

Mr DA Higgs
Non-Executive Directors Review
Room 2142
1 Victoria Street
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5 September 2002

Review of the role and effectiveness of non-executive directors

Thank you for inviting comments and also answers to the questions that you set out in your consultation paper on the role and effectiveness of non-executive directors issued in June 2002.

As a leading professional services firm we of course have regular and frequent contact with non-executive directors in the course of our activities. In respect of our clients, we meet with their audit committees on a regular basis as well as other formal and informal meetings. Additionally, we have contact with non-executives that do not serve on the boards of our clients, including briefings that we hold every three months, to which we invite non-executives of the FTSE 350 companies. I have been organising and chairing these events since their introduction eight years ago.

We held a series of briefings this summer attended by some 250 non-executive directors and the briefings focussed on many of the questions you raised in your consultation paper.

We attach a copy of our publication "Sounding Board", which summarised the briefings and incorporated the views expressed by the non-executive directors who attended.

The presenter at these briefings was Roger Davis, Head of Professional Affairs for PwC, who served as Deputy Chairman of the Turnbull Committee and who is currently spending much of his time liaising with Ministers and the Treasury regarding the proposed changes to accounting, auditing and corporate governance arising from the other Government reviews that are in progress and legislation recently enacted in the US.

We structure our contribution to your considerations in Appendix 1 to this letter. The introductory section outlines our strong support for the unitary board model and its effectiveness and sections A to E follow the format in your consultation paper. We summarise our conclusions at the end of this Appendix. In Appendix 2 of our submission to you, we have highlighted a number of the key points discussed in our briefings and included in Sounding Board and have sought to bring these more to life by including relevant quotes from the attenders.

We trust that you find our comments helpful.

Yours sincerely

JH Salmon

REVIEW OF THE ROLE AND RESPONSIBILITIES OF NON-EXECUTIVE DIRECTORS

Introduction

The current focus on corporate governance has emanated from problems that have arisen in the US, although we are aware that the UK review on the role and effectiveness of non-executive directors was set up before those events came to light. Our overall view is that the non-executive director community in the UK makes a valuable contribution to the boardroom. The position and influence of non-executives has increased markedly over the last decade as a result of the many corporate governance initiatives in the UK in that period. The position is very different in the US where, as recently as a year ago, the term ‘corporate governance’ was rarely used.

The UK has done a great deal to advance the cause of corporate governance whilst trying to ensure that the monitoring aspects of non-executive directors’ duties do not get in the way of the need for corporates to do business, i.e. accepting considered levels of risk and seeking to ensure that the company prospers. We are of the view that the system of corporate governance has been well developed in the UK. It serves UK business well and is not in need of major overhaul.

We believe that the UK unitary board concept has been a major factor in assisting non-executive directors to perform their role and responsibilities, including the increased monitoring role. A unitary board unlike, other board models, has the opportunity to ensure there is a well balanced board of both executive and non-executive directors. It involves all directors with a proper sharing of responsibility. It meets regularly and, in particular, it enables the non-executive directors to have a better feel for what is going on which will improve their own contribution.

The danger of further regulation is that it is likely to undermine the effectiveness of the unitary board. By putting further pressures on its monitoring role, it can lead towards a dysfunctional board with differing interests of its members and the non-executive directors feeling they are being further confined to a policing role.

We strongly support the principle of the unitary board model which has been shown to work effectively. We believe the focus should always be on the whole board and not just part of it, such as its non-executive directors. Whilst improvements can always be made, we would oppose any measures which sought to undermine this board model.

There are of course areas where reality or perception means that the role of the Board and the role of the UK non-executive director, either needs to be strengthened or made more transparent. One such area is a structured and, we believe, independent review of board performance, the fact of which is reported to shareholders. It is in the interests of all shareholders and stakeholders that their board of directors is as effective as possible and

that the board has undertaken proper steps to achieve that. This point is developed further in this paper.

A number of suggestions were discussed at our non-executive director briefings held this summer and the views have been summarised in the July edition of our publication Sounding Board. This paper expands on those views and proposes further recommendations on the role and responsibilities of the Board and non-executive directors. The recommendations are summarised at the conclusion of this paper.

A: Role.

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

Your detailed questions rightly start with “What is the role of the board?”. As noted in Sounding Board, the Cadbury and Hampel codes looked at board process, but did not fundamentally address the actual role and function of the board. We draw your attention to a table below, extracted from Sounding Board, which sets out our views on what may be seen as the role of the board. This model was discussed at our briefings and there was general agreement on it.

