

(Submitted by email to feedback@walkerreview.org)

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GlaxoSmithKline plc

980 Great West Road

Brentford

Middlesex

TW8 9GS

Tel. +44 (0)20 8047 5000

www.gsk.com

Dear Sirs

Response to the Walker Review of corporate governance in UK banks and other financial industry entities

We are pleased to have the opportunity to provide comments on the consultation under the Review.

We are encouraged to note that Sir David shares the widely held view that the Combined Code on Corporate Governance continues to be fit for purpose and provides the most responsive and flexible mechanism for translating into practice the principles of sound corporate governance. It is similarly assuring that the Review accords with the widespread support that exists for the Code's 'comply or explain' principles-based approach to governance, rather than for prescriptive rules-based regulation.

In our view the governance issues that have come to light within the worlds of banking and finance and that have been found to have contributed to excessive risk taking in the lead up to the financial crisis have been specific to the unique complexities of the business models adopted within those sectors.

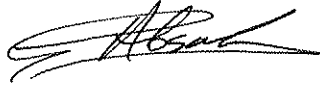
We therefore strongly believe that, in the main and with the exception of all but one of the proposals to encourage engagement between boards and shareholders or where otherwise indicated in our response, the recommendations and Code changes which the Review proposes in respect of banks and other financial institutions (BOFIs) are only pertinent to and should remain confined to those entities. We will also be making this view clear to the Financial Reporting Council in relation to this aspect of its own general review of the Code.

Please find attached our views and comments on the report, which primarily focus on the extent, albeit limited, to which those recommendations and any proposed Code changes could also be applicable in respect of non-financial listed companies. In this respect our comments tend to follow the pattern of the groupings of the Walker Review recommendations as set out in the FRC's progress report on its review of the Code. We will be reiterating many of these comments in our response to that consultation. Please note that, in general, we have not commented on the suitability of your recommendations for BOFIs themselves which we believe to be a matter for them and their regulators.

Finally, to the extent that the Review implements the additional, more exacting, requirements and Code changes for BOFIs, these should be set out in a separate addendum and guidance to the Code issued by the Financial Services Authority, rather than being amalgamated as BOFI-specific sections within the Financial Reporting Council's main Code and guidance for all other listed companies.

Should you have any queries please do not hesitate to contact either me or Victoria Whyte, (Deputy Company Secretary) (020 8047 4509).

Yours faithfully

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Simon Bicknell
Company Secretary

1. Board composition, the functioning of the Board and evaluation of performance

The responsibilities of the Chairman and the Non-Executive Directors

We agree with the Review and market participants' belief that the quality of governance ultimately depends on behaviour and not process. Further clarification of the expected boardroom behaviours and responsibilities of the Chairman, the Senior Independent Director (SID) and the non-executives could therefore usefully be made for all companies in the Combined Code on Corporate Governance (the Code), or in a specific annex to the Code. In this context your recommendations 6, 9 and 11 (to the extent that 11 is not already covered by existing provision A.3.3 or elsewhere in the Code), and in the case of the Chairman the 'leadership' element (only) of recommendation 8 could also be encapsulated in the Code or the annex as it applies to all companies.

It may be helpful for indicative guidance to be provided in the Code on the likely time commitment which may be expected of the role of a 'typical' Chairman, SID and non-executive director. However, beyond the rather specialised financial services sector, we believe that specifying minimum expected time commitments (for example, as set out in recommendations 3 and 7) are too prescriptive for most companies. Directors are increasingly aware that their role can no longer be described in terms of a notional number of days per year. In the event that a director is perceived to spend an inadequate amount of time on their role, the issue should be addressed through the board evaluation process, enabling directors to provide feedback on their perception of the adequacy of the general time commitment required. The Chairman could then take action to address any issues identified.

Dominant management has proven to be a key theme in a number of recent cases of failure or fraud. Boards should bear this in mind to ensure that they always act to support the role of the chairman in his efforts to balance the non-executive and executive elements of the board so as to maximise the effectiveness of the board as a whole. In this regard, the chairman's role is obviously pivotal in identifying issues for consideration and debate by the board as a whole. It is also vital that the non-executive directors should have full confidence in the skills and judgement of the executive directors and the executive management team.

Board balance and composition

We do believe that it is important for boards to include members who have relevant sector or industry experience, such as former CEOs or senior executives who are able to bring practical experience and insight. Each such appointment would need to be carefully assessed to establish the scope for potential conflicts of interest and whether these could be managed without impeding the director's participation in board activities. However, relevant industry expertise greatly benefits board deliberations and enables the non-executive team to challenge from a position of strength proposals from management on industry specific issues. From GSK's perspective, we have already identified the need for board members with scientific knowledge to bring an independent perspective to debate on scientific issues. In our view this has proved beneficial.

