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Chairman
Financial Reporting Council
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Date 21/05/09

FRC's Review of the Combined Code

... Marks & Spencer is pleased to respond to the FRC's review of the effectiveness of the Combined Code – our detailed response is attached (**Appendix A**).

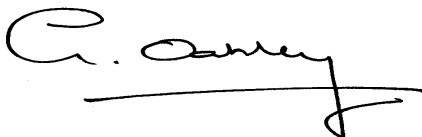
Leadership and governance go hand in hand in a successful company. For both to work well you need a clear plan of what you want to achieve. Our focus on the M&S Board is to build a sustainable business for the long term, generating shareholder value through consistent profitable growth, whilst making sure that our customers can always trust us to do the right thing. Our governance is key to how well management runs the business and how well equipped our people are to achieve the Company's overriding objective.

In our 125th anniversary this year we have reaffirmed our brand values of Quality, Value, Service, Innovation and Trust. We are very pleased to have been voted Britain's most trusted retailer by a recent YouGov survey. We have a responsibility to protect the Company's reputation in everything we do and our Code of Ethics helps us to maintain trust in the M&S brand.

We publish our Annual Report on 4 June and this year we are giving shareholders a greater insight into governance at M&S – from the boardroom to the shop floor. We will send you a copy next week, together with our How we do Business Report (both to be available at www.marksandspencer.com/thecompany.)

It is in all our interests that UK companies continue to be led in a way which facilitates business success and the management of risk and we support the FRC's role in ensuring that the Combined Code facilitates this. However, it can only offer a framework. It cannot set the style or tone of a company's culture or behaviours. This is the role of the board and will differ across sectors and companies.

We look forward to receiving the FRC's findings in due course.



GRAHAM OAKLEY

Group Secretary and Head of Governance

Enclosed:

Appendix A Detailed response to the FRC's review of the effectiveness of the Combined Code
Appendix B M&S response to BERR re Shareholder Rights Directive
Appendix C M&S Governance Framework including Board role profiles
Appendix D Code of Ethics

To follow:

Annual report, How we do business report, AGM Notice of Meeting

MARK & SPENCER
DETAILED RESPONSE TO THE FINANCIAL REPORTING COUNCIL
REVIEW OF THE EFFECTIVENESS OF THE COMBINED CODE

Issues for comment

1 The FRC would welcome views on both the content of the Combined Code and the way that it has been applied by companies and enforced by investors using the 'comply or explain' mechanism.

Marks & Spencer believes that the Combined Code has contributed to higher standards of governance among UK listed companies and that there is no need for dramatic changes. Its principles set the standard to be followed, whilst recognising that best practice is constantly evolving and that "no one size fits all".

Non-compliance may be justified if good governance can be achieved by other means. In these circumstances effective disclosure and engagement with shareholders can create a greater understanding of the reasons for non-compliance and the balancing controls put in place by the board to mitigate governance concerns. However, 'comply or explain' is sometimes interpreted as 'comply or else' by some shareholder representatives.

Shareholders express their support for management through voting at the AGM and in recent years there has been a welcome increase in the level of voting, with the opportunity to support, abstain or vote against resolutions. Shareholders should be encouraged not to give mixed messages – a greater alliance between governance and trading personnel would help.

It is accepted that at times shareholders will not be in agreement with management and may requisition a resolution at the AGM putting forward their own recommendations. We recognise that this is a legitimate route for shareholders to take but we do not support the current proposals in BERR's consultation on the implementation of the EU Directive on shareholder rights, which is due to come into effect on 3 August 2009. They are detrimental to good governance and risk significant additional costs being incurred by companies as well as the increased environmental impact of multiple mailings. The current procedures set out in the Companies Act 2006 balance the interests of companies and shareholders and encourage productive engagement with those who wish to requisition a resolution. A copy of our response to BERR is enclosed (**Appendix B**).

