Financial Reporting Council

Review of the effectiveness of The Combined Code

Summary of the main points raised in responses to the March 2009 Call for Evidence

July 2009

SUMMARY OF THE MAIN POINTS RAISED IN RESPONSES TO THE MARCH 2009 CALL FOR EVIDENCE

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INTRODUCTION

The consultation document on the impact and effectiveness of the Combined Code issued on 18 March 2009 asked four questions:

- Which parts of the Code have worked well and 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?

While inviting views on any aspect of the Code and its application, the paper specifically invited 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, addressed to institutional investors.

The consultation closed on 29 May. 114 responses were received, including 25 from companies and their representative bodies, 18 from investors and their representative bodies, 11 from accountancy firms and their professional bodies, seven from other professional bodies, 19 from assorted service providers and 11 from academics. The remainder came from individuals and assorted organisations including exchanges and think tanks. A full list of respondents is attached, and copies of individual responses are available at:

http://www.frc.org.uk/corporate/2009reviewresponses.cfm.

The main issues identified by these respondents are set out below. Section 1 summarises comments on the content of the Combined Code and Section 2 on its implementation.

THE OVERALL IMPACT AND EFFECTIVENESS OF THE CODE

While many respondents suggested specific changes to the Combined Code or commented on shortcomings in the way "comply or explain" has worked in practice – these views are summarised in the later sections of this paper – almost all respondents considered that the Code had contributed to improvements in the overall standard of governance among listed companies. Most respondents said that they continued strongly to support the flexible, principles-based approach of the Code and "comply or explain" as opposed to a more rule-based approach.

"We believe that the UK has one of the best governance regimes in the world. The comply-or-explain approach is effective and flexible. It is up to companies and shareholders to fulfil their roles conscientiously in order to make the process work more effectively." [Aviva Investors]

"It is our view that the Code generally reflects good and responsible governance practice. Its drafters intended that it should do just that and were successful. We suspect therefore that most responsible UK companies would choose to govern themselves in accordance with the key principles in the Code, even if it did not exist." [SAB Miller]

"We engage daily with the key people responsible for creating effective boards – chairmen, executive and non-executive directors, and company secretaries. The Combined Code is an essential reference tool in these conversations… The principles-based approach, as opposed to a more prescriptive rules-based regime, is an essential part of what makes the Combined Code valuable, allowing companies to devise for themselves a governance structure and processes that are most relevant." [Odgers Berndtson]

"While we are inclined to extend to the principle of comply or explain Churchill's famous dictum about democracy… we are wholehearted supporters of this approach. We have no doubt that a rules-based approach would be incomplete, difficult to interpret and would lead to an unhelpful atmosphere of loop-holing." [Towers Perrin]

A small number of respondents took the opposite view, arguing that there was a need for more regulation.

"*Given that the public at large evidently no longer has confidence in the current manner in which the Combined Code is implemented in practice, I recommend that the FRC abandons the "comply or explain" mechanism… [and] actively monitors and applies sanctions for non compliance with the Code.*" [Timothy Boatman]

"There are sufficient examples across the sectors for us to conclude that corporate governance in general, not just within financial institutions, has let us down. Fine tuning of the current system will not resolve this problem, since it has not done so in the past… ACCA believes that regulation of corporate governance in the UK is currently so light touch as to have very little impact at all. While we do not suggest that we move to the other extreme, we consider that there is now a clearly demonstrated need for more robust regulation in this area." [Association of Chartered Certified Accountants (ACCA)]

Other respondents, while supporting the Code and the "comply or explain" approach, considered that a radical overhaul of the contents of the Code was needed.

"The AIC recommends that the Combined Code should be adapted to embrace a more outcomes-based system which is focussed on delivering results. This would enable companies to adopt a more flexible approach to compliance and encourage investors to consider the company's corporate governance arrangements in a more qualitative way. An outcome-based system would also help to reduce boiler-plate disclosures to a minimum and encourage investors to carry out a more qualitative assessment of a company's compliance with the Combined Code." [Association of Investment Companies (AIC)]

"We believe that the time is now right for a considered review of the Code from first principles… the next step should be a detailed consultation on the purpose of the Code and how the code can best be structured to achieve that purpose. We believe that the bulk of the content of the Code is fit for purpose, but that it needs to be put into a contextual framework." [Quoted Companies Alliance (QCA)]

<u>The governance of financial institutions</u>

A number of respondents commented on the apparent governance failures in some financial institutions. The majority considered that these were not indicative of poor governance standards across the listed sector or fundamental weaknesses in the regulatory framework that applied to non-financial listed companies.

"The key issues faced by financial institutions… are in many respects unique to this sector and are being addressed accordingly by the government and FSA... Unfortunately, there can be no containment of the effects of the financial crisis, but we believe there can and should be a confinement of the solution. This is because we can find no evidence to justify the same or similar regulatory action being applied to sectors outside banking and finance, especially in regards to corporate governance and the Code." [Ernst & Young]

"The current financial crisis is not primarily a failure of corporate governance in the commercial world at large. There has been no repetition of the corporate governance failures of the early part of this decade. Nor has there been a corporate governance failure in the non-banking sectors of the financial services industry in UK." [Prudential]

<u>The limitations of codes and regulation</u>

A number of respondents commented on what they saw as the limitations of any Code or regulatory framework in attempting to deliver good governance, arguing that there was accordingly no need for wholesale changes to the Code or a move away from "comply or explain".

"*Governance failure is just as likely to result from matters that cannot be codified… as it is from weak processes. Most instances of governance failure would not have been prevented by a rules-based system*" [Spencer Stuart].

"Even the best corporate governance… will not prevent poor management decisions.... We strongly believe that future effort should largely go into improving the effectiveness of the existing provisions of the Code rather than radical reform". [BT Group]

"It is important to bear in mind what good governance can and can't achieve. The Combined Code, or any governance regime, can never turn a bad company into a good one or protect absolutely against corporate failure... The Combined Code does not, and should never seek to, provide a set of rules, compliance with which will ensure good governance and business success." [Hanson Green]

<u>"Apply or explain"</u>

Many comments were received on the effectiveness of the "comply or explain" mechanism. These are summarised in Section 2 of this paper. A number of respondents considered that the term "comply or explain" was responsible for some of the problems identified, arguing that it created the false impression that a company could only comply with the Listing Rules by following the detailed provisions of the Code. Some of these respondents argued that the term "apply or explain" should be used instead.

"We believe that the Code needs to do more to encourage the appropriate boardroom behaviours rather than greater compliance with it. Boards should not feel obliged to appear to comply with all of the Code's provisions… an "apply or explain" approach would be a more effective way of achieving this". [Capita Company Secretarial Services]

"We would support the development of… "apply or explain"… While a subtle change, we believe this change would underpin the Code as a set of principles as opposed to a set of rules." [Cable & Wireless]

SECTION 1: THE CONTENT OF THE COMBINED CODE

THE RESPONSIBILITIES OF THE CHAIRMAN AND DIRECTORS

The call for evidence requested views on the respective roles of the chairman, the executive leadership of the company and the non-executive directors. A number of respondents commented on the following issues:

- The role of the chairman;
- The role of the senior independent director;
- The role of the non-executive directors;
- The role of the executive directors; and
- The relationship between the board and the board committees.

The role of the Chairman

Respondents who commented on this issue considered that the chairman had the key role in promoting good governance, for example by setting the boardroom culture and overseeing relations with shareholders.

"The importance of the role that the Chairman brings to bear on a board and organisation through setting and applying standards and behaviours cannot be underestimated." [Severn Trent]

"The key non-executive is the chairman. His role is to lead the enterprise, project its character and standards, lead and manage the Board, supervise and monitor both performance and future development, partner the CEO. The behaviour of the Board - the way that power and influence is brought to bear - time and space for discussion and time for decision, is in the chairman's hands." [Patrick Haighton]

"We look to the chairman to uphold the highest standards of governance… We find that meeting with a chairman gives us a better understanding of key issues such as how well the governance works in practice, the strategy and the main risks that the business faces." [UBS Global Asset Management]

"We consider the Code should be amended so that… Chairmen are responsible for overseeing communications with investors and are encouraged to inform the whole board of investors' concerns (whether expressed directly or through brokers and advisers)". [Investment Management Association (IMA)]

The role of the senior independent director

Of those respondents who commented on this topic, the majority felt that the role of the senior independent director (SID) had evolved well since the Higgs Report, although a few dissented.

"Board balance, structure and independence have all been reinforced by the Code and generally work well. We note particularly the evolution of the role of the SID into a valuable contact point for shareholders." [National Association of Pension Funds (NAPF)]

"The position of senior independent director should be re-considered as it does not seem to have evolved into a role of any great significance, serving it seems merely to enhance the c.v. of the person holding the 'title'. It could be abolished, save in the case of companies with a combined post of chairman and CEO." [Professor Brenda Hannigan]

Some respondents considered that the Code should recognise that the senior independent director had a specific role to play during difficult times.

"The role of the SID needs to be better defined. In particular, the SID should have a specific role in times of corporate stress or where there is contention with the shareholder base. The SID should go out and discuss shareholder concerns and report back to the board as a whole." [Association of British Insurers (ABI)]

In addition, respondents raised the role of the SID in reviewing the chairman's performance and in selecting a successor to the chairman.

"The SID should chair the nomination committee in the appointment of a new chairman, take the lead in appraising the performance of the chairman, and act as the focal point for non-executive directors in the event that they are dissatisfied with the chairman's performance. SIDs should not see themselves as the chairmen-designate." [Odgers Berndtson]

<u>The role of the non-executive directors</u>

Some respondents highlighted what they saw as the key responsibilities of non-executive directors.

