



STANDARD LIFE



STANDARD LIFE INVESTMENTS

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Sir Christopher Hogg
Chairman
The Financial Reporting Council
5th Floor, Aldwych House
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By email: codereview@frc.org.uk

Dear Sir Christopher

REVIEW OF THE EFFECTIVENESS OF THE COMBINED CODE - PROGRESS REPORT AND SECOND CONSULTATION

We write on behalf of Standard Life plc, as a major UK listed company, and its wholly-owned subsidiary Standard Life Investments Limited, as a major institutional investor. Both companies welcome the Financial Reporting Council's ('FRC') progress report on its review of the effectiveness of the Combined Code on Corporate Governance ('the Code') and are keen to offer their views on the issues for consideration.

At this time we are also submitting our response to the recommendations proposed in the Walker Review, and we would like to reinforce our opinion that the recommendations arising from the Walker Review should, wherever possible, be consistent with and incorporated into the Code, so that, going forward, entities required to comply with the Code, and stakeholders reviewing statements of compliance with the Code can both implement and interpret the Code responsibly and realistically. Equally, we would caution the FRC from adopting within the Code principles, wholesale, any Walker review recommendations which are applicable to banking and other financial institutions ('BOFIs') only. If there are final recommendations which the FRC wishes to reflect in the Code, but which are applicable to BOFIs only, it may be appropriate for these to be included in a "BOFI-specific" guidance note attached to the Code, with the status of the Higgs recommendations.

Standard Life Investments Limited, tel. +44 131 225 2345, a company registered in Scotland (SC 123321) Registered Office 1 George Street Edinburgh EH2 2LL.

The Standard Life Investments group includes Standard Life Investments (Mutual Funds) Limited, SLTM Limited, Standard Life Investments (Corporate Funds) Limited and SL Capital Partners LLP. Standard Life Investments Limited acts as Investment Manager for Standard Life Assurance Limited and Standard Life Pension Funds Limited.

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We support the FRC's intention to "strengthen the Code where it is necessary to do so, but in a proportionate way and avoiding an increase in the overall level of prescription". We would encourage the FRC to cross-refer to our submission on the Walker Review (which we have included) in terms of considering our responses to those recommendations, as well as to refer to our earlier response to the call for evidence on the effectiveness of the Code, which we submitted in May 2009.

We have reviewed all of the issues for consideration from the points of view of both Standard Life plc as an issuer of securities, and Standard Life Investments Limited as an institutional investor.

1. Three Guiding Principles

We support the three guiding principles identified. We agree that most value is derived from the Code by not approaching its implementation from the point of view of a "box-ticking" exercise, and we agree that individual disclosure, appropriate to the circumstances of the entity, is more informative than "boiler-plate" statements. However, we suggest that the FRC may wish to consider providing further guidance in the Code as to how corporate governance reports might be reviewed and interpreted, so that non-standard or explanatory disclosure is viewed in context and in a more enlightened way. As part of this, we recommend that the FRC revisits whether it would be reasonable to amend the "comply or explain" requirement to become an "apply or explain" requirement as this could represent a more realistic assessment of how the Code has been implemented. We are also very supportive of the intention to retain the "principles-based" approach to standard-setting, as we feel that any increased prescription in this area would not be a progressive reaction to any recent corporate governance breakdowns.

2. The Responsibilities of the Chairman and the non-executive directors

Generally we support the issues noted for further potential guidance and clarification, although we believe that there is already significant relevant guidance on the role of the chairman contained in the Code and the Higgs recommendations, and so any additional guidance should build on those foundations. We would not be supportive of a stated minimum time commitment for the chairman, the senior independent director or non-executive director ('NED') board members, as we feel that NEDs should recognise that, in accepting the role, they are committing to the time required to fulfil the requirements of the role, whatever that might be. We are not convinced that the effectiveness of a NED's contribution would be increased because they could demonstrate and report that they had fulfilled a minimum time requirement.

