

# Review of the role and effectiveness of non-executive directors

## Response by The National Association of Pension Funds

### Introduction

The National Association of Pension Funds (NAPF) is the UK's leading body representing the interests of those who provide and support employer sponsored retirement provision. Today, pension fund assets total around £600 billion of which around one half is invested in UK companies. Since such a high proportion of pension fund assets is held in the equities market, the UK's pension funds have a very significant interest in the creation, development and governance of companies, and in their ability to be successfully entrepreneurial in today's highly competitive global markets. The NAPF itself represents some 1000 plan sponsors, as well as over 400 leading organisations providing professional services such as fund management, investment consultancy, accountancy, actuarial and legal services to pension schemes.

The NAPF is therefore pleased to comment on the Consultation Paper and wholly supports the Government's and Derek Higgs's intention to devise an approach based on best practice rather than imposed regulation or legislation. In the NAPF's view, any recourse to rules and red tape would inevitably give rise to a box-ticking mentality and, if anything, a lowering of standards.

The NAPF has been at the forefront of thinking, for many years, on corporate governance issues; and this has been demonstrated by its policy statements and their practical application, through its Voting Issues Service, to large plcs.

As part of its engagement process, the NAPF has consulted widely with non-executive directors, so that a number of the questions raised in the Consultation Paper have already been addressed in the NAPF's guide *Independent directors – what investors expect*, which was published in May 2002. A copy is therefore attached to this submission but, in a number of the responses to the questions raised, the opportunity has been taken to clarify and/or develop the NAPF's position.

### NAPF responses to the questions raised in the Consultation Paper

#### A: Role

What role should non-executive directors perform, and how does this compare to the present position?

Q1 *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 board's role is to lead and control the company on behalf of shareholders. Key to this, in the NAPF's view, is the need to agree corporate strategy and set performance benchmarks, ensuring that the right people are in place. The board should then reasonably satisfy itself that those executives are appropriately implementing the agreed strategy. It follows that a critical subsequent role is to challenge performance

and review strategy. The board should set an appropriate control framework and, as per Turnbull, take ownership of risk. It should also ensure that the board structure is appropriate and that both board collective and individual self-appraisal take place. The NAPF suggests that this process might usefully be summarised in company annual reports. Other important roles include supervision of executive actions and representation of outside shareholders' interests.

The chairman's role is to guide the board. The Chief Executive Officer's role, on the other hand, is to understand the business, formulate proposals on strategy for the board and implement its decisions. The Chairman's pivotal role, and its relationship to the non-executive directors (NEDs), was succinctly described by Cadbury as "being primarily responsible for the working of the board, for the balance of its membership, subject to board and shareholders' approval, and for ensuring that all directors, executive and non-executive alike, are enabled to play their full part in its activities".

Chairmen come in many styles and even part-time non-executive chairmen have a vital position in leading the board's agenda and managing the skills and experience necessary to drive forward business performance.

An important duty of the chairman is to ensure that NEDs on the board have a full opportunity to comment on all relevant matters, thereby minimising the risk of any over-dominance by executive members of the board.

**Q2** *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?*

One key requirement of NEDs is to support the executive directors in the creation of long-term shareholder value. To achieve this, NEDs need to ensure that they are adequately informed about the business and its stakeholders. This would include listening regularly to company/subsidiary company management, customers, suppliers and institutional shareholders; asking pertinent questions (of executives, chairman etc); running the audit, remuneration and nomination committees; and helping executives focus on the critical and strategic issues.

In view of the dual nature of the role of NEDs (in terms of strategy and monitoring), and the complexity of companies, it is probably not possible for NEDs to fulfil all roles in some companies. Thus, given the increasingly exacting demands/expectations on/of all directors, it should be expected that, among the NEDs, there is a diverse range of up to date, requisite skills to enable them to perform their collective board functions well. For example, it may be necessary for a pharmaceutical company to have a director with specialist knowledge of the industry to assist with strategy, but a strong independent representation on the board would require other professional skills, such as those required by the audit committee.

There are differences between independent non-executive directors (IDs) and the remainder of NEDs in terms of their representation on certain committees. The remuneration committee should be made up entirely of IDs, and the nominations committee should have a majority of NEDs, with either a NED or the chairman of the board being its chairman. The audit committee should comprise only NEDs of whom a majority should be independent. There is also growing support for audit committees being made up entirely of IDs. The NAPF recommends that the audit committee chairman should always be an ID.

