

# **Legal & General: Response to the Review of the Role and Effectiveness of Non-Executive Directors Consultation Paper**

## **Introduction**

Legal & General believes that Non-Executive Directors have a critical role in good corporate governance. They should provide appropriate test to executive management and should assist with development of corporate strategy. In a well governed group of companies they help ensure that shareholders, customers, employees and other stakeholder interests are given due consideration as well as ensuring that the group is run in a way that is not adverse to the wider community, recognising its social responsibility and any environmental impact.

The Nominations Committee, when considering the composition of the Board, takes into account the likely demands of the Board and its committees, and the requirements of good corporate governance. The Board of Legal & General Group Plc aims to achieve a broad spread of expertise and experience from its Non-Executive Directors. The composition, blend, reputation and balance of the Board are key factors in good governance.

## **Specific Responses**

### **A: Role**

#### Independence of Non-Executive Directors

- (a) A prerequisite of independence is that appropriate Non-Executive remuneration is paid (see Remuneration below).
- (b) There are several suggested indicators which are put forward by interest groups as tests of independence. In particular, it is suggested that after a period of time a Non-Executive Director cannot be said to be independent by reason of length of service.

The current Legal & General practice is to indicate on initial appointment that Non-Executive Directors will be expected to serve two 3 year terms; Non-Executives would not be expected to serve more than three 3 year terms, formally reviewed by both sides after one 3 year term. (ref. A4)

In the case of the Chairman and Deputy Chairman, the overall length of service may exceed the 9 year period in that it would be expected that the selection of an individual for one of these key roles would tend to come from the existing Non-Executive Directors. (ref. A4)

- (c) Where an individual has had a previous Executive role within the Company, Legal & General takes the view that their appointment as a Non-Executive Director should recognise that they are not independent without a long quarantine period. On occasion it may be desirable to appoint an Executive to a Non-Executive position. However, it should be clear that under these circumstances the individual cannot be seen to be independent. (ref. A4)
- (d) Legal & General reviews the independence of Non-Executive Directors every year prior to its Annual General Meeting. The independence of Directors is one factor which would be periodically reviewed as part of the Group Board's appraisal (see below). (ref. C21)

#### Number of Non-Executive Positions

- (a) The number of Non-Executive positions that an individual can reasonably be expected to hold whilst giving the degree of attention required in each of the positions will be dependent upon the types of companies concerned. Inevitably some positions will be more onerous than others and will require more attention than others. In addition, where an individual holds a senior position within the corporate governance framework, for example Chairman of the Audit Committee, the additional time commitment required by that role should be taken into account. (ref. A6.)

Nominations Committees should take into account capacity issues prior to appointment as well as reviewing potential conflicts (ref. B10, 11, 12). Individuals should be careful not to over-commit themselves and should understand that the demands of more than one role are not likely to flow smoothly and that periodically each role may demand additional attention. (ref A6)

- (b) Non-Executives may be selected from the ranks of full time Executives of other companies. Given the likely responsibilities of those Executives selected it is difficult to see that they could be asked to undertake more than one or two Non-Executive Director roles. (ref. B10, 11, 12)

#### Role of the Senior Independent Non-Executive Director

- (a) Legal & General's Deputy Chairman fulfills the role of Senior Independent Non-Executive Director, though it should be noted that the Chairman is a Non-Executive Director and is regarded by Legal & General as being Independent (appointed to the Board in 1998). This allows investors and others access to the other Non-Executive Directors of the Board should they require it. The Senior Independent Non-Executive Director role is seen as being the alternate, in this respect, to the Chairman. (ref. A7)

Legal & General's Investment Management business (LGIM) would regard a Chairman who is a Non-Executive Director as an appropriate contact. They view the Chairman as a Senior Independent Director and first point of contact for serious strategic discussions, unless his independence has been undermined in some way, e.g. previously an Executive Director.

- (b) As an institutional investor Legal & General would tend to communicate with either the Chairman or the relevant Committee Chairman of its investee companies. Only where the issue under concern would preclude that person would Legal & General seek out the Independent Non-Executive Director. LGIM actively seeks meetings with board members on matters appropriate to the member, e.g. remuneration or succession. In addition, LGIM works with the ABI Investment Committee in respect of most governance issues. There is great benefit in talking to other long term investors about these issues of strategy.