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3. Board balance and composition

We support the issues for consideration in this area, and note the following particular comments:

We welcome a review of the independence criteria and the way they have been applied with a view to enabling more flexible interpretation of the criteria currently used. It is our experience that some NEDs with longer service bring great expertise to board discussions, and indeed their contribution increases with increased experience of the Board's operations. This is generally as a result of the knowledge, character and behaviour of the individual director. Therefore, it would be appropriate for the Code to focus on assessing these attributes as part of the board balance and composition review process so that the valuable contribution of a particular director is not lost, rather than allowing all directors to remain on the board for a lengthened period.

However, we would emphasise that it is equally important that "new blood" continues to flow into the board in order to ensure fresh challenge and new perspectives are brought to the board's deliberations. Therefore, any revisions to the current principles should focus on this need for balance.

We also recognise that relevant industry experience does bring value to the board's discussions, but we would emphasise the collective responsibility of the board, so that an individual who is seen to be bringing "relevant experience" does not become the focus of undue pressure and accountability within the collective responsibility of the board.

4. Frequency of director re-election and binding or advisory votes

We have commented at some length on this area in our submission on the Walker Report as follows:

"We believe that a well-run company recognises the importance of having appropriate board and chairman succession plans in place which aim to reach a balance of both stability and renewal. In addition, we believe that the succession to the chair, in particular, is a significant exercise requiring much planning and consideration to ensure appropriate accountability and maintain board continuity. In our view, a company does not consider lightly the succession of the chairman, and will always aim to appoint the best available candidate. Therefore, we are not supportive of the recommendation that the director appointed by the board as chairman should be subject to annual re-election.

We recognise the context which led to this recommendation but we are concerned that it could result in a requirement to remove the chairman (depending on the result of the re-election vote), as a consequence of a knee-jerk reaction, rather than a considered shareholder decision which is in the best interests of the company. In addition, this recommendation might require companies to implement changes to their Articles (which would require shareholder approval). During our discussions, we have identified that there are alternative proposals on this issue. We note the position proposed by the ISC, suggesting that the chairmen of all of the main board committees should be proposed for re-election each year, and if the result of this votes were less than 75%, then the chairman would stand for re-election the subsequent year. However, in practical terms, at Standard Life plc, we currently have five board committees (and would have six if a risk committee were established). If the chairman of each board committee were proposed for re-election every year, this would result in almost all of the non-executive directors being proposed for re-election. Equally, as the chairman is the chairman of the nomination and governance committee, he would also stand for re-election by default.

As an alternative to these cumbersome administrative procedures, we would encourage the final recommendations to take account of and give due prominence to the opportunities offered by the introduction of the Shareholder Rights Directive ('SRD'). If shareholders have issues regarding the performance of the chairman of the company or the chairmen of the various board committees, the SRD has provided shareholders with increased means to express these concerns by giving them the right to raise questions for proper discussion at the AGM as well as easier means of raising resolutions to be put to a vote at the AGM".

In addition, we do not see a clear benefit in introducing a non-binding vote on the company's corporate governance statement. Given the breadth of the information contained in the report, and the various styles of report used by different companies, we feel that the more appropriate forum to question information in the report is to raise questions for discussion at the AGM via the extended opportunities provided by the SRD as noted above.

On non-binding votes generally, we are not convinced they will result in improved engagement between boards and shareholders. However, whilst this allows shareholders to register some form of support or protest, the status of these votes is not helpful. Furthermore, as a practical matter, there is a risk that they clutter the AGM agenda. Also, the experience in the United States is that non-binding votes have given rise to a high incidence of frivolous shareholder resolutions. Therefore, we strongly caution against increasing the incidence of non-binding resolutions.

