

Crowthorne Enterprise Centre
Crowthorne Business Estate
Old Wokingham Road
Crowthorne
Berkshire
RG45 6AW

Tel: +44 (0) 1344 751672
Fax: +44 (0) 1344 751679

info@nedaglobal.com
www.nedaglobal.com

Chris Hodge
Financial Reporting Council
5th Floor
Aldwych House
71-91 Aldwych
London WC2B 4HN

Friday 5 June 2009

Dear Chris

2009 Review of the Effectiveness of the Combined Code: Call for Evidence

INTRODUCTION

The Non-Executive Directors Association was established in 2007 to support and represent the needs of Non-Executive Directors and ensure they are properly educated, trained and developed.

This review of the effectiveness of the Combined Code was undertaken by NEDA as we believe that although the FRC will receive many submissions from professional advisers there is particular value in receiving feedback from NEDs themselves.

For some time we have been campaigning on behalf of NEDs to improve and enhance a number of key areas which have a direct bearing on certain elements of the Combined Code. The specific areas we consider most important are set out under the three headings below:

Knowledge

1. Need for better training and education for Boards and NEDs, including proving 'knowledge and understanding' by testing - this would include better induction procedures.
2. Evidence that Boards and NEDs understand and drive their organisation's governance, risk management and internal control systems.

Performance

3. Need for more rigorous and formalised performance evaluation of Boards and NEDs.
4. Better reporting of how the Board and NEDs have provided good governance during the year.

Independence

5. The role of Chairman and CEO must be kept separate (already expected in the Combined Code).
6. Evidence of well balanced Boards: with appropriate diversity (including the use of a 'woman quota'); appropriate number of skilled NEDs; and clarity in the role and responsibility of NEDs.

RESPONSE

We welcome the opportunity to review and comment on the effectiveness of the Combined Code as laid out in the Consultation Paper and set out below a summary of some of our key views. In the Appendix we provide more detailed feedback on specific Principles and Provisions in the Code.

Our review was undertaken based on consultation with a cross section of members of the Association and represents the views of NEDs who have an interest in corporate governance matters and have experience in interpreting and applying the Code through their various NEDA related roles.

Approach to governance

We believe that a strict rules based style of regulation is not desirable in the UK and the Association would encourage the FRC to continue to ensure that the Combined Code does not veer away from its principles based 'comply or explain approach'. However, given that the Code has now been in existence in its present form since the late 1990's it may be a good time to commission a more fundamental review of the overall structure and alignment of the UK corporate governance framework for listed companies.

The purpose of the Combined Code

We believe that ultimately the purpose of the Code is to provide shareholders with comfort on how the company is being run. This comfort cannot be quantified and the Association fears that the structure of an annual review may inadvertently encourage a box ticking approach to corporate governance and mean that companies are not taking a holistic approach to corporate governance and sometimes cannot see the wood for the trees. This is clearly not in the interests of shareholders.

Focus and structure of the Code

The current focus and structure of the Code lends itself to a more compliance based approach and apart from the Preamble there is little linkage and connection made with an individual company's primary focus on the achievement of strategic and corporate objectives. The current structure is also very linear and given the dynamic nature of corporate governance there may be some merit in reflecting this in the overall framework.

Supporting guidance to the Code

The Code benefits from being short and direct, providing organisations with the flexibility needed in establishing their own governance structure. However, the good work and guidance provided by the Turnbull, Higgs and Smith Reports can be lost because they are separate documents. Much as the original Combined Code represented a consolidation of a number of key Committee guidelines it might be an opportune time to consider a way of better integrating guidance on internal control, NEDs and the Audit Committee.

Scope

Whilst the Code applies only to listed companies, we note that unlisted companies and especially those quoted on AIM and PLUS are increasingly seeking to comply with the code. We are encouraged by this trend and would wish to see it continue. However, this should not hold the Code back from evolving in line with desirable changes for governance in listed companies. We would also like to see companies demonstrate the rigour with which they have implemented the Code, and some evidence the activities undertaken to comply with the Code.

Evolving governance

We believe that the Code may be overly focussed in how governance currently operates in a business. It may be that companies would benefit from considering the future changes in the organisation and considering sooner the requisite changes that may be required in their governance structure and processes to meet the new demands arising from change. The Business Review introduced by the Companies Act 2006 may be a good starting point for the board to consider the future direction of the business.

Board and NED induction and ongoing education

Recent events have highlighted what many people felt was an issue in some organisations. Our anecdotal evidence suggests that the induction process for non executive directors is not as rigorous as it might be. This may have been a factor in recent events where there appears not to have been sufficient challenge by NEDs to the executive directors.

We believe that companies should need to demonstrate more clearly that their directors, both executive and non-executive, have had ongoing training and education during the year on key matters and skills relevant to the fulfilment of their roles and responsibilities.

Evidence of this ongoing training might even be used to create some form of recognised 'Continuing Professional Education' ('CPE') for directors. It may be in future that all directors of all listed companies are required to meet a certain recognised standards and to undertake continuing professional development to maintain their status. This is an area we are looking at for our members.

Company Culture

Some of the recent events may have been failures in corporate governance but were brought about by an undesirable company culture. Whilst this is difficult to regulate and codify, the Council may wish to consider guidelines to avoid such undesirable company cultures from perpetuating. Sometimes relatively small non-compliance of the Code may be symptomatic of company culture issues.

