Financial Reporting Council

2007 Review of the Combined Code: Summary of responses to Consultation

November 2007

2007 REVIEW OF THE COMBINED CODE

SUMMARY OF RESPONSES TO CONSULTATION

Introduction

1. Public consultation ran from 18 April to 20 July 2007. In total 107 responses were received, of which 56 were from listed companies and 19 from investors and their representative bodies. The full list of respondents, excluding those who asked for their response to remain confidential, is in the Appendix.

2. The consultation document invited views on four questions:

   - Does the Code support better board performance over time?
   - Is the 'comply or explain' approach working effectively?
   - What impact has the Code had on smaller companies?
   - Do disclosures on the Combined Code in annual reports provide useful information to shareholders at proportionate cost to companies?

Does the Code support better board performance over time?

3. Many respondents considered that the Code provided a framework that could help boards to operate effectively, although many noted that improvements in board performance would not follow unless driven by the board itself. In the words of one respondent:

> "The Code supports better performance but does not generate or initiate better Board performance on its own. The key to ensuring improved Board performance over time is that the Chairman and Board members see the true value from investing time in this key area. It is about an attitude of mind, rather than a particular process and the Code and disclosure can be the catalysts to instigating this work. The Code can help to provide the 'glue' and the framework which allows the directors to focus on the areas that will enhance their performance" [Marks & Spencer]

> "The Code provides the right framework for a balanced and constantly refreshed board. It sets out requirements for timely flows of information, training and evaluation, which support the effectiveness and performance of the board over time". [GC100]

"The IMA considers that the principles and provisions in the Code essentially support better board performance over time. In particular, since the last major revision of the Code in 2003 our members have noticed improvements in, and better disclosure of, board practices and procedures". [Investment Management Association (IMA)]

"The Code has helped to provide a basis for the growing recognition of the need for a professional and systematic approach to performance and governance, and if correctively applied by companies and interpreted by investors the Code provides an appropriate balance between the corporate performance and compliance aspects of the directors' role". [IOD]

4. A number of respondents identified specific improvements in board practice to which they considered the Code had contributed. These included:

- Increased professionalism of the board, including as a result of performance evaluation: "We believe the operation of the Code has been a powerful spur to increased professionalism of Boards and to ensuring that the unitary board system works well in a practical way that is consistent with its objectives. The role of non-executive directors has developed in important ways, and the practical importance of these roles, which are complementary to the business and management roles played by the executive directors, will have contributed to cohesiveness of boards and to improved overall decision-making". [ABI]

- "The description of the roles of the chairman and CEO has promoted clarity in the division of responsibilities at the top of companies" [3i]

- Benefits resulting from regular board evaluation, including better succession planning: "Areas where the Code has contributed to improvement are performance evaluation, professional development and succession planning. These practices contribute significantly both to bridging the monitoring role of non-executive directors with the board's cohesive nature, and to ensuring that the board's real priorities are not subordinated by disproportionate attention to the letter, rather than the spirit of the Code" [PriceWaterhouseCoopers]

- More effective audit committees: "the emphasis on having financial experts on the audit committee appears to have improved the committee's functioning, which is highly welcomed given its expanding set of responsibilities" [Barclays Global Investors]

- Better engagement with shareholders: "The particular area where we as investors have seen a change is in discussions about appointments of directors, prior to the announcement… The opportunity to meet the Chairman or Senior NED to discuss Board or company performance has [also] been greatly assisted by the Code". [LGIM]

5. The majority of companies who commented on the issue considered that the compliance burden associated with the Code had not prevented the board from devoting sufficient time to its primary role of providing entrepreneurial leadership of the company. However, a few took the opposite view and considered that the level of detail in the Code detracted from its effectiveness, partly because of the time commitment required but also because – combined with the perceived 'box-ticking' approach of some investors and governance services agencies – it encouraged some boards to view it as a compliance exercise rather than as a potential aid to better performance.

   "Many directors, particularly those not in an executive capacity in the company, do indicate that they consider that a disproportionate amount of their effort is directed towards compliance and conformance, rather than the strategic direction of the company". [IOD]

6. The Association of Investment Companies (AIC) considered that the Code has achieved the attitudinal shift towards governance that was the major prize. However, now that the relevance of higher governance standards has been established in the market, the AIC believes that the detailed nature of the Code could, in some ways, be detracting from the governance process."

