

CAD-01075

COMMITTEE
ON
THE FINANCIAL ASPECTS
OF CORPORATE GOVERNANCE

31.7.91

Sir Adrian

This letter arrived for you today. I have kept a copy for
our files.

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Pat

FROM LORD EZRA



Ack'd. 9/8/91.
S. H. H.

Sir Adrian Cadbury
Committee on Corporate Governance
P O Box 433
Moorgate Place
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29 July 1991

Dear Adrian,

I refer to my letter to you of 21 June in response to your request that I might submit my views to the Committee on Corporate Governance which you are chairing. I now attach a short note on the duties and responsibilities of Non-Executive Directors in larger quoted companies. As you will see I take the view that a consensus is now emerging as to what should be the qualifications, functions and responsibilities of such Directors, but I raise the question of whether there should not be some legislative backup for these proposals. Otherwise it could take a very long time before they are generally applied.

I hope this note will be of assistance in your deliberations.

M.

Seeh

CORPORATE GOVERNANCE

The Role and Responsibilities of Non-Executive Directors in the Larger Publicly Quoted Companies

Submitted by Lord Ezra in July 1991

Having been invited to submit my views to the Committee on Corporate Governance I propose to do so in relation to the role and responsibilities of non-executive directors in the larger publicly quoted companies. The definition of larger quoted companies is that contained in the PRO NED Code of Recommended Practice on Non-Executive Directors issued in April 1987: that is companies with a turnover of £50 million or more and whose employees number 1,000 or more.

I believe that a consensus of opinion is growing as to the role of non-executive directors in such companies. This is based on the feeling that there should be a clearly defined counterpoise to the power inevitably exercised by executive directors in large quoted companies. This can best be provided by an appropriate number of non-executive directors having the following qualifications and responsibilities:

1. The ability of non-executive directors should be assured by suitable past experience and performance, as well as appropriate qualifications.
2. The independence of non-executive directors should be secured by the fact that they should not have been employed in an executive capacity in the company, should not be professional advisers or associated with professional advisers to the company, and should not be a significant customer or supplier to the company (these points are set out in the PRO NED document).

3. It would be desirable for the chairman to be non-executive and for there to be a separate Chief Executive.
4. In the larger quoted companies at least one third of the directors should be non-executive.
5. The non-executive directors should be members of an Audit Committee.
6. They should also be members of a Compensation or Remuneration Committee which should be responsible for the appointment, dismissal and remuneration of the top executives in the company and review their remuneration at least annually.
7. They should be consulted on all major issues of policy and should be provided with sufficient information to exercise a sensible judgement on these issues.

The above list of the role and responsibilities of non-executive directors represents the emerging consensus. The difficulty, however, is that the document issued by PRO NED and similar documents issued by the Institutional Shareholders Committee, the CBI and the Institute of Directors are all recommendations. The result is that the appointment, role and functions of non-executive directors in the larger quoted companies vary enormously. While there has no doubt been some progress in recent years for a number of companies to follow the recommended practice, it is clearly going to take a considerable time before the bulk of companies do so.

The question therefore arises whether, once there is agreement on the role and responsibilities of non-executive directors (a point which I believe has practically been reached), serious

consideration should be given to legislative enforcement. The Companies Acts are noticeably deficient in any reference to the functions of directors. In the whole corpus of Companies Acts the only reference to their functions is in Section 309 (1) of the 1985 Act which lays down that they should have regard to the interests of the company's employees as well as to the interests of its members in the performance of their duties.

It needs to be seriously considered whether in the next Companies Bill suitable clauses should be introduced to cover the responsibilities of non-executive directors as now emerging from the studies carried out by the leading bodies in this field.