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Non-Executive Directors Review
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Dear Mr Higgs

Review of the role and effectiveness of non-executive directors

Morley Fund Management (Morley) is a leading UK institutional investor with approximately £105 billion under management. We manage on behalf of clients approximately 1.8% of the UK equity market. We take corporate governance very seriously and believe that being an active and interested shareholder is part of the responsibilities of being a large UK institutional investor. Effective non-executive directors, properly supported, are vital to the UK system of corporate governance. We are therefore pleased to have the opportunity to respond to the current consultation paper on the role and effectiveness non-executive directors.

In view of recent events in companies listed on major exchanges around the world, this review is well timed. These unfortunate situations may have been avoided if there had been more appropriate checks and balances on those boards and more vigilant shareholder scrutiny. The events in the US, in particular, reinforce our preference for the UK's voluntary approach which we believe is more effective in changing corporate behaviour than rigid adherence to legal and regulatory requirements. However, we hope that this review does not in any way lessen the legal position of non-executive directors who, in British Law, have equal responsibility for the board's actions and decisions.

On current evidence the UK system works as well as any other system in the world, furthermore, this approach is respected by many practitioners in other markets. No system is foolproof against crooked or incompetent directors. However, if political, legal, regulatory and voluntary environments continue to work together to create a culture where good practice and good behaviour is rewarded and bad behaviour is punished, then the UK should maintain a record of fewer business failures through poor governance. The Government's interest in auditing and remuneration matters and encouragement of a more active interest from institutional shareholders should, hopefully, ensure that the right internal and external checks and balances exist to focus on company performance. At the same time we must ensure that the environment does not stifle enterprise and innovation.

A large amount of current comment and debate revolves around a presumption that directors are "policemen". Whilst agreeing with this direction, we need to stress the

importance of board "teamwork" and low levels of politicisation. From time to time, non-harmonious or politicised boards have caused greater shareholder loss than the current spate of control weaknesses.

The answers we provide below are given from the perspective of an institutional shareholder and not from the perspective of a board director. They highlight areas where, without the advantage of seeing how boards work in practice, we believe improvements can be made and where non-executive directors can provide reassurances that their boards are observing the principles of good governance, and have the right people on their boards, to operate effectively.

Specific questions:

A: Role. What role should non-executive directors perform and how does this compare to the present position?

Q1:

- (a) What is the role of the board?*
- (b) what is the role of the Chairman and*
- (c) How does it relate to the non-executive directors?*

(a) Cadbury said "Every public company should be headed by an effective board which can both lead and control the business". This is a good summary of the role of the board. In order for boards to do this effectively it is important that the right people are present in terms of skills, experience and temperament. Board members should formulate strategy, ensure that satisfactory progress is made towards achieving the agreed strategy and be aware of and monitor risk continuously. The board should act to make changes when it is not functioning properly or where strategy is faltering. Boards should always remember that they are working as a team on behalf of shareholders.

The role of the chairman is in securing good corporate governance. This involves ensuring the board is functioning properly and that it is properly "leading and controlling" the business. This includes ensuring that proper discussion and debate takes place, board membership is appropriate, succession is planned, training is available and all relevant information is provided. Where governance breaks down it is the Chairman to whom we would look for answers.

The role of the non-executive directors is to participate and contribute towards the deliberations of the board in performing its duties. However, as the interests of individual (executive) directors and the interests of shareholders are often conflicted we would look to non-executive directors (including the Chairman) to have a more specific role as guardians of shareholder interests. In order to do this, non-executive directors should constantly monitor board performance and in particular, that of the executive, to ensure it is acting in the company's interest. They should also make the Chairman aware of any concerns. Where a non-executive director believes that the board no longer works in shareholders' interests despite efforts to remedy the situation, they should make their views known externally. The process must, of course, be carried out with care so that the future of the company is not jeopardised.

Q2: (a) *What should be the key roles of non-executive directors on the board and*
(b) *What should be the balance between the different components?*
(c) *Within a board should all non-executive directors be expected to fulfil each of the different roles?*

(a) All non-executives should test, question and challenge the rest of the board, as appropriate. They must have the objectivity, skill, expertise and information to allow them to fulfil their roles. It is the non-executive's responsibility to make sure they continue to have the right skills and information to contribute meaningfully to board discussions and they insist on a thorough induction and ongoing training.

