.
[2] Some of the organisations that have formally endorsed Chartered Director include: The CBI; Co-operative Insurance; National Association of Pension Funds; Hermes; The Building Societies Association; Investors in People; Secretary of State for Business, Enterprise and Regulatory Reform; Department for Education and Skills; Tomorrow's Company; USS; The British Bankers Association; Investment Management Association; The Institute of Business Ethics; The Quoted Companies Alliance; Institutional Shareholder Services; Association of Investment Trust Companies; and the Local Authority Pension Fund Forum
[3] The IoD has proposed the addition of a provision in section A.5 of the Combined Code as follows: "The Chairman should encourage board members to become Chartered Directors or to engage in equivalent professional training that specifically enhances their functioning as company directors".

CEO, he or she may feel inhibited in serving the interests of the non-executives in an independent manner.

The strengthening of the company secretary in the role of supporting non-executives is preferable to that of encouraging non-executive directors to seek independent advice from outside the company. Except in cases where it has been pre-discussed with executive management, the latter approach has the potential to create an atmosphere of mistrust and confrontation between executive and non-executive board members (although it may be necessary in extreme circumstances).

Recommendation 3
NEDs on BOFI boards should be expected to give greater time commitment than has been normal in the past. A minimum expected time commitment of 30 to 36 days in a major bank board should be clearly indicated in letters of appointment and will in some cases limit the capacity of the NED to retain or assume board responsibilities elsewhere.

We agree with the sentiment behind this recommendation. It has similarities with our own proposal to the Walker Review: “The Combined Code should provide guidance on the maximum number of board positions that should be held by directors of listed companies”.

We would be happy to see a provision in the Combined Code that stresses the broad time commitment expected of NEDs. This would make it clear that the NED role is challenging and time consuming. It would also stress that multiple directorships beyond a certain level are not commensurate with best practice.

However, we would not want specific time commitments to be stated in the Combined Code, e.g. in terms of a minimum number of days. This is too prescriptive. Time commitments of individual directors will vary across different types of enterprise. Ultimately this is an issue on which individual boards should make their own judgements.

Recommendation 4
The FSA’s ongoing supervisory process should give closer attention to both the overall balance of the board in relation to the risk strategy of the business and take into account not only the relevant experience and other qualities of individual directors but also their access to an induction and development programme to provide an appropriate level of knowledge and understanding as required to equip them to engage proactively in board deliberation, above all on risk strategy.

We agree with this recommendation in relation to Banks and Other Financial Institutions (BOFIs). BOFIs that are ultimately underpinned by the taxpayer require more effective and wide-ranging supervision from regulators than is necessary for non-financial firms.

As part of this process, supervisors should give detailed consideration to the type of training and ongoing professional development that is required of directors. As we have argued with respect to recommendation 1, there is a need to go beyond expressions of generic support for the concept of professional development. A more defined professional framework – incorporating training and induction processes (particularly relating to the risk oversight role) - is needed for the directors of large, complex financial institutions.

Recommendation 5
The FSA’s interview process for NEDs proposed for major BOFI boards should involve questioning and assessment by one or more senior advisers with relevant industry experience at or close to board level of a similarly large and complex entity who might be engaged by the FSA for the purpose, possibly on a part-time panel basis.

We agree with this recommendation.

Recommendation 6
As part of their role as members of the unitary board of a BOFI, NEDs should be ready, able and encouraged to challenge and test proposals on strategy put forward by the executive. They should satisfy themselves that board discussion and decision-taking on risk matters is based on accurate and appropriately comprehensive information and draws, as far as they believe it to be relevant or necessary, on external analysis and input.

We agree with this recommendation. Non-executive directors should be clear that it is their duty to challenge and test the proposals of the executive in a constructively critical manner. In slightly adjusted form, this recommendation is equally relevant to non-financial companies, and could be included in the Combined Code.

