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Derek Higgs  
Non Executive Directors Review  
Room 2142  
1 Victoria Street  
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Dear Derek

**REVIEW OF THE ROLE AND THE EFFECTIVENESS OF NON EXECUTIVE DIRECTORS**

I have read your consultation paper with interest and congratulate you on reviewing this topic in such a comprehensive and open manner. I do not intend to answer all the questions which have been thought through as I am sure you will receive many submissions, but having been a non executive director for a number of years, and been involved in a number of debates around this issue, I would like to make the following observations.

This whole subject has stemmed from the problems in the United States of America and whilst the capital markets are global, I think it is important for those examining the issues going forward to realise the significant difference between a UK Unitary Board and a US Board. Generally speaking in the United States, the Chairman and the Chief Executive are the same person and the only Executive Directors on the Board are the Chief Executive and the Chief Financial Officer. This makes the role of the non executive director very much more difficult from the point of view of monitoring governance. I do believe that the implementation of the split between Chairman and Chief Executive in this country and the general practice of the Unitary Board including a number of Executive Directors in addition to the CEO and CFO is a considerable strength. I appreciate that many feel that non executive directors should be part of a supervisory mechanism purely monitoring governance but in my view if they do not have continuous access to a wide range of executive directors, their responsibilities become more difficult to deliver rather than less so.

The UK style Unitary Board has many strengths and one which many countries aspire to. In my view it should be retained and any move to supervisory boards or different responsibilities defined in law for executive and non executive directors strongly resisted.

I believe it is too simplistic nowadays to purely talk of non executive directors, independent directors or part time directors. I believe that there are directors who are appointed on a part time basis in a non executive capacity for the contribution they can make to the performance of the company, whether it be from the experience of finance, marketing, engineering etc and

there are those directors who are appointed on a part time and non executive capacity who will be there to hold the reins on some of the governance issues such as the Remuneration Committee and the Audit Committee. My first suggestion is that when someone is being proposed as a non executive director, the information submitted to shareholders should set out the role that director is expected to play.

I am not a believer in the use of the term independent directors as everyone has dependencies. Questions I would ask are whether directors who own shares are independent and directors who are paid by the company are independent. I would keep the term 'Non Executive'.

On the subject of skills, knowledge and attributes required, I believe one has to look at the roles that the non executive director will play in order to define that. The one major attribute is the inner strength to ask questions and to take an objective stance at Board meetings and with management.

As far as the recruitment and appointment of the best people to fill non executive roles are concerned, I would suggest that all public companies are encouraged to allow their Chief Executive and Chief Financial Officer and other directors to hold non executive appointments and that the major professional firms should also encourage senior partners also to take on such roles.

With regard to structures and procedures, it is very important that these remain totally flexible. The key person is the Chairman as it is his or her role to ensure that a proper strategy is in place and proper management are appointed to implement that strategy. I feel it would be counterproductive to start issuing guidelines on the number of hours that any director should spend in a given company or indeed the number of directorships that an individual should hold. Every company is different and every individual is different in terms of their effectiveness. On many Boards each director may have different contributions to make and indeed different expectations of time and that can be recognised in the director's remuneration.

On the subject of remuneration, the risk reward balance has moved substantially in recent times, most directors will spend more time than at present and I suggest a guideline of increase in the region of 50% to 100% of present rates if we wish to attract properly experienced people.

As regards the role of the senior non executive director, I feel this is only really necessary where the Chairman has an Executive function. Also it may be a role that is carried out by the ~~Deputy Chairman in certain companies, but it will depend on the circumstances.~~ On balance, I think it is better that an individual is recognised, but it should be considered a more passive rather than active role in most cases.

On the subject of Audit Committees, you will have read of my views that they should take responsibility on behalf of shareholders for proposing the appointment and remuneration of auditors and approving any non audit services provided by the external audit firm. I also believe that the Audit Committee should make a report to the Annual General Meeting on such matters and should be required to review but not necessarily change the audit appointment on a five to seven year basis. I am encouraged that the Financial Reporting Council together with yourselves will be looking at the role of Audit Committees and the composition and duties, together with mechanisms for finding the right people. Clearly any Audit Committee needs to have a degree of financial literacy and in particular its Chairman should have a knowledge of financial reporting standards. Whilst I believe that the Audit Committee should solely consist of non executive directors, I would have thought that two accountants on the Audit Committee

would be quite sufficient as more wider commercial skills are also helpful in making a number of judgements on accounting issues and risk management issues.

On the subject of Remuneration Committees, I feel that this is one of the most difficult areas as many of the problems that we have seen in governance are due to highly incentivised environments. In practice I feel it would be helpful for the Remuneration Committee to have someone experienced in human resource issues.

I also support the continuation of the concept of a Nomination Committee and would add to its role the appraisal of directors and the role they are playing. As a matter of practice, I feel that the Chairman of the company should be the Chairman of the Nomination Committee and that he or she should have an annual meeting with each director to assess the contribution that is being made, objectives for the following year and letters of appointment.

On the subject of the relationship with shareholders, I believe that pressure should be brought to bear on the Institutions, not only to meet with Chief Executives and Chief Financial Officers, but also the Chairman or Senior Non Executive Director to discuss governance issues. The present practice of shareholder action groups or Institutions commenting on governance matters normally at the time of election of directors and AGMs without talking to those charged with governance is a weakness in our infrastructure.

From an international perspective, I would suggest that consideration be given to studying the Japanese practice of asking shareholders not only to approve the proposed dividends to shareholders, but also the bonuses to management based on the performance of the previous year or years. I believe that this would align the shareholders and performance management much more closely together.

As regards support for non executives, I would suggest that the Institute of Directors have a specific branch and build on the initiatives to date, together with a helpline service where experienced non executive directors should be prepared to fulfil a mentoring role in times of difficulty.

Finally, might I say that I do not believe that there is a need for another Code of Practice. We should be proud of the corporate governance mechanisms we have in the United Kingdom. I believe that we are leaders around the world in this area and certainly this is what I found when I chaired the Task Force on International Corporate Governance by the International Capital Markets Group who published "Who Holds the Reins?" in 1995.