The role of the board	
●	Maintaining an enduring globally competitive company ("strategy")
●	Observing, encouraging and advising the management
●	When necessary, replacing management
●	Promoting good corporate behaviour and accountability
●	Setting the tone of (leading) the company
●	A conduit to shareholders (and other stakeholders):
	- to justify its own actions
	- to justify shareholders' and others' actions

Role of non-executive directors

The role of non-executive directors is described in the Cadbury and Hampel Reports. They bring an independent and objective viewpoint to the board. They provide both support and, as necessary, a challenge to the executive management. They provide strategic input, and, increasingly over the past decade, perform a monitoring role keeping under review the activities of the executive directors. This latter element is made possible through the UK practice of having a unitary board, since nothing is better than sitting eye to eye with executive directors at board meetings.

It is important that both the strategic and the monitoring elements of their role are maintained, since to change the role so as to make it purely a policing one, would not attract the right calibre of people who could bring value to the board. In fulfilling the monitoring role, independence is vital. For smaller listed companies the strategic role may well have more importance than the monitoring function. In such companies it is usually the experience, objectivity and broader perspectives of the non-executives that these companies find most useful.

Independence of non-executive directors

The independence of non-executive directors is a highly important, but just as subjective, question. The key issue is independence of mind in practice and the points made at our NED briefings are worth repeating here –

- The willingness and ability to say “no” – or to say “yes” if management is too risk averse
- Not depending on NED directorships for a livelihood – the ability to walk away
- Increasing substantially the payment for NEDs could compromise independence
- The term “independent” rather than “non executive” director might better symbolise the role.

Balance of the Board

With regard to the balance of individuals on the board, and the need to ensure that the non-executive directors present a credible challenge to the executive, the question of the number of non-executives is not necessarily, in our view, the key determinant. It is the strength and ability of the non-executives, and the respect that they are accorded by executive management, that comprise the key determining factors on their influence. Also, in difficult situations, it is vital that their cause is recognised and supported by the Chairman. However, the number of non-executives will have a bearing upon their effectiveness and their potential involvement on committees. It would seem to us that it is difficult to argue against the proposition that at least 50 per cent of the board should comprise non-executive directors.

NED Time Commitment

Another of your detailed questions addresses the time commitment needed by non-executive directors. Our recent research indicates that a non-executive spends 15 days a year with board meetings and papers, and an additional five days for committee activities.

The general view expressed at our briefing was that the time commitment was often more than this, particularly if a difficult issue or situation arises during the year. So non-executive directors need to be aware of the likely time commitment from the outset, and take care not to assume that the average is adequate in any year when it is likely that they will be drawn into one or more time consuming areas. For smaller listed companies, the time commitment may be less, depending upon the complexity of the business.

Number of NED Roles

As to the question of the number of non-executive posts that may be taken on, clearly this will depend upon the degree of effort put into the role by any individual. It will depend on how well the individual manages their time, and on whether or not they hold committee roles, or committee chairman roles which will be more demanding. It may also depend upon their particular skills and expertise, and past experience. Except possibly in the case of a non-executive director who also has a role as an executive director elsewhere, we do not believe that setting an arbitrary limit will be helpful, because of the factors we have mentioned. There was little support at our briefing for the idea of setting limits.

If holding an executive role, a director must be realistic about the amount of time that will be available for his non-executive activities. It must be questionable whether a full-time executive director can hold more than one major non-executive position – however it depends on their own organisation.

Senior non-executive director

With regard to the role of a senior non-executive director, as was proposed in the Hampel Report and taken up in the Combined Code, we believe that in situations where the chairman and chief executive roles are combined, then it is very useful. This message came out clearly from our briefings. We also believe that the role is important where there is discontent with the chairman's method of dealing with the board as a whole, or in dealing with particular issues. We consider, therefore, that this role should be retained in the Combined Code provisions.

Statement of directors' duties

We strongly support the proposed statutory statement of directors' duties and firmly believe that to seek to distinguish in law between the executive and non-executive directors would damage the unitary board concept.

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?

Skills Required

It is not in doubt that diversity of skills is needed in a boardroom but the skills of each director and their ability to work as a team must be shown to add value to the company and its shareholders. We support such diversity and the issue is not around the principle, but more whether the individuals with relevant skills are available.