"Non-executives – should contribute individually and collectively to:

- *The selection, appointment, pay and, where appropriate, removal of the executives leading the business and the succession planning necessary to support this;*
- *The development and approval of strategy;*
- *The setting of targets and the subsequent monitoring of performance;*
- *Assessment of the management of risk and the strength of the internal control environment;*
- *Effective governance… to ensure shareholders' interests are protected."* [Lonmin]

Several respondents were concerned that the Code should not encourage unrealistic expectations of what non-executives could achieve.

"We have concerns that some stakeholders expect a non-executive role to be closer to that of an executive director's and, at times, there appear to be unrealistic expectations of non-executives capabilities... The role of the non-executives is to act as a 'sounding board' which can question and test strategic proposals, help to refine them, and thereafter provide advice and support in their implementation and propose corrective actions if there are implementation difficulties." [Institute of Chartered Accountants of Scotland (ICAS)]

"In our view, it is important to recognize that inherently unmanageable complexity (as in the case of the banks, for example) arises principally as a result of executive over-stretch. If a non-executive director is not able to broadly understand the business of a group in a sector they are familiar with, in say 25 to 35 days per annum, then it is likely that the executive team are not really in a position to manage it." [Balfour Beatty]

A number of respondents commented on the need for greater time commitment from non-executives, but there were differing views as to whether the Code should be more prescriptive, either by recommending a minimum time commitment or a maximum number of board appointments.

"The role and duties expected of non-executive directors cannot be satisfied by an individual who has heavy and demanding responsibilities in another full-time job… The same point would apply to a non-executive director who has many other non-executive posts." [Pinsent Masons]

"Indicative hours required of non-executive directors should probably be increased… The original restrictions on the number of chairmanships and directorships were widely criticized when first introduced. However, recent developments would suggest that they were well founded." [International Corporate Governance Network (ICGN)]

"*Not in favour [of restrictions on the number of directorships]. The Code already requires boards to take care when directors are appointed that they have enough time available to do the job, and to ensure (through annual evaluation) that they continue to demonstrate commitment to the role. Further prescription is therefore unnecessary and risks losing benefits of knowledge transfer*." [CBI]

The role of the Executive Directors

Some respondents considered that the Code paid insufficient attention to the role of the executive directors on the board, and commented on some aspects of what they saw to be the executive directors' role and responsibilities.

"We feel that the emphasis in the Code on arrangements to secure the independence of non-executive directors results in too little emphasis on the role of executive directors. Given the UK unitary board framework there is a need for a clear statement in the Code that accountability for managing the business day to day rests with the executive and not the non-executive directors.." [Prudential]

"The Combined Code currently states that the chairman is responsible for ensuring that the directors receive accurate, timely and clear information. We believe this responsibility should be shared with the chief executive and other executive directors on the board as they have primary control of the relevant information." [Mazars]

The relationship between the board and board committees

Some respondents suggested that the emphasis in the Code on the role of board committees consisting only of non-executive directors was in danger of undermining the unitary board or reducing its effectiveness.

"In order to promote further the unitary board model, and to remind directors not to abdicate responsibility for the work of board committees, there should be a reminder too about the ultimate responsibility of the board itself in all Code sections which refer to the establishment of a committee of the board." [Institute of Chartered Secretaries and Administrators (ICSA)]

"We believe it is critical for the FRC's review to consider, in the context of reporting, how the interaction between the main board and its separate sub-committees operates, so as to avoid each element being treated as if it is a separate silo of activity. [Increasing the role of individual committees]… may only exacerbate a sense of fragmentation which needs to be avoided." [Report Leadership Group]

BOARD BALANCE AND COMPOSITION

Many respondents commented on the composition and effectiveness of the board as a whole. Key themes highlighted in the responses were:

- The balance between executive and non-executive directors, and the effect on the size of the board;
- The balance between independence and expertise; and
- The role of the nomination committee and succession planning

The balance between executives and non-executive directors

A number of respondents were concerned by the trend for there to be fewer executive directors on boards, which they considered made it more difficult for boards to exercise proper oversight of the company.

"There is a tendency (perhaps following the US example) for boards of directors largely to comprise non-executives, with only the chief executive and finance director as executive members… A board is more likely to understand the business of the company if it has managers among its members who are present at regular board meetings to be challenged on what the company is doing and to provide explanations in response to questions put to them. Not having that executive presence on the board risks isolating the directors from the every day business of the Company." [Pinsent Masons]

"The board should consist of executive directors in addition to the Chief Executive and Finance Director… Executive directors bring to the board debate and discussion their unique knowledge, experience and perspective on the company's businesses and the competence of the company to deliver and the market environment." [Severn Trent]

Some of these respondents considered that the provision in section A.3.2 of the Code that 50% of the board of FTSE 350 companies should comprise independent non-executive directors may have been a contributory factor in the declining numbers of executives on boards, or an increase in board size. The majority, but not all, considered this an unwelcome trend.

"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." [Non-Executive Directors Association (NEDA)]

"*We feel that the requirement for at least half the board, excluding the chairman, to comprise non-executive independent directors, can lead to over-large boards. Although well intended this can have perverse effects.... We believe that as long that there is an appropriate number of strong non-executive directors providing the right level of contribution and challenge in the board, it should not be necessary to prescribe the number of non-executive directors.*" [Tesco]

"The reduction in size of boards and the consequent increase in independent NEDs to 50% has enhanced the effectiveness of boards." [Marks & Spencer]

The balance between independence and expertise

Many respondents commented on the need for boards to achieve the right balance of skills, experience and independence, and considered that this should be the over-riding objective when selecting non-executive directors. The appropriate balance between these qualities, and the specific skills and expertise needed, would depend on the company's circumstances.

"Board composition should be determined by the need to achieve the aim, strategy and plans within a framework of effective performance measurement and risk management. The skills, experience, amount of time devoted and behaviour of individual directors will determine the overall effectiveness of the board." [Armstrong Bonham Carter]

"The Code already recognises the need for an effective board including the appropriate people and skills... Clearly the requirements will vary from company to company – a large company with highly qualified resources might seek NEDs with broad financial experience, whereas a smaller company might have needs to access specialist skills that it cannot maintain in-house." [Association of Corporate Treasurers (ACT)]

Some respondents considered that the balance had been tilted too much towards independence at the expense of expertise, either as a result of the emphasis placed on independence in the Code or the way in which those provisions had been applied by companies or shareholders.

"The Code may have focused too much on the independence of non-executive directors where its main thrust might better be directed towards skills and experience." [British Airways]

"It may be that this emphasis on independence… is misplaced in that it may have the effect of diminishing the independent directors' sense of collective responsibility for the leadership of the company. 'Independence' may be translated in practice into distance and disengagement from the company as opposed to independence of mind in the collective leadership of the company." [Professor Brenda Hannigan]

Many respondents commented on the specific independence criteria set out in section A.3.1 of the Code. The criterion that attracted most comment was that related to length of tenure. The majority of those who commented on this criterion considered it to be inappropriate, although some qualified this statement by saying that there should be a balance between long-serving and newer non-executive directors.

"The long term nature of corporate strategy may benefit from longer serving directors who have experienced the business cycles in that industry. Consequently, length of service (i.e. not limited to 9 years) should not necessarily be seen as an aspect of non-compliance but as a potential benefit, as long as the individual director's performance remains effective. The lack of flexibility taken by voting agencies when interpreting this guidance may have served to undermine the potential effectiveness of boards." [Standard Life]

"We are opposed to the provision that deems a Director no longer to be independent once he/she has served for 9 years on a Board. Long experience can add significantly to a Director's contribution and whilst no two situations are the same, we would not want to discourage companies from retaining the services of Directors who have served for a long time but are no longer deemed to be independent." [Fidelity International]

"We readily recognise that longer serving directors with experience of several business cycles in the sector may have a valuable role to play in ensuring that the board retains sight of the longer term perspective in setting corporate strategy and so on. However, we do consider that the non-executive director element of a board as a whole needs to be balanced between those directors who have served on the board for a length of time such that their knowledge of the business is invaluable in terms of providing challenge and oversight to the executive directors, balanced against fresh blood which will serve to challenge deep-rooted norms of boardroom, and company, behaviour." [Railpen Investments]

A few respondents commented on other criteria in section A.3.1.

"The available pool of non-executive directors with sector experience, and thus the depth of understanding of the business available in non-executive director deliberations, could be strengthened considerably by relaxing the 'independence' requirement of the Combined Code to enable the recruitment of a small number of retired former employees and executive directors as non-executive directors after a shorter period than is currently prescribed." [Prudential]

"Why it is thought that an individual who represents a major shareholder, but who is clearly independent of management should be less able effectively to discharge the duties of a member of the audit committee than a director who has no other connection with the company at all, is quite unclear. The focus of independence should be independence of management, and not relationship to a shareholder." [SAB Miller]

One respondent called for the Code provisions on independence to be strengthened.

"The provisions of the Code relating to independent non-executive directors should be amended so as to tighten the criteria for independence and so as to strengthen their position relative to the executive directors." [FairPensions]

Some responses from investors indicated a willingness to be more flexible in voting for individual directors who did not meet independence criteria. Several of these responses made the point that this would be easier if investors had access to sufficient information to make an informed decision on the contribution individual directors could make.

"We believe it would be helpful if companies provided more detailed biographical notes on board directors, setting out clearly their relevant skills and experience rather than just listing their career history… This helps to give a clear picture of the skills and experience the board deems necessary for it to discharge its responsibilities and it helps shareholders assess the diversity of skills and perspectives around the board table." [Governance For Owners]

Several respondents commented on the extent to which non-executives should have directly relevant experience and skills.

