This paper gives the Institute’s response to the Consultation Document “Recommendation on the role of (independent) non-executive or supervisory directors”, published by the services of the Internal Market Directorate of the European Commission on 5th May 2004.

For further information please contact:

Patricia Peter
Corporate Governance Executive
Institute of Directors
116 Pall Mall
London SW1Y 5ED
United Kingdom

Tel: +44 (0)20 7451 3113
Fax: +44 (0)20 7839 2337
E-mail: patricia.peter@iod.com
THE INSTITUTE OF DIRECTORS

The Institute of Directors (IoD) is a non-party political organisation of individual members founded in 1903 and has more than 53,000 members in the United Kingdom. The membership is drawn from across the business spectrum. Over 75% of The Times Top 1000 companies have IoD members on their boards, but the majority of members (some 60%) are directors of small and medium-sized enterprises, ranging from long-established businesses to start-up companies. The organisations from which our members are drawn employ over 10 million people in the UK, i.e. over 40% of the workforce.

In addition to representing the interests of its members, the IoD is strongly committed to delivering improvements in professional standards and boardroom practice. The IoD’s Chartered Director qualification is the world’s first independently accredited professional qualification for directors. This, combined with professional development programmes and publications, puts the IoD at the forefront of improving standards in boardrooms.

INTRODUCTION

Many of the proposals for the Recommendation reflect the existing regulation, codes and best practice in the United Kingdom and would therefore not have a great impact on United Kingdom companies. However, we have approached our response to the Consultation Document from the viewpoint of what is appropriate intervention at EU level irrespective of the impact or lack of it at national level.

These comments are divided into two parts: firstly general comments on the perceived need for intervention at an EU level, secondly the detail of the proposed Recommendation.

The perceived need for intervention

The proposal for a Recommendation is based on the observations of the High Level Group of Company Law Experts and the subsequent Company Law Action Plan. Much of the detail relied on is unassailable per se. But the resulting proposals for action, as with other proposed interventions in the field of corporate governance, are characterised by approaching the issues from the premise that detailed intervention at EU level is necessary.

Corporate governance is characterised by a tendency for money to pursue best practice, so long as the fundamentals for the effective exercise of ownership rights are in place. There are no structural impediments to any country adopting good practices, usually only political inertia or expediency. To that extent it is a self-regulating system, and one which requires little extra-national intervention. Rather than introduce detailed measures on various aspects of governance, what are required are
strong underlying measures to facilitate effective exercise of ownership rights across all Member States thus enabling free movement of capital (one of the four freedoms at the heart of the Internal Market), and these are what effort should be concentrated upon. If such are in place, the market will be enabled to work effectively and capital will have the ability, if it wishes, to move to those locations which have strong corporate governance, thus putting pressure on both nations and companies to adopt best practice. The IoD therefore does not believe that the proposed Recommendation is necessary to achieve the aims of the Internal Market.

The detail of the proposed Recommendation

In general we consider that the proposed Recommendation would be too detailed, and leave little scope for national approaches to governance to develop. Some of the areas in which a high level of prescription is proposed are areas where there are still ongoing debates about the appropriate basis even in countries with sophisticated governance regimes.

We would advocate that in framing any Recommendation, the Commission has regard to the level of detail addressed in the Principles and Supporting Principles contained in the United Kingdom’s “Combined Code on Corporate Governance” published in July 2003, and does not seek to go into greater detail.

The IoD’s comments set out below should be read in the light of these general observations.

1. ORIENTATIONS FOR THE COMMISSION’S RECOMMENDATIONS: THE FORM

1.1 Legal basis

We have no comment.

1.2 Addressees

We agree that any Recommendation should be addressed to member States, not directly to companies. This will allow of the greatest possible flexibility.

1.3 The Comply or Explain Approach

We are familiar with, and advocate, the ‘comply or explain’ approach. We would not wish to move away from it, and it is also believed by many experts to have advantages over a regulatory compliance approach. Therefore, to identify it as a so-called ‘minimum standard’ is not appropriate. It would more appropriate to state that the national approach could either be that of regulatory compliance or ‘comply or explain’. This would have less of a pejorative connotation, and be more in line with international thinking on the ways in which best practice in governance is developed.
1.4 **Implementation and follow-up**

Although there is comparatively little that the UK would have to do to implement the proposed Recommendation, the proposed time-frame is too short. For Member States where significant levels of revision to regulation or code would be required, this would leave little time for national debate and consultation if the Recommendation is adopted in September 2004. Each of the dates should be extended by one year.

