

Review of the role and effectiveness of non-executive directors

Watson Wyatt's response

Introduction

Watson Wyatt welcomes the review of the role of non-executive directors. Recent corporate events have highlighted the need for effective, independent directors to maintain high standards of corporate governance. Watson Wyatt also supports the Government's view that this issue is best addressed through best practice rather than legislation. The aim should be to encourage high standards of integrity and effectiveness, without restricting the flexibility necessary to allow companies and non-executive directors to respond appropriately to the many different requirements and environments within which they operate.

We set out below our responses to the particular questions raised in the consultation document. For the sake of succinctness, we refer to non-executive directors and Chairman in the masculine form. This is merely a stylistic device, and is intended, of course, to encompass the feminine also.

A: Role

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?

- 1.1.** The role of the Board (and that of directors, both jointly and severally) is to give strategic direction to the business of the company, to monitor and ensure effective performance both of people and of assets, and to ensure effective management succession, particularly that of the chief executive. In doing so, it must represent the best interests of all the company's shareholders, and take fully into account the interests of employees and other stakeholders. The term "shareholders" should be understood to mean both current and prospective shareholders. However, it is surely wrong to widen it, as Hampel

does, to include all future shareholders, as this could leave the Board's decision-making effectively unfettered. In a crucial sense the Board is the nexus between the management of the company and its shareholders and other stakeholders.

1.2. The role of the individual designated as Chairman is clearly different according to whether he is a non-executive or executive Chairman. In the latter case, the role combines that of the Chairman and the chief executive, no matter what title is given to anyone else. For the purposes of this discussion, it is necessary to focus purely on the non-executive chairman. His role is to manage the Board, to ensure that it effectively meets all the responsibilities identified in paragraph 1.1 above, and to work closely with the chief executive and all other directors to achieve this.

1.3 The Chairman's role in relation to the non-executive directors (the 'NEDs') is to ensure that those who are appointed provide an appropriate balance of the skills and experience required by the company; that they are properly inducted and trained; and that they are effectively briefed. He is also responsible for monitoring the effectiveness of the NEDs and the performance of all directors. The Chairman's role is seldom defined, however, a formal definition would be helpful. To assist in this process, a generic description is set out at Appendix 1.

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?

2.1 The role of NEDs has two critical components – the "enabling" aspect, and the monitoring or "policing" aspect. The enabling aspect encompasses their strategic input; provision of their experience and expertise, their external

independent perspective on how the company's decisions and actions may be viewed by others; and their participation in major corporate decisions (including the approval of the report and accounts). The monitoring aspect is their key contribution to effective corporate governance, and involves monitoring the performance of management (including the chief executive); and identifying actual or potential conflicts of interest on the part of management - especially the executive directors, but also other NEDs. In brief, they should act as the conscience of the Board.

2.2 Once again, the role of the NEDs is often in practice only loosely defined. A suggested generic definition is set out in Appendix 2.

2.3 In order to discharge their role effectively, it is vital that NEDs ensure that they have access to the information they need - preferably from management, but if necessary from outside advisers.

2.4 The enabling and monitoring aspects of the role are of approximately equal importance, but may of course vary from time to time. All NEDs should be responsible for both aspects of the role. However, the experience and background of individuals will on occasions tilt the balance one way or the other. For example, in a takeover situation those with previous experience of such an event will clearly come to the fore.

Q3. How does this compare to the present position?

3.1 Although there are many Chairmen who would dispute this, there is probably not enough emphasis on the monitoring aspect of the NEDs' role. Recent events in the US indicate starkly the risks that companies run when this is the case. There are undoubtedly many Boards where potential conflicts of interest (especially in the area of executive remuneration) are not adequately policed. There is always the possibility that a strong chief executive, backed up by executive directors, may push through major decisions (e.g. on succession) without sufficient discussion or scrutiny.

- 3.2** Given the restricted pool from which NEDs are currently drawn (see paragraph 12.1 below), they may be over-inclined to accept uncritically the management perspective. Although their viewpoint is external to the company, it may not be external to the management frame of reference.
- 3.3** The most critical, but seldom discussed, current weakness is the relative lack of information on which to base a properly independent view. This is especially likely to be the case if NEDs have not been involved in the formative phase of considering strategic and policy options. There is a case for NEDs being given much more systematic access to independent sources of information and expertise when they feel that they require it. Perhaps to facilitate this they should have access to a specified budget with full discretion as to how to apply it.

