

Mr Chris Hodge
Corporate Governance Unit
Financial Reporting Council
Fifth Floor
Aldwych House
71-91 Aldwych
LONDON
WC2B 4HN

8 October 2009

Dear Sir

Thank you for the opportunity to provide our views on the second consultation in relation to the FRC's review of the effectiveness of the Combined Code.

PricewaterhouseCoopers LLP (PwC) is a leading proponent of good governance, both for our clients and our firm, and we believe it is essential for the wellbeing of any firm. Consequently we welcome this review as an opportunity to reflect on the effectiveness of the Combined Code as a benchmark for best practice corporate governance.

As indicated in our response letter dated 29 May 2009, PwC has, in past years, responded to all of the FRC's consultations concerning the Combined Code. In our responses, drawing on the range of our activities and experience, we have provided comments and opinions on proposed changes by the FRC and also offered suggestions that in our view might lead to improvements in the governance framework. As we indicated in our May 2009 response letter, we have recently undertaken an exercise, through our programme of professional development for non-executive directors, to seek feedback from them on a number of questions around potential changes to corporate governance. We will be pleased to share these findings with you.

In relation to your proposals in the second consultation, we support the three guiding principles whereby amendments will only be made to the Code or additional non-binding guidance provided where clarification of best practice is needed; the FRC will seek to encourage more informative disclosure on the issues of most importance to investors and to discourage boiler-plate and box-ticking; and the FRC will preserve its principles-based approach and seek to avoid an increase in the overall level of prescription.

We believe that the Combined Code should continue to be principles-based and that the 'comply or explain' mechanism is effective, provided there is active and challenging engagement between investors and boards.

Whilst we support many of the recommendations made in the Walker Review for banks and other financial institutions, we believe that incorporating all of these recommendations into the Combined Code will result in additional compliance burdens and costs across all sectors for little benefit.

Indeed, we note that a number of the Walker recommendations around non-executive directors are already implicit in the Code, albeit at a high level.

Overall, we believe that the Combined Code is not a root cause of the current economic crisis and that, intrinsically, it is fit for purpose. We believe that, regardless of the quality of the Code in place, it is the culture, the tone at the top and the personal behaviours of directors that influence the direction of companies and it is very difficult to address these within the existing governance framework. With respect to the behavioural aspects, boards need to regulate themselves, as any rigid set of rules would be too prescriptive and may ultimately restrict entrepreneurialism. However, we support the periodic use of external facilitators in board and director evaluations to underpin the self-regulatory framework and thus enhance market confidence.

We have also addressed in the Appendix to this letter the specific issues raised for consideration in your consultation document. Should you have any questions in relation to our response, please do not hesitate to contact either myself, Pauline Wallace, or Margaret Cassidy at the address above.

Yours faithfully



PricewaterhouseCoopers LLP

Appendix

The responsibilities of the chairman and the non-executive directors

Guidance on roles

Guidance on the role of the chairman is important as this is pivotal to the success of the Board. However, we believe that introducing further material into the Code may be overly prescriptive, since there are already guidance notes in existence about the roles of the chairman, senior independent director and chief executive officer (for example, from the Institute of Chartered Secretaries and Administrators (ICSA)).

For non-executive directors, we believe the current level of guidance is appropriate, although there could be more emphasis around expected behaviours. Whilst we recognise that it is difficult to address these in the existing governance framework, some suggestions about how (legitimately) to act in concert may be helpful for a non-executive director who needs support in opposing a board policy.

Time commitment

According to the 2009 PricewaterhouseCoopers/Monks Non-executive Director Practice and Fees survey, the current time commitment for non-executive directors is around 20 days and around 100 days for Chairmen. This is lower than was suggested by the Walker Review recommendations in both cases.

Our view is that in many cases the time commitment may need to be higher, but it should not be rigidly prescribed. The time commitments set out in the letters of appointment required by the Code for non-executive directors should be realistic, although one size is unlikely to fit all circumstances.

Recommendation number 7 of the Walker Review, suggesting that a Chairman should commit two-thirds of his or her time, also seems overly prescriptive and is unlikely to be appropriate for smaller boards or less complex businesses.

Other comments

There is a need to broaden the pool of non-executive directors and companies should be encouraged to consider this when recruiting non-executive directors.