5. Board information, development and support

We would stress that whilst we believe that NEDs should be permitted to and should consider using independent sources of advice, we believe that any such advice should be used to inform the director's contribution to the collective responsibility of the unitary board, rather than to inform the director with regard to his own personal position or responsibilities. Also we would expect any advice to be sought with the knowledge and approval of the board, the chairman or the senior independent director, such approval not to be unreasonably withheld.

6. Board evaluation

We have commented at some length on this area in our submission on the Walker Report as follows:

"Standard Life plc is fully committed to undertaking a formal annual board evaluation process, and to reporting the results of the review in the Annual Report, but we do not believe that the review process would be significantly strengthened by introducing the prescriptive requirement that it is externally facilitated every two or three years. We acknowledge that there are likely to be benefits in having the review independently facilitated, as it may lead to an increased openness in contributions, and bring additional external benchmarking not available in house, but we do not believe that there are sufficient benefits from the exercise to justify the proposed external-use timescale. In addition, the company incurs significant cost in having this review externally facilitated.

As a balanced solution, we recommend that a company should have a defined and standard policy regarding its approach to board evaluation, which is disclosed in the corporate governance report and applied on a "comply or explain" basis in order to provide a basis for effective accountability".

7. Risk management and internal control

Generally we support the provision of increased guidance in these areas. Although we believe that the board's responsibility for risk management is clearly established in the current Code, it may be useful to provide increased pragmatic guidance on areas such as Risk Appetite.

In our submission to the Walker Review, we have expressed our support for the introduction of a board risk committee, where it is appropriate to do so. We also commented that it would be necessary for the risk committee to establish the correct level and balance of oversight and involvement. In particular, we do not believe that it should be the intended role of the committee to micro-manage specialist risks or

operational risks. Rather we believe that it should focus its activities on reviewing the processes to identify and manage strategic risks in particular.

On risk reporting, we support the FRC's intention to rationalise existing disclosure requirements. Currently we present risk management information to comply with the relevant requirements of the Business Review (Companies Act 2006) and IFRS reporting as well as the Code and Turnbull Guidance. Understanding the nature of these differing requirements, identifying an overall and comprehensive view of the risks the company is running and gaining an understanding of the framework which manages these risks, and its effectiveness, is challenging.

8. Remuneration

Generally we support the provision of increased guidance in the remuneration areas proposed. However, we would not be supportive of giving shareholders a more direct role in setting remuneration. The FRC has already noted that this might be challenging to achieve (by requesting comment on how it might be achieved). We believe that there are many issues which would require robust debate if this were to progress. These include the consequences if the proposed level of remuneration were rejected; the consequences if the proposed level of remuneration were approved for some individuals and not others; the challenges of agreeing the elements of remuneration to be voted on; whether the vote would be on a range (with some discretion retained by the company) or on a particular amount; whether the chairman of the remuneration committee would have to present the proposals to all shareholders in advance. In particular, we would not support this proposal for senior employees who were not executive directors.

We would be supportive of increased consistency of disclosure, so that stakeholders would read Remuneration Reports from a fully informed point of view, and preparers would be able to draft the report on the basis of compliance with a single set of requirements. Prior to the completion of a single consolidated set of disclosure requirements, we would request the FRC to undertake a consultation exercise so that there was a reasoned justification why particular elements of remuneration should be disclosed. We also believe that it would be informative to disclose the level and nature of fees paid to the independent advisors to the remuneration committee in order to provide a basis for effective accountability.

9. The Implementation of the Combined Code

We support the issue for consideration that the FRC should undertake greater monitoring and enforcement of "comply or explain" statements. We believe that we make a significant effort to draft a comprehensive "comply or explain" statement, backed up by realistic and complete supporting disclosures, and Board and Board Committee time is given to reviewing these disclosures, as well as significant Company preparatory time to draft them. As we aim to demonstrate accountability through our Corporate Governance disclosures, it would be appropriate to have a formal regulatory means of identifying "comply or explain" statements from companies which do not meet the standard expected by the Code so that stakeholders had a clearer view of what was acceptable and perhaps could compare various disclosure against a benchmark.