"*We believe that it is important for boards to include members who have relevant sector or industry experience… Each such appointment would need to be carefully assessed to establish the scope for potential conflicts of interest and whether these could be managed without impeding the director's participation in board activities. However, relevant industry expertise greatly benefits board deliberations and enables the non-executive team to challenge from a position of strength proposals from management on industry specific issues*." [GlaxoSmithKline]

"*[The respondent] does not believe it would be appropriate for all of a company's non-executive Directors to have relevant industry or sector specific experience as this would be to the detriment of the diverse skills/experience that the Board needs to be fully effective*". [Confidential response]

"*[Section] A3: Board balance and independence… could be extended to include a balance of skills, knowledge and experience should also be a prerequisite on a board. A regular skills audit of board members could be reported on, ensuring that appropriate professional qualifications of a specific nature (e.g. engineering or finance) or general nature (e.g. Chartered Director or MBA) are included*." [Institute of Business Ethics]

Nomination committees and succession planning

Some respondents considered that Code should say more on succession planning. These comments supported greater disclosure or an explicit role for the nomination committee in succession planning.

"Greater transparency of the nominations committee process and subsequent appointment processes and the board and individual director evaluation process would be useful for market participants to understand the company's strategy on human capital." [Institute of Chartered Accountants in England and Wales (ICAEW)]

"In the future, investors may want to be more proactive in the selection of non-executives. In this context, we consider that the Combined Code should emphasise succession planning more clearly, through a provision that encourages the chairman to report annually on the process followed and progress made." [IMA]

"The Code has detailed guidance on the operation of the board, audit committee and remuneration committee. Higgs guidance contributed to the effectiveness of the non-executive directors. More guidance would be helpful on the role of the nomination committee and in particular, consistency around leadership development and succession planning within the organisation and on shareholders' expectations on the level of disclosure required." [Marks & Spencer]

THE FREQUENCY OF DIRECTOR RE-ELECTION

A number of respondents – primarily institutional investors and their representative bodies – suggested that some or all board directors should be put up for annual re-election. The balance of comments received on this subject is not necessarily representative of the views market participants as a whole as, unlike the other subjects covered in this summary, views were not explicitly sought on this issue in the consultation paper.

The majority of those that commented on this issue considered that the chairmen of the main board committees, and in some cases the company chairman as well, should stand for annual re-election.

"*Given the rights shareholders have to propose resolutions to and to call extraordinary general meetings, we believe a rolling three-year period is generally acceptable. However, we recognise that there are matters for which the chairman of the board and the chairmen of the board sub-committees take particular responsibility and thus for which shareholders deem them particularly accountable. Rather than annual election of all directors, we suggest that the chairmen of the board and the sub-committees could usefully stand for annual election. We expect that this may well give them more impetus in difficult discussions, particularly in relation to remuneration where the levels of mistrust between boards and shareholders recently witnessed need to be reduced*." [Governance For Owners]

"*In order to increase the accountability aspect of the Code, we would recommend that at least the chairmen of the individual committees face annual re-election… This should be implemented on a comply-or-explain basis, in the first instance. Further if support for any individual fell below 75 per cent (including abstentions), the chairman of the board should be expected to stand for re-election the following year. This would be a powerful incentive to resolve shareholder concerns during the intervening period.... In order to address concerns that this could lead to short-termism or unwillingness to challenge other board members, we suggest that the directors be appointed for three-year terms with annual approval by shareholders not the board*." [ABI]

Two respondents considered that all directors should stand for annual re-election, with one other considering this should be a long-term aim.

"*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… 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*." [Niall FitzGerald]

"*LGIM believes that special attention should be given to the Board Chairman, the Senior Independent Director and the Chairman of the Board Committees. LGIM would prefer these individuals to stand up for re-election annually in order for shareholders to express their views on any decisions taken by the Board and their Committees. In the longer term, LGIM would like to see all members of the Board standing for re-election annually.*" [Legal & General Investment Management (LGIM)]

One respondent was opposed to annual re-election on the grounds that "*if a blanket requirement is introduced, there is a risk that the election of directors becomes a routine process, with little or no consideration given to the skills and contribution made by the director concerned. Where shareholders do have serious concerns about the continuing appointment of a director, they have the option of tabling a resolution for a vote on his/her re-election. For shareholders to demonstrate the seriousness of their intent by pro-actively laying motions to remove a director would be a far more powerful mechanism for shareholders to highlight their concerns than the mechanistic routine of annual votes for all directors*." [AIC]

BOARD INFORMATION, DEVELOPMENT AND SUPPORT

Many respondents highlighted the need for the non-executive directors to have sufficient knowledge of, and information about, the business to be able effectively and constructively to challenge the executive. As well as ensuring that they collectively had sufficient relevant experience (see the section on Board Balance and Composition), respondents considered this could be obtained in a number of ways:

- Through the information and advice they received, whether from the executive or from independent sources;
- Through induction and ongoing professional development; and
- Through greater contact with the operational activities of the company.

The provision of information and advice

A number of respondents considered that the non-executive directors had not been sufficiently proactive in seeking additional information, from whatever source.

"*We believe that sometimes directors feel that they can rely on the board's sources of knowledge to keep themselves up to date and therefore do little themselves*" [Capita Company Secretarial Services]

"*Non-executives remain too dependent upon executive management information flows for information about the business and there is a wide variation in practice as to what is provided. The potential for non-executives defining additional information needs, visiting different parts of the business, seeking analytical support and generally 'knowing what they don't know that they need to know' as well as the role of the Company Secretary in this regard needs further examination to help define best practice*" [The Chairmen's Forum]

A number of respondents commented on the importance of the board and committees receiving relevant and timely information.

"*It is essential that Boards receive appropriate, clear, timely and reliable information on risk and financial results and forecasts to enable them to undertake an effective role in directing and controlling the organisation. Non-executive directors need to be in a position to be able to scrutinise and challenge the complex business strategies and proposals presented to them*". [Chartered Institute of Public Finance And Accountancy (CIPFA)]

One respondent commented that "*while it is potentially divisive to imply that the judgments of executives may be flawed, it is essential for both executive and non-executive directors to understand that even the most experienced decision makers can suffer from distorted judgments under certain conditions. One of the board's most important roles is to help executives avoid the flawed strategies and policies that can result from these distorted judgments*." [Andrew Campbell and Jo Whitehead]

For this reason, other respondents commented on the need to encourage non-executive directors to make more use of provision A.5.2 of the Code, which states that they should have access to independent professional advice at the company's expense when needed, to enable them to carry out their duties on the board and committees. Some felt that this provision should be strengthened.

"*The AIC recommends that the chairman should be given specific responsibility for ensuring that independent advice is obtained where the directors consider it necessary to their understanding. This should include obtaining expert opinions or reviews on any area of the business which the directors consider necessary in order to make sound business decisions and to achieve effective governance*" [AIC]

One respondent noted that the internal audit function was a source of objective advice within the company. They considered that "*the need for internal audit is somewhat buried, within the section on Accountability and Audit and subsidiary to the duties of the audit committee… it would valuable to recognise the importance to the board of having a professional source of independent and objective assurance on all aspects of directing and controlling the company, not just one aspect*." [The Institute of Internal Auditors (IIA)]

Induction and ongoing professional development

A number of respondents commented on the importance of induction and ongoing professional development for non-executive directors. While some supported greater disclosure of the company's policy or practice, there was no consensus on the extent to which more prescription as to the level of training expected and what form this should take would be appropriate.

"*As part of the process of increasing the professionalisation of the board, a greater emphasis should be placed on the training of board members in their specific role as directors. Board members assume a key role in corporate governance which is distinct from that of senior operational managers… We propose the addition of a provision in section A.5 of the Code along the following lines: "The Chairman should encourage board members to become Chartered Directors or to engage in equivalent professional training that specifically enhances their functioning as company directors"*." [Institute Of Directors (IOD)]

"With an ever increasing complexity of products and services offered by companies, particularly in certain sectors such as the financial services industry, it is paramount that all directors understand the complexity involved and the risks arising under differing scenarios. We do not believe that the introduction of specialists to perform this role is the right way forward. On the contrary, we believe enhanced training and development for all directors would improve the level of understanding and thereby improve the level and depth of challenge which non-executive directors can bring to the executive management." [GC100]

"*Formalising induction and setting mandatory training for board members … [would be] too prescriptive… [and would] not provide sufficient flexibility for the wide diversity of firms governed by the Code.*" [CBI]

Contact with the business

A number of respondents commented on the importance of non-executives developing a better understanding of the business beyond the boardroom.

"*Ensuring all directors (but particularly non-executives) are given the opportunity to make business visits and to get a fuller understanding of the risks which exist within the organization and how these might impact on strategy, are practices which effective boards should be seeking to encourage. It is important though not to impose a prescribed approach but to allow boards and individual directors to determine what is required and to then report to shareholders.*" [Balfour Beatty]

"*We believe that the Code could usefully include a provision that NEDs should have access to wider sources of advice from within the company rather than relying on materials provided to them in board packs. This could be facilitated by the company secretary. While we would not wish to expand the role of the NED to such an extent that they become an additional layer of decision making or become "semi-executive" we believe there would be merit in making access to employees below board level and any other additional resources and information they require available to NEDs in a structured way.*" [Royal Bank of Scotland]

The role of company secretary

A number of respondents commented on the important role played by the company secretary in underpinning the effective functioning of the board.

Various proposals were put forward for increasing its effectiveness, for example through greater resource, more clearly defined responsibilities or a change of reporting lines.

"*The company secretary's role, in addition to supporting the chairman in the effective management of the board and its business and managing regulatory compliance, should be to procure, and advise on, all the information necessary for the chairman and directors to discharge their obligations; as well as advising the board on its task of governing the company – all this leading to appropriate disclosure to shareholders*." [ICSA]

"*The company secretary should be acknowledged as the head of governance with sufficient resource to satisfy the governance arrangements for the organisation as a whole*". [Marks & Spencer]

Two respondents considered that the company secretary should also be secretary to all the main board committees to ensure effective communication between the committees and the board.

A number of respondents commented on the suggestion that there should be an independent secretariat to support the non-executive directors. While there was some support for the idea, the majority of those who commented were opposed.

