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**Response on behalf of the**

**Institute of Chartered Secretaries and Administrators  
to the consultation paper**

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

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## **Introduction**

This response has been compiled by ICSA based on the practical knowledge and experience of professional Company Secretaries.

Input has been sought from:

- ICSA Members many of whom are involved in ICSA's original area of expertise – company secretarial practice in the UK;
- The Company Secretaries Forum. A Group of 20 senior Company Secretaries who provide the primary input into the Institute's thinking on company secretarial matters;
- The ICSA Company Secretaries Group. A specialist group of some 850 senior company secretarial practitioners, both Members and non-members of the Institute; and
- On this occasion, Company Secretaries of all FTSE 350 companies where not already covered by the above.

Whilst we have addressed all the issues raised in the consultation document, and, in fact, provided further comments towards the end which we felt also needed to be made, in prior discussion with the Review team we were asked to comment specifically on the contribution of the Company Secretary. We have, therefore, in addition to answering the particular question on this subject, included an appendix in which we provide additional comment and recommendations in this area together with a specimen job description of the Corporate Governance aspect of the Company Secretaries role.

As we mention later in the response, a Company Secretary who has the right knowledge and experience, but who also possesses integrity and the trust of the board, should make a major contribution to good governance. There is a strong argument for changes to safeguard/strengthen the independent role of the Company Secretary, but we are wary of making changes that would jeopardise the essential, trust-based, relationship between the Company Secretary and the directors. The safety valve for that relationship is a professional code of conduct and ethics to which the Company Secretary can point in times of difficulty. Membership of a professional body such as the ICSA also gives the Company Secretary added support should he come under pressure in adhering to that code.

We appreciate the recent circumstances that have given rise to this Review, but we would suggest that the UK is starting from an already high standard in comparison to some other jurisdictions. Nevertheless the Review provides a welcome opportunity to improve that standard still further.

## Main Points and recommendations

- We are strongly in favour of, and committed to retaining, the **unitary nature** of the UK board structure. Responsibility for board actions and decisions is, and should remain, the same for all directors. We have some concerns about the proposed statutory statement of directors' duties as worded but accept the concept in principle as long as it makes clear that the duties and responsibilities are the same for all directors. (Q1 & Q8)
- Subject to the preservation of the joint responsibility referred to above, it may be time to recognise, in Best Practice as opposed to legislation, a particular role for 'independence' and to ensure that only those non-executive directors (NEDs) who are **truly independent** sit on the key board committees. (Q5)
- Many of the perceived problems of the present structure may boil down to a failure on the part of directors, particularly **executive directors**, to appreciate their **legal responsibilities** as directors and the fact that these responsibilities are separate and distinct from any other responsibility they may have within the company or otherwise. This is a matter that should be clearly addressed during the induction process. (Q5 & Q29)
- Subject to certain caveats, Best Practice should be that NEDs should be **limited to no more than three or four NED positions** and that any one individual should not be Chairman of more than two Listed companies, nor should a Chairman of one company hold more than two other NED positions. However, the 'control' over this should be the Nomination Committee and company concerned. We **recommend** that '**other directorships**' **should be disclosed** in the Annual Report and that, if a Director has more than the recommended maximum number of appointments, the company should explain why it considers the commitment involved to be manageable. (Q6)
- The appointment of a **nominated senior independent director is divisive** and more often than not ineffective. If there is any need for a second contact point other than the Chairman it should be a Deputy Chairman. (Q7)
- The most important attributes for a director are **integrity and business experience**. In many ways integrity may be more important than independence as a director with true integrity will be able to put aside and ignore any other influences. (Q9 & Q10)

- **Remuneration** of NEDs is rising, and will continue to do so, reflecting the increased risk, responsibility and workload. A balance needs to be struck between a fair reward and an amount which risks compromising the independence of the director concerned. On balance we believe that NEDs should be paid in cash and, if they want to be classified as truly independent, should have no material interest in the company or its shares. (Q14)
- **Director's and Officer's liability insurance** is a subject that should be reserved for the board to consider. The difficulties in obtaining adequate D & O insurance at a reasonable rate may become a significant impediment to recruitment of NEDs. (Q15)
- The question of whether a director is **independent** or not should be one for the company to decide, but in doing so it should be prepared to convince shareholders of its point of view. (Q16)
- We believe the **Combined Code** to be working reasonably well and **suggest** that, to allow for flexibility in specific situations and for more rapid changes in the light of events, any changes or requirements resulting from the Review should be incorporated into the Code rather than in Statute. (Q16)
- Although the **size of a company's board** will be influenced by the size, complexity and nature of the organisation, we believe that somewhere between 8 and 12 directors is the optimum for most companies. (Q18)
- It should be a requirement of the Combined Code that the board should undergo a **regular, and objective assessment of its effectiveness**, that a statement that such an evaluation has been carried out should be included in the Annual Report, but that the company should not be required to disclose the results of such evaluation. (Q21)
- It is important that NEDs particularly, have the **strength of character** to stand up to their fellow directors and be able to argue their case constructively. (Q22)
- We **suggest** that consideration be given to amending the Combined Code to incorporate a provision allowing any director to make a statement at a general meeting of the company. (Q22)
- We do **not** concur with the view that NEDs should be required **to meet separately with shareholders**. (Q23)

- We believe that shareholders should be **more questioning** when it is proposed that **a CEO moves to become Chairman**. (Q25)
- **Company Secretaries have a pivotal role** in the efficient operation of, and support to, the board. Whilst we agree with the suggestion that changes should be made to support the Company Secretary and protect his independence, we are concerned that nothing should be done that would jeopardise the essential trust based relationship between the Company Secretary and the directors that underlies this position. (Q26)
- For consistency it should be a requirement of the Combined Code that the Company Secretary, or his nominee, should act as **Secretary to all board committees**. (Q26)
- Efforts should be made to identify training requirements of directors. Particular attention should be paid to induction training which should include guidance on the **role and responsibilities of the directors themselves, the Chairman and the Company Secretary**. (Q28 & Q29)
- The Company Secretary should be seen to have the full support of the board and, specifically, the Chairman. To this end the Combined Code should be amended to make it clear that **the reporting line for Company Secretary** should be direct to the Chairman. (Appendix)
- Greater emphasis should be placed on the **directors' duty to appoint**, to the position of Company Secretary, someone who has the requisite knowledge and experience to carry out the functions required of the role. (Appendix)
- To avoid conflicts of interest, it is fundamentally wrong for **internal audit** to report through to the Finance function. (Appendix)
- The role of Company Secretary is a separate and distinct function and should not be assumed by the Finance Director or a member of his team as this may give rise to severe conflicts of interest. (Appendix)

Please note that, for simplicity of drafting, we have used the masculine form of address throughout this document, i.e. in referring to he/his. We recognise, however, that there is a welcome growth in the number of female directors (and Company Secretaries) and, therefore, these references should be read to include the feminine also.

