

29 September 2009

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By email to: codereview@frc.org.uk

Dear Chris,

Review of the effectiveness of the Combined Code – progress report and second consultation

Thank you for the opportunity to comment on the above consultation.

We note that the views expressed in the initial consultation will be taken into account when assessing the overall evidence gathered as part of the review of the Combined Code ('the code'). However, we thought it would be helpful to send our response to the Walker Review, particularly as we have indicated which of the 39 Walker recommendations could be applied to the wider corporate sector. We have also addressed some of the specific questions raised in the progress report.

One general point that has emerged in the light of recent corporate governance developments is that of appropriate names. We would suggest that the time has now come to drop the word 'combined' and that the code should be renamed as the Code of Corporate Governance.

SECTION 1 - CONTENT OF COMBINED CODE

Three guiding principles for reform

- Any changes will be made through amendments to the code or additional non-binding guidance (e.g. like Turnbull)
Agreed
- Rationalise disclosure requirements to encourage more informative disclosure
Agreed
- Preserve principles based style
Agreed

Walker Review

- Which of Walker's recommendations should be applied to wider corporate sector?

Some of our suggestions are on the grounds that Walker's recommendations are not, in our view, substantively different from what is already in the Combined Code. Please refer to the Appendix of our response to the Walker Review for those recommendations we believe could be applied to the wider corporate sector.

The responsibilities of the chairman and the non-executive directors

- Is further clarification required on the roles, expected behaviours etc of the chairman, SID and NEDs?

We believe that the code with its associated guidance is already very comprehensive. Please refer to our comments on Walker recommendations 6, 9 and 11.

- Further guidance required in respect of time commitments.

We do not think this is necessary. In our previous response, we pointed out that 'time poor but experience rich' NEDs can be very valuable. Too much prescription here could reduce the pool of qualified people. What is important is the overall balance of the board in terms of time commitment which, as a whole, is able to dedicate adequate time to the business. Please refer to our comments on Walker recommendations 3 and 7.

Board balance and composition

- Does the code give sufficient emphasis to need for relevant experience among NEDs collectively?

The supporting principles already refer to the balance of skills and experience needing to be appropriate for the requirements of the business. However, the main principle merely says that balance should ensure that no individual(s) can dominate decision making. Maybe the main principle should broaden the concept of balance to include skills and experience more explicitly.

- Have the independence criteria resulted in loss of experience?

The evidence suggests that they have had this effect in the banking sector. We note that the Walker Review cites this as an area where companies should feel free to depart from the code and explain. We agree and feel that this clearly demonstrates the need for ensuring that the 'comply or explain' principle is effective.

- Has 50% NED recommendation resulted in fewer executives on boards and/or larger boards?

This is not an area which we have researched directly.

- Is more guidance needed on succession planning and the need to ensure that board composition is aligned with present and future needs of business?

Yes – we believe that this has been largely overlooked and yet, we believe that when done well, succession planning can make a significant difference to the long-term success of the company. This was demonstrated by some of the case studies which we researched as part of our Enterprise Governance project in conjunction with IFAC. We believe that succession planning needs to relate to both executives and NEDs.

Frequency of director re-election

- Annual re-election of chairman?
- Annual re-election of board committee chairs?
- Annual re-election of NEDs?

We do not believe that the code should recommend annual re-election. As it stands, the code does not prevent annual re-election and we do not think there is any merit in being more prescriptive here. We are not convinced that it would enhance board effectiveness.

- Binding or advisory votes on specific issues or corporate governance statement as a whole?

We believe that this is worth considering.

Board information, development and support

- Should there be more guidance here? E.g. induction, CPD, dedicated support for NEDs etc

Please refer to our recommendations 7, 12,13,14 in our initial response..

Board evaluation

- Should board evaluations be externally facilitated at least every two or three years?

Yes – in our recommendation 9 in our initial response, we argued that evaluation should be subject to independent external review. Every two or three years seems reasonable.

