

## **IRISH STOCK EXCHANGE**

### **Response to the Financial Reporting Council on the Review of the Effectiveness of the Combined Code**

The Irish Stock Exchange (the 'Exchange') welcomes the Financial Reporting Council's Review of the Effectiveness of the Combined Code (the 'Review'). Corporate governance issues, particularly in relation to financial institutions, are challenging many countries across the globe and recent events have highlighted a requirement to address corporate governance culture in these institutions. We believe that many of the governance issues that have come to light in the banking area should be addressed in a targeted way through prudential regulation, rather than through more generally applicable corporate governance requirements, such as the Combined Code.

Companies listed on the Exchange are required to disclose their compliance with the Combined Code (the 'Code') bearing in mind that certain provisions of the Code may be less relevant for smaller companies, particularly in the Irish market, given their smaller size and nature of operations when compared with their UK and EU counterparts. Although the Code does not form part of the Listing Rules of the Exchange, listed companies are obligated to state in their annual report:

1. how they have applied the principles of the Code; and
2. whether they have complied with the Code's provisions and, if not, to explain any non-compliance.

#### **Roles of the chairman, the chief executive and the board**

Recent events have highlighted the importance of the respective roles of chairman, chief executive and non-executive directors, and the relationships and interactions between them. It is clear that a well functioning board requires a clear understanding of these roles and how they interact and that processes are in place to ensure that respective responsibilities are articulated and honoured. In particular, company boards should have:

- Clarity regarding the respective roles of the chairman, the chief executive and the non-executive directors;
- Transparent processes regarding the appointment and empowerment of the chairman, the chief executive and non-executive directors and their interactions with each other; and
- Processes within the board structure which ensure that the chairman and/or chief executive do not exert undue influence over other board members, especially the non-executive directors.

Non-executive directors must bring independence of thought to the board, be empowered (by the Chairman) to raise any concerns and discuss them openly in an appropriate forum, be it within the Board meeting or at separate scheduled meetings.

We would encourage the FRC to consider the above issues with a view to establishing principles which would guide listed company boards in defining and managing these fundamental roles and relationships within the board structure of their organisations.

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

We believe that the Code is generally operating well and facilitating listed companies in adopting good corporate governance procedures.

***Code provision A.2.1***

In order to ensure a clear division of responsibilities at the top of a listed company between the running of the board and executive responsibility for the running of the company's business, Code provision A.2.1 provides that the roles of chairman and chief executive should not be exercised by the same individual. We believe that this provision should be strengthened to clarify that the roles of chairman and chief executive should not be combined, other than in exceptional circumstances and with very explicit reasons detailed in the annual report.

Where a company's chairman resigns and a replacement is not readily available, in many instances it may be more appropriate for the senior independent non-executive director (rather than the chief executive) to act as chairman on a temporary basis until such time as a new chairman is appointed.

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

In general, we believe that the Code has enhanced the effectiveness of listed company boards and we are not aware of any parts of the Code that have reduced the effectiveness of the board.

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

Other than our comments regarding the roles of the chairman, the chief executive and the board, we are not aware of any aspects of good governance practice that are not currently addressed by the Code or its related guidance.

**Is the 'comply or explain' mechanism operating effectively and, if not, how might its operation be improved?**

We support the 'comply or explain' mechanism which we believe operates effectively and delivers transparency to investors to enable them to make informed investment decisions, while, at the same time, not imposing a 'one size fits all' governance regime on a diverse corporate sector. However, we believe that there is scope for companies to enhance transparency around their corporate governance practices.

The availability of quality information on a timely basis is the cornerstone of any well functioning market. Excellence in communication, transparency and reporting fosters trust. That trust brings certainty and loyalty from all company stakeholders. Markets are intolerant of ambiguity, opaqueness and poor standards and the current financial turmoil has demonstrated a need for enhanced transparency in the financial markets.

### ***Importance of meaningful explanations***

At times, standardised or minimal explanations are provided by companies that do not comply with a particular Code provision. We consider it very important that companies provide sufficiently detailed and meaningful explanations to investors where, for their particular circumstances, they have chosen not to comply with a certain Code provision. More meaningful disclosures would facilitate more detailed understanding and analysis by investors and minimise the possibility of them ‘box-ticking’ on the basis of non-compliance. We believe that there may be an opportunity for the FRC to facilitate companies in this regard by providing guidance in this area. There would also appear to be a role for investors to voice their concerns when they are not satisfied with the explanations provided by a listed company.

### ***Disclosure of how Code provisions are applied***

In addition to the requirement in the Listing Rules for listed companies to disclose how they have applied the Code’s principles, specific provisions of the Code itself require disclosure of information in the annual report or by making it available to investors by other means, for example, by publishing the information on its website.

The level of corporate governance information provided by listed companies on their websites varies considerably from company to company. Outside of areas where disclosure is mandated, it can at times be difficult for investors to gain an understanding as to how a listed company has complied with Code provisions.

There is an opportunity for companies to enhance corporate governance disclosure on their websites in order to facilitate investors by including a section which details how each of the Code provisions has been applied (or provides a link to the information), bearing in mind the need to strike a balance between the cost of providing this information and its usefulness to investors. This approach would also enable companies to keep their corporate governance information for investors up to date.