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

- 4.1** It is surely self-evident that NEDs need complete independence for the monitoring aspect of their role, in particular for identifying and responding to potential conflicts of interest (e.g. on the Audit and Remuneration Committees). It is also highly desirable for them to be independent in relation to their strategic input, ensuring that they are able to provide fresh thinking and to question received wisdom.
- 4.2** Once again, there have been few attempts (with the praiseworthy exception of the NAPF) to define the concept of independence. A suggested formulation is set out in Appendix 3. It would, however, be undesirable to insist on independence for all NEDs, since those who are former executive directors of the company can often provide valuable insight and historical perspective.

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?

- 5.1** The main circumstances in which NEDs can play a crucial role in protecting the interests of the company, are those involving the interests of management. The list is long, but the most important situations are those concerning acquisitions or divestitures (especially management buy-outs); threatened takeovers; management (especially chief executive) succession; accounting reporting and disclosure; avoidance of short-term focus; and last (but far from least) executive remuneration.
- 5.2** The crucial requirement to enhance the effectiveness of NEDs (as noted in paragraph 3.3 above), is for there to be access to better information, including from independent sources, if required. NEDs should also regularly meet separately from management. Their remuneration should not be directly linked to company performance. Their term of office should be sufficient for them to develop a good understanding of the company and its business, but not so long that they become over-identified with the interests of management (it would however be a serious error to set inflexible rules on length of service).
- 5.3** It is astonishing that current practice is for NEDs very seldom to meet major shareholders. It is worth considering whether such meetings (without management present) should not be regularly offered, and whether NEDs should indeed make a formal report to all shareholders.

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?

- 6.1** It is impossible (and the attempt would be foolish) to prescribe other than in the broadest terms how much time is required for the role of Chairman and for NEDs. Clearly, larger and more complex companies will require more time commitment than smaller, simpler ones. That said, it is difficult to see that the Chairman could adequately fulfil the role for a FTSE 350 company on much less than a half-time basis, which implies that it should be unusual for anyone to be Chairman of three significant companies (and exceptional to be Chairman of more).
- 6.2** For NEDs the commitment is likely to be a few days a month, depending on the scale and complexity of the company's business and on their familiarity with it. However, there are situations, most obviously hostile takeovers or other crises, where the time commitment will escalate, particularly for the Chairman.
- 6.3** It would be wrong for there to be fixed rules for NEDs in this area, since there is so much variety in the requirements. Common sense indicates that any individual who is employed full-time elsewhere has a much smaller capacity than one who has retired. It is doubtful whether a full-time employee can adequately take on more than one or two NED roles in a FTSE 350 company, unless there is a degree of overlap. However, much of the recent furore over the number of directorships held by Members of Parliament missed the point that membership of the Board of the quoted subsidiary of a company, on whose Board the NED also sits, is likely to be

far less demanding than a similar role in a wholly separate company.

Q7. Should there be a special role for a ‘senior independent’ non-executive director?

7.1 The appointment or designation of a 'senior independent' NED is absolutely essential where the Chairman and chief executive roles are combined. Equally, it is highly desirable even where these are split roles, to provide a point of contact for shareholders when they have a problem with the Chairman or the chief executive. A 'senior independent' NED could also be a useful point of contact for whistle-blowers, but great care would be needed in defining the circumstances in which this was appropriate.

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?

8.1 Whilst the duties of executive directors and NEDs are clearly different in practice, it might be unwise to embody the distinction in statute, since that might relieve executive directors from some aspects of the accountability and legal liability to which they can currently be held. The proposed statement of directors' duties in the Company Law Reform White Paper seems to be perfectly satisfactory, and it fills what is at present an extraordinary vacuum.

B: Attracting and appointing non-executives

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?

