

Chair and Non-Executive Director Guidelines

(search, selection and remuneration)

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First Flight Non-Executive Directors Ltd - www.NonExecutiveDirector.co.uk
ShareSoc (UK Individual Shareholders Society Ltd) - www.sharesoc.org

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Foreword

ShareSoc, in conjunction with First Flight Non-Executive Directors Ltd who have special expertise in this area, have developed these guidelines covering the search, selection and remuneration of Chairs and Non-Executive Directors.

Our goal is to encourage the raising of standards in the selection and performance of such Directors. It provides guidance for companies, and their shareholders, on how Non-Executive Directors and independent Chairmen should be appointed and remunerated and what should be expected of them.

The role of the Non Exec has evolved considerably since Cadbury in 1992 and the Higgs report in 2002 and is still evolving as regulators, shareholders and companies themselves seek to improve Corporate Governance.

The importance of having active and competent Non-Executive Directors (including Chairmen) cannot be over emphasised. They can make all the difference between the long term success or failure of a business and will help introduce a "culture of success".

ShareSoc Chairman Roger Lawson made these comments:

"Improving the standards and performance of Non-Executive Directors is surely one way to improve UK business performance. They were seen as the solution to many corporate ills when first introduced, but the results have been disappointing. Major problems have continued to arise where Non-Executive Directors either failed to understand what a company was doing, or failed to control the enthusiasm and risk taking of Executive Directors. Likewise they have failed to control excessive pay packages. Strengthening their role and their independence may help to solve some of those ills."

First Flight Managing Director Chris Spencer-Phillips, who helped to produce these guidelines, made these comments:

"Our guidelines are the first of their kind focusing solely on the search and selection of Chairs and Non Execs. Non Execs have such a crucial role to play in good Corporate Governance, best practice, effective Boards and good shareholder relations so appointing the right ones is vital. Good Governance helps companies work smarter but sadly we still see evidence of unprofessional and poorly performing Non Execs, many not having the skills a company requires, many who are not truly independent and many having too many roles preventing them from contributing effectively. Changes are happening but many companies are not using "best practice" in the way they source and appoint their Non Execs and it is hoped that these First Flight and ShareSoc guidelines will assist companies get the most from their Non Execs."

First Flight is a specialist Search firm providing Chair and Non-Executive Directors to strengthen Boards, provide outside objectivity and specific skills which a Board needs to operate effectively. First Flight has successfully completed over 150 Non Exec recruitment projects and it sponsors the Non-Executive Director of the year award at the Quoted Company Awards - www.NonExecutiveDirector.co.uk

ShareSoc represents and supports individuals who invest in the UK stock markets. Membership of ShareSoc is available from their web site and is open to everyone with an interest in stock market investment. ShareSoc provides a monthly newsletter, educational events, networking opportunities and general advice to members on stock market investment - www.sharesoc.org

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1. Executive Summary

- 1.1 Capitalism around the globe is being questioned because some major companies have been seen to be badly managed, with the Directors not doing their jobs competently. Much of the blame has been laid at the feet of the Non-Executive Directors for not controlling imprudent executives or not even fully understanding what companies were doing and why.
- 1.2 Corporate Governance lays down the framework under which company boards operate. It underpins the development of a company's strategy and the delivery of strong financial performance in an increasingly difficult environment of external scrutiny by regulators and the wider public.
- 1.3 Independent Non-Executive Directors (including Chairmen*) have a key part to play in the effective running of Boards. However if they are not truly independent, do not take the time to understand the business, or do not challenge executive management when appropriate, they will be ineffective. Similarly if they have too many roles in other organisations so they cannot commit sufficient time to their duties, they are going to fail their obligations to the companies of which they are a Director.
- 1.4 Listed** companies should comply with the Financial Reporting Council's UK Corporate Governance Code.
- 1.5 AIM companies are not covered by the Code (they are technically not Listed) however we believe both AIM and unquoted companies should be encouraged, where appropriate, to adopt the provisions in the Code.
- 1.6 If Companies ignore the UK Corporate Governance Code, as many do, they will continue to be part of these grim statistics: *"only 29% of UK companies declared their Non Execs met standards of independence"* and *"56% of companies do not feel confident of getting good performance from their Non Execs"****. As a result they are likely to end up on the front pages of newspapers for the wrong reasons like Enron, Northern Rock, Olympus, Barclays, News Corp and others.
- 1.7 We are not advocates of what we describe as the old fashioned "generic" Non-Executive Director. There are too many cases of the same Non-Executives being appointed to too many Boards with the result that in many instances they fail their companies.
- 1.8 We strongly believe in broadening the Non-Executive gene pool which produces more effective and committed Non-Executives who have sufficient time to be effective and really add value to their boards and bring a "culture of success".
- 1.9 Our key guidelines on how to improve the performance of Non-Executive Directors are given on the following page.