## Detailed response to questions

### 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?**

The principal role of the board is to set the strategy/direction of the company, to monitor and hold accountable management for implementing it and to allocate the resources necessary to achieve it, with the objective of maximising the return to current and future shareholders.

The role of the Chairman is to chair and manage meetings of the board and shareholders, to be the public face of the company (particularly on corporate governance issues) and, with the aid of the Nomination Committee, ensure continuity by effective succession planning. The Chairman also plays an important leadership role in guiding the board in setting the strategy of the company. In chairing the meetings, the Chairman should ensure that they are effective, that all directors have an equal opportunity to participate and, accordingly, should encourage directors to take an active part.

In some cases the Chairman may also have certain executive responsibilities delegated to him by the board the extent of which will depend, to some degree, on whether the company also has a separate Chief Executive (CEO).

We do not see that the Chairman's principal role as regards non-executive directors ("NEDs") differs from his role to any other director as regards their membership of the board.

**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 role of NEDs is to bring a 'real world' (or at the very least an external) focus and influence to the board's discussions - particularly as regards the consideration of strategy and business development and its implementation. Whilst taking care to maintain the unity of the board, NEDs should also play a constructive role as devil's advocate, particularly where one member of the executive is so forceful as to make it likely that other executive directors will always concur with him. Their role is to be objective, to support but also to challenge the executive directors and, consequently, they need to know enough about the business to do this effectively and understand when things are going wrong.

There are a number of other aspects to the role such as:

- i) opening up business opportunities through new contacts and experience,
- ii) acting as a confidant to and providing advice to executive directors and commenting on their ideas/plans,
- iii) serving on board committees eg Audit and Remuneration,
- iv) safeguarding shareholders' and other stakeholders' interests by ensuring these are paid regard to when business decisions are taken,
- v) helping to maintain an ethical climate and encouraging probity in the conduct of the company's business,
- vi) monitoring and reducing, where they exist, executive excesses (although it is not enough just to spot these when the share price or dividends are plummeting)

Whether or not a board operates effectively will depend largely on the experience and judgement of directors and their willingness to challenge robustly the executives and each other when confronting situations and decisions. A NED must be prepared to 'go it alone' if necessary. NEDs should not generally be serving for the sake of personal development: the key factor is that they are able to, and do, make a positive contribution.

It is unrealistic to expect all NEDs to fulfil all roles; they should have been selected for their diversity of background and experience, which will equip them better for some roles than for others. Each company should identify the specific skills, attributes and knowledge that it requires to meet its overall needs and those of its board. Serving on the Audit and Remuneration Committees, for example, should be reserved to the genuinely independent NEDs.

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

In principle it does not differ, but each company will have taken its own approach to the selection of NEDs and to making use of their abilities. It is clear however that some have been better than others in identifying their specific needs and some more effective than others in their use of NEDs. The key is to ensure that the best practice of many companies (not necessarily the largest) is shared with, and adopted by, the majority.

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

Independence is crucial for the role of safeguarding the interests of shareholders and other stakeholders and therefore to serving on the board and its key committees.

What makes a director independent, or more importantly what might jeopardise independence, is the subject of varied opinions. In our view, far more important than independence is integrity. If a director has integrity then he is much less likely to be swayed by 'other' influences. Independence is clearly not essential to the role of opening up business opportunities nor, necessarily, for monitoring or challenging the executive management. However, integrity, and the ability to influence the other members of the board, is a determining factor.

**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?**

The first point to make here is that, under the unitary board system, all directors have the same duty and responsibility. We believe this is the most appropriate system for UK plc and one we are very concerned to preserve (see response to Q8 below). Whilst it is arguable that it should be the role of, particularly, the independent NEDs, more than of the executive directors, to take a wider view of what is good for the company – the ‘stakeholder’ rather than the narrower ‘shareholder’ approach - and whilst they may be better equipped to do so, the fact remains that the same duty rests with all the directors.

It has to be recognised that some of the activities of NEDs that we identify in answer to Q2 above may not sit comfortably together. Setting executive pay and incentives, which requires an independent perspective, may be problematic where the NED has been instrumental in setting business strategy and facilitating opportunities for the business. Subject to preserving the joint responsibility referred to above, one possible solution may be to recognise in best practice a particular role for independence and ensure that only those NEDs who are truly independent sit on the key board committees. To recognise such independence, Best Practice guidance could also give them special responsibility for ensuring that the board as a whole has due regard to the interests of shareholders and other stakeholders.

Conflicts of interest can arise for a number of reasons. The most frequently mentioned include the fact that executive directors are often seen to have their own job preservation in the forefront of their minds and that their ‘fat cat’ salaries seriously jeopardise their ability to apply the necessary independent judgement. The experience of the ICSA in this respect is that the popular view is incorrect. Executive directors are strongly influenced by their perceived loyalty to the Chief Executive and the management team but this does not (in most cases) blind them to an inherent sense of justice and responsibility to the company and its stakeholders. The NED’s role on the board and its key committees such as the Audit and Remuneration Committees, are obvious ‘protections’ here. Inclusion on the Nomination Committee should also guard against abuse by making sure that each director’s contribution is ‘independently valued’ when directors come up for re-election.

Undue influence generally can be a major problem. The independence of NEDs is often seen to be compromised by too great an interest in, or involvement with, the company itself, the existence of cross directorships or close links with other parties such as individual creditors, professional advisers, consultants or even major shareholders. As mentioned above conflicts of interest can arise where, for example, executive directors are backing a powerful chief executive because they have a reporting line to him and may feel that they owe their positions to his patronage. NEDs can help here by trying to establish themselves in the minds of the executive team as confidants (see Q10 below) but what this may boil down to is a failure on the part of executives to appreciate their legal responsibilities as directors. This underscores the need for training for all directors (see response to Q28 below).

The essence of the UK structure is that every member of the board should be able to separate their role as a director from any other interest they may have within the company or otherwise. Company law provides adequate guidance on what should happen if a conflict of interest does arise. The right for directors to seek independent professional advice (see ICSA Guidance Note 011102 enclosed) and to have unfettered access to the Company Secretary are key points here.

**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?**

There is some dispute as to whether any Chairman can be accurately referred to as being non-executive as the time commitment necessary to do the job effectively has to be considerable. The Chairman also needs to have a reasonably comprehensive understanding of the business such that some argue it cannot possibly be a non-executive position let alone an independent one.

The Chairman should be available to the CEO at all times and, conversely, should himself initiate regular contact with the CEO to ensure that he is kept abreast of things. The ability and capacity for work of different individuals varies considerably but in general we would not expect any one individual to be Chairman of more than two Listed companies nor for a Chairman of one company to hold more than two other NED positions.

