CFA UK is a member society of

Call for evidence
Review of the effectiveness of the Combined Code

A response by

CFA Society of the UK

1st June 2009

About CFA Society of the UK

The CFA Society of the UK (CFA UK) represents the interests of more than 8,000 leading members of the UK investment profession. The society, which was founded in 1955, is one of the largest member societies of CFA Institute and is committed to leading the development of the investment profession through the promotion of the highest ethical standards and through the provision of continuing education, advocacy, information and career support on behalf of its members.

CFA UK supports the CFA, Associate (ASIP) and IMC designations. Most members hold either the Chartered Financial Analyst (CFA), or Associate designation. CFA Institute is best known for developing and administering the CFA curriculum and examinations and issuing the CFA Charter. CFA Institute's mission is to lead the investment profession globally by setting the highest standards of ethics, education and professional excellence.

Most CFA UK members also belong to the CFA Institute and reaffirm annually their adherence to its Code of Ethics and Standards of Professional Conduct. Both CFA UK and CFA Institute are committed to providing members with a wide range of continuing education opportunities. All members are encouraged to undertake ongoing post-qualification continuing education.

CFA UK is the awarding body for the IMC, the benchmark entry-level qualification for those working in investment management in the UK. The examination is accredited by the Office of the Qualifications and Examinations Regulator (Ofqual) and is designated a recommended examination by the Financial Services Skills Council (FSSC) for the purposes of the Financial Services Authority's training and competence requirements. The IMC is held by more than 15,000 investment professionals.

About this response

CFA UK welcomes the opportunity to provide evidence on the effectiveness of the Combined Code. The society recognises that the Combined Code is the core document providing guidance on corporate governance in the UK and thanks the Financial Reporting Council (FRC) for its continuing efforts to seek feedback from issuers, intermediaries and investors on the value and performance of the Code.

As noted earlier in this response, CFA UK is a member society of CFA Institute. CFA Institute believes that:

- Financial markets should be equitable, free, and efficient so that every investor has a chance to earn a fair return
- The interests of the ultimate investor must take precedence over the interests of all other market participants
- High ethical principles and self-regulatory standards are as important to market efficiency and fairness as rules and regulations

CFA UK shares these beliefs and supports efforts to maintain and/or raise standards of corporate governance. As Ben Graham and David Dodd stated in *Security Analysis*: 'The choice of a common stock is a single act, its ownership is a continuing process. Certainly there is just as much reason to exercise care and judgment in being a shareholder as in becoming one.'

CFA UK has recently hosted several events for members on corporate governance. On April 30th, Robert Jenkins, chairman of the IMA, spoke to members and encouraged them to use their power to call companies to account. He commented: "*Boards don't own the companies in which we invest. Our clients own the companies in which we invest. It is not the boards' money. It is our clients' money. I would encourage active managers who hold the shares to engage. And I would encourage all shareholders who engage to vote down directors of Companies they judge to be poorly run. Hold them accountable. Who else will?*

Let me be clear. It is not our responsibility to manage the companies in which we invest. It is our responsibility to maximise client returns within guidelines. But surely it must be a good thing for our industry and industry more generally that company boards listen to the agents of their owners. Alas, many will not do so unless they believe there will be consequences if they do not. And they will not believe there will be consequences until they have seen that there could be. Let us put a body on the street when engagement fails so that future engagement might better succeed. Voting directors down is likely to do more for governance than all the Code revisions in the Realm."

A second event on governance – featuring representatives of L&G Investment Management, the ABI and ICGN – was held on May 28th. The purpose of that event was to provide members with insight into the reasons to engage and some of the difficulties in doing so.

At the event, it was noted that engagement can help to:

- Preserve shareholder rights and value
- Ensure companies have an effective strategy
- Ensure boards function effectively
- Ensure shareholder value is not being paid excessively to employees
- Achieve alignment of interests
- Achieve lower levels of corporate failures, and
- Achieve high standards of ethical behaviour in capital markets

Discussion at the event also touched on the value of a collaborative approach to engagement, but commented on the difficulties of acting collaboratively. It would be valuable for the Code to give improved guidance to support collaborative behaviour by investors and/or their agents.

In order to inform the discussion at the May 28th event – and to provide substance to the society's response to the FRC – a survey was sent out to members in mid-May asking them to comment on the value of governance and the performance of the Combined Code. The society received 391 responses to the survey which is attached with this response.

The survey results confirm that members regard engagement as a fiduciary duty and see an awareness of governance issues as a due diligence requirement. Member opinion also appears to support the view that engagement can generate excess return. However, members also believe that it is often more profitable to sell the shares of a company where governance is questionable, than it is to engage actively.

Response

The review seeks comments on the following four questions:

- Which parts of the Code have worked well? Do any of them need further reinforcement?

  Before asking members to comment directly on the Code's performance, we thought it would be valuable to assess members' awareness of the Code. Many respondent members (42%) were not aware of the Code. While this can be partly explained by the location of many of our members in functions where knowledge of the Code is not required (and by the presence of student members within the response base), the result suggests that greater efforts should be made to promote the Code.

  In commenting directly on the Code, members broadly supported the view that the Code had encouraged good practice in relation to the composition and effectiveness of the Board as a whole and in defining the roles of the chairman, executive staff and non-executive directors. However, overall members did not agree that the Code had encouraged good practice in risk management at Board level, or in the activities of remuneration committees. On the question of whether or not the Code had done enough to encourage institutional shareholder engagement, the survey provided a more balanced response, but, in aggregate, respondents felt that it could have done more to encourage institutional shareholder engagement.

  Last, we should take the opportunity of this review to remind the FRC of a previous recommendation. In April 2008, CFA Institute highlighted a possible weakness in Section D of the Code, 'Relations with Shareholders'[1]. CFA Institute noted that there is evidence that suggests companies' investor sentiment surveys are frequently commissioned by the finance department (or other element of the executive). In such cases, therefore, the finance department holds discretion to edit unfavourable investor comments on individuals or disagreements with corporate policies, should they determine this to be appropriate; thus potentially compromising the independence of the results. CFA Institute recommended that for the Chairman to *"ensure that the views of shareholders are communicated to the board as a whole"* (D.1.1), that the Chairman, or preferably the non-executive side of the board, should have control of the resources to

[1] See http://www.cfainstitute.org/centre/topics/comment/2008/pdf/relations_with_shareholders.pdf

commission *“surveys of shareholder opinion”* (D.1.2). CFA UK supports CFA Institute’s recommendation that the Section D be amended to take effect of this.

- Have any parts of the Code inadvertently reduced the effectiveness of the board?

We did not survey members on this question and would not want to comment without supporting data from a member survey.

- Are there any aspects of good governance practice not currently addressed by the Code or its related guidance that should be?

While we did not survey members on this question and would not want to comment without supporting data from a member survey, the society’s recent event on engagement suggested that there may be member support for additional guidance within the Code on how to engage. Event attendees expressed some support for integration of parts of the Institutional Shareholders’ Committee guidance into Section 2 of the Code.

- Is the ‘comply or explain’ mechanism operating effectively and, if not, how might its operation be improved?

Overall, survey respondents do not believe that the ‘comply or explain’ mechanism is operating effectively. More members (29% of respondents) disagree with the statement ‘Overall, the comply or explain mechanism is operating effectively’ than agree with it (23%). We did not seek comment from members on how the mechanisms operation could be improved, but would be pleased to do so in future.