The Hundred Group
of Finance Directors

Investor Relations & Markets Committee

Chris Hodge
Corporate Governance Unit
Financial Reporting Council
5th Floor, Aldwych House
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London WC2B 4HN

15 October 2009

Dear Chris

Review of the Effectiveness of the Combined Code: Progress Report and Second Consultation (July 2009)

We are pleased to submit our comments on the above consultation.

Who we are

The Hundred Group is a non political, not-for-profit organisation which represents the finance directors of the UK's largest companies, with membership drawn mainly from constituents of the FTSE100. Our aim is to contribute positively to the development of UK and International policy and practice on matters that affect our businesses, including taxation, financial reporting, corporate governance and capital market regulation. Whilst this letter expresses the views of The Hundred Group of Finance Directors as a whole, they are not necessarily those of our individual members or their respective employers.

Introduction

The Hundred Group was involved in the initial development of the Combined Code, and we believe it has stood the test of time well. Since, its introduction, the UK has largely avoided serious corporate failures and the recent extreme events have been constrained to very few organisations in one highly-complex sector.

We have read with interest many of the comment letters submitted by stakeholders during the first round of consultation and the useful summaries prepared by the FRC. It seems there is almost wholesale support for the Code principles – a stance we support.

In times of stress, it is important to consider the factors that have caused the stresses and whether an alternative regulatory model would have performed any better. In our view it is unfair of stakeholders to place the blame of the recent economic crisis at the door of Corporate Governance. Many parties have assessed the impact – perhaps most eloquently De Laroisere – and most agree that there were a number of factors working together that caused the failure of parts of the banking sector. Whilst it is admirable to attempt to develop a Governance structure that can operate in the most extreme of environments, one must guard against such a course of action for fear that the beast you create becomes unwieldy, unmanageable and ineffective for day-to-day operations.

It is with this in mind that we provide our comments on the FRC's consultation.

Characteristics of a "good" Code

The Hundred Group supports a Code for all companies. We like that it is scalable and adaptable to all situations. We agree that a review of systemically important financial institutions is required, but within the framework of existing, rather than new, regulation. Sir David Walker's findings may apply more broadly, but there is no evidence to suggest governance failure across the remainder of the business sector, nor has evidence emerged that an alternative governance model has proved more robust.

The Hundred Group supports a principles-based approach to Corporate Governance, and would discourage any stakeholder who supports the development of a set of rules. Good governance is about people, behaviours and culture and in our view excessive legislation would not deliver a "step-change" in the quality of governance.

A principles based approach encourages diverse boards composed from a broad talent pool of executive and non-executive directors, and recognises that the board is responsible for challenging business strategy, risk management and financial performance. The FRC has the opportunity to develop a Code that encourages the very best non-executive talent and should be wary of developing a monster which puts these people off.

We believe that the *"comply or explain"* approach has worked well in the past but recognise that this, in some instances, can lead to a "box-ticking" approach to governance and/or a "boiler-plate" approach to disclosure. We would support steps towards an *"apply or explain"* approach if other stakeholders recommended such a move. A simple change in emphasis may encourage better behaviours across all companies.

We support a Code that recognises that institutional shareholders play an important role in challenging the effectiveness of boards and that these powers should be exercised in practice. However there is a significant difference between encouraging such behaviour and providing shareholders with inequitable powers that disrupt the ongoing management of the company. Yes shareholders are important stakeholders, but they are not the *only* stakeholders. We welcome the development of an institutional investor "code of practice", but we see this as a parallel process to changes to the Combined Code and would discourage any pollution of the quality of the Code as a consequence of attempting to pull together the responsibilities of Boards and those of Shareholders.

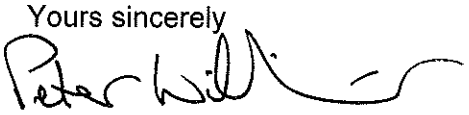
Above all, we need a Code that encourages competitiveness and enterprise within the UK. The Sarbanes-Oxley regulation in the US had a serious impact on the competitiveness of that market – indeed many foreign registrants delisted as a consequence. Such a "knee-jerk" reaction imposes excessive costs on business and, inevitably, undermines the quality and effectiveness of regulation in those areas where it is important. We reiterate our earlier comment that very few commentators believe that there are fundamental flaws with the existing Code.