The key requirement of a non-executive director is to understand the needs required by a competitive corporation in the global environment. Clearly personal qualities such as high ethical or moral standards, personal courage, good communications skills, robustness in the face of adversity and the ability to ‘think outside the box’ are key and most desirable.

Below is a brief list of the attributes, other than those already mentioned, that we consider to be of importance:

- Supportive yet challenging, as appropriate, of executive management
- Presence and credibility to be able to challenge the executive management
- Persuasive in their approach, but ability to be confrontational where the situation demands it
- Independence of mind
- Understanding of risk management and controls in a business
- Sectoral and geographical knowledge, experience and awareness
- Tenacity and a probing nature.

However, it is unlikely that all the non-executives on a board will have all of these – the aim must be to have a population of non-executives that in aggregate possess these attributes.

One of the more common attributes that is stated to be required of an individual to serve as a non-executive director of a larger listed company currently is that he (or, less frequently, she) has served as an executive director or as a non-executive director on a FTSE 100 or mid-250 board. Based on our research there is a perception that the best non-executives are former or existing CEOs, because they understand best how a Board operates and what it is tackling.

Clearly, this pool of people can only fill a minority of the NED requirements of boards. There are many other well qualified people with some or all of the qualities outlined above who undertake an NED role most effectively. And they do not need to have been a director previously, provided they understand the corporate and competitive landscape.

Skills for small companies

Typically, non-executives of smaller listed companies are drawn from a different population; the emphasis is more on the individual’s experience in the particular sector or industry, rather than their presence on other FTSE boards. In many smaller listed companies, there is the influence of founder or family shareholdings, but these may not necessarily have the right attributes to act as non-executives, since they are representing particular interests. Indeed, in our experience, such companies often need truly independent non-executives to help resolve differences that arise between companies and their major shareholders.

Widening the pool of non-executives

Widening the pool of non-executives is clearly on the wish-list of the current Government, and there is nothing wrong with this in principle so as long as any non-executive director

appointment adds value to the board through their commercial knowledge and will ultimately be beneficial for the company. The individuals must possess the skills that fit the needs of the current board, and not simply be appointed so as to introduce diversity, or to satisfy ‘politically correct’ or individual stakeholder motives. Once in the boardroom, a director must act for the good of the company rather than just for an individual interest. They must help to create a sustainable competitive advantage for the company.

NED Remuneration

It is likely that the current fee levels reduce the size of the population that is likely to be attracted to the role and have some bearing on the number of non-executive directorships held by an individual. This brings us onto the topic of remuneration.

We consider that the current level of reward for non-executives is disproportionate to what we believe to be the “size of the job” (i.e. the risks and responsibilities of the non-executive role). Average non-executive fees are in the region of £25,000 to £30,000 per annum. For most individuals of the calibre sought by FTSE 350 boards, this equates to 10 to 15 days’ input. This might be appropriate in a year when there is no special call on the non-executives, but in a year in which, say there is a takeover, or where some kind of problem perhaps emerges, then the amount of time commitment can increase dramatically. The debate following Enron has highlighted the fact that non-executives share the same risk as the executive directors but with considerably less involvement and reward.

We would therefore suggest that there should be some reflection of the additional contribution that is often required from individual non-executives, and this may be achieved by having a base fee level at or above the current average, with additional remuneration (based on a per diem rate) where substantial involvement, over and above that originally expected, is required. This additional pay formula should be included in the remuneration package of a non-executive director, which is agreed before that person joins a board. Any additional remuneration should not become the annual norm.

We believe that non-executives should be paid for the time and effort that they contribute and that where there are unusual or exceptional circumstances, their terms and conditions should allow for appropriate extra remuneration. By having it on this formula basis, it ensures that annual base pay does not get too high, which might be seen to impair their independence.

Risk

A related and major issue is how the non-executive director covers himself or herself against the risk of the role. Directors and officers insurance is generally not seen to be adequate. The Equitable case is a worry for many non-executives who will be closely watching the outcome. Legal fees of a defence can be penal and the potential risks of the role in a more litigious society can be substantially out of proportion to the rewards.

The Equitable case will clearly be seen as a precedent and, depending upon the outcome, may well discourage the supply of good non-executive directors. It may mean that the provision of safe harbour provisions will need to be considered. How this might be

effected would have to be a matter for further major study. One issue would be whether such cover should extend to executive directors as well and there could be major implications on the principle of the unitary board.

C: Structures and accountability

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

Combined Code

We believe that the Combined Code has been working well. A PwC survey of annual report disclosures was carried out last year, and there was a high degree of compliance evident with most of the provisions of the Code. As part of that survey we noted a reluctance on the part of some companies to appoint a senior independent non-executive director.

