

Response from Philip Heyes to consultation document of 16 July, 2009

Unitary versus two-tier board structures

1 Paragraph 2.14 reaches the conclusion that there is no persuasive case for adopting a two-tier board structure in preference to the UK unitary model. I agree with that conclusion, but believe that there are features of a two tier board system which could be useful applied to a unitary model.

2 Two issues are identified that, it is suggested, have led UK companies and their shareholders not to seek such a change:

(i) the inability of non-executives on a supervisory board to access management information of adequate quality in a timely fashion;

(ii) the lack of opportunity for interactive exchange of views between executives and NEDs.

3 These are also issues, I suggest, in a unitary board structure, where it has become commonplace for the day to day running of the company to be conducted by an executive committee of the board with only matters that relate to strategy and corporate policy being referred to the board.

4 The key issue is not the formal structure of the company, but the willingness and ability of the non-executives to engage in constructive dialogue with the executive team and the chairman both at and outside board meetings. My own experience of the two tier board is that members of the supervisory board have ready access to members of the management board and to additional information on key agenda items ahead of the relevant board meeting.

5 Two tier board structures typically have the following features:

(i) the formal separation of governance between supervisory and management boards can provide the opportunity for more direct shareholder involvement in the affairs of the company through nomination of candidates for the supervisory board;

(ii) key members of the executive team can sit on the supervisory board, but not dominate it;

(iii) committees of the supervisory board will commonly be empowered to obtain information from the executive in formats that facilitate effective supervision of the company's activities.

6 The Russian regime of corporate governance for public companies illustrates how a two tier system can be structured. Russian corporate law was recreated following the collapse of the Soviet Union and drew upon an extensive review of corporate law in Western countries. It is a system which, if followed conscientiously, does promote a constructive relationship between shareholders, non-executives and executive management.

7 The key features of the Russian regime are:

7.1 a supervisory board elected annually by the shareholders using a cumulative voting system

The cumulative voting system works by multiplying the number of votes attaching to a shareholder's shares by the number of directors on the supervisory board. A shareholder can divide his votes between the candidates in whatever way he wishes, so can cast all his votes for one candidate or split them between a number of candidates. The candidates winning the highest number of votes are elected. Thus, if there is a supervisory board of ten members, a shareholder or shareholders controlling 10% of the voting shares can ensure the election of a particular candidate.

The requirement for annual election of all directors has not in practice led to a lack of continuity at board level but does allow for continued scrutiny of performance of all directors.

7.2 nominations to the supervisory board may be made by any shareholders holding 2% of the voting shares

An eligible shareholder or group of shareholders can nominate as many candidates as there are directors to be elected and so, with the cumulative voting system, it is relatively easy for institutional shareholders to promote one or more candidates to the board.

The system encourages dialogue between the Chairman and key shareholders in identifying effective non-executive directors, but leaving the appointment of the executive team to the Chairman and his supervisory board.

7.3 no more than a quarter of the members of the supervisory board can also be members of the management board and the CEO cannot also be chairman of the supervisory board

Russian supervisory boards usually comprise between 12 and 18 members, so it is possible to include key executives from the management board on the supervisory board. However, because non-executives have to comprise at least 75% of the board and the functions of the board are distinct from that of the management board, the balance of power lies much more with the non-executives.

7.4 a shareholder cannot be a member of the supervisory board

Only natural persons can in any event be a member of the board, so in the context of a corporate shareholder base the requirement is of little significance. The prohibition does however serve to underline the responsibility of members of the supervisory board to look to the interests of the shareholders as a whole rather than those of an individual shareholder.

7.5 listed companies are required to have at least one "independent" director on the supervisory board

As a matter of good practice an independent director will chair the key committees (audit/ remuneration/ nomination) of the board and so a typical board will have 3 or 4 board members that meet the requirement of independence.

7.6 the remuneration of the supervisory board members and allowable expenses are determined each year by the shareholders in general meeting

The remuneration of the management board as a whole is set by the supervisory board, including the size of any bonus pool. Changes to the terms and conditions of employment of the management board require the approval of the supervisory board.

8 It is worth noting that the credit rating agencies attach importance to the corporate governance practices of issuers and, particularly in emerging markets, this has served as a catalyst for the adoption of higher standards of governance among banks seeking to access the capital markets. The CRAs act as independent evaluators of corporate governance practices and their conclusions can provide valuable guidance to the non-executives in identifying areas of concern.

Philip Heyes

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