



# The City of London Law Society

4 College Hill  
London EC4R 2RB  
Tel: 020 7329 2173  
Fax: 020 7329 2190  
[www.citysolicitors.org.uk](http://www.citysolicitors.org.uk)

## **CLLS response to the ICSA Review consultation on the Higgs Guidance**

---

The City of London Law Society ("CLLS") represents approximately 13,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response in respect of ICSA Review consultation on the Higgs Guidance has been prepared by a working party of the CLLS Company Law Committee. The Committee's purpose is to represent the interests of those members of the CLLS involved in company law and related regulation.

The second of ICSA's two consultations dated July 2010 asks for views on the draft guidance, "Improving board effectiveness", and for comments on three particular questions, as well as a fourth question on the guidance notes on the ICSA website. We respond below:

### **1. VIEWS ON THE DRAFT GUIDANCE**

- 1.1 We welcome the stated aim of the guidance, namely to assist boards when they consider how to apply the relevant principles of the UK Corporate Governance Code. If the Code can be characterised as telling boards what they need to achieve, this guidance should be telling them how to achieve it.
- 1.2 Given the generality of many of the main principles of the Code, and even of the supporting principles and code provisions, there is scope for practical guidance as to the means by which those principles and provisions can be put into effect. Sections 6 and 9 of the draft guidance contain useful material to that end.
- 1.3 We are, however, concerned that the draft guidance does not take full advantage of this opportunity. There is considerable repetition of the principles and provisions of the Code itself (see, for example, paragraphs 3.1, 4 and 7.2) with little new material added. Where there is new material, it often seems to be background information explaining why a principle or provision has been included in the Code. In summary, there is much "what" and "why" in the guidance, but there could be more "how".

## **2. ARE THERE ANY AREAS THAT HAVE NOT BEEN COVERED?**

- 2.1 Developing this point further, we think it would be useful, particularly for smaller listed companies, if the guidance gave examples of how the Code's principles and provisions might be applied. Examples of good practice might be gleaned from sources such as published annual reports, the Walker Review and the FRC's own reports.
- 2.2 To give just one example, the Walker Review (paragraph 3.16) noted that, as part of the induction process for a new non-executive director, some boards provide for the NED to be mentored by a senior member of the executive team. In similar vein, the 2010 Marks & Spencer annual report discloses that a newly appointed executive director spent time with a non-executive director as part of his induction process to prepare him for his wider responsibilities as a main board director.
- 2.3 These examples should not in any way be prescriptive. There will be other ways of satisfying the Code's principles and there should be no suggestion that the examples provided are any better than other methods which a company may choose to follow. Each company must find those means of applying the Code's principles which suit it best. We nonetheless think that it would be extremely useful for ICSA to collate such examples and to include them in the guidance, and to update them periodically.
- 2.4 The guidance given in paragraph 9.4 of the draft on the decision-making process is an example of the practical advice which we think is needed and of which we think more could perhaps be provided.
- 2.5 No reference is made in the draft guidance to the importance of the concept of the unitary board and the collective responsibility of all directors. Paragraph 3.1 of the draft, which in part follows the wording in the opening paragraph of the Higgs Guidance on the role of the non-executive director, should also repeat and explain the Higgs reference to the unitary board.
- 2.6 Section 7 on the role of non-executive directors refers to their role in developing proposals on strategy. Reference might also be made to their work in scrutinising management performance, on risk and in setting remuneration and appointments to the board.
- 2.7 Section 13 of the guidance refers to evaluations of the performance of the board and directors. We repeat the point made in paragraph 3.3 of our response to the first consultation that it would be helpful to have guidance on appropriate standards for the evaluation process and the management of potential conflicts of interest (as anticipated in paragraph 3.42 of the FRC's Final Report of December 2009). It would be useful for this to be included in the revised guidance when it is adopted and issued by the FRC.

## **3. ARE THERE ANY AREAS COVERED WHICH ARE CONSIDERED SUPERFLUOUS OR IRRELEVANT, AND COULD THEREFORE BE OMITTED?**

- 3.1 We have made the point above about the repetition in the guidance of material from the Code. We appreciate that in places this may have been done to put other material in context and to avoid the reader having to make constant references back to the Code, but we see a danger in the guidance

being seen as a document to be read on its own. Rather, it should be a supplement to the Code and not attempt to replace it by paraphrasing its terms. Readers should be encouraged to go back and look at what the main principles of the Code actually say and to see the Code provisions and this guidance as examples of how those principles might be applied.

- 3.2 We do not think that paragraph 10.8 of the draft guidance ("Once on the board, a director will wish to be sure that he or she is complying with the duty to exercise reasonable care, skill and diligence owed to the company") adds anything of use and could be omitted. It effectively repeats s.174(1) of the Companies Act 2006 without providing any further commentary. In addition, we think there is little reason to reproduce ss.170 to 177 of the Act in Appendix B. Directors can obtain advice on these duties from other sources.

