

## **The Higgs Review**

### **Review of the role and effectiveness of non-executive directors**

**1. What is the role of the board? What is the role of the Chairman and how does it relate to the non-executive directors?**

It is the role of the Board acting on behalf of Company stakeholders to:-

- Decide, and monitor implementation of, strategy and business plan and operational plan.
- Elect Chairman and other senior Director (Vice Chairman).
- Appoint, monitor and remove Chief Executive.
- Appoint, monitor and remove Board members.

It is the role of the Chairman to guide and manage the Board to achieve the Board's agreed goals. To take a leading role in appointing/removing/developing Directors in order to increase Board effectiveness. To take a leading role in the structure and membership of Board Committees. With Non-Executive Directors, Chairman should draw on their characteristics in addressing needs of the company. It is the role of the Chairman also to chair meetings of shareholders.

**2. What should be the key roles of non-executive directors on the board and what should be the balance between the different components? Within a board, should all non-executive directors be expected to fulfil each of the different roles?**

The key roles of Non-Executive Directors are questioning, assessing, understanding the nature and performance of the business and (where necessary) ensuring corrective action is taken and problems are addressed in the interest of representing the stakeholders. Independence from the company and its executive management is an important attribute and should be decided by the company. Non-Executive Directors need to test the activity of the company against the world beyond the company.

Responsibility of all Directors, including, the Non-Executive Directors, is believed to be joint and several but one Director alone cannot fulfil all the roles required. The "team" needs to provide the range of skills, experience etc.

**3. How does this compare to the present position?**

The present position reflects the above.

**4. How independent do non-executive directors need to be for the different roles?**

There is a need to properly define "independence". It is suggested that rather than a blanket approach to independence, appropriate mechanisms to deal with conflicts of interest are the key.

5. **What are the main potential conflicts of interest which may arise within a company where non-executive directors can play a role in protecting the interests of the company? What can be done to help non-executive directors to be effective in relation to these conflicts?**

Potential conflicts include:-

- The short term success versus long term success.
- External links with company advisers.
- The broad view rather than the parochial.

Directors could be assisted in the assessment of conflicts of interest by recognising the acceptability of declaration of conflicts and an appropriate proforma addressing the interests of each stakeholder.

Job description for Non-Executive Directors would help to clarify the role and possible conflicts. Training should remind Directors that disclosure of conflict is a statutory duty.

6. **What time commitment is needed for the role of Chairman and for non-executive director roles, and how far does this vary between different companies? Are there any implications for the number of non-executive posts that one person can sensibly take on?**

The time commitment will vary depending on the industry, the company's stage of development and the extent of delegation to the executive management. Directors should be expected, in normal circumstances, to attend all Board and Board sub committee meetings.

The number of Non-Executive posts that one person can sensibly take on is subject only to practical constraints. Intuitively, a limit of five or six appears appropriate with less if they perform the role of chairmen at any of these positions. One plc chairmanship per individual is considered appropriate. This is an important consideration of the Board when considering an appointment. Existing Directors should be required to seek approval from the company before accepting any additional Director positions.

7. **Should there be a special role for a "senior independent" non-executive director?**

Yes there is a role for a Senior Non-Executive Director in addition to the Chairman – this can provide another line of communication in the event of problems with a Chairman.

It is believed and appropriate that the senior Director can also perform a useful role as Chairman of the Audit Committee.

See Q16 also in connection with independence.

8. **Do you have comments on the proposed statutory statement of directors' duties, which does not seek to distinguish between the legal duties of executive and non-executive directors?**

Duties of a Director should be the same for Executives and Non-Executives. It is believed that a unitary Board is beneficial.

- 9. What are the key skills, knowledge and experience which are needed by non-executive directors to perform the role effectively, and how is this likely to change over the next, say, 10 years? Are some skills essential and, if so, what are they?**

The key skills, knowledge and experience should relate to the Company at the point in time and will change over time subject only the need for continuity. Achieving the correct balance of skills, knowledge and experience within the Board is a key role for the Chairman. The period of tenure of Non-Executive Directors may become shorter in the future as the need to change the mix on the Board to suit business requirements is recognised.