We would not advocate further definitions of independence to be introduced into the Combined Code. The important point is to blend independence with the relevant knowledge and experience that will add value to the company, as discussed earlier. We do, however, consider that some boards have difficulty in arriving at a firm decision on the independence or otherwise of an individual director, due to the variety of criteria that institutional investors apply.

Board Committees and Training

Board committees are useful in providing a focus for non-executives' contribution. However, it is necessary for the non-executives serving on a particular committee to have relevant experience in the subject matter for that committee. Where non-executives lack relevant experience, we believe that there is a case for recommending them to undertake some form of training in the subject. For example, with the greatly increased focus on remuneration and the impact it has on corporate behaviour, knowledge of best practice and of the behavioural aspects of reward may be critical, but a number of non-executives serving on remuneration committees may lack such practical knowledge and experience.

Audit Committees

We believe that audit committees work well in the UK and have a positive influence. From our viewpoint, they have an important and necessary role in their interaction with the external auditors.

Clearly a number of recommendations for the role and responsibilities of audit committees are emerging from the USA at present. To a large extent, their proposals follow what is already best practice in the UK, but in some areas they go further. For example, in the Sarbanes-Oxley Act 2002, it is required that audit committees are comprised solely of independent directors, and that they have specific duties to make recommendations directly to shareholders on the appointment and remuneration of the auditors.

In following this US law and making these appointments, it will be important for US audit committees to remember that for the external audit to work at its best, there must be a good working relationship with management, with trust on both sides.

As regards membership of an audit committee it is clearly desirable for at least one member of the audit committee to be financially literate (by this we would envisage that the individual would have a background in finance or accountancy), and we would suggest that all members should undertake suitable training and regular updating to obtain and maintain sufficient financial understanding to be able to discuss matters arising on the financial statements. We would also recommend that an understanding of risk management and controls was a basic requirement for directors serving on the audit committee.

Report by an Audit Committee

As part of accountability and transparency, it is interesting to note that it is now standard practice that the remuneration committee is the only board committee that reports on its activity. Indeed, there is no formal report by the board itself on its activity. We recognise issues of confidentiality and commercial sensitivity clearly apply in relation to such reports, but perhaps there should be a report from the chairman of the audit committee on the work of the committee during the year. We are aware that the ICAEW is giving consideration to greater transparency of audit committee activities, through disclosure of the terms of reference and the procedures adopted to ensure that the auditors maintain their objectivity. We would support these moves to ensure that investors better understand the role and responsibilities of this committee and a separate report to shareholders may well be beneficial.

Structured Review of Board Performance

There is no requirement for a review of the performance of the boards of UK listed companies to be undertaken although it would be accepted to be best practice. Whilst such reviews may be undertaken and probably by the chairmen in differing ways, there is no evidence in UK corporate reporting of effectiveness reviews taking place.

The effectiveness of a board is crucial to its performance. And upward as well as downward feedback is a common HR process for appraising performance at many levels within organisations but not necessarily at board level. And if this is undertaken independently, this mechanism can facilitate expression of views which may not be fully made or heard at the boardroom table or in informal discussion, due to other factors or interests. For companies that have experienced troubled times, it is interesting to consider how much their cause would have been helped by a more effective board.

Non-executive directors have told us that they believe there is a good case for independent reviews of the board and we believe there is a case for it to be incorporated into the Combined Code as a recommendation for listed companies. If the review is carried out by an external organisation it will be objective, the company will benefit by the frank feedback that such independence will generate, by the recommendations following the review and also by disclosure of the fact of the effectiveness review, and the directors'

subsequent actions as appropriate, in its annual report. Such a recommendation in the Combined Code may, we acknowledge, cause some concern to chairmen, since it may mean that the way they manage and run the board may have to change and of course they are exposed to potential criticism by their board colleagues.

However, in order to satisfy their institutional and other shareholders that the directors are taking proper steps to ensure that their board is as effective as possible, we believe there is a strong case for structured performance reviews to be undertaken and the fact that this has been done should be reported to shareholders. Our discussions with some company chairmen lead us to believe that such a recommendation would not be unacceptable.

Finally in this area, we have already made a number of comments in section B above with regard to the necessary qualities of a non-executive in being able to successfully challenge executive decisions. We would reiterate the possible need for a senior independent non-executive director to handle difficult situations that may arise and to ensure that challenges are adequately dealt with.

