

26 May 2005

DG Markt G3  
European Commission  
B-1049 Brussels

Dear Sirs

### **Recommendation on the Role of (Independent) Non-Executive or Supervisory Directors**

The IMA is the trade body representing the UK asset management industry. IMA Members include independent fund managers, the asset management arms of banks, life insurers, investment banks and occupational pension scheme managers. They are responsible for the management of approximately £2 trillion of funds (based in the UK, Europe and elsewhere), including institutional funds (for example, pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, our Members manage 99% of UK-authorized investment funds.

The IMA is an active member of FEFSI<sup>1</sup> and EAMA<sup>2</sup>, which represent the pan-European investment fund and asset management industries respectively. The IMA is also a founder member and current chair of the Institutional Shareholders' Committee (ISC). The members of the associations that belong to the ISC between them account for the majority of institutional investment in the UK.

In managing assets for both retail and institutional investors, IMA Members are major investors in companies whose securities are traded on regulated markets. They engage with those companies, enter into an active dialogue and decide how these shares will be voted on the principals' behalf. It is from this standpoint that we have an interest in the role of companies' non-executive or supervisory directors.

We welcome the Commission seeking to harmonise the role of non-executive or supervisory directors and believe this is likely to be one of the most important initiatives in the Corporate Governance Action Plan. There is a clear, distinct and important role for directors that do not form part of the management team running the company day-to-day. Non-executives can have an independent but informed perspective on key decisions, and can ensure that proposals from executive management are thoroughly and rigorously tested before being finalised and acted

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<sup>1</sup> The Fédération Européenne des Fonds et Sociétés d'Investissement ('FEFSI') is the pan-European association of investment funds and companies.

<sup>2</sup> The European Asset Management Association ('EAMA') is the pan-European association of asset managers.

upon. Our specific reservations about particular proposals in the draft are set out in the attached appendix A. These reservations are based on the orientations for the Commission's recommendation in section 2 of the consultation document, we have not seen the draft recommendation. In this respect, the fact that the Commission is proposing to issue a recommendation means that the draft will not be debated through the European Parliament and Council. It is important the Commission safeguards the good governance of the process by offering a public consultation on the draft recommendation; notwithstanding the fact it intends to publish it in Autumn 2004. We believe that this is important to obtain the buy in from both the corporates and investors by requesting their feedback.

Please do contact me if you would like me to clarify any of the points in this letter or if you would like to discuss any issues further.

Yours faithfully

Liz Murrall  
Senior Adviser – Corporate Governance

## APPENDIX A

### **Recommendation on the Role of (Independent) Non-Executive or Supervisory Directors**

#### **Comments by the Investment Management Association (IMA)**

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Overall the IMA welcomes the main proposals in the draft recommendation on the role of (independent) non-executive or supervisory directors. However, those proposals where we have specific reservations are set out below.

#### **Matters the recommendation should address**

##### *A senior non-executive director*

A particular concern for institutional investors is how to communicate any concerns they may have to the board. While regular meetings are normally held with the executive management team, these are not necessarily the best forum for communicating broad views or concerns about the company's governance or strategic direction. Investors have to look to the board, and in particular to non-executive directors, to manage their interests in such a way as to anticipate and avoid problems.

There needs, however, to be a proper conduit of communication, which is open to investors, other than direct to executive management. There may be cases where investors believe management should be challenged, and it is for non-executive directors to do this. They need to be in a position to communicate their concerns to those non-executive directors. From our experience in dealing with this issue, the concept of the "senior independent non-executive director" is an effective means of dealing with this, and we would welcome its extension widely throughout the EU. The key considerations should be that the individual is fully independent of management, has sufficient weight and standing, and has significant influence within the board. Part of the role should be to maintain informal contact with leading investors and act as a channel of communication for investors' concerns. In conclusion, the recommendation should specify that there should be a senior independent non-executive director and the role he should play.

##### *The wider role of the non-executive directors*

The draft recommendation focuses on the role of the non-executive or supervisory director almost exclusively in relation to the nomination, remuneration and audit committees.

