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12 July 2012

By e-mail to codereview@frc.org.uk

Dear Chris,

Smith & Nephew plc Response to Consultation Documents on Revisions to the UK Corporate Governance Code, Guidance on Audit Committees and Revisions to the UK Stewardship Code

Smith & Nephew plc welcomes the opportunity to respond to the Consultation Documents on revisions to the UK Corporate Governance Code, Guidance on Audit Committees and revisions to the UK Stewardship Code. Smith & Nephew plc is a UK FTSE 100 company, with a secondary listing on the New York Stock Exchange. We have around 20,000 registered shareholders and operate in over 30 countries across the world.

We have arranged our comments according to the main themes of the consultation documents as follows:

UK Corporate Governance Code Provision C1.3 (Fair, balanced and understandable)
We are not convinced that the requirement for directors to set out in the annual report the basis on which they consider that the report is fair, balanced and understandable adds very much to the current disclosure framework. There are existing staututory and governance disclosure requirements (for example the directors' responsibility statement, the compliance statement on corporate governance and the auditors' "true and fair" statement) in the annual report which provide comfort on the quality of disclosure. Whilst the "front half" is not audited, the auditors are already required to confirm that the front half does not contain anything that contradicts the "back half". The meaning of "true and fair" is well understood by those who prepare and use annual reports. "Fair, balanced and understandable" however introduces new terminology, where there is no common understanding as to what exactly is meant and this could cause confusion.

Guidance on Audit Committees paragraphs 2.2, 3.3, 4.4 (Extending the role of Audit Committees to consider the role of the whole report and advise on fair, balanced and understandable)
Extending the role of the Audit Committee to consider the whole annual report, including the narrative rpeort in order to advise the Board as to whether the annual report, viewed as a whole, is fair, balanced and understandable represents a significant increase in the role and remit of the Audit Committee. It is the role of the Board to approve the whole annual report and acounts, placing reliance on the appropriate committees, frameworks, processes and controls as well as the Board's own review to reach that conclusion. Whilst the

Audit Committee may be best placed to reveiw some elements of the narrative report, it could be that other Board committees comprising Non–Executive Directors, with slightly different skills and experience might be better placed to review other elements of the narrative report. This will vary from company to company, but could include Risk Committees, Health & Safety Committees or, as in our case, the Ethics & Compliance Committee. We believe that Boards are best placed to determine how and from whom they wish to obtain assurance in respect of the annual report as a whole or particular elements of the narrative report.

UK Corporate Governance Code Provision C3.6, Audit Committee Guidance 4.20 (putting the external audit contract out to tender at least every ten years)

We are supportive of the proposal that the audit contract be put out to tender more frequently, although we are not sure that ten years is necessarily the right length of time for every company. We believe that the Board should determine the appropriate timescale for putting the audit contract out to tender and that therefore any requirement for mandatory tendering should be on a "comply or explain" basis. We recognize that there may well be circumstances in year ten, which might make it impractical to tender the audit contract that year (for example a major transaction or investigation or key personnel changes at the company). Whilst a requirement to tender the audit contract on a ten yearly basis would be workable in most circumstances, this may not be the case for every company, particularly those going through a period of significant transition. We therefore welcome the proposed transitional arrangements for those companies, like ourselves, who have not tendered this contract in the past ten years. We would not support alternative proposals from Europe for the compulsory rotation of external auditors on shorter periods of time and believe that a provision for more frequent within the UK Corporate Governance Code would indicate that UK corporates had a process for addressing the concerns around auditor independence, without having to resort to compulsory rotation.

We do not however support the requirement in the Audit Committee Guidance that Audit Committees should announce their intention to carry out a tender in the following year. There are many reasons why a company might choose part the way through a year that they would wish to tender the audit contract and it would not make sense to delay that tender for another year if a suitable window had arisen, merely because shareholders had not been given prior warning. Similarly, a company might wish to postpone a previously announced tender because of an intervening transaction or other event, which may, in some circumstances, be of a price sensitive nature.

UK Corporate Governance Code – Introductory comments on "Comply or Explain"

We do not believe that companies which deviate from the Code's provisions should be required to indicate a timescale in which they intend to comply, as for some companies, an alternative governance practice may be appropriate and they may never intend to comply. Appropriate explanation for alternative practices should be seen as equally valid as compliance with the Code.

Stewardship Code

We welcome the revised definition of "stewardship" and in particular the distinction made between asset owners and asset managers. We do believe however that there are a number of areas where engagement between issuers and investors could be improved, particularly relating to the voting process, which needs to be streamlined. The current process gives investors very little time to make their voting decisions and submit

their votes to their agents and yet issuers typically only receive the votes through the voting process 48 hours before the meeting. This does not allow for sufficient time for effective engagement. ESMA recently consulted on the role of proxy advisors, which is one part of the voting process. There are however other areas which need attention, which are detailed in the GC100 response to the ESMA consultation (copy attached). We would make the following general points on principle 6:

- We believe that there should be a focus not only on the role of proxy advisors but also on the way that their services are used by investors. Responsible investors use research provided by proxy advisors and then make their voting decisions based on their investment priorities. There are however, some investors, who refuse to engage with issuers and seem to rely entirely on the proxy advisors' voting recommendations. A requirement for shareholders holding in excess of 1% to engage directly with the issuer if they intend to vote against or to withhold their vote would contribute to effective engagement. We would encourage proxy advisors to develop a code of conduct governing their services.

- If investors refuse to engage with issuers in these circumstances, they should then authorise their agents to engage on their behalf, so we can better understand the concerns of our shareholders. It is frustrating when we are unable to engage with either our investors or their agents. Proxy advisors should also be required to share their reports with issuers prior to publication for the purposes of checking accuracy

- The complexities of the voting chain need to be resolved, as this inhibits effective engagement, as does the practice of certain voting agents attempting to sell voting intentions rather than submitting votes through the proper process. At present, it would seem that the custodians, being the registered shareholders, determine the method and timing of voting. We believe, however, that investors, being the asset owners, should have a greater say in when and how votes should be cast on their behalf to allow more time for engagement with companies.

- We welcome the new requirement for disclosure of approach to stock lending and recalling lent stock.

We note that the 7th bullet point under Principle 4 should also refer to General Meetings not EGMs.

We would welcome the opportunity of discussing these points with you further, if that would be useful.

Yours sincerely,

Susan M. Swabey

Susan Swabey
Company Secretary