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Mr C Hodge
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Dear Mr Hodge

REVIEW OF THE EFFECTIVENESS OF THE COMBINED CODE: CALL FOR EVIDENCE

I write on behalf of Standard Life plc, as a major UK listed company, and its subsidiary Standard Life Investments Limited, as a major institutional investor. Both companies are strong supporters of the Combined Code and its principles-based approach to corporate governance and believe that its effective and pragmatic implementation strengthens board performance and helps engender mutual respect and accountability between companies and investors.

We recognise that in the light of the recent financial crisis it is an appropriate time for the FRC to review the Code's effectiveness, and we welcome your call for evidence. We are keen to ensure that the Code's effectiveness is enhanced, that it can be implemented cost effectively, that meaningful disclosures are made, and that there is effective engagement and dialogue between listed companies and institutional investors.

We also recognise that at this stage, the FRC is making a high-level call for evidence and has not issued a consultation paper for review and detailed comment with a view to amending the Code as a result. Therefore, we have identified the following general points regarding the implementation of the Code and in response to the specific questions that you invited respondents to address.

Basis of Code

- We support the Principles and Provisions basis of the Code and would not be supportive of a move towards a greater rule-based approach.
- We believe that the Code requirements should enable and not inhibit entrepreneurial leadership and managed risk taking.
- We would not be supportive of increased disclosure for disclosure's sake.

FRC's role

- 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.
- We should welcome a discussion on the FRC's possible role to challenge unreasonable compliance disclosures or the prevalence of standardised boiler-plate disclosures.
- It would be useful if the FRC would develop a means of being able to react more swiftly between formal revisions of the Code to allow it to address interim behavioural and Code implementation issues in a timely and authoritative manner.

Implementation Matters

- We believe that it is appropriate to re-examine the amount of work undertaken by board committees, particularly the Audit Committee, to consider whether there is an unrealistic burden of work and expectation.
- The FRC should re-examine the cost of compliance with the Code and recognise that additional and expanded provisions may increase this cost.
- The Code may benefit from providing greater definition in its supporting principles to the roles of the Chairman and the Senior Independent Director, which have arguably developed since the Code was first published.

Institutional Investors

- Institutional investors should be assertive in holding boards to account and in satisfying themselves regarding the quality of the disclosures and explanations provided.
- Individual institutional investors should evaluate regularly the resource they invest in corporate governance engagement, with a view to ensuring that their relationships with investee companies are credible and effective.
- Institutional investors should ensure that the quality of staff involved in corporate engagement is of a high enough calibre to result in an effective two-way relationship.
- Institutional investors may benefit from focussing more engagement resource on understanding audit and risk matters at investee companies.

Specific questions

Which parts of the Code have worked well? Do any of them need further reinforcement?

The Code's approach works well; the Principles and Provisions provide effective benchmarks. We prefer this approach to the rigidity of a more detailed, formal rule book. The principles and provisions regarding board balance and composition have generally strengthened boards and introduced a wider range of candidates as board members. The board evaluation process has allowed boards to examine their role and supporting processes and identify improvement action plans as a consequence. The "comply or explain" approach has allowed boards the flexibility of explaining why they have chosen to follow a particular course of action, as long as the non-conformity is supported by a credible explanation. Boards' relationships with institutional investors are generally more effective and more structured.

Have any parts of the Code inadvertently reduced the effectiveness of the board?

The **emphasis on compliance at the expense of strategic initiative**: we have reservations about the level of emphasis that is sometimes attached to compliance with the Code and believe this could be at the expense of focusing on corporate strategy and entrepreneurial leadership. Arguably, some boards may be able to demonstrate full compliance with the Code whilst avoiding key strategic decisions or challenges.

Independence and length of service guidance for independent non-executive directors: we question whether automatic adherence by many companies to the Higgs recommendations on independence and length of service are fully appropriate, or whether recent board performance issues have shown that non-executive directors require more intensive experience and knowledge of the business in order to fulfil their role effectively. Furthermore, the complexity of a large multinational listed company may require several years of service from a non-executive director before they can be fully effective. This is particularly the case for a chairman of any listed company. Also, perceived independence of directors can be seen as more important than experience, whereas 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.

Are there any aspects of good governance practice not currently addressed by the Code or its related guidance that should be?

The following aspects of good governance practice are not currently addressed by the Code and we believe they are worthy of consideration:

- Provisions that will enable directors, officers and auditors who resign 'unhappily' to explain the basis of their decision to shareholders and investors that provides, on the one hand, timely transparency and, on the other hand, a form of 'safe harbour' that protects them from litigation (and the threat thereof) and other forms of retribution. Too often the circumstances of such resignations are (1) hidden by the cloak of confidentiality and (2) a behavioural tendency to wish to depart quietly and peacefully.
- Improved transparency pertaining to the independent advisers to the remuneration committee. Shareholders have a legitimate wish to understand the true nature of the advisers' relationship in order that they can assess their independent standing. Therefore, we should like to see a brief commentary describing the relationship and disclosure of the fees paid in respect of services provided to (1) the remuneration committee and (2) the company and its subsidiaries.
- Guidance for disclosure on audit and risk matters. The absence of such guidance has resulted in very varied standards of disclosure being applied by audit committees and suchlike. The lack of transparency and authoritative guidance has contributed to the environment which has diminished the overall confidence that is placed on relevant information contained in annual reports

and audited financial statements. We should like to see such guidance provided in the Code or appended thereto.

