



FINANCIAL REPORTING COUNCIL

**REVISIONS TO THE UK CORPORATE GOVERNANCE CODE
(FORMERLY THE COMBINED CODE)**

MAY 2010

INTRODUCTION

1. The review of the Combined Code which the Financial Reporting Council carried out during 2009 took place against the background of a significant decline in economic conditions since the previous review in 2007, and in parallel to a separate review of the governance of banks and other financial institutions carried out by Sir David Walker. Following earlier consultation on the impact and effectiveness of the Code, the FRC consulted on a draft revised Code in December 2009.
2. At the same time, the FRC announced that the Code would in future be known as the UK Corporate Governance Code, in order to make the Code's status as the UK's recognised corporate governance standard clearer to foreign investors, and to foreign companies listed in the UK that, as a result of changes to the FSA's Listing Regime, now need to report on how they have applied the Code if they have a Premium Listing of equity shares.
3. Consultation on the draft revised Code ended in March 2010. 127 responses were received. Copies of all responses, with the exception of those that respondents asked to be kept confidential, are available on the FRC website¹. This report explains how the main issues that were raised by respondents have been addressed. The revised Code will apply to reporting periods beginning on or after 29 June 2010.
4. Overall the response to the FRC's proposals was positive. There was strong support for the FRC's desire to promote better board behaviour by refocusing attention on the Code principles, which should take precedence over its more detailed provisions, and encouraging boards to think more about how to apply these principles in order to best discharge their responsibilities. The general view of respondents was that the structural changes proposed to the Code had achieved this objective. There was also strong support for the FRC's decision to adopt only those of Sir David Walker's recommendations that it considered were relevant to all listed companies.
5. Appendix A to this report summarises the main differences between the content of the new UK Corporate Governance Code and the 2008 edition of the Combined Code. These include:

¹ <http://www.frc.org.uk/corporate/2009DecConsultationamendments.cfm>

- To encourage boards to be well balanced and avoid “group think”, there are new principles on the composition and selection of the board, including the need to appoint members on merit, against objective criteria, and with due regard for the benefits of diversity, including gender diversity.
 - To promote proper debate in the boardroom, there are new principles on the leadership of the chairman, the responsibility of the non-executive directors to provide constructive challenge, and the time commitment expected of all directors.
 - To help enhance the board’s performance and awareness of its strengths and weaknesses, the chairman should hold regular development reviews with each director and board evaluation reviews in FTSE 350 companies should be externally facilitated at least every three years.
 - To increase accountability to shareholders, all directors of FTSE 350 companies should be re-elected annually and chairmen are encouraged to report personally on how the principles relating to the leadership and effectiveness of the board have been applied.
 - To improve risk management, the company’s business model should be explained and the board should be responsible for determining the nature and extent of the significant risks it is willing to take.
 - Performance-related pay should be aligned to the long-term interests of the company and its risk policies and systems.
6. All new provisions of the Code, such as those relating to board evaluation and annual elections, will be subject to the existing ‘comply or explain’ approach.
 7. There are also some structural changes to the Code. Appendix B shows where the principles and provisions of the 2008 Code are located in the new Code. An impact assessment covering the main changes to the Code is presented in Appendix C.
 8. The revised Code is the culmination of a review process that began in March 2009. Throughout the process, until he stepped down as Chairman of the FRC at the end of April 2010, Sir Christopher Hogg dedicated a significant amount of time and energy, both setting the direction for the review and immersing himself in the detail. The FRC would like to take the opportunity to pay tribute to his leadership and his personal commitment to increasing the effectiveness of company boards.

THE MAIN ISSUES RAISED BY RESPONDENTS

9. The main issues arising from the consultation on the draft Code were:
- the frequency of director re-election;
 - boardroom diversity;
 - external facilitation of board effectiveness reviews;
 - the requirement to report on the company's business model;
 - the board's responsibility for risk;
 - the Code provisions dealing with remuneration; and
 - the use of company websites rather than annual reports for disclosures on corporate governance.

