

Linklaters

Response to the Consultation Paper by Derek Higgs

“Review of the role of non-executive directors”

1 Introduction

The views set out in this response to the consultation paper are those of Linklaters and are based on discussions held with our clients.

Linklaters' employee benefits and incentives team is one of the largest and most experienced in the field of employee benefits. Typically, we advise large UK and non-UK multi-nationals on the design and implementation of their executive incentives. We act for over 25 of the FTSE 100 companies.

2 Role of the non-executive

The overwhelming view is that non-executive directors currently fulfil a highly valuable role which has developed steadily since the Cadbury Report. This role is seen as predominantly one of helping companies to develop a strategy, networking, representing the company and monitoring corporate governance. They also have valuable roles on committees such as the remuneration committee and audit committee.

A review of the role and function of non-executives is to be welcomed. However, it is hoped that it will not lead to a set of prescriptive rules as to their functions and responsibilities. Flexibility is needed to allow non-executives to carry out their role for different types of businesses in difficult circumstances. Also, the increased focus on the corporate governance monitoring role of non-executive is welcomed but needs to be seen in context and in the light of their overall functions and duties and what they can reasonably achieve given the time they spend with companies. Expectation and accountability should not be set so high that their role is unattractive and so that it detracts from their other roles. It should be accepted that non-executive directors, even if their role is expanded, cannot be a guarantee against corporate fraud.

It is agreed that the unitary board system works well and should not be changed.

It is also agreed that the same duties should apply to both executives and non-executive directors. However, it would be expected that the application of any legislation on duties would take account of the levels of time commitment available to a non-executive director.

3 Attracting and appointing non-executive directors

Companies are struggling to recruit non-executive directors of the appropriate calibre and with the relevant experience. One of the issues seems to be that institutional shareholders are reluctant to accept individuals with whom they are not familiar. At the same time, the risk of greater liability and the increasing difficulty of getting Directors' and Officers' liability insurance are likely to further reduce the pool of potential candidates.

The pool of potential candidates could be widened to include the following:

- directors of subsidiary companies;

- company secretaries;
- former civil servants; and
- directors of overseas companies.

In relation to remuneration, there seems to be general agreement that it is inappropriate to grant stock options to non-executive directors. Opinion is divided as to whether it is appropriate to pay non-executive directors in shares. In terms of quantum, the view is that non-executive directors should be properly remunerated for their time commitment, their experience and expertise and their reputational risk. However, it is accepted that increasing fees may jeopardise independence.

4 Structures and accountability

The majority of companies do not have any formal process for monitoring the performance of either executive directors or non-executive directors. However, the general feeling is that any performance issues are, in practice, dealt with effectively by the chief executive or chairman. Most companies see little value in adopting a formal performance monitoring process.

5 Developing effective relationships with shareholders

Companies believe there is, for the most part, sufficient communication with shareholders. There have been calls for increased communication with institutional shareholders. However, as a practical matter, we believe it is questionable whether institutions have sufficient time to do this, other than for the largest of companies.

16 September 2002
Linklaters