(b) The ability to question and challenge the board is a prerequisite for all non-executive directors. Specific skills and experience and how these are to be used would depend on the requirements of individual boards and the nature of their businesses. The important thing is that the body of non-executive directors has the required mix of skills.

(c) Not all non-executive directors need to be independent or fulfil similar roles but all should be able to assess if the board is functioning in the best interests of all shareholders and have the courage to take action if required.

Q3: *How does this compare to the present position?*

We suspect that some non-executive directors are too complacent, too deferential to the CEO, and too wary of taking a line that is out of step with the rest of the board. It is difficult for shareholders to know how non-executives are performing but we see very few examples of public demonstration of courage from non-executive directors. For example, even when companies have encountered difficulties, non-executive directors are often silent or invisible. This needs to change. Non-executive directors should be more proactive and made more accountable when things have gone wrong.

Q4: *How independent do non-executive directors need to be for the different roles?*

Not all non-executive directors need to be independent so long as there is a sufficient level of independence on a board. In Morley's view, at least 30% or more of a board should be independent as defined by ABI/NAPF guidelines. If the Chairman and Chief Executive roles are combined then we may expect a greater level of independence. We believe that Chairmen and Senior Independent directors should always be independent.

Q5:

(a) *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?*

(b) *What can be done to help non-executive directors to be effective in relation to these conflicts?*

(a) Conflicts of interest arise when the interests of individual (normally executive) members of a board are at odds with the interests of shareholders. The most obvious situation in which this happens is in the area of executive pay and accounting issues. However, it can

also happen in take-overs, disposals, boardroom succession or other strategic considerations where particular actions may benefit directors disproportionately.

(b) First of all the non-executive directors themselves must be free of conflict. This is why we are against share options being awarded to non-executive directors. Their appointment to the board must be via an objective process and they should not have any other financial, business or family relationships with any members of the board but particularly with the executive members. In addition:

- There should be a sufficient number of non-executives on boards so they can support each other.
- They should have regular designated times when they can meet without executives being present.
- They should be able to call upon external independent advice at the company's expense when required.
- The company secretary could report to the non-executive directors rather than the executive. We think this idea deserves further consideration.
- Properly constituted board committees e.g. entirely independent Audit, Remuneration and Nomination committees.
- Communication with shareholders. Non-executives should be able to initiate contact with shareholders when required. However, this should be done in an orderly way through the Senior Non Executive Director.

Q6:

- (a) *What time commitment is needed for the role of Chairman and for non-executive director roles, and*
- (b) *How far does this vary between different companies?*
- (c) *Are there any implications for the number of non-executive posts that one person can sensibly take on?*

(a) and (b) Time commitments will vary from company to company depending on the business and on the role of the individual. However, the time commitment required of Chairmen is likely to be significantly greater than for other non-executive directors.

(c) In order for non-executive directors to devote sufficient time to each of his directorships there must obviously be limits on the number of directorships he or she can have. It is difficult to be prescriptive about the exact number as circumstances vary between directors, the types of companies where they have directorships, and whether they have other commitments e.g. on charity boards. Non-executive directors must have sufficient additional time to give to companies that are going through a tough time.

An executive director will be very unlikely to have sufficient time to take on more than one other non-executive directorship. Chairmen will be expected to have fewer directorships because of the additional time commitments required of them. We would expect an individual not to hold more than five non-executive positions if he is to perform his role diligently. If a company appoints a non-executive director with more than, say, five

directorships they should justify this by publicly explaining the time commitment expected from the new appointee and how he is able to meet these expectations.

Companies could disclose in their annual report the time they expect each non-executive to give to the company including study and preparation time for each meeting and the number of meetings attended by each non-executive. This should put a natural limit to the number of positions that can be reasonably held.

Q7: Should there be a special role for a "senior independent" non-executive director?

A senior independent non-executive director should be the natural point of contact for other board members and shareholders when there are matters of concern. This role takes on a more important role when there is an executive Chairman or/and there is no Deputy Chairman. In view of the likelihood that non-executive directors will have increased exposure to shareholders and stakeholders we believe all public companies should identify a senior non-executive to facilitate such communication.

Q8:

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 believe that all directors should have the same legal duties. Although Common Law already takes into account the knowledge and expertise of individual directors in assessing their liability, The Company Law proposals will incorporate this approach into Statute. We hope that this will not mean that people with exceptional skills and experience are deterred from joining boards because they may be assumed to have additional skills and hence added liability.