Director re-election

10. Provision B.7.1 of the Code addresses the frequency with which directors should be put forward for re-election. In the consultation document issued in December 2009 the FRC sought views on three options: that all directors should be re-elected at least every three years, as in the 2008 edition of the Code; that all directors should be re-elected annually; or that the company chairman should be re-elected annually, with all other directors being re-elected every three years.
11. Respondents were divided on the merits of the three options. The majority of institutional investors who responded supported annual re-election of all directors, while the majority of listed companies supported re-election every three years. There was limited support for annual re-election of the company chairman only. Some respondents considered this appropriate as the chairman has the ultimate responsibility for corporate governance, but more considered it was inconsistent with the concept of the unitary board and risked undermining the chairman's position.
12. Supporters of annual re-election of all directors considered that it would enhance the board's accountability, and promote more robust engagement between the board and shareholders. Opponents argued that it would encourage short-term thinking and create the potential to destabilise the board.
13. The FRC shares the view of those respondents who argued that it was appropriate that shareholders, as the company's owners, should have an annual opportunity to express their views on the performance of the directors. The FRC believes this will give boards a strong incentive to understand and respond to shareholders' concerns before the annual general meeting, which should in turn lead to ongoing engagement. If boards are receptive to those concerns, there should be little reason for

shareholders to vote against directors. It is not in shareholders' interest to undermine confidence in the board as this might potentially affect the value of their own investment.

14. Evidence suggests that investors generally use their voting rights responsibly. The FRC has looked at voting records for the period 2000 to 2009². In that period only 19 directors from nine companies on the FTSE All Share Index lost a vote. Nevertheless, the FRC believes that shareholders should have the opportunity to vote against a particular director at the annual general meeting without having to wait up to two years longer to express their concerns.
15. Changes in the investor base and the greater use made of voting services agencies over the last ten years have not to date led to any noticeable change in voting patterns when directors stand for re-election. In addition, anecdotal evidence suggests that those companies that already put the whole board up for annual re-election have not observed a change in this pattern.
16. A few respondents raised concerns that annual re-election might make it more difficult to recruit directors, who might be concerned about security of tenure. The FRC notes that, in accordance with an existing provision of the Code, executive directors are typically already employed on twelve month contracts. While non-executive directors are commonly recruited for three-year terms, completion of that term will normally be conditional on continued performance and re-election. The FRC does not consider that more frequent re-election necessitates any change in practice.
17. For these reasons, the FRC did not find the objections persuasive and has decided to amend Provision B.7.1 to state that all directors should be subject to annual re-election.
18. However, the FRC recognises the concern that smaller companies with a more concentrated shareholder base³ might be exposed to disagreements between their major shareholders, and therefore has limited the new provision to FTSE 350 companies. Smaller companies should, of course, consider their policy on director re-election carefully.

² Data provided by Manifest Information Services Ltd.

³ In April 2010 the FRC looked at the shareholder base of a sample of companies in the FTSE Index. In this sample the average combined share of the three largest shareholders was 39% in companies on the FTSE Small Cap and Fledgling Indices, compared to 20% in the FTSE 100 and 25% in the FTSE 250.

19. As with all other provisions of the Code, companies are free to explain rather than comply if they believe that their existing arrangements ensure proper accountability and underpin board effectiveness, or that a transitional period is needed before they introduce annual re-election. The FRC will assess the impact of the revised provision when it carries out its next review of the Code and will keep a close watch on voting patterns in the intervening period.
20. The FRC considers annual election of directors to be only one part of a drive to improve engagement between boards and shareholders. It needs to be matched by a greater willingness by institutional investors to engage constructively. This is one of the objectives of the Stewardship Code, on which the FRC has recently consulted and which it aims to publish by the end of June 2010.