Recommendation 7
The chairman should be expected to commit a substantial proportion of his or her time, probably not less than two-thirds, to the business of the entity, with clear understanding from the outset that, in the event of need, the BOFI chairmanship role would have priority over any other business time commitment.

We agree with this recommendation. It is equally relevant to non-financial companies, and could be included in the Combined Code.

However, as with Recommendation 3, we would prefer that specific time commitments (i.e. the two-thirds proposal) are not stated in any Code provisions. Rather, the significant time commitment required of a chairman should be described in qualitative terms. Exact or minimum time commitments should be left to individual boards.

Recommendation 8
The chairman of a BOFI board should bring a combination of relevant financial industry experience and a track record of successful leadership capability in a significant board position. Where this desirable combination is only incompletely achievable, the board should give particular weight to convincing leadership experience since financial industry experience without established leadership skills is unlikely to suffice.

We agree with the sentiment behind this recommendation. However, this is not something for the Combined Code. It should be taken into account by the financial regulator when assessing the suitability of potential BOFI chairmen.

Recommendation 9
The chairman is responsible for leadership of the board, ensuring its effectiveness in all aspects of its role and setting its agenda so that fully adequate time is available for substantive discussion on strategic issues. The chairman should facilitate, encourage and expect the informed and critical contribution of the directors in particular in discussion and decision-taking on matters of risk and strategy and should promote effective communication between executive and non-executive directors. The chairman is responsible for ensuring that the directors receive all information that is relevant to discharge of their obligations in accurate, timely and clear form.

We agree with this recommendation. It is equally relevant to non-financial companies, and should be included in some form within the Combined Code.

Recommendation 10
The chairman of a BOFI board should be proposed for election on an annual basis.

We agree with this recommendation. It is equally relevant to non-financial companies, and should be included in the Combined Code.

We believe that an annual re-election of the chairman is a more viable suggestion than that of annually re-electing the entire board. An annual vote on the chairman would highlight the central role of the chairman in the functionality of the board, and increase his or her specific accountability to the owners of the company.

Recommendation 11
The role of the senior independent director (SID) should be to provide a sounding board for the chairman, for the evaluation of the chairman and to serve as a trusted intermediary for the NEDs as and when necessary. The SID should be accessible to shareholders in the event that communication with the chairman becomes difficult or inappropriate.

We agree with the viewpoint expressed in this recommendation. However, we are not convinced that it adds a great deal to the provision that is already present in the Combined Code (and which has already been largely incorporated into board practice over the last 6-7 years).

Recommendation 12
The board should undertake a formal and rigorous evaluation of its performance with external facilitation of the process every second or third year. The statement on this evaluation should be a separate section of the annual report describing the work of the board, the nomination or corporate governance committee as appropriate. Where an external facilitator is used, this should be indicated in the statement, together with an indication whether there is any other business relationship with the company.

Recommendation 13
The evaluation statement should include such meaningful, high-level information as the board considers necessary to assist shareholders understanding of the main features of the evaluation process. The board should disclose that there is an ongoing process for identifying the skills and experience required to address and challenge adequately the key risks and decisions that confront the board, and for evaluating the contributions and commitment of individual directors. The statement should also provide an indication of the nature and extent of communication by the chairman with major shareholders.

The above recommendation is welcome. However, it could have been bolder in encouraging the adoption of more meaningful board evaluation practices.

According to a recent ICSA report, only 21% of the 200 largest UK companies currently undertake board appraisal utilising external assessors. The vast majority undertake some form of self-appraisal. However, this lacks objectivity, and is unlikely to provide much reassurance to external stakeholders regarding the functionality of the board. Consequently, the Walker Review's encouragement of externally-driven board evaluation is welcome.

However, a problem with external board evaluations is that they can be expensive, often manipulated by the Chairman and CEO, and opaque in adding value. Furthermore, external consultants utilise a wide variety of different approaches (sometimes of dubious quality) in order to implement board evaluations. As a result, an externally-facilitated board evaluation does not necessarily guarantee that the right questions have been asked, or that board functionality has been tested in a rigorous manner.

