

Review of the role and effectiveness of non-executive directors

Response to the Consultation Paper
from

The Places for People Group

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RESPONSE TO THE CONSULTATION PAPER

REVIEW OF THE ROLE AND EFFECTIVENESS OF NON-EXECUTIVE DIRECTORS – JUNE 2002

The Places for People Group Limited (PfPG) welcomes the Review of the role and effectiveness of non-executive directors but wishes to ensure that the Review recognises the unique governance arrangements applicable to large registered social landlords (RSLs) such as PfPG.

General Comments and Context

PfPG is the country's largest RSL with a turnover of £180 million and net assets of almost £900 million. PfPG's size is, therefore, similar to many FTSE listed companies and should be able to operate similar governance arrangements. PfPG is a company limited by guarantee and is non-profit distributing. Board members are not, therefore, strictly accountable to shareholders in the same way they would be in a plc but have responsibilities to wider interests such as the Group's customers and other major stakeholders including lenders and of course, are regulated by the Housing Corporation.

They are also accountable for the impact of their actions on the community and environment.

PfPG is governed by a parent Board of Directors made up of nine voluntary non-executive Directors and up to two co-opted Executive Directors. The limit on the number of Executive Directors is a restriction imposed by the regulator of RSLs, the Housing Corporation.

In our view, corporate governance of RSLs has failed to keep pace with the increase in their size, dynamics and direction. The agenda is now so wide ranging and diverse that it is no longer reasonable to place total reliance and legal responsibilities on voluntary, non-executive Directors. Although PfPG has co-opted two Executive Directors, in a constitutional sense, the paid Executive can largely be seen as invisible, making many key decisions but not strictly sharing the Board's legal liabilities.

We support unitary Boards. The relaxation of the Housing Corporation's restriction to allow full Executive Board members would foster a sense that Executive and Non-Executive Directors are part of a single decision-making team which is, in fact, the case. It also reflects current practice in many other organisations. However, we believe that non-Executives should always be in a majority on the Board.

The Housing Act 1996 made it lawful for RSLs to pay fees to their non-Executive Board Members, subject to the issue of a Housing Corporation determination. Although the Housing Corporation accept there is a substantial level of support for offering remuneration, it has yet to relax the present restriction on payment. In our view, this restriction exacerbates the problems facing the larger RSLs in recruiting and retaining non-Executive Board Members for what are substantial enterprises.

Detailed below are our responses to some of the specific questions raised in the consultation document in the context of the role of non-Executive Directors in the RSL sector.

A: Role of Non-Executive Directors

1. The key roles of non-Executive Directors on RSL Boards should be the same as on unitary boards in PLCs. Their main responsibilities are contributing to the strategic direction of the organisation and reviewing its performance. They are also responsible for participating in major decisions that have been clearly identified as being reserved for decision. The Chairman, who should be a Non-Executive Director, should lead the whole Board, ensuring that all Directors can contribute effectively to reach clear decisions. The Chairman has a pivotal role in ensuring that non-Executive Directors are making a contribution to the Board and especially in terms of ensuring that effective Board Member appraisal and development programmes are in place.
2. It is unrealistic, in our view, to expect non-Executive Directors to fulfil all roles within a Board. This is especially true in very diverse enterprises. The Board should recruit a broad range of skills and experience; individual Board members with particular skills may then play specific roles in supporting the work of the organisation, eg in information technology, finance or contractual matters but only in an advisory and monitoring role.

In addition, there may well be appropriate sub-committees of the Board, focused on scrutiny of more detailed levels of work with appropriate Board members appointed to the sub-committees. In our view there should not be too many sub-committees as that can restrict the information available to and the scrutiny exercised by, the whole Board.

On RSL Boards non-Executive Directors should have no financial interest other than a pre-determined, fixed fee. No fee is currently paid.

4. We believe non-Executive Directors should be wholly independent in making their views known, with the clear intention that the Chairman and the Board, collectively, determine a strategy and work closely to ensure that it remains appropriate, is regularly reviewed and that the agreed strategy is delivered. Non-Executive Director's independent views are an important tool for executive management to test proposed strategies and propositions.

5. Clearly the way in which non-Executives are recruited to the Board can be one way to minimise any potential conflicts of interest. Conflicts can exist with non-Executives in relation to their own business or other non-Executive roles that they might hold. Rigorous Disclosure is clearly necessary when dealing with particular potential conflicts of interest but so is the reduction of any potential conflicts at the recruitment stage.

Rigorous disclosure rules should be enforced within the Board and non-Executives should be encouraged to point out where, in their view, there may be a conflict of interest involving another Board member.

6. Determining the time commitment needed for the role of Chairman and non-Executive Director roles is difficult. It does vary enormously, depending on the size and activity levels of individual companies. It can also vary as companies go through major activities, such as acquisitions or restructuring. With a great deal of caution, it could be seen that between two and four days a month might be required for non-Executive roles. Clearly Non-Executive Directors may be contacted by telephone or e-mail outside of this time.