In our view, the economic crisis may result in a change in behaviour in those areas where its needed. We *all* now have relevant experience of "expecting the unexpected". It is our belief that many of our members are already challenging the application of the governance framework within their organisations – reassessing their approach to strategy, risk management (identification, mitigation and reporting) and remuneration. Such a measured response would not be delivered through an ever increasing set of rules.

We set out in an Appendix to this letter our response to many of the specific issues raised by this consultation. We hope you find these comments useful as the project proceeds to its next stage.

Please feel free to contact me if you wish to discuss our comments or if there are additional areas where you feel the Hundred Group can contribute to the project.

Yours sincerely



Peter Williams
The Hundred Group – Investor Relations & Markets Committee

Appendix 1 – Responses to specific issues for further consideration

SECTION 1: THE CONTENT OF THE COMBINED CODE

The responsibilities of the chairman and the non-executive directors

Specific issues for further consideration include:

- ***Whether it would be helpful to give further clarification of the role, key responsibilities and expected behaviours of the chairman, the senior independent director and/or non-executive directors, either in the Code or in non-binding guidance.***

- ***Whether it would be helpful to provide further guidance on the time commitment expected of the chairman, senior independent director and/or non-executive directors.***

We do not support either suggestion.

The Code provides adequate guidance on the role of the chairman, the senior independent director and non-executive directors. Additionally, disclosures in annual reports provide shareholders with an understanding of how the roles work in practice for each organisation and a good board evaluation process can indentify any issues regarding non-fulfilment of role. We believe boards have a strong understanding of how to work and any perceived weakness in this area has arisen from application in practice, rather than confusion at the outset.

Providing guidance over time commitment is precisely the type of legislation that we should guard against, and we believe that the recommendations by Sir David Walker in this area are flawed. Individuals that take on such roles in organisations typically have years of relevant business experience. They know better than anyone how much time they need to dedicate to the role and that this commitment will flex depending on the complexities of the company at any one time. Referencing responsibilities to a time commitment undermines the role and their talents.

Board balance and composition

Specific issues for further consideration include:

- ***Whether the Combined Code gives sufficient emphasis to the need for relevant experience among the non-executive directors collectively.***

- ***Whether the independence criteria and the way they have been applied by boards of companies and investors have unnecessarily restricted the pool of potential non-executive directors, and in particular whether the so called "nine year rule" has resulted in a loss of continuity and valuable experience.***

- ***Whether the recommendation that the boards of FTSE 350 companies should comprise at least 50% independent non-executive directors has resulted in fewer executive directors sitting on boards and/or boards becoming larger.***

- ***Whether more guidance is needed, in the Code or elsewhere, on succession planning and the need to ensure that board composition is aligned with the present and future needs of the business.***

The Code must work to enhance the talent of the pool of non-executive and executive directors – this must be an overriding principle – rather than rules around numbers and time served (the "nine-year rule"). As we highlight in our introduction, the FRC must guard against producing a monster which discourages talented people from becoming non-executive directors.

In our view there has been a trend to reduce the number of executive directors on boards. Much of that is due to a desire to limit the number of people on boards to ensure it remains effective. The danger in this trend is that we move away from a hybrid board structure to one where the business of the day is debated and determined by a sub-committee of executive management.

We would encourage many of the existing provisions of the Code to be relegated to supporting principles (or guidance), with greater emphasis placed on the experience and independence of the board as a collective (rather than rules about individual members). This is likely to deliver better balanced boards (through an appropriate mix of independence and relevance, breadth and years of experience).

An apply or explain approach would then enable companies to outline the reasons for the decisions taken. Ultimately, if the shareholders disagree with the board's conclusion they have sufficient power to remedy.