2 The Combined Code consists of high-level principles and more detailed provisions. While boards are expected to apply the principles, 'comply or explain' allows them a degree of flexibility in choosing whether to follow the Code's individual provisions. Bearing this in mind, views are invited on these questions:

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

The Code has detailed guidance on the operation of the board, audit committee and remuneration committee. Higgs guidance contributed to the effectiveness of the non-executive directors. More guidance would be helpful on the role of the nomination committee and in particular, consistency around leadership development and succession planning within the organisation and on shareholders' expectations on the level of disclosure required.

It would also be helpful to differentiate between the roles of chairman and chief executive being combined (A.2.1) and the chief executive stepping up to be chairman (A.2.2). Governance concerns for the former relate to the effectiveness of the board and for the latter, to the effectiveness of the new chief executive.

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

We do not agree that the company chairman should be a member of the remuneration committee as we think this could compromise his or her ability to act as the advocate for the chief executive's remuneration and at the same time adversely impact the authority of the committee chairman. The company chairman's presence as a non-member would be more appropriate.

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

There is merit in considering whether the wider stakeholder duties set out in s172 of the Companies Act 2006 should be reflected in the Code, for example disclosures on how the board keeps informed of such matters. The board is the appropriate forum to discuss the effectiveness of governance throughout the organisation. There could be more emphasis on regular reports to the board across a range of governance activities. Not only from the non-executive chairs of the key committees (nomination, audit and remuneration) which relate principally to shareholder interests. But also executive reports on the mechanisms in place to inform the board on wider issues, including CSR, customer feedback on products and service, Health and Safety, employee consultation and sustainability.

The board also sets the company's values and standards to ensure its obligations to shareholders and others are understood and met. More focus could be given to various options on how the board sets the tone at the top and outlines the behaviours that are expected from employees to ensure business is conducted with the highest standards of honesty and integrity. We have recently undergone a root and branch review of our Code of Ethics policy. This is owned by Sir Stuart Rose. It is now a source document for all our principal company policies and we have extended sign off to our top 500 senior managers who give assurances that it is applied in their areas of responsibility. A copy is available on our website and is also enclosed (**Appendix C**).

Leadership development programmes within the organisation also have a role to play in developing the appropriate behaviours in the executive team and leaders of tomorrow. This year we have launched our 'Lead to Succeed' programme for the development of our top 300 people, built around our M&S brand values – quality, value, service, innovation and trust.

2.4 *Is the 'comply or explain' mechanism operating effectively and, if not, how might its operation be improved? Views are invited on the usefulness of company disclosures and the quantity and quality of engagement by investors.*

There is clearly room for companies to improve their governance reporting. It is hoped that the new Hermes/ICSA Awards will encourage companies to make governance reports more relevant to their own businesses rather than a prescriptive response to the Code which results in boilerplate statements of little value to shareholders.

Institutional investors have made efforts to engage with companies in recent years and voting levels have improved. However, section 2 (E) of the Code could be reviewed to encourage investors to account for their own governance arrangements.

There is also a case for more joined up governance in both investors and companies to promote a greater understanding of the value of governance. There can be different contacts within investors for governance, remuneration, voting and the trading of shares. Equally, the liaison between secretariat, investor relations and corporate communications departments can be improved within companies.

3 **Content of the Code**

While respondents are welcome to comment on any aspect of the Code, the FRC would particularly welcome views on:

3.1 *The composition and effectiveness of the board as a whole;*

The reduction in size of boards and the consequent increase in independent non-executives to 50% has enhanced the effectiveness of boards from a governance perspective.

3.2 *The respective roles of the chairman, the executive leadership of the company and the non-executive directors;*

We believe there should be clarity in the descriptions of the roles and accountabilities of specific Board members. In June 2008 we reviewed and updated the job profiles for our Board members with particular emphasis on increased governance responsibilities during the tenure of a combined chairman/chief executive to mitigate shareholder concerns. These form part of our Governance Framework (**Appendix D**).