D: Relationships with shareholders and others

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

Meetings with Institutional Investors

As mentioned above, we are strong supporters of the unitary board and would be against any moves that could undermine that concept. We would not recommend that non-executive directors meet alone with institutional investors. As we say in Sounding Board it is a desirable objective to improve the relationship between the board and the investing institutions, particularly to hold them to account as much as the board. However, we received a clear message from our briefings that such meetings should be for the whole board, not the non-executives on their own. On their own, they are unlikely to have the depth of operational knowledge required to answer the questions of the institutional shareholders and the likelihood of unintentional miscommunication could harm both the company and its shareholders.

However there could be benefit for a non-executive director to accompany the executive directors to their meetings with institutional shareholders if the chairman does not already attend those meetings and it was thought worthwhile.

Effectiveness of non-executive directors

In relation to your question on whether the chairman creates the conditions for the best effectiveness of non-executive directors, our view would be that this comes back once again to the need for structured reviews of board effectiveness. Through this mechanism, non-executives can express their views in an open and frank manner, leading to a stronger likelihood of honest opinions and changes being made where appropriate. In the future in the interest of accountability and transparency, it will be important for boards and chairmen to be seen to be taking the effective performance of the board seriously.

The unitary board demands open relationships between executives and non-executives. They need to meet regularly, and the non-executives should have the right to request senior management to attend meetings. Like all directors, non-executives should continue to have the right to external independent advice at the expense of the company. Clearly audit committees have the right at present to meet alone with the external auditors, and this is important to preserve and put into practice.

The quality of performance of non-executive directors can be influenced by the quality of information about the company that they have available. It is vital that chairmen and chief executives recognise the need for the board to be properly informed, both through oral and written reports, but without being overloaded with information or not given reports on a timely basis for proper consideration, both of which are regular criticisms which we hear. Non-executives can be helped by a structured review of the information they receive together with seeking their views, so that improvements can be made.

To gain a greater understanding of the company, there is little doubt that visits by non-executive directors to company locations, meeting with management and employees, is beneficial for all. This practice should be encouraged.

A lesser established practice is the use of non-executive directors to chair or be members of subsidiary group boards or to be asked to take a special interest in particular areas of the business. Obviously, this takes extra time but the upside is a better informed and involved non-executive director. And it should not harm the independence of his role.

E: Support

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

The issue that is raised with the questions you ask in this section is the need for and the ability of the non-executive directors to keep up to date. There is a necessity to have mechanisms available for the non-executives to keep up to date with company information, industry and financial information, and with corporate governance developments. The popularity of our briefings highlights this. The importance for non-executives of finding the time to update themselves cannot be underestimated.

Information Sources

Comments regarding the importance of receiving good quality information on a timely basis are made above. It is the quality of the information and the degree of its relevance that are critical to the effectiveness of the non-executive, rather than the volume. In most cases, standard financial data is abundant but it is less usual for non-executives to receive information of a more forward-looking or externally-orientated nature. Some non-executives consider that the information that is gathered at ground level from site visits is more valuable than the hard facts delivered in board papers.

Training of NEDs

Induction training should remain flexible since the need for it will be dependent upon the size and complexity of the business, and the previous experience of the individual. The

nature of training is something that merits consideration. There is often short sharp training on legal requirements provided, but there is relatively little on how groups of people work together. This is particularly important when the groups in question are filled with highly intelligent, strong-minded characters and an important aspect inherent within the role of a non-executive is to ask challenging questions.

Assessment of board effectiveness includes assessment of non-executives effectiveness and of the effectiveness of performance of committees. Value can be added in providing feedback to non-executives from an independent external source.

Smaller listed companies and international aspects

We have made appropriate reference within the above commentary to aspects relating to smaller listed companies and the international context.

Conclusion

We believe that the UK corporate governance regime works well, but there are a number of areas where the role and performance of the board and the non-executives could be improved.

This view was supported by the overwhelming conclusion from our briefings that the aim should not be more regulation of corporate governance. Rather it should be to ask “What do the best of us do best?” as an example for others to follow.