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?

Q9:

- (a) What are the key skills, knowledge and experience which are needed by non-executive directors to perform the role effectively, and*
- (b) How is this likely to change over the next, say, 10 years?*
- (c) Are some skills essential and,*
- (d) If so, what are they?*

(a) Specific knowledge and experience required will vary. For example, large companies may require directors with experience on other large boards. Insurance companies may look for directors with knowledge of accounting for insurance companies. High tech companies may require people with technical knowledge, etc. It is important that companies appointing new directors have thought carefully about the range of skills and experience required and non-executive directors accepting such positions are able to contribute as required.

(b) These requirements are unlikely to change. There may be moments when certain events may raise the profile of certain attributes e.g. cases of recent US corporate fraud will highlight the requirement for directors to be financially literate, for non-executives to be independent from management etc.

Auditing and accounting issues are already high priority. Over the longer term, our view is that corporate social responsibility matters will become increasingly important and boards should ensure their boards are ready to address these issues.

(c) and (d) As referred to above, boards should have a sufficient number of non-executive directors with appropriate strategic, financial and accounting knowledge.

Q10: What personal qualities and attributes are needed?

Essential personal qualities would be an independent and enquiring mind with the confidence and courage to act upon their convictions. Individuals should be honourable people with integrity, with a clear purpose of working for the benefit of shareholders but with a developed sense of responsibility to stakeholders and the environment. They must have the time to devote to the company to address the needs of the business. It is important that they are able to look at the company's strategic direction but also ask searching questions on detail.

Q11:

(a) What sort of mix of experience and attributes is desirable on a board?

(b) Specific examples of cases where non-executive directors have contributed with particular effect to company performance or to corporate governance would be helpful.

This would depend on the company and the complexity of its business. When considering what the appropriate mix of experience and attributes are, boards should consider their company's strategic aims and objectives over the long term and ensure that these requirements are identified via an independent process. Non-executive directors must be aware of company, business and economic risks and ensure that these are properly addressed.

Q12:

(a) How easy is it to recruit non-executive directors with the right skills and attributes?

(b) Could recruitment and appointment mechanisms, including Nomination Committees, be improved?

Anecdotal evidence points towards increasing difficulty in recruiting non-executive directors with the right skills and attributes. A number of directors we have spoken to deny this. It may therefore be the case that the people are available but boards are not looking in the right places. There are a number of reasons why recruitment may be getting more difficult:

- i. Boards are looking at too small a pool of people believing that only people with very established reputations and a long history of success would be appropriate.
- ii. Boards are not looking at people without such a history because they believe the City will not accept them.
- iii. Boards will not consider non-executive directors from wider, non-business backgrounds.
- iv. Boards only nominating people they know personally.
- v. Enscoced Boards may be afraid or unwilling to appoint a non-executive whom they know WILL question them!
- vi. Non-executive directors themselves are less reluctant to come forward as the risk/reward balance is increasingly working against their favour.
- vii. Pay (at some companies) may be too low to accommodate the increased risks - we note that the spectrum of risk may be getting much wider than the spectrum of reward.
- viii. There is no incentive at recruitment agencies to place a non-executive director because their fees are not as large as placing a full time executive director.

(b) Yes, there is considerable scope for improvement in recruitment and appointment mechanisms. All the issues listed above need to be addressed. An independent nomination committee, using an independent external recruitment agency, with well thought out profiles of skills and experience required would be starting points

Q13:

(a) What could be done to widen the pool of potential non-executive directors and introduce greater diversity into appointments?

(b) What are the constraints on this?

(c) Is there scope for greater international representation on UK boards?

- i. Boards should be willing to move beyond the small pool of people they normally consider.
- ii. They may need to speak to shareholders about potential candidates.
- iii. Boards should advertise vacancies.
- iv. There should be sufficient forward planning
- v. Possibly, more effort could be put towards developing a national pool of qualified non-executive directors. E.g. by establishing a qualification and a national register.
- vi. Companies should start to develop promising individuals below board level by allowing them time to gain some experience on a board and giving them appropriate training. Over time this should increase the pool of properly qualified individuals.
- vii. Boards should use nominations committees properly.
- viii. Pay levels should match responsibilities.