If board evaluation processes are to become more meaningful – both in terms of adding value to boards and providing sufficient reassurance to shareholders – the application of a more consistent board evaluation approach across listed companies should be encouraged by the regulatory authorities[4]. As with a financial audit, the use of a recognised evaluation methodology would offer some reassurance that a robust board evaluation process had taken place. This would then be disclosed to stakeholders in annual reports.

Although the Walker Review notes that a more standardised approach to board evaluation "may emerge over time as a matter of best practices" (p.58), such a development could have been given greater impetus through the tabling of an explicit recommendation in the Review.

Recommendation 14
Boards should ensure that they are made aware of any material changes in the share register, understand as far as possible the reasons for changes to the register and satisfy themselves that they have taken steps, if any are required, to respond.

We agree with this recommendation. Information on this issue should be a regular part of the reporting package that is distributed to NEDs. It is applicable to listed companies in all sectors.

Recommendation 15
In the event of substantial change over a short period in a BOFI share register, the FSA should be ready to contact major selling shareholders to understand their motivation and to seek from the BOFI board an indication of whether and how it proposes to respond.

We have significant doubts about the second half of this recommendation, even with respect to systemically important financial institutions.

On the one hand, dialogue with the shareholders is likely to represent an important aspect of the financial regulator's market intelligence activities.

However, it is unrealistic to believe that the regulator should fulfil some kind of intermediary function between shareholders and boards. In such a role, they are likely to be both ineffective and subject to potential manipulation by market participants.

Regulators and shareholders have different interests and incentives. Regulators should focus on their own role, rather than attempting to act as messengers or interpreters of the interests of other market actors.

Recommendation 16
The remit of the FRC should be explicitly extended to cover the development and encouragement of adherence to principles of best practice in stewardship by institutional investors and fund managers. This new role should be clarified by separating the content of the present Combined Code, which might be described as the Corporate Governance Code, from what might most appropriately be described as Principles for Stewardship.

We agree with this recommendation. It is similar in nature to the proposal that we submitted to the Review: "Investors should be subject to their own combined code, with regard to which they should either "comply or explain".

We believe that the FRC is an appropriate body to take "ownership" of the proposed "principles for stewardship". Under the umbrella of the FRC, a wide range of stakeholders should have input into defining behavioural norms for fund managers.

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[4] This was proposed by the IoD in its consultation response: "A standardised boardroom appraisal process should be endorsed by the main stakeholders of the UK corporate sector (i.e. regulators, investors and boards). Listed companies should be encouraged to undertake this appraisal process on an annual basis, and disclose the outcome in their annual report".

It would not make sense for the new code to be defined and administered by the fund management industry itself. Indeed, the whole purpose of the new code is to try and overcome the short-termist and/or insufficiently engaged ownership approach that is practised by many money managers.

Recommendation 17
The present best practice "Statement of Principles – the Responsibilities of Institutional Shareholders and Agents" should be ratified by the FRC and become the core of the Principles for Stewardship. By virtue of the independence and authority of the FRC, this transition to sponsorship by the FRC should give materially greater weight to the Principles.

We agree with this recommendation. It represents a practical starting point for the proposed new "principles of stewardship" for fund managers. However, it is important that the Principles subsequently evolve to reflect the interests of a wider constituency than the fund management industry alone.

Recommendation 18
The ISC, in close consultation with the FRC as sponsor of the Principles, should review on an annual basis their continuing aptness in the light of experience and make proposals for any appropriate adaptation.

We believe that the FRC – not the ISC – should conduct this review. The fund management industry would of course be an important stakeholder in the review process. But it is not appropriate for the industry itself to define its own code of behaviour. The code should evolve under the aegis of an independent arbiter of the entire stakeholder community, such as the FRC.