7. Prompted by these concerns a number of respondents considered that, as one outcome of the current review, the FRC should emphasise that the primary objective of the Code is to support the board in providing entrepreneurial leadership of the company. One respondent commented:

   "We are conscious, however, that some directors still express concern that significant amounts of board time are spent on corporate governance issues that they view as being compliance-orientated. It may therefore be helpful to stress the overarching purpose of the Code in the preamble and to exhort boards to apply it with this goal to the fore." [Mazars]

8. A number of respondents were concerned that the emphasis placed by the Code on the responsibilities of non-executive directors potentially risked undermining the unitary board:

> "Corporate Governance can have the effect of setting the non executive directors against the executive directors. This is because the Code makes them feel they must act as policemen" [Fuller, Smith & Turner]

> "The monitoring/ supervisory role sits a little uneasily with the board acting as a whole, hence the importance of the Code in requiring formal and informal meetings of non-executives, i.e. the committee structure and other less formal NED-only meetings."[BAE Systems]

> "We believe that the concentration on 'non-executive' directors and the consequent language of the Code has made an unwitting contribution to some of the issues that are being raised in the current review, particularly perceptions of a breakdown in board cohesiveness… [although] if correctly applied by companies and interpreted by investors the Code provides an appropriate balance between the corporate performance and compliance aspects of the directors' role" [IOD]

9. In addition some of those who considered that the overall effect of the Code had been beneficial raised concerns about specific aspects of the Code and its application, including the level of prescription in some provisions. Some of the specific examples of provisions that were considered to be unnecessarily prescriptive are covered in the section on 'Suggested Changes to the Code' (paragraph 49 onwards).

Is the 'comply or explain' approach working effectively?

10. There was strong support from all respondents for the principle-based approach and 'comply or explain' in preference to other, more regulatory, approaches, and many considered it to be working well:

> "In our experience, direct communication between UK companies and their institutional investors on matters of governance has improved markedly over recent time. The explanations provided for non-compliance with a Code recommendation, even if not accepted by investors, are usually the basis for a discussion and better understanding". [ICGN]

"Companies and investment institutions have developed a meaningful dialogue over what constitutes sensible departures from the Code. This is one of the areas of greatest improvement in recent years" [Hanson Green]

"It is an essential catalyst for the discussions between companies and investors."[LGIM]

"The key challenge in strengthening overall board performance is how that framework is implemented on a practical and on-going basis. We therefore recognise the Code as one part of an overall balanced toolkit. We also welcome the Code's principles-based approach."[Standard Life]

11. However, concerns were raised about how 'comply or explain' was working in practice.

12. For companies, the most significant concern was perceived 'box-ticking' on the part of voting services agencies. Many companies commented that these agencies appeared to be unwilling to consider explanations, treating them as 'non-compliance', while others complained that some agencies, and some institutions, applied their own standards that deviated from or were more onerous than the Code:

"There is a trend for investors to sub-contract their voting at shareholder meetings to third parties. These third parties appear to take a very black and white approach to Code compliance and appear oblivious to the qualitative judgements expected from the 'comply or explain' approach. We have examples of votes being lodged against the re-election of directors purely because of Code non-compliance, with complete disregard to the explanations given which have fully satisfied the relevant fund managers at the institutions involved". [Havelock Europa]

"We fully support the principles-based approach as being preferable to a rules-based approach. However, it is apparent that practice has emerged which does not regard the 'explain option' as being in compliance. This box ticking undermines the principles-based approach."[GC100]

"We believe that if institutional shareholders or voting agencies choose to establish their own governance policies they should be based on the Code and should not be in conflict or penalize companies for abiding by the "comply or explain" principle of the Code."[GlaxoSmithKline]

13. As a result, it was claimed that some companies, in particular smaller companies, effectively felt compelled to adopt the provisions of the Code, regardless of whether it was the most sensible thing to do in their particular circumstances:

> "Non-compliance, even when accompanied by an adequate explanation, seems to be characterised by the governance industry as a bad thing... This can lead a company to conclude that it is not worth its while to 'explain'... and, more importantly, could force a company to take action to become 'compliant' that could very well be contrary to the interests of the company and its shareholders". [SABMiller]

14. Some respondents suggested the need for increased transparency on the part of, or a possible code of conduct for, voting service agencies:

> "The FRC should undertake market research into the role of governance agencies and develop a code of best practice to ensure that where the specific provisions of the Combined Code are not implemented, alternative approaches and their explanations are properly considered." [AIC]