(b) Boards need to be more imaginative in selecting non-executive directors. They need to move beyond their comfort factor and appoint individuals who would be most able to help them achieve their company's ambitions. Yve Newbold once said that boards appoint clones of themselves – this is a recipe for poor performance. The constraints on widening the pool may therefore be prejudices and self-interest inherent on boards.

(c) International representation on boards may be appropriate on some boards where its business requires international experience but this may not be appropriate for all boards.

Q14:

(a) *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?*

(b) *Are current pay levels a significant factor in whether good non-executive directors can be attracted?*

(a) Many commentators have said that pay levels for non-executive directors are too low. This may be true in some instances, but do not believe that this is necessarily the case at all companies, especially the larger companies. Rewards for non-executive directors need to be appropriate to the role and responsibility. We acknowledge that the responsibilities of non-executive directors have increased and they need to be paid a fee that takes this into account. In many cases rates (per hour/day) should remain the same but fees may increase to take into account the additional amount of time they devote to the company and their specific responsibilities on the board and on board committees. We would be wary of wholesale increases in non-executive fees without any corresponding increase in commitment or responsibilities. We need to be aware of the risk of compromising independence by paying too much for fear of losing their jobs.

If non-executive directors are not attracted to jobs because of increased risk, we need to minimise that risk by providing sufficient support and help for them to perform their job properly. [Adequate director liability insurance should also help mitigate the need for higher fees].

We believe that non-executive directors should be paid in cash and/or shares. The payment in shares is acceptable if payment is subject to an objective process and if there are restrictions on the sale of shares whilst still a director. Like many other UK shareholders we would be unhappy if payment is made in share options as these are likely to skew the judgement of non-executives. Options are highly geared (as the upside is much larger than the downside) and vesting is usually based on performance over a short-term (3 year) period. Incentives need to be closely aligned with shareholders and with a longer-term perspective. With share options, as they are currently structured, it would be difficult for non-executive directors to take objective decisions in the long-term interest of all shareholders.

(b) We do not believe that current pay levels are a significant factor in whether good non-executive directors can be attracted. However, higher pay levels may need to be paid in the future to correlate with the increased amount of risk and time that non-executive directors will be expected to take and spend at each company.

Q15: Do you have comments on the issue of risks or insurance provision for non-executive directors?

This is not an area where we have a great deal of information. However, we believe litigation against directors is increasing in the UK and the US and it is important that suitable arrangements can be made so as this does not dissuade individuals from taking on non-executive roles.

C: Structures and accountability

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

Q16:

- (a) *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?*
- (b) *Is further definition needed of independence in the Combined Code and, if so, what would a sensible definition be?*

The Combined Code forms a benchmark for good practice in corporate governance and its link to the Listing Rules means it has more effect than codes that are purely voluntary. We believe the process works well. However, the Code itself needs to be continuously reviewed and updated to reflect the changing environment in which it works. Morley believes that at least one third of all boards should be *independent*. We have a lot of sympathy with the New York Stock Exchange requirements that at least 50% of boards should be independent and may review our own guidelines in this respect.

We think it is helpful to have a recognised benchmark for measuring independence. We would suggest that the ABI/NAPF definition of independence be adopted.

Q17:

- (a) *Do the recommended structures for board committees facilitate governance and an effective contribution by non-executive directors?*
- (b) *Are board meeting procedures working effectively? Do you have comments on board size?*

(a) So far as we are aware, board committees work effectively. We believe Audit, Remuneration and Nomination committees should comprise independent non-executive directors only. This gives the non-executives opportunities to meet independently of executive management and non-independent non-executives to discuss sensitive issues. Executive directors may be consulted as appropriate. However, we suspect that on some boards the influence of the Chairman and/or Chief Executive may be as strong despite the

fact that he/she may not be on the committees. It is difficult for shareholders to know how the structure is really working on each board.

Board size should vary according to each company. However, companies should avoid expanding their boards to a size that detracts from effective decision taking. We believe there are examples of overly large boards. There appears to be growing evidence that the optimal size for decision making is approximately 8 or 9 members.

Q18:

- (a) Do you have comments on the composition and duties of Audit Committees?*
- (b) How effectively are Audit Committees working in practice?*
- (c) Do you see a need to strengthen the existing Combined Code provisions on Audit Committees?*

(a) The importance of qualities of independence of Audit Committee members is at least as great as for Remuneration Committee. The Combined Code needs to be strengthened to require Audit Committees to comprise only independent non-executive directors. Non-executive directors on Audit Committees should be financially literate. They must be able to ascertain if accounting policies are appropriate and if they are properly applied. They need to be able to disagree or agree with any accounting judgements that are applied to the accounts.