* This guide uses the terms 'Chairman' and 'Chairmen' because these are the phrases used by a majority of companies and by the Financial Reporting Council. The terms do not imply any gender bias.

** Listed. Companies that are listed on the main market of the London Stock Exchange (i.e. excluding those quoted on AIM).

*** Coutts Research – See "A Good Piece Of Advice - How You Can Use Non-Executives To Unlock Value In Your Business" published by Coutts & Co.

First Flight and ShareSoc's key guidelines:

1. The Financial Reporting Council's UK Corporate Governance Code applies specifically to Listed companies who should adhere to the Code;
2. AIM companies are not covered by the Code (they are technically not Listed) but we recommend that they and unquoted companies should adopt the provisions in the Code.
3. With regard to Non Execs, the Code states: "Except for small companies, at least half the Board, excluding the Chairman, should comprise Non-Executive Directors determined by the Board to be independent. A smaller company should have at least two independent Non-Executive Directors". Companies benefit from having Non-Executive Directors who are truly independent (other than those who represent major investors) and they should ensure that they have a sufficient number of high calibre Non Execs on their Board who comply fully with the independence criteria;
4. Non Execs should be approved by all members of the Board and by shareholders at the AGM and Chairmen and CEO should be discouraged from appointing their friends to their Boards;
5. Non-Executive Directors must have sufficient time free to fulfil their role (as per the Code); in our view, companies should not generally have Non-Executives on their Board who have more than 4-5 roles and should not generally consider appointing Non-Executives who have more than 3-4 other roles (other than those such as Charities where Board meetings are held quarterly);
6. All Non-Executives should be subject to an annual election by shareholders at the AGM and should not remain on the Board for more than nine years as per the Corporate Governance Code but we recommend that each NED should be subject to a thorough review of their performance and contribution after three years and the company should then choose whether or not to extend their appointment;
7. Nomination Committees should look at the overall Board composition and when proposing new Non-Executive Directors they should ensure significant weight is given to relevant skills, whether they contribute to diversity, their intrinsic personal qualities and their underlying competencies. Proven prior career experience as a Board Director should not be the sole or prerequisite criteria so as to expand the pool of candidates; the objective should be to ask: "what skills does the Board require?" not "who do we want on the Board?";
8. As per the UK Corporate Governance Code all Quoted Companies should have effective Remuneration and Nomination Committees made up of a majority of independent Non Execs;
9. Transparency and accountability should underpin both the Remuneration and Nomination Committees which should both produce clear and concise annual reports, covering their recommendations which the shareholders should have an opportunity to approve;
10. We believe that Non-Executive Director fees should increase (although not in all cases) in return for greater professionalism, increased time commitment (fewer roles) and better understanding and more scrutiny of strategy and risk;
11. Companies should remunerate their Non Execs with a combination of fees, shares and share options appropriate to the size and nature of the company.