#### **4. ARE THERE POINTS OF DRAFTING DETAIL?**

- 4.1 There are many references throughout the draft guidance to boards "ensuring" a particular outcome. For example, paragraph 2.5 says: "Boards should maintain robust governance arrangements to ensure they always act in a way that will generate sustainable value for the company." While sustainable value is a goal, its achievement cannot be certain. Boards should be encouraged to put in place and apply procedures and other means towards a particular end, but the language of this guidance should not suggest they can guarantee its achievement.
- 4.2 Paragraph 2.5 might therefore read: "Boards should maintain robust governance arrangements to assist them to act in a way that will generate sustainable value for the company." Other uses of "ensure", "ensuring" and "make certain" throughout the draft guidance might be similarly amended.
- 4.3 Paragraph 4.1 of the draft guidance says, in commenting on main principle A.3, concerning the role of the chairman: "This requires living and upholding the highest standards of integrity and probity inside and outside the boardroom...." We are concerned that this wording risks seeming to regulate purely private conduct which has no bearing on the company concerned. We assume that is not the intention and suggest it is made clear that this point only relates to matters of relevance to the company, for example by substituting for the words quoted above: "This requires living and upholding the highest standards of integrity and probity in carrying out the role of the chair...."
- 4.4 Paragraph 5.3 of the draft guidance says that the Code requires the role of the senior independent director to be set out in writing. Is that correct? Although it may be desirable, we have not been able to find any provision in the Code which states that requirement. If there is such a requirement, would ICSA consider expanding the guidance in section 5 into text which could be included in the senior independent director's letter of appointment?
- 4.5 Paragraph 6.4 of the draft guidance says that executive directors should view themselves as representatives of the owners of the business, rather than as having solely executive responsibilities. We do not think it correct to characterise directors as "representatives" of shareholders. Directors, including executive directors, are responsible for managing the company in accordance with their duty under s.172, Companies Act 2006, to promote the success of the company "for the benefit of its members as a whole" and the

six factors in that section to which directors must have regard (amongst other matters).

- 4.6 The first sentence of paragraph 6.4 might therefore read: "For their part, executive directors should view themselves as having responsibilities as members of a unitary board for the whole of the business, and to all of the company's stakeholders, rather than as responsible purely to the CEO in their executive management capacity."
- 4.7 Supporting Principle B.2 calls for due regard to be had for the benefits of diversity on the board, including gender. It may be useful for the guidance to make reference in paragraph 10.2 to other types of diversity. See, for example, the references in the Walker Review to the need for a diversity of skillsets and experience (paragraph 3.13).
- 4.8 In paragraph 10.3, it might help the casual reader if there were further clarification of what is meant by the phrase "diversity of psychological type". Is it suggested that some form of psychological testing will be introduced before appointment to the board and as part of the annual evaluation process?
- 4.9 Paragraph 13.3 suggests that evaluation of the board, its committees and of directors might be conducted over a period of years, with, for example, the board being evaluated one year and its committees the next year. This seems to run counter to main principle B.6 which requires annual evaluation of each of the board, its committees and of directors. Listing Rules 9.8.6R(5) and 9.8.7R require a listed company to apply the main principles and so we query whether the guidance should be suggesting a departure from B.6.
- 4.10 Paragraph 14.4 says "The Annual Report and Accounts should be seen as the single most important communication between a company and its shareholders, and not simply as a marketing document." The Report and Accounts are, of course, required by law and much of what is contained in the document is dictated by legislation and accounting standards. Our concern on this point, however, is that the sentence quoted above seems to downplay the importance of regular communication with major shareholders as required by main principle E.1 and the importance of the AGM emphasised in main principle E.2. The insertion of the word "formal" before "communication" in the quoted sentence may help, together with some reference to Section E of the Code.

**5. WOULD IT BE USEFUL FOR THE GUIDANCE NOTES PRODUCED BY ICSA TO BE UPDATED, AND REFRESHED PERIODICALLY, AND TO CONTINUE TO BE MADE AVAILABLE ON THE ICSA WEBSITE?**

- 5.1 We agree that it would be useful for ICSA's guidance notes listed at the end of the consultation document to be updated, and for them to be kept up to date and available on the ICSA website.
- 5.2 We also think it would be helpful for them to be referred to in the guidance. So, for example, section 7.2 on non-executive directors should refer to the model letter of appointment and section 11 on induction might make reference to the induction check list. As currently drafted, the reader would be unaware that such further guidance exists. As a purely practical

consideration, the guidance should, in this respect, be a comprehensive document which includes all such relevant material.

- 5.3 The induction checklist is, as it currently stands, merely a list of documents to be made available to a new director. It would be useful if it included other material contained in the guidance on induction in the June 2006 Higgs Guidance.
- 5.4 Similarly, it would be useful to include in the revised guidance an updated version of the Higgs Guidance on performance evaluation.

If you wish to discuss any of the above points, please contact Martin Webster of Pinsent Masons LLP, on 0207 418 9598 or [martin.webster@pinsentmasons.com](mailto:martin.webster@pinsentmasons.com).

6 October 2010

© CITY OF LONDON LAW SOCIETY 2010.

All rights reserved. This paper has been prepared as part of a consultation process. Its contents should not be taken as legal advice in relation to a particular situation or transaction.