

Private and Confidential

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Dear Mr Hodge

Review of the effectiveness of the Combined Code - Call for Evidence

We welcome the opportunity to contribute to the third review the Financial Reporting Council has carried out into the effectiveness of the Combined Code, since major revisions were made to it in 2003.

Your review is being carried out, as you acknowledge, in the light of significantly changed economic conditions. We would urge that no fundamental change is made to the “comply or explain” mechanism as a premature response to the effects of the current economic conditions, without suitable research indicating that the mechanism, in itself, is a contributory factor to poorer governance in practice. We do not believe that a more rules-driven approach is likely to improve the real underlying level of corporate governance, whilst it brings with it costs which undermine the relative efficiency of British businesses.

Specific issues comment

1. Which parts of the code have worked well?

The code has significantly increased the disclosure of how Boards and their Committees operate, how remuneration is dealt with and how Boards approach financial reporting, internal control and audit. This has given a welcome degree of transparency to stakeholders, allowing them to make investment and other decisions with more information to hand than they might otherwise have had.

2. Have any parts of the code inadvertently reduced the effectiveness of the board?

There is, intuitively, a sense that the reinforcement of the roles and responsibilities of non-executive directors, which is inherent in the code, has created some divide between executive and non-executive directors. In particular there does appear to be some concern amongst chairmen and chairwomen of Audit Committees that more matters are referred directly to them, even to the point of abrogation by the board as a whole, and

that Audit Committees are simply not broad enough in their composition to deal with highly significant issues on their own. Particularly in small unlisted companies there is a concern that the Audit Committee Chair will often be the only member of that Committee with significant financial experience and thus can receive insufficient support when there is potential conflict with the executive directors, save for the presence of a strong chairman of the Board as a whole.

3. Are there any aspects of governance practice not currently addressed by the code?

The code does not currently address the broader interests of stakeholders other than shareholders. Governance in the broader sense should have some regard to the interests of other important groups, such as lenders and employees.

4. Is the “comply or explain” mechanism operating effectively?

We believe that the “comply or explain” mechanism is an appropriate one for the UK listed company market place. It is our view that good corporate governance is largely determined by an individual business’s “culture” and is the outcome of a number of drivers, such as independence, the diversity and skills of the board, the level of engagement of the Board and the degree of shareholder interest. We believe that the introduction of closely defined rules to promote good governance may well result in much activity, but little underlying change in the culture of the companies concerned, and thus not lead to better governance in practice. However we do recognise that this is largely an anecdotal response and we would welcome appropriate research being undertaken to underpin the present position, or indeed to cause for it to be more seriously reviewed.

5. Content of the code

The present code provisions appear to us to remain largely appropriate.

6. The respective roles of the Chairman, the executive leadership of the company and the non-executive directors

The code provisions appear to us to remain appropriate.

7. The Board’s role in relation to risk management

Whilst we acknowledge that the role of risk management has been highlighted in the current economic environment, risk is an essential component of any business decision, in the same way that opportunity must be. It is tempting to create a particular emphasis on it and to delegate the review of significant risks to committees or create some other mechanism. Indeed it may be appropriate for individual companies to adopt specific mechanisms, but we believe it would be wrong to require it in any way. In essence risk

management is part of the decision making process and a company's management, in the first instance, and its Board should be sufficiently able and experienced, in the listed environment, to think about "what ifs" as they arise. More complex companies may well wish to review the risk management they have undertaken to ensure that they have sensibly understood the risks involved in their activities and in the environment in which they operate, but in our view these should remain matters for the entire board. Again we believe that this is an area where research into the outcome of corporate collapses could usefully identify how risks were overlooked, or under-weighted in terms of their size or impact, in those companies' management and Boards' decision making processes.

8. The role of the remuneration committee

The code provisions appear to us to remain appropriate. Once again, if only to reassure the public at large and investors, it may be sensible to review how remuneration committees operated and what information was disclosed, in relation to those cases that have had a high level of public profile.

9. The quality of support and information available to the Board and its Committees

We believe the code provisions remain appropriate.

10. The content and effectiveness of Section 2 of the code.

We support the principle of dialogue with shareholders. This is an area which appears to be working reasonably well in larger companies, and there does appear to be a rise in shareholder activism, perhaps not unconnected with the economic circumstances. We do query whether the code can actually have an impact for smaller PLCs, given the number of those companies and the relatively small number of significant institutional investors. However the code is phrased in such a way as to encourage behaviour, rather than to require it, and therefore appears to us, again, to remain appropriate.

As we have set out above we believe it is now appropriate to carry out research into the real impact of the Combined Code, or otherwise, in a number of areas. This would give a basis for action that would be sounder than what are necessarily intuitive or anecdotal responses, made in the light of an adverse economic situation, which might therefore lead to "knee-jerk" amendments to the current corporate governance framework. Such changes might not lead to improved governance, which we believe are largely to be driven by internal factors rather, than by regulation.

Should you wish to discuss these comments, please contact James Roberts on 01293-591087.



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Yours faithfully

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