The NAPF considers that NEDs should comprise not less than one-third of the board with a minimum of three.

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

As a generalisation, the lines of communication between NEDs, and particularly IDs, on the one hand, and shareholders, management, customers and suppliers on the other, are not as developed as they should be. The emphasis, particularly for IDs, is still weighted towards monitoring and policing, roles which are particularly challenging for those individuals who spend relatively little time with the company. Nevertheless, recent events, particularly in the US, have highlighted the critical nature of this role as well as the fact that most NEDs need to spend more time with the companies on which they serve.

The latest available data compiled by the NAPF's Voting Issues Service, which covers the AGMs and EGMs of the UK's top 400 companies, excluding investment trusts, indicates that just over half of those companies were compliant in 2001 as regards composition of their remuneration committees, a proportion which was on an upward trend. For audit committees, the figure was about 80%, understandably higher because of the lower compliance requirement, but with little evidence of growing compliance.

Currently, it is difficult for outsiders to assess properly the contribution of NEDs to a company, and most evidence is purely anecdotal.

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

All directors, including NEDs and IDs, have the same function of improving company performance, and thereby creating shareholder value. However, it is the IDs especially who are regarded as representing the interests of all shareholders on the board. This is particularly important when conflicts of interest may arise in respect of, for example, remuneration issues for executive members of the board. From that perspective, it is important that the remuneration committee should be comprised solely of IDs.

Given the complexity of, and recent controversy surrounding, the audit function, it may be necessary to move towards greater independence of the audit committee. As previously recommended, the NAPF considers that the audit committee chairman should always be an ID.

Q5 *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 Cadbury Committee identified examples of areas of potential conflict as takeovers, boardroom succession and directors' pay. It is important, therefore, that NEDs carefully scrutinise all merger and acquisition proposals. There have been many examples where the results of such proposals have resulted in significant loss of shareholder value.

It is suggested that counter-measures might include more robust remuneration committees, a stronger link between executive pay and shareholder return and setting targets for executives to hold shares in their company.

Q6 *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?*

It is wrong to be prescriptive as regards the time commitment placed on the chairman's role. Inevitably, this will vary from company to company so it is important that the chairman allocates, in each case, an appropriate amount of time. This might, for example, require a full-time commitment during a takeover battle. As regards NEDs generally, there can be no definitive answer on the optimum time commitments. This will depend, to a large extent, on the size, diversity, complexity and geographical parameters of the company. Other factors will include whether the company is expanding or contracting and, if the latter, whether that is by accident or design. The human factor will also come into play, as there may be a wide variance amongst NEDs in their capacity to deal with workloads.

The NAPF starts from the premise that a NED, to be reasonably effective, needs to devote sufficient time to the company in question. Anything less and his/her ability to assimilate information, question the executive, talk to management, interface with shareholders and visit key company locations etc is likely to be compromised. On that basis, the NAPF considers that, as a rule of thumb, a full-time executive should not take on more than one outside directorship. The NAPF would expect a director holding purely non-executive positions to justify how they can manage more than five posts (including the boards of charities etc). Whilst the NAPF would not wish to discourage directors from taking on work for charities or public boards, any such non-plc work should nevertheless be taken into account when assessing workloads, as some may require time commitments that are every bit as demanding as those of plc boards.

The VIS, as part of its engagement process, will seek an explanation from companies who employ NEDs with more than five directorships. In respect of individuals with more than five directorships, the NAPF recommends that each listed company, for which that NED holds a directorship, should be required to include a brief statement in their annual reports to the effect that the NED in question is able to devote the agreed amount of time to the company.

The NAPF further suggests that consideration be given to requiring disclosure, in company annual reports, of the total number of meetings held by the board and its sub-committees, together with the number of days worked for the company by each NED.

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

The NAPF regards it as being a basic part of the chairman's role (if a non-executive chairman) to act as a channel for communication on matters of serious concern. The NAPF considers, therefore, that a need to approach a senior ID directly is seen as a last resort and would indicate that there is something seriously amiss. In situations where the problem may be with the chairman, the NAPF would generally expect the deputy chairman to take on the "senior independent" role.

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?*

No. As regards directorships, the duties should be the same.

## 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 *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?*

The NAPF considers that the key skills, knowledge and experience should include the following:

- an ability to contribute to strategy development and to challenge executives on strategy options and other matters, as necessary
- an ability to challenge the company's mergers and acquisitions policy
- an ability to contribute to financial and capitalisation issues
- an ability to participate in board decisions on major issues of business development and direction
- relevant experience for the needs of the company's business.

