

Questionnaire - Non-Executive Directors Review

A. Role

1. The role of non-executives on a Board is to contribute to and agree the overall strategic and financial policy of the company and to monitor progress against targets set. All Board members, whether non-executive Directors or executive Directors are equally responsible to shareholders and stakeholders and should be as open and transparent as possible about their current performance and future plans.

The Chairman's main role is to chair the whole Board and to help ensure a range of relevant skills and experience in those NEDs (non-executive Directors) appointed. The Chairman also needs to be aware of any concern NEDs, senior staff or indeed analysts have about the company's current performance and/or leadership. An equally crucial role is to work with and be a friendly but critical ear for the Chief Executive of the company.

2. It is the role of the Chairman, together with the Chief Executive, to ensure that NEDs have all essential information on which to make decisions and fulfil their vital watchdog supportive role. For NEDs to play an effective part in contributing fully to strategic decisions the Board needs to take, the earlier they are involved in emerging company thinking, the more useful their contribution is likely to be. Most NEDs bring - indeed are chosen for - particular skills and experience and to that extent may be helpful to the company in different ways. However, the main role for NEDs is to decide on the Board's overall policy and financial parameters.
3. Clearly some Boards use their non-executive Directors' individual skills at a secondary level of involvement in a more successful and targeted way than others. But clearly not every NED should be expected to fulfil the roles for which they do not have the necessary qualifications or experience. I'm not sure however that there is any one effective blueprint. It will depend on the company and the individuals concerned.
4. It is essential for NEDs not only to be independent but to be seen to be independent. Inevitably, we all think we are independent but identifying potential conflicts of interest needs very careful assessment, not least in light of the recent human rights legislation.
5. Two main conflicts can arise. The most important is when the Board loses confidence in its Chief Executive. This is the moment when NEDs, especially the Chairman, must be prepared to step in, taking executive responsibility temporarily to make key decisions on replacements etc. The second role, also of considerable importance, is in helping the Chief Executive evaluate the performance of senior staff. Here, the Chairman's role, together with those NEDs with particular relevant skills and background, can be particularly

helpful. Ensuring NEDs have all the necessary background information to help them evaluate the seriousness of a particular situation is crucial.

6. The Chairmen of FTSE 100 companies probably need to spend 2 to 3 days a week minimum and NEDs 3 to 4 days a month. The situation varies considerably between companies. Smaller companies may need less time but time commitment will inevitably depend on individual circumstances. The number of non-executive Directorships a person takes on depends on the time an individual has available. 3 or 4 such Directorships would seem a reasonable limit for those with at least some other responsibilities. The question of an NED's independence, as well as commitment, may also be called into question if too many Directorships are accepted.
7. Appointment of a senior independent NED could be useful and is increasingly popular. Their vital role is to liaise with the other NEDs and get their candid views on the company's performance. Regular meetings with analysts and investors (previously seen as the prerogative of executive Directors) is increasingly seen as a relevant responsibility.
8. The principal assumption that all - independent and executive - directors have the same legal responsibility is clearly right. However, in circumstances where NEDs have been deliberately misled and could not reasonably have known or foreseen what was happening, then equal legal responsibility would be hard to prove. However, it is assumed if the proposal for a statutory statement of Director's duties became law, then many believe it would be increasingly difficult to recruit NEDs. Their remuneration would also need to be considerably increased.

B. Attracting and Appointing non-Executive Directors

9. An accountancy background is probably the most popular source for NED recruitment. However, whilst it is important to be able to read and compare balance sheets, many other valuable disciplines are under-represented at Board level, for example lawyers and academics. Certainly a broad background of business experience as well as the appropriate level of seniority are important. However, in today's world there is also a need for at least some NEDs to have knowledge and experience of community and consumer expectations.
10. On personal qualities needed, judgement, objectivity, ability to work as a team player, lateral thinking, a sense of humour, a nose for potential trouble are some of the attributes to look for. Also important is an ability to put views on matters under discussion clearly, succinctly and persuasively and wherever possible, with suitable acknowledgement of others' contributions - even when you disagree with these.
11. Previously, of course, the selection and appointment of NEDs was seen as the prerogative of the Board's Chairman. Considerable improvements have been

made over recent years with many Boards setting up nomination committees as well as bringing in headhunters to assist them in identifying the skill gaps that a modern Board might have. For example, those with Human Resource and marketing expertise are now seen as useful to have as NEDs on the Board.