"*It might be appropriate that they [the non-executive directors] have an independent secretariat reporting directly to it which is able to gather information, resolve enquiries and engage with management as appropriate. Clearly this is not appropriate for smaller companies where the costs may be prohibitive and the benefits less easy to justify*." [Hermes Equity Ownership Scheme]

"*Regarding the quality of support and information available to the Board and its committees, we do not believe that there should be a requirement for a separate secretariat for the non-executive directors. This could increase Board divisiveness and undermine the concept of the Unitary Board. We believe how companies make arrangements to support their non-executive directors is best handled on an individual company basis.*" [Deloitte]

"*Mandating the need for a separate company secretariat was not supported, which would be expensive and unwieldy for smaller companies in particular*." [London Stock Exchange]

BOARD EVALUATION

All respondents who commented on this issue saw board evaluation and effectiveness reviews as potentially beneficial, but doubts were raised about whether all companies were sufficiently rigorous in the way in which the reviews were carried out, and therefore whether they were deriving the full benefit.

"*Board evaluation is proving valuable as a focus for important issues such as the skill set of the board, development of management talent and strategy.*" [UBS Global Asset Management]

"*Areas where perhaps the Code has worked particularly well are in the increased use and development of director induction programmes and annual performance evaluations; both of which have arguably improved Director and Board performance.*" [National Grid]

"*Evaluations were a major new feature of the Combined Code which was developed following the Higgs Review and good progress has been made on them by many boards. But the rigour with which they are carried out does vary between boards.*" [Mazars]

Evaluation process and frequency

One way of adding rigour to the evaluation process is through the involvement of an independent, external facilitator. Almost half of the respondents who commented on board evaluation considered that the Combined Code should either encourage or require externally facilitated reviews to take place at least every two or three years.

"*The Code already includes provisions on the evaluation of performance of the board and individual directors… [and] with the theme of trying to make the implementation of that principle more effective we believe that there should be an encouragement for external assessment of effectiveness every 3 years, say.*" [ACT]

"*Shareholders are unable to determine how effective boards are because they are not able to see boards in action. The next best thing for shareholders is to have an independent evaluation of how boards work from a respected source. Without such verification, shareholders are more likely to insist on best practice structures e.g. removal of non executive directors that have exceeded 9 years, vote against Chairmen who were CEOs etc. We do not believe it is necessary to carry out an external evaluation every year but certainly every 2 or 3 years.*" [Aviva Investors]

A smaller number of respondents were opposed to the introduction of any requirement for external involvement in annual reviews: "*A rigorous evaluation of the board and its committees is an important aspect of the Code identifying potential weaknesses giving the opportunity for continuous improvement. We do not, however, agree that this should mean that external independent reviews should be mandated. Companies should continue to be able to choose how best to undertake their own evaluations as their circumstances require*." [British Airways]

A small number of respondents considered that the Code's recommendation for a full annual review of the board's effectiveness was excessive and could be counter-productive: "*Although it is justified to expect annual assessments of directors, the full board evaluation would be more usefully conducted, perhaps every three years, and external evaluation from time to time should be encouraged. More frequent assessments can lead to 'box-ticking'*." [Balfour Beatty]

A few respondents commented that more clarity might be needed about the scope of these reviews and the criteria against which effectiveness was measured. For example it was suggested that effectiveness needed to be linked to "*the achievement of strategic goals*" [The Chairmen's Forum] and "*whether the board composition is aligned with the business as it is expected to be over the next few years and not as it is now, or in the past.*" [Grant Thornton]

One respondent proposed that a standardised evaluation process should be adopted to aid consistency and transparency. This process "*should be endorsed by the main stakeholders of the UK corporate sector (i.e. regulators, investors and boards). Listed companies should be encouraged to undertake this appraisal process on an annual basis, and disclose the outcome in their annual report*". [IOD]

One respondent recommended that "*the FRC should consider undertaking a periodic review of a sample of board assessments, whether self-assessment or external. It should then produce a report (on a strictly no names basis) on how practice, both good and bad, is developing with the aim of helping to improve the quality of reviews over time.*" [Independent Audit]

<u>Disclosure</u>

Nearly half of the respondents who commented on this issue highlighted the need for more informative disclosure, either on the review process or on the main findings of the review.

"*We recommend that there is a specific provision introduced into the Combined Code that requires companies to disclose in more detail the nature of their board performance evaluation process, and that more information is reported in the annual report and accounts about the key areas that were evaluated and where improvements can be made*." [Railpen Investments]

"The annual disclosure should explain the review process… significant recommendations and/or any changes or improvements that the Board has committed to following the review. .. The annual disclosure should always name the reviewer, and disclose whether the reviewer provides any other services to the Board and/or the Company." [Boardroom Review]

One respondent considered that the results of externally facilitated reviews should be "*independently assessed, signed-off and disclosed in the Annual Report & Accounts – much like an audit report. This will enable shareholders to judge and consider any potential risks relating to the operational performance of Boards and their Directors.*" [LGIM]

One respondent suggested that the board's report on the evaluation review be broadened to become an "*'assurance statement' on the effectiveness and fitness of the board to fulfil its role… [in which] the Chairman of the Board and/or Nomination Committee Chair [would] confirm to shareholders… that the board has the breadth of skills and experience to address and challenge adequately the key decisions and risks which confront it.*" [Sir John Parker]

It was suggested that this statement might address such factors as the skills, knowledge and experience of the board as a whole and the non-executive directors in particular, the time commitment of the non-executive directors, and their capacity individually and collectively to challenge management and influence outcomes.

RISK MANAGEMENT AND INTERNAL CONTROL

Over half the respondents to the consultation commented on one or more aspect of risk management and internal control. These comments addressed a wide range of issues including:

- The role of the board;
- The role of board committees;
- The Turnbull Guidance on internal control; and
- Reporting on risk

The role of the board

Many respondents commented on the necessity for the board to take ultimate responsibility for risk management. While this was made clear in the Turnbull Guidance, some respondents considered that it needed to be made more explicit in the Combined Code itself.

"*It is particularly noticeable, given recent events, that the management of risk is not mentioned in the Code as a core responsibility of the board. The Institute believes that the Code should place much greater emphasis on the board's responsibility for risk management. Risk management should be identified as a core responsibility of the board, as part of its general responsibilities to direct and control the organisation… [in addition] the Code obscures the importance of risk management to the strategic health and performance of the company because it fits it into a section on accountability and audit.*" [IIA]

"*Successful risk management is crucial to the long term success, and indeed the survival, of all businesses. We therefore believe the Combined Code should make very clear that the board as a whole has responsibility for the effectiveness of the company's risk management and internal control systems and that while the board may delegate various activities in relation to monitoring them to, say, the audit committee, it cannot delegate its overall responsibility to ensure the appropriate systems are in place and are working as intended.*" [Mazars]

Some respondents commented that the board had particular responsibility for setting the company's risk appetite and for identifying and overseeing the management of major and strategic risks.

"Chairmen and boards must take ownership of enterprise-wide risks on a 'top down' basis rather than delegate (or even abrogate) responsibility to committees or sub-committees. It is important to have a clear alignment between Group strategy and risk appetite and to categorise risks between those which constitute a risk of ruin and those which represent a risk of business objectives, in terms of strategy, profitability or reputation… There is also a need to ensure that sufficient Board time and resource is devoted to 'horizon watching' including researching and understanding the global economic context and political risk environment as well as the impact of a combination of risks rather than focusing on narrow business specific issue." [The Chairmen's Forum]

Some respondents distinguished between the board's role in relation to strategic and operational risks, with a few considering that boards may have paid too much attention to the latter at the expense of the former.

"Whilst operational risks are extensively reviewed and appropriate systems and controls put in place, the financial crisis has highlighted the need to consider contingency planning for 'high impact/very low probability' macro risks and this area may warrant further guidance. Once again, companies are keen to avoid creating unrealistic expectations for the risk management process and raise a concern that imposing excessive prescription within the Code on this area would inhibit what should be an iterative process." [London Stock Exchange]

"Is it possible that its emphasis on boards exercising a great deal of control over a wide range of risks has caused some boards to concentrate too much on the minutiae and not nearly enough on the major risks to the industry and the specific company?... this problem is not the fault of the Code but it may be a result of it. Perhaps any updated Code should emphasise that boards (not audit committees) should concentrate more on these major business risks rather than on the operational risks on which some boards have devoted so much time?" [David Tyler]

A number of respondents commented on the importance of ensuring that the board received relevant and timely information on risks.

"A major lesson from the financial crisis is the need to identify, understand and manage risk better. In particular, the financial crisis revealed that an insufficient emphasis had been placed on "low probability, high impact" risks. This demonstrates the importance of ensuring that Boards get the right information about key risks and have the skills to interpret and challenge them." [CBI]

"It is critical to ensure that that there is a structured system for escalating information from divisional entities to ensure that the Board has a clear line of sight on 'blow ups' within a group structure and a recognition of the fact that subsidiary managements are not always able to evaluate the impact of 'local' risks on the wider group." [The Chairmen's Forum]

The role of board committees

A number of respondents commented on the merits or otherwise of having separate risk committees. Many of those who commented considered that they may be appropriate, at least for larger or more complex companies.

"*At large and complex companies audit committees' work-load can be substantial and they may not be able to devote sufficient time to their risk management responsibilities. We would therefore support moves at such companies to set up separate risk committees*." [ABI]

"We consider that the current economic crisis suggests that it would be preferable for boards to have risk committees, not least in view of the other burdens placed upon audit committees." [ACCA]

"*The whole board should be involved in the identification of risk and concentrate on a limited number of risk factors; it should be the responsibility of a committee to monitor risk controls and ensure they are exercised properly. Audit tends to be backward-looking, whereas risk is forward-looking. Our respondents believe there is a case for more financially complex companies to set up a separate committee whose sole function is to identify and monitor risk. This is a matter for individual boards to decide*." [Spencer Stuart]

A smaller number of respondents were opposed to or sceptical of risk committees.