There is, in our view, definitely a maximum number of non-Executive posts that one person can take on. A key factor is whether an individual is currently has an executive role with another company. If they have an executive role with another company, they should only have a maximum of two non-Executive Director posts. Where they do not have an executive role in a company, we suggest a maximum of four. Clearly there will be many views about this and we advance this as our contribution to that debate.

7. We are not sure there should be a special role for a “senior independent non-Executive Director”. On the one hand it could provide a communication route where it is perceived that direct communications are ineffective but it could be argued that were that the case, the Board itself would need to debate how best to deal with improving communications. In many Boards, the Vice or Deputy Chairman often takes this role in any event and the role of Company Secretary can be used to facilitate communication.
8. The fundamental reforms in company law proposed by the Company Law Review Steering Group are long overdue. The proposed statutory statement of Director’s Duties will encourage responsible and informed decision-making and provide transparency on the role of Directors. There are distinctions between the roles of Executive and non-Executive Directors, primarily due to the fact that Executive Directors inevitably possess more information than non-Executive Directors about the state of the business. In practice, a non-Executive Director’s knowledge is made available by Executive Directors and this should be acknowledged in the proposed statement.

B Attracting and Appointing non-Executive Directors

9. PfPG is aware of the need to attract and appoint non-Executive Directors with knowledge, skills and experience to meet the challenges of an increasingly complex and competitive business environment. We see the following skills as essential on the Board:-

- Business Executive experience
- Financial knowledge and experience
- Urban regeneration
- Construction
- Housing
- Public Relations, especially financial PR
- Customer Awareness
- Marketing

All of these skills are as important as each others. An important role of the Board and especially the Chairman, is to ensure that these skills are available in the right balance within the Board and are up to date and are being employed effectively.

There is no doubt that at least one independent director should have financial expertise and over the next ten years, some skills are going to be more essential. In our view these skills are:-

- Financial understanding
- Technological understanding
- Scenario planning

10. Personal qualities required include the ability to listen and understand differing viewpoints, independence of mind and good communication skills. These qualities also include the ability to absorb large amounts of information and see patterns emerging which would guide the strategic direction of the organisation. The ability to contribute at meetings, share responsibility for decisions and be committed to prepare for meetings are also important qualities.

11. Our comments earlier have set out the sort of mix of experience and attributes we see as desirable on a Board. We have had specific examples where non-Executive Directors with particular expertise have contributed to:-

- the development of our treasury arrangements;
- decisions about the acquisition of subsidiaries;
- the establishment of new companies.

12. Recruitment of non-Executive Directors with the right skills and attributes is not easy. Obviously there is a degree of reliance on contacts within the

existing Board. However, for the last round of recruitment for the main Board and for subsidiary Boards, the Group has used advertising and recruitment agencies.

We do also think that an objective assessment of Board needs is a crucial element, as we set out earlier in our comments.

13. In the RSL sector the inability to pay non-executive Directors makes it more difficult to attract Board members of the right calibre and with the skills required. It is particularly to attract recruits who are still working professionals. In our view the complexity of the business and accountability requirements can no longer be reconciled with the principle of voluntarism.

PfPG have utilised a number of recruitment methods to attract non-executive Directors, including direct advertising, recruitment agencies and contacting professional associations. The method of recruitment is determined by taking into account the existing blends of skills, knowledge, expertise and the ethnic and gender mix of the Board. A small sub-group of the Board should shortlist and recommend members to the full Board. Whether this formally needs to be called a Nominations Committee should be open to Boards to decide.

PfPG is developing Board member assessment and appraisal techniques to assist in the objective identification of skill gaps in Board member development programmes. We think we are doing a lot within the constraints we have already described to widen the pool of potential non-executive Directors and have a good record in introducing greater diversity into appointments.

There may well be scope for greater international representation on Boards, depending on the nature of the business.

14. We have already commented in some detail on the need for payment for non-executive Directors of RSLs and as a non-profit distributing company, share and share options are not available. In any event, our view is they can interfere with independence and therefore, be counter-productive.
15. While we have a detailed Risk Management Framework within the Group and we are aware of the balance of risks we face, some of them high, we manage them and we have non-executive Directors involved in the creation and management of the Risk Management Framework, primarily by the Audit Committee. There are forms of insurance provision for non-executive Directors but over use of these provisions could introduce a false sense of security which would not be helpful in the ability of the Board and individual non-executives to assess risk effectively.

C Structures and Accountability

16. PfPG is not a listed company but complies as far as possible with the Combined Code. Unfortunately, as we have set out elsewhere, the Regulatory Framework operated by the Housing Corporation makes full compliance with the Combined Code difficult.

The balance between Executive and non-Executive Directors in the RSL sector requires revision, in our view.

17. PfPG would prefer a Board with a maximum of twelve members consisting of five Executive Directors and seven non-Executive Directors.

The recommended structure for Board committees should facilitate governance and effective contribution by non-executive directors.