The time commitment required of a NED will largely depend on the demands that the company places upon him. It is certainly no longer enough (if it ever was) just to read the papers on the morning of the meeting. In addition to the commitment necessary to meet obligations arising from membership of various committees, it is essential that the NED takes the time to understand the business of the company which would include such things as site visits etc. It is also important to maintain a dialogue, at least with the Company Secretary, to ensure that the NED understands the issues affecting the company and/or those before the board at any point in time.

Commonsense dictates that there should be a limit on the number of directorships an individual can handle but it will not be the same for all individuals and may be difficult to prescribe by law or regulation. It is hard to see that any one individual can effectively fulfil the requirements of more than three or four NED positions especially where one or more of them are overseas appointments. Whether such limits should incorporate directorships of subsidiary or unconnected private companies must depend on the nature of those appointments. In many cases, the appointment is purely a paper exercise and the 'extra' work involved is minimal. In other cases, the subsidiary may be a fully autonomous operating company where the workload may be just as demanding as an entirely unrelated appointment.

An example of the problem is that of Allan Leighton, the former head of ASDA, who has been appointed to 10 NED positions, and has been criticised by some institutions claiming that he cannot possibly devote enough time to each role; he has argued that the different positions require different inputs at different times.

One way to address this issue would be to evaluate the contribution of NEDs formally (see response to Q5 above). Allan Leighton's critics will, presumably, be silenced if his companies consistently outperform their industry averages but generally, for the reasons given in the preceding paragraph, we prefer limiting the number of NED appointments for each individual.

Control effectively lies in the hands of the Nomination Committee and the company making the appointment and there is a strong argument for Combined Code guidance on this point. We **recommend** that 'other directorships' are disclosed in the Annual Report. It will then be open to shareholders to object to the appointment if the director appears to be taking on too much. If the number of 'other directorships' disclosed might exceed the accepted limit, the company should be free to explain in the Report why it considers the commitment involved is manageable.

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

The Combined Code already seeks to create a special role for a senior independent NED. We have always argued against this, believing that it is likely to be very divisive. We recognise the view of institutional shareholders who wish to have a contact through which they can raise any concerns about the chairmanship of the company but such a shareholder should know the directors sufficiently to be able to identify the most suitable conduit should such action be necessary.

Indeed anecdotal evidence suggests that the senior independent NED has, on occasions, been ignored by institutions who have raised concerns with other NEDs on the board. In at least one case known to us, an approach to the senior independent NED was referred by him directly to the chairman over whom concern was being expressed.

There may however be a case for a senior independent NED where the role of Chairman and Chief Executive are combined. The problem is that even the title itself implies a divide in the boardroom. If such a position is deemed necessary, we would much prefer the appointment of a Deputy Chairman which will be seen as much more supportive and therefore less likely to create division than a nominated senior independent NED.

**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?**

We do have some concerns over the proposed statutory statement of directors' duties as laid out in schedule 2 of the Government's white paper Modernising Company Law. For example clause 1(b) raises a question over the extent to which shareholders as a class (or in general meeting) can 'instruct' the board and consequently interfere with the management of the company<sup>1</sup>. Also the obligation 'to act in the way ...most likely to promote the success of the company...' raises some concern about the directors' obligations e.g. when there is no reasonable prospect of success.

That said, we do support a statutory statement of directors' duties and especially one which makes it clear that they are the same for all directors. We believe it important that the present 'unitary board' situation, where all directors have the same legal responsibility for the actions of the board, should be retained. The single board structure engenders a 'community of interests' amongst the members who are fixed with 'cabinet style' responsibility for decisions and their consequences. In practical terms, however, a NED will rarely have the same degree of knowledge about an issue as an executive director will have. This situation is recognised, for example, in clause 4 of the proposed statement of directors' duties and by s 214 (4) of the Insolvency Act 1986.

Reported experience of some European two tier boards indicate that Supervisory boards are often little more than statutory 'rubber stamps'. From a subjective point of view the Supervisory boards exercise little, if any, control or challenge over the behaviours and decisions of the executive management.

## **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?**

Integrity and business experience are probably the most important attributes that all directors should possess. Companies are, after all, about making legitimate profits for shareholders. Boards should be concerned with raising productivity and profitability in the context of sound and ethical business practices and with due regard to the interests of shareholders and other stakeholders.

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<sup>1</sup> Most companies' Articles of Association clearly confer the power of management on the board not the shareholders. See regulation 70 of Table A

Certain knowledge-based skills, such as accountancy or marketing, will depend largely on the balance of skills already available in the boardroom and on the nature of the company and the business it is in. For example, a wholesale distributor is unlikely to need specialised retail marketing skills and a small company with few employees will not need the same HR input as would a company with many thousands of employees. The important thing is to ensure that the board as a whole has the skills necessary to understand and run the business.

All directors, however, need a basic financial understanding and at least one or two of the NEDs should have a higher degree of financial awareness, appropriate to the company, so that they are not totally dependent on the advice provided by the Finance Director or even outside advisers. With the increasing use of electronic communications, basic IT skills are already desirable and will become more so over the coming years. Good diplomacy and communication skills are needed to be able to get across their point of view constructively and without causing major discord.

A knowledge and understanding of the major Corporate Governance issues is essential for NEDs, although this can be assisted by the Company Secretary.

It should also be recognised that possession of all the appropriate skills is not sufficient if the board is starved of the requisite management information. Directors should have the strength of character to press the Chairman and CEO until such time as the board receives the information which will enable it, and its committees, to function effectively. The Company Secretary, who normally collates such information, can be a useful conduit for the board and management in this respect.

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

We have mentioned above some of the attributes needed by NEDs but integrity is probably the most essential. NEDs also need objectivity and to be strong-willed enough to challenge the executive team. They should have the ability and willingness to ask even the most mundane of questions when required, but to do so in a constructive way.

NEDs should be prepared to admit when they do not have the knowledge necessary to assess a particular situation and not be afraid to bring in expert advice when needed. They will also need to be able to work well as part of a team and must have the strength of character necessary to stand alone on a point of principle if the circumstances warrant it.

An essential requirement is regular attendance at board meetings. Too frequently NEDs miss meetings and companies should give consideration to the automatic removal of a director who misses too many meetings without good cause. (i.e. to enforce a power which already exists in many companies' Articles of Association.)

One problem that is not always given enough attention is how to part company with a NED when he reaches a certain age or comes to the end of his tenure. Even where the appointment is for a fixed term, renewal is often expected to be automatic. NEDs should perhaps be more inclined to recognise when their 'usefulness' has diminished and the time has come to move on. This situation is often aggravated by the fact that ready replacements are not always to hand, a situation that the Chairman and the Nomination Committee should be planning for well in advance.