"*A number of commentators have suggested that risk oversight could be improved by the formation of a specialist board risk committee or the appointment of a Chief Risk Officer to the board. We do not think that these proposals represent the right solution for most companies (with the possible exception of large, complex financial institutions). Both are likely to encourage a "siloing" of risk expertise, and the shifting of accountability for risk issues to particular board members. This may inhibit the development of risk awareness across the board as a whole*." [IOD]

The Turnbull Guidance

The majority of respondents who commented on the Turnbull Guidance considered that it remained largely fit for purpose, but some felt it needed to be better integrated into the Combined Code

"*The good guidance on internal control and risk management areas provided in the Turnbull Report is not picked up and merits better integration*." [NEDA]

"Given the crucial importance of the Turnbull Guidance, it is questionable whether it makes sense for the Guidance to be contained in another document. For example, the last paragraph of the Preface to Turnbull emphasises the board's responsibility for risk management in the widest sense, but that strong position is not really reflected in C.2. The emphasis in Turnbull on board responsibility and judgment surely needs the higher visibility of statement in the Code." [Professor Brenda Hannigan]

A number of respondents considered that, while the Guidance was sound, it had not always been implemented effectively.

"*In our view, the principles underlying Turnbull are sound, but many boards place too much emphasis on "the Turnbull process". Board review of "compliance with Turnbull" is often limited and has become increasingly rote. Board reports on internal control and Turnbull compliance are often boilerplate and give little assurance that boards or audit/risk committees have undertaken a thorough review.*" [Independent Audit]

A few respondents considered that the Guidance dealt more effectively with internal control than with risk management, and that this needed to be addressed.

"*It is worth reflecting on the difference between risk management and internal control. Risk management is the forward looking executive role that anticipates and evaluates risks and ensures that efficient and effective controls are developed and implemented… the existing Turnbull requirements focus on internal control and the need to ensure adequate control of the significant risks facing an organisation... [but] are not sufficiently detailed in relation to pro-active and forward looking risk management activities.*" [AIRMIC and the Institute of Risk Management]

A few respondents felt that more substantial revision of the Guidance, or additional guidance, may be needed.

"*In our opinion, there is a need for a review of the Turnbull guidance, as issued in 2005, to determine if it adequately handles areas such as an assessment of a company's exposure to systemic risk, procedures for risk escalation situations, recovery strategies, the adequate testing of business models and strategies, and the proper consideration of risk in major transactions such as business acquisitions and in complex financial instruments.*" [Deloitte]

"This is a particular area where we believe that the FRC could play a particularly useful role in articulating what good governance looks like and provide useful case studies of best practice. For example, one area that could be considered would be what are common indicators of excessive risk being taken by an organisation." [Chartered Institute of Management Accountants (CIMA)]

Reporting on risk

A number of respondents were critical of the quality of reporting on risk, both in relation to the disclosures expected under the Combined Code and Turnbull Guidance and those required under the Business Review. They considered that most disclosures provided little information of value.

"*Relatively little information is generally provided on how the risk management process is expected to operate or has worked towards identifying risks that are impacting the organisation and how their effects are to be mitigated or have been mitigated*." [Armstrong Bonham Carter]

"*Disclosures on risk management are particularly poor at the moment. Typically, the disclosure of key risks – most usually contained in the Business Review – is no more than a laundry list of all possible risks such as might appear in a prospectus document*." [Hermes Equity Ownership Service]

A number of respondents suggested ways in which the usefulness of reporting on risk could be improved, including in some cases by adding additional disclosure either to the Code or the Business Review or by making the requirements of the two more joined-up.

"*A Code requirement to explain how risk appetite was set and strategic risks are addressed by the board, and how operational risks are managed, would be a material step forward.*" [Lonmin]

"*Issuers should be encouraged towards more connected reporting of risks, controls and strategy, thereby placing greater emphasis on the Directors to acknowledge their responsibility for the embedding and effective operation of risk management practices. In doing so, we believe it would stimulate a far more rigorous and ultimately permanent shift in a company's approach to managing the risks around the achievement of their strategic objectives*." [Grant Thornton]

Other issues

One respondent suggested that shareholders should be given an advisory vote on risk at the annual general meeting on the grounds that "*investors should… be engaging with boards with respect to the company strategy and risk profile. Consequently, it is proposed that shareholders should also be granted the right to an advisory vote on risk - based on the forward looking risk disclosures contained within the Business Review - at the annual general meeting*." [IOD]

REMUNERATION

Over half the respondents to the consultation commented on one or more aspect of remuneration policy. These comments addressed a wide range of issues including:

- Views on the existing regulatory framework;
- The link between risk and remuneration;
- The need to ensure remuneration policies promoted the long-term interests of the company;
- The design of remuneration packages;
- The remit, composition and effectiveness of the remuneration committee;
- The remuneration of employees below board level;
- The use of remuneration consultants; and
- The need for further guidance or disclosure on different aspects of remuneration.

The existing regulatory framework

A number of respondents considered that the existing framework for setting and approving remuneration policy – primarily the Combined Code and the Directors Remuneration Reporting Regulations 2002 – had failed to prevent a mismatch between remuneration, performance and the long-term interests of the company. A few respondents considered that some elements of the framework had contributed to the problem.

"*When companies are drawing up their remuneration policy a passing reference to the need to attract, retain and motivate should not be considered sufficient in compliance terms. Rather the company should take into account and make specific reference to its situation… The substantial ratchet seen in executive pay over the last few years would indicate that the supporting principle [to use comparisons with caution] has not been properly applied.*" [ABI]

"*We believe that the issues have been around application of the Code's principles, not with the principles themselves. An excellent example of this is the Code's main principles on the level and makeup of remuneration… While these principles continue to be valid, we are aware that… in some cases "a significant portion" linked to performance has led to escalation of overall remuneration and too much emphasis on the incentive element*." [Deloitte]

"*Since the implementation of detailed reporting of executive compensation following the Greenbury Report, there has been very significant growth in management reward. We do not believe that this is co-incidental and while the disclosure is highly commendable from the standpoint of transparency, it does not serve as a method of restraining pay*." [Lonmin]

Many specific suggestions were made for changing the framework, including those summarised below. However, some respondents considered that changes were not necessary outside the banking and financial service sector.

"*The CBI believes that the existing Combined Code already makes adequate provision on remuneration issues, supported by extensive existing legal requirements for disclosure and accountability*." [CBI]

<u>Risk and remuneration</u>

Some respondents commented on the need for better alignment between companies' risk appetite and exposure and their remuneration policies in order to avoid creating perverse incentives that might encourage inappropriate behaviour.

"*The AIC also recommends that the Business Review contains a statement of the risks to the company arising from the remuneration policy. Where no statement is given, an explanation should be provided in the annual report as to why the risks are not disclosed. This might highlight to shareholders, for example, the introduction of short-term incentives which are to the detriment of the longer-term interests of the business. Disclosure would provide useful information to shareholders when considering the risk: reward profile of their holding*." [AIC]

"*In line with the proposed implementation of the FSA's Remuneration Code of Practice, we feel that the Code should emphasise that any remuneration policies including bonus payments should be consistent with and promote effective risk management within the company... The remuneration committee should ensure that remuneration procedures, policies and practices do not have the effect of encouraging an excessive risk-taking approach by directors and senior management*." [GC100]

<u>Promoting the long-term interests of the company</u>

Some respondents commented on the need for remuneration policy and practice to be better aligned with the business strategy in order to ensure that it operated in the long-term interests of the company.

"*The Code should encourage companies to set remuneration in a manner that encourages long-term orientation and is not divorced from risk. To this effect… Code provisions should require companies to disclose in their remuneration reports how the remuneration of executive directors and other senior executives is structured to promote long-term performance and minimise enterprise risks.*" [Nestor Advisors]

"*Remuneration committees need to match rewards against the specific key performance indicators that are used by the board to manage and oversee the business.*" [Hanson Green]

The design of remuneration packages

A number of respondents commented on the need for the Code to provide greater or amended guidance on different aspects of the design of remuneration policies and packages, such as the balance between fixed and variable pay and the form that the variable element should take.

"*Our specific recommendations are that the Code should strongly advise against frequent benchmarking of pay and that performance-based pay should be largely in shares*." [NAPF]

"*There should be a much stronger presumption against the use of share option schemes, since they provide a one-way leveraged bet which executive directors cannot lose*." [Anthony Williams]

"*The Code requires performance-related elements of remuneration to form a significant proportion of the total remuneration package of executive directors. Should we consider the length of time for measuring these performance-elements? The Code refers to long-term incentive schemes and share options but does not require any portion of the annual bonus to be measured over a period of time*." [GC100]

"*It is vital that reward for failure is avoided and therefore this should be more explicit in the Code provisions. The one-year notice period should be seen as a ceiling not a floor (as recommended in ABI's Remuneration Guidelines). Companies should take all steps possible to ensure that termination payments should only constitute salaries and related benefits. The payment of unearned bonuses in the event of termination is not acceptable*." [ABI]

The remuneration committee

A number of respondents commented on the role, remit and effectiveness of the remuneration committee. There were mixed views on the effectiveness of the Committee.

"*In the area of remuneration committee work we have seen good compliance with the requirements of the Code. The need for a coherent policy and structure in the determination of executive remuneration is understood and respected. The level of debate between companies and investors on remuneration issues is indicative, in our view, of good disclosure*". [Prism Cosec]

"*There are concerns that remuneration committees are not operating well and are conflicted because many of them are executives themselves and have no concept of what "fair" pay is*." [Aviva Investors]

One respondent suggested that *"if only to reassure the public at large and investors, it may appear sensible to review how remuneration committees operated and what information was disclosed, in relation to those cases that have had a high level of public profile."* [BDO Stoy Hayward]

The perceived failure of the remuneration committee to represent the interests of the shareholders led two respondents to conclude that the shareholders should be given a more direct role in setting remuneration of directors.