Our main thoughts are summarised below:

- The UK has the highest standards of corporate governance in the world and its unitary board model has been shown to work effectively. We would strongly oppose any measures to seek to destroy this model for board structure.
- The non-executive community in the UK makes a valuable contribution to the boards of UK business.
- The UK regime of corporate governance works well and is not in need of major overhaul.
- It is important that both the strategic and the monitoring elements of a non-executive director’s role are preserved, since to make the role a purely ‘policing’ one would not attract the right calibre of people who would bring value to the board.
- In our view, at least 50 per cent of the board should be made up of non-executives.
- It is questionable whether a full-time executive can hold more than one major non-executive position.
- The role of senior independent non-executive director should be retained in the Combined Code provisions.
- Smaller listed plcs often need truly independent non-executives to help resolve difficulties that arise between companies and their major shareholders.

- Widening the pool of non-executives is good so long as any non-executive appointment adds value to the board, is in the shareholders' best interests and will ultimately be beneficial to the company.
- Non-executive directors should not be appointed to represent a sectional interest or stakeholder, unless the particular circumstances of a company demand it.
- The current level of reward for non-executives is disproportionate to the level of risk they face as part of their role, particularly for those who serve on, or more particularly chair, board committees.
- Non-executives should be paid for the time and effort that they contribute and where there are unusual or exceptional circumstances, their terms and conditions should allow for appropriate extra remuneration.
- Where non-executives lack relevant experience for their particular roles on the board or in committees, we believe that there is a case for recommending them to undertake some form of training in the subject.
- All members of the audit committee should undertake suitable training and regular updating to obtain and maintain sufficient financial understanding, to be able to discuss matters arising on the financial statements.
- Structured and independent reviews of board performance and effectiveness would provide valuable insight to any board, chairman, chief executive or non-executive, to enable improvements to be made and to demonstrate accountability to shareholders.
- We would not recommend that non-executive directors meet alone with institutional investors.
- It is vital that chairmen and chief executives recognise the need for the board to be properly informed, both through oral and written reports, but without being overloaded with information. A review of information flows from time to time would be worthwhile.
- Non-executive directors should be encouraged to visit company locations. Use of them on subsidiary group boards is likely to be beneficial.

We hope you find our comments helpful in developing your thoughts in the area of the role and effectiveness of boards and non-executive directors. We would be delighted to discuss our views with you and would welcome any opportunity to do so.

September 2002

REVIEW OF THE ROLE AND EFFECTIVENESS OF NON-EXECUTIVE DIRECTORS

notes from the PwC NED Briefings held in summer

Issue	Sounding Board comment	notes from participants
A cosy club	<p>“It is implicit in the Government's terms of reference for Higgs that NEDs are seen as cosy club . And for perhaps political, as well as practical reasons, it is clear in the Government's remit that NEDs should be drawn from a wider pool, perhaps to include company stakeholders”.</p>	<p>“If you want Independent Directors who've got real experience, real ability, have a knowledge of experience on Boards, then the pool is fairly small. You only need to start looking for people to find out how difficult it is to actually find the people with the attributes you're looking for. And I suppose one worry I have, is that if we widen the net, that it is just seen as a training ground for nice youngsters to be able to learn a few things and meet a few people, which I think will be a great mistake.”</p>
From where should NEDs be drawn?	<p>“Most chairmen prioritise the selection of NEDs on the basis of current business experience - executive directors of other companies or their major divisions. That surely goes with the grain of corporate governance as the means to a competitive economy.</p> <p>But there is evidence that current executives balk at the time commitment of serving, for example, on the audit committee. Understandably so. Retired business people, civil servants, professional advisers and other wise old birds can chair committees, though the committees should include some current business experience. This states the obvious: that a board requires a balance of skills. Given that an effective unitary</p>	<p>“If the object of this exercise, as far as any of these likely proposals are concerned, is to improve competitiveness, I really can't see it being achieved by widening the pool to non-business people.”</p> <p>“I do think that a proper balance of Non-Executive Directors with suitable independence, which has been emphasised, time and time again, transcends the individual qualifications and numbers of letters they've got after their names.”</p> <p>“You need the right team on the Board, it's like a sporting event, isn't it? I mean, you need a goalkeeper, centre forward and all the rest of it. The key thing is it goes back to what you had on one of your slides; it's balancing the</p>

