



**FINANCIAL REPORTING COUNCIL**

**REVISIONS TO THE COMBINED CODE**

**SUMMARY OF RESPONSES TO CONSULTATION**

**MAY 2008**

## REVISIONS TO THE COMBINED CODE

### SUMMARY OF RESPONSES TO CONSULTATION

#### Introduction

1. Following the 2007 review of the Combined Code the FRC consulted on two possible changes to the Code:
  - removing the restriction in provision A.4.3 on an individual chairing more than one FTSE 100 company; and
  - for listed companies outside the FTSE 350, amending provision C.3.1 to allow the company chairman to be a member of, but not chair, the audit committee provided he or she was considered independent on appointment.
2. In the consultation document the FRC also proposed that the preamble to the Code should be updated to reflect some of the main issues arising from the review, and that Schedule C to the Code (which sets out what information companies are required to disclose about their corporate governance practices) should be expanded to include relevant details from the FSA's new Corporate Governance Rules.
3. Consultation began in December and concluded in March 2008. 36 responses were received, including 14 from companies and bodies representing corporate interests, nine from investors and their representative bodies and ten from the accountancy profession. A full list of respondents is at [Appendix A](#).

## Proposed changes to the Combined Code

### Chairing more than one FTSE 100 company

4. In the consultation document the FRC proposed removing the restriction on an individual chairing more than one FTSE 100 company. If this were agreed, the revised provision A.4.3 would read:

*For the appointment of a chairman, the nomination committee should prepare a job specification, including an assessment of the time commitment expected, recognising the need for availability in the event of crises. A chairman's other significant commitments should be disclosed to the board before appointment and included in the annual report. Changes to such commitments should be reported to the board as they arise, and included in the next annual report. ~~No individual should be appointed to a second chairmanship of a FTSE 100 company.~~*

5. Only two respondents opposed the proposal on the grounds that chairing the board of a leading UK company required a significant commitment, that there was a risk that the chairman could not devote sufficient time to both jobs – particularly if one or both companies were in a crisis situation – and there was no evidence that the current recommendation has created a disruption in the supply of Chairmen. Independent Audit commented that:

“There are certain risks connected with a chairman chairing more than one FTSE 100 company. Apart from the obvious one of whether in fact the chairman is unable to devote enough time on a continuing basis, there is the question of what happens in the event that a “crisis” situation develops in both companies at the same time. In these circumstances, it is unlikely that it would be possible for the chairman give sufficient attention to both companies. In either or both, there is a significant risk that shareholders’ interests are not looked after to the fullest extent possible.”

6. All other respondents that commented supported the proposal, and in most cases were happy to delete the relevant sentence without replacing it other text. The arguments in favour of doing so were summed up by the IMA, which said:

“IMA supports a relaxation of Code provision A.4.3 in that we considered it was too prescriptive and restricted the supply of skilled people willing and able to serve as Chairman of large listed companies. It also ignored the impact of the chairman’s commitments outside the FTSE 100, which could be significant, and that fact that a certain individual may well be able to take on a number of sizeable commitments. In this respect, provision A.4.3 already requires a Chairman to disclose his other commitments before appointment and any changes thereto to the board and in the annual report. Investors consider that this transparency is vital

to ensuring that chairmen have sufficient time available to devote to their role.”

7. A number of respondents commented that the FRC should keep the impact of a change under review to ensure it did not lead to a proliferation of dual chairmanships, and/or that there was merit in having a deputy chairman in such cases, but did not feel this needed to be reflected in changes to the Code. There were two exceptions:
  - the NAPF recommended that the penultimate sentence in the provision should be amended to read “Changes to such commitments should be reported to the board as they arise, considered as part of the annual board evaluation process and included in the next annual report”
  - KPMG suggested that Supporting Principle A.4 should be strengthened to recognise that the time commitment required of the non-executives, particularly the chairman of the board, might increase significantly in times of crisis.

#### Audit committees of smaller listed companies

8. In the consultation document the FRC proposed loosening the requirements on audit committees for smaller listed companies (i.e. those outside the FTSE 350) to allow the company chairman to be a member of, but not chair, the committee where he or she was considered independent on appointment. The proposed revised provision C.3.1 would read:

*The board should establish an audit committee of at least three, or in the case of smaller companies two, ~~members, who should all be independent non-executive directors.~~ In smaller companies the company chairman may be a member of, but not chair, the committee in addition to the independent non-executive directors, provided he or she was considered independent on appointment as chairman. The board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience*

9. Views on this proposal were divided. 18 respondents supported the proposal, arguing that the change would benefit smaller companies without putting the effectiveness of the audit committee at risk.

“We believe that that this change will make it easier for some companies to comply with the Code. There may be some other benefits to smaller companies, such as better performance of their audit committees, without increased costs.” [Hermes]

“We support the relaxation for smaller companies to have the chairman as a member of the audit committee. This should help smaller companies

avoid the need to recruit additional non-executives purely to meet the Code requirements as opposed to the achievement of any real business benefit.” [Deloitte]

“Amending the code to allow the chair of companies outside the FTSE350, to become a member of the Audit Committee is practical. It is also a useful change since, when chairs currently do attend audit committee meetings, their involvement tends to raise the stakes and makes managers pay more attention to their responses and actions. This increases the profile of the committee and makes it even more effective.” [IIA]