Boardroom diversity

21. In the draft Code published in December, the FRC proposed amending an existing Supporting Principle on appointments to the board to state that they should be made “against objective criteria that do not inappropriately restrict the talent pool from which the candidates will be identified”. The intention behind this proposal was to encourage boards to consider the diversity of the board when making new appointments.
22. This proposal was welcomed by those who commented on it in response to the consultation. A number of respondents considered that the FRC should amend the Supporting Principle so that the intention was stated more explicitly. Some respondents considered that there should be a specific reference to gender diversity, arguing that, in the words of one respondent, “we cannot see how such an oblique provision [as that proposed by the FRC] is likely to encourage the cultural change that has to be achieved”.
23. The FRC supports the argument that diversity in the boardroom, defined broadly, can improve the quality of decision-making and reduce the risk of “group think”. This is the rationale for the revised Main Principle B.1 of the Code, which emphasises the need for a balance of skills, experience, independence and knowledge of the company. The FRC also notes that the number of women on company boards remains very low. According to the 2009 Female FTSE Board Report⁴, women account for only 12 percent of all directors in FTSE 100 companies, and seven percent in FTSE 250 companies. One quarter of FTSE 100 companies have no women on the board at all.

⁴ Sealy, Vinnicombe and Doldor; The Female FTSE Board Report 2009; Cranfield University; 2009

24. For these reasons, the FRC has decided to amend Supporting Principle B.2 to encourage nomination committees explicitly to include the board's gender mix in the factors that are taken into account when considering the need for new appointments. The principle now reads: "The search for board candidates should be conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender".

Board Reviews

25. Since 2003, the Code has contained a principle stating that the performance of the board should be reviewed annually. In the December consultation document the FRC proposed adding a recommendation that these reviews should be externally facilitated at least every three years because of the potential benefits resulting from the greater objectivity that an external facilitator can bring to the evaluation process.
26. The majority of respondents either supported or did not comment on the proposal. However, approximately 25 percent of the listed companies that responded to the consultation raised concerns. Some of them considered it should be left entirely to the board to judge when and whether external involvement in the review process would be beneficial. Some were concerned about the potential cost of employing an external advisor, while others questioned whether there were sufficient good quality providers of such services to meet the increased demand that would result from such a provision.
27. The FRC acknowledges that in the short to medium term there will continue to be concerns about the availability of board evaluation services, and for that reason has decided that the new provision should at present apply to FTSE 350 companies only.
28. This is still a relatively new market and the FRC believes that these concerns may be addressed as the market matures and new entrants stimulate competition and innovation. The FRC will continue to monitor the development of the market and consider whether there are any steps that it should take to raise standards among service providers, and will consider as part of the next review of the Code whether to extend this provision to smaller listed companies.

The Business Model and Risk

29. The FRC proposed two additions to the section of the Code dealing with accountability: a new provision stating that companies should disclose their business model in the annual report, and a new principle setting out the board's responsibilities in relation to risk, which with hindsight the FRC considers to have been a significant omission from previous versions of the Code.
30. A few respondents opposed the proposal to explain the company's business model on the grounds that it went beyond the statutory requirements in Section 417 of the Companies Act 2006 relating to the Enhanced Business Review. However the majority of those who commented shared the view of the FRC and the House of Commons Treasury Select Committee that there is currently a gap in reporting and that setting out in layman's terms the company's strategy for generating long term value would enhance the ability of investors and other users of reports to assess the disclosures required under the Business Review. The FRC believes it would also help to illustrate how the board has applied the new principle on risk.
31. The FRC has therefore retained this provision from the consultation, and would encourage companies to include this description in the same part of the annual report as the Business Review.
32. Furthermore, the FRC considers that companies that are properly applying the Accounting Standards Board's voluntary Reporting Statement on the Operating and Financial Review will already be providing this information. In order to reduce the risk of confusion and duplication, the FRC has revised the wording of the new provision to mirror that in the Reporting Statement. The Reporting Statement also provides guidance on how this provision can be complied with.
33. Respondents overwhelmingly agreed that the proposed new principle on the board's responsibilities in relation to risk was an important addition to the Code. The only disagreement was whether the terminology that the FRC had used, "defining the company's risk appetite and tolerance", properly conveyed the intention behind the new principle.
34. A number of respondents were concerned that the terms "risk appetite" and "risk tolerance" were not well understood or that there was no common agreement on their meaning. Others pointed out that, within financial sectors, they tended to be associated with specific metrics and modelling techniques, and were concerned that these might be imposed on companies in other sectors for which they were not suitable.

