

Response by Edis-Bates Associates to the Review of the Role and Effectiveness of Non-Executive Directors

A: Role

What role should non-executive directors perform, and how does this compare to the present position?

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?*

In our experience, directors can be unclear as to whose interests they represent. Many will see themselves as working in the best interests of the company, considering this also to be in the best interests of the shareholders. But different groups of shareholders can have differing interests.

To help directors (particularly those less experienced) some form of clarifying statement as to the roles of the key directors and the board as a whole might be prepared and reviewed from time to time. Some companies already do this. This can sit alongside the statement of directors' duties to be incorporated into the next Companies Act.

The Chairman's role is pivotal in creating an effective board. Certainly informal discussions and formal meetings with the NEDs work well in practice.

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 elements of NEDs' roles, in our view, involve:

- Acting as a check and balance, including internal controls.
- Providing advice and support to the Executive.
- Reviewing strategy.
- Fulfilling committee duties.

Surely boards will benefit from the presence of a substantially diverse range of skills and experience. These should cover the key areas and fill any gaps. So, whilst all non-executives will be expected to display integrity, independence and curiosity about their business, they might all make other contributions which complement (rather than duplicate) one another.

We believe that a board with a majority representation by NEDs would be ideal in the case of a large company. We accept that for smaller companies, one-third might be more appropriate.

We have seen the benefits of diversity many times and boards with strength in only one suit (or discipline) are the poorer for it.

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

We have been surprised (during directors' training sessions we have run) how narrow the areas of know-how and experience have been. To provide balance, we have also encountered remarkably talented boards. Any steps which directors take to produce a broad, well-rounded set of skills and experience must be good news.

In technical areas (e.g. share options and other remuneration issues, Companies Act, Listing Rules and other compliance issues) we believe directors would benefit from increased knowledge and experience. We suspect that training for directors is not welcomed, but is much needed. We believe the level of training will not increase without some form of encouragement in the form of best practice.

For an individual NED faced with a specific real concern and an unreceptive management, the question is how to encourage the rest of the board to come to the right decision. However this is done, the onus is on the NED to challenge the executive. These matters can be mishandled unless an experienced NED is involved.

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

Whilst we are aware of instances where non-independent NEDs function very well and add value, we believe that a robust independence and a balanced, objective, unprejudiced approach is very much needed. We favour best practice guidelines such as those prepared by the NAPF.

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?*

No comment.

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?*

A non-executive who has no executive role is clearly able to spend more time on any one directorship than one who also works as an executive. The professional non-executive needs to build in some slack to enable him to spend additional time on those companies in crisis or otherwise needing additional input. A sensible limit on the number of positions he might hold would be four or possibly five maximum.

An executive in a full-time role might sensibly restrict himself to one non-executive directorship only.

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

We have witnessed in two specific cases the role of a Senior Independent Director working exceptionally well. In one case, the SID acted as contact point for institutional investors when the joint chairman/CEO was removed. In the second case the SID provided feedback from the institutions and others to the chairman, whose role (as a result) was carried out in a significantly better way.

It may be that the role of the “SID” should be built into that of the deputy chairman, and a clearer definition of that role established.

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?*

This will undoubtedly help directors understand their duties.

B: Attracting and appointing non-executives

What knowledge, skills and attributes are needed, and what can be done to attract, recruit and appoint the best people to non-executive roles?

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?*

We believe that it is the role of the chairman and the nomination committee to ensure that a range of skills is made available to the board by the non-executive contingent. This range should be determined by the kind of business the company is engaged in.

There should be an emphasis on relevant experience. For example, a NED from an academic background or the public sector may, in appropriate circumstances, satisfy a particular need (e.g. in a research-based company or one engaged in government contracts), but in most cases the non-executives must be able to contribute strongly within a commercial environment.

In relation to board committees, we believe that the committee chairmen should have (or acquire) strong skills in the relevant area. For example, audit committee chairmen should have a strong accounting or financial background (and be up-to-date on current issues). And remuneration committee chairmen should have a sound knowledge of remuneration issues.

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

- Integrity.
- Independence of mind.
- Experience relevant to the company.
- The confidence to challenge.

- 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.**

A broader range of diversity than currently exists on many boards would be desirable. The areas of experience and attributes will depend upon the specific company's requirements. For example, whilst BP will require international experience, a fledgling company whose market is overwhelmingly British may have other priorities. We have seen many examples where a NED has successfully taken a strong position on matters of integrity and on conflicts of interest.

- 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?**

The role of the Nomination Committee could be significantly enhanced. Rather than a rubber-stamping role, it might analyse the board's requirements (or oversee such an analysis), propose job specifications for key directors, carry out succession reviews and board evaluations, as well as carrying responsibility for directors' training. In our view this is an under-utilised committee.

- 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?**

The concept of internal non-executive directorships would provide a good training ground for younger directors and senior executives. This would enable them to be a NED in a group subsidiary and to learn from other NEDs. Furthermore, some form of mentoring relationship whereby experienced NEDs "sponsor" or lend support to more junior colleagues.

- 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?**

We believe that companies would be better served by their NEDs having fewer Non-Executive Directorships, but receiving an increased remuneration package. This assumes that they invest adequate time learning about the business.

We are in favour of NEDs receiving fees in cash (perhaps at the current fee levels), plus an award of shares (released after each three year term) and a requirement to hold an appropriate share qualification.

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

No comment, except that the risk of litigation will make the role of NED so unattractive (in the absence of some form of protection) that the best NEDs will wisely steer clear.