Recent events suggest that, for the future, there will be an increased demand for NEDs with financial expertise, and particularly in risk management and mitigation, who will not only understand the fine detail of the company's report and accounts but who will also be able to listen knowledgeably to the relevant company management and auditors about the company's financial state and dealings, and so be in a better and timely position to either spot problems and/or 'whistle blow'.

Whilst it will be essential for some NEDs to have financial skills, the board as a whole needs to be balanced. A critical function is to ensure, monitor and question succession planning. From time to time, for example in a critical situation, NEDs may need to lead in replacing the CEO or other executive directors.

Q10 *What personal qualities and attributes are needed?*

The NAPF would suggest a need for the following personal qualities and attributes:

- a willingness to learn and continue to learn, not only about the business and its market sectors, but also about the role of the NED
- good judgment, common-sense and the tenacity to follow through with tact
- integrity
- courage and independence of mind
- sufficient time to devote to the needs of the business
- a proven track record of success/achievement
- to be prepared to 'whistle blow' as necessary
- a preparedness to resign over matters of principle and, if appropriate, to explain why to shareholders.

Q11 *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?*

A large company is likely to be very complex, and the mix of experience and attributes should vary accordingly. However, there needs to be a certain level of professionalism to permit NEDs to deal competently with modern accounting, legal and financial practices. The requirement, therefore, is for confident and articulate individuals, able to

manage the necessary communication/meetings with the executive, institutional shareholders and, depending on the business, advisers, suppliers and customers.

Q12 *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?*

Much of the evidence put forward to the NAPF by NEDs, including company chairmen, suggests that it is becoming increasingly difficult to recruit the right people, in sufficient numbers, to boards. One reason given is that the pool is too narrow as NEDs are very often trawled from a limited range of FTSE companies. Another reason suggested is that the risk/reward ratio is a disincentive to recruitment.

The NAPF considers that there is considerable scope for improving the recruitment and appointment mechanisms. In the first instance, the recruitment pool could be widened (as discussed at Q13 below). Secondly, potential recruits need a greater understanding of what would be expected of them as NEDs, and there needs to be a commitment to continuous development. A problem with the generality of nomination committees, and indeed boards, is that they seem to some to be “self-perpetuating oligarchies” which invariably recruit in their own image and narrow network. There seems to be a need, therefore, to break out of this mould, but that can only happen gradually as and when the pool widens. In addition, the nominations committee’s responsibilities should be extended to encompass not only current appointments but also medium-term succession planning issues.

Q13 *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 clearly no legal restriction which prevents boards recruiting from as wide a pool as they might wish. The most obvious sources could be drawn from senior plc management, institutional investors, senior civil and public servants, academics, trades unionists and consumer representatives. The fact that the pool has not widened, despite the shortage of good new recruits to the NED ranks, suggests that there is a need to educate both boards and recruitment consultants on the advantages, and existence, of the wider possibilities. Clearly, appropriate training for NEDs – and possible consideration of a qualification, at least for prospective NEDs – is called for.

A national register might improve the availability of high calibre individuals, but it would obviously require careful vetting to maintain a standard. It should also be sub-grouped by industry experience/specialisation.

The major constraint on wider coverage is the introspective nature of many boards. But there are also practical difficulties in finding people with the right kind and level of experience and expertise with sufficient time to devote to their NED duties. The NAPF strongly suggests that the Review examines the merits of encouraging companies to advertise board vacancies, as is now common practice in the public sector.

It should be noted that there is a fundamental dilemma which the Review should address. On the one hand, it is very desirable to broaden and deepen the pool from which NEDs are selected. On the other hand, it is an unfortunate fact of life that even people of great integrity and courage can find their flexibility compromised if they become accustomed to receiving directors’ fees which are very significant in relation to their other income. As the ability to resign on a matter of principle is very important, this would appear to narrow the field.

No doubt many UK boards with actual or prospective interests abroad already enjoy

international representation. For the others, it is not immediately apparent why such representation would be beneficial beyond that which should normally be derived from a balanced board of UK members. The NAPF would therefore be broadly neutral on this issue.