- Should the recommendation that the main board committees be evaluated every year be relaxed e.g. to recommend a rolling cycle of committee reviews?

Yes

- How could disclosures in annual report be more informative either in relation to process and/or outcomes? FRC believes the proposal for an assurance statement merits further consideration – would welcome views on what that statement might cover.

The statement should provide an outline of the process and key areas reviewed. It should focus on skills and experience, time commitments, training, contributions of individual directors, challenge processes, succession planning, key issues considered and information used. It should also indicate support provided both internally and externally. It should disclose that action has been taken to address any shortcomings. We believe that the statement should form a 'stewardship report' by the board.

Risk management and internal control

- Should board's responsibility for strategic risks and setting risk appetite be made more explicit in the code? Is the current balance between code and guidance correct?

Yes, the board's role in risk governance needs to be more explicit. Risk is barely mentioned in the current code where the emphasis is on the need to maintain a sound system of internal control with risk only becoming explicit in the Turnbull Guidance. We believe that it is possible to do this without being unduly prescriptive.

- Should Turnbull be reviewed?

Turnbull is an excellent piece of principles based guidance and does emphasise the board's responsibility to consider the nature and extent of the risks facing the company as well as risk appetite. However, it would be worth reviewing the code to assess whether there would be value in providing some additional material on strategic risk.

- Which bits of Walker are relevant? E.g. separate risk committees

We do not believe that non-financial companies need separate risk committees unless they choose to have them. They should also be free to decide whether they need a dedicated CRO (although there should be a senior executive responsible for risk). But Walker proposals 25-27 are relevant although the provisions would apply to the board/audit committee rather than the risk committee. Please refer to our Walker response.

- How can risk reporting be improved? E.g. by rationalising existing disclosure requirements or providing guidance on good communications tools.

It should be possible to bring all risk reporting requirements together into a single risk report that also incorporates or cross-refers the mandatory elements.

Remuneration

- Whether to revise code to ensure consistency with EU Recommendations, FSA proposed code for BOFIs and Walker recommendations.

Yes

SECTION 2 – IMPLEMENTATION OF COMBINED CODE

Quality of disclosure

- Possible and desirable to rationalise disclosure requirements?

Please refer to Appendix 3 of our initial response which includes the submission that we made to the Walker Review in our capacity as members of the Report Leadership Group. This response highlighted areas that are more important and valuable to investors and where more focus should be given: board agenda, board balance, board reporting, performance evaluation, internal control and risk management, remuneration.

As indicated above, it should be possible to rationalise risk reporting in a way that simplifies requirements whilst incorporating or cross-referring the mandatory elements – most of which require descriptions of processes and risks.

- Is it appropriate for FRC or FSA to undertake greater monitoring and enforcement of comply or explain statements?
Our understanding is that the FSA is responsible for ensuring that comply or explain statements are made. We did suggest as a longer term project whether this arrangement should be reviewed (see recommendation 5 from our initial response). However, we do not believe this to be an immediate priority.
- Any other actions that could encourage more informative disclosure?
Please refer to our Report Leadership Group response (Appendix 3 of our initial submission).

Engagement between boards and shareholders

- Walker framework and appropriate role for FRC
- Role for FRC in encouraging collective engagement
- Further guidance on best practice?
- What other steps could be taken to encourage both companies and investors to be more proactive about regular engagement with a longer term focus.

Please refer to our Walker response; in particular, we strongly support recommendation 17 for the FRC to ratify the proposed Principles of Stewardship. That said, we believe that there needs to be careful consideration of the costs and benefits in relation to improving involvement of shareholders. It may be useful to consider alternative control mechanisms to ensure board accountability.

I hope that these comments are helpful. Please let me know if you have any queries and we look forward to commenting on further consultation papers.

Yours sincerely

GILLIAN LEES

Director of Corporate Governance