We are supportive of the provisional conclusions of the ministerial review of auditing and accounting matters, which advocate an expansion in the duties of the Audit Committee to include the oversight of the appointment of the auditors. Audit Committees should monitor business risks. In particular we consider the following conclusions of the Co-ordinating group chaired by the DTI and Treasury Ministers to be constructive recommendations:

- The Audit Committee rather than Management should be responsible for recommending to shareholders the appointment of auditors
- There should be improved guidance for Audit Committees under the Combined Code
- The Audit Committee should approve the purchase of non-audit services from the firm which is the appointed auditor
- Audit engagement partners should be subject to rotation every 5 rather than 7 years
- The case for mandatory audit firm rotation should be examined further (we are not yet convinced that this is in the best interests of the company)

Q19: Similarly, do you have comments on the composition, duties or operation in practice of Nomination and Remuneration Committees?

Nomination committees should comprise all independent non-executive directors. We acknowledge that for board dynamics to work effectively board members should be able to work together and this requires some executive input. For this reason, it is understandable that an executive director should be involved in the nominations process (though not as a voting member of the committee) and discussions should take place with executives as

appropriate. An objective nomination process is critical to ensuring a properly constituted board with the right checks and balances. More attention needs to be paid by shareholders to the importance of the nomination process in securing good governance.

Information on Nomination Committees and nomination processes need to be improved. Each year nomination committees should confirm to shareholders, in the Annual Accounts, that they have reviewed the membership of the board and have or have not identified any gaps. They should describe the process by which they have come to their conclusions e.g. the use of head hunters, board assessment results etc. Where they identified weaknesses e.g. lack of succession planning, Nomination Committees should describe the steps they are taking to rectify the situation and the time-table they have set themselves.

Nomination and remuneration committees should work together to ensure that their boards are properly structured, properly remunerated and appropriately incentivised.

Remuneration Committees should comprise only independent non-executive directors. Despite this, there have been a number of examples where shareholders have been concerned that the decisions made by remuneration committees have not been in shareholders interests. It is natural to suspect that this is because it is not in any director's interest to constrain the pay of colleagues who might one day decide the level of their own pay. Remuneration committees should take into account the pay in the rest of their organisation and should be aware of public opinion.

Q20: What processes are in place for setting objectives and reviewing performance against those objectives, for the board as a whole and for individual directors?

Shareholders get very little information on board evaluation. However, it is essential that board effectiveness is assessed regularly and at least every two years. The recommendation for board evaluation is already in Morley's Governance and Voting Guidelines and we will be looking for evidence that this is being done. In particular, we would like to see disclosure of the process of board evaluation.

Q21:

(a) Could more be done to review performance?

(b) Should more information on board performance be reported to shareholders

(c) Should companies provide more information on the performance of non-executive directors?

Yes, we understand board evaluation and training is not commonplace. Having a competent board that is up to speed with its company and business environment is crucial. We believe board assessments should be carried out annually or at least every two years. The first step is for companies to disclose to shareholders how they review performance for the board as a whole and for individual directors. Assessment may be carried out by an objective, external consultancy. This requirement is important enough to be included in a revised version of the Combined Code.

There should be a process to clarify succession planning, identify gaps in skills and experience and training shortfalls. See answer to Q19 regarding disclosure. It is important

that Chairmen should be similarly assessed, perhaps by the non-executive directors or Nomination Committee.

Q22:

(a) Are non-executive directors able successfully to challenge executive decisions or expose serious problems?

(b) Should it be made easier for them to do so and, if so, how?

Although anecdotal evidence suggests that non-executive directors do challenge executives on boards, in practice, we do not believe that non-executive directors are always able to successfully do this or to expose serious problems. There are many reasons for this e.g. lack of independence, knowledge, time, experience etc. Very importantly, we believe this because we do not think that non-executive directors currently have the time, support or training to do their job properly and this is an important area that needs to be addressed.