Recommendation 19
Fund managers and other institutions authorised by the FSA to undertake investment business should signify on their websites their commitment to the Principles of Stewardship. Such reporting should confirm that their mandates from life assurance, pension fund and other major clients normally include provisions in support of engagement activity and should describe their policies on engagement and how they seek to discharge the responsibilities that commitment to the Principles entails. Where a fund manager or institutional investor is not ready to commit and to report in this sense, it should provide, similarly on the website, a clear explanation of the reasons for the position it is taking.

We agree with this recommendation.

Recommendation 20
The FSA should encourage commitment to the Principles of Stewardship as a matter of best practice on the part of all institutions that are authorised to manage assets for others and, as part of the authorisation process, and in the context of feasibility of effective monitoring to require clear disclosure of such commitment on a "comply or explain" basis.

We agree with this recommendation.

Recommendation 21
To facilitate effective collective engagement, a Memorandum of Understanding should be prepared, initially among major long-only investors, to establish a flexible and informal but agreed approach to issues such as arrangements for leadership of a specific initiative, confidentiality and any conflicts of interest that might arise. Initiative should be taken by the FRC and major UK fund managers and institutional investors to invite potentially interested major foreign institutional investors, such as sovereign

wealth funds and public sector pension funds, to commit to the Principles of Stewardship and, as appropriate to the Memorandum of Understanding on collective engagement.

We agree with this recommendation.

Recommendation 22
Voting powers should be exercised, fund managers and other institutional investors should disclose their voting record, and their policies in respect of voting should be described in statements on their websites or in other publicly accessible form.

We agree with this recommendation.

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Recommendation 23
The board of a BOFI should establish a board risk committee separately from the audit committee with responsibility for oversight and advice to the board on the current risk exposures of the entity and future risk strategy. In preparing advice to the board on its overall risk appetite and tolerance, the board risk committee should take account of the current and prospective macro-economic and financial environment drawing on financial stability assessments such as those published by the Bank of England and other authoritative sources that may be relevant for the risk policies of the firm.

This recommendation may be of relevance for certain large and complex financial institutions. However, even for many BOFIs, it may be overly prescriptive. Ultimately, the board is best placed to determine the precise format of its committees and management structures, based on its specific needs and circumstances.

Such a recommendation would not represent best practice for non-financial companies (or smaller listed or unlisted enterprises). In most cases, the establishment of a dedicated board risk committee would reduce the focus and accountability of the main board in respect of risk oversight issues.

Risk oversight – alongside strategy – is a central responsibility of the board as a whole. Just as it would be unthinkable for strategy to be delegated to a particular board member or committee, it is inappropriate to suggest that risk oversight should be allocated to a sub-group of the board unless this was deemed necessary in particular company circumstances.

Given that this recommendation would only be applicable to a relatively narrow range of companies, we would not wish to see it incorporated within the Combined Code. It is ideally best incorporated within the financial regulator's supervisory regime.

Recommendation 24
In support of board-level risk governance, a BOFI board should be served by a CRO who should participate in the risk management and oversight process at the highest level on an enterprise-wide basis and have a status of total independence from individual business units. Alongside an internal reporting line to the CEO or FD, the CRO should report to the board risk committee, with direct access to the chairman of the committee in the event of need. The tenure and independence of the CRO should be underpinned by a provision that removal from office would require the prior agreement of the board. The remuneration of the CRO should be subject to approval by the chairman or chairman of the board remuneration committee.

Once again, this recommendation may be of relevance to certain large and complex financial institutions. But it would not make sense with respect to many other types of enterprise.

Risk oversight is the responsibility of the entire board, and risk management is the responsibility of the entire executive team. Best practice should not imply that responsibility or accountability for these functions should be delegated to particular individuals or sub-committees.

Consequently, this recommendation should not be incorporated in the Combined Code, although it may well be a factor for consideration by financial supervisors when evaluating the risk profile of a systemically important financial institution.

Recommendation 25
The board risk committee should have access to and, in the normal course, expect to draw on external input to its work as a means of taking full account of relevant experience elsewhere and in challenging its analysis and assessment.