> "Governance voting agencies should be encouraged to consider explanations given by companies more fully. They should also be required to consider and state the likely implications of their voting recommendation" [GC100]

> "…[the FRC should engage] with the voting service agencies to encourage them to provide companies with enough time to comment on their compliance reports, and to ensure that they understand that explanations should be given proper consideration, and is not non-compliance."[CBI]

15. Other companies recognised the constraints under which those agencies operate:

> "It is important that they [investors] are seen to act responsibly and discharge their own duties. To do this, we are of the opinion that, greater reliance is given to agents such as PIRC, RREV and Manifest. However, these firms are under severe time restrictions for review and comment to their clients, so, in practice, we often only receive 24 hours to respond to detailed reports."[Confidential response]

16. A number of respondents proposed a change in terminology, which would replace 'comply or explain' with 'apply or explain'. It was argued that this would more accurately reflect how the Code was intended to be applied and remove the negative connotations which led to explanation being considered to be 'non-compliance':

> "Using the terminology 'apply or explain' may be a preferable way to express the fact that companies do have a real choice and thereby encourage a more open-minded interpretation from investors and their advisers. We are not suggesting that explanations should not be rigorously reviewed, but simply that this review should be undertaken with an open, unprejudiced mind. The current terminology of non-compliance (rather than non-application) immediately presents a negative connotation and therefore a degree of prejudice. This shift in terminology might also help companies take the 'explain' route more often; sometimes avoided even when it is in the better interests of the company, owing to a fear of a box-ticking negative response and the resultant impact on voting." [ICSA]

17. Views were divided among companies as to whether institutional investors were also guilty of 'box-ticking'. Some considered this to be the case, at least in cases where the governance and fund management functions had been separated:

> "Compliance departments of institutional shareholders adopt a box-ticking approach and are disconnected from those who make the investment decisions, who often take a more positive and practical stance, yet this may not be reflected in their voting." [Fuller, Smith & Turner]

> "In our experience the advisors to institutional investors, while noting an explanation, inevitably tick the box for full implementation of the rule, and their clients vote against." [A G Barr]

18. But many others commented that their shareholders were applying the spirit of 'comply or explain', as illustrated by the fact that they would not always to follow recommendations made by voting services agencies:

> "Concerns have been expressed that shareholders are inclined to take a 'black and white' approach to non-compliance, and are deaf to sensible justifications. From our discussions with UK chairmen and directors, we do not believe that is the case. Both companies and investment institutions have developed a meaningful dialogue over what constitutes sensible departures from the Code. This is one of the areas of greatest improvement in recent years."[Hanson Green]

"Institutional investors are refreshingly pragmatic in their approach to the Code" [British American Tobacco]

"The problem lies with bodies that take recommendations as rules and overlay even more onerous requirements. This leads to some extreme voting recommendation, which, fortunately, the shareholders have ignored to date! However, if that position was to change, then I think the frustrations felt would become more serious" [Chaucer Holdings]

19. A number of investors and their representative bodies considered that the charge of 'box-ticking' could not fairly be leveled at institutions, and that what was seen by companies as 'box-ticking' may sometimes simply be reluctance on the part of investors to accept an inadequate explanation:

"We do not believe that "box ticking" is prevalent among large institutional investors in the UK. Rather, most institutions seek to understand the individual context of a company prior to arriving at a voting decision." [Barclays Global Investors]

"The 'comply or explain' approach can only work if companies respect the obligation and give sound reasons for non-compliance. Although undoubtedly explanations have improved since the Code was last revised not all companies provide adequate explanations and some consider any explanation will suffice". [IMA]

"It is fair to say that companies could often do more to provide better explanations. If they were to abandon boilerplate in favour of clear communication of their approach to governance and the way their board operates, institutions would have less excuse for not helping to make comply or explain work." [Independent Audit]

"We do take the view that some companies fail to adequately explain why it is that they have not applied the Code. There is a tendency for largely boilerplate statements to be made in annual reports which do not adequately reference a company's individual circumstances as to why it is felt inappropriate to apply the Code in a particular instance."[PIRC]

20. Some institutions and other respondents also considered that some companies and their advisers were themselves guilty of adopting a 'box-ticking' approach, treating the Code as a compliance exercise:

"We do not consider concerns about 'box-ticking' by investors to be well-founded. It is as likely to be the case that companies that have doubts about their ability to make adequate explanations have themselves fallen back on a compliance with checklist approach to minimise the likelihood of criticism". [ABI]