Non-executive directors should be given information on their role and responsibilities on appointment. They should also be given information on training available to them on an ongoing basis. It ought to be compulsory that non-executive directors attend regular courses. Non-executive directors should spend more time getting to know the company and its business. They should have regular access to managers below board level and carry out site visits. Non-executive directors should have access to external advisers, at the company's expense, when required. Structure of non-executive pay and incentives should be reviewed to see if more encouragement can be given to non-executives to act objectively and openly. Non-executives should be kept aware of broker and shareholder views about their company.

D: Relationships with shareholders and others

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

Q23:

(a) How well do relationships between non-executive directors and shareholders and stakeholders work, and

(b) Could they be improved?

(c) For example, we would be interested to hear views on what the relationship might be between non-executive directors and institutional shareholders.

(d) How could this relationship be strengthened?

We consider non-executive directors to be guardians of shareholder interests and, yet, there is very little communication between the two parties. Our experience indicates that some executive directors are very reluctant to allow their non-executive directors to meet shareholders without an executive presence. Non-executive directors themselves seem very keen to develop a relationship with shareholders.

Morley would be in favour of more regular communication. However, we believe we should only meet when there are concerns or issues to discuss. Shareholders should ask to see the

non-executive directors when they have matters that they wish to make known to non-executive directors or to get answers from them. It would be almost impossible for us to have annual meetings with non-executive directors from all the companies in which we hold shares. Non-executive directors could ask institutional shareholders, on an annual basis, if they would like to meet. This would make it easier for non-executive directors with concerns they wish to share with institutional shareholders a chance to raise the issue.

Consideration should be given to the proposal that there should be additional disclosure from the Nominations/Board, Remuneration and Audit Committees. These statements should describe each year, in the Annual Accounts, how their committees have operated over the year and confirm that there are no pressing areas of concern which they need to bring to shareholders' attention.

There should be more opportunities for shareholders to meet non-executive directors on a routine basis. Perhaps this could be done with a number of non-executive directors from a number of companies rather than on a company by company basis. For example, institutional shareholders (or groups of institutional shareholders) could arrange regular informal meetings with the senior non-executive directors from companies where they hold a significant proportion of shares. As these meetings would be routine and likely to discuss non-specific issues, executives may be less concerned. The advantage of these meetings is that shareholders can establish a personal rapport with non-executive directors and this should make it easier to discuss issues when they arise. Under most circumstances, these meetings should be arranged through the Senior Non Executive Director.

For this to happen, all companies should have a senior independent director who is independent.

Q24:

- (a) To what extent are Chairmen creating the conditions for non-executive directors to be effective?*
- (b) 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?*

It is the Chairman's responsibility to ensure that the conditions are present for non-executive directors to be effective. Non-executive directors should make themselves aware of shareholder/broker views and ensure that concerns are discussed and that appropriate paperwork is available. Chairmen should consult with non-executive directors prior to board meetings about any specific issues they wish to raise. Non executives should make their expectations known to Chairmen.

Annual board appraisals and regular training courses should ensure that any shortfalls in their performance are addressed. If Chairmen are not creating the right conditions for non-executives to be effective, non-executive directors should make this known to shareholders.

Q25:

- (a) What should be the relationship between non-executive directors and executive directors, and with senior management?*

(b) What should their relationship be with the Chairman and the Chief Executive?

(c) What should their relationship be with key advisers to the company?

Non-executive directors and all other members of the board and key advisers should act as professionals working as a team for the good of the company. How the chairmen, CEOs, other members of the board relate with the non-executives will be determined by the personalities of the board and its members. Members should trust and respect each other. The fact that non-executive directors are seen increasingly as "policemen" on boards does not necessarily mean that they need to work against each other. Quite the opposite, the executive directors ought to co-operate with non-executive directors to ensure that maximum transparency, explanation and justification is given to shareholders to give them confidence in the functioning of the board as a whole.

Q26: How can Company Secretaries support effective performance by non-executive directors?

More attention should be paid to the role of the company secretary and how they can help provide the optimal environment and provide additional checks and balances for effective board performance. Consideration should be given to company secretaries reporting to/through the non-executive members of the board. This could give the non-executive directors more influence over access to timely and relevant information, board agendas etc. Company secretaries should assist the independent chairman by facilitating the training needs of non-executive directors. Company secretaries often have non-routine conversations with shareholders. They should ensure that all shareholder concerns are disseminated to the board as a whole.

Ultimately, however, the company secretary is responsible to the board and his or her appointment and removal should be a matter for the board as a whole.