9.1 Substantial business knowledge and experience at a senior level is absolutely essential in order for a NED to perform the role effectively. However, executive experience in one company alone, however senior, is not sufficient. As well as breadth of experience, a crucial skill is the ability to differentiate the important and relevant from the unimportant and irrelevant; to analyse issues clearly; and to identify concerns. In addition, to perform an effective role, a NED must command respect, and have the interpersonal skills to influence others and exercise authority without direct power.

9.2 It is impossible to say how these requirements are likely to change over the next 10 years; this will depend upon the role required of a non-executive director during that period. However, none of the requirements identified in paragraph 9.1 is likely to diminish in importance.

Q10. What personal qualities and attributes are needed?

10.1 Ideal personal qualities and attributes for a NED include integrity; honesty; perseverance; the ability to take an independent view; communication skills; attention to detail; initiative; confidence; determination; and moral fortitude. Whether it is possible to find individuals who combine all these attributes is another question!

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.

11.1 It is impossible to generalise about the mix of experience and attributes desirable on a Board, other than by referring to the skills and attributes identified in paragraphs 9 and 10 above. What is important is that, in combination, the NEDs should possess the range of experience and attributes that the Board needs.

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?

12.1 It is clearly becoming more difficult to recruit NEDs with the right skills and attributes. This is for two main reasons. Firstly, it is clear - particularly given recent high profile corporate cases - that potential liabilities for NEDs are ever increasing. Secondly, the current restriction (in the great majority of cases) to former or current executive directors of PLCs means that the pool of candidates is limited.

12.2 It is important therefore to widen the scope of potential candidates, and to introduce some fresh thinking about the types of individuals who might be appropriate for these positions. However, liability and pay issues will need to be addressed in order to attract the appropriate candidates.

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?

13.1 In order to widen the pool of potential NEDs, there should no longer be an

effective restriction of this role to former or current executive directors of PLCs. Such individuals may not in any case possess the necessary skills. A wider pool of candidates could include current or (more likely) retired professional advisers, with knowledge and experience of a wide range of companies and businesses.

13.2 There is probably scope for greater international representation on UK boards, although the UK is better than most countries in this respect. However, recruiting internationally may have an impact on the time and availability of individuals for meetings, and the consequent ability to fulfil responsibilities adequately – video conferencing may partly fill this gap, but it is currently a poor substitute for face-to-face contact.

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/options? Are current pay levels a significant factor in whether good non-executive directors can be attracted?

14.1 As liability and time demands for NEDs increase, so it may be desirable to increase the level of pay for this role. This might also be appropriate if the number of appointments were to be limited and reduced. However, it is important to balance an increase in pay against any impact on the independence of the individual. NEDs should never be dependent upon the fees from any one company.

14.2 In terms of the form that remuneration takes, cash or shares are appropriate, and holding shares can be used to align the interests of NEDs with those of shareholders. Options should not be granted to NEDs in normal circumstances, as they provide an inappropriate risk profile, and are potentially too leveraged. However, pay is not a crucial issue in the

recruitment of NEDs, as most individuals become NEDs for many other reasons.

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

15.1 Insurance should be available for NEDs, except in the case of wilful negligence or fraud. However, the availability of insurance should not undermine their personal accountability.

15.2 There is a clear conflict between the interests of shareholders and the ability of directors (executive and non-executive) to limit their liability through purchasing insurance cover. One protection which might be attractive to shareholders would be to require shareholders to approve the level of insurance cover purchased for directors, or to require shareholder approval for insurance cover above a stipulated level. However, there would be clear difficulties with this approach – not least the reluctance of insurance companies to permit the disclosure of levels of cover.

C. Structures and Accountability

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?

16.1 The question is a curious one, as far as the formal requirements of the Combined Code are concerned, since data on the relative numbers of executive directors and NEDs are readily available from annual reports, and several firms of consultants provide an annual summary. These show that the purely formal requirements are satisfactorily met by most significant companies, especially the FTSE 100, although there are still a few cases where the Chairman and chief executive role are combined. It is less obvious that the spirit of the Code is always adhered to, but this depends crucially upon a high-calibre Chairman fully committed to the highest standards of corporate governance. Larger companies (e.g. the FTSE 100) have generally gone beyond the requirements of the Code in terms of the balance between executive directors and NEDs, and on average there is a roughly equal number of each.

