

Dear Sir David

I am pleased to comment on your most thorough report with its significant emphasis on the behaviour within, rather than the structure of, corporate boards.

I concur with the majority of your recommendations (or have only minor reservations), but I do have significant difficulty with some of the proposals. I am anxious that your final recommendations result in a continued emphasis on principles rather than excessive prescription born of the perceived need to respond to particular, but possibly narrow, events.

I write in a personal capacity but as a non-executive Chairman of two FTSE 250 Companies, a non-executive Director of F SE 50 Company, and a non-executive Director of two unlisted companies, both smaller BOFIs.

I will limit my comments to recommendations in respect of which I have concerns.

Recommendation 3:

I have no difficulty with the suggestion that the time obligations of non-executive directors should be more clearly spelt out, and doing so in the letter of appointment, is clearly preferable to a prescriptive requirement for disclosure under the Code.

However, I believe that individual boards should themselves undertake a fuller discussion of the role and responsibilities of non-executive directors and I do not think it helpful to be setting targets in terms of the number of days required. If, for example, a non-executive director is currently committing twenty days, but under your analysis should be spending thirty days, what is it that he/she should be doing in the future that they have not been doing in the past? There is a temptation under this proposal to spend time getting bogged down in the detail rather than to ration it and selectively target the most important issues.

What I think you are saying is that directors must commit the amount of time needed to do their job properly. I certainly agree with that, but I would hate the Corporate Governance box-tickers to move from the school register attendance of directors at meetings, to a statement in respect of each director as to how many hours/days they have spent on the company's business during the year. That seems to me to be the proper province of the board led by the chairman and the SID through the board's selection, nomination and evaluation processes.

Recommendation 5:

I can understand this Recommendation but there are clearly dangers if the FSA see their brief as to ensure that the board is constituted only of those with an apparent deep knowledge of the Financial Sector. I remember many years back the chairman of one of the large banks that has remained relatively unscathed by recent events, telling me that if an executive project could not be explained to his lay non-executive directors, it did not get the approval of the board. There is room on the board for people with a broader set of experiences, common sense and an ability to challenge. One of the reasons for the current banking crisis, in my opinion, is that many of those with expertise in the subject matter held common views on the liquidity and volatility of the markets and were not prepared for the unexpected.

There is also a challenge in the proposals to the broader push to increase the diversity in the gene pool on corporate boards.

Recommendation 10:

In principle, I have no problem with this Recommendation since a director serves at the pleasure of shareholders. However, I believe that there are potential risks to smaller listed

companies, where the level of shareholder voting may not be as high, and opportunities could be created for hostile minority shareholders to destabilise the boards.

I would hope that institutional investors would be able to make their views on the chairman known outside the general meeting process and if annual re-election is suggested, I would urge it to be on an advisory rather than a binding basis.

Recommendations 14 to 22:

Your Report appropriately challenges the extent of the engagement between institutional shareholders and a company. The issues raised by these recommendations apply to non-BOFI as well and I am sure that you and the FRC, in addressing these issues, will wish to guard against the creation of excessive bureaucracy within the institutional investor community as well as between institutional investors and companies.

The problems are of long standing and the Recommendations challenge the basis of business of many institutional investors. I would urge a full and extensive dialogue before any decisions are taken to codify behaviour or disclosure obligations.

Recommendation 23:

It may well be that a board risk committee is an appropriate response in particular organisation, but I do not believe that it should be mandatory. It is the board of directors itself that is responsible for establishing the risk appetite of the business and understanding and overseeing the management of such risks.

In establishing the risk appetite and understanding the inherent risks, the board will be advised by management and in my opinion it is the primary responsibility of the CEO to secure an understanding of the company's risk appetite and then to manage and embed the relevant risk management process across the business. Parking risk into a board risk committee reduces the responsibility of the CEO and I believe in the long term that would be harmful to an organisation.

In a large BOFI I fully understand that there are many elements of risk to be understood and managed and additional internal or external resources should be available. However, if a director does not understand what is going on the problem is not solved by pushing it into a board risk committee where only the experts get involved.

Recommendation 24:

In a similar vein, it may well be appropriate for there to be a CRO but I would expect the CRO to have a joint report to the CEO as well as to the chairman/board.

Recommendations 25 to 27:

For reasons explained in the context of Recommendation 23, I support the Recommendations but believe that they should be the responsibility of the board rather than a board risk committee.

Recommendation 33:

While sympathetic to the Recommendation, I believe that it would not be appropriate for details such as the testing period of awards to be set on a mandatory basis. They should be set by the BOFI by reference to its business strategy and the decisions that they take should be explained within the remuneration report.

Recommendation 35:

For the same reason expressed in Recommendation 23, the interaction between the remuneration committee on the subject of risk adjustments should be a matter for the board as part of the setting of their risk appetite

I hope that these comments may be of help.

Yours sincerely

Peter Smith