**B: Attracting and Appointing Non-Executive Directors**

Executive Director/Non-Executive Director

The current legal view of duties and liabilities of Directors does not sufficiently distinguish between the Executive and Non-Executive roles. The proposed Statement of Directors Responsibilities in the forthcoming Companies Act continues this lack of distinction. (ref. A8) Legal & General recognises that as a matter of fact Executive Directors will have greater access to and greater appreciation of the operational detail of the Group's business. (ref. E27.) If issues were to arise that had not been fully disclosed to Non-Executive Directors and where it could be demonstrated that Non-Executive Directors had made all reasonable enquiries it is difficult to see that any Non-Executive liability should be incurred. (ref. B15)

LGIM believe that a distinction should be made between the level of responsibility between Executive Directors and Non-Executive Directors. This should be reflected in any difference in potential liability. The pool of good quality independent candidates might be significantly reduced if the possibility of liability is beyond what reasonable people acting responsibly could expect.

The Group believes in the importance of attracting Non-Executive Directors with a wide skill set which complements and enhances the breadth and knowledge of the Board as a whole. Where a Non-Executive Director is asked to take on a particular role, such as Chairman of the Audit Committee, the Group would look to a Non-Executive Director with an appropriate background and training. A thorough induction and continuing training for Non-Executive Directors into the Company's business is important.

## Remuneration

Legal & General believes that the role of Non-Executive Director is important and can be onerous and that the remuneration of Non-Executive Directors should reflect these responsibilities. As a result of recent developments in both the UK and the US it could be argued that the risk of litigation attaching to the role has increased. The remuneration of Non-Executive Directors does not currently reflect these risks. (ref. B14)

Legal & General believes that Non-Executive Directors should be encouraged to maintain an equity interest in the Group and expects Non-Executive Directors to use £20,000 per year of their fees to acquire shares in the Group (which they are expected to hold until the end of their period of office). In addition, Legal & General support the practice of Non-Executive Directors acquiring shares in the Group. Whilst it recognises that current institutional shareholder opinion is against, the Group believes that a case can be made for the grant of conditional shares to Non-Executive Directors at the beginning of their term, to vest over the term. The current practice of an annual purchase means that directors have their greatest holding just before departure. Clearly, any early allocation of conditional shares should not be so large as to undermine the independence of Non-Executive Directors. (ref. B14)

## Risk and Insurance

As a result of recent events, premiums for Directors and Officers insurance have dramatically increased. Recent American legislation allows for penal action to be taken against Directors of companies. This is not limited to US companies as it includes non US companies having SEC related issues. British companies differ from American companies in that (except through D&O insurance) it is not usual for Directors to be given comfort or indemnity. Consideration should be given to whether or not a greater degree of comfort could be given to Directors given the increasing risk and the possibility that suitable cover may not be achievable. A limited indemnity where a Director has acted in good faith, within the terms of his appointment (without being grossly negligent or criminal) is not unreasonable. It should be noted that D&O insurance is only available on a 'claims made' basis, i.e. the policy has to be in force for the period in which the claim is made and a good faith disclosure applies at the start of the period. This could be quite costly insurance. Other liability insurances are generally based on 'date of event' and policy liability in force at that time. (ref. B15)

## **C: Structures and Accountability**

### Board Size

Legal & General aims to have more independent Non-Executive Directors than Executive Directors on its Board. Ideally it aims to have a working balance of two more Non-Executive Directors than Executive Directors so as to ensure the likelihood of Non-Executive Director majority at any given meeting. (ref. C17)

## Committees

Legal & General has Audit, Remuneration and Nominations Committees.

The Audit Committee comprises exclusively Non-Executive Directors. The Group Chief Executive, the Group Director (Finance) and other senior executives attend. The duties of this key Committee require a significant level of understanding of accounting rules and practice as they apply to the Group's business. (ref. C17, 18)

The Remuneration Committee comprises exclusively Non-Executive Directors and is Chaired by the Deputy Chairman of the Group (also being the Senior Independent Non-Executive Director). The Group Chief Executive attends except in relation to the discussion of his remuneration. All the Non-Executive Directors of the Group are members of the Remuneration Committee, including the Chairman, as the Group recognises that the setting of remuneration policy and the award of senior individual remuneration packages are important elements in forming the culture of the Group and are key indicators to staff, investors and stakeholders generally. (ref. C17, C18)

The Nominations Committee can comprise all Directors of the Legal & General Group Plc but must have a Non-Executive Director majority. In practice most Directors of the Group are involved in Nominations Committee matters as the Group recognises that the appointment of Directors is important in shaping the Board for the future. (ref. C17, 18).