The FSA has made it clear that non-executive directors will be held to account for failure to act resulting in company failures in the bank and other financial institutions sector. We note that there is existing case law indicating that non-executive directors in non-financial services sectors can also be held liable for failure to robustly challenge when deemed appropriate to do so; the FRC should consider ways to communicate developments in this area to non-executive directors.

Board balance and composition

Relevant experience

Whilst non-executive directors in the UK environment have traditionally been recruited for their general business experience, there now needs to be a focus on achieving an appropriate balance of non-executive directors with industry experience and those without, particularly in more complex businesses.

Impact of 50% independent non-executives recommendation

PricewaterhouseCoopers and Monks survey data suggests that the median board balance is a 50/50 split with 3 or 4 of each of non-executive and executive directors on the Board and that larger

companies tend to have a higher proportion of non-executive directors. Therefore we do not believe that the recommendation that boards of FTSE 350 companies should comprise at least 50% independent non-executive directors has resulted in fewer executive directors sitting on boards and/or boards becoming larger. We believe that the 50% rule is reasonable and should be retained.

Impact of independence criteria

It is often the case that the 'nine year rule' is seen by boards as problematic, but we believe in regular refreshing of the board and consider that it is an effective safeguard against non-executive directors remaining on the board for too long. In practice, where the 'nine year rule' has been exceeded, and the board decides to retain the director as one of the independent non-executives, there is scope to provide an explanation for the departure from this Code provision, normally reflecting the valuable experience brought by the individual and in some cases the current need for stability in the board. The "material business relationship" and five year freeze out period for prior employees may exclude some individuals who could potentially provide valuable business experience. As regards independence criteria in general, in our view it is the demonstrable independence of mind and clear integrity underlying the duties performed by directors that is vital. This could be more explicitly expressed in the Code.

Succession planning

Our experience is that succession planning for key roles is generally poor. Nomination Committees are often not sufficiently pro-active and do not have a dynamic approach to identifying correct skills required in non-executive directors. We recommend that further guidance is provided in this area.

Other comments

There needs to be effective, non-confrontational interaction between non-executive directors and executive directors. The Code might usefully place further emphasis on this.

Frequency of director re-election

Changes to voting

Recommendation 10 of the Walker Review on annual re-election of the Chairman might be considered for inclusion in the Code and thus be made applicable to all companies. We believe that it may be reasonable to re-elect the Chairman every year, as a vote of confidence in the board leadership, but would not wish to extend this proposal to other directors as this could give rise to problems with continuity and could perhaps have the unintended consequence of making reappointment a routine step. Company law already provides investors with the mechanism to remove a director from office if they are dissatisfied with his or her performance, conduct or commitment.

Advisory votes on governance

An advisory vote on specific issues, or on the corporate governance statement as a whole, in a similar vein to the advisory vote on the directors' remuneration report, would encourage boards to improve their corporate governance reporting and avoid the use of boiler plate language.

Board information, development and support

Board information and support

A common issue for non-executive directors is insufficient briefing and insufficient depth of knowledge of issues. The intention behind the Walker recommendation in relation to dedicated support to help the non-executive directors is a good one, but should only be implemented after

appropriate consideration. Having a separate support function may help to ensure that the non-executive directors receive the level of information they need to make informed decisions, but there is potential for overlap and conflict if there are two separate secretarial support functions. We suggest, as a starting point, that the FRC liaise with ICSA to produce examples of different business models where a separate function (possibly outsourced) has been successfully established, and make these available on their web site.

Induction and professional development

Whilst the Combined Code already has principles and provisions relating to updates and induction for non-executive directors, our view is that these principles and provisions could be strengthened by taking into account Walker recommendation number 1, in particular; this advocates thematic business awareness sessions for non-executive directors on a regular basis and annual review with the Chairman of the induction, training and development programme for each non-executive director. However, as noted above, it is recommended that non-executive directors should be encouraged to spend more time in the business, (without becoming in any way executive) to ensure that they can input effectively to strategy and other Board decisions.

More emphasis on the need for ongoing professional development (possibly with some mechanism for monitoring this on an individual basis – e.g. keeping CPD records) may be a useful addition to the Code.

Board evaluation

Regular external evaluations

Effective challenge by non-executive directors is a consistent area of concern in board evaluations. It is difficult to see how the need for this could easily be prescribed in the Combined Code, but regular Board or individual director evaluations may improve the level of challenge.

We agree that periodic (e.g. every 3 years) facilitation of board performance evaluation by a third party would be helpful, although there may be a need for guidance/monitoring of those organisations that offer board reviews.