This is a principle that should apply to any board committee, and to the board as a whole. We do not see the purpose of a statement of this kind that relates to a particular board committee.

Recommendation 26
In respect of a proposed strategic transaction involving acquisition or disposal, it should as a matter of good practice be for the board risk committee to oversee a due diligence appraisal of the proposition, drawing on external advice where appropriate and available, before the board takes a decision whether to proceed.

These types of transactions are ultimately a matter for the board as a whole. How the board chooses to conduct its due diligence should be a matter for individual boards. It is too prescriptive – even for systemically important financial institutions – to stipulate that such transactions should be evaluated by a particular board committee.

Board committees exist to support the operation of boards, not to create an additional administrative burden.

Recommendation 27
The board risk committee (or board) risk report should be included as a separate report within the annual report and accounts. The report should describe the strategy of the entity in a risk management context, including information on the key exposures inherent in the strategy and the associated risk tolerance of the entity and should provide at least high level information on the scope and outcome of the stress-testing programme. An indication should be given of the membership of the committee, of the frequency of its meetings, whether external advice was taken and, if so, its source.

There is already a risk disclosure section in the business review, which forms part of the annual report. We do not see the purpose of creating an additional risk report within the annual report, even with respect to systemically important financial institutions.

We recognise that a financial supervisor may require a more detailed risk report from BOFIs than is published in the annual report. However, this is something that should be defined within the financial supervisory framework.

Recommendation 28
The remit of the remuneration committee should be extended where necessary to cover all aspects of remuneration policy on a firm-wide basis with particular emphasis on the risk dimension.

We agree with this recommendation.

Recommendation 29

The terms of reference of the remuneration committee should be extended to oversight of remuneration policy and remuneration packages in respect of all executives for whom total remuneration in the previous year or, given the incentive structure proposed, for the current year exceeds or might be expected to exceed the median compensation of executive board members on the same basis.

We agree with this recommendation, although we see it as being primarily applicable to the financial sector.

Recommendation 30
In relation to executives whose total remuneration is expected to exceed that of the median of executive board members, the remuneration committee report should confirm that the committee is satisfied with the way in which performance objectives are linked to the related compensation structures for this group and explain the principles underlying the performance objectives and the related compensation structure if not in line with those for executive board members.

We agree with this recommendation, although we see it as being primarily applicable to the financial sector.

Recommendation 31
The remuneration committee report should disclose for "high end" executives whose total remuneration exceeds the executive board median total remuneration, in bands, indicating numbers of executives in each band and, within each band, the main elements of salary, bonus, long-term award and pension contribution.

We agree with this recommendation, although we see it as being primarily applicable to the financial sector.

Recommendation 32
Major FSA-authorised BOFIs that are UK-domiciled subsidiaries of non-resident entities should include in their reporting arrangements with the FSA disclosure of the remuneration of "high end" executives broadly as recommended for UK-listed entities but with detail appropriate to their governance structure and circumstances agreed on a case by case basis with the FSA. Disclosure of "high end" remuneration on the agreed basis should be included in the annual report of the entity that is required to be filed at Companies House.

We agree with this recommendation, although we see it as being primarily applicable to the financial sector.

Recommendation 33
Deferral of incentive payments should provide the primary risk adjustment mechanism to align rewards with sustainable performance for executive board members and executives whose remuneration exceeds the median for executive board members. Incentives should be balanced so that at least one-half of variable remuneration offered in respect of a financial year is in the form of a long-term incentive scheme with vesting subject to a performance condition with half of the award vesting after not less than three years and of the remainder after five years. Short-term bonus awards should be paid over a three year period with not more than one-third in the first year. Clawback should be used as the means to reclaim amounts in limited circumstances of misstatement and misconduct.

We support the principles of bonus deferral and clawback with respect to variable remuneration awards. Executive remuneration in all sectors of the economy – and in the financial sector in particular – needs to be better aligned with the company's long-term performance and risk appetite.