Frequency of director re-election

Views are invited from companies and investors on whether changes to voting would increase accountability to shareholders and which, if any, of the following options would support the recommendation for possible inclusion in the Code:

- ***Annual re-election of the company chairman***
- ***Annual re-election of the chairs of the main board committees***
- ***Annual re-election of all directors***
- ***Binding or advisory votes on specific issues, or on the corporate governance statement as a whole***

We do not disagree with the principle of more frequent re-elections of board members, but are less convinced that it creates better governance.

The re-election of a board member is a shareholder's ultimate power and one that must be preserved. However, if we were to envisage that at an AGM the entire board did not get re-elected, this would smack of abject failure of Corporate Governance, rather than good Corporate Governance – in other words, "how on earth did things get so bad"!

As the FRC's views in this area develop, we would encourage them to consider the impact and influence of activist shareholders whose goal is to disrupt, rather than contribute proactively to the betterment of the company and its members as a whole.

Board information, development and support

Views are invited on whether it would be helpful to provide more guidance on [board information, development and support], either in the Combined Code or in non-binding guidance.

In our view, this area is sufficiently outlined within the existing Code, and perhaps any perceived weakness in this area is about application in practice, rather than fundamental flaw.

Better disclosure could be provided by Companies in this regard to explain the rigorous approach to information, development and support the vast amount of companies undertake.

Board evaluation

Specific issues for further consideration include:

- ***Whether the Code should be amended to recommend that board evaluation should be externally facilitated at least every two or three years for some or all companies.***

- ***Whether the recommendation that the effectiveness of all the main board committees should be evaluation every year should be related in some way, for example to recommend that after the initial evaluation there was limited value in subsequent annual reviews.***

- ***How disclosures in the annual report might be made more informative, either in relation to the process that was followed and/or the outcomes of the effectiveness review.***

We believe that current board evaluation processes are robust, rigorous and effective, but are mindful of some of the criticisms received by the FRC in this area.

Perhaps the issue is less about the underlying process, but about how can companies provide shareholders with visibility of performance evaluation and how it is linked with company financial performance, achievement of strategic goals and levels of remuneration. We all have a role here to provide more insightful disclosure.

Additionally, Boards should be encouraged to look at ways of capturing the views of major investors as part of its evaluation processes.

Risk management and internal control

Specific issues for further consideration include:

- ***Whether the board's responsibility for strategic risks and setting risk appetite – as set out in the Turnbull Guidance – should be made more explicit in the Code, and whether the current balance between the Code and the Guidance is the right one.***

- ***Whether there is a need for all or parts of the Turnbull Guidance to be reviewed.***

- ***To what extent the particular mechanisms recommended for banks and financial institutions would also be appropriate for other listed companies. For example, there were mixed views among commentators about whether separate risk committees were necessary for companies with less complex business models***

- ***How reporting on risk might be improved, for example by rationalising existing disclosure requirements or providing guidance on good communications tools.***

Much of the debate in this area (and certainly an aspect explored by Sir David Walker) is whether there is a need for a separate Risk Committee.

The Hundred Group believes that this should be a decision of choice (rather than mandated in the Code) and one that reflects the work load of the Board and Audit Committee. Practice diverges in this area for very sound governance reasons, as companies seek to ensure risk management is appropriately integrated into the strategy and processes of the business.

In some companies the workload of the Audit Committee (and particularly its Chairman) is considerable, and therefore companies should be able to create a sub-Committee to consider specific areas. However, in most instances, responsibility for areas such as risk should not be abdicated by the Audit Committee (or the Board), since such consideration is essential when undertaking its other roles (principally considering the annual report). We would envisage companies providing explanation as to why it has chosen to set up a risk committee (or otherwise).

Some of the criticism levied at disclosure is unwarranted, and certainly it is an area where corporate disclosures are improving year on year, without additional legislation. We note, that in many instances investors have little regard to or interest for Corporate Governance disclosures[1].

The Hundred Group is currently working with several UK stakeholders (including the FRC) in assessing how Corporate Reporting can be made more useful for Users. Rather than regulate at this stage, we would encourage the FRC to consider the outcomes of its own Complexity project and the work of the Hundred Group before forming any new conclusions.

We do not believe that the Turnbull Guidance needs specific review at this time, but clearly with any regulation ongoing assessment of relevance is important.