16.2 If any change were to be made it should provide for a majority of the Board to be NEDs. However, there is little need to insist on that, because major issues are only very exceptionally resolved by a straight vote. A key factor is obviously the calibre of the NEDs and their knowledge of the company.

16.3 The definition of independence provided by Cadbury is too brief to give much real guidance in practice. However, definitions should not be so

detailed and prescriptive that they are perceived to be unreasonably restrictive and inflexible (e.g. the suggested age limit of 70 in the NAPF's commendably thorough definition). Further, if definitions are treated as exhaustive, clear conflicts of interest which are not specifically forbidden may be considered permissible. A possible compromise is the two-tier definition proposed in Appendix 3.

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?

17.1 The current structure of Board committees is adequate, as virtually all companies now have Remuneration and Audit Committees, although some still lack Nomination Committees. However, the meetings of these committees need to be properly minuted, and the minutes made available to the full Board. It is essential that sufficient time is devoted to briefing, and that members have the opportunity to probe, and have access to reliable and accurate information.

17.2 On the question of size, it is difficult to see that effective discussion can be carried out in Boards of more than about 10 to 12 in number. However, some flexibility may be necessary for Boards with wide international membership, where physical attendance at all Board meetings may simply not be feasible (see paragraph 13.2 above).

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?

18.1 Audit Committees should be composed exclusively of independent NEDs,

and have private access both to internal and external auditors (which is supposed to happen now). They should probably have some say in the appointment of internal auditors, and the ultimate say on the external auditors to be recommended to shareholders for appointment, as well as monitoring the amount of non-audit work carried out by the same firm.

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

19.1 The role of Nomination and Remuneration Committees is reasonably clear in general terms, although there should be written terms of reference for both. There is some ambiguity in relation to questions of management development and succession, which are sometimes the province of one and sometimes of the other. However, this is a degree of flexibility which can be left to the individual Board to determine.

19.2 The chief executive should be a member of the Nomination Committee, since otherwise there would be the ridiculous situation where he was unable to have a say in the appointment of immediate subordinates (i.e. the other executive directors). However, he should not have a veto over the appointment of NEDs, and certainly no role in their recruitment (as distinct from their selection). All other members, with the possible exception of the Chairman, should be fully independent.

19.3 The Remuneration Committee should be composed exclusively of independent NEDs, and it should appoint and brief the consultants. Consultants should be ultimately answerable to the Remuneration Committee, although clearly they will need in the course of their work to obtain information from management (just as external auditors do).

19.4 Both Committees should hold regular meetings, rather than *ad hoc* ones when

there are specific decisions to be taken.

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?

20.1 This question is rather too general to be given a useful answer.

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?

21.1 Performance assessment and review for the Board is an emerging area.

Reviews of performance are certainly required, but formal reports to shareholders would inevitably focus on relatively trivial matters such as the number of meetings attended and the amount of time spent, and could not possibly deal with the quality of contribution.

21.2 Assessment of the performance of NEDs is impossible to schematise, and should be left mainly to the Chairman to judge. There would also be a significant advantage in major shareholders meeting NEDs separately, and making their own judgements, not so much on their performance as on their capabilities.

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?

22.1 The ability of NEDs successfully to challenge executive decisions or expose serious problems depends on the calibre and experience of the individuals, as well as on the quality and quantity of the information that they can obtain, and facile generalisations are pointless. It would probably be desirable for NEDs to obtain external advice more regularly from those with relevant

expertise.

D: Relationships with shareholders and others

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?

23.1 NEDs should be available for private meetings with institutions and other shareholders. It may be that in order to fulfil their monitoring role sufficiently, they should make a formal report to shareholders (see paragraph 5.3 above). At present, the relationship between NEDs and the institutional shareholders is virtually non-existent, and recent research confirms this.

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?

24.1 There are many ways in which the Chairman could improve the conditions for NEDs to be effective. All the areas suggested in the question are important, and especially the management of information flows. A clear definition of the role of the Chairman would assist in prompting improvements in this area (see paragraph 1.3 and Appendix 1).

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 the Chief Executive? What should their relationship be with key advisers to the company?