**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.**

As we mention in answer to Q9 above, this will be largely influenced by the nature of the company concerned, e.g. the board of a high tech software company will have a very different look to that of a heavy engineering company or an international bank. An effective board will have a balance of skills, ages and abilities but there also needs to be a balance of executive directors, NEDs and independent NEDs. It follows from this that not all NEDs are, or need to be, independent and there is a definite role for all three categories of director.

Management can frequently benefit from 'wise old heads' matched or balanced by younger, more ambitious new talent. The essential thing is to get a good mix where the skills and abilities of the members compliment each other and who can work well together as a team.

Some executive directors are more open to corporate governance issues than others and the NEDs can frequently play an important role in steering things in the right direction. The general experience regarding the effectiveness of NEDs is very positive although the circumstances make disclosure difficult as it is too easy to identify the companies involved. We are advised of situations where NEDs have acted to resolve company performance issues, sometimes involving the replacement of a CEO or Chairman. Also, where there were corporate governance concerns arising from an imbalance of authority between the roles of Chairman and CEO, NEDs have been in a position to bring about significant changes in a discreet way through being seen as independent by those directly involved.

We are advised of one situation where the chairman of the Audit Committee made a very helpful and constructive contribution to a key regulatory relationship. On the other hand, another experience reported to us is that of a UK Holding Company which, although a subsidiary of a US multinational, had a majority of NEDs on its board. Despite including some well-known names amongst the NEDs, they were virtually ineffective as they were not prepared to stand up to the parent company and merely acted to rubber-stamp the parent company's behind-the-scenes decisions. As we have said in answer to Q10, integrity and strong will are the keys to an effective board.

**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?**

It is often difficult to recruit a range of ages as few younger people are free enough to take on the role. (It is however a good opportunity for a company to give a young executive broader experience by allowing him or her to take up one non executive post in another company providing he is sufficiently experienced and knowledgeable to make a positive contribution in a role which differs from his executive role.) The ‘pool’ of NEDs is currently quite small and many, specifically smaller, companies have reported difficulties in finding suitable candidates. We believe the situation could be alleviated a little by better advance planning by Nomination Committees to give themselves longer to identify possible candidates.

Longer term planning, possibly during an annual discussion between the Chairman and the NEDs (without the other members of the board) may also be beneficial.

Companies might also consider advertising more publicly rather than resorting to head-hunters who tend to fish in a small pool. Recruitment consultants themselves could also do more to identify potential NED candidates rather than sticking to the old boy network. Looking at it from the other side, how easy is it for someone wishing to be considered for a NED position? To whom should he make his interest and availability known and stand a reasonable chance of success?

**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?**

There is, to our knowledge, no restriction on where non-executives may be recruited from except in so far as companies have traditionally used the ‘old boy network’. Ideally the NED element should be drawn from a resource which is skilled in industry and commerce in its broadest sense although one would normally avoid recruiting someone currently in the same business sector to avoid potential conflicts of interest.

There is an argument for having at least one NED who is a serving CEO of a major listed company as this helps to keep the skills ‘fresh’, although his induction training (see Q29) will have to help him work effectively in a non-executive role. Senior managers, one step below board level, might also provide a wider pool of NEDs for medium-sized and smaller companies and the experience and corporate governance knowledge (as well as, at least in the case of Chartered Secretaries, knowledge of law, tax and business finance) of Company Secretaries could be useful attributes in a NED.

Whilst international representation will be desirable for a company with international operations or ambitions, or which is subject to competition from overseas, we see no need for it generally. Experience in one market, while helpful, is not necessarily transportable to others. Overseas directors, particularly from the US, may also require significantly higher fees than those in the UK which could be a public relations issue for some (although see our response to Q14 below). It can also cause logistical problems and higher costs associated with attending meetings etc.

**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?**

In recent years the time commitment required of NEDs has increased considerably, especially as regards committee work. The workload has also increased as a result of the focus on corporate governance issues and the risk of damage to one's reputation is also significantly higher than it was. It is probably the case that remuneration has not kept up with this increased risk and responsibility although it is moving in the right direction. If there is to be a limit on the number of NED posts any one individual can have, then remuneration levels will undoubtedly have to increase further to compensate.

It is important that NEDs are adequately paid for their services but they should not be significantly dependent on this remuneration such that it would impair their ability to stand on their principles as and when necessary. This may become a problem if NEDs are restricted to say three positions - where standing on a point of principle may jeopardise one third of their income. This applies equally to a non-executive Chairman as, if overly dependent on his remuneration, he may be dominated by a strong-minded CEO to the point where the Chairman might be expected to manage the board to a decision with which he might not be in total agreement.

A balance needs to be struck between paying them a fair rate for the job and paying so much that it risks compromising their independence. It has, however, been argued that NEDs become more accountable the more they are paid because the performance expectations might be commensurately higher, but we do not subscribe to this view.

The form of compensation has been the subject of debate for many years with some advocating payment in shares (to align the director's interest with that of the shareholders) and others demanding that all payments should be in cash to avoid compromising the director's independence. It seems however that most agree that share options should not be part of the package.

It is perhaps a little surprising that, in the UK, it is generally thought desirable for a NED to build up a shareholding in a company whilst share options are regarded as compromising their independent status. The risk of loss on a shareholding must be just as likely to compromise independence as the risk of a gain on options. Truly independent directors should not be paid in shares or receive share options and should not even have an interest in the company's shares. We are inclined towards the idea that all NEDs should only be paid in cash.

We did consider the suggestion that NEDs should be allowed, if not encouraged, to buy shares in the company themselves with, to avoid any short-termism, a restriction on being able to sell them for say three or five years after leaving. Whilst this has some attractions, in that it would help to align the director's interest with that of shareholders generally, it could create difficult situations. The restriction on trading would hit at the very moment when a director is most likely to need cash to replace a lost income. Also, if introduced, would a similar restriction also have to apply to executive directors? On balance we felt that this would act as a serious deterrent to people becoming NEDs and problems outweighed the benefits.

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

This may be **the** most important impediment to the recruitment of a wider base of NED candidates. We strongly believe that s310 Companies Act 1985 needs updating and welcome the recommendations in paragraphs 6.2 & 6.3 of the Final Report of the Company Law Review<sup>2</sup>.

Adequate Directors and Officers insurance without an exclusion for “insured versus insured” is becoming increasingly difficult to obtain<sup>3</sup>. It is now very difficult, if not impossible, to obtain cover above £50m in the aggregate and then only in Excess layers.