Q14 *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?*

There is a recognition that pay, certainly for many NEDs in FTSE companies, has not kept pace with the increasing expectations and risks being placed on them. Having said that, it is for each company to determine what is the appropriate level of pay given the complexities and demands etc of the company. There should therefore not be a 'one size fits all' approach. However, the NAPF firmly believes that NEDs should be properly rewarded to reflect their contribution, relevant experience, industry knowledge and the time spent on behalf of the companies concerned.

The NAPF considers that NEDs should have the choice of being paid in shares or cash (or a combination of both). Where they are paid wholly or partly in shares there is a clearer alignment of their interests with those of institutional investors. However, the NAPF is strongly opposed to the granting of share options on the basis that the greater leverage involved, emphasis on short-term (up to three years only) performance and lack of financial commitment may result in NEDs' decision-making becoming compromised.

Share options give executives (both executive directors and executives who are not on the board) a geared play on the performance of a company's stock. This is (or rather was) seen as a way to incentivise management and to encourage them to build capital and to act like entrepreneurs rather than glorified bureaucrats. One of the dangers of share options, however, is that the asymmetry of the pay-offs can encourage executives to take greater risks than they would otherwise prudently take, although this is clearly not their purpose. Of course, the skewed trade-off between the risk (limited) and the reward (huge) should be a major motivating factor ... otherwise the options are not working. NEDs have many functions but one of the most important is to provide balanced oversight of corporate strategy on behalf of all shareholders. For that reason, the NEDs should have the same financial interest and risk profile as outside shareholders and should not have asymmetric incentives.

Share options given to NEDs in private equity situations are different because, there, the lead investors' concerns are for early realisation or other form of exit.

Not all NEDs retain fees received, with many being passed back to the company where they have executive roles. Where a NED has a full-time executive role elsewhere, the NAPF believes that NED fees received should be passed back to the "lending" company. Companies allowing their executive directors to serve as a NED elsewhere (which the NAPF supports) should include in their remuneration policy reports whether or not the executive(s) may retain such earnings.

Current pay levels will not be a factor for full-time executives who pass back NED fees as described above. However, if fees are significantly enhanced for commensurately greater time commitments, tensions may be expected, on the one hand from the NEDs who will wish to retain those greater fees, and on the other hand from the sponsoring companies who may be less inclined to release their executives.

For full-time NEDs working in plcs, the average remuneration package is probably

about right for 15-20 days' work a year. The increasing demands being placed on NEDs, with a significant increase in the time needed to be devoted to doing the job properly, suggests that current pay levels may be inadequate to attract more of the right calibre of individuals.

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

In an environment which has become increasingly litigious, adequate insurance is essential if existing NEDs are to be retained and future NEDs recruited. Unfortunately, adequate and affordable insurance is becoming increasingly difficult to obtain. It may therefore be necessary for the Government to take on a role here.

### C: Structures and accountability

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

Q16 *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?*

UK companies have now been subject to the Combined Code for some four years. During that time the NAPF's Voting Issues Service has monitored compliance by the top 400 companies, excluding investment trusts. The evidence, up to and including the 2001 reporting season, indicated that only 19% of monitored companies had met all Combined Code provisions and had utilised, in the view of VIS, best practice in corporate governance. The main reasons for this apparently low level of compliance are that almost 50% of the companies were eliminated because of the composition of their remuneration committees, and a significant proportion (41%) retained executive directors with notice periods longer than 12 months.

However, the foregoing belies the fact that there have been encouraging or even excellent levels of compliance in a number of important areas, including the following;

Roles of chairman and chief executive separated (92%)

NEDs should comprise not less than one-third of the board (96%)

Majority of independent NEDs amongst the company's NEDs (82%)

Retirement by rotation (97%)

AGM notice and papers to be issued at least 20 working days before meeting (96%).

The Combined Code's definition of independence is general in nature and, in 1999 – in conjunction with the ABI – the NAPF devised a detailed definition in order to help investors and companies determine more precisely what constitutes independence. The NAPF acknowledges the reality that independence is a state of mind, and that no definition can do other than indicate where circumstances might not encourage that situation. The definition is as follows:

*In assessing the independence of a non-executive director, the assumption is that the individual is independent unless, in relation to the company, the director:*

- *was formerly an executive*
- *is, or has been, paid by the company in any capacity other than as a NED*

- *represents a trading partner or is connected to a company or partnership (or was prior to retirement) which does business with the company*
- *has been a NED for nine years – i.e. three 3-year terms*
- *is closely related to an executive director*
- *has been awarded share options, performance-related pay or is a member of the company's pension fund*
- *represents a controlling or significant shareholder*
- *is a new appointee selected other than by a formal process*
- *has cross-directorships with any ED*
- *for whatever reasons, is said by the company not to be independent*

*There may be other reasons which could cast doubt on the independence of a NED.*

The NAPF recognises the contentious nature of its 'nine year' rule and that, if independence is a state of mind, some IDs will never be genuinely independent and others will always be so. Nevertheless, the NAPF believes that it is right for companies to refresh their ID cadre, remembering that the 'time-served' ID may continue to have considerable value to the board as a NED.

