



**Local Authority
Pension Fund
Forum**

***Response to the consultation on the
Revised UK Corporate Governance Code***

March 2010

David Sellors
Chief Operating Officer
LAPF Forum
Email: David.Sellors@lapfforum.org

Report Origination: PIRC Limited
Report Author: Tom Powdrill

Background

The Local Authority Pension Fund Forum (LAPFF) was set up in 1991 and is a voluntary association of 51 local authority pension funds based in the UK. It exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders to promote corporate social responsibility and high standards of corporate governance amongst the companies in which they invest. The Forum's members currently have combined assets of over £80 billion.

The Forum has taken the opportunity below to provide our view on those issues which we consider relevant to our activities.

Name and structure of the Code

The Forum is supportive of the change in the title to the UK Corporate Governance Code as we believe that this is a much more straightforward description of the content. We are comfortable with the proposed changes to the structure of the Code, including the removal of the section dealing with shareholders which we address later.

Section A - Leadership

Division of responsibilities

In light of recent experience at Marks & Spencer, we believe that the main principles of Section A could clearly state the need to keep the roles of chair and chief executive separate. This is already clearly implied in the main principles section by the phrase "No one individual should have unfettered powers of decision". Therefore we see no reason why the need to split the roles could not be made explicit in the main principle, rather than in the subsequent A.2.1 provision. The provision could then provide guidance on how the split in roles is communicated, whilst the main principle would clearly set out what is best practice.

A.3.1 Chief executive going on to become chair

Once again, we believe that recent experience amply demonstrates the inherent dangers in allowing a former chief executive to go on to become chair of the same company. Often comments made by chairs who have previously been chief executives reveal a great deal about how they view their new role, and it is apparent that many have difficulty making the transition to the role of chairman and giving up the more immediate strategic decisions that are in the ambit of a chief executive.

We further consider the language in this section could be strengthened. At present half of the provision describes how a deviation from the principle should be handled by companies, which may serve to make such a decision seem more of a legitimate option to boards. A greater focus on why the provision exists, together with a statement that deviations from this provision should only be in absolutely exceptional circumstances, would be welcome.

Succession planning

As we have seen in a number of recent cases, poorly-handled succession-planning can become a major problem for shareowners. This is particularly the case where, as at M&S, the outgoing chief executive is determined to play a significant role in choosing his own successor to the exclusion of others. Therefore it would be useful if the Code were refined to more directly address the issue of succession planning.

Section B: Effectiveness

B.3 Commitment

LAPFF believes that a focus is required on the time that directors have available to perform their role, and this must logically raise a question about individuals with multiple directorships. We note that the Walker Review set out a minimum expected time commitment of 30 to 36 days in a major bank board. Although the Code already suggests that a full-time executive should take on no more than one FTSE100 non-executive position, the Forum believes that the FRC could consider more specific commentary on the time commitment required.

B.6 Evaluations

LAPFF supports the Walker Review's recommendation that the board should undertake a formal and rigorous evaluation of its performance with external facilitation of the process every second or third year, and that a statement on this evaluation should be a separate section of the annual report. It also supports the recommendation that the evaluation statement should include such meaningful, high-level information as the board considers necessary to assist shareholders' understanding of the main features of the evaluation process.

Relevant disclosure in this regard is likely to be found in:

- the behaviours that the board evaluation is designed to measure and encourage,
- the board's learning from the evaluation,
- the action points arising from the evaluation process, and
- performance against prior action points.

Outside agencies can appraise the board's composition, including its mix of skills and experience. Yet the Review consistently (and correctly in our opinion) observes that board composition is a poor predictor of board performance. Our view is: only when shareholders get better disclosure on past board performance will they be in a position to predict future board performance.

Currently the critical dynamics created by a board's composition and the nature of the board's functioning as a high performance team is not evident from disclosure. We believe this puts an onus on the board to evidence how it functions as a team, particularly in regard to the quality of any challenge process to decisions on major risk and strategic issues. The most likely place for such disclosure is in the board's annual evaluation statement.

B.7 Re-election

The financial crisis has clearly demonstrated that core governance concerns can emerge rapidly. Whilst investors will generally want to be supportive of management, on occasion this will result in the desire to oppose the re-election of a given director. At present it is not always possible to do this, because the typical term of appointment is three years, although we note that a number of FTSE100 companies already have annual elections.

The Forum therefore believes that it is time to consider annual elections for all directors. In practice we do not think this will pose practical problems for companies, and they will not face a challenge unless there are genuine shareholder concerns. But it seems reasonable that the voting right should be there, as it is to vote on remuneration policy every year.

Of the two options proposed, we therefore favour annual election for the board as a whole as opposed to annual elections for the chair alone.

Section C: Accountability

C.3. Audit Committee and Auditors

As stated in our previous submission, the Forum believes that the FRC could consider the possibility of requiring companies to prepare a risk report as part of their audit committee report to shareholders, and that the audit committee report should be subject to an annual shareholder vote. In addition to encouraging reporting by non-financial companies, it would also encourage investors and their advisers to properly consider the risk disclosures made by companies before approving them.

Section D: Remuneration

LAPFF believes there needs to be more emphasis on the need to be sensitive to pay and employment conditions elsewhere in the group. The Forum would favour this being made into a new main principle, with a supporting principle providing guidance on how companies might meet it.

LAPFF also believes that there is room for improvement in the area of executive pension arrangements. Historically preferential treatment such as better accrual rates in DB schemes, or contribution rates in DC schemes has been offered to directors but not to other employees. More recently companies have begun to offer directors significant payments in lieu of pension. Yet too often this detail is not included in remuneration reports, and there is almost never an explanation for such generous and/or preferential treatment provided. We continue to advocate that the Code be strengthened to push for such disclosure. In addition it should encourage companies to provide a rationale for any preferential treatment. The Forum is currently working with the NAPF to develop some guidance for companies on best practice in disclosure in respect of pensions.

We welcome the reference to the long-term success of the company, but believe that this could be taken further. LAPFF believes that non-financial performance measures should form a significant part of the performance assessment process, and that poor management of non-financial areas such as risk management, can be detrimental to performance. We believe companies should take account of non-financial measures in their long-term incentives as well as for bonuses, because poor management of non-financial areas can also be detrimental to sustained long-term performance. Therefore we believe that the Code should make reference to the use of non-financial factors in remuneration policy as a way of tying rewards to long-term success.

Section E: Communication

We are comfortable with the removal of the section of the Code relating to shareholders on the understanding that these issues will be dealt with under the proposed Stewardship Code. As stated in our previous submission we fully support the creation of the Stewardship Code, and believe it is important that responsibility for it sits with the FRC.