



**FINANCIAL REPORTING COUNCIL**

**REVIEW OF THE EFFECTIVENESS OF THE COMBINED CODE  
CALL FOR EVIDENCE**

**MARCH 2009**

## REVIEW OF THE EFFECTIVENESS OF THE COMBINED CODE

### Introduction

1. The FRC is seeking views from listed companies, directors, investors and other interested parties on their experience of implementing the Combined Code. Comments are requested by **29 May 2009**.
2. Since the last major revisions to the Combined Code in 2003, following the Higgs and Smith reports on non-executive directors and audit committees respectively, the FRC has reviewed the impact and implementation of the Combined Code every two years. This is the third such review.
3. The 2007 review found that companies and investors considered the Code to be having a broadly beneficial impact, and to have contributed to higher overall standards of governance among UK listed companies. Consequently only two changes were made to the Code as a result of that review.
4. The 2007 review also found that, while there were many positive indicators to suggest that the 'comply or explain' approach was working reasonably well, investors had some concerns about the overall usefulness of disclosures by companies, while companies had concerns about the overall quantity and quality of engagement by investors on governance matters.
5. Since that review was concluded, there has been a significant change in the economic conditions under which companies (and in particular those in the financial sector) are operating. As a result the effectiveness of the Combined Code and the 'comply or explain' mechanism are being tested to a greater extent than under the previous, relatively benign conditions. The same can be said of many other regulatory regimes in the UK and internationally.
6. While there is no assumption that the Combined Code is fundamentally flawed, or that a different regulatory framework for corporate governance could have prevented some of the current problems, it is appropriate that the review should look at all aspects of the content and application of the Code, and the use made of 'comply or explain', to ensure that it remains effective.
7. This invitation to comment is one element of the evidence-gathering phase of the review. In addition the FRC will be meeting company directors and investors to get their views on the impact of the Code, studying a selection

of corporate governance statements in annual reports, and analysing existing and new research.

8. The FRC will publish its findings later in 2009. If the review results in any proposals to amend the Combined Code or related guidance, or to improve the effectiveness of the 'comply or explain' monitoring mechanism, there will be separate consultation supported by a Regulatory Impact Assessment.

#### The Walker Review of bank governance

9. In recent months the governance of banks has been the subject of particular scrutiny, as a result of which the Government has asked Sir David Walker to conduct an independent review on that subject. Some of the issues Sir David will be addressing may have broader applicability to the rest of the listed sector; others may not. While the two reviews will be conducted separately, the FRC will work closely with Sir David and share relevant research and other evidence.

#### **Issues for comment**

10. 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.
11. 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:
  - Which parts of the Code have worked well? Do any of them need further reinforcement?
  - Have any parts of the Code inadvertently 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?
  - 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.

## Content of the Code

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

- The composition and effectiveness of the board as a whole;
- The respective roles of the chairman, the executive leadership of the company and the non-executive directors;
- The board's role in relation to risk management;
- The role of the remuneration committee;
- The quality of support and information available to the board and its committees; and
- 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.

## Application of the Code

13. 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.

14. 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.

15. 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.

### **How to comment**

Comments should be sent by 29 May 2009:

by e-mail to [codereview@frc.org.uk](mailto:codereview@frc.org.uk)

or by post to:

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Corporate Governance Unit  
Financial Reporting Council  
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It is the FRC's policy to publish on its website all responses to formal consultations issued by the FRC and/or any of its Operating Bodies unless the respondent explicitly requests otherwise. A standard confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure. We do not edit personal information (such as telephone numbers or email addresses) from submissions; therefore only information that you wish to be published should be submitted. We aim to publish responses within 10 working days of receipt.



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