"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… 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." [City Group]

A number of respondents, mostly from the investment community, suggested that the chairman of the remuneration committee should automatically be put up for re-election at the next annual general meeting in the event of the remuneration policy being rejected by shareholders (see the section on the re-election of directors).

<u>The remuneration of employees below board level</u>

A number of respondents commented on the remuneration of executives below board level, particularly those in positions where their behaviour could materially affect the risk exposure of the company. Some respondents considered that the remit of the remuneration committee should be extended to address these employees, and/or new disclosure requirements introduced.

"There should… be transparency around the employees who are material to the company below Board level with the Remuneration Committee having appropriate oversight of their remuneration." [National Grid]

"The AIC recommends that the remuneration report should include a description of the general remuneration policy for highly paid employees. This would provide shareholders with more complete information about the remuneration practices of the company, and allow them to make a more informed decision about whether or not to approve the remuneration report." [AIC]

Other respondents commented on the relationship – or lack of it – between the remuneration of senior executives and that of all other employees of the company.

"*The guidance that the remuneration committee should "be sensitive to pay and employment conditions elsewhere in the group" is widely ignored. It exists in the Code but has little, if any, practical application. However, LAPFF continues to believe that this is important guidance to remuneration committees, and the fact that they have ignored it in practice is one of the reasons for the growing divide between the boardroom and other employees. Therefore the Code should be strengthened in this area.*" [Local Authority Pension Fund Forum (LAPFF)]

"*The Remuneration Committee [should be required] to explain differentials in the business and the rationale linking the highest and lowest levels of pay in the company, recognising that this is a matter of appropriate deployment of company funds but also a matter of public legitimacy.*" [Tomorrow's Company]

However, one respondent argued that "*populist calls for imposing limits or greater prescription around salaries should be rejected. Instead a better way to ensure responsible behaviour on pay would be to emphasise the existing requirement for companies to explain how executive pay links into the pay strategy and wage settlements for the wider organisation.*" [CBI]

The use of remuneration consultants

A number of respondents commented on the role of remuneration consultants and the potential for conflicts of interest where they also had a business relationship with the management of the company. Some respondents considered there should be more disclosure in the Annual Report on the company's relationship with the consultants and any fees paid. Other suggestions included publishing the consultant's terms of reference or obtaining shareholder approval for their appointment.

"*Remuneration consultants have an influential part in the determination of remuneration packages for executive management and we would recommend that the fees paid be disclosed in the Annual Report & Accounts.*" [LGIM]

"*Consideration should be given to whether remuneration consultants need to be subjected to a governance code, as is being considered with the audit profession… We are open-minded on this and feel that perhaps a discussion with the profession may suffice.*" [Spencer Stuart]

"*The oversight system has not worked well, however, with most remuneration consultant recommendations waved through by the remuneration committee… and it is in the interests of the remuneration consultants to retain their fees by proposing remuneration that is beneficial to the Board. To remove this conflict of interest, we suggest that the appointment of remuneration consultants needs to be voted on by shareholders.*" [Policy Exchange]

Further guidance or disclosure

In addition to the points summarised above, there were a number of other suggestions for further guidance or disclosure and improved communication, for example:

"*The Code should include more guidance for remuneration committees along the lines of Principle C.3 and the Smith Guidance*." [Independent Audit]

"*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*." [Niall FitzGerald]

OTHER COMMENTS ON THE CONTENT OF THE COMBINED CODE

In addition to the issues summarised in earlier sections of this paper, comments were received from a few respondents on other aspects of the Combined Code. These included:

- Consistency of the Code with company law and FSA rules;
- Sustainability and CSR issues;
- Ethical standards; and
- Whistle-blowing.

Consistency of the Code with company law and FSA rules

A number of respondents commented on whether the Code should cross-refer to, or where necessary be amended to be brought into line with, the statutory duties of directors set out in Sections 171 to 177 of the Companies Act 2006.

"*Section 172, the duty to promote the success of the company for the benefit of its members as a whole, requires directors to consider the interests of other stakeholders. This provides at least confusion between statute and the Code if not an actual conflict since the preamble to the Code focuses on shareholders*." [IIA]

"*In accordance with Section 175 of the Companies Act 2006, directors have a statutory duty to avoid conflicts of interest... The GC100 has issued comprehensive guidance in connection with this issue and therefore feel there is no need to consider the inclusion of a further Code provision relating to the board's consideration and disclosure of directors' conflicts of interest in line with the GC100's own guidance.*" [GC100]

One respondent suggested that "*there is an opportunity to increase compliance and to assist both companies and investors by taking the opportunity afforded by this review to transition the Code into a "one-stop shop" for all corporate governance matters by importing some of the mandatory requirements from the DTRs and other relevant regulation.*" [British Airways]

Another took the opposite view, commenting that "*any revised Code should be careful not to duplicate requirements that are already in place as a result of FSA regulations or statute.*" [QCA]

Sustainability and CSR issues

A few respondents considered that the scope of the Code should be extended to embrace sustainability and other CSR issues.

"*It is in the interests of the long-term owners of UK companies and in the wider public interest that financial institutions and other UK listed companies are managed in such a way that this capital reallocation takes place effectively… The Combined Code must support and encourage this by laying down relevant standards of good practice for companies, their owners (i.e. institutional shareholders) and the investment institutions that act as agents for their owners*." [UK Sustainable Investment And Finance (UKSIF)]

Ethical standards

Other respondents considered that the Code should address more explicitly corporate values and ethical standards.

"*Recent discussions have prompted us to suggest that the FRC considers whether the Code should discuss at the beginning the values which Boards should have. These values would be accountability, transparency, objectivity and considering long term interests. These would assist in evaluating board performance*." [Deloitte]

"*All directors should be expected to uphold the highest ethical standards of integrity and probity and this should be included as a principle in the Combined Code. This principle should be clearly reflected in all statements issued by the company and set the overall tone of the business*." [ICAS]

Whistle-blowing

A few respondents called for the Code provision on whistle-blowing to be strengthened, and/or for more guidance to be provided on the subject.

"*We suggest that the Code should contain a more positive and prominent statement that companies should: adopt and implement an effective Whistle-blowing/Serious Concerns policy, encourage whistle-blowing which is done in good faith, and give assurances to their staff that they will not be victimised*." [Lawyers in Commerce & Industry]

"*We make the following recommendations: the BSO Code of Practice to be the basis for recommended guidance to audit committees on how to meet good practice in their whistle-blowing arrangements; [and] organisations be encouraged to name one or more NEDs as a senior designated contact in their whistle-blowing practices*." [Public Concern At Work]

SECTION 2: THE IMPLEMENTATION OF THE COMBINED CODE

DISCLOSURE

<u>The quality and usefulness of disclosure by companies</u>

Many respondents – primarily investors and service providers – commented on the quality and usefulness of corporate governance disclosures. The majority of these respondents considered that, while there were some good examples, in general companies' corporate governance statements provided only limited information and tended to be 'boiler-plate' in nature.

"It has been said by some shareholders that the last place to look for any shortcomings in governance is in the governance report. In part, this reflects the fact that many companies take a largely compliance approach to governance reporting. While there are some good examples of innovative thinking, this is not the norm. Furthermore, we should recognise that governance reporting has evolved over a number of years in the UK and that some aspects of reporting, while informative in the past, now deliver little real value." [Report Leadership Group]

"We remain concerned that too many companies continue to choose boilerplate language over rich, textured disclosure that provides a genuine insight into the board and its functioning." [Hanson Green]

"In general much of the detail provided in annual reports is standardised, not sufficiently detailed and does not fully reflect the differing circumstances of individual companies." [Irish Association of Investment Managers (IAIM)]

There was particular criticism of the quality of explanations provided when companies chose not to comply with particular provisions of the Code.

"Meaningful disclosures facilitate engagement, reduce the amount of time and resources required of investors and companies, and lessen the perception of a "comply or else" approach as investors cast fewer votes against management and fewer conscious abstentions. In this context, certain of our members have commented that…disclosures and explanations are increasingly becoming standardised and of limited use; and not all companies provide adequate explanations for non-compliance and some consider any explanation will suffice." [IMA]

"*We believe that there is an inherent disincentive to companies to "tell their story" when it comes to "comply or explain" because auditors are encouraging standardised formats for disclosure and issuers tend to prefer safer boilerplate text rather than more expansive explanations*". [Prism Cosec]

"There have been many examples in recent times of a fundamental lack of credibility in terms of the explanations provided, and poor practices by companies in entering into dialogue with shareholders prior to announcing a major contravention of the Code's key principles". [Railpen Investments]

Improving disclosure standards

A number of respondents suggested steps that could be taken to improve the overall standards of disclosure. These proposals fell into three groups:

- Reviewing the disclosure requirements in the Code;
- Promoting best practices; and
- Introducing more formal monitoring and/or enforcement of disclosures.

Review disclosure requirements

A few respondents considered that some of the detailed requirements of the Code encouraged boiler-plate reporting and that it should therefore be reviewed with a view to promoting more outcome-based reporting.

"We believe there should be a thorough review of the disclosure called for under the Combined Code especially that arising from explaining how the principles have been applied. There would be merit in considering a new approach aimed at reducing boilerplate disclosures with boards, for example, called on to discuss:
- *their strategy and how the board keeps it under review and monitors its implementation*
- *steps taken to get the right board in place and the board's approach to issues such as succession planning and diversity*
- *the board's approach to attracting and retaining executive directors and staff and to motivating them to achieve the company's mission*
- *how the board promotes a culture of challenge and support in the boardroom*
- *how the board seeks to ensure it is working effectively as a team*
- *the board's risk appetite, the principal risks, and the board's approach to managing risks; and*
- *how the board keeps the performance of the business under review."*
  [Mazars]

"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." [City Group]

"We suggest that the FRC may wish to canvass the views of institutional investors as to what disclosure is beneficial to their decision making, if there is any existing disclosure which they disregard, and whether there is other disclosure that would be helpful to inform their understanding and actions". [ICAS]

A number of other respondents commented on changes that should be made to specific disclosure requirements in the Code to achieve the same effect, for example on board evaluation. These are summarised in the relevant sections of this document.