E: Support

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

Q27:

(a) How much access to information from management do non-executive directors need to be effective?

(b) In practice, are information flows and communication channels sufficiently open and unrestricted?

Non-executive directors should have access to all information held by the company. However, in practice, they rely on the chairman and chief executive to provide them with relevant and timely information. Non-executives do not spend sufficient time at each company for them to check that they are being made aware of all relevant matters or that the information given to them is complete, appropriate and reflective of the real situation. Our impression is that non-executive directors need to spend more time and be more proactive and careful that the board is discussing all substantive issues and that all the information has been made available to them. This is why non-executive directors need to

be aware of shareholder, employee and other stakeholder views. Non-executive directors should regularly visit company sites and have unrestricted access to internal and external auditors, company employees and shareholders (channelled through the Senior non executive director) when required. The company secretary should put non-executives in contact with the people and information they want, and arrange training as appropriate, without requiring the approval of executives.

Q28:

- (a) *What training and developments opportunities are available?*
- (b) *Could they be improved and, if so, how?*

There is a growing number of organisations which provide training. In particular the Institute of Directors "Chartered Director" training, the NAPF director forums and the Foundation for Independent Directors.

Q29:

- (a) *Can induction for non-executive directors be improved?*

We believe it is vital that non-executive directors should attend induction courses both on general and legal duties of directors and specifically about the company they are joining. Non-executive directors should get information packs on their joining. The company should ensure that information regarding his role on the board and board committees is provided. Packs for non-executive director should be available from Companies House on appointment just as they are for executive directors. This should include information on their function as non-executive directors, their role on board committees, codes of best practice etc.

Q30:

- (a) *Do non-executive directors get clear guidance on what is expected of them and,*
- (b) *Do they get feedback on whether they are meeting expectations?*

We suspect non-executive directors do not get clear guidance or feedback hence the importance of board evaluation.

F: Smaller listed companies

In what ways is the position different for smaller listed companies?

Q31:

- (a) *To what extent do different factors apply in the case of smaller listed companies?*
- (b) *Is different provision necessary?*

Requirements may differ for smaller companies bearing in mind they are likely to be more dynamic, growing companies. Different skills may be required. However, it is just as important for smaller companies to have good governance if they are to grow successfully. We believe that the Combined Code should relate to all listed companies irrespective of size

as shareholders capital is at stake. Some flexibility may be afforded to companies if they are able to explain why they are not able to comply fully with the guidelines.

G: International context

What can we learn from international experience?

Q32: What lessons can be learnt from international experience, either in terms of structures or behaviours?

Recent corporate scandals in the US have demonstrated the dangers of a lack of checks and balances on boards and inappropriate and excessive incentives. This reinforces our view that the role of chairman and chief executive should be split. They have also highlighted the dangers of an approach based on compliance with the rule of law rather than principles.

Lack of transparency on how boards operate and how they are incentivised can also create problems and lack of confidence e.g. ABB and Barnevik's pension arrangements.

US Listing Rules now require at least half of the board to be independent non-executive directors. We should consider amending UK Combined Code requirements to meet this level of independence.

Q33: Do other models of corporate governance or different boardroom roles or dynamics contribute more to company performance?

We are, on balance, supportive of the UK's unitary board. The US unitary boards do not operate in the same way as in the UK. For example, combined Chairman/CEO roles are the norm and they have far too much power and almost complete discretion regarding the appointment of non-executives. Therefore, the recent problems in the US do not mean that the unitary board in the UK is ineffective as we have more checks and balances.

We believe that executive chairmen of companies should not chair any board committees and finance directors should not be company secretaries.

Q34:

- (a) *Would it be beneficial to bring UK practice more in line with that in any other countries?*
- (b) *If so, why and how?*

We consider the UK board structure and models of corporate governance work well. We are not aware of any other models that work better. However, we should not be complacent and should continue to be aware of progress in other jurisdictions and to incorporate approaches that might further enhance UK practice. In particular, we have a code of best practice that is incorporated in our Listing Rules and an active shareholder base in the UK that increasingly monitors compliance. This makes companies more accountable, aware of their responsibilities and the consequences of non-compliance. The interaction between

legislation, regulation, Listing Rules and shareholder participation has created a culture of improving governance in the UK.

We hope our response will add value to the consultation process. Please feel free to contact us if you would like more information.

Yours sincerely

Anita Skipper
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