Evaluation of effectiveness of committees

It is possible that the Committees could be evaluated on a cyclical basis rather than every year, as the current requirement probably leaves little time between reviews for any real change.

Disclosure of process and outcome of evaluations

More meaningful disclosure in this area would be helpful to users of accounts, provided appropriate guidance is in place to help avoid disclosures becoming boiler plate.

We would welcome further consideration on the merit of an 'assurance statement' by the external facilitator but the 'assurance statement' would need to be meaningful for investors and not simply a boiler-plate report.

Risk management and internal control

Comments drawn from our recent survey of non-executive directors suggest that risk assessment and risk management have been areas of weakness both within and outside of the financial services sector and more explicit guidance on the board's role, and specifically the non-executive directors' role in this process would therefore be helpful. This might be developed through additions to the Turnbull Guidance.

For public interest reasons, financial services companies are perceived to need a stronger oversight mechanism for managing risk. As many of the risks faced by banks are not faced by other companies, we are not in favour of all companies needing to have a separate risk committee, as proposed by Walker.

If a company has a separate risk committee, there is a possibility that the executive directors on the board may see risk management as being the responsibility wholly of the committee and the non-executive directors; the terms of reference and operating procedures of any risk committee would need to be carefully defined to avoid confusion with executive management's responsibilities.

There is also scope for overlap of responsibilities between the audit committee and the risk committee; their respective responsibilities would need to be made clear, as well as how reporting to the board, which has ultimate accountability for risk, would work. Our experience is that a degree of common membership of audit and risk committees can be helpful in ensuring that both committees operate efficiently.

On risk identification, we believe that non-executive directors have a reasonable understanding of their role in assisting with the board's agreement on the key risk areas, and setting up the processes to monitor these. However, there is less certainty about their role in relation to risk management: what are they meant to do when they receive reports and to what extent is their involvement appropriate, or should this be an entirely executive function? Clarification of these responsibilities should be provided.

Remuneration

Whilst many of the principles in the Walker report being considered by the FRC are appropriate, including linking remuneration to risk, promoting the long-term interests of the company, remuneration of employees below board level, and the role of consultants, our view is that greater consideration needs to be given to how these can be achieved in practice and guidance for directors in this area would be valuable.

We would question whether shareholders should be given a more direct role in relation to remuneration. There is already a process in place where members have the right to cast an advisory vote on the remuneration report, which works as a control, and we do not believe that the responsibilities of shareholders should be extended in this area. Shareholders also have the facility to vote against re-election of directors, which is powerful.

The quality of disclosure by companies

We consider that there tends to be too much boiler-plate reporting, particularly around risk management. It should be made clear that the disclosure section of Turnbull is not intended to be followed to the letter, but that appropriately full, relevant, transparent reporting should be the aim. Disclosures around risk in the governance statement should be consistent with risk disclosures elsewhere in the report.

In other areas, we believe that current disclosure practices place too much emphasis on providing information on structures and "form", and that the substance of the governance activities is not generally well captured. In the case of board committees, the disclosures should focus on the activities of the committees in the period, rather than a listing of their responsibilities. Steps should be taken to establish more clearly that this is the expectation and to provide guidance as to how it may be achieved by companies. We would note that the annual PwC publication "Best Practice Corporate Governance Reporting" includes examples of disclosure by companies that illustrate good practice.

Engagement between boards and shareholders

As noted in our response to the first consultation, for 'comply or explain' to work effectively it is essential that there is engagement between boards and shareholders. Greater dialogue between investors and boards would undoubtedly be helpful but there is a need for more concrete guidance on both sides to encourage this. Currently, there often seems to be unwillingness from both parties, possibly because the benefits of engagement have not always been realised, and possibly due to the institutional nature of many shareholders. The JCA Group research that the FRC has made available on its website is helpful in highlighting the areas that need to be addressed to improve engagement.

Internal audit

It would be possible to amend the Code provisions on internal audit to give the function a more specific role in risk management and internal control; the current provisions are very limited, merely around the board considering the need for an internal audit function. An alternative would be to include additional material in the Turnbull Guidance on risk management and internal control. We note that the FRC Guidance on Audit Committees considers the role of non-executives on the audit committee in approving the remit of internal audit, but it can be difficult for them to do so, if there is widespread misunderstanding of what an appropriate remit should be in this area. It is noteworthy that Walker makes no mention of internal audit and its role in risk management.