The benefits of relevant experience should be identified as part of the board's determination that it is of sufficient size that the balance of skills and experience is appropriate for the requirements of the business. If it is widely felt that an explicit reference to relevant experience would be a useful addition at A.3 of the Code, we do

not see any downside to its inclusion in the Code for all companies, provided that any new wording were to be tempered by the recognition of the availability of people with appropriate experience and available to carry out the roles.

With regard to recommendation 4, we believe that ultimately boardroom behaviour will stem from the personal integrity of the individuals on a board. Whilst the general content of that recommendation is not applicable to extend to non-financial institutions, the issue it raises regarding the consideration of individual directors' 'other qualities' is therefore something that could potentially be built upon for all companies in the context of the appointment provisions of the Code and the further clarification of boardroom behaviours.

We do not believe that recommendation 5 has any practical application beyond the banking and finance sectors.

Frequency of director re-election

Beyond the finance industry, changes to the frequency of director re-election or other changes to voting are not necessary. As mentioned, whilst governance failures within BOFIs have been found to have contributed to the financial crisis, we do not believe that this is reflective of UK listed companies generally. Accordingly, recommendations 10 and 36 should not be extended to non-BOFIs.

Board information, development and support

Most listed companies will already be meeting the requirements of recommendation 1 through their compliance with A.5 of the existing Code. The requirements of recommendation 2 will be met by adherence to the principles and provisions of A.5, and recommendation 9 is also already clearly stated through a combination of that section and A.2.

The current Code clearly sets out that the Chairman should ensure that the board continually update and refresh their skills and their knowledge and familiarity with the Company to fulfil their roles both on the board and on its committees. It requires the Chairman, in conjunction with the Company Secretary, to take responsibility for ensuring that this happens.

Similarly in relation to the quality of support and information available to the board and its committees, the Code already states that the board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. As the Review notes, it requires the Chairman to take responsibility for ensuring that this objective is fulfilled.

Whilst non-executive directors of BOFIs may well need extra support, the reference, in recommendation 2, to 'dedicated' support appears to perhaps imply a separate or discreet support function, which has the potential to undermine the unitary nature of the UK board model. Further there have been proposals that Secretariats should be made independent to assist non-executive directors in this respect. We believe that a fully integrated Secretariat can provide most value by ensuring the provision of accurate and balanced information to the board. A well run Secretariat links the executive with the non-executive directors and ensures that the information that is presented to the board is appropriate and not ambiguous. A separate and isolated independent Secretariat would not necessarily be able to assess and assist the Chairman in carrying out his obligation under the Code. Secretariats should provide

an effective and appropriate resource to enable all directors, both non-executive and executive, to carry out their roles.

Board evaluation

We believe that the extent to which board evaluations are conducted externally or otherwise should generally be left for individual boards to determine, in conjunction with their ongoing dialogue with the company's shareholders. Consequently for non-BOFIs there is no need to include a recommendation about the frequency of external evaluations in the Code. Recommendation 12 is therefore not applicable to non-financial institutions. Where an external facilitator is used, existing Code provision A.6.1 would prompt disclosure of this fact in the board evaluation statement. The evaluation statement itself should already be a clearly defined section (with its own distinct sub-heading) in the corporate governance report within the annual report. In our view, it would serve little purpose for the statement to appear as a distinct separate section of the annual report.

Under the existing Code the evaluation disclosure in the annual report should be providing the 'meaningful, high-level information' to enable shareholders to understand the main features of the process, as referred to in the first sentence of recommendation 13. Transparency is vital, so that shareholders are able to gauge both the integrity and effectiveness of the process, including being able to see the fruits of the exercise. If the outcome of the review results in any material shortfalls being identified these should be disclosed, together with any remedial steps taken or to be taken.

It is obviously crucial for shareholders to also be provided with a level of comfort as to the objectivity of any external facilitator (in keeping with the spirit of the second part of the final sentence of recommendation 12). From our perspective, the provision to shareholders of an indication of the nature and extent of communication by the Chairman with major shareholders (the final sentence of recommendation 13) more appropriately flows from and is already covered by existing Code provision D.1.2.

2. The role of institutional shareholders: communication and engagement between boards and shareholders

Some boards and individual directors may well behave differently when they are being closely observed by investors. For this reason it is vital that the 'comply or explain' mechanism of the Code should always be effectively enforced by shareholders.