We consider that non-executives have a wider role to play than envisaged in the draft. As noted in the covering letter, they are not involved in the day-to-day running of the company and can bring a fresh perspective and an objective approach to a variety of matters. Thus they can scrutinise, constructively challenge and monitor the management team. They can also help in developing the company's overall strategy. As currently drafted, the recommendation does not address these functions.

## **Scope – section 2.1**

### *EU Companies – other companies – section 2.1.2*

The draft proposes that Member States will be invited to adopt measures which will influence the way listed companies are organised and that, as the draft covers more than the provision of information, it should not cover non-EU companies listed in the EU. The consultation proposes to "...invite each Member State to adopt measures which would be applicable to companies (listed in the EU) having their registered office in that Member State".

We disagree with this proposal. It is the Member State in which the company is listed (rather than the country in which it has its registered office) that a public offer of shares is made, and where a public interest arises in ensuring that appropriate corporate governance measures are adopted. Therefore, we believe that the recommendation should invite each Member State to adopt measures to apply to companies (whose registered office is in the EU) that are listed in that Member State.

We note that the recommendation does not extend to companies from third countries having their listing in the EU. We support this and believe it is each Member State's listing authority's responsibility to assess the equivalence of corporate governance of companies from third countries, rather than the European Commission.

## **The need for some board committees – section 2.2**

### *Composition of the whole (supervisory) board – section 2.2.2*

The draft recognises that in the EU, companies typically have a one or two tier board and does not propose expressing a preference for either. Section 2.2.2 addresses how many independent non-executive or supervisory directors should be present on the unitary or supervisory board. It draws a distinction between independent directors and non-executive or supervisory directors and proposes "a number of independent directors should be elected to the (supervisory) board of companies that is adequate in relation to the total number of non-executive or supervisory directors and significant in terms of representativeness [sic]".

We do not consider that this addresses the position of the unitary board, which is made up of both executive and non-executive directors and where the balance of non-executives, independent and otherwise, needs to be considered in relation to the number of executives. The recommendation should cover this.

### *Chairman – CEO – section 2.2.3*

On the roles of the chairman and CEO, the draft states "in the absence of a clear consensus, it is not considered desirable to include in the recommendation a statement aimed at presenting the separation of these roles as best practice".

Our experience of dealing with this issue is that the roles of the chairman and chief executive are separate – chairing the board is quite different from having responsibility for the day to day running of the company. In the UK Cadbury first recommended that the roles should be separate more than a decade ago.

The separation of the roles of the chairman and chief executive avoids concentration of authority and power in one individual and differentiates leadership of the board from the running of the business. As noted in the last paragraph of section 2.2.1, the balance of the board should be “such that no individual or small group of individuals can dominate the decision taking”. Furthermore, we believe there are difficulties if the chief executive becomes the chairman. A chairman who was formerly the chief executive of the same company may simply take for granted his inside knowledge and fail to act as a bridge for information to the non-executive directors. In addition, having been responsible for the day-to-day running of the company, the detailed knowledge acquired can make it difficult for the chairman to make way for a new chief executive.

We believe that the benefits of differentiating the roles of the chairman and chief executive are such that, in the interests of harmonising governance standards throughout the EU, the recommendation should specify that, as a matter of best practice, they should be separate. Furthermore, the chairman needs to foster trusting relationships with both the executive and non executive directors and a degree of detachment from the executive can be valuable in ensuring there is objective debate. Thus we consider that the chairman should be independent and that the draft recommendation should make this clear.

### **Profile of (independent) non-executive or supervisory directors**

#### *Commitment – section 2.3.2*

Section 2.3.2 sets out proposals to ensure that directors, executive and non-executive or supervisory, have sufficient time for their role. The proposals seek to ensure there is a proper flow of information and that a director’s other commitments are disclosed in the annual report every year.

