

RESPONSE TO THE REVIEW OF THE ROLE AND EFFECTIVENESS OF NON-EXECUTIVE DIRECTORS

We welcome the opportunity to respond to the consultation paper on the role and effectiveness of non-executive directors and enclose our comments. However we also wish to highlight a number of points which we consider to be of considerable significance and would urge that full attention is given to them.

These are as follows:-

- i) Throughout the last ten years considerable attention has been paid to Corporate Governance matters within the UK. The Combined Code has been adopted and has weight and enforceability through its relation to Listing Rules and the Listing Authority being part of the FSA and because of the active interest in these matters from institutional investors. Yet Corporate Governance such as the separation of the role of the chief executive and chairman which is the norm for all major plc's in the UK, is still not common in the USA. And, whilst most, if not all, EU countries have a corporate governance code, we understand that none of them are enforceable other than that of the UK. In addition, the current role and responsibilities of non-executive directors as they are understood in the UK, are not replicated across the EU.

None of this detracts from the need to ensure that UK companies have first-class corporate governance and that non-executive directors understand their role and their responsibilities. It does, however, mean that considerable care must be taken not to make changes to UK procedure simply because of the problems in a few plc's. In addition, it is becoming increasingly noticeable that because of the transparent and open way in which the UK conducts itself that this very willingness to discuss, question, criticise and review in public is being interpreted by those elsewhere as Britain having continuous, corporate and financial problems. We believe that it is imperative to avoid such an impression as this review has the potential to adversely affect confidence in corporate Britain, the investment institutions and the investing public.

- ii) We have become increasingly concerned about some of the public statements made such as, for example, non-executive directors should spend one day a week at the company, enquiring and questioning the decisions that the chief executive and his senior team are making. It would seem to us that should this become a requirement, then such a non-executive has become a de facto part time executive within the company and is therefore less likely to be able to use independent judgement. Also, such a requirement would result in large numbers of individuals who hold executive positions, and are also a non-

executive in another company, from continuing with that non-executive role because of this time requirement. Whilst believing that a board benefits from a variety of experiences of its non-executives, it would be detrimental if time requirements would have the effect of preventing participation by those who hold challenging executive positions elsewhere.

- iii) Corporate governance is, and always has been quite rightly highlighted by major investors as being of major importance particularly for the major UK plc's. Corporate governance is also broad covering many aspects of a company's operation from investor relations through to internal audit. It is therefore both a cost to a company as well as a benefit. It would be unreasonable for the corporate governance requirements of a FTSE 100 company to be applied equally to all companies. Separation out of the different roles in a FTSE 100 company is sensible management operation, whilst to a small plc it could well make little practical and financial sense. As this particular consultation paper relates to non-executive directors only, we wish to point out that it is also not an easy proposition to get non-executive directors generally and the smaller the company the harder it can be.
- iv) The increasing responsibilities of non-executive directors, and perhaps particularly those who sit on audit and remuneration committees, means that it is becoming increasingly difficult for companies to attract high calibre people to undertake the role. The current view, which appears to be gaining considerable support, that non-executive directors are there to police the board is inappropriate and not feasible. It is our belief that it is these sorts of proposals which need to be rebutted as a matter of priority if the pool of those willing to serve as non-executive directors is to be prevented from shrinking any further.
- v) Directors' and Officers' liability insurance must be maintained at a reasonable cost. Insurance costs are spiralling and capacity is being reduced, yet without it non-executives will simply not be prepared to serve. We note also the action being taken by the Equitable Life against its former board of directors. Should this action be successful against the non-executive directors, then it is our belief that this will be a powerful deterrent to many, if not most, to continue in their post due to the personal financial risk to which they would be exposed.
- vi) Transparency and openness are fundamental to ensuring confidence. With this in mind we consider that all large plc's should state how they chose their non-executive directors and make available all other directorships and relevant interests that the non-executive directors may have. The investors can therefore make the decision on the appointment of the individual or individuals and on whether they consider them "independent" or not.