21. Although other respondents considered that, where this occurred, it was often as a response to the perceived lack of engagement by investors:

"An explanation requires there to be another party to form the other half of a dialogue. Too often, companies do not believe that they have an intelligent conversation partner and so feel that they cannot take the risk of explaining but must simply comply". [Hermes]

"Companies will be disinclined to give meaningful explanations that can require them to disclose sometimes personally sensitive information if they believe that such explanations will be widely ignored and a box ticked on the basis of 'non-compliance'." [IOD]

22. One respondent noted that engagement was not a cost-free option for either companies or investors and their advisers:

"While the Code has led to more constructive engagement with investors, this too can create problems. Not wishing to invite adverse publicity, comment or voting trends, companies now wish to consult regularly. As more do so, so more is required of the investment community which does not perhaps have the time or resource to do justice to all such requests" [Confidential response]

23. Other respondents commented on the resource and other constraints under which investors and governance agencies operate, such as the difficulty caused by the bunching of Annual General Meetings around seasonal peaks:

"Another weakness of the regime is the concentration of the dialogue in the time leading up to the AGM. All would benefit from those discussions being held at any other time of the year."[NAPF]

24. Notwithstanding the practical difficulties, some respondents considered that for 'comply or explain' to work effectively it was incumbent on both companies and investors to devote adequate and timely resource to engagement:

"For the [comply or explain] approach to operate effectively, a heavy responsibility exists for companies to explain fully in a timely fashion and with enough opportunity for an appropriately detailed dialogue. A reciprocal obligation also lies with institutional investors and shareholder representative bodies to conduct themselves in similar vein. Where this occurs, the outcome is invariably positive; where the dialogue is inadequate or constrained by time, misunderstanding and dissonance develops all too frequently" [Standard Chartered]

"Both companies and investors need to dedicate sufficient resources to reporting and monitoring respectively. In our own experience such resources have increased over the past 5-10 years, although there is still room for improvement, particularly in making face to face discussions on governance matters more fruitful" [Governance For Owners]

"We are concerned that this situation may not accord with the investment industry's commitments under the Institutional Shareholders' Committee Code, the statement of principles on The Responsibilities of Institutional Shareholders and Agents. The FRC may therefore need to encourage all parties to live up to the commitments which they themselves have made."[Hermes}

What impact has the Code had on smaller companies?

25. Many of the issues discussed in the two previous sections were also raised specifically in relation to smaller listed companies.

26. Many respondents considered that the Code had had a broadly beneficial impact on smaller listed companies, with one arguing that the positive impact had probably been greater than for larger companies:

"The positive effects of the Code are that it has increased awareness of governance issues among smaller companies and it provides a useful framework on which they can build their governance practices. These are the companies that on the whole would not be at the forefront of governance developments, often because of resource constraints. To that extent the Code has had a significant impact on smaller companies; in terms of real impact on their governance practices probably greater than on many larger companies". [IOD]

27. Another respondent argued that by implementing the Code smaller listed companies improved their ability to attract capital:

> "Whilst we recognise that smaller public companies bear a relatively greater regulatory burden in complying with the Code, we would argue that they probably also benefit disproportionately from the confidence that investors take when they fully implement the Code's recommendations." [ICGN]

28. There was a general recognition that the costs and benefits associated with implementing the Code were probably more finely balanced for smaller companies as the costs of compliance were proportionately more significant. Some respondents considered that on balance the benefits outweighed the costs while others took the opposite view. While 'comply or explain' provided flexibility, neither option was cost free.

29. Two thirds of the responses from smaller listed companies and the chairmen of such companies raised concerns about perceived 'box-ticking' by voting services agencies, although there were differing views on the extent to which the recommendations made by these agencies influenced the views and votes of their shareholders.

30. Four respondents suggested either that there should be a separate corporate governance regime for smaller listed companies, or that further derogations for smaller companies should be considered.

31. In addition four other respondents – including the CBI and the QCA – suggested that the footnote to provision A.3.1 should be disapplied for small companies, i.e. that it should be possible for a chairman of a company outside the FTSE 350 who was considered independent on appointment to continue to be classified as independent for the purposes of the Code. It was considered that this could improve the effectiveness of the board committees:

> "Particularly as an aid to smaller listed companies, consideration should be given as to whether the non-executive chairman can continue to be to be considered independent following appointment, and not just on appointment. The non-executive chairman could then be regarded as an independent director when considering committee membership" [CBI]

32. However the majority of respondents who commented on this issue opposed widespread derogations from the Code for smaller listed companies, arguing that the same governance standards should be applied to all companies regardless of size and that 'comply or explain' allowed small companies the flexibility not to follow particular provisions where they felt it appropriate.