2. Introduction

- 2.1 There are four main Board tasks:
1. Policy formulation;
 2. Strategic thinking;
 3. Supervision of management;
 4. Ensuring accountability.
- 2.2 Non-Executive Directors are there to ensure that a Board fulfils its statutory duties to the company, the legislators, the regulators and the stakeholders including shareholders. They have a crucial role to play in Board performance; they bring complementary skills to those that exist within the Executives on the Board and they must fully understand the issues faced by the Company, provide outside objectivity, challenge the Executive and ensure healthy debate on key issues.
- 2.3 In the USA Non-Executives are called Independent or External Directors which is 100% what they should be. If they are not independent, they are likely to be ineffective. Sadly in the UK cronyism is still rife in the appointment of Non-Executives and according to recent research only 29% of UK companies declared their Non Execs met standards of independence; it is hard to see how a Non Exec can be truly effective if he or she is not independent and this probably accounts for the depressing statistics that: *"56% of UK companies don't feel confident of getting good performance from their Non Execs"* and *"33% of companies experienced poorly performing NEDs"* (Coutts research).
- 2.4 Perhaps this is not surprising considering these findings:
1. *"Networking (89%) and business referrals (88%) are the selection routes of choice for companies"* (Coutts);
 2. *"Most NEDs are appointed through personal contacts"* (from the Opus Executive Partners report entitled *"How's Mine Doing: A Review of Boards, Performance and Risk in the Mining Sector 2011"*);
 3. *"Only 4% of NEDs are interviewed formally"* (Opus report mentioned above);
- This is of major concern; many companies are clearly not adhering to the provisions set out in the UK Corporate Governance Code for the appointment of Non Execs. As a result, a large number are not performing well. Shareholders should be playing a greater role in ensuring that the right Non Execs are being appointed to their companies.
- 2.5 Cass Business School's 2011 "Roads to Ruin" report on 20 major corporate failures found common themes in these failures including in all cases that there were: *"Limitations on Board skills and competence and on the ability of the Non Execs to exercise influence or control"*.
- 2.6 There are four main reasons for poorly performing Non Execs in the UK:
1. Many are appointed without going through a proper interview process, very often because they are well known to the Chairman or CEO;
 2. Many do not comply with the "truly independent" criteria;
 3. Many are clones and "more of the same" resulting in Boards with a distinct lack of diversity on them;
 4. Many Non Execs have too many roles to be effective.
- 2.7 Many UK Companies can improve their Corporate Governance with a more rigorous and professional approach to the search and selection of Non-Executives which will stand them in good stead.

3. The UK Corporate Governance Code

- 3.1 The UK Corporate Governance Code, which was updated in September 2012, has a number of provisions to encourage companies to facilitate effective, entrepreneurial and prudent management that can deliver the long term success of the company. The first version of the Code was produced in 1992 by the Cadbury Committee; its paragraph 2.5 is still the classic definition of good Corporate Governance:

“Boards of Directors are responsible for the Governance of their Companies. The shareholders’ role in Governance is to appoint the Directors and Auditors and to satisfy themselves that an appropriate Governance structure is in place. The responsibilities of the Board include setting the Company’s strategic aims, providing the leadership to put them into effect, supervising the Management of the business and reporting to shareholders on their stewardship. The Board’s actions are subject to laws, regulations and the shareholders in general meeting.”

- 3.2 The Code is a guide to a number of key components of effective Board practice. It is based on the underlying principles of all good Corporate Governance: accountability, transparency, probity and focus on the sustainable success of an entity over the longer term.
- 3.3 The Code applies specifically to Listed companies and not AIM companies (which technically are not Listed) however we believe both AIM and unquoted companies should be encouraged, where appropriate, to adopt the provisions in the Code.
- 3.4 Externally managed investment companies typically have a different board structure which may affect the relevance of particular provisions; the Association of Investment Companies’ Corporate Governance Code and Guide can assist them in meeting their obligations under the Code.
- 3.5 The main principles of the UK Corporate Governance Code include (using the Code’s numbering):

Section A: Leadership:

1. *Every Company should be headed by an effective Board which is collectively responsible for the long-term success of the Company.*
2. *As part of their role as members of a unitary Board, Non-Executive Directors should constructively challenge and help develop proposals on strategy.*
3. *(A.3.1) The Chairman of the company should meet the independence Criteria on appointment.*