In all well run companies the steps set out in recommendation 14 should already be taking place as a matter of routine board best practice. We also broadly agree with the proposals (which should be applicable in respect of all listed companies) of recommendations 16 to 18, subject to our preference for the broader content of International Corporate Governance Network's (ICGN) Statement of Principles on Institutional Shareholder Responsibilities (an updated version of which is expected to be published shortly) over the current ISC Statement of Principles. We are also supportive of the remainder of the framework for enhanced engagement by shareholders proposed by in recommendations 19 to 22, and for its application in respect of investments in all UK listed companies. We do not believe that recommendation 15 is applicable to extend beyond the banking and finance sectors.

It would also be helpful for the FRC to play a supporting role to encourage broader participation generally, through the endorsement of any specific mechanisms for

engagement that are developed by the investment community itself, as well as by working with all interested parties to further change behaviours of both investors and companies over time, for example, through the active promotion of the potential best practice research findings of the JCA Group for boards and investors regarding effective shareholder engagement, as referred to in the FRC's progress report on its review of the Code..

As part of the regular scheduled periodic reviews of the Code, the FRC should ensure that Sections D and E of the Code are kept abreast of best practice developments, so that the Code provides an effective and robust framework for encouraging dialogue and engagement. Best practice developments (arising from refinements and enhancements devised by market practitioners, or from salient research and the like) should be distilled into embellished Code principles or provisions or annexed to the Code as practical guidance. Similar guidance should also form an integral element of the Principles of Stewardship.

However, we agree with Sir David that additionally the Financial Services Authority ("FSA") should assume a meaningful role in the process of encouraging shareholder engagement in respect of equity investments in all UK listed companies through its oversight of fund managers and other financial institutions and their corporate governance departments. In this regard, the FSA's recent clarification of its rules around collective shareholder dialogue and engagement represents a positive initial step.

It is probably necessary, in view of the magnitude of the crisis that has engulfed the banking industry and in respect of amended provisions for BOFIs, for there to be an explicit and dedicated Combined Code review and monitoring process beyond that currently undertaken by the FRC. However, this is not necessary for other listed companies outside of the financial sector, particularly given the measures which are likely to be taken to encourage greater engagement and dialogue between companies and shareholders. A potential risk of, say, the FRC or the FSA undertaking more monitoring or enforcement of 'comply or explain' is that shareholders become more complacent and engage less, taking the view erroneously that the regulators are somehow discharging their own responsibilities to identify instances where no explanation was given for a departure from the Code or to challenge unsatisfactory explanations for any non-compliance.

In our view the debate surrounding the terminology of 'comply or explain' versus 'apply or explain' represents slight semantics and risks distracting market participants from the more pressing issues arising from the review.

3. Governance of risk

The Code clearly sets out that it is the board (rather than its committees) that should maintain and review a sound system of internal control to safeguard shareholders' investment and the company's assets. We advised the FRC as part of its call for evidence earlier in its consultation on the effectiveness of the Code that it may wish to give this greater prominence in the Turnbull guidance on internal control that accompanies the Code. The Code also already recognises that risk is matter for the whole board and not one for which responsibility can simply be abrogated to non-executive directors with their very finite time constraints or to the executive team.

The Code requires boards to demonstrate that they have informed themselves of the prevailing risks and satisfied themselves that the systems in place to eliminate and/or manage risks are sufficiently sound to safeguard the company's assets. The

directors, and particularly the non-executive directors, have a duty to ask probing and challenging questions.

The board's role is not to take decisions about management of a company's business, rather, it exists to appoint the chief executive officer (CEO) and to critically appraise the business plan of the company and the strategy for its execution as proposed by the CEO and the executive team. The board's role is to monitor the company's performance against that plan and the strategic objectives. Boards need to avoid straying into areas of management, so as to be able to continue to see the 'wood for the trees'. More importantly boards must avoid delegating to board committees the responsibility for matters that should be reserved for the attention of the board as a whole.

Since the Turnbull guidance was last updated in 2005, and having been first issued in 1999, it would seem appropriate and timely, four years on, for a second periodic review to be embarked upon once the Walker Review and the FRC's own review of the Code are completed.

Our comments regarding the extent to which the particular risk management mechanisms recommended for BOFIs would be appropriate for other listed companies are given below.

We do not believe that separate risk committees are necessary for companies outside the financial services sector with less complex business models (Recommendation 23), although the committee/entity which has responsibility for risk management should as a matter of course and as stated in the recommendation have responsibility for oversight and advice to the board on the current risk exposures of the organisation and its future risk strategy.