> "However, most governance principles apply as well to smaller companies as large ones, and the more governance disciplines that a smaller quoted company can adopt the better. Flexibility, and an intelligent approach to compliance, is essential."[Hanson Green]

33. Except for changing the status of the chairman, this position was supported by the QCA, which commented that "We believe that the same code should apply to companies of all sizes with only limited derogations for smaller companies, if any. A system of governance should reflect good business practice and an appropriate code will not impose additional burdens."

34. This position was also supported by investors, a number of whom stated that they took the size of the company into account when considering explanations:

> "We do support some arrangements that would not be generally appropriate at a large company so explanations are all important. Smaller companies typically have a smaller shareholder base and it is possible to get support from a majority of shareholders if the business proposition is right." [LGIM]

> "The Code already contains derogations in certain respects and, institutional investors would expect the volume of disclosure by smaller companies to be significantly less than that of large ones."[ABI]

Do disclosures on the Combined Code in annual reports provide useful information to shareholders at proportionate cost to companies?

35. Comments on this question addressed two issues: the time and cost involved in producing the corporate governance statement, and the usefulness to investors of the information it contains.

36. The majority of companies that commented on this question considered that the cost of producing the corporate governance statement was proportionate, although some smaller companies took a different view. A number of companies questioned the necessity of some of the specific disclosures recommended by the Code, while others suggested that greater use should be made of company websites rather than the annual report as a means of providing shareholders with information on the company's governance arrangements.

37. There was much more widespread concern about the cumulative cost to companies of complying with all the disclosure requirements now placed on them, which has also had the effect of greatly increasing the length of the annual report. One respondent reported that the length of the company's annual report had increased from 7800 words in 1987 to 52000 words in 2007 (an increase of over 650% in twenty years).

38. The transition to IFRS and EU and UK company law and financial market regulations were cited as the main source of this increase, which as well as increasing the cost to companies was also felt by some respondents to be making it more difficult for investors to extract value from annual reports. The NAPF noted that "the combination of growing corporate governance disclosures and the new accounting requirements means that annual reports are becoming so long that shareholders can struggle to identify the important elements."

39. Respondents' views on the usefulness and quality of corporate governance statements were mixed, although there was broad agreement that the quality had improved in many respects. One respondent considered that:

> "Our surveys of governance reporting over the past three years have indicated a gradual but discernible improvement in governance reporting by FTSE 100 companies. Audit committee reporting has shown a marked improvement. Reporting on the board itself is patchy, particularly in relation to what the board has actually done during the year and how its membership meets its strategic development needs. Reporting on how remuneration and nomination committees meet their responsibilities remains particularly weak." [Independent Audit]

40. Companies generally accepted the need to provide shareholders with useful information on the performance of the board, and the majority considered that they already provided such information, although as noted above some questioned the value to investors of some of the information they were expected to disclose under the Code. One company chairman commented that:

> "Although governance departments and representative bodies do take an interest in the disclosures, I cannot recall any instance where an institutional fund manager or private shareholder has raised a question on the subject. This could simply mean that they are satisfied with the information provided but it might also imply that "real investors" do not find this information valuable" [Peter Warry]

41. While acknowledging that that there were many examples of useful and high quality corporate governance statements, a number of investors and other market participants raised some concerns. The two issues raised most often were the varying quality of the explanations provided when companies chose not to comply with one of the provisions, and the 'boiler-plate' nature of many disclosures. On the latter point, one investment institution commented that:

> "Whilst disclosures on the Combined Code provide a helpful means for us to assess companies, we are concerned by the boiler-plated nature of some disclosure. We would appreciate more reporting on the characteristics and experiences of individual companies, rather than statements of the same structure, which do nothing to aid the understanding of companies by investors." [CIS]

42. Another saw a connection between 'boiler-plate' disclosures and the tendency for some companies to see compliance as "the line of least resistance":

> "We are concerned that the 'simply comply' approach is driving company governance disclosure towards boilerplate and away from disclosure which generates understanding and so adds value to the relationship between the company and its investors." [Hermes]

43. Some companies acknowledged that there was an element of 'boiler-plating' in the corporate governance statement, but considered this was at least partly linked to the resources available to them, and to the "standard" and "minor" nature of some of the practices being described. One chairman of a smaller listed company commented that:

> "the majority of the information contained in the corporate governance section is copied from year to year or plagiarised from somewhere else. There is neither time nor the appetite for discussion or debate about the quality of the content. Consequently, I question its value to shareholders but I am not sure how one can modify this situation easily without an increase in overhead" [Ian Paterson]

44. The QCA commented that the poor quality of some corporate governance statements may be linked to the time pressures associated with the production of the annual report:

> "Limited time at year ends often mean that boards do not focus much attention of the CGR [corporate governance report], and how to make it more useful for readers of the accounts. It may be that by separating the CGR from the annual report, it will get more attention from directors and be more meaningful. Boards should be encouraged to review the CGR early in the year end process" [QCA]

45. They and others felt that, for this reason and because of the concerns about the overall length of the annual report, consideration should be given to moving some or all of the corporate governance statement out of the annual report and onto the company's website:

> "Consideration should be given to the possibility of permitting the use of the company website to publish a company's corporate governance statement required by the Listing Rules in place of in the annual report" [CBI]

> "Companies could more appropriately be required to maintain a corporate governance statement on their website, where that statement must be refreshed at least annually and each time there is significant change to the entity's corporate governance practices."[Grant Thornton]

46. Others suggested a standard format for corporate governance statements:

> "It may be too late in the day to provide companies with a reporting structure as many companies have developed their own style, however issuing a 'recommended structure' in the same manner as the ASB 'reporting statement: OFR' may be useful and encourage some companies to report non- compliances more fully."[KPMG]

47. Three respondents – including the CBI and QCA – commented that the requirement in the Listing Rules for boards to state how they have applied the Code's principles (as well as how they have complied or explained with its provisions) was adding unnecessarily to the 'boilerplate' disclosures because it "is often interpreted as a requirement to explain how all 60+ elements of the Main and Supporting principles are applied". [*QCA*]

48. In addition to the comments on the quality of explanations and 'boiler-plating', some respondents identified particular issues on which they would like to see more informative and company-specific disclosures. These included the process and outcome of evaluations of the board and individual directors, the process followed when recruiting new directors, and the report of the audit committee.

Suggested Changes to the Code

49. Reflecting the views set out above about the overall effectiveness of the Code, and a desire for a period of stability following significant legislative change, many respondents stated that there was no need for significant changes at this time:

> "CBI members do not seek major changes or a significant re-write of the Code at this point in time. Rather they seek a period of stability, and for a more detailed review of the Code left to be undertaken at the time of the next review in say 2009 /10 when experience of the new Companies Act and implementation of the new requirements of the 4th, 7th and 8th Directives, Transparency Directive, and Shareholder Rights Directive, and their impact on the Combined Code, has been gained" [CBI]

> "We believe the Combined Code is working well in practice and see no reason for any further revisions to be made in the short term" [The Hundred Group]

"There would be sense in envisaging the possibility of a need to update the Code to reflect regulatory and other developments on a number of fronts and to plan with a view to consultation at an appropriate future time on updated guidance. However, we would emphasise our central message that the Code continues to work well and that there is no obvious need for a revision of the Code in order to improve its effectiveness" [ABI]

"Recently there have been many changes to corporate reports and the rate of change is continuing. There has been the introduction of IFRS, revised Turnbull guidance, the enhanced business review, and new requirements under the Transparency Obligations Directive and the Companies Act 2006. We consider that these changes should be given the opportunity to bed down before further amendments are considered to the Code" [IMA]

50. The only notable exception was the Association of Investment Companies, which considered that "the detailed nature of the Code could, in some ways, be detracting from the governance process. This is particularly the case where it encourages focus on (sometimes very discrete) issues that assume the same importance as other more significant considerations", and recommended a significant number of changes intended to reduce the level of prescription in the Code.

51. Notwithstanding the general desire for stability, many respondents proposed specific changes to the Code. They are too numerous to list in full, and many were proposed by only a single respondent, but the changes that were most frequently sought are summarised below.

52. Revising the Preamble: a number of respondents suggested that the Preamble to the Code should be updated to emphasise more clearly the purpose of the Code and how it should be applied. It was suggested, for example, that the Preamble should state that the purpose of the Code was to promote value-enhancement through higher board skill levels and better board processes and emphasise that long term value creation is one of the principal criteria of good governance:

"The Code needs to emphasise more that a key outcome from any corporate governance system should be value creation… It does not make clear that, especially in smaller companies, the governance structures should give as much, if not more, emphasis to value creation than to value protection." [*QCA*]

53. Allowing individuals to chair more than one FTSE100 companies: ten respondents, including the ABI, IMA, CBI and GC100, recommended removing the restriction in provision A.4.3 on an individual chairing more than one FTSE100 company.