Q17 *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?*

It is difficult for an outsider to assess the effectiveness of the contribution of NEDs, as little is known about board and committee meetings. Board size varies according to a company's needs, but it is self evident that an overly large board may become unwieldy and difficult to run efficiently and effectively. Conversely, too small a board may find its duties too onerous to complete, thus placing the directors in a position of unnecessary risk of failing to fulfil their individual duties.

Q18 *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?*

The NAPF's *Independent directors – what investors expect* sets out, at Section A, the responsibilities of the Audit Committee. It is inevitable and right that recent events, particularly in the US, should focus attention on the need, if any, for UK boards to strengthen their audit practices and procedures. Whilst the NAPF is not aware of anything untoward in the UK in this respect, commonsense suggests that it would be foolhardy to be complacent and that, instead, it is appropriate to examine where current practices could be improved.

In that respect, the NAPF suggests that consideration should now be given to changing the balance of the audit committee, from all NEDs with a majority of IDs, to being exclusively made up of IDs. This would place it on the same footing as the remuneration committee, and thereby remove at least one area of potentially inappropriate interference by the company. In addition, whilst the appointment would be the decision of the full board (acting on shareholders' authorisation), the choice of auditor and terms of engagement should be endorsed by the recommendation of the audit committee, which should also be responsible for the allocation and oversight of both audit and non-audit services, if any, provided by the audit firm.

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

It is understood that the nominations committee works effectively as currently structured. However, as recommended in the response to Q12, there is a case for extending the responsibilities of this committee beyond consideration of current appointments to encompass also medium-term succession planning issues.

The remuneration committee works less well as evidenced by pay leap-frogging and perceived excessive pay increases. In the NAPF's view, the remuneration committee spends insufficient time looking at trend performance and trying to link pay to relative performance, both internally and externally, rather than simply comparing absolute pay and benefit levels at other companies.

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?*

Few companies provide information on this. However, a number of organisations now offer board evaluation processes, and the NAPF supports their use by companies, from time to time.

Q21 *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?*

Yes. Shareholders would certainly like to know that board performance measures are in place. More reporting of total shareholder return (TSR) or similar measures would help, and the new Regulations introduced for accounts ending on or after 31 December 2002 should also help. The new requirement is for TSR for the previous five years to be graphically shown against the TSR of the relevant market index. This should help to focus board attention on company performance and will be reported annually to shareholders.

Q22 *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?*

Anecdotal evidence suggests that NEDs, and particularly IDs, do challenge executive decisions. However, in practice, as the Combined Code requires that NEDs "should comprise not less than one third of the board" and that the majority of NEDs should be IDs, they are at a numeric disadvantage in many companies. In fact, that is not the case amongst FTSE 100 companies but, for many of the rest, the implication is that challenges could be easily defeated. One solution, when a widened pool of recruits makes it feasible to do so, would be to increase the number of NEDs on the board to not less than one half, with a majority of NEDs being IDs. NEDs do, of course, have recourse to the very powerful, but seldom used, tool of resigning on a matter of principle and publicly giving their reasons.

#### D: Relationships with shareholders and others

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

Q23 *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?*

The NAPF regards the ID in particular as representing shareholder interest on the board. Arguably, the most significant factor militating against a strengthening of that relationship is the time available to the ID. As and when all NEDs are able to devote more time to that role – thereby allowing greater contact with the company’s senior management, employees, customers and suppliers etc – so they will bring more value to their relationship with shareholders. This could then be strengthened by the use of ad hoc meetings on corporate governance issues, allowing shareholders to voice more actively any concerns. However, generally speaking, companies are reluctant to allow both sides to meet.

**Q24** *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?*

More rotation of NEDs and a greater influx of younger NEDs (for example, plc executives) would help. Some boards spend too much time on board papers which document current year issues rather than longer term strategic matters. Some board papers arrive too late to be challenged critically, whilst some subjects which deserve detailed papers get little or none. Boards need to spend more time (for example, the away day) on both future strategy and self-assessment.