35. It was not the intention of the FRC to promote particular methodologies for dealing with risk, but simply to state that it was the responsibility of the board to consider how much risk the company can bear and how willing it should be to take risk on. In the light of comments, the FRC has reworded the principle to read: "The board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems".
36. Further guidance can be provided, if necessary, in the Turnbull Guidance, which is to be reviewed later in 2010.

Remuneration

37. The FRC proposed a number of changes to the Code provisions and schedule dealing with remuneration policy, some of which were intended to address those of Sir David Walker's recommendations that the FRC considered should apply to all listed companies.
38. There was general support for these proposals, and for the associated principle to make explicit the link between remuneration and the long-term success of the company, but a number of respondents commented on three specific points:
- Some respondents had interpreted the proposed reference to the use of non-financial performance metrics as performance criteria for long-term incentive schemes to mean that such criteria should be used in all cases. The FRC had only intended to recommend that they should be used if appropriate, and the wording has been amended accordingly;
 - Some questioned the feasibility of risk-adjusting the payment of bonuses outside the financial services sector. This reference has been dropped from the revised Code, although the requirement for remuneration incentives to be compatible with the company's risk policies and systems has been retained; and
 - In response to a number of queries, the recommendation that companies consider contract provisions enabling them to reclaim performance-related remuneration in cases of "mis-statement and misconduct" has been amended to refer to "mis-statement or misconduct", to clarify that this might be considered in either circumstance, not only when both occur in the same case.

Use of Company Websites

39. The FRC sought views on whether the requirements in the Code for specific information to be disclosed in the annual report should be amended to enable companies to take advantage of the flexibility available under Section 7.2 of the FSA's Disclosure and Transparency Rules, which allow companies a choice of whether to put the corporate governance statement on the website or in the annual report. It was suggested that this might lead to a situation where the full corporate governance statement was placed on the website with an edited version containing the most important information in the annual report.
40. Approximately twenty percent of respondents commented on this issue. Views were mixed with a slight majority, including most investors that commented on the issue, objecting to the suggestion because of concerns that this would reduce the quality of information available in the annual report, and might send a signal that governance had in some way been devalued.
41. Others welcomed the suggestion as an opportunity to make this part of the annual report more focused on the information of most interest to users, although some qualified this support by saying that guidance would be needed on what information should continue to be contained in the annual report.
42. In the light of these comments the FRC has decided not to make any changes to the Code at this time, but will give further consideration to this matter as part of its wider project to reduce the complexity of annual reports.

Financial Reporting Council
May 2010

APPENDIX A

CHANGES TO THE UK CORPORATE GOVERNANCE CODE

This Appendix summarises the main differences between the content of the new UK Corporate Governance Code and the 2008 edition of the Combined Code.

There are also many structural changes to the Code, and Appendix B shows where the principles and provisions of the 2008 Code are located in the new Code. The most significant structural changes are:

- Section A in the 2008 Code has been divided into two new sections called “Leadership” and “Effectiveness” (Sections A and B in the 2010 Code);
- Section E in the 2008 Code, which was addressed to institutional investors, has been moved to Schedule C in the 2010 Code and will be removed entirely when the new Stewardship Code for institutional investors comes into effect; and
- Schedule B to the 2008 Code, on the liability of non-executive directors, has been deleted. Guidance on this issue will be incorporated to the extent necessary in the revised Higgs Guidance being developed by ICSA on the FRC’s behalf.