Section B: Effectiveness:

1. *The Board and its Committees should have the appropriate balance of skills, experience, independence and knowledge of the Company to enable them to discharge their respective duties and responsibilities effectively.*
2. *All Directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively.*
3. *The Board should undertake a formal and rigorous annual evaluation of its own performance and that of its Committees and individual Directors.*
4. *All Directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.*
5. ***Except for small companies, at least half the Board, excluding the Chairman, should comprise Non-Executive Directors determined by the Board to be independent. A smaller company should have a least two independent Non-Executive Directors.***

Section B.2: Appointments to the Board:

1. *There should be a formal, rigorous and transparent procedure for the appointment of new Directors (including Non Execs) to the board.*
2. *There should be a Nomination Committee which should lead the process for Board appointments and make recommendations to the Board. A majority of members of the Nomination Committee should be independent Non-Executive Directors.*
3. *A separate section of the annual report should describe the work of the Nomination Committee, including the process it has used in relation to Board appointments. This section should include a description of the board's policy on diversity, including gender, any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives. An explanation should be given if neither an external search consultancy nor open advertising has been used in the appointment of a Chairman or a Non-Executive Director. Where an external search consultancy has been used, it should be identified in the annual report and a statement made as to whether it has any other connection with the company.*

Section E: Relations with shareholders:

1. *The Chairman should ensure that the views of shareholders are communicated to the Board as a whole. The Chairman should discuss Governance and strategy with major shareholders. Non Execs should be offered the opportunity to attend scheduled meetings with major shareholders.*
2. *The Board should state in the Annual Report the steps they have taken to ensure that the members of the Board, and in particular the Non-Executive Directors, develop an understanding of the views of major shareholders about the company, for example through face-to-face contact, analysts or brokers briefings and surveys of shareholder opinion.*

3.6 Our comments on the above are:

Re B.1 above; there are numerous examples of Boards not having the necessary skills they require to operate effectively.

Re B.2; many Non Execs have too many roles (10% have 10 or more) to contribute effectively.

Re B.3; many Boards do not carry out "formal and rigorous" Board Evaluations.

Re B.4; many Directors are not being submitted for re-election and the shareholders are paying little attention to whether or not they have performed.

Re B.5; many Non Execs do not comply with the Code's independence criteria.

Re B.2.1; many Non Execs are still being appointed through personal contacts.

Re B.2.3; Nomination Committees have a crucial part to play in succession planning but not all companies have Nomination Committees and many Nomination Committees do very little and get by-passed by forceful Chairmen.

Re E.1; many companies could and should improve their communication with shareholders.

- 3.7 The UK Corporate Governance Code is a "comply or explain" approach which claims to be strongly supported by both companies and shareholders. However evidence and research indicates that bearing in mind the five principles listed above under "Effectiveness", a number of companies have failed to comply and some have been reviewed by Cass Business School's report which covered the failures at Enron, Northern Rock, AIG, BP and RBS etc and more recently at Olympus, News Corp and Barclays.

- 3.8 Non-Executive Directors have responsibilities in the following areas:
- **Strategy:** Non Execs should constructively challenge and contribute to the development of strategy.
 - **Performance:** Non Execs should scrutinise the performance of management in meeting agreed goals and objectives and monitoring.
 - **Risk:** Non Execs should satisfy themselves that financial information is accurate and that financial controls and systems of risk management are robust and defensible.
 - **People:** Non Execs are responsible for determining appropriate levels of remuneration of executive directors and have a prime role in appointing, and where necessary removing, senior management and in succession planning.
- 3.9 Non-Executive Directors are the custodians of the governance process. They should not be involved in the day-to-day running of the business but they should monitor the executive activity and contribute to the development of strategy.
- 3.10 Shareholders should be more demanding of their companies to ensure their basic adherence to the UK Corporate Governance Code and best practise.