## Board Appraisal

There is an external appraisal of the Board of Legal & General Group Plc every other year. The appraisal process is conducted through a third party facilitator (currently, a professor of the London Business School). It encompasses the Board practices and procedures and individual members of the Board. The appraisal consists of questionnaires and individual interviews. The results are presented to the Group Board together with the recommendations as to changes in Board practice or policy. Individual matters are dealt with by the Chairman in one-to-one interviews with Directors. (ref. C21 and E30)

## Succession

The Non-Executive Directors meet once a year to discuss succession issues for the Executive Director and Senior Management levels. Discussions on the Chief Executive take place without the Chief Executive.

## **D: Relationships with shareholders and others**

### Investors and Stakeholders

Under normal circumstances the Group would expect investor or stakeholder enquiries or liaison to take place through the Group's Investor Relations and Communications Departments. However, it recognises that in specific instances there would be a need for direct investor or stakeholder contact with the Chairman or Chairmen of specific Committees or the Senior Independent Director. There have not been any reasons in the last decade where such a meeting has been sought by investors. (ref. D23)

### Senior Management

Legal & General ensures that Non-Executive Directors have access to senior management below Executive Director level, typically through presentations by senior management, joint attendance at senior management training, and through visits to the main functional offices. This allows Non-Executive Directors to assess the quality and depth of the executive pool and the strength of the Group's succession policy. (ref. D 25)

## **E: Support**

### Management Information

The Group aims to provide Non-Executive Directors with timely, sufficient and appropriate management information. It expects that Executive Directors and senior management will ensure that all significant or material issues are drawn to Non-Executive Directors' attention in a clear coherent form. The Group expects any reasonable requests for appropriate information from a Non-Executive Director to be met in timely fashion.

The Group would expect any failing in this respect to be drawn to the attention of the Board as a whole and it is the subject of the individual one-to-one meetings which the Chairman has with all directors on an annual basis. Issues raised are dealt with at an annual meeting, where the Agenda items for the following year are also discussed.

The Group and LGIM would regard any significant failure in respect of these matters as being extremely serious as it would undermine a key area of corporate governance. Non-Executive Directors must be able to rely on the information being supplied to them. (ref. E27)

## **G: International Context**

### International Structures

The Group is aware of the American and German corporate governance models. On balance it prefers the British unitary board system. Its criticism of the American model is that non-executive directors are frequently not fully independent of the executive and, in particular, that the role of the chairman and chief executive are normally combined, whereas the Group believes that they should be separated as in the U.K. model. Its criticism of the German model would be that the structure could be too rigid in defining responsibilities and some of the benefits of discussion with operational directors can be lost.

The Group believes that there should be sufficient Executive members of a Board to represent the management of the Group in question, i.e. greater than just the CEO and CFO; and sufficient Non-Executive Directors to command a majority and provide an effective check and balance to Executive management.  
(ref. G32, 33, 34, C17, A6)

The Group strongly encourages all Non-Executive Directors to demonstrate independence whilst performing their role on respective Group committees. However, the whole Board is expected to support the strategy once decided.

6 September 2002

Note: The references above cross-refer to the references in the Higgs consultation paper.

Filename: Legal & General.doc  
Directory: C:\tmp\work\R501110\KAREN\R501110  
Template: C:\Documents and Settings\kanese.DEVELOPMENT\Application  
Data\Microsoft\Templates\Normal.dot  
Title: DRAFT  
Subject:  
Author: DB21401  
Keywords:  
Comments:  
Creation Date: 08/10/2002 11:34  
Change Number: 2  
Last Saved On: 08/10/2002 11:34  
Last Saved By: camassey  
Total Editing Time: 1 Minute  
Last Printed On: 11/10/2002 11:19  
As of Last Complete Printing  
Number of Pages: 7  
Number of Words: 2,318 (approx.)  
Number of Characters: 13,216 (approx.)