<u>Promote best practice</u>

A few respondents encouraged the FRC to do more to promote best practice.

"Better disclosure is one factor that will make it easier for investors to engage properly with companies and enable them to call them to account when necessary. We also believe that better behaviour, better disclosure and engagement by investors are inextricably linked and each will act as a catalyst for improvements… We believe that the FRC should consider how best it can encourage companies to improve their disclosure." [Hermes Equity Ownership Service]

"*More meaningful disclosures would facilitate more detailed understanding and analysis by investors and minimise the possibility of them 'box-ticking' on the basis of non-compliance. We believe that there may be an opportunity for the FRC to facilitate companies in this regard by providing guidance in this area.*" [Irish Stock Exchange]

One respondent from a listed company described an additional disclosure that the company had introduced to its annual report which it had found to be useful in communicating with shareholders: "*There is a danger that reporting on corporate governance simply becomes a checklist repeating the principles of the Combined Code without providing any sense as to how effectively that governance actually operates within a company. To address this, three years ago we introduced a report by the SID which we include as part of our annual corporate governance report in the Annual Report & Accounts and which is specifically addressed at our AGM. We have found this report to be very useful in providing additional flavour and comment on the way corporate governance operates... in effect, we report on behaviours within the top team.*" [Cable & Wireless]

<u>Monitoring and enforcement</u>

A small number of respondents commented on the appropriate role of regulators in monitoring and enforcing the Code. Some thought that consideration should be given to the FRC or another body being more active in monitoring, and in some cases challenging, disclosure.

"We should like the FRC to consider whether it or other bodies, such as the Institutional Shareholders Committee, should take a more active role in overseeing enforcement of the Code… We would be keen for the FRC to provide decisive and assertive leadership when unsatisfactory Code application and compliance have the potential to undermine confidence in the Code itself." [Standard Life]

"While we believe such challenge is primarily the responsibility of investors and (in financial services the banking regulators), there are two ways in which the FRC might take on an enhanced role. First, the FRC could consider trends in governance disclosures and key current governance topics and seek to engage companies and other stakeholders with a view to encouraging movement towards best practice. Second, the FRC could from time to time look at the governance disclosures made by individual companies and raise questions with the companies directly, e.g. via the FRRP." [Grant Thornton]

"As a longer-term project, [the FRC should] review the current regulatory arrangements for the Combined Code and consider whether responsibility for enforcement should be taken over by the Financial Reporting Review Panel (FRRP)." [CIMA]

ENGAGEMENT BETWEEN BOARDS AND SHAREHOLDERS

As noted in the section on the overall impact and effectiveness of the Code, responses continue to show strong support for "comply or explain" as an appropriate basis for the Combined Code. There was thus general support for the principle of engagement.

However, not all companies and investors had found engagement to work effectively in practice, and there were therefore differing views about its value. A number of frustrations were evident on both sides, and a number of obstacles to engagement and suggestions for improvement were identified.

Company views on engagement

Responses from companies and their representative bodies reported differing experiences of engagement. Some commented that they had been able to develop constructive relationships with their major shareholders, while others raised concerns about, for example, box-ticking and investor voting policies that were at variance with the Code.

"*In our experience our institutional investors show a close interest in Tesco's approach to governance and are keen to engage as often as necessary in order to discuss any concerns they may have. Our largest shareholders attend regular meetings with our chairman and we have an ongoing dialogue with those who monitor governance matters at such institutions, not just following the publication of our Annual Report and in the run-up to the AGM, but also throughout the year.*" [Tesco]

"It is fruitful to note that, as experience of how to apply the Code's principles has developed and knowledge of companies has grown, the review of governance has moved on from the much criticised slavish 'box ticking' approach." [Wm Morrisons Supermarkets]

"In general terms we find that this [the 'comply or explain' mechanism] operates satisfactorily. In our experience there is a wide variance in the quality and quantity of resource devoted to this area by institutional shareholders and while some still operate on a 'box ticking' basis, others are prepared to engage openly and constructively with the company." [Lonmin]

"Some investors have persisted in publishing their own corporate governance codes, in spite of earlier assurances that the Code would replace these. It can be confusing to have so many different codes in place and, if institutional investors could be encouraged to embrace the Code itself, and not seek to impose their own requirements which can be more prescriptive, this would be a helpful step forward." [Balfour Beatty]

"More and more we find that some institutions' compliance departments are applying a box-ticking approach which runs contrary to the spirit of this principle [comply or explain] of the Code. It seems to reflect a one size fits all approach to governance rather than an approach which seeks to understand and appreciate the circumstances in a particular company. This does not engender positive company / shareholder relations." [Cable & Wireless]

"Investors have a tendency to adopt a box-ticking approach to Code compliance, i.e. they do not give due attention to explanations, and mechanically penalise companies for deviations from the Combined Code. The latter is particularly true of proxy voting agencies, to which shareholders may outsource their voting rights. Both of these practices undermine the development of a meaningful dialogue between boards and shareholders." [Institute of Directors]

Investor views on engagement

Investors' overall views on engagement were largely consistent with those of companies. They considered that while there was some good practice it was not sufficiently widespread, and some put forward suggestions for how it might be built on. Some respondents were critical of other investors for not doing more to engage with companies.

"Most of our face to face engagement with boards is with the chairman although we are finding the senior independent director to be a very useful alternative point of contact. Access to chairmen in the UK is generally good and we find that most welcome the opportunity to have a constructive discussion and to understand the views of major shareholders." [UBS Global Asset Management]

"Engagement over compliance with the Code has improved in both quantity and quality in recent years, but with excessive focus on remuneration (which is of course subject to a vote) and too little on board effectiveness… There is room for improvement in reporting the results of engagement activity on the part of boards to their shareholders and investment managers to their clients." [NAPF]

"We are supportive of initiatives which deepen the relationship between shareholders and Chairmen or independent Directors but do not favour a formal, separate dialogue… One possibility would be to encourage Chairmen and independent Directors occasionally to attend company roadshow meetings with major shareholders in order to hear the flavour of the discussions and also to meet the key decision makers." [Fidelity International]

"We do believe that for comply-or-explain to work effectively there needs to be a sufficiently representative number of investors that respond to companies and engage effectively. Whilst there are a number of investors that do this in a diligent and considered manner, our view is that not enough investors consider voting and engagement as sufficiently important to be a core part of their investment activity." [Aviva Investors]

"We encourage institutional investors to enter into an assertive but informed dialogue in order to satisfy themselves regarding the explanations provided. We also encourage institutional investors to re-evaluate the level of resource they invest in corporate governance engagement so that the relationship with the investee company is credible and effective." [Standard Life]

Investors' views on the Institutional Shareholders' Committee's proposal to strengthen its Statement of Principles, and the role of Section 2 of the Code, are summarised in the next section.

Obstacles to engagement

Respondents identified a number of obstacles to effective engagement. These included:

- Large investment portfolios and limited resources.

  "The time and resource required by both companies and investors for meaningful engagement can be significant. Investors, even ones well resourced in terms of governance activities, cannot engage with all the companies in which they invest and need to prioritise their engagement activities and may choose to devote their time to those companies where they have the largest investments or where there seem to be the greatest risks." [ICGN]

- The declining market share of UK institutional investors.

  "The fragmentation of the UK shareholder register, including the decline in holdings of traditional investors such as insurance companies, presents a challenge. Given this, the FRC should actively aim to increase participation of other shareholders, for example foreign institutions and sovereign wealth funds." [ABI]

  "The role of institutional shareholders has been the focus of much attention, particularly since the Government's bail-out of some UK banks. It is important to recognise the limitations of UK institutional shareholders, who, it is estimated, now hold a minority of the UK market (pension funds own about 13%) and are by definition not insiders or management consultants." [NAPF]

- Barriers to collective engagement.

  "[Members commented on] the value of a collaborative approach to engagement, but commented on the difficulties of acting collaboratively. It would be valuable for the Code to give improved guidance to support collaborative behaviour by investors and/or their agents." [CFA Society of the UK]

- Communication difficulties between boards and shareholders.

  "Boards should be clear about the identity of their shareholders and their respective information requirements: i.e., what information they need and how they prefer to receive it. This should help boards to inform different categories of shareholder with a level of detail and means of delivery appropriate to the requirements of each category." [Ernst & Young]

  "Boards are finding it increasingly hard to create a dialogue with shareholders that do not want to engage with them or remain hidden on the register. The converse can also be true where some institutional shareholders find it hard to engage with some boards." [ICAEW]

- Bunching of annual general meetings.

  "Although possibly outside the scope of this review, we are concerned that the AGM 'season' in the UK is becoming increasingly condensed. If shareholders are to vote intelligently and to engage with companies on voting and other issues in a timely manner AGMs must be more spread out over more than the current dozen weeks in Spring. [ICGN]

Suggestions for improvement

Some respondents suggested actions that could be taken by companies or investors that might make engagement make effective.

"The Combined Code would benefit from giving more formalised recommendations of the type of activities companies should consider, to ensure that the dialogue with investors is both open and transparent, but also demonstrably available to the whole Board, including non-executive directors…. key aspects of this best practice include… a full independent audit of investor opinions provided to the Board at least once a year… [and] independent directors to actively consider having their own independent third party review conducted of investor opinions towards the business, its management and performance." [Financial Dynamics]

"Institutional investors might strengthen their input to the governance of the company if there was a separate meeting each year with the chairman and company secretary, and on occasion the senior independent director, specifically to discuss the governance of the company… Guidance on engagement between shareholders and such directors may assist in more effective engagement, whilst the generality of communication with all non-executive directors could be removed." [ICAS]

SECTION 2 OF THE CODE

Section 2 of the Code is directed at institutional shareholders and their agents. Unlike companies, investors are not subject to the "comply or explain" and other disclosure requirements in the Listing Rules.