There is a definite gap in the market for legal expenses cover for both current and former directors. What do they do, for example, during the period prior to there being a claim which can be registered with the D & O insurer?<sup>4</sup> Inadequate cover will undoubtedly deter people from accepting the responsibilities and liabilities that go with being a director. Even an indemnity from the company will be inadequate if, for example, it is the company which is suing the director for negligence or the company has become insolvent.

**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?**

We believe that the Combined Code is, generally speaking, working well although it has not entirely overcome the ‘box-ticking’ mentality. We would not advocate tinkering with the Code just for the sake of appearing to be doing something, but there are issues as we have mentioned elsewhere in this response which could be dealt with in this way.

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<sup>2</sup> S310 invalidates any provision exempting any officer or auditor from, or indemnifying them against, any liability for negligence, default, breach of duty or breach of trust in relation to the company. Paras 6.2 & 6.3 suggest several changes to S310 e.g. that it should not extend to officers other than directors and that it should only apply to liabilities under the general duties to be incorporated in the statutory statement of directors’ duties.

<sup>3</sup> Many policies exclude cover for actions between parties covered by the same policy eg the company and the directors. In such circumstances the director would not be covered if sued by a fellow director. In the past, many policies also excluded cover where the company sued the director but this latter restriction, which is common practice in the United States, is less typical in the UK at the present time although we understand that it is a factor in the Equitable Life case.

<sup>4</sup> D & O insurance frequently only covers amounts that the insured is legally liable to pay e.g where they have been found liable by the court. This means that the company or director have to fund the costs up to that point.

There are some problems with certain ‘representative bodies’ resorting to arbitrary yardsticks, e.g. a director that has been in place for nine years can no longer be considered independent, and this leads back to a box ticking approach: a backward step we are particularly concerned about. Some Institutional investors, however, are beginning to take a more pragmatic approach and showing willingness to take the particular circumstances of the company into account.

We have also mentioned elsewhere that there is a place on the board for executive directors, NEDs and independent NEDs. The Combined Code recommends that NEDs should make up at least one third of the board and that the majority of the NEDs should be independent. We believe this balance to be fair and reasonable although it has to be recognised that in a relatively small board of say six with the minimum number of NEDs (two), this places a higher workload on the NEDs. With a larger board and NED contingent the workload can be more easily spread. The main problem, however, seems to arise with the definition of independence, any dispute over which could affect whether or not the Combined Code recommendation is met.

It should be up to the company to decide whether a director is sufficiently ‘independent’ but in doing so it should be prepared and able to convince shareholders to its point of view. This is contrary to the ‘box ticking’ mentality where, however strong the company’s argument, an ‘advisory service’ recommends an ‘against’ vote. That said, there are certain factors which must be considered to disqualify someone, eg family membership, cross directorships and relationships with major suppliers, customers or even, as we mention elsewhere, with major shareholders. In general, a NED will not qualify as independent if he has been a previous executive of the same company, or if he has any material financial involvement with it (other than fees).

Other than the ‘senior independent NED’ the Code does not propose a different role for executive, non-executive or independent directors: nor should it. The joint nature of the unitary board should be enhanced, not diminished by further categorising sub-groups within it. The answer may lie in being clearer about what constitutes independence and what, if any, additional role the independent NED fulfils. On this latter point see our response to Q5 above.

In summary, we prefer any requirements arising from the Review to be incorporated in the Combined Code (to allow for flexibility in specific situations and for more rapid changes in the light of events) rather than in statute.

**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?**

We have enclosed with this submission copies of the ICSA Guidance Notes on Terms of Reference for the three major board committees in which we give our recommendations for their size and makeup.

It is quite clear from almost daily headlines that some boards are not working as effectively as they might. The question does, however, correctly identify that it is the board procedures that are all important. Regular, well run and well informed meetings addressing a specific schedule of matters reserved for the board to deal with, will assist in improving the board's effectiveness. ICSA has recently introduced a Board Performance Evaluation Service, details of which have already been given to the Review team. The ICSA service focuses on the evaluation of the board processes and information flows, ie the effectiveness of the board as a working unit rather than the performance of the individual directors.

The size of a company's board will depend largely on the specific nature of the company. However, it is obviously essential to have sufficient directors to carry the load and, particularly, enough NEDs and Independent directors to provide the right balance. Too many directors will however tend to make the board too unwieldy and ineffective. We believe somewhere between 8 and 12, depending on the size and nature of the company, to be the optimum size for an effective board.

**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?**

As mentioned above, we enclose a copy of our Guidance Note *Terms of Reference for Audit Committees* in which we give our views and recommendations on the composition and role of the committee. We would, however, emphasise that the Audit Committee should have a key role (as spelt out in the Guidance Note) in relation to the internal audit function where one exists.

Whilst we would not go so far as to say the Audit Committee should appoint the external auditors (this is a matter for the shareholders) it should have a significant role to play in this area, making recommendations to the board which should in turn explain the reasons in the Annual Report should the Audit Committee's recommendations not be accepted.

The Combined Code requirements are best kept to points of principle but the Code could benefit from a better description of the role and objectives of the Audit Committee. (See attached Guidance note)

There is an argument that the Audit Committee should comprise all the NEDs on the basis that this can help reduce the need to repeat the Audit Committee's discussions at board meetings and give the directors a more in-depth understanding of the company. Where there are sufficient numbers of independent NEDs, we do not favour this approach as not all NEDs (i.e including non-independent NEDS) will have the required skill set but minutes of Audit Committee meetings should be circulated to all the directors.

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

We enclose copies of our Guidance Notes *Terms of Reference for Remuneration Committees* and *Terms of Reference for Nomination Committees* as referred to above. These incorporate our views on their composition and duties.

As regards practical operation, we do question the way that external consultants are used by some Remuneration Committees as, although they can provide an independent view, it is important that they are properly managed. They are only as good as the terms of reference set for them (or assumed by themselves).

**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 practices vary considerably from company to company but the general impression is that most executive directors are now set objectives in agreement with the Remuneration Committee and performance against those objectives measured at the appropriate stage to decide bonus levels. In our opinion, it is not common practice for boards (as a whole) to set objectives – other than perhaps the attainment of the agreed strategic plan – and most boards seem very reluctant to undergo any form of assessment.

It is often claimed that Chairmen themselves carry out assessment of the board. Whether or not this is the case we do see a definite problem with this approach. The obvious concern is that the problem may be with the Chairman himself and other directors may be reluctant to raise this with him. In addition, if the Chairman does not agree with an issue it can very easily be dropped.

**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 it is incumbent upon a board to ensure that it is working effectively as a unit but, as we stated in response to the previous question, most boards seem reluctant to undergo this. There is, therefore, a strong argument for making this a requirement under the Combined Code.

