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Dear Sir

Response to the FRC review of the Combined Code

City Group provides outsourced company secretarial services to smaller quoted companies. As such we have extensive practical experience of corporate governance issues, developed over many years.

We believe that good corporate governance is founded on an understanding by directors of the stewardship role that they are undertaking.

We believe that good corporate governance reports are fundamental to any shareholder engagement and we believe that the current focus on principles and provisions all too often leads to a “box-ticking” approach and “boilerplate” corporate governance reports. This poor communication discourages engagement with shareholders by making it more difficult for shareholders to understand what the company is doing right and what it is doing wrong.

We could ask for additional guidance to encourage better corporate governance reporting, but our preferred option is to try to slim down and refocus the code as a result of a fundamental review. There is currently a disconnect between the principled approach set out in the preamble to the code and the shopping list of principles and provisions in the main body of the code. We would prefer a code that is focussed throughout on promoting good outcomes.

We consider that the essential structures and processes to achieve good corporate governance in most companies should include:

- 1) A strong independent Chairman, who is not also the Chief Executive, and who has clearly defined responsibilities for the running of the Board (i.e. corporate governance), the processes for setting and monitoring execution of strategy, and shareholder relations. The

focus of the Chief Executive's responsibilities should be on execution of the Company's strategy.

- 2) An experienced Company Secretary reporting in to the Chairman to ensure that the Board addresses all topics that should be on its agenda and has the necessary information to inform its decision making. The Company Secretary may be a part time or outsourced role and should not be the Finance Director. (The FD has more than enough responsibilities without this additional burden.)
- 3) Corporate Governance reports which specifically acknowledge directors' stewardship responsibilities and clearly explain why independent directors are considered to be independent.
- 4) NEDs should be rewarded for the time that they spend on the company's business and engagement letters should set out pay rates for a minimum number of expected hours and an hourly rate of pay for time spent in excess of that minimum.
- 5) A rigorous annual review of the performance of the Board and its individual members. Such a review should be externally facilitated at least once every three years and the name of the facilitator should be reported to shareholders (to ensure that a reputable facilitator is used). The review should identify skill shortages to be filled by the recruitment of additional or replacement directors, and areas to be addressed by individual or whole Board CPD programmes.
- 6) A full induction process for new directors organised by the Chairman or Company Secretary.
- 7) A formal, at least annual, review of the execution of the Company's strategy and determination of how that strategy should evolve.
- 8) An annual review of the risks to which the business is exposed and the extent to which they are managed. Unless there have been changes in the composition of the committee performing the review, at least once every three years, an external facilitator should be employed to provide a fresh challenge of the risks to which the business is exposed. The name of the facilitator should be reported to shareholders.
- 9) Remuneration policies should reflect the risks to which the business is exposed, with bonuses focussed on long term sustainable performance improvements. Some further thoughts on remuneration approval are provided in the attached appendix.
- 10) Audit and remuneration committees with responsibilities as set out in ICSA draft terms of reference. There needs to be ample time set aside at Board meetings for Boards to discuss and endorse decisions of these committees.
- 11) Succession and contingency planning to ensure that there is cover for key members of staff, to reduce possibility of dominance by key executives, and improve the company's bargaining position in pay negotiations.
- 12) Directors need to be drawn from the widest possible range of candidates. Headhunters should be engaged to assist in the recruitment of new non-executive directors and the name of the headhunters used should be disclosed to shareholders.

- 13) Where possible companies should consult shareholders when seeking to recruit new directors from outside the company.
- 14) The annual report should focus on providing users with useful information in a useable format. There should be continuity between the Business Review, Corporate Governance Reports (including audit and remuneration committee reports) and the Accounts.
- 15) All directors should stand for re-election every year.
- 16) As the Chairman is responsible for shareholder relations, he should attend all meetings with shareholders.

If you wish to discuss these issues with us, we will be pleased to attend a meeting.

Yours sincerely,

Edward Beale
Chief Executive

Combined Code Review – Remuneration issues

Directors have a stewardship role on behalf of shareholders. As such, directors' remuneration should be set by shareholders.

If shareholders do not want to exercise this responsibility directly, then they can delegate this to the board, which can in turn delegate various elements of this responsibility to a remuneration committee.

Delegation

We believe that any delegation of responsibility for setting remuneration from shareholders to the board must be confirmed by a special resolution of shareholders (75% of those voting in favour) every year. Voting on such a resolution would be informed by any disclosures in the annual report and accounts, in particular the remuneration report. This would focus more attention on making the remuneration report informative. Delegation might be for all remuneration related decisions, alternatively, shareholders might wish to retain the right to approve bonuses.

Instead of delegating to the Board, shareholders could by means of an annual special resolution, delegate responsibility for setting remuneration to the (say) 6 largest shareholders who are not related parties to any of the directors and who consent to act. This raises potential liability issues for such shareholders, which would need to be covered by a standard form agreement and professional indemnity insurance paid for by the company. The company would also need to cover the cost of a firm of independent remuneration consultants that such a group might engage, but the shareholders' representatives should not be paid. Any shareholders agreeing to act would need to be careful about managing insider dealing concerns.

Directors and their related parties should not be allowed to vote on resolutions concerning the delegation of responsibility.

No Delegation

If responsibility for setting remuneration is not delegated (or delegation is withdrawn), then shareholders will need to approve in advance any bonuses or changes to terms and conditions.

On appointment, the board should set the remuneration package for the director, for an initial term ending at the next AGM/EGM.

The vote for (re-)appointment at the AGM/EGM should specify (or cross-refer to) the proposed remuneration package (basic pay, bonuses, benefits and notice conditions) for the director standing for (re-)election and the annual increments proposed for the period until expiry of the term of office. Such increments would typically be some measure of inflation (e.g. cpi).

Bonuses could be approved in advance, by approval of a scheme setting out clearly defined limits on the magnitude of awards and the discretion that could be exercised by the Board or Remuneration Committee. Alternatively, bonuses could be approved in arrears.

Pay for non-executive directors would need to be set at a daily or hourly rate to reflect the variability of the time requirements for non-executive directors. A minimum time requirement should also be set.

Directors and their related parties should be allowed to vote on changes to remuneration packages, since they too are shareholders, but such votes should be discouraged. Where directors and related parties vote this should be disclosed, so that shareholders can see the extent to which changes to remuneration changes have depended upon such support.

Transition

If delegation is withdrawn, then the default should be that fee increases are limited to an inflation measure and no bonuses are paid or benefits are changed, unless and until approved otherwise by shareholders. This will need to be built into remuneration agreements.

Where delegation is granted, delegated decisions could be taken immediately, or from a date set out in the delegation resolution.

Introduction

Remuneration agreements may need to be redrafted upon introduction of such a process to acknowledge the shareholders' supremacy in setting basic pay, benefits and bonuses. This should just be an administrative process as there need not be any fundamental changes to a director's terms and conditions of employment/engagement.

Benefits

The benefits of such an arrangement would be that:

- directors clearly understand that their remuneration is linked to shareholder perception of their performance,

- shareholders have more involvement and therefore less reason to complain if they are not happy with levels of remuneration, and

- shareholders have a clear mechanism that they can use to take control if they do not trust the remuneration committee !!

The most obvious disadvantage is that Boards could focus more on managing shareholder expectations to the detriment of creating shareholder value. Also, activist shareholders could use this mechanism to put pressure on directors to act in a manner not in the best interests of all shareholders, by threatening to call an EGM to vote on removing delegation for the setting of remuneration.