The role non-executive directors perform

The role of a non-executive director was defined by Cadbury as having two particular important contributions to the Board; the first in reviewing the performance of the Board and the second in taking the lead where potential conflicts of interest arise. Hampel amplified this in the statement in which he said that "non-executive directors are normally appointed to the Board primarily for their contribution to the development of the company's strategy, and that they should have both a strategic and a monitoring function".

These are comments which we believe to have continuing validity. Corporate UK has benefited from its Unitary Board system to which information is brought by the executive team and where matters can be discussed in an open and frank way. We would not wish changes from the Unitary Board process.

However within this we still wish to see properly recognised that different directors have different responsibilities.

- The chairman clearly has a greater involvement with the chief executive and on a more frequent basis than the remainder of the non-executive team. We would anticipate that the Chairman ought to have knowledge of key decisions and be kept well informed between board meetings of any matters of substantive importance.
- Whilst we do not consider it necessary to have a deputy chairman, many companies have a non-executive individual fulfilling such a function, usually as part of the succession planning arrangement for the chairmanship of the company. It should remain up to the company as to whether or not it wishes to have such an appointment.
- Key roles played by particular non-executive directors are as chairman of the audit committee and as chairman of the remuneration committee. Individuals fulfilling such a role will need to ensure that they have the relevant experience to undertake this responsibility. Whilst it is possible to translate such a statement in respect to the audit committee such that the chairman has to be an accountant, we are not sure that this should necessarily be the case. The greatest importance is to be able to question both the auditors of the company and the executive team, separately and together as necessary on issues relating to the accounts.
- We believe that there is a role for a senior independent non-executive director in major plc's. Whilst the intention is for board relationships never to breakdown, nor relationships between the company and the investors to sour, should either of these two events take place then there needs to be an obvious individual for concerned parties to approach. It is better to have such an individual in place prior to problems arising rather than trying to resolve the role after the event.
- The law does not currently distinguish between executive and non-executive directors and it is not proposed to make such a legal differentiation in future. We find it difficult to understand why such a decision has been taken and we would urge that there is proper clarification made in law between the two. Referring again to the case of the Equitable Life, should the case against the former board be successful and not differentiate between the two types of directors, even though evidently their responsibilities were different and knowledge was different, then this will act as a very severe deterrent for individuals considering taking up the non-executive role.

Structures and Accountability

We consider that the existing structures and procedures with respect to board committees, the balance between executive and non-executive directors, the role of independent non-executive directors, and the duties of the various committees as set out in the Combined Code are providing a good framework in which boards can operate. The essence of the difference between a board operating well and one operating badly is the competence of the individuals

who make up the team. There is no structure that will ensure that a non-executive director challenges executive decisions should they not wish to do so! The workability of the process is therefore vested entirely in the personal strengths and weaknesses of the individuals involved.

It is no doubt possible for performance of non-executive directors to be reported to shareholders. Performance could be in terms of the number of hours spent on company business; additional matters with which a particular non-executive individual has been involved; and attendance record. However we question as to whether this is of real benefit. We view with concern the increasing tendency for excessive attention being paid to such things as the Chief Executive's salary particularly and insufficient attention being paid to the commercial performance of the company. Yet we consider the latter to be of much more importance and perhaps especially in current economic climates.

Nevertheless, as companies choose their non-executives by a number of different methods then the route by which a non-executive is chosen should be made available to the investors along with other directorships and relevant interests that the individuals may have. The investors then have the opportunity to decide on the appointment of the individual and whether they consider them "independent" or not.

Relations with Shareholders and Others

As a generality there is little interaction between the institutional shareholders and non-executive directors. The two exceptions to this are firstly the increasing tendency of the chairman of the remuneration committee to discuss the incentive schemes and remuneration package for the senior team prior to the AGM. Secondly where institutional investors are concerned about certain aspects of the performance of the company or individuals and have not had what they consider to be satisfactory discussions with the executive team, then an approach to the non-executives is often a route that is followed.