3.3 *The board's role in relation to risk management;*

Further guidance on risk management is welcomed following the significant change in the economic conditions under which companies (and in particular those in the financial sector) are operating. It is helpful that the FRC will work closely with Sir David Walker, who is conducting an independent review on the governance of banks, to share relevant research and other evidence.

3.4 *The role of the remuneration committee;*

As the size of boards has reduced, consideration should be given to the remit of the remuneration committee in relation to those operating at the level below the board. The committee could have specific matters reserved to it, for example ratification of executive pay and benefits to the next level below the board, paying particular attention to the effects of any discretionary element (including share and pension related benefits) in relation to appointment, retention or departure of senior management. The remuneration of the company secretary should also be a matter for the remuneration committee.

3.5 The quality of support and information available to the board and its committees; and

The role of the company secretary is key to effective governance. He or she not only acts as secretary to the board and its key governance committees, but is also an important resource to the non-executive directors to ensure they can be effective and that most appropriate use is made of their time. A properly resourced secretariat function is an important feature of good governance. And the company secretary should be acknowledged as the head of governance with sufficient resource to satisfy the governance arrangements for the organisation as a whole.

A written report presented by the company secretary at each board meeting is an efficient way to keep the board informed on governance, whilst not distracting from reviewing strategic and operational performance.

3.6 The content and effectiveness of Section 2 of the Code, which is addressed to institutional shareholders and encourages them to enter into a dialogue with companies based on a mutual understanding of objectives and make considered use of their votes.

It is helpful for representative investor bodies to host meetings between a range of investors and the company to maximise the use of time for all concerned. It is unhelpful if meetings held in private are then reported in the press. This will always make companies wary of discussing governance arrangements in advance of making them public, to avoid breaching their responsibilities as listed companies to shareholders as a whole.

The overriding principle of governance is that directors are appointed by shareholders to run the company in the long term interests of investors. Short term focus can hamper the board's efforts to invest for the longer term. It is also acknowledged that different shareholders will take different views on governance. Very often it is those with the least shareholding in a company that take the more extreme view.

4 Application of the Code

4.1 The 'comply or explain' approach has a number of theoretical advantages over traditional regulation: it allows boards a degree of flexibility in designing their governance arrangements, and it enables shareholders to judge whether those arrangements will make it more likely that the board will act in their long-term interest.

Agreed. However 'comply or explain' is sometimes interpreted as 'comply or else' by some shareholder representatives.

4.2 In order to be effective it requires boards to provide investors with the necessary information on which to make that judgement, in particular where they have chosen not to follow the Combined Code; and it requires a sufficient number of investors to take a long-term view and to engage constructively with the companies in which they invest through dialogue and the use of their voting and other rights.

Agreed. There is room for improvement on both sides – see 2.4 above.

4.3 The 2007 review found that, while the 'comply or explain' approach was felt to be working reasonably well, there were some concerns on both counts. The FRC would be interested to know whether those concerns have increased or decreased in the intervening period and, if they still remain, whether there are steps that could be taken by the FRC or others to increase the usefulness of disclosures and the effectiveness of engagement.

Some institutional investor models show intransigence – they do not allow them any discretion in supporting management, when there are breaches of the Code. If the board is able to demonstrate that sufficient notice has been taken of their governance concerns, and appropriate controls put in place to mitigate governance concerns, they should be able to take a more flexible approach.

5 Other Matters

5.1 **Annual re-election** – whilst we do not feel strongly about the need for directors to retire and seek annual re-election by shareholders at AGMs, we are not opposed to it.

5.2 **Nomination Committee** – we support the CEO being a member of the Nomination Committee, recognising their contribution to the Executive membership of the Board, which is our own practice. The CEO can then be excluded from the meeting for discussions regarding his or her successor.

5.3 **Senior Independent Director** – the SID is a useful contact for investors but the board as a whole should be kept in touch with investor contacts, including through the Chairman, CEO, Finance Director or any other board member.