> "…I should take this opportunity, once again, to reiterate my view that the current rule which prevents the same individual from holding the chairmanship of more than one FTSE 100 company should be reconsidered. This rule strikes me as being highly arbitrary and prescriptive in the context of a Combined Code which very much adopts a principles-based approach." [BAT]

> "The meetings of the FRC with Chairmen in May/June 2006 suggested that this restriction is overly prescriptive in their view and as a major shareholder LGIM appreciates their concern. The rule importantly refers to the time required for the role and the individual's other commitments. The reference to FTSE100, however, does not take account of similar sized organisations in the USA or Europe that are equally complex. Removing this "two chairmanship" rule may help meet the objective of achieving an adequate supply of skilled and experienced people willing to serve on Boards." [LGIM]

54. The status of the chairman of smaller listed companies: as noted in paragraph 31, four respondents suggested that it should be possible for a chairman of a company outside the FTSE350 who was considered independent on appointment to continue to be classified as independent for the purposes of the Code.

55. The company chairman being a member of the audit committee: Reclassifying the chairman as independent would have the effect of enabling them to sit on the audit committee. While not specifically proposing any change, the NAPF noted that its revised voting policy guidelines accepted that the chairman of a small company could sit on the audit committees where they had been independent on appointment.

56. Two other respondents considered that, in the same circumstances, the chairman should be able to sit on the audit committee irrespective of the size of the company.

> "I suspect that most FTSE250 companies have the chairman in attendance at Audit Committee meetings for the reasons mentioned above. If companies see this as a necessity then rather than adopting the subterfuge of "in attendance" it would be much better than the Code was changed to permit, indeed encourage, the chairman's membership." [Peter Warry]

57. Length of tenure of independent directors: seven respondents suggested that length of tenure should either be removed from the list of independence criteria in provision A.3.1, or that the current wording should be replaced by a more general requirement to take length of tenure into account when assessing independence.

> "The inclusion of what has been interpreted as an objective criterion of nine years' service within the Code is therefore in need of clarification. Shareholders are already safeguarded by the requirement that directors who have served for nine years or more must submit themselves for re-election on an annual basis."[Lonmin]

58. A further three respondents suggested that it should be made more clear when calculating length of tenure that only time served on the main board should be included, not prior service on the boards of subsidiaries.

> "Provision A.3.1 sets out the relationships or circumstances which may appear relevant to the Board's determination of a Director's independence, including if the Director 'has served on the Board for more than nine years from the date of their first election'. Increasingly, we are seeing this being interpreted to include service on subsidiary companies or indeed service on companies before they are acquired."[HSBC]

59. Board evaluation: two respondents suggested that the requirement for annual formal evaluation in provision A.6.1 should be loosened.

> "Clause A.6 provides that the board should undertake a formal and rigorous annual evaluation of its performance and that of its committees and individual and individual directors. Whilst I accept that each board, of whatever size company, should undertake an annual evaluation of its performance I wonder whether for smaller companies it needs to be 'formal and rigorous' every year if ever. Such an evaluation can take up considerable time and effort - especially in the early years. Perhaps a formal and rigorous review could be undertaken every three years with more informal reviews in the intervening years."[Gibbs & Dandy]

60. Use of remuneration consultants: two respondents considered that, where the remuneration committee had employed remuneration consultants, they should be identified in the annual report.

61. Company-specific disclosure: two respondents suggested that a new principle should be added to the Code emphasising the need for disclosures in the annual report to be focused on the specific circumstances of the company. In addition two respondents considered that there was a need for more informative audit committee reports**.**

> **"**Disclosures on Code compliance in annual reports provide some useful information but frequently do not directly address the reason for non-compliance satisfactorily. The Forum considers that a principle of the Code could emphasis of the need for relevant and focused disclosure on circumstances specific to the company.
>
> The Code already requires that companies report on committee activities during the year, but our research found that 23% of companies in the FTSE 350 do not adequately report on the activities of their audit committees; in these cases, the disclosure amounts to little more than a summary of the audit committee's terms of reference. The Forum considers that the Code should reinforce the need for an informative description of the work covered during the year, rather than a general statement of responsibilities."[LAAPF]

62. Use of website for disclosure: as noted in paragraph 45, five respondents suggested that some or all of the corporate governance statement should be disclosed on the website rather than in the annual report.