25.1 The NEDs and the executive directors should form a cohesive team when it comes to developing the strategy of the company. NEDs have an additional role of monitoring the performance of executives and protecting the interests of shareholders, wherever there is any potential conflict with the interest of executive directors and senior management (see paragraphs 2.1 and 2.2 above).

25.2 The members of the Remuneration Committee should appoint their own advisers on remuneration issues. The Audit Committee should also have unimpeded access to the auditors, although it is probably more appropriate that auditors are recommended to shareholders by the Board as a whole (see paragraph 18.1 above).

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

26.1 The role of the Company Secretary can be crucial in providing effective support to NEDs. In particular, the Company Secretary should ensure appropriate information flows; distribute meeting papers etc on a timely basis; produce full minutes which are published and circulated appropriately; and provide additional support services and access to documents and records when required.

26.2 It would be preferable for the Company Secretary to be appointed by the NEDs.

E: Support

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?

27.1 NEDs need substantial access to information from management. In relation to the strategy of the company, they need relevant business and performance information in order to understand and review the prospects for the business. In terms of monitoring the executive directors, they need access to sufficient information to identify potential conflicts and police them appropriately. It is however crucial that they should not be swamped by large amounts of unnecessary detail: it should ultimately be for them to determine the format and content of information supplied to them.

27.2 In practice, these information flows and communication channels are rarely sufficiently open.

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

28.1 There are very few training and development opportunities available. Still fewer companies recognise the need for appropriate training and development (other than initial induction) for directors. Specifically, training in corporate governance is essential for NEDs. This area could be improved substantially, in particular in relation to the knowledge, cognitive and interpersonal/group skills required (see Appendix 4 for a minimum list of these): to improve these, fresh thinking is required for the design of appropriate seminars – a purely knowledge-based approach is simply inadequate.

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

29.1 Induction for NEDs can be substantially improved, and is rarely adequately undertaken.

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?

30.1 It is unusual for NEDs to get clear guidance on what is expected from them, though this is a clear responsibility of the Chairman (see paragraph 1.3 above and Appendix 1). There is little, if any, measurement of the performance or effectiveness of NEDs. Any feedback NEDs get is usually in the event of a disaster.

F: Smaller listed companies

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

31.1 Many similar issues arise in the case of smaller listed companies, and the standards of integrity and probity should be no less high. However, some requirements can be less rigorous for smaller companies, and the size of the board can be proportionately smaller.

G: International context

Q32. What lessons can be learnt from international experience, either in terms of structures or behaviours?

32.1 Very little can be learned from other countries (including the US), since in virtually all respects their structures and processes are worse from a corporate governance point of view. The only possible area for consideration would be two-tier Boards, with a much more open election process to the Supervisory Board. However, the examples of Germany, the Netherlands, and to a limited degree France, are not encouraging.

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

33.1 No.

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

34.1 No.

CONCLUSION

It has not proved easy in practice to give coherent, balanced and succinct responses to the questions posed in the Consultative Document, since they are frequently vaguely and loosely phrased, and in many cases overlap to a confusing degree with each other. Furthermore, there are serious omissions, most obviously over the election process. The tacit assumption appears to be that NEDs are, and should be, appointed by the Board, and that the process of election by shareholders at the AGM is a charade. This need not be the case, and it is perfectly feasible to envisage a situation where major

shareholders nominate individuals for election as NEDs. There should in many cases be contested elections with much more information being provided about the background, experience, and intentions of the candidates, if elected. At present this only happens in rare crisis situations (e.g. British Land or, some years ago, Liberty), but there is no *a priori* reason to suppose that if it became more common it would not prove beneficial. Boards would almost certainly not like it, but that is a different matter.

Appendix 1

Role of the Chairman

Purpose

Ensure the effective and profitable direction and management of the company, now and in the future, in the best interests of its shareholders and all other stakeholders, and the effective management and guidance of the Board, to the highest standards of corporate governance, in order to achieve this.