Many companies, including GSK, now have both an individual and a department or forum with specific executive responsibility for the oversight and management of risk. Indeed, we have also seen it argued that in reality a company's CEO can be regarded as the organisation's 'de facto' CRO, since he/she is responsible for implementing the company's business strategy which will only be achieved successfully if the risks associated with the business are properly managed. Nevertheless, on balance and based on the risk management lessons usefully learned from the financial sector, it may be beneficial for all boards to now be served by a separate CRO on the basis of recommendation 24. However, for non-BOFIs, it should be left to companies to decide whether to appoint a CRO.

It is sensible that the relevant board committee/entity should be in a position to operate in the way envisaged by recommendations 25 and 26. In the case of the latter, the practicalities of being able to effect such transactions in an efficient and responsive manner may dictate that it is necessary, at least in the case of non-BOFIs, for the recommendation to be limited to individual acquisitions/disposals which are regarded as being material or significant in relation to the current size or nature of the company.

Boards already effectively produce what amounts to a separate risk report (Recommendation 27), albeit through clear cross-referencing between the corporate governance internal controls statement and the business review disclosures regarding the principal risks and uncertainties faced by the business. In light of recommendation 25, the corresponding disclosure under the Code could be widened slightly for all companies to provide an indication of whether external advice was taken during the year and, if so, its source.

We will be advising the FRC that we agree with its stated approach to seek the rationalisation of the various underlying disclosure requirements relating to risk management and internal controls to assist companies with being able to compile a comprehensive, risk report which enables readers of the annual report to gain a clear, meaningful and company-specific understanding of the key risks faced by the business, the process used to identify and control those risks, and the tangible benefits of that process for the business, with the emphasis on providing a level of assurance to shareholders to counteract any prevailing market uncertainties.

In our view the effectiveness of the existing internal controls reporting requirement under the Code has been called into question in respect of the unique complexities of the business models within the finance industry, where it is apparent from the financial crisis that internal controls failures arose stemming from those complexities, despite the boards of certain listed BOFIs having been able to make their annual internal controls review statements in the run up to the crisis. The relevant Code disclosure requirement nevertheless remains appropriate in its existing form for companies outside the finance sector.

We believe that an aim of the wider review of governance disclosures should be to make governance reporting more integral with corporate reporting generally. Recent research by corporate reporting agency Black Sun suggests that investors and their fund managers do not always regard governance statements with significance when considering annual reports. This may be partly attributable to the fact that corporate analysts can view such statements as having been produced merely as a box ticking exercise. The more that boards can be encouraged to add value to their corporate reporting through high quality, meaningful and integrated governance reporting (rather than in some cases it simply being regarded as a compliance exercise) the more the perception of investors and their advisers will change, as they come to recognise the very tangible benefits that can flow from it and that sound governance can deliver real shareholder value over the long-term. They in turn will then start to demand clear and more effective reporting in this area. This has the potential to create a 'virtuous reporting circle' which would also have the effect of drawing boards and their investors closer together on governance matters. The process could be further supported, as part of current efforts to encourage shareholders and boards to engage more fully with one another, by making it clear to shareholders in the Code for all companies that there is also a very real onus on them as the owners of the businesses in which they are invested to demand useful and relevant governance information. In our view, no areas would benefit more from this process, at this particular juncture, than the banking and finance sectors.

4. Remuneration

BOFI remuneration structures tend to be very different from those of other listed companies. Very few (if any) other listed companies remunerate as many employees as highly as the banks do below the board and senior executive team.

In our view the applicability of the Review's recommendations on remuneration for other listed companies varies. We believe that recommendations 35 (in relation to the relevant board committee/entity that oversees risk management), 38 and 39 could potentially be extended to non-BOFIs, whereas recommendations 28, 29, 30, 31, 33, 34 and 37 should not be extended beyond the financial services sector. Similarly we do not believe that recommendation 32 has any practical application beyond FSA-authorized BOFIs. Please note, however, that it is imperative that the professional body for remuneration consultants formed in accordance with recommendation 38

should also include independent, non-‘remuneration consultant’ representation within its membership, such as an FRC member.

When companies are considering significant changes to their board remuneration policies it is customary and best practice for the proposals to be discussed with their major shareholders. Their views are then factored into the remuneration committee’s decision making process. Whilst we continue to follow the ‘say on pay’ debate that is taking place in a number of jurisdictions, we believe that, provided shareholders are always given a clear and concise description of a company’s board and senior executive remuneration policy and its core elements in the annual report, and that both the board and shareholders maintain a healthy dialogue and are willing to engage where necessary throughout the year - and not simply in the run up to the annual vote on the remuneration report - the existing mechanisms of the Code will, for non-BOFIs, enable all shareholders to play a full and thorough role in the setting of remuneration.

The remuneration-related elements of the Code should naturally be updated from time to time to ensure that they are kept in line with developments in best practice.