

Non - Executive Directors

The role of non-executive directors

The UK Corporate Governance Code (the **UKCG Code**) contains various principles and provisions of relating to non-executive directors.

References: UK Corporate Governance Code 2010

UK Corporate Governance Code 2012

The UKCG Code applies to UK and overseas companies with a premium listing of equity shares in the UK (**listed companies**). However, some companies (in particular, AIM-listed companies or companies with a standard rather than premium listing) choose to comply with the UKCG Code in the interests of best practice and good governance even though they are not required to do so.

References: The Listing Rules, LR 9.1.1R, LR 9.6.8R (5), LR 9.6.8R (6) and LR 9.8.7R

The current version of the UKCG Code was issued in September 2012 and applies to companies with accounting periods beginning on or after 1 October 2012.

The previous version of the UKCG Code was issued in June 2010 and will continue to apply for a transitional period to companies that are still within accounting periods beginning prior to 1 October 2012.

The Combined Code was the predecessor to the UKCG Code. It is no longer applicable (it applied to companies with financial years beginning before 29 June 2010).

Requirement to appoint non-executives

A main principle of the UKCG Code is that the board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.

References: UKCG Code 2010, main principle B.1

UKCG Code 2012, main principle B.1

The board should include an appropriate combination of executive and non-executive directors (and, in particular, independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision taking.

References: UKCG Code 2010, main principle B.1

UKCG Code 2012, main principle B.1

At least half the board of FTSE 350 companies, excluding the chairman, should comprise non-executive directors determined by the board to be independent. A company that falls outside the FTSE 350 should have at least two independent non-executive directors.

References: UKCG Code 2010, provision B.1.2

UKCG Code 2012, provision B.1.2

Independence

The board is expected to identify in the annual report and accounts each non-executive director they consider to be independent for the purposes of the UKCG Code. In making its assessment, the board is required to determine whether the director is independent in character and judgment and whether there are relationships or circumstances that are likely to affect, or could appear to affect, the director's judgment.

References: UKCG Code 2010, provision B.1.1

UKCG Code 2012, provision B.1.1

The UKCG Code includes the following non-exhaustive list of circumstances which would indicate that a director is not independent:

References: UKCG Code 2010, provision B.1.1

UKCG Code 2012, provision B.1.1

- o the non-executive director has been an employee of the company or group within the last five years
- o the non-executive director has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company
- o the non-executive director has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or a performance-related pay scheme, or is a member of the company's pension scheme
- o the non-executive director has close family ties with any of the company's advisers, directors or senior employees
- o the non-executive director holds cross-directorships or has significant links with other directors through involvement in other companies or bodies
- o the non-executive director represents a significant shareholder, or
- o the non-executive director has served on the board for more than nine years from the date of their first election

If the board determines that a director is independent despite one of the above-listed circumstances applying, it should state its reasons for finding that the director is independent in the annual report.

References: UKCG Code 2010, provision B.1.1

UKCG Code 2012, provision B.1.1

Governance role of non-executive directors

As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy.

References: UKCG Code 2010, main principle A.4

UKCG Code 2012, main principle A.4

Non-executive directors are responsible for:

References: UKCG Code 2010, supporting principle to main principle A.4

UKCG Code 2012, supporting principle to main principle A.4

- o scrutinising the performance of management in meeting agreed goals and objectives and monitoring the reporting of performance
- o satisfying themselves on the integrity of financial information and that financial controls and systems of risk management are robust and defensible, and
- o determining appropriate levels of remuneration of executive directors and have a prime role in appointing, and where necessary removing, executive directors, and in succession planning

Non-executives will contribute to these governance functions through their membership of the main board committees and by attending board meetings. It should be noted that non-executive directors need not all be considered independent and will often be retained to fill other knowledge or experience gaps.

