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Dear Seamus

Review of the Higgs Guidance: Second stage of consultation

ICAEW welcomes the opportunity to comment on the consultation paper *Review of the Higgs Guidance: improving board effectiveness* published by The Institute of Chartered Secretaries and Administrators (ICSA) in July 2010.

ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council (FRC). As a world leading professional accountancy body, we provide leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

ICAEW has participated in consultations regarding the Combined Code/UK Corporate Governance Code (the Code) and plays an active role in the development of corporate governance in the UK and internationally.

This response has been drafted after consultation with ICAEW's Corporate Governance Committee which includes representatives from the business and investment communities. We have also received input from our Special Interest Group representing non-executive directors (NEDs) in particular in respect of those areas which would impact NEDs most directly. We have highlighted some general observations below in response to the consultation questions.

GENERAL OBSERVATIONS ON DRAFT GUIDANCE

- The revised guidance is commendable for its sheer common sense. We particularly welcome the sections on the importance of the chairman, and of each individual director taking responsibility for ensuring his/her own suitability for the role and their individual responsibilities in terms of induction. We support the approach taken for short, non-prescriptive guidance to help boards understand and implement the Code. In particular we support the approach taken in

the revised guidance to cover the structure, mechanics and processes which lead to effective decision-making.

- We support the view that ultimately it is for each board to devise governance arrangements, based on the Code and the revised guidance, suited to each individual company and their business model. We welcome the emphasis in the preface that the guidance is not intended to be comprehensive but that it aims to focus on key issues concerning practical implementation of the principles in the Code. We especially support and welcome the sentiment that the guidance emphasises good governance practice as a business enabler delivering the outcomes of transparency, accountability, probity and focus on the sustainable success of the company over the longer term.
- Accountability for governance throughout the guidance is not as clearly delineated as it could be. Para 2.1 states that the board is the cornerstone of the company's governance framework. Para 2.5 maintains that boards should maintain robust governance arrangements to ensure that they always act in a way that will generate sustainable value for the company. Yet the paragraph goes on to say it is the company secretary who should ensure that governance systems remain fit for purpose at all times. How do these pieces of guidance work and interact? Is there a case for looking at the terms 'framework', 'systems', 'arrangements' all of which are used interchangeably in describing governance throughout the body of the guidance to ensure consistency and clarity of intention? The board, led by the chairman, should have ultimate responsibility for the governance framework of the company.
- Section 5 is very comprehensive and the examples provided are clear and relevant. We wonder whether in this section it would be helpful to include examples of situations where executive directors are subjected to more 'stress' than non-executive directors. For example in a takeover situation the objectives of directors may not be fully aligned due to personal contractual situations.
- Executive directors reporting to the CEO can be put under tension because of their individual duties as statutory directors and a reporting line to the CEO. Non-executive directors should be alive to this tension and it may be helpful to include a reference to this in paragraph 7.
- The additional extra steps that a board can take to ensure effective decision making contained in paragraph 9.4 are useful. In particular, the three stage process (concept; proposal for discussion; proposal for decision) for important board decisions could be given greater prominence in the guidance. The advantages of this approach are considerable and where used to best effect it allows NEDs to challenge in a positive way and support a rigorous decision making process. Intelligent influencing from the NEDs is more productive than adversarial challenge in our view and the consistent repetition of the need for NED challenge may be counter productive to good board process.

RESPONSES TO CONSULTATION QUESTIONS: ANY AREAS THAT HAVE NOT BEEN COVERED?

- It may be useful to consider whether there are any monitoring mechanisms available to chairmen to ensure the effective and smooth running of the board.
- The ability for non-executive directors or indeed executive directors to access the services of independent professional advisers at the company's expense where they judge it necessary to discharge their responsibilities as directors is not covered anywhere in the guidance. We feel that this is a missed opportunity and this important topic warrants some guidance.
- We agree with the content of paragraphs 2.4 and 6.1 which state that the chair's relationship with the CEO is a key dynamic and that the relationship should be clearly defined. It may be helpful to expand on this slightly to give some examples of how this might be defined in a practical way and what checks and balances may be put in place to ensure effectiveness of the board. It may be helpful to provide some further guidance on the respective roles of the chairman and the CEO.