Other issues raised by respondents

Foreign registrants

63. Five respondents commented that foreign registered companies on the Main Market should be required to report on how they have applied the Code (at present this is only required of UK registered companies). This issue is being considered as part of the separate Listings Review being undertaken by the FSA.

Private equity

64. A number of respondents commented on the different governance models in the listed and private equity sectors, and the relative attractiveness of the two:

> "The size of the private equity sector is a clear demonstration that the Code is not the only viable model and that the proximity of "real" ownership is a better spur to performance than a rigid approach to corporate governance" [Caledonia Investments]

"There is an obvious correlation between the growth of private equity and the increased scope, cost and personal risk involved with the corporate governance requirements of a public company. This disparity should be addressed by reducing burdens on public companies not increasing regulation of private equity". [Scarborough Minerals]

APPENDIX

RESPONDENTS

In total 107 responses were received. Of these, 56 were received from listed companies and 18 from investors and their representative bodies. The list of respondents is below. It excludes those respondents who requested that their comments be treated as confidential. Copies of the individual responses are available at: http://www.frc.org.uk/corporate/2007reviewresponses.cfm

1. Association of British Insurers
2. Association of Chartered Certified Accountants
3. Alliance & Leicester plc
4. Alliance Trust plc
5. Armstrong Bonham Carter
6. Association of Investment Companies
7. Aviva plc
8. BAE Systems plc
9. Baker Tilly UK Audit LLP
10. Barclays Global Investors
11. A G Barr plc
12. Barratt Developments plc
13. BG Group plc
14. Bovis Homes Group plc
15. British American Tobacco plc
16. Cadbury Schweppes plc
17. Caledonia Investments plc
18. Capita Company Secretarial Services
19. CBI
20. Chartered Institute of Management Accountants
21. Chaucer Holdings plc
22. Chesnara plc
23. Coal Pension Trustee Services
24. Compass Group plc
25. Cookson Group plc
26. Co-Operative Insurance Society
27. Debenhams plc
28. Deloitte & Touche LLP
29. Diageo plc
30. Ernst & Young LLP
31. Fuller, Smith & Turner plc
32. GC100
33. Gibbs & Dandy plc
34. GKN plc
35. GlaxoSmithKline plc
36. Governance For Owners LLP

37. Grant Thornton UK LLP
38. Keith Hamill
39. Hammerson plc
40. Hanson Green
41. Havelock Europa plc
42. Hays plc
43. Hermes Equity Ownership Service
44. HSBC Holdings plc
45. Rodger Hughes
46. The Hundred Group of Finance Directors
47. Imperial Tobacco Group plc
48. Independent Audit Ltd
49. Institute of Chartered Accountants in England and Wales
50. Institute of Chartered Accountants of Scotland
51. Institute of Chartered Secretaries and Administrators
52. Institute of Directors
53. International Corporate Governance Network (ICGN)
54. Investment Management Association
55. ISCL (ISCA Corporate Services Ltd)
56. J Sainsbury plc
57. KPMG LLP
58. Richard Lapthorne
59. Law Society (Commerce & Industry Group)
60. Legal & General Group plc
61. Legal & General Investment Management Ltd
62. Liberty International plc
63. Local Authority Pension Fund Forum
64. Lonmin plc
65. Lloyds TSB Group plc
66. Marks & Spencer plc
67. Mazars LLP
68. George Miller
69. Dr Yuval Millo
70. MM&K Ltd
71. National Association of Pension Funds
72. National Grid plc
73. Newton Investment Management Ltd
74. Iain Paterson
75. Pensions Investment Research Consultants (PIRC) Ltd
76. PricewaterhouseCoopers LLP
77. Prudential plc
78. QinetiQ plc
79. Quoted Companies Alliance
80. Ricardo plc
81. Royal & Sun Alliance Insurance Group plc
82. SABMiller plc

83. St Modwen Properties plc
84. Savills plc
85. Scarborough Minerals plc
86. Schroders plc
87. SEGRO plc
88. Severn Trent plc
89. Standard Chartered plc
90. Standard Life plc
91. SVG Capital plc
92. 3i Group plc
93. UK Shareholders Association
94. United Business Media plc
95. Stuart Wallis
96. Peter Warry

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