New Code Principles

There are four new Main Principles in the Code, some of which reflect wording previously contained in the Supporting Principles. These Principles address:

- the chairman’s responsibility for leading the board (New Principle A.3);
- the non-executive directors’ role in challenging and developing strategy (New Principle A.4);
- the need for the board to have a balance of skills, experience, independence and knowledge of the company (New Principle B.1); and
- the need for all directors to have sufficient time to discharge their responsibilities effectively (New Principle B.3).

In addition, former Main Principle A.5 on information and development has been divided into two separate principles (New Principles B.4 and B.5). A new Supporting Principle has been added to B.4 concerning the need for directors to have appropriate knowledge of the company and access to its operations and staff.

A new Supporting Principle has been added on the level and components of remuneration (New Principle D.1). This states that the performance-related elements of executive directors' remuneration should be designed to promote the long-term success of the company.

Amendments to existing Code Principles

Some existing Principles have been extended or amended as follows:

- the Main Principle on the role of the board now states that the board is responsible for the long-term success of the company (Principle A.1);
- the Supporting Principle on the role of the chairman has been extended to refer to the chairman's responsibilities for ensuring a culture of openness and debate, and that adequate time is available for discussion (Principle A.3);
- the Supporting Principle on appointments to the board has been extended to encourage boards to consider the benefits of diversity, including gender diversity, when making appointments (Principle B.2);
- the Main Principle on internal control has been extended to cover the board's responsibility for risk (Principle C.2); and
- the Supporting Principle on dialogue with shareholders now makes it the responsibility of the chairman for ensuring that all directors are made aware of shareholders' concerns (Principle E.1).

There are also drafting changes to some other Supporting Principles that the FRC does not consider change the substance of the Code.

Amendments to Code Provisions

There are a number of new provisions and some amendments to existing provisions. These include:

- the provision describing the role of the senior independent director has been extended to state that they should provide a sounding board for the chairman and act as an intermediary for the other non-executive directors when necessary (Provision A.4.1);
- a new provision has been added stating that the chairman should agree and regularly review the training and development needs of each director (Provision B.4.2);
- a new provision has been added stating that the evaluation of the board of FTSE 350 companies should be externally facilitated at least every three years, and that any other connections between the facilitator and the company should be disclosed (Provision B.6.2);
- the provisions on re-election of directors have been revised to state that all directors in FTSE 350 companies should be put forward for re-election every year (Provision B.7.1);
- a new provision has been added stating that the annual report should include an explanation of the company's business model (Provision C.1.2);
- the provisions on remuneration have been amended to clarify that the remuneration of non-executive directors should not include any performance-related elements (Provision D.1.3), that payouts under incentive schemes should be subject to non-financial performance criteria where appropriate and compatible with the company's risk policies and systems, and that companies should consider provisions that enable them to reclaim variable components in cases of mis-statement or misconduct (all in Schedule A);
- the provision on non-executive directors meeting shareholders has been amended to clarify that compliance can be achieved without needing to set up separate meetings for non-executive directors (Provision E.1.1); and
- the provision on making the results of votes available has been amended to clarify that it applies only in cases where a vote has been held on a show of hands (votes held on a poll are subject instead to the Companies Act) (Provision E.2.2).

There are also drafting changes to some other provisions that the FRC does not consider change the substance of the Code.

APPENDIX B

THE STRUCTURE OF THE 2008 AND 2010 CODES

The principles and provisions in the 2008 Code are listed in the left hand column. The right hand column shows their location in the revised Code and indicates where the wording has been changed.