First Flight/ShareSoc guidelines regarding the UK Corporate Governance Code:

1. The Financial Reporting Council's UK Corporate Governance Code applies specifically to Listed companies who should adhere to the provisions in the Code;
2. AIM companies are not covered by the Code (they are technically not Listed), however we believe both AIM and unquoted companies should be encouraged where appropriate, to adopt the provisions in the Code;
3. With regard to Non Execs, the Code states: "Except for small companies, at least half the Board, excluding the Chairman, should comprise Non-Executive Directors determined by the Board to be independent. A smaller company should have at least two independent Non-Executive Directors". Companies benefit from having Non-Executive Directors who are truly independent (other than those who represent major investors) and they should ensure that they have a sufficient number of high calibre Non Execs on their Board who comply fully with the independence criteria.

Note regarding AIM companies: Although the UK Corporate Governance Code does not technically apply to AIM companies, we suggest that they should adhere to the obligations of the Code unless there are very good reasons to do otherwise. It is particularly important in AIM companies, who are often dominated by shareholder insiders, that there are adequate numbers of independent Non-Executive Directors. According to a recent survey of AIM companies undertaken by First Flight, the longest serving Non-Executives in AIM companies frequently serve more than 9 years and hence do not fulfil the "independence" criteria.

4. Nomination Committees

- 4.1 Quoted companies should have a Nomination Committee to evaluate and propose the appointments of Directors including Non-Executives to the Board and to the shareholders at the AGM.
- 4.2 A majority of members of the Nomination Committee should be independent Non-Executive Directors.
- 4.3 The Nomination Committee should be independent of the company's Board of Directors and candidates for election to the Board including Non-Executives should be proposed by the Nomination Committee to the shareholders at the AGM.
- 4.4 The Chairman, being responsible for leadership of the Board, can Chair the Nomination Committee. The CEO should have input into the Board appointment process, but should not be a formal member of the Nomination Committee.
- 4.5 In our view there is insufficient engagement between companies (Boards/Nomination Committees) and investors on:
- Board appointments
 - Succession planning
 - Board evaluation
- 4.6 Nomination Committees are the guardians of board composition and as such should:
- With much greater rigour than at present, regularly review the structure, size and composition (including the skills, knowledge, experience and diversity) of the Board and make recommendations to the Board with regard to any changes;
 - Give full consideration to succession planning for Directors and other senior Executives in the course of its work, taking into account the challenges and opportunities facing the company, and the skills and expertise needed on the Board in the future;
 - Keep under review the leadership needs of the organisation, both Executive and Non-Executive, with a view to ensuring the continued ability of the organisation to compete effectively in the marketplace;
 - Keep up to date and fully informed about strategic issues and commercial changes affecting the company and the market in which it operates;
 - Be responsible for identifying and nominating for the approval of the Board, candidates to fill board vacancies as and when they arise.
- 4.7 In our view Nomination Committees generally have insufficient oversight of succession planning and evaluation below the Board level – this responsibility generally lies with the CEO, divisional heads or HR at present.
- 4.8 Nomination Committees do not always approach Board appointments in a 'professional' or 'scientific' manner and are unduly influenced by either deep rooted 'traditions' or fashionable causes. As such, Nomination Committees should take professional advice when determining the role and capabilities required for a particular appointment.
- 4.9 The Nomination Committee should actively seek to represent the views of shareholders in general, and should ensure that its recommendations are endorsed by the largest shareholders and not just the Board of Directors.
- 4.10 Having the Nomination Committee composed of shareholder representatives as is done in some Scandinavian countries is something we would like to see the FRC consider in future to include in their Code.