The government's guidance on the role and effectiveness of non-executive directors, drafted by Derek Higgs and published in 2003 (the **Higgs Report**) said that to be effective, non-executives:

References: The Higgs Report

- o should be independent in judgment and have an enquiring mind

- o need to build a recognition by executives of their contribution in order to promote openness and trust
- o need to be well-informed about the company and the external environment in which it operates, with a strong command of issues relevant to the business
- o need formal and tailored induction
- o should seek continually to develop and refresh their knowledge and skills to ensure that their contribution to the board remains informed and relevant
- o should be provided with information sufficiently in advance of meetings to enable thorough consideration of the issues facing the board, and
- o should develop an understanding of the views of major investors

Senior independent director

The UKCG Code requires boards to appoint one of the independent non-executive directors as the senior independent director, and to identify the person so appointed in the annual report.

References: UKCG Code 2010, provisions A.4.1 and A.1.2

UKCG Code 2012, provisions A.4.1 and A.1.2

The role of the senior independent director envisaged by the Code includes:

- o acting as a sounding board for the chairman and an intermediary for other directors when necessary
References: UKCG Code 2010, provision A.4.1
- o UKCG Code 2012, provision A.4.1
being available to shareholders if they have concerns which contact through the normal channels of chairman, chief executive or other executive directors has failed to resolve or for which such contact is inappropriate, and
References: UKCG Code 2010, provision A.4.1
- o UKCG Code 2012, provision A.4.1
taking the lead in assessing the performance of the chairman
References: UKCG Code 2010, provisions A.4.2 and B.6.3

UKCG Code 2012, provisions A.4.2 and B.6.3

The UKCG Code also recommends that the senior independent director should attend sufficient meetings with a range of major shareholders to listen to their views in order to help develop a balanced understanding of the issues and concerns of major shareholders.

References: UKCG Code 2010, provision E.1.1

UKCG Code 2012, provision E.1.1

The senior independent director is also likely to serve on one or more of the main corporate governance committees, possibly in the capacity of chairman.

Non-executive fees

The fees of non-executive directors should be decided by the board or, where required by the articles of association of the company, the shareholders within any limits set by the articles. Where permitted by the articles, the board may, however, delegate this responsibility to a committee, which might include the chief executive.

References: UKCG Code 2010, provision D.2.3

UKCG Code 2012, provision D.2.3

The remuneration of the chairman, whether considered executive or non-executive, should be determined by the remuneration committee.

References: UKCG Code 2010, provision D.2.2

UKCG Code 2012, provision D.2.2

Levels of remuneration for non-executives should reflect the time commitment and responsibilities of the role. Remuneration should not include share options or other performance-related elements. However, if options are to be granted, shareholder approval should be sought in advance and any shares acquired by exercise of the options should be held until at least one year after the non-executive leaves the board. The holding of share options could be relevant to the determination of the non-executive's independence.

UKCG Code 2012, provision D.1.3

Appointment of non-executives

The UKCG Code envisages that the nomination committee should make recommendations to the board on the appointment of new non-executives as well as executive directors.

References: UKCG Code 2010, provision B.2.1

UKCG Code 2012, provision B.2.1

When making an appointment, the nomination committee is expected to evaluate the balance of skills, knowledge and experience on the board and, in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment.

References: UKCG Code 2010, provision B.2.2

UKCG Code 2012, provision B.2.2

Non-executive directors should be appointed for specified terms subject to election and the provisions of the Companies Act 2006 relating to the removal of a director. Any term beyond six years should be subject to particularly rigorous review and should take into account the need for progressive refreshing of the board. Service beyond nine years is generally considered to compromise a non-executive director's independence. References: UKCG Code 2010, provisions B.2.3 and B.1.1

UKCG Code 2012, provisions B.2.3 and B.1.1

The terms and conditions of appointment of non-executive directors should be made available for inspection at the registered office during normal business hours and at the AGM. The letter of appointment should set out the expected time commitment.

References: UKCG Code 2010, provision B.3.2

UKCG Code 2012, provision B.3.2

The Higgs Report

The board should not agree to a full time executive director taking on more than one non-executive directorship or chairmanship in a FTSE 100 company.