2008 CODE	2010 CODE
Main Principle A.1	Main Principle A.1 - new wording
Supporting Principles A.1	Supporting Principles A.1, except for third paragraph (moved to Main and Supporting Principle A.4)
Provision A.1.1	Provision A.1.1
Provision A.1.2	Provision A.1.2 - new wording
Provision A.1.3	Provision A.4.2
Provision A.1.4	Provision A.4.3
Provision A.1.5	Provision A.1.3

2008 CODE	2010 CODE
Main Principle A.2	Main Principle A.2
Supporting Principle A.2	Main and Supporting Principles A.3 - new wording
Provision A.2.1	Provision A.2.1
Provision A.2.2	Provision A.3.1

2008 CODE	2010 CODE
Main Principle A.3	Supporting Principle B.1 - new wording. New Main Principle B.1 added.
Supporting Principles A.3	Supporting Principles B.1 - new wording
Provision A.3.1	Provision B.1.1
Provision A.3.2	Provision B.1.2
Provision A.3.3	Provision A.4.1 -new wording

2008 CODE	2010 CODE
Main Principle A.4	Main Principle B.2
Supporting Principles A.4	Supporting Principles B.2 - part of first paragraph replaced by Main Principle B.3; new wording added
Provision A.4.1	Provision B.2.1
Provision A.4.2	Provision B.2.2 - new wording
Provision A.4.3	Provision B.3.1
Provision A.4.4	Provision B.3.2
Provision A.4.5	Provision B.3.3
Provision A.4.6	Provision B.2.4

2008 CODE	2010 CODE
Main Principle A.5	Divided into Main Principles B.4 and B.5
Supporting Principles A.5	Divided into Supporting Principles B.4 and B.5; additional wording in B.4
Provision A.5.1	Provision B.4.1 - new wording and new provision B.4.2 added
Provision A.5.2	Provision B.5.1
Provision A.5.3	Provision B.5.2

2008 CODE	2010 CODE
Main Principle A.6	Main Principle B.6
Supporting Principle A.6	Supporting Principle B.6
Provision A.6.1	Split into Provisions B.6.1 and B.6.3 - new Provision B.6.2 added

2008 CODE	2010 CODE
Main Principle A.7	Main Principle B.7 - second sentence moved to Supporting Principle B.2
Provision A.7.1	Provision B.7.1 - new wording
Provision A.7.2	Provision B.7.2 - new wording

2008 CODE	2010 CODE
Main Principle B.1	Main Principle D.1
Supporting Principle B.1	Supporting Principles D.1 - new wording
Provision B.1.1	Provision D.1.1 - first sentence moved into Supporting Principles D.1
Provision B.1.2	Incorporated into Schedule A
Provision B.1.3	Provision D.1.3 - new wording
Provision B.1.4	Provision D.1.2
Provision B.1.5	Provision D.1.4
Provision B.1.6	Provision D.1.5

2008 CODE	2010 CODE
Main Principle B.2	Main Principle D.2
Supporting Principles B.2	Supporting Principles D.2 - wording deleted
Provision B.2.1	Provision D.2.1
Provision B.2.2	Provision D.2.2
Provision B.2.3	Provision D.2.3
Provision B.2.4	Provision D.2.4

2008 CODE	2010 CODE
Main Principle C.1	Main Principle C.1
Supporting Principle C.1	Supporting Principle C.1
Provision C.1.1	Provision C.1.1 – new wording
Provision C.1.2	Provision C.1.3 – new wording, and new provision C.1.2 added

2008 CODE	2010 CODE
Main Principle C.2	Main Principle C.2 – new wording
Provision C.2.1	Provision C.2.1

2008 CODE	2010 CODE
Main Principle C.3	Main Principle C.3 – new wording
Provision C.3.1	Provision C.3.1
Provision C.3.2	Provision C.3.2
Provision C.3.3	Provision C.3.3
Provision C.3.4	Provision C.3.4
Provision C.3.5	Provision C.3.5
Provision C.3.6	Provision C.3.6
Provision C.3.7	Provision C.3.7

2008 CODE	2010 CODE
Main Principle D.1	Main Principle E.1
Supporting Principles D.1	Supporting Principle E.1 – new wording
Provision D.1.1	Provision E.1.1 – new wording
Provision D.1.2	Provision E.1.2