- 12/13 The assumption continues - to my mind mistakenly - that there is a considerable shortage of people with the right skills, attributes and experience for appointment as NEDs. Currently, every Board's favourite choice is the Chief Executive of another listed company.

My own view is that a far wider range of talents and experience need to be assessed. By far the largest pool of untapped talent and experience is women - 50% of the population. Some 27 years after the passing of the Sex Discrimination Act, many women by now hold highly relevant and responsible positions in a variety of employment areas. In addition to them having acquired the right level of seniority for appointment as NEDs, because of their different experience of life, they bring another important perspective to a Board's decision making.

International NED appointments are increasingly popular - especially for those companies working in a more global field. However, the first priority should be to look for a far wider range of untapped British talent and experience. In a nutshell, companies and headhunters are still far too conservative in where they look for recruits.

14. Responsibilities of NEDs have increased considerably over recent years. Overall remuneration should be proportionate to executive pay and any relevant market price. On whether this remuneration should be at least partly paid through shares or share options, there are two completely opposing views. 1. that by having shares in the company it shows commitment and 2. that by owning shares or share options, this imperils independence. I can see the force of both arguments!

C. Structures and Accountability

16. The Combined Code, which of course started some years ago with the publication of the Cadbury Report, has clearly made a considerable contribution to Boards' thinking and behaviour on Corporate Governance. Almost certainly this has helped to prevent some of the worst excesses seen recently in the US. However, those recent events have already led to calls for an even tighter regulatory framework for companies. As far as the balance between executive and non-executive Board members are concerned, my belief is there should always be more non-executives than executives. Finally, although there will almost certainly be further calls for a statutory definition of "independence", (not least again in light of the recent Human Rights legislation), I'm not convinced that such a definition would be helpful.

17. My own experience of Board committees is that they are useful and an effective contribution can be made by non-executive Directors. As far as Board size is concerned, between 12 and 15 is manageable.
18. Audit Committee should consist fully or mainly of non-executive Directors with the majority of these having a more detailed knowledge of financial matters. It is also important for the Audit Committee to have at least 1 meeting a year with the Auditors, without there being any executive Board members present. Audit Committees should not, however, be allowed to become over dominant. For example, the recommendations of the Turnbull Report on Risk Management specifically recommended that the responsibility for this should rest with the full Board. However, that particular recommendation that risk management should not be delegated to the Audit Committee is not always followed by Company Boards.
19. a) As I've already said, Nomination Committees are a relatively new concept and almost certainly their effectiveness could be and probably will be improved over time. My own view is that all NED positions should be advertised. Failing that, headhunters should be used in the vast majority of cases to help ensure that allegations of cronyism are less likely to be made.

b) Most remuneration committee members are also by definition highly paid members of other companies. Almost inevitably, the remuneration committee's expectation of what is the appropriate scale of executive remuneration has become somewhat incestuous. Consultants appointed to help with this task use an equally narrow band of comparative salaries to help the committee decide what the correct market level for their company's top executives should be.

The result is a growing public unease at the wide disparity of pay between what companies pay their top executives and what others at a comparative peer level of achievement receive - for example academic civil servants or those at the top of the medical profession.

E. Support

29. Far more information from management is available these days for NEDs. Certainly, in my experience any information I felt I needed was always provided. However, it's important for an NED to get to know the business sufficiently well to recognize when they haven't enough information to come to a sensible conclusion. Combined with that, they must have a determination to ensure they do get the information they require. On training and development for NEDs, much of this now takes place within companies. In addition, there are also external organisations who will train people to be non-executive Directors, both at company and at public appointment level.

As far as induction training for non-executive Directors is concerned, again this kind of training has grown considerably in the last few years. For this to be

really valuable, it should help the individual Director to understand where, in addition to main Board responsibilities, they could give added support.

30. Today, letters of appointment to new NEDs, apart from giving the length of time for which they will be appointed, also give a much clearer picture of what will be expected of them. Increasingly too Boards are evaluating their own performance collectively as well as individually.

F. **Smaller Listed Companies**

31. Smaller Listed Companies are far less likely to have any non-executive Directors on their Boards and yet this is exactly where experienced NEDs could make a considerable difference. The IOD and Ernst & Young have been urging this for some time.

At present, the usual age of retirement from a FTSE 100 company is 70, although this may (and certainly should) change when age discrimination becomes unlawful in the EU in 2006. But in any event, there are retired or retiring NEDs out there who could and should be making a considerable difference to smaller and medium sized companies.