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7 October 2009

Dear Chris

## **Review of the effectiveness of Combined Code, Progress Report and Second Consultation, July 2009**

### **1. Introduction**

- 1.1. Mazars, the leading integrated international accountancy organisation with 10,500 professional staff in 50 countries, is pleased to submit its views on the above consultation.

### **2. Three guiding principles**

- 2.1. We strongly support the three guiding principles to be adopted by the FRC in assessing the lessons to be learned from the financial crisis and the case for changes to the Code and its accompanying guidance.
- 2.2. We believe significant caution needs to be exercised before assuming that proposed changes to the Code as discussed in the Walker Review, which we strongly support for leading banks, are relevant to listed companies generally. We are not aware of evidence to support the view that failures in effective governance in the banking sector were more prevalent across the listed sector generally. Moreover, the circumstances of the banking sector are unique in terms of the degree of systemic risk it gives rise to across the economy.
- 2.3. Where it is decided that changes are needed to the Combined Code, we believe that a rigorous cost/benefit analysis should be undertaken before deciding whether the changes should apply to all listed companies or just to FTSE 100 or FTSE 250 companies. Great care should be taken, in view of the current economic situation, before increasing the costs expected to be borne by smaller listed companies.
- 2.4. As we have indicated previously, we believe the area of disclosures called for in the Combined Code would benefit from a thorough review.
- 2.5. The present principles and provisions dealing with matters of disclosure can lead to significant amounts of 'boilerplate' disclosure. More importantly, companies are not currently asked to provide information on some key aspects of board effectiveness.

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The principles should call on the board to provide an overarching statement on strategy, performance and board cohesiveness, covering:

- their strategy and how the board keeps it under review and monitors its implementation
- steps taken to get the right board in place and the board's approach to issues such as succession planning and diversity
- the board's approach to attracting and retaining executive directors and staff and to motivating them to achieve the company's mission
- how the board promotes a culture of challenge and support in the boardroom
- how the board seeks to ensure it is working effectively as a team
- the board's risk appetite, the principal risks, and the board's approach to managing risks
- how the board reviews the performance of the business

- 2.6. Some but not all of the above issues are dealt with by the current principles and, in some instances provisions, but the principles also address some less fundamental issues.
- 2.7. A move to focus on a more strategic statement by the board, of the kind proposed above, on how it is fulfilling its role, in place of the current detailed disclosures relating to the application of the main and supporting principles, would provide a much better insight into board effectiveness. It would also emphasise the Code's role in providing a framework for boards to maximise value creation in the business and to protect it effectively.
- 2.8. The suggested new approach to disclosure may lead to some of the supporting principles becoming provisions, with appropriate adaptation, so that there was helpful discussion when they were not considered applicable to a particular business. In addition, some of the current provisions may end up being dealt with as part of the board's statement on strategy, performance and cohesiveness.

### 3. **The responsibilities of the Chairman and the non-executive directors**

- 3.1. We are not persuaded of the need for change in this area and, in particular, do not consider further guidance is needed on the time commitment expected of the chairman, senior independent director and/or non-executive directors.

### 4. **Board balance and composition**

- 4.1. We are not convinced that change is needed in this area.
- 4.2. With regard to the nine year rule, whilst it needs to be applied sensitively, and having regard to the circumstances of the board taken as a whole, it does seem to have led to a lessening of the previous situation whereby some directors served on boards for periods far in excess of 9 years and that is to be generally welcomed. Boards do have the opportunity to state that they believe a director remains independent despite being on the board for a period in excess of 9 years and we therefore do not consider that change is needed in this area. Moreover, we do not consider the independence criteria generally have unnecessarily restricted the pool of potential NEDs.
- 4.3. We believe the expectation that boards of FTSE 350 companies should comprise at least 50% of non-executive directors should remain and that this is achievable without boards becoming unduly large or there being an unwelcome restriction on the number of executive directors serving on them.



**5. Frequency of director re-election**

- 5.1. We do not support the annual re-election of the company chairman or other directors as we consider it potentially gives rise to unhelpful uncertainty of tenure in these leadership positions in the company. We also believe that with effective engagement institutional investors normally have sufficient means when dealing with UK listed companies to make their voices heard, and to get the necessary changes made, when they have governance concerns.
- 5.2. We believe it would be helpful for there to be advisory votes on the reports of each of the committees of the board as these deal with matters of substantial import and where there are concerns it would be helpful for it to be clear to which they relate. We also believe it would be helpful to review the expected contents of the reports for the nominations, remuneration and audit committees. Otherwise, we would not propose changes in the current situation with regard to binding or advisory votes.

**6. Board information, development and support**

- 6.1. We do not consider changes in the Code or its associated guidance are needed in these areas.

