

Nigel Peace Esq, Secretary
Committee on the Financial Aspects
of Corporate Governance
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LONDON EC2P 2BJ

July 13, 1992

Dear Mr Peace,

Having read the committee's report with great interest I wish to make a few comments.

I have spent the last 12 years as a consultant on board level organisation and rewards, after some years of general management within a large UK listed group. Last year I wrote a survey report (for New Bridge Street Consultants) on remuneration committee practice in 51 listed companies with a median turnover of £1 billion. I also instigated a conference on the subject with ABI, CBI and PRONED involvement - my interest is not new.

In the middle 1980's I was a "partner equivalent" in KMG Thomson McLintock, i.e. a non-accountant with voting rights and much contact with senior audit partner colleagues; I also ran a consultancy group within KPMG. I therefore have a semi-detached ex-insider's view of large accounting practices.

Underlying Concerns

- 1.1 I support the majority of the recommendations and the Code - particularly those on openness - but not quite all. Underlying my specific areas of concern are some more general issues.
- 1.2 Corporate governance itself never made a widget, provided gainful employment or paid a dividend. I think the report draws too sharp a distinction between the roles of executive and "non-executive" directors in companies.
- 1.3 They all must contribute to the overall direction and progress of the company as well as fulfilling the additional requirements of executive management or independent oversight.
- 1.4 If independent directors are normally seen as positive contributors then their ability to restrain the executive, when necessary, should be enhanced.
- 1.5 I think that auditors have had kid glove treatment.

- 1.6 Sanctions have to be credible to be effective. Delisting may not be. More teeth are therefore needed before the "nuclear" option has to be invoked.

Specific Comments

Compliance with the Code

- 2.1 There will be perfectly proper reasons for departures from the Code in a few circumstances. They should, as you say, be explained. Auditors must have a duty to give an informative and unambiguous opinion about directors' statements that are made. If a statement about compliance is not made then auditors should point out clearly that this is contrary to recommended practice.

The Board

- 2.2 I used to work for a well known company where, for the avoidance of doubt, the top man called himself chairman, chief executive and managing director... I can think of few circumstances outside a corporate rescue where this can possibly be justified in a listed company.
- 2.3 Independent directors should be paragons and available in adequate numbers - there's the rub. A formal appointment process must be right.
- 2.4 The current wisdom of every top 100 executive director having one non-executive directorship is helpful. But it produces another apparently cosy circle to add to those of the chairman's cronies and the merry-go-round of chief executives sitting on each others' boards.
- 2.5 It is seen as risky to appoint someone who is not already on a plc board - as PRONED well know. I suspect that only institutional pressure can break this logjam and tap the wider pool of relevant talent available. Are the institutions ready to do this?
- 2.6 Insisting that all directors nominate new NXDs could cause problems when the need is for removal of existing "sleeping" NXDs. (I have seen them sleeping...) In the long run your insistence on positive rather than automatic renewal should handle the problem.

Board Committees

- 2.7 The remuneration committee should have a clear NX majority and a NX chairman. Unfashionably, I think the chief executive should normally be a member, although non-voting and absent during discussion of his own package. I think the risk of impractical decisions can justify the right to attend.

Board Remuneration

- 2.8 Remuneration of directors needs to be open. Many companies still dribble out inadequate information, taking opportunities to obfuscate or conceal for as long as possible. This is bad for the whole corporate sector.
- 2.9 The existence and basis of all performance rewards needs to be spelt out in advance. Any subsequent changes should be justified.
- 2.10 I regard 3 year contracts as the maximum acceptable; unfortunately they seem to be the norm regardless of need or a sensible balance between risk and reward.
- 2.11 I agree that NxD pay should vary with time put in on committees etc.
- 2.12 NxDs (should) have a duty to contribute at least to medium term corporate performance as well as a custodial role. Is it always wrong to reward success in this?
- 2.13 It seems, for example, a bit odd that directors' shareholdings are considered desirable but, say, a modest medium term reward plan, related to real growth in "shareholder value", is reckoned to compromise NxD independence unacceptably.
- 2.14 As a perhaps extreme example I was happy to recommend a performance related package - rather than an excessive flat fee - for the new chairman of British & Commonwealth in what proved to be its dying days. Admittedly this was probably better described as a part-time executive role, with the likely time input decreasing with success...
- 2.15 No director, executive or otherwise, should ever have any share related "incentive" unless its value is linked to genuine performance.
- 2.16 I have heard a suggestion that compensation should be available for NxDs who resign on matters of principle. It would perhaps reduce the reliance on noblesse oblige but clearly has some problems. If the idea found favour then the problems might be contained if the absolute limit of "compensation" was one year's fees.

Auditor Issues

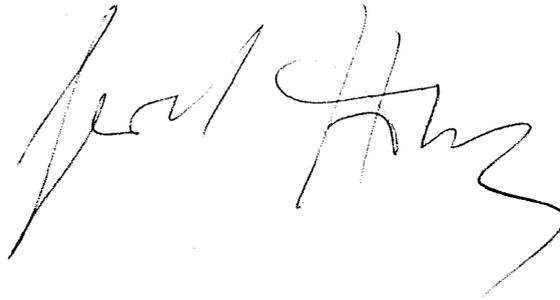
- 2.17 Despite having been a consultancy "partner" at KMG Thomson McLintock I have never met a convincing rebuttal to those who would either quarantine audit from other services or alternatively insist on rotating auditors.

2.18 To apply neither restraint shows touching faith in the opacity of chinese walls and - possibly - ignorance of the pressures within large accounting firms. Accountants are human too - why run a system that assumes they are all totally immune to pressure?

2.19 I would both debar auditors from supplying most other services to their listed audit clients and rotate firms - doubtless a very unpopular position...

I would be happy to discuss any of these comments in more detail if this would be helpful.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Gerard Howe". The signature is written in a cursive, somewhat stylized font with a long, sweeping tail on the final letter.

Gerard Howe