We believe it is important that a director’s other commitments and changes thereto are disclosed so that it is easier to assess suitability and availability, as well as understand board balance. In this respect, it is important that there is clarity as to the expected time commitment required. We believe it is for the nomination committee to assess what this should be, as envisaged in section 2.5.2 of the draft, and to judge whether a director has sufficient time for the role in view of his other commitments. A director’s other commitments are only relevant in the context of the time he is expected to spend as one of the company’s non-executive directors.

#### *Independence – section 2.3.3*

We consider it important that non-executives are independent of mind and can challenge and question. Independence from management is a key qualification for the role of the non-executive director and this should be clear. We welcome companies being required to disclose annually which directors they consider to be independent and on what grounds.

The draft also proposes that the company should require the independent directors to revalidate their independence periodically. In this respect, we believe it should be for the board and/or nomination committee to determine whether a particular

director is independent. We, therefore, question the value of self-certification and the need for independent directors to revalidate their independence annually.

As regards the list of minimum criteria as to what constitutes independence, we consider in certain respects this is too detailed given the Commission's wish not to create "a set of detailed principles designated for direct use by listed companies" (section 1.2).

## **The board committees: common features – section 2.4**

### *Terms of reference – section 2.4.3*

Section 2.4.3 states that terms of reference for the main committees must be made available to the public at least once a year "as part of the information to be disclosed by the company in its annual report on its corporate governance structures and practices".

Whereas we support the terms of reference being made available, we believe it is too prescriptive for the recommendation to specify that this should be in the annual report. Terms of reference are not likely to change significantly, if at all, from year to year and including them in the annual report would merely add to the length of the report without adding value to an analysis of the company's organisational and financial position. However, it is important that terms of reference can be accessed and we recommend that companies should be required to make them available on their web-sites.

## **The Nomination Committee – section 2.5**

### *Composition – section 2.5.1*

We strongly support the draft recommendation proposing that the nomination committee should comprise the majority of independent non-executive or supervisory directors. The conflicts of interest that can arise between directors and shareholders in relation to nomination, remuneration and audit, were succinctly described by the High Level Group of Company Law Experts:

"In these three areas, executive directors clearly have conflicts of interest. Nomination is about the continuation of their own jobs and the jobs of their colleagues and potential new colleagues, and the persons who monitor them. Remuneration is about the rewards the executive directors receive for their services to the company. Audit is about the probity of the financial and non-financial accounting for the performance of the company by the executive directors who are responsible for its performance."

The Action Plan proposes that certain of these conflicts can be resolved by establishing audit and remuneration committees with a majority of independent non-executive directors. By the same logic we strongly believe that nomination committees should also be made up of a majority of independent, non-executive directors.

Of course there are differences in the operational requirements of nomination, remuneration and audit committees. For example, just as audit committees require

members with a working knowledge of financial accounting, so nomination committees require members with a working knowledge of, as per the Action Plan “the challenges facing the company and of the skills and experience of human resources grown up within the company”. A nomination committee with a majority of independent non-executive directors is able to benefit from the operational experience of executive directors, whilst safeguarding any potential conflicts of interest by relying on the majority of non-executive independent directors. However, in instances where there is a unitary board, requiring that the CEO is among the members of the nomination committee is too prescriptive and errs too far in the direction of the committee’s operational requirements. It is also does not consider that, given his other commitments, the CEO may not be able to devote sufficient time to the process of board appointments nor to the conflicts that would arise when the committee is dealing with his successor.

#### *Chairmanship of the nomination committee*

The draft does not mention who should chair the nomination committee. In this respect, we consider that the chairman or an independent non-executive director should chair the committee and that this should be specified in the recommendation. However, it should be clear that the chairman should not chair the committee when it is dealing with the appointment of his successor.

### **The Remuneration and Audit Committees**

#### *Composition*

The draft states in relation to the remuneration and audit committees that they should be “composed exclusively of non-executive or supervisory directors, who are in the majority independent”.

We question whether this goes far enough. In the interests of good corporate governance and ensuring that important board duties are being discharged, we recommend that the remuneration and audit committees should be made up exclusively of *independent* non-executive directors and that the recommendation should make this clear.