**7. Board evaluation**

- 7.1. We would support amending the Code to call on FTSE 350 Companies to have an externally facilitated evaluation at least every 3 years. Significant progress has been made by many boards in undertaking thorough evaluations and a number of FTSE 100 boards, in particular, do already use external facilitators at least on a cyclical basis. We do believe that including a provision calling for FTSE 350 boards to have their reviews externally facilitated at least once every three years would increase the overall level of board effectiveness and provide a good return for any monetary expenditure incurred. We also believe it would be helpful for the identity of the external facilitator to be disclosed.
- 7.2. In view of the importance of the work of the main board committees to the overall effectiveness of the board, we would retain the call for annual reviews of their effectiveness.
- 7.3. There would be merit in asking for a discussion of changes to be made as a result of the board evaluation process. Voluntary disclosure in this area is already provided by a number of FTSE 100 companies. This would be in addition to the current expectation that the evaluation process will be discussed.

**8. Risk management and internal control**

- 8.1. We would strongly support setting out explicitly, as in the Turnbull Guidance, the board's overall responsibility for risk management and within that for strategic risks and risk appetite. The board may delegate specific tasks relating to risk management and internal control but cannot delegate their overall accountability. Some lack of clarity seems, however, to have crept in to the Code and/or other guidance on this matter in the years since the Turnbull Guidance was first published.
- 8.2. We believe the approach adopted in the Turnbull Guidance remains very appropriate and would be strongly opposed to any move towards a more bureaucratic or legalistic system. Risk management is a key business issue that needs to be owned by the board.



- 8.3. We believe there are unique circumstances justifying the establishment of separate risk committees for leading banks, not least the degree of systemic risk generated by banks and the complexity of their business models. We do not believe it would be appropriate to expect listed companies generally to introduce separate risk committees.
- 8.4. On risk disclosure, we would support the inclusion of a specific provision calling on boards to explain how they have managed their principal risks though we recognise this is already considered to be good practice.
9. **Remuneration**
- 9.1. We do not consider changes similar to those proposed for the banking sector are called for with regard to listed companies generally. We would, however, be supportive of a principle highlighting the need to ensure remuneration packages promote the long-term interests of the company. We also think a more fundamental review of the relationship between remuneration and motivation performance which we suspect is for more complex than sometime appears to be suggested.
10. **‘Comply or explain’**
- 10.1. A move from ‘comply or explain’ to ‘apply or explain’ would be confusing. Boards are called on to apply the principles of the Code and to comply with its provisions or provide an explanation of the reasons for departure from them. Thus, the terms relates to the Code as a whole and ‘comply or explain’ to that part of it comprising provisions in these circumstances. It is not clear how a change of terminology would be helpful nor why it is needed.
11. **Implementation of the Combined Code**
- 11.1. We have discussed at the beginning of this response (see especially paragraph ... 8) our view that a thorough review of disclosures called for under the Combined Code would be helpful.
- 11.2. We do believe a case can be made for the FRC, perhaps through the FRRP, undertaking more monitoring of ‘comply or explain’ statements or, perhaps preferably, all corporate governance disclosures made as a result of applying the Code. This would probably best be done in conjunction with the FSA given the link with the Listed Rules. The quality of disclosure on corporate governance has improved significantly in overall terms in the years following the publications of the original Cadbury Report but it does remain variable and does rely on institutional investors pushing for better disclosures where needed. This will have limited effect in those companies, especially some smaller listed companies, where there are not many, or any, institutional shareholders. Moreover, the FRRP already review directors’ reports, including business reviews, and thus extending its remit to corporate governance statements might not be expected to involve substantial extra monitoring costs. As well as liaising with specific companies where imposed disclosure was needed, the FRRP could also follow its general policy of seeking to promote good practice by indicating in its annual report areas where improvements in disclosure would generally be helpful to the market.
12. **Engagement between boards and shareholders**
- 12.1. We strongly support the development of Principles of Stewardship based on the ISC Statement of Principles and the annual review of those principles and, at least as importantly, the extent to which they have been applied in practice, by the ISC and FRC.

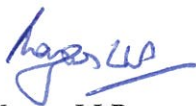


12.2. We would also propose that a broad-based review be conducted under the overall auspices of the FRC to assess the effectiveness of institutional investors in monitoring its application by listed companies. It should consider whether enough resources are being devoted to governance issues, whether the governance teams in institutions have appropriate influence when fund managers make decisions on investments, whether consistent messages are given to companies in which an institution has investments by the governance and fund management teams respectively and whether sufficient resources are devoted to the stewardship of investments in smaller listed companies. The review should also consider what action institutions should take when they are unable to resolve governance issues satisfactorily with boards through private discussions including whether they should make their concerns known publicly. We recognise that this raises sensitive issues when the preferred route may be to sell the shares and walk away or when disclosure may adversely impact the share price.

13. **Further discussion**

13.1. If you would like to discuss further any of the issues raised in our submission, please do not hesitate to contact Anthony Carey on 020 7063 4411.

Yours faithfully



Mazars LLP