- 4.11 Provision B.2.4 of the UK Corporate Governance Code states: *“A separate section of the annual report should describe the work of the nomination committee, including the process it has used in relation to board appointments. This section should include a description of the board’s policy on diversity, including gender, any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives. An explanation should be given if neither an external search consultancy nor open advertising has been used in the appointment of a Chairman or a Non-Executive Director. Where an external search consultancy has been used, it should be identified in the annual report and a statement made as to whether it has any other connection with the company”*.
- 4.12 The Corporate Governance Code provision B.2.2. states: *“The Nomination Committee should evaluate the balance of skills, experience, independence and knowledge on the Board”*;
- 4.13 There is evidence that Boards often fail to define the criteria for the role of their Non Execs because they focus on “who they want on their Board”, not what skills they require.
- 4.14 The appointment process of Non-Executives on UK Boards has been criticised as a flawed process. Evidence indicates that many Company’s Nomination Committees are fairly ineffective, widely accepted as the weakest Committee and that the Chairman, CEO and sometimes the Board itself make the decisions on new appointments rather than the Nomination Committee and that many fail to carry out a formal and professional assessment of potential Non Execs: according to Opus: *“only 4% of NEDs are interviewed formally”* - this is of major concern and urgently needs to be addressed in order to raise the quality of Non Execs.
- 4.15 Surprisingly not all UK quoted companies have Nomination Committees and when they do they frequently approve the appointment of Non-Executives who do not comply with the UK Corporate Governance Code’s “independence” criteria due to the domination of the selection process by the “old boy network” .
- 4.16 The Nomination Committee should post onto the Company’s web site the candidates they are nominating for election or re-election with the following information:
- The name, age, education, work experience and core skills of the candidates (assessed according to the FSA’s 6 core competencies – see under Diversity);
 - Any work they have performed for the company and/or any professional or business connections they have with the company;
 - Any holdings of shares owned by the candidate or his/her legal vehicles;
 - Where the company sourced the candidate from and how many candidates have been interviewed for the role;
 - How many other roles the potential candidates have;
 - Whether the candidate complies 100% with the UK Corporate Governance Code “independence” criteria and whether the candidate knows personally or professionally any of the Directors including the Chairman and to what extent;
 - In the case of re-election, the year the Non-Executive was first elected.

First Flight/ShareSoc recommendations regarding Nomination Committees:

1. As per the Code all quoted companies should have a Nomination Committee to lead the process for Board appointments;
2. A majority of the Nomination Committee should be made up of independent Non-Executive Directors;
3. When Companies require Non Execs the Nomination Committee should look at the overall Board composition and ensure significant weight is given to relevant skills, diversity and intrinsic personal qualities and underlying competencies, not just proven prior career experience; the objective should be to ask: "what skills does the Board require?" not "who do we want on the Board?";
4. Companies and their Nomination Committees should make the appointment process for Non Execs more transparent and show evidence of using an external Search firm or advertising of the role, creating proper short lists of candidates who will have been formally interviewed;
5. Potential Non Execs should be formally proposed by the Nomination Committee at the company's AGM (not announced as having already been appointed) and the Annual report should state how they have been sourced, what skills and competencies they bring to the Board and how many other roles they hold;
6. Once a new Non Exec is appointed, the Chairman and Nomination Committee must ensure that they are provided with a formal and comprehensive induction; this should include an introduction to all key managers, visiting company sites, customers, suppliers and shareholders and access to any business plans, Board Evaluations, previous Board papers etc. Non-Executive Directors should attend a Training Course if they have not done so;
7. All Non-Executives should be subject to an annual election by shareholders at the AGM and should not remain on the Board for more than nine years as per the Corporate Governance Code but we recommend that each NED should be subject to a thorough review of their performance and contribution after three years and the company should then choose whether or not to extend their appointment.

5. Independence of Non-Executive Directors

5.1 The Higgs Report in 2003 made the following comment:

“Although Non-Executive Directors need to establish close relationships with Executives and be well informed, all Non Execs need to be independent of mind and willing and able to challenge, question and speak up. All Non Execs need to be independent in this sense.”

This is as relevant today as it was in 2003.

5.2 The Higgs report identified other personal characteristics for Non Execs which are linked to an independence of mind:

- Integrity and high ethical standards.
- Sound judgement.
- An ability and willingness to challenge and probe. Within the “collegiate” environment of a unitary Board, Non Execs must have the strength of character to obtain full and satisfactory answers to their questions.
- Strong interpersonal skills. The effectiveness of a Non-Executive Director depends on exercising influence whilst not giving orders. To exercise influence, a NED must have the trust of his or her colleagues.