Remuneration

Specific issues for further consideration include:

- ***Whether to revise the Code to ensure consistency with the European Commission's Recommendations and, where appropriate, the FSA's proposed code of remuneration practice for financial institutions and the recommendations of the Walker Review.***

- ***Whether any other changes to the Code, or additional guidance, are required to reflect developments in best practice.***

- ***Whether shareholders should be given a more direct role in setting remuneration and, if so, how this might be achieved.***

Remuneration has become a public interest debate, played out and up through the media. We appreciate that Government and regulators face pressure to be seen to be doing something, but believe it is important that any response remains measured and protects the long term interests of UK plc.

In our view, the debate that regulators face is not about absolute pay levels, but rather how pay structures complement the risk appetite and Corporate Governance structure within organisations.

We agree that the Remuneration Committees should consider pay and bonus structures and align them with the longer-term interests of organisations (and disclose how this has been achieved). However we are less convinced that Walker's 13 steps on remuneration are either

[1] Corporate reporting: Is it what investment professionals expect, PricewaterhouseCoopers (November 2007).

proportionate or appropriate to either the financial services sector or to the wider corporate environment.

This issue also highlights an increasing problem encountered by UK companies. Over the past decade we have witnessed a substantial expansion of regulatory mandates. Key regulators (UK, European and international) have either been given mandates which are too broad or duplicate the work of others. Corporates are buckling under the strain of red tape and are struggling to identify which regulation they are required to adhere to. Our fear is that the environment within the UK becomes too uncompetitive and corporates seek to be headquartered elsewhere.

SECTION 2: THE IMPLEMENTATION OF THE COMBINED CODE

The quality of disclosure by companies

Specific issues for further consideration include:

- ***The extent to which it would be possible and desirable to rationalise the disclosure requirements set out in the Code. We would particularly welcome the views of investors on what information is of most value to them, and the views of companies on what information is most costly to produce.***

- ***Whether it would be appropriate for the FRC or the FSA to undertake greater monitoring and enforcement of "comply or explain" statements, and if so what form this might take.***

Views are invited on these issues, and on whether there are any other actions that the FRC might take to encourage more informative disclosure.

Most companies put considerable effort into the production of annual reports, and the charge that disclosures are unhelpful and boiler plate do little to move the debate on.

As we state earlier, the Hundred Group is committed to working with other stakeholders to provide Corporate Reporting which is relevant, reliable, comparable and understandable to current and potential investors to assist them in making rational economic decisions about the company. The debate over the usefulness of Corporate Reporting will continue into the future, and the FRC's review of the Combined Code should not be held up in order to tackle the issue.

We question the role the FRC can play in monitoring Corporate Governance statements. We are sure the FRC is aware that independent auditors already have a responsibility in this regard, and our members are not aware of any adverse audit report as a consequence. This highlights the difficulty auditors and regulators encounter on reviewing and reporting on behaviour and culture.

Engagement between boards and shareholders

Specific issues for further consideration include:

- ***The framework proposed by Sir David Walker, and the appropriate role for the FRC.***

- ***What role, if any, it would be appropriate for the FRC to play in encouraging collective engagement.***

- ***Whether further guidance on best practice for companies, investors or proxy voting services would be helpful, either in the Combined Code or elsewhere, and***

whether the practices currently recommended in Sections D and E of the Code continue to represent best practice.

- ***What other steps might be taken, by the FRC or others, to encourage both companies and investors to be more proactive about regular engagement and with a longer term focus than on the annual results presentations.***

We would not encourage the FRC to expand its remit in considering the responsibilities of institutional shareholders and agents.

Shareholders are providers of finance, just as debt holders are. Each should (and do) undertake their own diligence before investing in a company, and take appropriate measures to protect their interests. Whether or not they do in practice is the responsibility of the investors, the people they represent and the rules of those by which they are regulated.

That said, we recognise that some improvements could be made to encourage shareholders and agents to act more effectively and in the longer term interests of the company and the economy as a whole. We therefore agree that there is a role for the development of a "Statement of Principles", which should be led by the FSA.