Shareholders have a right to be reassured that the board has undergone an objective assessment process on at least an annual basis and the nature of that process; however, confidentiality would make it unwise to require companies to report the results of a board evaluation. The Board Performance Evaluation Service offered by ICSA allows the company to include in its report and accounts a statement that it has undergone the process (if it wishes to do so). A description of the service offered by ICSA has already been provided and a broad outline is enclosed with this submission. We would, however, be pleased to provide further details if required.

**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?**

The corporate governance initiatives of the last decade have emphasised, to some degree, the monitoring role of NEDs at the expense, perhaps, of their more positive strategic role. It is, however, critical to note that strengthening the role of NEDs would not stop another Enron or WorldCom if executives are intent on committing fraud and then covering it up.

If the NEDs are just saying ‘no’, that is counter-productive. They are there to ask ‘why?’ or ‘have you thought of?’ and to say ‘when I was in Germany I was.....’. Whilst there is a role for NEDs to play as corporate governance policemen, especially the independent NEDs (see our comment in response to Q5), we should also be looking for a more active input from NEDs in the company’s affairs.

As mentioned previously the strength of character to stand up to others and constructively to argue a case is essential for NEDs. If they are subsequently unable to live with a board decision, they have the right to have their objection minuted or in the extreme case to resign. We understand that some companies include a provision in their Articles allowing any director to make a statement at a general meeting; whilst such a situation would be divisive, it might be more constructive than resignation and we therefore **suggest** a recommendation along these lines should be incorporated into the Combined Code.

Confidentiality must go with the director role and there should be no scope for encouraging some external organisation or the press to second-guess a board decision that is yet to be implemented. (Though the press can and will pillory decisions that, with hindsight, are shown to be wrong.)

As a general rule, standard terms of appointment should make it clear that contact with the media should only be with the prior consent of the Chairman. We would however mention Lord Denning’s comment that there can be no confidentiality concerning inequity – confidentiality obligations can be overridden by circumstances. Guidance as to what such circumstances might be could be useful.

The question refers to ‘serious problems’ but it is not clear what this implies? If there are illegalities, the duty is clear. If strategies are not working out, that is an internal matter and the exposure should be to the board, to be resolved by changing the management.

**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?**

It is very difficult to give a general answer to this question as the relations vary considerably from one company to another. As far as we are aware, institutional investors are already able to access directors, whether non-executive or not. There is, however, increasing caution being expressed because of the provisions of the Financial Services and Markets Act. Quite rightly the rules governing the provision of information to shareholders and 'the market' are tightly drawn. These are difficult enough for a company to police when external contacts are limited to a small list of approved speakers (such as the Chairman, CEO and Director of Corporate Affairs). It would be even more difficult if NEDs were also authorised to speak to shareholders/stakeholders.

We do not believe there is any need to 'strengthen' the relationship between non-executives and shareholders and/or other stakeholders. We do not concur with the view that shareholders should specifically meet with NEDs by themselves other than in exceptional circumstances. To do so, especially on a regular basis, is likely to create more problems than it solves in that it could be very divisive. It would also give the executive directors the opportunity to disclaim any responsibility for what was said at such a meeting. The board should act as a cohesive unit and should consult with shareholders on a regular basis. If institutional shareholders subsequently have a problem, they will quickly make it known to the board.

In our experience, shareholders tend to be mainly interested in the operational aspects of the business and NEDs are far less likely to be able to answer questions in this area than the executive directors. It might also make NEDs appear unsure or evasive thus creating an unfavourable perception, possibly unfairly. If the issue is one of Corporate Governance, this is probably best raised initially with the Company Secretary or Chairman or, if the problem is the Chairman, with the Deputy Chairman (see Q7).

By the same token, we do not see a case for shareholders to be directly elected to the board except in exceptional circumstances. Such a director would be unlikely to qualify as independent and there is a distinct risk that he will take a parochial rather than a broad interest in the company's affairs. On the other hand, directors need to recognise their responsibilities to all shareholders. Some directors seem reluctant to accept even once a year that they should spend time after the AGM with shareholders.

- 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 quality of the Chairman is all-important in this as is the relationship between the Chairman and the Company Secretary. Management of meetings is an art but a good Chairman will ensure that all directors have their say and are able to make a full and effective contribution.

An effective Company Secretary will ensure the correct and adequate flow of information so that all directors, and particularly the NEDs, who are not generally as immersed in the day-to-day business as are the executives, are properly informed. The Company Secretary will also act as a focal point for directors seeking further information, clarification or advice.

There should however be a continuing dialogue between the Chairman/Company Secretary and NEDs outside the formal board meeting.

The question does seem to overlook the role of the CEO. If the CEO is uncooperative with the NEDs, the other executives will follow suit. Conversely, many CEOs appreciate the constructive assistance they can get from their NEDs. This goes back to our earlier comment about the willingness of the Chairman and CEO to set the tone – irrespective of what may be stated in a corporate governance code. If they wish to pull the wool over the eyes of the NEDs they can do so, at least temporarily. This underscores the importance of obligatory, independent assessment of board performance, because that is one of the few ways in which NEDs' concerns will be brought properly into the open.

**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?**

Subject to the caveat that NEDs should not attempt to manage the business, NEDs should make a point of having dialogue with the top few tiers of management (and not just executive directors) so as to understand the business better. This also gives management a better understanding of the board and greater confidence that the directors have a true understanding of what the company is about. There should also be a corresponding obligation on the Chairman and CEO to keep the NEDs onside, which all executive directors should support.

One area of concern that we do have is that NEDs should not be seen as 'opposition' to the executive directors, as this would seriously impact the cohesiveness that is so important to the effective operation of the board as a whole.

It is now generally accepted that the roles of Chairman and Chief Executive should be separate but there is also concern about individuals moving from Chief Executive to the position of Chairman and such a move should be challenged more strongly than it is. We are advised of one situation where such a move resulted in a 'not invented here' syndrome, seriously hampering the effectiveness of the board. We feel shareholders should take a more questioning view of such a move, but if that does not improve matters, it may be necessary to amend the Combined Code.

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

We welcome the recognition by the Review of the significant role of the Company Secretary in board performance and effective corporate governance.

The Company Secretary can do a great deal to ensure the board runs smoothly. As mentioned above, an effective Company Secretary will ensure the timely flow of accurate and concise information, act as a link between the executive directors/management and the NEDs and as a source of independent guidance and impartial advice, particularly to the NEDs but also to the executive directors. We are aware, for example, that some Company Secretaries issue regular ‘newsletter’ type updates to directors on relevant issues such as developments in corporate governance and Best Practice.

It should be a requirement of the Combined Code that the Company Secretary or his designee should also be secretary to all board committees.

Although the Company Secretary will be on hand to advise the board against inappropriate action, it is not just a case of saying ‘you can’t do that’ but coming up with a practical solution as to how the desired result can be achieved.