5.3 The independence of a Non Exec should be agreed by the rest of the Board. If the Non Exec is being proposed because he or she is a friend of the Chairman or CEO then they do not satisfy the independence criteria and it is hard to see how such a Non Exec can be truly effective.

5.4 The Board is required by the UK Corporate Governance Code to identify in each annual report, the Non Execs that it has identified as independent and do not meet any of the following criteria:

- a. Have been an employee of the company in the last 5 years.
- b. Have had a material business interest in the company for the last 3 years.
- c. Receive income or remuneration other than Director fees.
- d. Participate in the company’s share option/performance related remuneration or pension scheme.
- e. Have close family ties with company advisers, Directors or senior employees.
- f. Have conflicting cross directorships or have significant links with other Directors of the Company through involvement in other Companies or bodies.
- g. Represent significant shareholders.
- h. Has served as a Non-Executive Director for more than 9 years with the company (on the basis that a Non Exec’s independence will erode over time).

We would like to see the word “family” removed from e. above as past friendships or business associations also prejudice independence.

5.5 The following research confirms that “cronyism” is still fairly widespread in Corporate UK which explains why so few Non Execs pass the “independence” criteria:

- Coutts research found that: *“Networking (89%) and business referrals (88%) are the selection routes of choice for companies when appointing Non Execs”.*
- And Opus research states that: *“Most NEDs are appointed through personal contacts”.*
- Opus research finds: *“Shockingly [their words] only 29% of companies declared their Non Execs met standards of independence”.*

5.6 Independent Non-Executive Directors are the cornerstone of effective Boards but with only 29% of Boards able to declare their Non-Executive Directors as being independent, this indicates a fundamental problem.

- 5.7 The UK Corporate Governance Code has as Provision B.2.4: *“An explanation should be given if neither an external search company nor open advertising has been used in the appointment of a Chairman or Non Exec.”* This does not go far enough in our view, to discourage companies from appointing Non-Executive Directors who are not independent.
- 5.8 The US has recently passed legislation (the Dodd-Frank law) which amongst other things is intended to ensure that their Non Execs have to be truly independent of the Chief Executive and Chairman making it “more difficult for Chief Execs and Chairmen to create a Board of Directors from their Country Clubs”.
- 5.9 Most smaller or AIM companies cannot justify the £45-50k minimum that major London Search firms charge for a Non-Executive project. But specialist search firms such as First Flight can provide effective Non Execs for much less.
- 5.10 Ineffective Non-Executive Directors result in ineffective Boards which can be enormously expensive and sadly we see too many examples of this.

Investment Trusts: individuals who are linked in any way to the fund manager of an investment trust should not be on the Board of the trust. Neither should an individual serve on more than one company Board with a common fund manager. City of London Investment Group give further recommendations in their Corporate Governance Guide on the issues at such companies which are well worth following – see www.citlon.co.uk/reg_reports/Corp_Governance.pdf

First Flight/ShareSoc’s recommendations regarding the independence of Non Execs are:

1. The Code states: “Except for small companies, at least half the Board, excluding the Chairman, should comprise Non-Executive Directors determined by the Board to be independent. A smaller company should have a least two independent Non-Executive Directors”. Companies benefit from having Non-Executive Directors who are truly independent (other than those who represent major investors) and they should ensure that the Non Execs on their Board comply fully with independence criteria;
2. The independence of a Non Exec should be agreed by the rest of the Board. If the Non Exec is being proposed because he or she is a friend of the Chairman or CEO then they do not satisfy the independence criteria and it is hard to see how such a Non Exec can be truly effective.

