

Review of the Impact of the Combined Code

A Discussion Paper from the Financial Reporting Council

A response by

The National Association of Pension Funds

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This response is from the National Association of Pension Funds (NAPF). The NAPF is the leading voice of workplace pension provision in the UK. Some 10 million working people are currently in NAPF Member schemes, while around 5 million pensioners are receiving valuable retirement income from such schemes. NAPF members hold assets of some £750bn, and account for one sixth of investment in the UK stock market.

The NAPF welcomes the opportunity to comment on the FRC discussion paper.

Pre-amble

In addition to the responses below the NAPF supports the suggestion put forward by David Morgan, of Coal, that the voting process still leaves much to be desired. It is too complex, participants are all too seldom held to account for failing to register votes and companies do not provide reports on proxies cast in a consistent format.

Recent years have seen many foreign companies list their shares in London. While this development has generally been in the interests of both investors and the London market, there remains confusion around the standards of corporate governance expected of these companies and it would be helpful if the FRC through the Combined Code would clarify the situation. Our view is that where a company has its primary or only listing on the London Stock Exchange it should be subject to the full rigours of the Code. For companies who choose a secondary listing in London, there are minimum standards which should apply, even where these go beyond the requirements of the company's primary listing. An AIM - listed company should provide the disclosures required of it by the AIM rules, regardless of whether the listing is primary or secondary.

We recognise that this issue concerns the FSA as well as the FRC but, as has been discussed on several occasions, it is an important one for investors and should be addressed.

Questions

1. Does the Code support better board performance over time?

The NAPF agrees with the proposition that the Code supports better board performance over time. However, investors can only assess boards by measuring the performance of the company in delivering growth in earnings and dividends and a

satisfactory return on capital employed. This needs to be done over at least a complete business cycle if it is to be meaningful. Shareholders have found the introduction of board evaluations to be helpful, particularly when a board has chosen to set out its conclusions in some detail.

2. Is the “comply or explain” approach working effectively?

“Comply or explain” normally works well. However, there can be a presumption by companies that investors should accept an “explanation” and investors are known to be reluctant to accept any explanation when there is a breach of a key principle of their guidelines. The pressure points are often around remuneration and director independence and in these instances boards need to consider how best to deal with the legitimate concerns of shareholders. There is little doubt that among smaller companies these issues are more difficult to deal with due to limited resources at company and investor level. Companies have increased significantly the amount of engagement with shareholders on directors’ remuneration. However, base pay continues to escalate at a rate well above UK inflation and the link to company strategy and performance remains weaker than many investors would like. 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.

3. What impact has the Code had on smaller companies?

We believe that smaller companies have welcomed the Code, to the extent that it provides a clear statement of best practice. The NAPF has taken the view that for companies which are not listed on the LSE, the Code’s provisions should be applied pragmatically and it published new guidelines to support this earlier this year. For smaller companies on the LSE, the NAPF Guidelines covering the Code provision on audit committee independence were relaxed in 2006, to permit the Chairman, if independent on appointment, to serve on the committee where the composition of the board warranted it.

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

The disclosures are helpful and in most cases essential if shareholders are to be fully informed as to how the directors have carried out their responsibilities. However, 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.