NEDs need to get reference points from outside the boards and committees on which they serve. To that end the NAPF has instituted a series of discussion seminars for NEDs. The Institute of Directors, auditors, legal advisers and others already do much, but could do more, to facilitate neutral venue/Chatham House rules exchanges.

**Q25** *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 Chief Executive? What should their relationship be with key advisers to the Company?*

Listening and mentoring. The chairman mentors the CEO; the NEDs should mentor the chairman and, to a lesser extent, the other executives; the audit committee chairman should mentor the finance director; and the remuneration committee chairman should mentor the CEO on pay and influence the HR side generally.

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

The NAPF considers that the company secretary is one of the most effective, but often overlooked, company resources. Being an officer of the company, at the heart of the company and board procedures, the company secretary is well placed to ensure that steps are taken to help align the interests of the shareholders and company management. As the Cadbury Code suggests, this role is central to the proper functioning of the board’s procedures. The company secretary safeguards the rights of all those who have an interest in the prosperous future of the organisation.

The company secretary is therefore ideally placed to facilitate, and promote, at least some of the meetings referred to previously between NEDs and company senior management, customers, service providers and shareholders.

## E: Support

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

Q27 *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 should have unfettered access to all information held by the company. In practice, they must of necessity rely on the chief executive and other officers of the company to provide them with relevant and timely information. For their part, NEDs will be in a better position to know what to ask for if they have had the time and opportunity to talk informally to senior and other management and to prepare for meetings, etc.

Q28 *What training and development opportunities are available? Could they be improved and, if so, how?*

The NAPF is aware of the 'Chartered Director' initiative, recently introduced by the Institute of Directors, which aims to raise the bar in terms of NEDs' levels of knowledge. The NAPF supports the principle of such initiatives although it would not see such a qualification as being a pre-requisite to board membership, particularly given the expected slow rate of growth in the numbers becoming qualified.

Q29 *Can induction for non-executive directors be improved?*

A planned and formalised induction process by companies should result in NEDs getting up to speed more quickly.

Q30 *Do non-executive directors get clear guidance on what is expected of them and do they get feedback on whether they are meeting expectations?*

The NAPF suspects that, generally, NEDs do not get clear guidance and feedback, but believes that this should be encouraged. In that respect, the NAPF has already initiated a series of discussion seminars for NEDs to provide both guidance and feedback.

## F: Smaller listed companies

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

Q31 *To what extent do different factors apply in the case of smaller listed companies? Is different provision necessary?*

The provisions of the Combined Code are broad and not overly prescriptive, ensuring that compliance is attainable. The NAPF recognises that smaller companies may find it more difficult to satisfy some requirements, such as assembling board committees, which may be deemed excessive if the company has a relatively small workforce or is less complex in nature than other larger companies. However, it is arguable that many smaller companies have a greater need of guidance from experienced and/or professional NEDs than the larger well-resourced companies. Any changes to the role of the NED should incorporate guidance for smaller companies so that any further improvements do not become overly burdensome.

## 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?*

The corporate world has become increasingly global in nature and, as a result, many companies are now familiar with the different corporate cultures that exist. Many countries have both good and poor examples of corporate behaviour. It is therefore in the UK's best interests to monitor practices, and failures, abroad as a means of continually improving standards of corporate governance at home. For example, many northern European countries are more advanced on matters of corporate social responsibility and on how to disseminate this information to shareholders and the community. A point also worth noting is that Australia, which made substantial amendments to its company law provisions in the 1990s, following the excesses of the 1980s, has much less reliance on NEDs who are CEOs elsewhere.

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

There are lessons to be learned from venture capital/private equity and also from shareholder activism.

Q34 *Would it be beneficial to bring UK practice more in line with that in any other countries? If so, why and how?*

No. Although UK practice is not perfect, and any system of governance will periodically be subject to extreme stress, the NAPF considers that it is better than most. Specifically, it is less cumbersome and offers more protection to shareholders than is the case of the Continental European two-tier system. In addition, UK practice has developed in a more open and pro-active fashion than is the case in North America because US institutions, with the honourable exception of state and local authority pension funds through the Council of Institutional Investors, have singularly failed to play a responsible part in the development of good corporate governance, unlike the UK where the NAPF represents pension funds from all sectors of the economy. As a result, UK practice has led the way in responsible thinking on these matters and (vide this consultation exercise) continues to do so.

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