<p>From where should NEDs be drawn? cont</p>	<p>board needs to be a manageable number of directors, just what that balance is depends on the company's priorities of the day. For example, an industry in transformation will require a good weight of industry knowledge”.</p>	<p>mix on the Board, that is the issue.” “.. to try to do that widen the pool without retaining the requirement for the experience to the commercial world, knowledge of how companies work and experiences of assessing risk would be very dangerous, and I'm not sure how you can widen the pool very much from where we are without getting into areas where people don't have that necessary experience.”</p>
<p>Redefinition of global capitalism</p>	<p>“A question in the Government's mind appears to be whether there should indeed be a wider pool of NEDs: employees, consumers, academics and a potentially endless list. The instinctive reaction in many boardrooms might be dismissive. But at least we might pause for thought in a world where a redefinition of global capitalism, with responsibilities to a wider society, is undoubtedly with us”.</p>	<p>“Can I put in a word of support for Bob Geldof? We talked about broadening the net. If I look back to my own career as Chief Executive, the pressure that the Senior Executives of companies are under at the moment to produce continued, steady performance, deal with strategy, etc., are enormous, and to expect them to make up the cadre of Non-Executive Directors seem to me to be asking too much of them. They are under tremendous pressure. It's true that the Non-Executive experience does broaden their view as Chief Executives or senior managers of the companies that they primarily work for, but I do think there is something to be said for trying to widen the net. I mean, why not have the odd-ball around the place? They don't always have crazy ideas.”</p>
<p>NED’s time commitment: avoiding a “tick in the box”</p>	<p>“Do NEDs need to spend more time to be effective? We hear it said that they might be limited to, say, two directorships. We believe that this would be a tick in the box. Current executives and those who, say, chair major public bodies or</p>	<p>“The most effective Non-Executive Directors are those who have the time to actually be there, read the papers, think about them and come to all these committees and visit other companies for dinners and lunches and so forth; so that you really get to know a company. If</p>

<p>NED's time commitment: avoiding a "tick in the box" cont</p>	<p>charities might not realistically have enough time. But restricting those who are less active in business could well be counter-productive in limiting the current experience they bring to the board.</p> <p>Our own research tells us that board meetings and papers take 15 days a year, 20 days with committee work. The question is on what would additional time be spent? The point was made at our briefings that a minority of NEDs see no more of the company than the headquarters reception in and out of board meetings . But the best practice is for NEDs to spend time with management and employees on the ground. A useful idea is for NEDs to chair subsidiary divisional boards".</p>	<p>you're a senior executive in a major company, I can't understand how you can get away at all, and certainly not for more than one non-executive directorship."</p> <p>"You suggested that 15 days a year is appropriate for a Non-Executive Director. It depends very much upon the company. I personally think a Unitary Board should meet at least 10 times a year. If they're a substantial company, that means one day of preparation, one day attending meetings, plus more time, possibly on Committee meetings, and more times, visiting various parts of the company and its subsidiaries, so I think probably 30 to 40 days a year for a substantial company. For a smaller company, 15 days is very adequate."</p> <p>"Having seen a lot of companies in the past that have got into trouble, it's amazing the number of times that you find that the NEDs have never visited the operating subsidiaries or trading operations of the business, and therefore, in my view, how can they possibly be making decisions or giving views when they don't understand what the business is about."</p> <p>" there is no doubt at all, unless you're willing and able to put in the time to understand what's going on, making even strategic decisions is extraordinarily difficult. I don't to assess the amount of time you're prepared to spend."agree with capping at two or any particular number, but I do think you have to assess the amount of time you're prepared to spend."</p>
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<p>Independence of NEDs</p>	<p>“The independence of NEDs is a highly important, but just as subjective, question.</p> <p>What matters is the independence of mind in practice. The points made at our briefings might be summarised as:</p> <ul style="list-style-type: none"> • Willingness and ability to say ‘no’ or to say ‘yes’ if management is too risk averse • Not depending on NED directorships for livelihood – the ability to walk away • Increasing substantially the payment for non-executive directorships could compromise independence • The term ‘independent’ rather than ‘non-executive’ might better symbolise the role”. 	<p>“It’s a question of independence - what do you mean by ‘independence’ - and I think at the back of our minds, it probably means the ability at the end of the day to say 'No', even if you're in a minority of one on the Board and even if that means that your colleagues drum you out, because they don't agree with you.”</p> <p>“ this idea of limiting the number of Directorships, by law, to two, is something which we ought to fight very hard, because this is actually a contradiction with the concept of independence.”</p> <p>“What I do think is very important, and I have observed this on a number of Boards that I've sat on and been involved in helping choose people to sit on Boards; the importance is to stress the independence of that person. What you don't want to have is people who are carrying an agenda to a Board. Whether that person was an environmentalist, a worker, a customer, or whatever, so to bear in mind that if you are thinking about the so-called widening the net, that shouldn't detract from ensuring that the people who are looked at have the right degree of professionalism, knowledge, competence, and therefore, any suggestion that you have of widening the net should be accompanied by ensuring that you have the right quality of people and the right independent process of choosing them preferably for professional advisors choosing them, so that we don't get into the situation where the Unitary Board is reduced in effectiveness through</p>
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<p>Independence of NEDs cont</p>		<p>either lack of competence or divisiveness.”</p> <p>“If you happen to know somebody on another Board, you might be ruled out as not being independent. On the other hand, in my experience, the best way of judging whether somebody would be a good and valuable Non-Executive Director of Company A, is if you had experience of working with them on company B. If you want a really good Non-Executive Director, they're probably still very good after 10 years, whereas a lousy Non-Executive Director will be no good after 10 minutes, and to put these timescales on it, it seems to me to narrow the thing artificially.”</p>
<p>Risks and rewards for NEDs</p>	<p>“The billion pound lawsuit against the directors of Equitable Life is a worry for many NEDs. Even the legal fees of a defence - not necessarily borne by a current employer - can threaten personal solvency.</p> <p>Two issues arise. First, should NEDs continue to be paid just for their time contribution as is the present practice? In many cases, the value of their contribution has been paid hundreds of times over in stopping or starting major deals or replacing management. Second, the risks can be out of proportion to the rewards.</p> <p>As we have said, the view from our briefings was that substantial increases in remuneration could compromise independence.”</p>	<p>“ a huge amount of the risk is being placed on those in the oversight role, rather than those who are in the position to gain the rewards from the success, so there seems to be an imbalance between those who're gaining from the success of an enterprise, and those who suffer from the failure of an enterprise.”</p> <p>“ if this action against the Non-Executive Directors of Equitable is sustained, then I would have thought every Non-Executive in the country should immediately resign. No increase in fees can possibly compensate for those risks, and the Directors' and Officers' liability policies are very limited in their cover, ...”</p> <p>“ Risks have increased five-fold for NEDs.”</p>