18. The existing composition of the PfPG Audit Committee complies with the Hampel Code in that the Committee consists entirely of non-Executive Directors. The Audit Committee works to set terms of reference which fully comply with the duties recommended in the Combined Code. We see a need to strengthen the existing role of Audit Committees and to strengthen the distance between Audit Committees and other sub-committees of the Board. We are happy that auditors report directly to Audit Committee and clearly, Audit Committees need to have the right level of skills and experience from the non-executives who make up the Committee. This is a key issue within the objective analysis of board member skills which we have commented on elsewhere.

20. PfPG has processes for setting objectives and reviewing performance against those objectives. These need to be strengthened and we have recently involved an external consultant to help us identify better ways to deal with these issues.

21. It could be argued that a sub-committee of the Board should undertake this role and there are arguments for the Board doing it as a whole. Our view is that there is a role for a sub-committee of the Board perhaps looking at the objective setting and performance management systems operated by the Board, with a view to reporting to the Board on these issues.

22. The suggestion that non-Executive Directors should be able to successfully challenge Executive decisions or expose serious problems reflects a degree of reality now. Non-Executive Directors do express their views about propositions that the business may be considering or particular strategic directions that Executives might see as appropriate. There have been many occasions where non-Executive intervention has meant that the organisation has gone in a slightly different direction or the original proposition has been amended.

Fundamentally we believe that Executive Directors should be judged on performance. Non-Executive Directors have access to the Audit Committee in the event that they identify a serious problem or they can raise the issue in the full Board.

D Relationships with Shareholders and Others

23. PfPG is a company limited by guarantee and has already developed strong relationships with its stakeholders. We have increasingly involved non-Executive Directors in the work we do on developing relationships with our stakeholders. An example of this is non-Executives are now invited as a matter of course to the seminar with Lenders that the Group has and non-Executives of appropriate subsidiary companies regularly meet our customer groups. There is no doubt that we could involve non-Executives more, individually and collectively, in developing stakeholder relationships and this issue is under consideration at present. We do not think that non-executives ought to have an exclusive role in shareholder/stakeholder relationships. The primary role in that regard is that of the Executive Directors and the Non-Executive Chairman.
24. The responsibilities of the Group Chairman are set out in the Group's Standing Orders. The Group has a Board Health Check process where individual non-Executives can comment on their views about the way meetings are dealt with, relationships are handled and their contribution is being made. The Group then has an Annual Plan to deal with any of the issues that arise from the Health Check. All of the issues that are described in point D24 within the consultative document are clearly part of the Chairman's role.
25. The relationship between non-Executive Directors and Executive Directors and senior management should be one of support, advice and assistance but also scrutiny.
26. Company Secretaries can assist effective performance by ensuring that papers are sent out well in advance of meetings, at least a week, preferably ten days.

E Support

27. Often views on access to information can be very subjective. Different non-Executives require different levels of information on different things. There are arguments that there ought to be obligations, perhaps statutory obligations, on Executive Directors to provide all relevant information, although that appears heavy handed. PfPG has recently employed an external consultant from the Henley Centre to advise on the extent of information required by Boards and the format for effective performance

reporting. Perhaps a requirement on Boards for an external examination of their information flows, communication channels and reporting arrangements say every two years, might be valuable.

28. We acknowledge that training and development opportunities need to be improved and that there is a limitation on the amount of time commitment that an RSL can reasonably expect from voluntary members. There needs to be a specific emphasis on corporate financial training for all Non-Executive Directors. It could be argued that training and development should not be necessary if recruitment is effective. However, there is a constant need to ensure that non-Executive's knowledge of the business environment, new techniques and new approaches, is constantly updated and therefore new approaches to training and development are required.
29. Induction for non-Executive Directors is ad hoc and insufficient. Induction ought to be provided to a high standard and the PfPG has now established an induction process for non-Executive Directors, equivalent to the standard provided for staff members.
30. Non-Executive Directors receive guidance on what is expected of them in various ways, although this can always be improved. There is a tendency for such guidance to only be given at the early stages of a non-executive's time with a company and not to be continued. This is a key role for the Chairman and for processes such as the Board Health Check, described earlier. Non-Executive Directors ought to get more feedback on whether they are meeting expectations, both from each other, the Executive members and from the Board as a whole. This is a difficult area and will obviously require careful attention.

F **Smaller Listed Companies**

31. Proposals for smaller listed companies ought to be less prescriptive and recognise that they have fewer resources and can sometimes be more reliant on non-Executive Directors in their early years. Equally, Executive Directors will need to be protected from being swamped by individual non-Executive Directors requirements.

G **International Context**

- 32-34 There are models of two tier governance arrangements that could be investigated (ie the practice of having small executive boards with larger supervisory or advisory boards providing the scrutineering role, such as the German model). Although it can be argued that supervisory Boards can become too remote. Equally, the practice of advisory boards where groups of non-Executive Directors are brought together around specific projects and then disbanded once the project is completed, merits attention.

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