References: UKCG Code 2010, provision B.3.3

UKCG Code 2012, provision B.3.3

The Higgs Report includes 'Guidance on Letters of Appointment for Non-executives'. In addition, the Institute of Chartered Secretaries and Administrators (**ICSA**) has issued guidance on non-executive appointment letters (see precedent: ICSA guidance: a sample non-executive director's appointment letter).

Induction, development and information

All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.

References: UKCG Code 2010, main principle B.4

UKCG Code 2012, main principle B.4

Induction

The chairman should ensure that new directors receive a full, formal and tailored induction on joining the board. As part of this induction, directors should avail themselves of opportunities to meet major shareholders. The secretary is expected to play a role in facilitating this induction process.

References: UKCG Code 2010, provision B.4.1 and supporting principle B.5

UKCG Code 2012, provision B.4.1 and supporting principle B.5

According to the induction checklist in the Higgs Report, induction programmes should:

References: The Higgs Report

- o build an understanding of the nature of the company, its business and the markets in which it operates
- o build links with company people, and
- o build an understanding of the company's main relationships, eg, auditors, major customers, major suppliers, major shareholders

ICSA has also recently issued guidance on the induction of directors.

References: ICSA guidance on induction of directors

Development

The chairman is expected to ensure that the directors continually update their skills and the knowledge and familiarity with the company required to fulfil their role on the board and on board committees. The company is required to provide the necessary resources for developing and updating its directors' knowledge and capabilities in this regard.

References: UKCG Code 2010, supporting principle B.4

UKCG Code 2012, supporting principle B.4

The chairman is expected to regularly review and agree with each director their training and development needs.

References: UKCG Code 2010, provision B.4.2

UKCG Code 2012, provision B.4.2

Information

All directors should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties.

References: UKCG Code 2010, main principle B.5

UKCG Code 2012, main principle B.5

The chairman is responsible for ensuring that the directors received accurate, timely and clear information. Management has an obligation to provide such information but directors should seek clarification or amplification where necessary.

References: UKCG Code 2010, supporting principles to main principle B.5

UKCG Code 2012, supporting principles to main principle B.5

The company secretary has responsibility, under direction of the chairman, for ensuring good information flows and is responsible for advising the board through the chairman on all governance matters.

References: UKCG Code 2010, supporting principles to main principle B.5

UKCG Code 2012, supporting principles to main principle B.5

The board should ensure that directors, especially non-executive directors, should have access to independent professional advice at the company's expense. All directors should have access to the advice and services of the company secretary.

References: UKCG Code 2010, provisions B.5.1 and B.5.2

UKCG Code 2012, provisions B.5.1 and B.5.2

Re-election

The UKCG Code's main principle on re-election is that all directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.

References: UKCG Code 2010, main principle B.7

UKCG Code 2012, main principle B.7

All directors of FTSE 350 companies should be made subject to annual re-election by shareholders.

References: UKCG Code 2010, provision B.7.1

UKCG Code 2012, provision B.7.1

Directors of smaller companies (meaning those outside the FTSE 350) are not made subject to annual re-election. Instead, they are expected to be made subject to election by shareholders at the first annual general meeting after their appointment, and re-election thereafter at intervals of no more than three years.

References: UKCG Code 2010, provision B.7.1

UKCG Code 2012, provision B.7.1

The model articles for public companies include suitable wording for the re-election of directors of smaller companies. These articles should be amended as appropriate if the company is a FTSE 350 company.

References: Companies (Model Articles) Regulations 2008, SI 2008/3229, Schedule 3--Model articles for public companies

The names of directors submitted for election or re-election to be accompanied by sufficient biographical details and any other relevant information to enable shareholders to make an informed decision on their election.

References: UKCG Code 2010, provision B.7.1

UKCG Code 2012, provision B.7.1

The board is also expected to set out in the annual general meeting papers accompanying a resolution to elect a non-executive why they believe that individual should be elected. The chairman is also expected to confirm to shareholders when proposing re-election that, following formal performance evaluation, the individual's performance continues to be effective.

References: UKCG Code 2010, provision B.7.2

UKCG Code 2012, provision B.7.2