Key factors here are the integrity and independence of the Company Secretary. There is a strong argument for changes to safeguard/strengthen that independence - but we are wary of making changes that would jeopardise the essential, trust-based, relationship between the Company Secretary and the directors. The safety valve for that relationship is a professional code of conduct and ethics to which the Company Secretary can point in times of difficulty. Membership of a professional body such as the ICSA also gives the Company Secretary added support should he come under pressure in adhering to that code.

It is also essential to understand that the role of Company Secretary is not just a legal one. In order to be able to understand and assist in the drafting of board papers, for example, and to be able to anticipate, and advise on, the implications of various proposed courses of action, the Company Secretary needs to have a breadth of knowledge and experience incorporating finance, tax, HR, pensions and particularly corporate governance, knowledge that may not necessarily be possessed by a Company Secretary whose only qualification is a legal or accounting background. Chartered Secretaries, on the other hand, are specifically trained in these areas. By acting as secretary to the various board committees, the Company Secretary can also ensure consistency between the work of the committees and the full board.

The Company Secretary is, in effect, the Director of Corporate Governance in many well run companies – providing independent, objective and knowledgeable advice to the board as a whole and to individual directors.

The Company Secretary should also take responsibility for the proper induction of all new directors (see ICSA Best Practice Guide – *The appointment and Induction of Directors*) to ensure they are able to make a full and effective contribution as quickly as possible and to advise on board performance evaluation processes.

Ultimately, a Company Secretary who has the right knowledge and experience, but who also possesses integrity and the trust of the board, should make a major contribution to good governance.

Further information about the role of the Company Secretary is provided in the Appendix.

## **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?**

NEDs need all the information necessary to enable them to fulfil their obligations and carry out the role of directors and, where appropriate, as members of board committees. Whilst they may not need all the detailed information that executive directors receive, they will need concise summaries of key data. Indeed it is counter-productive to have too much information: it needs to be restricted to clear, essential data by the Company Secretary, working in conjunction with the executive team.

We believe that the flows and communications channels are working well in most Listed companies but it is clear from some of the recent ‘disasters’ that this is not always the case. It is, unfortunately, difficult for the NEDs themselves to know what they are **not** being told. As mentioned above, this is an area where the Company Secretary can play an important role in ensuring the effective flow of accurate and sufficient information.

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

NED training is a key requirement and training courses for directors are run by a number of different organisations, both specialist bodies such as the ICSA, IoD and Henley Management College and other commercial providers. The key is identifying the type of training needed and convincing the directors that they do in fact need training.

It might, for example, be prudent for all members of the Audit Committee to attend a training course in basic auditing techniques so that they can at least understand what the internal audit function and external auditors should be doing. In this case, an in-house training course can be arranged for the whole committee whereas, if an individual director is seen to need training in a specific area, it might be more sensible for him to attend an external course where he can gain from the experiences of other participants.

All executive directors would benefit from training, to understand better the role of the board as a whole (i.e. the dynamics of the board) and the specific role and responsibilities of NEDs as well as those of the Chairman and Company Secretary.

The Chairman, CEO and Company Secretary play important roles here as they should be able to identify most training needs from the contribution that each director makes in the boardroom even if the directors themselves do not ask. Time should also be taken to explain how the board actually works, as each company will work slightly differently to any other. Training needs may also be identified from an effective Board Performance Evaluation in which case the directors may be more inclined to accept them.

Training must also include developing a working knowledge of the company's business, markets and products (or services). This should be achieved not only through the induction programme (Q29 below) but also through regular discussions with (or presentations from) executive management below board level, copies of analysts presentations/reports, etc.

Rotating board meetings around different company sites, as well as board visits to receive management presentations, can be useful. These can also serve as good training for senior management in line for future board appointments and provide an opportunity for the NEDs to see the next generation in action and to assess their skills and suitability for future board membership.

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

This is a matter for each company. 'Improved' is relative and most things can be – is there evidence that induction is not satisfactory – or is it that not all companies bother? That reflects poorly on both the company, and on any director who accepts an appointment without the promise of adequate induction very soon after the appointment.

Good induction training is essential and it is important to ensure that even long standing directors are aware of their duties and responsibilities. This can often best be achieved by stressing the liabilities that can arise should those duties and responsibilities be ignored. To this end, the prospect of criminal sanctions and civil damages often proves to be the most effective deterrent!

A copy of the ICSA Best Practice Guide *The Appointment and Induction of Directors* is enclosed for reference.

**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?**

If the Company Secretary is a Chartered Secretary, we would expect them to ensure that all directors get clear guidance both individually and as a board but this is not necessarily the case in all companies.

As regards feedback, the Chairman obviously has the key role here as he is often best placed to judge whether someone is being effective and to provide feedback to the director concerned. The Company Secretary will also have an insight and it is important that the Chairman and the Company Secretary have a very good working relationship to make this as simple and easy as possible.

## **Additional Comments**

### **Term of Office/Independence**

The ABI/NAPF 'definition' of independence suggests that an upper limit of nine years service should apply: after nine years, a director is presumed to have ceased to be independent. We are concerned about such an arbitrary approach and note that some NEDs are not sufficiently independently minded at all whereas some remain so long after nine years involvement. It should be recognised that in some cases a NED will take two to three years before becoming really effective.

Whilst nine years may, therefore, be a good yardstick, this should be considered in relation to the specific individual and the circumstances of the company concerned including the rest of the board members. We believe that a 'comply or explain' approach should be adopted. This can however, only work if voting advisory services and investors are willing to give proper consideration to the explanation. Whilst some advisory services do this, past experience shows that some others rarely listen to an explanation of any variance from a code.

The key point about independence is the 'independence of mind' concept, ie the ability to be objective and to stand back and argue a point clear of any outside influence. The mere fact that 'other interests' exist, however, does not necessarily mean that the director will be swayed by them. This is where integrity comes in. A director with true integrity will not allow himself to be swayed by other interests.

It is accepted that a continuing influx of new ideas is required to keep the board and management of the company 'fresh', but there is no reason why a good NED should not remain on the board longer than nine years even if he is no longer considered 'independent'. On the other hand, there needs to be a balance between understanding the business and 'going native' which can quite easily happen.

## APPENDIX: The Role of The Company Secretary

As we mention in answer to question 26, there is a strong argument for strengthening the role of the Company Secretary. It is widely recognised that the Company Secretary has a vital role in enhancing best practice in Corporate Governance. As the principal corporate governance officer there is a need for mechanisms to protect and give security to the Company Secretary but which do not jeopardise the trust that is essential between the Company Secretary, the Chairman and each individual director as well as the board as a whole.