There have been a number of relevant developments since the consultation period ended. On 5 June 2009 the Institutional Shareholders' Committee (ISC) issued a statement announcing its intention to upgrade its Statement of Principles to a Code, and that signatories would disclose how it had been applied. On 16 July Sir David Walker issued a consultation paper on the governance of banks and other financial institutions which recommended an enhanced role for the FRC and FSA in relation to engagement by investors, including possible FRC sponsorship of the ISC Statement of Principles.

Institutional Shareholders' Committee Principles

ISC member organisations expressed their support for the proposals in the ISC statement. In addition, some investor respondents commented on the best means of implementing the ISC Principles to ensure their effectiveness.

"The NAPF has for some time encouraged the incorporation of the ISC Principles into pension schemes' "statement of investment principles" and in its review of the Myners' Principles makes explicit reference to the importance of corporate governance. The challenge, particularly for all but the largest schemes, is to improve the monitoring and accountability of their managers for compliance. We see some signs of improvement here, but more needs to be done." [NAPF]

Section 2 of the Combined Code and related issues

ISC member organisations had differing views on Section 2 of the Code. Some members of the ABI considered that Section 2 could be expanded and applied on a 'comply or explain' basis, for example, *"by embedding the ISC Principles directly in some form"*. However, the ABI also noted *"a considerable degree of concern regarding Section 2 of the Code. Any changes to this section should only be done after careful consultation with the investor community."*

The IMA commented that *"the ISC should be responsible for any framework for investor engagement in that the Committee brings together the main investor bodies in the UK and thus represents the consensus thinking of the major part of the UK's investment industry. Section 2 of the Code already refers to the Statement, and we do not believe it should go further than this."*

The IMA also expressed reservations about some of the principles in Section 2 on the grounds that they were impractical. *"For example, it imposes obligations on fund managers… To give an explanation to the company, in writing where they do not accept the company's position, where appropriate. Fund managers will as a matter of course advise companies of these situations but requiring explanations to be in writing puts additional pressure on resources at a time when managers are busiest. Otherwise they could become standardised, undermining investors' assessments and leading to a general dumbing down of the evaluation process."*

The NAPF considered that *"Section 2 of the Code has been less effective than perhaps hoped… We would also distinguish between engagement of a more routine nature which is aimed at supporting compliance with the Code and engagement which has a more strategic intent. Neither the Code nor the ISC Principles make this distinction. The larger institutional investors in the UK are well equipped to handle the former and the standard of reporting to clients has improved markedly in recent years. We see little reason to seek changes here except to encourage collaboration in the interests of efficiency for both investors and companies."*

A number of other respondents commented on Section 2 of the Code, with many of them supporting either expanding Section 2 and/or introducing a "comply or explain" for institutional investors and their agents, either against Section 2 or a separate code.

"Investors should be subject to their own combined code, with regard to which they should either "comply or explain"… The beneficiaries of investment institutions would hold the governing body of investment institutions (e.g. boards of directors or trustees) accountable with respect to their compliance with these principles of best practice." [IOD]

"There is no ISC equivalent of the Comply or Explain provisions of the Combined Code… We need a truly "combined code" for the stewardship of listed companies – one which brings together the obligations of boards with those of institutional shareholders, and which applies to each an equally effective requirement to comply or explain." [Tomorrow's Company]

"We believe there is a need for a clear and comprehensive code of best practice in relation to the fiduciary duties of institutional investors… setting out their responsibilities and proposing ways to meet them in spirit and in letter. We are concerned that, without this, most will be tempted to free ride and do nothing or to create the appearance of being active but doing very little of practical effect." [ICGN]

"It might be valuable to investigate mechanisms by which institutional investors could be incentivised and/or sanctioned to fulfil their ownership responsibilities. Ideas that have already been discussed publicly to a limited extent include tax benefits or sanctions, a loyalty dividend to long-term shareholders, and an enhanced dividend for shareholders who vote at general meetings. Regulation, say by the Financial Services Authority, is clearly another means to an end. Ultimately, client demand is likely to be the most compelling argument for institutional investors to develop governance capabilities but debating other mechanisms could also be productive." [Governance For Owners]

One respondent suggested that Section 2 should include a provision for fund managers to disclose their voting records to enable their beneficial owners to judge performance between the different fund managers, although there was no support for making voting mandatory.

"We believe that Section 2 of the Code must be strengthened… [it] should make clear that best practice – compliance – is to disclose voting records, and that a failure to do so should be explained." [LAPFF]

Monitoring of investor engagement activity

A number of those respondents who considered that there was a need for investors to report on their engagement activity went on to comment on how this should be monitored. Some considered this should be done by their clients and beneficiaries, while others felt there was a need for independent monitoring or regulatory action. Others felt that any formal monitoring regime would be inappropriate.

"Disclosure of compliance with the principles could be made on fund managers' websites. Pension funds should regularly report their approach and resulting activities to the members of their funds." [Aviva Investors]

"There is no mechanism with which to ensure inclusion of the Institutional Shareholders' Committee's Statement of Principles into fund managers' contracts. Where the Statement it is included within such contracts there is no mechanism to ensure that its provisions are enforced by the fund manager... We would welcome the FRC giving consideration to whether it or another party needs to act as a catalyst to encourage institutional investors fully to carry out the role envisaged for them under the Code." [Hermes Equity Ownership Service]

"Although our preference would be for self-regulation, we recognise that to get the attention of all regulated investment management firms, it may be necessary to make the "apply or explain" requirement of such a code part of the more formal regulatory oversight of the industry. Perhaps an interim measure would be to reserve powers to incorporate certain share ownership activities into the regulatory framework." [ICGN]

"*In our opinion only direct engagement between shareholders and boards can determine whether the stewardship role is being adequately performed, and if shareholders for whatever reason do not wish to engage in such discussions then it is not possible to force them. We do not believe that there are any workable and enforceable measures to require engagement from all shareholders and we consider that it is not equitable to introduce a system which only targets some shareholders.*" [QCA]

LIST OF RESPONDENTS

Note: This list excludes responses submitted on a confidential basis.

1. AIRMIC/ Institute of Risk Management
2. Armstrong Bonham Carter
3. Association of British Insurers (ABI)
4. Association of Chartered Certified Accountants (ACCA)
5. Association of Corporate Treasurers (ACT)
6. Association of Investment Companies (AIC)
7. Auty, Dr Andrew
8. Aviva plc
9. Aviva Investors
10. Balfour Beatty plc
11. BDO Stoy Hayward
12. Boardroom Review
13. Boatman, Timothy
14. British Airways plc
15. BT Group plc
16. Business Continuity Institute
17. Cable & Wireless plc
18. Campbell, Andrew & Whitehead, Jo
19. Capita Company Secretarial Services
20. CBI
21. CFA Society of the UK
22. The Chairmen's Forum
23. Chartered Institute of Management Accountants (CIMA)
24. Chartered Institute of Public Finance & Accountancy (CIPFA)
25. City Group plc
26. Corporate Value Associates
27. Cox, Paul
28. Davis, Stephen
29. Deloitte
30. Diageo plc
31. Erasmus School of Law, Rotterdam
32. Ernst & Young
33. FairPensions
34. Fidelity International
35. Financial Dynamics
36. FitzGerald, Niall
37. GC100
38. Gerard, Revd. Patrick
39. GlaxoSmithKline plc
40. Governance for Owners
41. Governance Integrity Solutions (UK) Ltd
42. Grant Thornton

43. Griffiths, David
44. Haighton, Patrick
45. Hannigan, Professor Brenda
46. Hanson Green
47. Hermes Equity Ownership Service
48. Howgate, Ian
49. Independent Audit
50. Institute of Business Ethics
51. Institute of Chartered Accountants of England and Wales (ICAEW)
52. Institute of Chartered Accountants of Scotland (ICAS)
53. Institute of Chartered Secretaries and Administrators (ICSA)
54. Institute of Directors (IOD)
55. Institute of Internal Auditors (IIA)
56. International Corporate Governance Network (ICGN)
57. Investment Management Association (IMA)
58. Irish Association of Investment Managers (IAIM)
59. Irish Stock Exchange
60. Lawyers in Commerce & Industry Group
61. Legal & General Investment Management
62. Local Authority Pension Fund Forum (LAPFF)
63. London Stock Exchange plc
64. Long, Alan
65. Lonmin plc
66. Marks & Spencer plc
67. Mazars
68. MM&K Ltd
69. Moore, Dr. Marc
70. MWM Consulting
71. National Association of Pension Funds (NAPF)
72. National Grid plc
73. The NED Group
74. Nestor Advisors
75. Non-Executive Directors Association (NEDA)
76. Odgers Berndtson
77. Osman, Philip
78. Palmer, Gavin
79. Parker, Sir John
80. Pinsent Masons
81. Policy Exchange
82. PricewaterhouseCoopers
83. Prism CoSec
84. Prudential plc
85. Public Concern At Work
86. Quoted Companies Alliance (QCA)
87. Railpen Investments
88. Ratcliffe, Philip

89. Report Leadership Group
90. RISC International (Ireland)
91. Royal Bank of Scotland plc
92. SAB Miller plc
93. Severn Trent plc
94. Shrives, Philip
95. Spencer Stuart
96. Standard Life plc
97. Tesco plc
98. Tomorrow’s Company
99. Towers Perrin
100. Tyler, Ben
101. Tyler, David
102. UBS Global Asset Management
103. UK Sustainable Investment and Finance (UKSIF)
104. White, David
105. Williams, Anthony
106. Wm Morrisons Supermarkets plc
107. Yafele, Aylwin

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