

FRC Combined Code Review

Submission from: NWA FitzGerald, Deputy Chair and S.I.D, Thomson Reuters.

The likely reaction to the financial crisis and evidence of governance inadequacies in financial institutions is further regulation. The wiser response would be to review how existing regulation can be more effectively applied and how corporate Boards can be held properly accountable for their actions.

The Combined Code and its application should be adopted to deal with the following issues:

1. Election of Directors.

A safety valve is required to allow shareholders to show their disapproval of Board behaviour. This is best achieved by all Directors standing for re-election each year. This is normal practice with a number of companies, including Unilever and Thomson Reuters.

It is argued that this is potentially very disruptive, but so it should be if a majority of shareholders are sufficiently disenchanted with Board decisions. It would allow disapproval to be expressed on individual Directors i.e. Chair, Chair Audit Committee, Chair Remuneration Committee etc. Votes must be binding.

2. Board Assessment.

A formal process of Board effectiveness and individual Board members' performance, facilitated by an independent professional, should be mandatory each year. This should be subject to 'comply or explain'.

It should be mandatory for the Chair to prepare a written appraisal of the CEO each year, which should be discussed with the Board.

3. Board Committees.

A report from key committees such as Audit and Remuneration should be included in the Annual Report. This should be signed by the committee Chair and should also describe the process of regular reporting to the full Board. The latter requirement is to guard against over-delegation to committees.

There should also be a description of the approach to risk evaluation by the Board, irrespective of the existence of a separate Risk Committee.

4. Independence and Conflict.

Some Directors are independent indefinitely; others lose their independence once they join the Board. The nine year rule should be broad guidance and a clear and acceptable explanation of tenure after 9 years should be regarded as compliance.

Also, short role descriptions for the Chairman and CEO should be included in the Annual Report.

There should be a requirement to list all key roles – corporate and others – held by the Chair and Chairs of key Board Committees, so shareholders can judge for themselves if individuals are likely to have adequate time (and energy) for the role.

The Code should mandate that the Chair and CEO are separate individuals. No exceptions should be allowed for listed companies.

5. AGMs.

Shareholders should be given the opportunity to ask questions at AGMs before resolutions are put to the meeting and prior to announcement of proxy votes.

Post the AGM, Boards should be required to write to shareholders outlining actions to be taken or explaining why no action is being taken in the event a resolution failed to get over 50% in favour.

6. Remuneration.

Clearly the most sensitive area, but also the most complex to address. However, “do nothing” is not an option! Here are some ideas:

- Major changes should require formal consultation prior to the AGM and the results of that consultation should be reported in the AGM circular.
- Performance conditions for variable pay – short and long – should be explicit and any decision to depart from these should be subject to consultation as above.
- A shareholder vote of 50%+ against the Remuneration Report should require a formal report by the Board to shareholders, outlining any changes to existing bonus awards or changes planned for the future.
- The detailed Remuneration Report is often opaque and difficult to interpret. A short – say one page – summary should be mandatory, setting out the shape and quantum of Senior Executive remuneration.

7. Shareholder Consultation.

The Annual Report should describe the process in place for shareholder consultation by NEDs and report on any significant consultation and the outcome in the past 12 months. It should be a requirement that the Chair, S.I.D and Chairs of the Audit and Remuneration Committees offer the opportunity for shareholder meetings at least once per year.

8. Resources.

The Chair / Board should be supported by an independent Secretariat which is not part of the Executive Management Team. Independent access by NEDs to Senior Executives i.e. not channelled through the CEO, should be encouraged and facilitated.

9. Audit Committee.

The focus on a single individual as “financial expert” is dangerous. Instead there should be adequate disclosure of the nature of the financial experience of the Audit Committee members and that it is sufficient to carry out the Committee’s functions.

10. Remuneration Committee.

External professional advisors must be completely independent of the Executive i.e. they cannot be employed to work for the Company on remuneration or related issues.

We also need a Combined Code for Investors, as recently proposed by the ICGN. There is insufficient provision in the existing Code on the role of Institutional Investors (1.5 pages out of 40). In particular, the issue of proxy voting needs to be addressed. Institutional shareholders should be required to vote – even though that presents practical difficulties – and there needs to be a single position from each Institution. Thomson Reuters had the recent bizarre experience of an Institution where the Portfolio Manager had built up a sizeable holding and was very supportive of management and their remuneration. Yet the proxy from the Compliance Department showed votes against the Board and Remuneration Report on the grounds of “non-compliance”. When this inconsistency was pointed out to the Institution, the proxy vote was changed!

The Code generally operates well. It would have greater impact if it had been applied in line with its principles, rather than the ‘box ticking’ approach of some shareholders and Governance Advisory Boards. Major structural change is not required but we do need to anticipate and implement necessary refinements and greater clarity or the pressure for heavy handed regulation will become irresistible.

NWAF / TR
May 2009.