The “permanent” requirements of a Non-Executive Director are business understanding and the ability to work within a team. The overriding requirement is the ability to question until full understanding of business activity is obtained.

- 10. What personal qualities and attributes are needed?**

See 2 and 9 above.

- 11. What sort of mix of experience and attributes is desirable on a Board? Specific examples of cases where non-executive directors have contributed with particular effect to company performance, or to corporate governance, would be helpful.**

The mix of experience and attributes will vary with the Company and from time to time in the same company. A key role for the Chairman of the Board and the Nominations Committee is to ensure the balance at any point in time is appropriate.

- 12. How easy is it to recruit non-executive directors with the right skills and attributes? Could recruitment and appointment mechanisms, including Nomination Committees, be improved?**

Probably difficult at the moment because of perceived risks, informality of process and pay levels. It is suggested that normal recruitment processes (ie: job description, person specification) as used elsewhere in the company should be equally applied at Board level. Companies could increase the supply of candidates by assisting younger Executives, as part of management training, to take up NED roles in other companies.

- 13. What could be done to widen the pool of potential non-executive directors and introduce greater diversity into appointments? What are the constraints on this? Is there scope for greater international representation on UK boards?**

Boards need to be specific in terms of their requirements by drawing up job descriptions, goals, period of tenure etc. Mechanisms are needed (eg use of headhunters and newspaper advertising and clarity of objectives) to identify the appropriate pool of labour. How many Non-Executive Director opportunities were advertised in the last 12 months? Companies could assist the supply by helping their retiring employees to find NED roles.

- 14. Are the rewards for non-executive directors appropriate, both in terms of levels of pay and the form that remuneration takes – e.g. cash/shares/share options? Are current pay levels a significant factor in whether good non-executive directors can be attracted?**

Pay levels need to reflect risk and responsibility in order to attract good non-executive directors. Arguably, the interests of Board members can be aligned with those of shareholders by payment in part via shares and performance related schemes.

- 15. Do you have comments on the issue of risks or insurance provision for non-executive directors?**

All Directors should be covered in the same way.

- 16. How is the Combined Code working in practice? In particular, how are the provisions on the balance between executive and non-executive directors and the role of independent non-executive directors working? Is further definition needed of independence in the Combined Code and, if so, what would a sensible definition be?**

The Combined Code perhaps needs to be redrafted because of the approach of the institutions and voting agencies to the application of the Combined Code. It is suggested that the problems with the definition of independence could be addressed by approaching the issue on the basis of providing for mechanisms to deal with conflicts of interest. Independence can also cause problems on small Boards and Board Committee structures.

- 17. Do the recommended structures for board committees facilitate governance and an effective contribution by non-executive directors? Are board meeting procedures working effectively? Do you have comments on board size?**

It is believed the recommended structures for Board Committees facilitate governance. Board Meeting procedures work effectively. The size of the Board depends on the nature of the company and the stage in its development. The overriding concern should be the appropriate size and experience of team for the circumstances.

- 18. Do you have comments on the composition and duties of Audit Committees? How effectively are Audit Committees working in practice? Do you see a need to strengthen the existing Combined Code provisions on Audit Committees?**

No comment on composition and duties. Most Audit Committees are effective but their success is very much reliant on chairman's ability to understand the issues and ensure adequate and effective financial controls are in place within the organisation. No comments or knowledge of need to strengthen the existing Combined Code provisions on Audit Committees.

- 19. Similarly, do you have comments on the composition, duties or operation in practice of Nomination and Remuneration Committees?**

No comments other than to recommend that recruitment practices for Directors should be aligned with the operation of the Nominations Committee.

**20. What processes are in place for setting objectives and reviewing performance against those objectives, for the board as a whole and for individual directors?**

The agreement of strategy and business plans and the monitoring of and reporting on results will show whether the Board is being effective. There is a school of thought that satisfactory Financial results prove the effectiveness of the Board.

**21. Could more be done to review performance?**

Yes – a formal appraisal process of individuals and the Board as a whole. This appraisal report should be considered by the Nominations Committee.

**Should more information on board performance be reported to shareholders? Should companies provide more information on the performance of non-executive directors?**

Perhaps reports to shareholders could provide information to demonstrate that processes are in place to protect the company. It is not considered appropriate to provide more information to shareholders on the performance of Non-Executive Directors individually or collectively.

