CAD-02449

N·A·P·F
The National Association of Pension Funds Limited
INVESTMENT COMMITTEE

7 August 1992

Nigel Peace Esq
Secretary
Committee on the Financial Aspects
of Corporate Governance
P O Box 433
Moorgate Place
LONDON EC2P 2BJ

Dear Nigel

NAPF COMMENTS ON DRAFT REPORT

Whilst criticism has and will continue to be made concerning some specific aspects of the draft report, the NAPF strongly supports its main aim in attempting to establish minimum standards for corporate governance and, on the strength of this alone, we will make every effort to ensure that the Code of Best Practice is widely adopted and adhered to. Most particularly, we would agree with your Committee's statement in paragraph 1.9, that action by boards of directors and auditors is expected and necessary and that responses to your draft report are welcomed on the precise nature that this action should take. Given that there is a need for action, we would very much hope that the comments submitted on your draft report by all interested parties will enable your Committee not only to identify most of the deficiencies in the present system - a task which we judge is largely accomplished in the draft report - but will also provide the necessary impetus to strengthen your Committee's final recommendations to ensure, so far as possible, that the changes needed are actually undertaken by boards and auditors.

Indeed, it is our intention that the following comments should be viewed by your Committee in that way.

The Board

4.6 This paragraph does not come out unambiguously against combining the roles of chairman and chief executive and yet the Committee provides no justification as to why the roles can be combined. Indeed, existing best practice is to have the roles separated - for reasons associated with preventing an undue concentration of power - and we would wish to see your Committee endorse this view.

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4.9 Best practice here is that *all* non executive directors should be "independent" and *we would press for the code to be expanded to ensure that, if an executive director of Company A is a non executive director of Company B, then no executive director of Company B should be allowed to serve as a non-executive director of Company A.*

4.10 In our view *it is essential* - rather than a matter of good practice - that non executive directors should not participate in share option schemes or receive pensionable fees from the company.

4.29 Given that the merits of audit committees have been recognised in the draft report - a view with which we concur - we see *no reason to allow a two year period of introduction*. Why not now?

4.33 Here rolling three year service contracts for executive directors appear to be condoned. Best practice is that fixed term contracts on the few occasions that they are warranted *should not exceed three years*, and that rolling service contracts should be for *no more than twelve months*.

4.35/
4.36 We would agree that it is quite impractical for shareholders to vote on the remuneration of an executive director. We are mindful, however, of the statement in the second sentence of 4.10 and suggest that directors be required to deduct from their remuneration an element representing time spent as a non executive director of other companies or that such fees be paid to the employing company.

So far as reporting to shareholders is concerned, your suggestion that the chairman of the remuneration committee be responsible for answering questions at the Annual General Meeting may well undermine, to some extent, the concept of the unitary board. We would endorse the views expressed to you by others in this regard and believe it is the responsibility of the board chairman to decide who should respond, on behalf of the board, to a query raised by a shareholder on any topic.

4.47 Whilst we would agree with your Committee's recommendations concerning interim reports, the inclusion of additional information should not be used as a excuse for delaying their publication.

4.51 We would draw to the Committee's attention that Government policy concerning the "earnings cap" on pensions is now working against the concept of "pensions governance" as set out in 4.51 given that an increasing number of directors and other highly paid employees are now finding that an element of their pensions is *totally unfunded.*

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Auditing

5.3 Here, your Committee states that "audit firms, like any other business, will wish to have a constructive relationship with their clients". We would suggest that *the case for "quarantining" audit from other services is well made in paragraph 5.10, although your Committee, in paragraph 5.11, offers no reasons for not being persuaded by this argument. We would suggest that a "clear distinction" between the two types of activity needs to be drawn to shareholders' attention and that your Committee should consider further the form that such a distinction should take.*

5.12 We feel that the approach of your Committee is appropriate on the question of rotation of auditors. However, if rotation of auditors is not to be compulsory, we would not wish any guide-lines to allow too great a "measure of flexibility" in the manner proposed.

5.22 We would most certainly agree with your Committee's arguments in paragraphs 5.18 and 5.19 together with its requirement, in paragraph 5.22, concerning a reasonable expectation that the undertaking is a going concern. *We therefore concur, absolutely, with the recommendations in paragraph 5.23.*

5.28 We have again noted that your Committee are not persuaded that the imposition of a statutory duty on auditors to report fraud to the appropriate authorities would make any practical difference. *We could not disagree more, believing that the necessity for the imposition of such a statutory duty is irrefutable.*

5.30 We support the Committee's recommendations here and suggest that there may be a case for establishing a legal audit to be carried out by solicitors rather than auditors.

5.32 Many investors are aware of the basis on which the House of Lords decided the Caparo case, which is usefully restated in Appendix 4 to your report. It is not, we feel, relevant to quote the words of Cardozo C J, who decided a case in 1931; many forms of third party liability fall into this category. The Caparo judgement itself is of fundamental importance to investors and it is our view that the law should be changed to better meet the reasonable expectations of investors. At present, they cannot be sure, incidentally, of what is meant by the term "shareholders collectively" (paragraph 5.33) without the kind of class action suits as seen in the USA.

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Conclusion

One unintended "benefit" of submitting late comments during a process of consultation is that we have been able ourselves to hear and to take account of the reported comments of some of the other interested parties. We have noted, in particular, that the London Stock Exchange does not now intend to sanction companies that fail to comply with the Code, even though such compliance will become a listing requirement. This decision has reinforced our view that, whilst your Committee has successfully identified and described the major areas of concern in the corporate governance field, a number of the remedies proposed are unlikely to prove workable or to command the attention of companies that they should deserve. We would urge, therefore, that during its consideration of comments on the draft report, your Committee should have particular regard as to whether the measures they are proposing are likely to be effective where boards and auditors are concerned.

We well appreciate that institutional investors - together with their representative associations - have a crucial role to play in the process of change that is needed. It is evident that an increasing number of pension funds are focusing on this very issue but they will most certainly need all the help and encouragement that a significantly strengthened final report from your Committee can provide.

Please do not hesitate to contact the NAPF if you would like further clarification of any of these points.

Yours sincerely

John Rogers.

J E Rogers
Secretary