FINANCIAL REPORTING COUNCIL

SECOND CONSULTATION

REVIEW OF THE EFFECTIVENESS OF THE COMBINED CODE

1. The comments below are from Pinsent Masons LLP, a top 15 UK full service commercial law firm, acting for private and public sector clients worldwide. They have been drafted by Martin Webster, the head of our corporate governance unit within our Corporate group which comprises 43 partners and more than 100 other lawyers. The latest Hemscott guides put us fourth among law firms for the number of fully listed clients and first for AIM clients. The firm was voted Legal Firm of the Year at the Real Business/CBI FDs' Excellence awards in May 2009.

2. We are not responding to all of the issues you have noted in your July 2009 Progress Report and Second Consultation and will instead confine our comments to a number of the specific points raised by you.

3. In May 2009 we responded to your March 2009 Call for Evidence and will not repeat here the points made then.

4. As a general point, we take the view that many of the recommendations from the Walker Review are of equal application to at least the larger listed companies (say those in the FTSE 350). We have identified below those which we think would be particularly useful.

Guiding principles

5. We support the guiding principles you have set out in the Introduction to Section 1 of the Progress Report.

Responsibilities of the chairman and the non-executive directors

6. We would not support the suggestion that the Code should prescribe further the role and responsibilities of the chairman, the senior independent director and the non-executive directors. There is a danger in being too prescriptive in this area. Boards and individual directors need to define their respective roles in ways which suit them, their companies and shareholders. Further non-binding guidance may be useful, perhaps drawing on the useful discussion in the Walker Review.

7. Again, without being too prescriptive, it may be useful to give guidance on the time commitment expected in larger companies from these individuals. That will at least help legitimise the inevitable increase in remuneration which will result.

Board balance and composition

8. We will enclose with this note a copy of our response to the Walker Review. Please note particularly our comments there on balance and diversity on the board.

9. We believe the "nine year rule" should be dropped. Designed as an indication of when a NED may have become "stale" or "gone native", it has been interpreted as a firm rule and is the most common "breach" identified by those who do not properly understand the "comply or explain" basis of the Code. Companies and their shareholders should be left to decide whether a director who has served more than nine years is still a worthwhile member of the board with something valuable to contribute. The appraisal process should be an adequate means of testing this and, if that process is more transparent, shareholders should be aware that the question has been considered and a conclusion reached.

Frequency of director election

10. We feel the debate about frequency of election of directors is rather artificial. In reality, if there were a 75% shareholder vote against a matter of relevance to a particular director (for example the chairman, or the remuneration committee chair) it seems inconceivable that the director would wish to stay. A 75% vote against is a fairly emphatic vote of no-confidence and surely the director concerned would have resigned long before a subsequent vote on re-election came around.

11. The current system of re-electing directors every three years is something of a lottery. A director may be very unpopular with shareholders but if he does not come up for re-election at the AGM, he stays in place; another director may be largely unconnected with the subject of shareholder discontent but, if he happens to be up for re-election, he may suffer for the sins of others.

12. It seems to us that there are two logical solutions: either drop any requirement for re-election and rely on the shareholders' ability to remove any director at any time by a simple majority vote; or require all directors to submit to annual re-election. The first would be seen as a retrograde step and is not politically feasible. In the case of the second, it is difficult to see what would be lost by implementing such a proposal. If directors only feel secure in their posts because, once elected, they know they don't have to face shareholders for another three years, there is something badly wrong in their relationship with the company's owners.

13. We would therefore advocate that the Code at least encourages (without requiring) companies to submit all their directors, executive and non-executive, to annual re-election. While removal of directors by shareholder vote is very rare in listed companies, this may well have the advantage of encouraging both the appraisal process for directors and increased dialogue between directors and shareholders.

14. We do not see any advantage in either binding or advisory votes of shareholders on a corporate governance statement or on other specific issues. If the vote is only advisory, what is achieved? (The recent history of advisory votes on remuneration reports does not demonstrate any obvious beneficial result.) If the vote is binding, what is the consequence? What is the company or the board to be obliged to do? If shareholders want to bring about a specific change in corporate governance, they can propose a resolution at the AGM on to achieve their point.

Board information, development and support

15. We strongly endorse the application of the Walker Review recommendations 1, 2 and 9 to all listed companies.

16. We would add an indirectly related point on training. We regularly provide training for boards of directors on corporate governance, directors' duties, the Listing Rules and the Disclosure and Transparency Rules. The request often comes from the executive directors who realise they need regular updates on these topics, and the invitation to the training is extended to the NEDs. Unfortunately, the common reaction from NEDs is that they have received such training before in respect of another company on whose board they sit and they don't need to go through the same issues again. This is unfortunate. No two companies are the same and the application of these rules to different companies will vary, so lessons learned in respect of one company may not be directly relevant to another.

17. Almost more importantly, it is of great benefit for a board to work through these issues together, as a team, to discuss their application to their company and to arrive at a common view. Board training should not be a matter of simply ticking a box, but rather a collective effort at working towards a sound compliance system.

18. We therefore suggest that the Code might encourage boards not only to receive training on a regular basis but to receive it together and to discuss and agree the application of relevant rules to their own circumstances.

Board evaluation

19. We support the application of the Walker Review recommendations 12 and 13 to larger listed companies (say the FTSE 350). Transparency on the appraisal process will be beneficial. Companies should not be shy in describing what they do (and do not do) in terms of board room appraisals.

Risk management and internal control

20. We do not think the Walker Review recommendations 23 to 27 have general application to companies other than those which were the subject of the Walker Review. Non-financial companies should be left to decide the best means of supervising their risk management and internal control.

The quality of disclosure by companies

21. We do not think that the FRC or the FSA should undertake greater monitoring and enforcement of "comply or explain" statements. Such monitoring is a job for shareholders and, if they do not like what they find, it is for them to take appropriate action. The FRC and the Walker Review rightly encourage further engagement by shareholders with companies in which they invest. For the FRC or the FSA to do this monitoring job on behalf of investors would be to excuse them from an important shareholder responsibility.

Engagement between boards and shareholders

22. We strongly support the application of the Walker Review recommendations 14 and 16 to 22 to all listed companies and their shareholders.

If you have any queries on the points made above, or require any further comment, please do not hesitate to contact Martin Webster on 020 7418 9598 or martin.webster@pinsentmasons.com or at Pinsent Masons LLP, CityPoint, 1 Ropemaker Street, London EC2Y 9AH.

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