

5 September 2002

NEDs and whistleblowing

This submission looks at the role and efficacy of non executive directors (NEDs) with regard to deterring and addressing corporate wrongdoing. In case you are not aware of this organisation, I start by explaining our own position.

Public Concern at Work

Public Concern at Work (PCaW) is an independent charity and was launched in 1993. We have four main activities:

- Providing free confidential help to people who are unsure whether or how to raise a concern about wrongdoing in the workplace;
- Training and supporting organisations on whistleblowing and accountability;
- Educating the public that there are safe alternatives to silence; and
- Informing public policy in areas of governance and regulation.

Within two years of our launch, our approach to whistleblowing (set out in the enclosed review) had been endorsed by the Committee on Standards in Public Life and by the Audit Commission. In 1995 and 1996, MPs asked us to prepare and promote draft legislation on whistleblowing, which was strongly supported by the then opposition. In its White Paper *The Governance of Public Bodies*, the last Conservative Government described us as ‘the leading organisation in this field’.

In 1997, the new Labour Government asked us to assist it and Richard Shepherd MP in formulating, consulting on and promoting the Bill which became the Public Interest Disclosure Act (PIDA). While technically a piece of employment law, this legislation was and remains supported by the CBI, IoD and TUC. For our work on PIDA, Lord Nolan commended us in Parliament ‘for so skilfully achieving the essential but delicate balance between the public interest and the interests of employers’. The Government has restated its strong support for PIDA in the current session of Parliament and amended both the Employment Act and the Police Reform Act in consequence.

Since our launch we have dealt with over 2000 whistleblowing concerns on our helpline – a handful of which have come from NEDs. We spend an equal amount of our time providing professional services to employers, regulators and other organisations – some of this work has involved NEDs, though rarely for PLCs. The practical utility of these services was recognised a month ago by the Court of Appeal at the start of its first judgement on PIDA when it referred to our ‘valuable activities... in providing assistance both to employers and employees’.

We believe we have a fair understanding of the role and value of NEDs through these activities, our policy work and also from various non-executive positions our Board and staff hold.

In this response we comment on the following two issues raised in your consultation paper.

- 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? (Qu 22)

Making whistleblowing work

- How much access to information from management do non-executive directors need to be effective? In practice, are management flows and communication channels sufficiently open and unrestricted? (Qu. 27)

NEDs as whistleblowers

We do not doubt that many NEDs are able to effectively challenge executive decisions and we imagine that in some instances they will have successfully exposed serious problems. While in the overwhelming majority of cases such internal whistleblowing is in the best interests of the public, the organisation and the individual whistleblower, an almost invariable consequence is that the internal whistleblowing does not become public knowledge and so may not inform public debate.

That said, there is both considerable evidence and a strong public perception from instances of serious corporate failure here and abroad that NEDs have not been able to challenge executive decisions or expose serious problems. On some occasions this will be because they do not have the information, a matter we address below. On others it will be because they are unsure whether or how to do anything about their concerns, and on others because they are fearful of the personal consequences they may suffer if they are seen to rock the boat. This significance of this last reason to the efficacy of NEDs has been recognised by the National Association of Pension Funds, which has called for more boardroom whistleblowing in its response to your review.

The Financial Times (30 August, page 2) quotes NAPF's manager of investments as saying: "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." We concur with this view and see no reason why individuals faced with such dilemmas should feel or act substantially differently, simply because they are an NED rather than an executive director.

At present an executive director who is dismissed, forced out or victimised because he justifiably raises genuine concerns about corporate wrongdoing is protected under the Public Interest Disclosure Act. He will receive an award of compensation based on what is just and equitable and on any actual financial losses suffered. However no similar protection is afforded to NEDs, as they are not in law employees or workers.

Although PIDA is part of employment law, it should be noted that the usual £50,000 ceiling on awards and requirements for a minimum length of service do not apply. On these issues we suggest that you make contact with Charles Phillips in Employment Relations at the DTI, to whom I am copying this, is the official responsible for PIDA as a piece of employment law.

The intended effect of PIDA is to reassure people in the workplace with genuine concerns about wrongdoing that there is a safe alternative to silence. In practice, it enables and guides them to raise such concerns internally, or where necessary, with an appropriate authority in a way that is both open and responsible. The consequence is that PIDA can help embed a corporate culture where the organisation is more keen to deal - and be seen to deal - properly with such genuine concerns.

Though it is still early days – the Act has been in force for 3 years – it appears that the practical effect is as intended. Rather than generate a tide of claims, there have so far been some 1200 PIDA claims registered (including at least one from a CEO). As to how the Act

helps to strike a practical balance between self-regulation and effective regulatory oversight, we refer you to the recent initiative of the Financial Services Authority, which can be found at www.fsa.gov.uk/whistle.

We recommend that your review asks the Government to amend PIDA so that it provides protection for non-executive directors that is comparable to that enjoyed under PIDA by their executive colleagues. We say comparable because certain PIDA protections – such as the option for a reemployment order – would not be suitable for an NED. In this respect it is important to note that PIDA already covers a wider range of workers than other pieces of employment law and is well suited to protect NEDs. Since commencement the Act has protected consultants, GPs and other professionals who provide services to the NHS and their self-employed status is directly analogous to that of an NED. Similarly this July, Government and Parliament amended PIDA – through the Police Reform Act - so that it will extend to police officers. Like NEDs, police officers were originally excluded from the scope of the legislation because they are not in law employees.

Information flows and NED oversight

From the point of view of organisational accountability, whistleblowing can and does play a key role in ensuring that management information flows work effectively. This is because it provides a failsafe to any actual or perceived monopoly over information, which may exist at any level of any organisation.

The mere fact a manager knows that it is safe and accepted for one of his team to raise a concern at a higher level than he is at has a number of beneficial outcomes. First, it makes it more likely that he will make himself open and accessible to genuine concerns. Secondly, in a case where the concerns may cause him some discomfort, there is a very strong incentive that he deal and is seen to deal with the problem effectively – thus giving good reasons why any temptation to sweep serious wrongdoing under the carpet should be resisted. Thirdly, it is our view that for many people the most powerful deterrent to engaging or condoning serious wrongdoing is the fear and shame of being caught, rather than the legal consequences that may follow. Fourthly, where there is any serious wrongdoing such a culture makes it more likely that it is detected early.

As it is under PIDA, whistleblowing by an employee to an NED will be protected as an internal disclosure under section 43C (for which, put simply, the protection applies where there is a genuine and reasonable suspicion of corporate wrongdoing). While it is not our view that NEDs should be the first or second port of call under a company's whistleblowing policy, we do see much merit in companies being encouraged or required to nominate an NED as having a role overseeing the company's whistleblowing policy. We add that such an oversight role would, in our view, readily lend itself to be part of the annual review of internal controls required by the Combined Code. As such it could appropriately be given to the audit committee.

This means that in a case where the concern relates to the conduct of senior management or its failure to deal with a serious matter, the whistleblowing policy will signal that there is a safe alternative to silence other than an external disclosure to, say, the FSA or DTI. The oversight role of the whistleblowing policy and of concerns raised and addressed under it will ensure that, where necessary, there are sufficiently open and unrestricted information flows and communication channels to the NEDs.

As importantly, such a NED role is likely to encourage the Board to view its whistleblowing policy more as a cultural issue than as one of tick-box compliance. This will help the Board not only to assert its accountability down through the company but also to demonstrate it – and also the role and efficacy of its NEDs - to shareholders and other stakeholders.

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