



Sir Christopher Hogg
Corporate Governance Unit
Financial Reporting Council
5th Floor
Aldwych House
71 – 91 Aldwych
London WC2B 4HN

16 Park Crescent
London W1B 1AH
United Kingdom

Tel: +44 (0)20 7612 7098
Fax: +44 (0)20 7612 7034

Email: secretariat@icgn.org
Web: www.icgn.org

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Dear Sir Christopher,

Financial Reporting Council Consultation on the Combined Code

We are writing on behalf of the Shareholder Rights Committee of the International Corporate Governance Network (ICGN), which as you know is a global membership organisation of institutional and private investors, corporations and advisors. Our membership spans over 40 countries and the investor members represent capital under management in excess of US \$10 trillion. The aim of the ICGN is to contribute to raising standards of corporate governance through the exchange of ideas and information across borders and the development of best practices. Accordingly, we thank the Financial Reporting Council (FRC) for the opportunity to submit comments to its review of the impact of the Combined Code.

We would agree with the findings of your meetings, namely that the Code is working reasonably well but that there is room for improvement on the part of both investors and companies to ensure that its guidance is applied usefully and pragmatically. It is our view that this is more likely to be achieved through continued improvement in practices rather than changes to the Code itself.

Before commenting on the specific questions raised in the consultation document, we should like to draw the review group's attention to a related issue, namely, the growing number of foreign companies listing in the UK yet, as is possible under the listing rules, not complying with the Combined Code. In our view, this potentially undermines the 'gold standard' reputation of the UK market. Of course, investor due diligence plays an important role in ensuring unwise investments are not made. However, whilst not all investors are governance experts, most would know that the UK's standards are amongst the highest in the world. Our concern is that investors assume that all companies listed in the UK comply with the Combined Code. The UK's is a liquid market. Companies wishing to benefit from that liquidity ought to be willing to meet the Combined Code's recommendations more fully than explaining that they don't have to comply

because they are foreign. Failing that, it might be useful to introduce a demarcation such as foreign listed company (FLC) to identify those companies over which investors need to take a little more care in relation to assessing their standards of governance. Index tracking investors, and the index compilers, would then more easily be able to screen out such companies.

On the review questions themselves, we believe that the Code does support better board performance over time. Firstly, its clear messages are that successful companies need effective boards and that the professionalism of the directors is an essential component of effectiveness. We endorse the point that board chairmen need to balance the risk management or control aspect of the board's role with that of directing for entrepreneurial success. The guidance provided by the Code on the 'housekeeping' matters which boards must deal with should free directors to focus on strategy and performance, where they can add the most value.

It is not surprising that the feedback to the FRC suggests a degree of frustration about the 'comply or explain' mechanism. It is difficult to imagine, however, that a more prescriptive, legalistic approach would be any less frustrating. Many companies provide plausible and well argued reasons for not complying, others do not. Equally, although many investors give full consideration to such explanations, others do not have the resources or the inclination to do so. Or, if they do, they still might not find the arguments for non-compliance plausible enough.

Companies sometimes criticise investors for interpreting the mechanism as being 'comply or else'. Equally, investors express frustration that some companies seem to believe that the fact that they have provided an explanation is sufficient to secure support. We would suggest that box ticking is not only carried out by investors - companies and their advisors can also be guilty of it.

On a more positive note, 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. Of course, we should not be complacent and more effort needs to be put in by both parties to ensure that such discussions are valuable and not just a formality. For its part, the ICGN has published principles on corporate governance and on shareholder responsibilities which we hope will support productive relationships between companies and investors. We also aim to facilitate at an international level communication and understanding between investors and company directors and management. To support this we are forming a directors committee.

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. We are not aware of any compelling reasons for smaller companies being exempted from the Code or even parts of it.

The disclosures on the Combined Code in annual reports can provide useful information to shareholders at a proportionate cost to companies when done well and in the spirit of informing rather than just disclosing. Anecdotal accounts suggest that it takes no more effort to provide thoughtful, company-specific explanations than to provide bland compliance reporting. Where investors consider disclosures to be inadequate it is incumbent on them to explain that to the company concerned and suggest improvements. This is currently happening on the matter of the quality of discussion in the report of the audit committee.

We are of the view that, overall, the UK's soft law approach to governance works well. One of its strengths is the implicit commitment to continual improvement and evolution in practice as experience and conditions dictate. The current review, which allows practitioners to air their concerns and frustrations, is an important part of such an approach. We hope that the published findings of the review, and our contribution to it, contribute to further refinements in practice.

If you would like to discuss any of these points, please do contact our Executive Director, Anne Simpson, on (020) 7612 6098 or by email at execdirector@icgn.org.

Yours sincerely,

Alastair Ross Goobey



Chairman, Hermes Focus Asset Management

Michelle Edkins



Managing Director, Governance for Owners