2008 CODE	2010 CODE
Main Principle D.2	Main Principle E.2
Provision D.2.1	Provision E.2.1
Provision D.2.2	Provision E.2.2 – new wording
Provision D.2.3	Provision E.2.3
Provision D.2.4	Provision E.2.4

2008 CODE	2010 CODE
Section E: Institutional Shareholders	Schedule C. Wording amended to refer to ISC Code.

2008 COMBINED CODE	2010 CODE
Schedule A: The design of performance related remuneration	Schedule A. Some changes to the wording.
Schedule B: Guidance on liability of non-executives	Removed
Schedule C: Disclosure of corporate governance arrangements	Schedule B

IMPACT ASSESSMENT

What are the policy objectives and intended effects?

1. The UK Corporate Governance Code (formerly known as the Combined Code) sets out standards of good practice for listed companies in relation to issues such as board composition and development, remuneration, accountability and audit and relations with shareholders. All companies with a Premium Listing are required under the FSA Listing Rules to report in their annual report on how they have applied the Code.
2. The last significant revisions to the Combined Code were made in 2003 when it was updated to incorporate recommendations from the Higgs report on the role of non-executive directors and the Smith report on audit committees. Further limited amendments were made in 2006 and 2008 following reviews by the Financial Reporting Council (FRC).
3. In March 2009, the FRC announced a further review of the Combined Code, the aim of which was to look at the impact and implementation of the Code. This review was carried out in parallel with Sir David Walker's review of corporate governance in banks and other financial institutions. Documents associated with the review, such as consultation documents and responses, can be found on the FRC website⁵.
4. Following the review, the FRC consulted in December 2009 on a number of changes to the Code. The resulting changes are summarised in Appendix A of this report.
5. The intent of the changes is to improve the governance of listed companies. The FRC considers that the changes strike an appropriate balance between encouraging directors to consider how they can best meet their responsibilities while not constraining their ability to govern their companies in the way they consider best represents the long-term interests of the shareholders. The majority of the changes enjoyed strong support from companies and investors that responded to the consultation, as did the FRC's decision to adopt only those recommendations of the Walker Report that it considered applied to all listed companies.

⁵ <http://www.frc.org.uk/corporate/reviewCombined.cfm>

What is the coverage?

6. Changes to the Combined Code directly affect those companies with a Premium Listing of equity shares in the UK, as they are required by the Listing Rules to report on how they have applied the Code. As of March 2010 there were 1,443 such companies (1,120 UK incorporated companies and 323 companies incorporated in other countries)⁶ operating across all business sectors.

Key assumptions, sensitivities and risks

7. The key assumption is that the 'comply or explain' approach to applying the Code will continue to operate. Under this approach, companies are expected to apply the principles of the Code, but can choose whether to do so by following its provisions or by some other means. This means that where a company considers that the costs of complying with a provision outweigh the benefits it can choose not to do so, and to adopt a more cost-effective alternative instead.
8. There is a risk that the 'comply or explain' approach could be replaced by a straight compliance requirement. There is also a risk that some investors might take a 'box-ticking' approach to the Code with the result that some companies may feel under pressure to comply whether appropriate or not.
9. In relation to annual re-elections, there is a risk that this could lead to a large number of directors being removed which could destabilise companies. However the FRC notes that in the ten years to 2009 only nineteen directors at ten companies lost a re-election vote, and that the average votes cast against directors in all elections was less than two percent.

Costs and benefits

10. The consultation on the draft revised Code asked respondents to provide data on the likely costs of benefits of the proposed changes to the Code where possible. Unfortunately for most of these proposals, while respondents were able to identify different potential costs and benefits, it has not proved possible to quantify them.

⁶ Based on data provided by the London Stock Exchange. These figures assume that all companies listed on the Main Market of the London Stock Exchange as at March 2010 would have been reclassified as Premium Listed companies when the FSA's new Listing Regime took effect in April 2010.