- We feel that the inherent dangers of conflicts of interest could have been given greater prominence and could have warranted some consideration rather than simply replicating section 175 of the Companies Act 2006 in this regard. Although conflicts of interests get a brief mention in paragraph 9.4 a slightly expanded reference would be useful.
- The role of board committees as decision making bodies could have slightly more prominence in the guidance in their role as decision making bodies although we agree that it is the board that has ultimate responsibility for governance.
- Paragraph 4.2 lists out the key elements of the role of the chair. We are surprised that not one of the elements includes a reference to the overall governance framework of the company or the interaction with the company secretary on this key aspect of effectiveness.
- Paragraph 5.1 sets out the role of the senior independent director but makes no reference to a potential role in the selection of the external evaluator. Our concern is that if the decision on an external evaluator rests solely with the chairman there could be a potential for the appointment of a 'tame' evaluator. The guidance would be improved if it was clear that the decision on an external evaluator did not solely rest with one person.
- Paragraph 5.2 lists examples of situations where the senior independent director intervention may be called upon. While we acknowledge that this list is not exhaustive it may be worth considering including an example of a serious failure of corporate governance systems within the company being a trigger for greater senior independent director involvement.
- Paragraph 7.5 quite rightly includes the importance of non-executive directors' obtaining accurate, clear and comprehensive information to enable them to take part in an informed debate at board meetings. It would be helpful to include here where non-executive directors have recourse should such information not be forthcoming or falls short of the standard expected to enable challenge and informed debate. In addition, it would be useful to include additional wording as a separate sub paragraph in Section 6 'The role of executive directors' to ensure that executive directors clearly understand their individual and collective responsibilities for ensuring that all non-executive directors are provided with all necessary information to properly discharge their responsibilities.
- Appendix B is useful and we wonder if there would be merit in including further appendix containing references to all other sources of good governance guidance so that the guidance can direct users to all other available relevant guidance.

RESPONSES TO CONSULTATION QUESTIONS: ANY AREAS THAT ARE COVERED CONSIDERED SUPERFLUOUS OR IRRELEVANT AND COULD HAVE BEEN OMITTED?

We believe that all the areas covered are worthy of inclusion and do not think anything currently contained is superfluous or irrelevant.

RESPONSES TO CONSULTATION QUESTIONS: POINTS OF DRAFTING DETAIL

- In paragraph 2.4 we agree that the chair's relationship with the CEO is particularly critical to the successful functioning of the board. The draft goes on to say that this should be clearly defined: it would be helpful to articulate what is meant by 'clearly defined'.
- The terms 'governance framework', 'governance arrangements' and 'governance systems' are used interchangeably throughout the body of the guidance. At times this is confusing so it may be preferable to have consistency of definitions if they are meant to have the same meaning.
- Paragraph 2.6 deals with policies and processes and additional precautions to ensure that conditions are created to make high quality decisions. As these form part of the governance framework of a company we think that it would be better to refer to them under the governance framework sections. The final sentence of the paragraph refers to the board's committees as constituting an important part of the decision-making process. We think that this needs to be expanded to be clear about where delegated authority exists or not. Committees act in different

ways: some have delegated powers and others are advisory and it would be better to be clear about how they can act on decision making.