Specific question from the FRC

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

We believe that in some cases a significant majority of NEDs may reduce the effectiveness of the board. This is because by having fewer executive directors it may be that those executive directors have greater control over the flow of information to the board and that the NEDs receive a narrower range of views. However we still believe that a majority of directors should be non-executive.

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

We would like to see greater emphasis placed on the establishment of more robust risk management and internal control systems and as previously noted better linkage between governance and the achievement of strategic objectives/creating shareholder value.

- 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.

Yes but we would like to explore how some parts of the Code can be better enforced because at the moment there is often a lack of compliance with the spirit of the Code as boards use 'boilerplate' words to "explain" non-compliance with key areas of the Code. Against this background it may be appropriate to review the role of both the external auditors and, where appropriate, the internal auditors as providers of independent assurance in respect of governance, risk and control systems. It would be important to understand the potential scope of activity and the cost/benefit of work in this area as there is no desire to follow the problems experienced in the US with the Sarbanes-Oxley internal financial control reporting requirements.

Conclusion

If you wish to discuss any of the issues raised in this letter we will be pleased to attend a meeting with you.

Yours sincerely,

Graham Durgan
Chairman

Appendix

Review of Combined Code Principles (Areas with specific comments)

SECTION 1 COMPANIES

A. DIRECTORS

A.1 The Board

The Association believes this is a very important area and that compliance should be better enforced.

We also believe that the last sentence of the first supporting principle regarding values and standards should be a main principle in its own right.

A.2 Chairman and chief executive

We believe that this principle should be better enforced. Recent examples show that even when shareholders are supportive of a breach of this principle it is seldom good for the company or its investors.

A supporting principle should be added acknowledging that whilst the Chairman role is non-executive it isn't necessarily part-time. Therefore after this change the title Chairman should therefore always be assumed to be non-executive.

A.3 Board balance and independence

We believe that the existing model of board balance is effective. We note the American model which favours fewer executive directors and more NEDs but we believe that this may produce a narrower range of executive director views for the NEDs to hear. It also potentially pushes decision making to the next level down, usually the Executive Committee, and reduces the ability of NEDs to directly ask decision makers the reasons for their decisions.

A.4 Appointments to the Board

The Association would like this section to be better enforced but recognises the difficulty with this in that objective measures cannot easily be applied.

In the supporting principles, we would suggest that full director information as disclosed upon appointment is updated and released regularly. This could be annual in the Directors report or a note to the accounts, or it could be every time the director is put up for reappointment at an AGM.

We would also like to see the original date of each director's appointment in the Annual Report as an indicator of the independence of each director.

Finally we believe that all NEDs should be able to devote appropriate time to the role. Therefore we propose that the sentence “This is particularly important in the case of chairman” be deleted.

A.5 Information and professional development

We believe that the second sentence of this main principle should be a separate principle as it is a very different point from the first sentence.

We also believe that induction and updates warrants greater prominence in the Code (links with earlier point on the better integration of supporting guidance material).

We note the increase in overseas companies listed in London and that an increasing number of board meetings are held over a conference call line or video link. We suggest that all companies should be required to have a minimum of two board meetings per year in person with a quorum present and we raise the point that for companies listed on a UK exchange that at least one of these meetings should be held in the UK.

A.6 Performance evaluation

Board performance evaluation is a key area set out in the Code but to date the rigor and formality promoted and expected has not been evident. Many companies have put in place an annual review that relies on a reactive 'checklist approach' with little focus on how individual directors have actually met their objectives and how the board and sub-committees have performed. Companies need to better apply the spirit of the Code in establishing a more robust and challenging framework that "recognises the strengths but addresses the weaknesses" of the board.

B. REMUNERATION

B.1 The Level and Make-up of Remuneration

We would suggest there should be further debate about adding the following highlighted words to the paragraph on performance and remuneration ie.

“link rewards to **long-term and sustainable** corporate and individual performance, **even beyond the tenure of the director**”.

C. ACCOUNTABILITY AND AUDIT

C.2 Internal Control

As previously noted the good guidance on internal control and risk management areas provided in the Turnbull Report is not picked up and merits better integration.

D. RELATIONS WITH SHAREHOLDERS

D.1 Dialogue with Institutional Shareholders

The Association believes that there should be broader contact between boards and investors and that investors should not speak only to the CEO, CFO and Chairman. This may help investors to get a better understanding of the company's performance and risks.

We believe that providing different levels of information to institutions than to private shareholders is unfair and undermines confidence in the market. Companies should be required to post investor presentations on to their websites. In future, this could be extended to broker analyst reports with a specific caveat or by those analyst reports not showing a recommendation but an analysis of the business and its prospects.

We would support the introduction of a rule to cover listed companies which is similar to AIM Rule 26 as we believe this would assist availability of information for private shareholders.

SECTION 2 INSTITUTIONAL SHAREHOLDERS

E. INSTITUTIONAL SHAREHOLDERS

E.1 Dialogue with companies

Shareholders should be encouraged to be more engaged with their companies, and also to have broader dialogue with other shareholders to help drive change where appropriate. The recent Select Committee report specifically noted that one to one meetings between companies and shareholders may not be in the best interest of all shareholders. We are aware of a number of institutional investors who already engage with fellow shareholders to discuss issues concerning their shareholdings.

E.3 Shareholder Voting

The Association believes that the results of proxy vote should be mandatorily disclosed in a regulatory press release.