2.1 **Scope**

We agree that Member States should be invited to adopt measures applicable to listed companies (as defined). We do not consider that the proposed Recommendation should make reference to any other category of company, but there should be no provision that prevents individual Member States applying all or some of the measures to other companies.

2.2 **The need for some board committees**

We believe that the proposed Recommendation errs on the side of a too detailed approach.

2.2.2 **Composition of the whole (supervisory) board**

The intention not to include a precise statement about numbers or ratio of non-executive directors (whether independent or not) is welcomed, and should be maintained. However, the proposed general statement needs to be re-written to make it comprehensible.

2.2.3 **Chairman – CEO**

We have no problem with the proposal that there should be no statement in the Recommendation that the separation of roles is best practice. The approach here of not attempting to create artificial consensus where there is none should be adopted throughout the proposed Recommendation.

2.2.4 **Nomination, Remuneration and Audit Committees**

Care must be taken that too prescriptive an approach to board and committee structures is not included in the Recommendation. The key is to enshrine the role of the non-executive directors in these areas, not to prescribe a particular structure.

2.2.5 **Role of the committees towards the (supervisory) board**

It is the IoD’s view that, particularly if the committee structure does become enshrined in a Recommendation, the power to delegate to a properly constituted committee is made absolutely clear.
2.2.6 *Flexibility in setting up the committees*

We agree with maximum flexibility of structure. See also the comments on 2.2.4.

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

Best practice dictates that all directors, executive and non-executive, should be subject to re-election, but we would not advocate this being included in the Recommendation, preferring the market to determine where best practice lies.

2.3.1 *Qualifications*

The level of detail proposed is excessive. The proposed Recommendation should state the principles behind the issues, but leave national systems to determine the appropriate detail for their system, including qualifications for particular roles.

2.3.2 *Commitment*

We agree that the proposed Recommendation should contain a general statement on the need for directors to have enough time to devote to their duties. It should go no further. The level of disclosure both on appointment and on an ongoing basis should be left to national systems.

2.3.3 *Independence*

The list should be eliminated. Firstly, the concept is contrary to the first paragraph of this section which, with admirable clarity, sets out why a list is inappropriate. Secondly, the general statement contained in the third paragraph, combined with a statement along the lines of the paragraphs following the list, should suffice to enable national systems to develop appropriate criteria if they deem this necessary. Independence of mind is of greater importance than ticking all the right boxes on a list. Also, the variety of board structures throughout the EU militates against an appropriate all-purpose list being developed, and indeed against the structure of boards moving in the direction of true independence in all regimes, particularly where there are enshrined board roles for various representatives or interest groups.

2.4 *The board committees: common features*

Yet again the proposal contains excessive detail both in the listing of the features for a committee and in the detail contained within each of those features.
2.5 The Nomination Committee

This section goes into excessive detail about the individual committee. Our
detailed comments are:

2.5.1 Composition

While recognising the provenance of the two possible recommended
structures, the fact that two such diametrically opposite models can be
considered as the basis for a single recommendation demonstrates why it is
unnecessary to make any recommendation at all.

2.5.2 Role

The need to cater for very different national models which do not fit within the
proposed Recommendation, but which it would be unacceptable to outlaw, is
yet another example of why the Recommendation should be drawn in the
broadest possible terms and not go into detail. The requirement for the role of
the nomination committee should be limited to ensuring that there is a formal,
objective and transparent process and that appointments have regard to the
need for the necessary balance of skills and experience on the board.

2.5.3 Operation

While the content of this statement is unexceptionable, its place is not in a
high-level Recommendation, but should be within the competence of Member
States.

2.5.4 Transparency

See our comment on the Role of the committee above. If the appropriate high-
level approach to that provision is adopted, this provision is otiose.

2.6 The Remuneration Committee

The comments on the nomination committee apply *mutatis mutandis* here.

2.7 The Audit Committee

The comments on the nomination committee apply *mutatis mutandis* here.