We **recommend** that the Combined Code should be amended to make it clear that the Company Secretary is responsible to the board and as such his line of report should be direct to the Chairman. (See our Guidance Note *Reporting lines for the Company Secretary* enclosed) It is essential that the Company Secretary is seen to have the full support of the board and particularly the Chairman. One suggestion that has been put forward is for the Company Secretary to be given a statutory right to address the Shareholders in General Meeting in the event of his removal, similar to that granted to auditors. At the very least the Company Secretary should, on leaving the company whether voluntarily or otherwise, have a right to address the Nomination and/or Audit Committee.

It is the risk of damaging this trust which makes us wary about legislating on the role of Company Secretary. We would, however, like to see more emphasis placed on the obligation under s 286 (1) of the Companies Act 1985 for directors of public companies to appoint someone who has the requisite knowledge and experience to carry out the functions of the role. The Act provides that the Company Secretary of such a company should not only be a member of one of the specified professional bodies (ICSA, solicitor/barrister or accountant) but also have, in the opinion of the directors, the requisite knowledge and experience. As it stands at present, few directors understand the role of the Company Secretary sufficiently to be able to make this judgement.

It is, for example, illogical that a Solicitor who has spent his or her whole career practising in criminal law can be appointed Company Secretary of a Listed Company. If a Company Secretary is to provide advice and guidance to the board on corporate governance matters, to help draft the Annual Report and to understand and assist with the drafting of board papers, it is essential that he is appropriately qualified with a knowledge of at least Corporate Law, Finance, Tax, HR and, particularly, practical Corporate Governance.

The relationship between the Company Secretary and the Chairman, CEO and individual directors will be key to the effective operation of the board. With the Company Secretary providing a source of impartial advice and guidance to the directors, and particularly the NEDs, a situation of absolute trust and mutual respect is essential. As the provider of information, it is also essential that the Company Secretary is aware of the level of knowledge and understanding of individual directors on different points. This is not just applicable to NEDs: an executive director responsible for one particular division may be just as much 'in the dark' about other parts of the organisation as the NEDs

We also mentioned, in response to question 26, the advantage of a Company Secretary being subject to a professional code of conduct and ethics - as the obligation to comply with such a code can be a valuable support when having to argue against 'doubtful' actions. Here at the ICSA we take this a stage further by providing active support to Members in the event that they find themselves in conflict and we have, on a number of occasions, stepped in to persuade a recalcitrant Chairman that the Company Secretary is correct and should be listened to.

We have said before that the Company Secretary is the obvious choice to act as the focal point for whistleblowers. We have also suggested that the Company Secretary, usually the only 'independent' member of the senior management team, should have a significant role in the Internal Audit function. Internal Audit frequently reports through the Finance function, presumably because it has historically been a finance audit. This is, however, fundamentally wrong as there is a direct conflict of interest in a Finance Director being responsible for the internal audit of his/her own department. On this point we also believe that a similar conflict arises where the Finance Director - or a member of his team - also assumes the role of Company Secretary.

## **Specimen job description for the Corporate Governance role of the Company Secretary**

- Ensuring the smooth running of the board's and board committees' activities by helping the chairman to set agendas, preparing papers and presenting papers to the board and board committees, advising on board procedures and ensuring the board follows them.
- Keeping under close review all legislative, regulatory and corporate governance developments that might affect the Company's operations, and ensuring the board is fully briefed on these and that it has regard to them when taking decisions.
- Ensuring that the concept of stakeholders (particularly employees – see section 309 Companies Act 1985) is in the board's mind when important business decisions are being taken. Keeping in touch with the debate on Corporate Social Responsibility and stakeholders, and monitoring all developments in this area and advising the board in relation to its policy and practices with regard to Corporate Social Responsibility and its reporting on that matter.
- To act as a confidential sounding board to the chairman, non-executive Directors and executive Directors on points that may concern them, and to take a lead role in managing difficult inter-personal issues on the board e.g. the exit of the Directors from the business.
- To act as a primary point of contact and source of advice and guidance for, particularly, non executive Directors as regards the Company and its activities in order to support the decision making process.
- To act as an additional enquiring voice in relation to board decisions which particularly affect the Company, drawing on his experience and knowledge of the practical aspects of management including law, tax and business finance. To act as the "Conscience of the Company".
- To ensure, where applicable, that the standards and/or disclosures required by the Combined Code annexed to the UK Listing Rules are observed and, where required, reflected in the Annual Report of the Directors – the Secretary usually takes the lead role in drafting the Annual Report, including the Remuneration disclosures and agreeing these with the board and board committee.
- Compliance with the continuing obligations of the Listing Rules e.g. ensuring publications and dissemination of Report and Accounts and interim reports within the periods laid down in the Listing Rules; dissemination of Regulatory News Announcements such as Trading Statements to the market; ensuring that proper notification is made of Directors' dealings and the acquisition of interests in the Company's incentive arrangements.

- Managing relations with investors, particularly institutional investors, with regard to corporate governance issues and the board's practices in relation to corporate governance.
- To induct new Directors into the business and their roles and responsibilities.
- As regards offences under the Financial Services and Markets Act (eg s395), ensuring that the board is fully aware of its responsibility to ensure that it does not mislead the market by putting out or allowing the release of misleading information about its financial performance or trading condition, or by omitting to state information which it should state, or by engaging in a course of conduct which could amount to misleading the market.
- Ensuring compliance with all statutory filings, e.g. forms 288, 88(2), Annual Returns, filing of resolutions adopted at Annual General Meetings/new Articles of Association and any other filings required to be made with Companies House.
- Making arrangements for and managing the whole process of the Annual General Meeting and establishing, with the board's agreement, the items to be considered at the AGM, including resolutions dealing with governance type matters, eg the vote on the Remuneration Report and votes on special incentive schemes involving directors. Information about proxy votes etc.

The above comprises a simple list of the main 'Corporate Governance' activities carried out by the Company Secretary. There are many other matters (e.g. risk management, trading standards etc) for which the Company Secretary will often be responsible and the extent of his other duties will depend on the particular company. Further details of these 'other duties' can be found in the results of an ICSA survey on the Responsibilities and Salaries of Company Secretaries 2000/2001.

*ICSA is the professional body for Chartered Secretaries and Administrators with some 45,000 members and 22,000 students worldwide. A large proportion of this membership remains involved in the ICSA's original area of expertise – company secretarial practice in the UK. In addition, in the company secretarial field, ICSA also*

*runs a Company Secretaries Group which is open to non members of the Institute so that we are better able to speak for Company Secretaries as a whole.*

*ICSA takes a leading role in corporate governance in all sectors providing supporting materials and Best Practice Guidance on relevant topics. For further information see our web site [www.icsa.org.uk](http://www.icsa.org.uk)*

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