As to "the form this might take", if the FRC were to pronounce publicly that a "comply or explain" statement did not meet the expected standard, we do not anticipate that this would require any re-issue of an Annual Report and Accounts, but we would anticipate that the notified company would be required to make a further public statement (perhaps as a Market Announcement) as to how it had responded to the FRC's conclusion.

Also as noted earlier, we recommend that the FRC revisits whether it would be reasonable to amend the "comply or explain" requirement to become an "apply or explain" requirement as we believe that this could represent a more realistic assessment of how the Code has been implemented. We believe that there are industry examples where "comply or explain" disclosure has been unfairly interpreted by the media as disregard for governance standards, whereas the disclosure actually represented a full and reasoned explanation supporting a board decision.

10. Engagement between boards and shareholders

As intimated in our response to the FRC's call for evidence in May 2009, we support the development of a constructive relationship which will add value to both the Company and the investor. We recognise that this may require increased formality around the relationship as well as an increase in the costs, time and quality of commitment from both boards and institutional investors, but without this genuine commitment from both parties, little benefit is gained from "box-ticking" engagement. We also support engagement which is pro-active and balanced, recognising a company's long-term strategy, rather than reactionary, short-term and "issue driven". We remain to be convinced that the collective engagement mechanisms proposed by Sir David Walker will work in practice.

While we recognise the importance of the Company's engagement with its institutional investors, we encourage the FRC to recognise that a Company's engagement with its private shareholders may also be significant, and as a result, any proposals to amend the principles need to apply to all shareholders, with perhaps the supporting guidance being extended to cover institutional shareholders in particular.

We have considered engagement at some length in our response to the Walker report, particularly with regard to BOFIs. In terms of applicability to all listed entities, we would also encourage the FRC to consider further the role of voting agencies and the extent of its responsibilities with regard to them. Currently these entities are unregulated and it would seem appropriate that a review is undertaken of their role and responsibilities to ensure that there is a clear and objective understanding of their processes and relationships with their clients. It may be appropriate that a "Code of Practice for Voting Agencies" is developed, similar to the Code of Practice of Remuneration Consultants. Voting agencies would be required to sign up and demonstrate adherence to the Code. We believe that this would provide increased assurance to issuers and to agencies' clients as to the quality of the analysis process and dialogue which had gone on to support the voting recommendation. The implementation and maintenance of this Code could be overseen by the FRC.

In addition to the above, we also noted these further comments in our response to the Walker Review. They may be of interest to the FRC.

"We welcome the introduction of the "Principles of Stewardship" on the responsibilities of institutional shareholders and agents and we hope that the final recommendations are clear with regard to status, ownership and maintenance of the Principles. We support the principle that the ISC would be the owner of the content and would be responsible for the periodic updating of the content, after proper consultation with the FRC which should be responsible for including the Principles in the revised Combined Code. The current drafting and terminology of the relevant recommendations should be clarified so that there is no confusion on this matter.

We also believe that a further challenge to the effectiveness of the relationship between institutional investors and issuers is the concentration of year-ends and the resulting short length of the period available to review Annual Reports and Accounts, engage with issuers and prepare and attend AGMs. This impacts the overall quality of engagement and should be addressed with due resolve, which may require more than reliance on market forces".

We hope that the above comments contribute to the review process. Please contact either of us if you wish to discuss any our comments further. We look forward to the formal consultation on these issues and hope that it will reflect fully the breadth of the observations made during the evidence gathering and review processes.

Conclusions

Overall we support the FRC's aim of strengthening current corporate governance processes in the UK. However, we are keen to reinforce that any revised or new principles should not be finalised without proper consideration of their practical application and likely efficiency, effectiveness, added value and increased accountability. Equally, we hope that prudential cost considerations and the risk of unnecessary bureaucracy are also taken into account.



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