10. Three respondents argued that the proposed change should go further: the AIC suggested in addition removing the recommendation that there should be a minimum number of committee members; 3i felt that the change should be extended to FTSE350 companies as well; while the IOD felt that all chairmen of smaller listed companies should be able to sit on the audit committee, not just those deemed independent because “the justification for the change is to assist smaller companies in achieving good quality committees [but] by restricting the amendment to chairmen deemed independent on appointment a lot of good quality committee members could be either precluded from serving or the subject of explanations, with all the issues about how effectively these are considered in relation to smaller companies.”
11. Three respondents said they would support amended versions of the proposal. All three suggested as an additional proviso that the chairman’s independence should not have been compromised since their appointment. In addition the NAPF suggested that the company should also demonstrate that the Chairman had “recent and relevant financial experience”, while PWC suggested that at least one of the other NEDs should have such experience to reduce the risk of the chairman dominating the other members of the committee.
12. Four respondents raised potential concerns but did not explicitly state whether they supported or opposed the proposal. The Audit Committee Institute conducted a survey of its members but views were divided: 28% felt it was appropriate for the company chairman of any listed company to be a member of the audit committee; 20% felt it was appropriate only for smaller listed companies; and 53% felt it was not appropriate.
13. The remaining nine respondents opposed the proposal completely, either because they were opposed in principle to applying different standards to companies on the grounds of size and/or because they believed that having the company chairman as a member of the audit committee would compromise its independence.

“As a matter of principle the ABI is opposed to carve-outs in the Code relating to a company’s size. The ABI does not believe that the principles of good governance are directly or solely related to a company’s size, while carve-outs always create a problem of thresholds. Our members support the principle that a company’s audit committee should consist solely of independent directors. The Code already provides for smaller companies to have a two-person independent audit committee, which the chairman is able to attend as an observer. Given this, and the fact that under the “comply or explain” regime it is possible for a company to derogate from the Code’s provisions providing an explanation is given, the ABI does not consider there is presently a prima facie need to introduce further flexibility.” [ABI]

“It is difficult to argue for special provisions to be applied to smaller companies simply because they are smaller companies... An extension of this concern is that inevitably, if the provision is relaxed, there may be times where non-independent chairman of smaller companies serve on the audit committee, either because the Company disagrees with shareholders’ assessment of independence of an individual, or where a non-independent Chairman is considered necessary for a short period or in the interim”. [Railpen Investments]

“Public companies should not be the personal fiefdoms of overly dominant individuals. Checks and balances are required and effective audit committees must be independent, objective and headed by strong audit committee chairmen who, when necessary, can stand firm against an overly dominant CEO or Chairman.”[KPMG]

### **Revised Preamble**

14. The Preamble to the Code, which has no formal status, provides an opportunity to reinforce important messages about the way in which the Code should be viewed and implemented. In the consultation document the FRC said that it intended to update the Preamble to reflect some of the main points to come out of its recent review; for example to reinforce “comply or explain”, to emphasise that good governance should support wealth creation and entrepreneurship as well as protect shareholder value, and to encourage companies to make relevant and company-specific disclosures. This proposal received strong support from respondents.

### **Overlap with the FSA Corporate Governance Rules**

15. The revised Combined Code should come into effect at the same time as the new FSA Rules needed to implement the corporate governance requirements in the 4<sup>th</sup> and 8<sup>th</sup> Company Law Directives. In the consultation document the FRC said that it would:

- add footnotes to those provisions of the Code that overlap with the Rules, drawing this to companies’ attention; and
- update Schedule C so that it lists all corporate governance disclosure requirements (i.e. those required by the Rules as well as those that companies are required to make in order to comply with specific provisions of the Code).

16. This proposal received strong support from respondents.

Financial Reporting Council  
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## APPENDIX A

### RESPONDENTS TO THE CONSULTATION

*Note: this list excludes those respondents that asked for their responses to be treated as confidential*

1. Association of British Insurers (ABI)
2. Association of Chartered Certified Accountants (ACCA)
3. Association of Investment Companies (AIC)
4. Audit Committee Institute
5. Barclays plc
6. British American Tobacco plc
7. BT Group plc
8. CBI
9. CFA Institute Centre for Financial Market Integrity
10. Chartered Institute of Management Accountants (CIMA)
11. Deloitte & Touche LLP
12. Ernst & Young LLP
13. GC100 Group
14. Grant Thornton LLP
15. Healthcare Financial Management Association
16. Hermes Equity Ownership Services Ltd
17. The Hundred Group of Finance Directors
18. Independent Audit Ltd
19. Institute of Chartered Accountants in England and Wales (ICAEW)
20. Institute of Chartered Accountants of Scotland (ICAS)
21. Institute of Chartered Secretaries and Administrators (ICSA)
22. Institute of Directors
23. Institute of Internal Auditors
24. Investment Management Association (IMA)
25. KPMG LLP
26. London Stock Exchange
27. Mazars LLP
28. National Association of Pension Funds (NAPF)
29. National Grid plc
30. PriceWaterhouseCoopers LLP
31. Prudential plc
32. Railpen Investments
33. Quoted Companies Alliance
34. Standard Life plc
35. 3i Group plc





**FINANCIAL REPORTING COUNCIL**

**5TH FLOOR**

**ALDWYCH HOUSE**

**71-91 ALDWYCH**

**LONDON WC2B 4HN**

**TEL: +44 (0)20 7492 2300**

**FAX: +44 (0)20 7492 2301**

**WEBSITE: [www.frc.org.uk](http://www.frc.org.uk)**