However, this recommendation is too prescriptive in terms of its structuring of variable pay policy. Different companies require different approaches to remuneration. In particular, it would not make sense to impose the above parameters on remuneration policy outside of the financial sector.

The FSA has already published its own remuneration code for FSA-regulated financial entities. That code should guide the FSA's assessment of the appropriateness of a BOFI's remuneration policy, and the implications of such a policy for regulatory capital requirements.

For non-financial companies, a less prescriptive statement of best practice remuneration principles – possibly in the form of guidance to the Combined Code – would be an appropriate way to promote best practice in remuneration.

Recommendation 34
Executive board members and executives whose total remuneration exceeds that of the median of executive board members should be expected to maintain a shareholding or retain a portion of vested awards in an amount at least equal to their total compensation on a historic or expected basis, to be built up over a period at the discretion of the remuneration committee. Vesting of stock for this group should not normally be accelerated on cessation of employment other than on compassionate grounds.

We agree with this recommendation.

Recommendation 35
The remuneration committee should seek advice from the board risk committee on an arm's-length basis on specific risk adjustments to be applied to performance objectives set in the context of incentive packages; in the event of any difference of view, appropriate risk adjustments should be decided by the chairman and NEDs on the board.

We feel that this recommendation is too prescriptive, and not applicable to companies outside of the financial sector. It also assumes the existence of a risk committee, which is not necessarily something that we would favour (see comment relating to recommendation 23).

Our preferred recommendation would state that the remuneration committee should take account of risk factors when recommending performance objectives set in the context of incentive packages, with the ultimate decision being made by the board as a whole.

Recommendation 36
If the non-binding resolution on a remuneration committee report attracts less than 75 per cent of the total votes cast, the chairman of the committee should stand for re-election in the following year irrespective of his or her normal appointment term.

We agree with this recommendation. Such a process would serve to increase the accountability of the remuneration committee vis-à-vis shareholders, and increase the "teeth" of the advisory vote on remuneration. We would be happy to see this proposal incorporated into the Combined Code, and applied to all listed companies.

Recommendation 37
The remuneration committee report should state whether any executive board member or senior executive has the right or opportunity to receive enhanced pension benefits beyond those already disclosed and whether the committee has exercised its discretion during the year to enhance pension benefits either generally or for any member of this group.

We agree with this recommendation.

Recommendation 38
The remuneration consultants involved in preparation of the draft code of conduct should form a professional body which would assume ownership of the definitive version of the code when consultation on the present draft is complete. The proposed professional body should provide access to the code through a website with an indication of the consulting firms committed to it; and provide for review and adaptation of the code as required in the light of experience.

We recognise the concern regarding potential conflicts of interest experienced by remuneration consultants that serve both remuneration committees and executive management.

However, the proposal to create of some kind of self-defined code and “professional body” for remuneration consultants – although probably not a harmful step – will not do much to increase the transparency and objectivity of consultant’s role in the setting of executive pay.

Our preferred approach is for companies to disclose in their annual remuneration reports the identity of any remuneration consultants that are advising the remuneration committee. This disclosure should also include a statement of whether such consultants are also receiving fees from executive management.

This would promote transparency on the issue, and increase external confidence that the remuneration committee is receiving objective advice. If the same remuneration consultants were advising both the board and executive management, this could be challenged by shareholders. Shareholders could subsequently object to company policy by voting down the remuneration report at the AGM.

Ultimately it is the remuneration committee – on behalf of the board as a whole - that should bear primary responsibility for executive pay, including the use of consultants.

Recommendation 39
The code and an indication of those committed to it should also be lodged on the FRC website. In making an advisory appointment, remuneration committees should employ a consultant who has committed to the code.

We broadly agree with this recommendation (subject to the above caveats).

Thank you once again for inviting the Institute of Directors to participate in this consultation. We hope you find our comments useful.

Yours sincerely,

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