Is the 'comply or explain' mechanism operating effectively and, if not, how might its operation be improved? Views are invited on the usefulness of company disclosures and the quantity and quality of engagement by investors.

We strongly support the 'comply or explain' principle as opposed to a more rigid regulatory compliance structure but, in practice, it may not always work in the most beneficial manner for companies. Too often, 'explain' may be viewed as 'negative' and 'comply' as 'positive'. As a result companies may be inclined to amend their procedures to secure full compliance regardless of whether it is appropriate and adding added shareholder value. The Code should state that where a company explains its policies and practices in support of compliance or non-compliance this is a positive and effective means of communicating to stakeholders.

Transparency suggests that there should be comprehensive governance disclosures. However, there is a risk that 'standardised disclosure' does not add value to current or potential shareholders, and companies may be apprehensive of moving away from the 'standardised disclosure' approach in the light of possible commentator reaction. 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.

In terms of the quantity and quality of investor engagement, to add full value to both the investor and the investee company, it is important that this engagement is balanced, and properly focussed and researched.

Content of the Code: The composition and effectiveness of the board as a whole

We support the principle that the board should include a balance of executive and non-executive directors, which is led by a chairman who can harness the input of all directors. The effectiveness of the board is enhanced by there being a majority of non-executive directors, but they must have the strength of character and relevant experience to challenge strategic proposals and executive recommendations effectively.

Content of the Code: The respective roles of the chairman, the executive leadership of the company and the non-executive directors

We agree with the contents of the Code regarding the roles of the chairman, the executive leadership of the company and the non-executive directors. We have concerns, however, that some stakeholders may expect a non-executive director's role to be closer to that of an executive director's and, at times, there appear to be unrealistic expectations of non-executives' role and capabilities. We recognise the collective and individual responsibility of all directors, but suggest that the Code might be strengthened by providing that companies should disclose how the members of the board operate to fulfil these various responsibilities.

Content of the Code: The board's role in relation to risk management

There is already significant risk management content in the Code and in the Turnbull and Smith Reports. It may be that certain elements of the risk management framework should be considered in more detail, such as the board's appetite for risk, and how that appetite is measured. There may also be scope for further practical guidance on the speed and manner in which material risk and internal control issues and breakdowns are escalated to the company's governance bodies.

Content of the Code: The quality of support and information available to the board and its committees

Corporate governance and the effective leadership of a public listed company are based on the premise that the executive team has both day-to-day delegated operational management responsibilities to run the company and responsibilities to develop strategic proposals to put forward for the board's consideration. The role of the non-executives is often 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. Such a leadership model works well if there is a suitable flow of timely and appropriate information to the non-executives, with the executives respecting and valuing the input from the non-executives. This element rests on human qualities and behaviour, and appointing the right people, so we question whether further guidance would be beneficial.

However it may be that the relevant provisions in the Code could be strengthened - directly or indirectly - to remind non-executive directors that knowledge of the company and obtaining information is a two-way process and that they should be proactive in:

- ensuring that they are provided with suitable induction training and site visits in order to understand the business fully;
- actively participating, and periodically going out and about around the company to understand its activities in order to be in a better position to assess what information is appropriate;
- asking for occasional reports or presentations from senior managers who are not members of the board; and
- obtaining independent advice (at the company's expense) when such advice may improve their ability to make informed decisions and judgements.

Effective board members do not simply expect that all relevant information will come to them without any further enquiry. Where things go wrong or greater risks are being taken, balanced information may be less easy to come by.

Content of the Code: The content and effectiveness of Section 2 of the Code, which is addressed to institutional shareholders and encourages them to enter into a dialogue with companies based on a mutual understanding of objectives and make considered use of their votes.

We have some concerns that there is not always an informed and considered reaction from institutional investors to companies that choose to explain rather than comply with aspects of the Code. 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. Some institutional investors place significant reliance on the views of voting and engagement agencies. The implications of such reliance should be carefully considered when they are reviewing the Code's effectiveness.

Application of the Code: Comply or explain – have the concerns expressed in responses to the 2007 review increased or decreased in the intervening period and, if they remain, are there steps that could be taken by the FRC or others to address this?

Although the intervening period has seen severe economic fluctuation, it has been relatively short in terms of annual reporting in which changing behaviours patterns by either companies or stakeholders could be observed or conclusions drawn.

Please do not hesitate to contact me should you wish to discuss any of the above points further. We look forward to continuing to contribute to the FRC's work on the Code and its effective implementation.

Yours sincerely

Gerry Grimstone