<p>Risks and rewards for NEDs cont</p>		<p>“As NEDs we take on horrendous risks for £30K a year.”</p> <p>“ part of independence is that you can walk away and you've got other things to do and you're not really over dependent on one particular company or another for your bread and butter ..”</p> <p>“One of the great points of their independence is that they don't need the job, and if they hate what they're being asked to agree to, they can resign, and if they need the fee, maybe they can't resign.”</p>
<p>Capping NEDs risks?</p>	<p>“It might be possible legally to cap the liabilities of NEDs. But that could well put the unitary board under terminal strain: creating two legal classes of director. And why should executive directors have open ended liability? They do not always know what their colleagues are doing.</p> <p>The recommendations of the independent company law review committee - on which a Government White Paper is expected imminently - do not suggest a legal distinction between responsibilities of executive and non-executives but refer to the reasonable expectations of each”.</p>	<p>“ what might be a move towards covering the risk, by capping the liability of Non-Executives for legal action, being maximised at a multiple of the Non-Executives fees.”</p>
<p>Conduit to institutional shareholders analysts</p>	<p>“It is an eminently desirable objective to improve the relationship between the board and the investing institutions, particularly to hold them to account as well as the board. But the view from our briefings was that this was for the whole board, albeit not least the NEDs”.</p>	<p>“ there might be a halfway house that Non-Executives should accompany Executives on meetings with institutional shareholders, but on their own, I think it's a dialogue of the deaf.”</p>

<p>Maintaining the unitary board</p>	<p>“The view from our briefings was equally forceful that more regulation of NEDs would kill off the unitary board. Its real value, in contrast with its US and Continental counterparts, is its frequent meetings so that NEDs are in regular touch with what is going on. That surely is a lesson to be learned from the US problems”.</p>	<p>“If the unitary board dies, it’d be a tragedy. The clinical discussions of NEDs only won’t move the performance of boards along. We should fight to keep the unitary board.” “Keep the Unitary Board, I think it's very, very important that it's not just left to the Chief Executive and the Finance Director to have little lunches and so on. I think the Non-Executives ought to be there.”</p>
<p>The role of the board</p>	<p>“The Higgs consultation paper's detailed questions, rightly, start with What is the role of the Board? The Cadbury and Hampel codes looked at board process, but did not fundamentally address the question: What is the board for?”</p>	<p>“Don’t differentiate between the board and directors. It is the role of the board that is crucial. Don’t sift out directors and give them pre-defined roles.”</p>