- Paragraph 4 is particularly clear and comprehensive: this is a much needed and valuable practical listing of a chair's role. However, it falls short of including a recommendation that this should be set out in writing as is done for the role of the senior independent director. We believe that it would be useful to be consistent here and include guidance that all roles should be set out in writing: this is consistent with best practice and is referred to in paragraph 6.1.
- Paragraph 6 does not include any reference to the provision of information in relation to executive directors: information flows to ensure good quality decision making have to come via executive directors as they are most intimately involved in the detail. We believe that it would be useful to mention in paragraph 6 that this aspect of information provision is the responsibility of the executive directors. By paragraph 8.1 the responsibility for this is placed on the shoulders of the company secretary. We agree that the company secretary can be a facilitator but the actual information in terms of accuracy, clearness and comprehensibility surely must be the responsibility of the executive directors?
- There is wording in paragraph 7.4 to the effect that non-executive directors have a responsibility to maintain confidence in the governance of the company. Is there a danger that this may be interpreted to mean that they should never challenge it? Surely one of the main objectives of non-executive directors is to critically appraise and constructively question the integrity of the company's governance framework? Non-executive directors have a responsibility to act in a manner which would maintain confidence of the governance of the company but not to maintain confidence in any governance framework which is found lacking.
- It would be helpful in paragraph 7.5 to articulate who is the point of contact for a non-executive director should accurate, clear and comprehensive information not be provided. The chairman is responsible for ensuring this according to the Code and management have the obligation to provide information.
- Paragraph 7.6 should not exclusively relate to non-executive directors. Executive directors should also supplement their knowledge with the views of stakeholders and shareholders: not all of them may get the same visibility of this as the CEO or Finance Director and so paragraph 7.6 should not be directed specifically to non-executive directors.
- In Paragraph 8.2 we believe that it would be helpful if this responsibility was to advise both the chairman and the CEO.
- We agree with the spirit of paragraph 8.3 but would point out that the company secretary can be no more independent than any other employee reporting to the CEO. Also why should this independence and impartiality be restricted to issues of 'process and the Code'? This does not seem logical and we believe the paragraph would be better having the words 'on issues of process and the Code' deleted.
- In paragraph 9.1 we believe that decision-making policies (an essential to good corporate governance) should be reviewed regularly to ensure that they remain always fit for purpose and not just subject to annual review. In practice changes need to be made as and when issues arise and so it would be better to have these subject to regular review: not simply an annual exercise.
- In paragraph 9.4 does any board ever intend to make a flawed decision? It may be better to open the paragraph with 'Flawed decisions can be made even if a company has good policies and processes in place.'
- In paragraph 13.3 you may wish to reconsider the wording 'For example, a board may wish to evaluate the board one year and its committees in the following year.' It is not clear if this is meant to refer only to external evaluation. The Code responsibility is that the board should state in the annual report how performance evaluations for the board and committees and individual directors have been conducted and we take that to be an annual commitment. Therefore it may be helpful to be clear in the guidance that the reference to an evaluation being done in alternate years refers to the external evaluation.

RESPONSES TO CONSULTATION QUESTIONS: VIEWS ON MATTERS REMOVED FROM ORIGINAL HIGGS GUIDANCE

- We understand the logic of removing the 'Summary of the Principal duties of the Remuneration Committee' and the 'Summary of the Principal duties of the Nomination Committee'. However, we feel that it is still important to reference the existing guidance and update it when necessary and to direct readers to the existing guidance on the relevant websites. We are sure users would find it useful for all this material to be updated, and refreshed on a regular basis, and to continue to be made available as Guidance Notes on ICSA or FRC websites.
- The pre-appointment due diligence checklist for new board members and the sources of information contained therein was a very useful source of information. It would be a pity if this was not maintained in some way somewhere on either the FRC or ICSA websites. We would support such material being updated and maintained on either FRC or ICSA websites and are of the view that it is essential that this valuable guidance is not lost.
- We agree with the removal of the sample letter of a non-executive director appointment. That is not to say that we disagree with the subject matter or the technical content but we believe that this issue is better covered elsewhere.
- The induction checklist and information on a best practice induction pack is useful information but we agree that the revised guidance is not the best place for this. Such a checklist is very useful but we agree that there are more suitable alternative locations for this information provided that there is always a reference to where such guidance can be located.
- We believe that there is a place for performance evaluation guidance but this needs to be more comprehensive than that contained in the existing Higgs guidance. For that reason we agree with its removal from the revised guidance but again would reiterate that this guidance does need to be available and referred to in the revised guidance.

Please contact me should you wish to discuss any of the points raised in this response.

Yours sincerely

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