**22. Are non-executive directors able successfully to challenge executive decisions or expose serious problems? Should it be made easier for them to do so and, if so, how?**

This depends on a strong Chairman and/or Senior Director and the relationship with the Executive Directors. The strength of character of the individual Directors and their ability to perform as members of a team should provide them with the opportunity to challenge Executive decisions and expose serious problems.

**23. How well do relationships between non-executive directors and shareholders and stakeholders work, and could they be improved? For example, we would be interested to hear views on what the relationship might be between non-executive directors and institutional shareholders. How could this relationship be strengthened?**

It is believed the relationships with shareholders and stakeholders can be properly delegated to the Chief Executive and Chief Financial Officer. The Chairman would normally play an active part in the relationship with institutional investors. There is a role for Non-Executive Directors to track this relationship by receiving information on press and analysts comments. Other stakeholders such as employees and the community at large similarly can be addressed by appropriate Company policies which will be implemented by Executive Directors. It is believed the Board should act as a single entity speaking with one voice. Individual Director contact with investors without the presence of another company representative could be divisive.

- 24. To what extent are Chairmen creating the conditions for non-executive directors to be effective? Is there more that they could do, by promoting constructive relationships, managing the discussion processes, encouraging challenging and effective contributions in board meetings and ensuring appropriate information flows, or otherwise?**

This is the essence of the Chairman's role. He needs to be a team leader providing a link between Non-Executives and the Chief Executive and ensuring the Board operates effectively and receives all the information it considers necessary.

- 25. What should be the relationship between non-executive directors and executive directors, and with senior management? What should their relationship be with the Chairman and the Chief Executive? What should their relationship be with key advisers to the company?**

The primary relationship for Non-Executive Directors is with the rest of the Board including the Chairman and the Chief Executive. Interaction with senior management through the Board or committees may be desirable but it is important for operational responsibilities not to be compromised. The relationship with key advisers to the company should be via the Board meetings or Committees.

- 26. How can Company Secretaries support effective performance by non-executive directors?**

The Company Secretary should be at the heart of governance issues with a role in the induction, training, recruitment and appraisal (individual and collective) of Directors. The Secretary should also provide a line of communication and advice/information for Directors on governance issues and facilitate the flow of information to Directors. The necessary administrative assistance to support the Board, the Board Committees and individual Directors should be provided by the Company Secretary.

- 27. How much access to information from management do non-executive directors need to be effective? In practice, are information flows and communication channels sufficiently open and unrestricted?**

Information flows to Directors should reflect the management information prepared for management. The timing is important to ensure that Non-Executive Directors have sufficient time for pre-Board preparation. In practice, information flows and communication channels are considered sufficiently open and unrestricted.

- 28. What training and development opportunities are available? Could they be improved and, if so, how?**

Induction and training are provided for all Directors. On-going training (development) should be accepted as the norm and some recognised minimum requirements put in place.

**29. Can induction for non-executive directors be improved?**

Presumably induction and other training can always be improved. There is perhaps a need to ensure that new Directors provide feedback to the Company Secretary on the quality of the induction.

**30. Do non-executive directors get clear guidance on what is expected of them and do they get feedback on whether they are meeting expectations?**

The guidance to Non-Executive Directors as to what is expected of them tends not to be transparent. It is believed that goal setting, team sessions and evaluation (individual and collective) are areas for improvement and transparency – in the same way as these issues are addressed elsewhere in the company.

**31. To what extent do different factors apply in the case of smaller listed companies? Is different provision necessary?**

No comments due to lack of personal experience with smaller listed companies.

**32. What lessons can be learnt from international experience, either in terms of structures or behaviours?**

There is a need to be aware of developing structures, behaviours and standards internationally but at the current time there is no indication that other models, eg in the USA, have been any more effective in the Corporate Governance area.

**33. Do other models of corporate governance or different boardroom roles or dynamics contribute more to company performance?**

See answer to 32.

**34. Would it be beneficial to bring UK practice more in line with that in any other countries? If so, why and how?**

See answer to 32.