Accountabilities

1. Ensure that the board functions effectively and in the best interests of all shareholders, both in general, by personal contribution, and in particular by:
 - maintaining an appropriate balance, both of talent and experience, and between executive and non-executive directors;
 - ensuring an effective appointments procedure, both to the board and its committees;
 - ensuring a process of determining directors' remuneration which minimises conflicts of interest (ie via the Remuneration Committee);
 - maintaining productive working relationships.
2. Ensure that appropriate aims, strategies and policies are set and implemented.
3. Represent the company externally as required to shareholders, the City, other stakeholders, governments and external agencies, and represent the board internally to employees where appropriate.
4. Ensure that effective arrangements exist for management development and succession planning, especially to the chief executive and other executive director positions.
5. Guide, assist and develop the non-executive directors, and ensure effective and relevant information flows in order to optimise their contribution to Board deliberations.
6. Define and exemplify the company's principles and ethical standards in all its business relationships.

7. Take the lead in ensuring that optimum decisions are reached on all issues of fundamental importance to the company's future (e.g. takeovers, restructuring, appointment or removal of chief executive, critical expenditures, emergencies, etc.).
8. Ensure that financial results are properly, accurately and completely reported, and that audit procedures are fully effective.
9. Ensure that all regulatory and statutory requirements are met, including those relating to corporate governance, in the best interests of the company and its shareholders and other stakeholders.
10. Monitor the performance of the chief executive, executive directors and other key executives, and take remedial action where necessary.

Appendix 2

Role of the non-executive director

Purpose

Ensure collectively with colleagues that the company is effectively managed, in the best interests of the shareholders and all other stakeholders, that all fiduciary duties and legal and other obligations are fully and properly met, and the highest standards of corporate governance maintained.

Accountabilities

1. Approve, monitor and review regularly the strategy and finances of the company, and the structure and relationships of the board.
2. Maintain a good all-round understanding of the company's business and activities, and contribute as appropriate on any major issues which arise.
3. Contribute to the reaching of optimum decisions on all issues of fundamental importance to the company's future (e.g. takeovers, restructuring, appointment or removal of chief executive, critical expenditures, emergencies, etc.)
4. Monitor and review the performance of the company and the chief executive.
5. Review the calibre and performance of the executive directors.
6. Participate effectively as required in discharging the functions of relevant board committees.
7. Take the lead in resolving potential conflicts of interest as and when they arise, and if appropriate act as the conscience of the board.
8. Identify the need for and initiate changes, in whatever area, when appropriate.

Appendix 3

Proposed Guidelines on Non-Executive Director Independence

It is impossible to lay down precise rules on what constitutes NED independence, but in order to give more guidance on the interpretation of the broad Cadbury definition, Watson Wyatt proposes that there should be two types of hurdles, as follows:

1. An NED cannot be independent if he:
 - a Is a former executive director of the company
 - b Is a recent former employee of the company
 - c Is closely related to an executive director
 - d Has either personally or through his employer a business relationship with the company
 - e Represents a controlling or significant shareholder.

2. An NED's independence may be questioned if he comes close to one or more of the above categories, e.g. if:
 - a The employment relationship was not recent
 - b The personal relationship was not close, or was by marriage
 - c The business relationship has ended, or was not significant
 - d The shareholding relationship has ended.

No claim is made that these lists are or could be comprehensive, but they should if generally adopted provide useful guidance to Nomination Committees and shareholders.

Appendix 4

To meet satisfactorily the accountabilities of the role, an NED must have as a prerequisite reasonably high-level experience of business and organisational functioning. He must in addition be able to transcend prior experience of a specific business and a specific management role to assume the much broader strategic perspective of the board. To do this and to contribute effectively, he requires a range of what may be unfamiliar knowledge and skills. What follows is a minimum list of these.

1. **Knowledge**

- Legal and Regulatory Framework
- Financial Reporting
- Corporate Governance
- Board Practice – inside and outside meetings
- Accountabilities of the role
- Possible crisis situations (eg takeovers).

2. **Skills**

a. **Cognitive Skills**

- Gaining adequate understanding of an unfamiliar business.
- Obtaining relevant information in a comprehensible form.
- Defining the key issues on which to focus.
- Developing a broad strategic vision of what the company requires (N.B. this permeates all the others).

b. **Interpersonal and Group skills**

- Developing credibility and acceptance by all colleagues
- Ability to ask discriminating questions
- Ability to exercise influence by constructive intervention

- Capacity to reshape issues and discussions (N.B. this also permeates all the others).

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