We consider it to be a good and sensible practice for a senior executive to meet regularly with the major institutional investors and to make public information about the company on a regular basis. Where non-executives have specific responsibilities such as chairing the audit or remuneration committee then there needs to be a well defined path of access to them by the institutional investors should those investors so wish. As with the identification of the senior independent non-executive director, it is an arrangement that needs to be known in advance of any issues arising. In addition, we consider that with the attention being strongly on remuneration, and with it periodically becoming a political issue, then the meetings as described between the chairman of the remuneration committee and institutional investors is a matter that should be encouraged, particularly at times of policy change.

The key external advisers to a company are the auditors, those who advise on remuneration and corporate advisers. The audit and remuneration committees should have the opportunity to question these advisers without the executive team being present. The advice of other advisers that may be employed from time to time, particularly on corporate actions such as acquisitions and mergers should be made available to all members of the Board.

Number of Directorships; Time Commitments; Payment

i) Number of Directorships

The number of directorships held by an individual is necessarily a function of their other responsibilities. An individual holding an executive position would be unlikely to be able to commit the time to more than three non-executive positions. However, we see no reason why a professional non-executive should not have a portfolio of 6 or even more, depending upon the type and nature of the companies.

ii) Time Commitments

The time required per non-executive directorship is equally variable depending upon the complexity of the company as much as on its size. It is this complexity that is more a key in the decision on how many directorships an individual can hold, whilst being able to discharge their duties effectively, than is the simple number that is held.

iii) Payment

Initially we were inclined to the argument that the increasing responsibilities of non-executive directors should be recognised by a significant increase in their remuneration. However, of vital importance is the ability of a non-executive director to resign from a Board over an issue. The reality of life, however, is that the more an employment pays, the harder it is for an individual to resign and therefore the less independent they have become.

Other Issues

Training for non-executives

Non-executives have the opportunity of some form of induction programme when they take up a post with a company, usually dependant upon the time that they have available, the time that the senior team of the company has available, and the previous experience and knowledge of the individual. No doubt this process can be formalised to a considerably greater extent than at present, but nevertheless it will always need to be tailored to the individuals. There are also other training programmes available such as those run by the Institute of Directors. Meanwhile, the knowledge gained from doing the executive job in another company is clearly providing very significant training for many of those currently undertaking non-executive positions. It is our view that any individual who is considered to have the ability for a non-executive role should also have the ability to ask the necessary questions and decide, in conjunction with the company, what particular information and training they need. Formalisation of this process should not be necessary.

Widening the Pool

There is considerable concern that the pool from which non-executives are drawn is too small. With the increasing attention on corporate governance, most major plc's have used external headhunters to whom they have given a remit and who have in turn provided a choice of potentially suitable candidates to the nomination committee for final selection. This has created

a greater independence of non-executives, has widened the pool and extended the type of candidate that is being appointed as a non-executive.

This pool can and should be extended further through, for example, advertising in the press and also by companies encouraging more of their senior team to take up non-executive responsibilities elsewhere. International companies have a tendency to employ non-executives from a variety of different nationalities, again adding to the diversity and knowledge on that Board, though such a practice is not necessarily widely applicable as it has a high cost associated with it.

Whilst we believe that it is in the best interest of companies to have a range of people, experiences and opinions on their Board, the essence of the UK system is that a member of a Board does not take a proprietary view. We therefore are not in favour of a mandated “quota” arrangement for any particular group.

Earlier we have said that the pool of directors is in danger of shrinking as a result of the three factors of increased responsibilities of non-executives, the threat of legal action, the reduction in directors’ and officers’ liability insurance, and thirdly action against non-executives on an equal basis as with the executive team. The need to address these three issues is of paramount importance and the increasing negativity surrounding the role.

APCIMS
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