C: Structures and accountability

Do existing structures and procedures facilitate effective performance by non-executive directors?

- 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, based on best practice and a “comply or explain” approach, appears to be working very well. A small minority of companies (we found during our survey) are however fudging their compliance statement, by providing a less-than-clear statement about areas of non-compliance and their reasons.

In relation to the definition of independence, we favour best practice guidelines – specifically we believe the NAPF guidelines are good. We believe an explanation of the company’s position would be helpful in this regard.

- 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?***

Board committees are essential to facilitate governance and effective contribution. Remuneration and Audit Committee membership should not include executive directors, although in the case of audit it is perfectly acceptable for them to attend (except on specified occasions). The committee needs both executive and non-executive input. Committees should have the power to appoint their own advisers, e.g. remuneration consultants.

Board numbers should be small enough to allow constructive debate and large enough to represent all significant business units with a significant presence of non-executive members. Companies should ensure that all committees of the Board have comprehensive terms of reference.

- 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?***

The Chairman of the Audit Committee should either be a qualified accountant or should have a finance background.

The company’s internal auditor should have at a minimum a dotted line report to the Chairman of the Audit Committee who should also participate in the appraisal process.

The members of the Audit Committee should meet with the external auditors and the internal auditors without any executive presence at least once per annum.

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

In relation to Remuneration Committees, we have commented in our covering letter. We believe that Remuneration Committees should receive independent advice from remuneration advisers.

In relation to the Nomination Committee, see 12 above.

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?*

See 21 below.

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

We believe that the performance of the board (as a whole) and each of its members should be reviewed/evaluated annually, in the same way as staff are appraised. The National Association of Corporate Directors in Washington D.C. has published documents on this topic (e.g. "Director Professionalism"). A procedure for carrying this out, possibly involving the Nomination Committee or external advisers, would need to be established. This might be supplemented by a contemporaneous review of board procedures and the company's approach to corporate governance. Many companies already do this.

There is merit in publishing an attendance record.

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 can be difficult. A critical issue is whether NEDs should rely wholly on information from the executive, or is it appropriate for NEDs to demand more? We strongly support the latter view.

The company should be required to state the reasons for the resignation of a non-executive outside the normal cycle. Companies should not impose gagging clauses or make payments on the resignation of non-executive directors in exchange for silence.

D: Relationships with shareholders and others

Do existing relationships with shareholders or others need to be strengthened?

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?***

The company should offer major institutional shareholders a meeting with the chairman and the SID. In addition, investors might meet the chairmen of the Audit, Remuneration and Nomination Committees, to discuss issues covered by those committees.

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?***

The chairman should have specific terms of reference which should include promoting the structured relationships, dialogue, challenge and effective contributions.

The chairman should ensure that the NEDs have regular access to information, both in board packs and in many other formats (e.g. one-to-one meetings with operational and head office senior executives). He should also ensure the board meeting process is sound and regularly reviewed.

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?***

Non-executive directors should be entitled to access to all senior management. Such access should, where possible, be made through the Company Secretary. Certain appointments should be in the gift of the Board as a whole, such as Head of Internal Audit, Company Secretary.

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

Non-executive directors should use Company Secretaries as a channel of communication with the company and directors and senior executives.

They should also use the Company Secretary as a sounding board and as a source of information.

In many cases, the Company Secretary's position is seen as a servant of the board. We strongly believe that, in the area of corporate governance, the Company Secretary should have more authority, acting as an expert on an equal footing with the directors. Easier said than done!

One way of supporting NEDs would be to provide them with more support within the company. We have in mind the availability of office accommodation, intranet access and secretarial/administration support. These facilities might sensibly be provided by the Company Secretary's department.

E: Support

How can non-executive directors best be supported to perform their role?

- 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?***

Non-executive directors have a right of access to all levels of management to obtain information or clarification of information. Best practice would be for non-executive directors to contact the appropriate executive director failing whom the Company Secretary to inform them in advance of their request for information and to seek guidance as to the appropriate individual for them to consult. In the event that a non-executive director considers he has received an unsatisfactory answer to his enquiry he should take the matter to the Group Chief Executive or the Chairman.

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

The company should maintain an ongoing training and development programme for all directors, whether executive or non-executive. The aim of the programme should be to ensure that directors are informed of all new developments relevant to their role. This will include a variety of topics, in particular compliance issues and business data. The programme may include a combination of briefing papers, presentations, seminars and visits, but should at the least include some interactive sessions. A particular director or the Company Secretary should be designated with responsibility for ensuring that the programme is maintained and that each director participates in it.

In our experience, the induction process (in relation to the business) can be very thorough; it is the area of directors' duties, compliance updates and training generally that require bolstering.

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

All companies should maintain an induction programme for newly appointed directors, whether executive or non-executive. The induction programme should be tailored to each individual director to reflect his or her own experience but should cover the following items:

- The group's principal businesses; products; assets and competitor analysis.
- The role of a director; duties and responsibilities; corporate governance.

- The company's constitution; group structure; significant contracts; joint ventures; distribution agreements and strategic alliances.
- The board structure; committees; board processes; conflicts of interests and ethics.
- Group financial structure; borrowings and treasury policies and procedures.
- Risk management processes.
- The group's accounts; significant accounting standards; unusual conventions or items.
- Remuneration policies; share and incentive schemes.
- Current price sensitive projects.
- Group shareholders; principal advisers; recent market activity and analyst reports.
- Introduction to senior personnel; visits to main locations; introduction to products and processes.

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?*

Performance of all non-executive directors should be reviewed each year. See 21 above.

31 to 34 inclusive: No comment

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