11. Most respondents considered that the overall impact of the changes would be beneficial and increase the likelihood of companies being well governed. If this were in turn to lead to better long-term financial performance of listed companies then the benefits could potentially be very significant, but impossible to quantify.
12. The specific changes to the Code that some respondents considered might result in direct costs or savings are:

- The principles that the board should have the appropriate balance of skills, experience, independence and knowledge of the company to enable it to discharge its duties and responsibilities effectively (Principle B.1), and that nomination committees should take account of the diversity of the board, including its gender mix, when making appointments (Principle B.2).

There may be some costs associated with these principles if a company concludes that changes in board composition or the appointment process are needed in order to apply these revised principles.

- The provision that the board evaluation process should be externally evaluated at least every three years in FTSE 350 companies (Provision B.6.2).

This is the provision that is most likely to lead to direct costs for those companies that choose to comply but are not already doing so. The type of evaluation services provided vary considerably, from simply providing and processing questionnaires, the results of which are then passed to the chairman to deal with as he or she sees fit, to a more tailored service where the external reviewer may interview directors and others and produce a detailed assessment. The cost of these services also varies considerably depending on the type of service used.

- The provision that all directors of FTSE 350 companies should be re-elected annually (Provision B.7.1).

There will be some direct costs for companies that adopt annual elections as a result of the greater number of AGM resolutions. Respondents who commented on this point were not able to quantify the cost although it was generally not considered to be significant for individual companies. The cumulative increase in resolutions will have cost implications for investors, particularly those who track the whole FTSE index, and for their agents.

- The changes relating to performance-related remuneration (Section D and Schedule A).

These changes may require some companies to review their remuneration policies, and there may be costs associated with doing so. The introduction of “claw back” provisions, as recommended in the Schedule, may lead to savings in some cases.

- The clarification that non-executive directors should meet shareholders can be complied with by their attending existing meetings, rather than by setting up separate meetings (Provision E.1.1).

This proposal might result in some marginal savings for companies that have previously arranged meetings specifically in order for non-executive directors to meet shareholders.

13. As noted in the previous section, the ‘comply or explain’ mechanism gives companies that consider the costs of individual Code provisions will outweigh the benefits the choice of not complying.

From what date will the revised Code be implemented?

14. Subject to the necessary changes to the Listing Rules, the Code will apply to reporting periods beginning on or after 29 June 2010.

How will the Code be enforced?

15. The Code will continue to be primarily enforced by shareholders, through engagement and the use of their legal rights, such as voting rights. This is underpinned by the FSA’s Listing Rules, which require companies with a Premium listing to ‘comply or explain’ with the Code.

When will the policy be reviewed to establish its impact?

16. The Code will next be reviewed in 2013.

Are there arrangements in place that will allow a systematic collection of monitoring information for future review?

17. A number of organisations such as Grant Thornton and Deloitte produce annual reports on the implementation of the Code and its impact on, for example, board composition. The FRC will commission further research as necessary.

18. The FRC meets regularly with companies and investors to discuss their experience of applying the Code. This has included, for example, meetings with 100 chairmen of listed companies in 2009. These discussions supplement the research referred to above and provide valuable insights into the practical impact of the Code.

Contact point

Chris Hodge
Financial Reporting Council
Fifth Floor
Aldwych House
71-91 Aldwych
London WC2B 4HN

E-mail: c.hodge@frc.org.uk

Telephone: 020 7492 2381



FINANCIAL REPORTING COUNCIL
5TH FLOOR
ALDWYCH HOUSE
71-91 ALDWYCH
LONDON WC2B 4HN
TEL: +44 (0)20 7492 2300
FAX: +44 (0)20 7492 2301
WEBSITE: www.frc.org.uk

© The Financial Reporting Council Limited 2010

The Financial Reporting Council Limited is a company limited by guarantee. Registered in England number 2486368.
Registered Office: 5th Floor, Aldwych House, 71-91 Aldwych, London WC2B 4HN.