6. Non-Executive Directors – how many roles?

- 6.1 Being a Non-Executive Director is a proper job with fiduciary duties. It is no longer an optional extra to fit in when you can. A rule of thumb is that it now takes 1 ½ days a week to carry out these duties in a public company. This horrifies some Non Execs who feel they can read the Board papers on their way to a Board meeting and the idea that they should do homework and other duties is unacceptable – in that case they should not be on the Board and the companies who are thinking of appointing them should think again. This may seem harsh but the law states that once you have signed the statutory forms to register as a Director you are on duty 24 hours a day, seven days a week. You are not a Director just when you enter the Boardroom;
- 6.2 The financial crisis and the “shareholder spring” have highlighted the need for companies to have more effective Non Execs who will spend more time on their responsibilities. It is now a much more demanding brief in areas such as risk, finance and technology, so the days of the gifted amateur Non Exec should be behind us;
- 6.3 KPMG say they see a noticeable fall-off of performance on the 3rd and subsequent role for Non Execs. However we are still seeing some Non Execs with too many roles – 10% of Non Execs in the UK have 10 roles or more making it nigh on impossible for them to contribute effectively to the Boards on which they sit. The recent resignation of Non Exec Alison Carnwath from the Barclays Board is an example; she said she was resigning because she didn’t have sufficient time as she has 8 top line Non-Executive roles; this is a good enough reason to resign but more importantly begs the question why she took on so many roles in the first place and why some companies took her on knowing she had so many other commitments? It is time for companies, their Search firms and the Non Execs themselves to realise that 4-5 Non Exec roles in major companies is now the maximum they can handle;
- 6.4 The Walker report recommended that Non-Executive Directors should not have more than five roles and First Flight does not put forward Non Execs who have more than 4 roles; however some companies seem to be attracted to Non Execs who have multiple roles on the basis that they “must be good” even though such Non Execs are unlikely to have sufficient time to be well enough informed and effective. It should be the responsibility of both the Chairman and Company Secretary to monitor not only the performance but the attendance of Non-Executive Directors at Board Meetings;
- 6.5 Baroness Howe recently said: *“I would limit the number of Non-Executive positions that can be held by any individual at one time. If there’s a crisis you need to drop everything and focus on sorting out the situation. But you can’t do this if you owe multiple boards your time.”* We strongly endorse Baroness Howe’s comment.

First Flight/ShareSoc guidelines regarding the number of roles a Non Exec should have:

1. Non-Executive Directors must have sufficient free time to fulfil their role effectively (as per the Code); in our view, companies should not generally have Non-Executives on their Board who have more than 4-5 roles and their Nomination Committees should not generally consider Non Execs who have more than 3-4 other roles (other than those such as Charities where Board meetings are held 1/4ly);
2. Companies should monitor how many other roles their Non Execs have and should not allow them to have more than 4-5 roles.

7. Board Diversity

- 7.1 Cranfield University's School of Management 2012 report on Gender Diversity on Boards key finding is: *"The Board appointment process remains opaque and subjective, and typically driven by a corporate elite of predominantly male Chairmen who tend to favour those with similar characteristics to themselves"*. They also criticised Boards (and their Search firms) with regard to the way Non Execs are appointed, for frequently starting with the question: *"who do we want as a Non Exec rather than what do we need?"*
- 7.2 The UK Corporate Governance Code (Supporting Principle B.2) states: *"The Search for Board candidates should be conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the Board, including gender"*;
- 7.3 The Higgs Review and Tyson Report in 2003 both called for more diversity in the talent pools from which Non Execs are recruited, acknowledging that the majority of Non Exec appointments are made informally through personal contacts. The 2003 Corporate Governance Code made clear recommendations for a rigorous, fair and open appointment process, to promote meritocracy in the Boardroom and ultimately to raise the standard of Corporate Governance – in 2012 it is fair to say that, at best, progress is slow;
- 7.4 Looking at UK quoted company Boards it is not unreasonable to conclude that many Chairmen don't feel comfortable with diversity on their Boards. We often see the same names on multiple Boards and there seems to be a tendency to clone and ensure a lack of diversity which results in an inability to think and debate policy and strategy from different viewpoints. In other words, too many of the same types of people – similar in age, sex, ethnic, educational and social background, professional training and so on – the "male, pale and stale" syndrome reduces the ability of the Board to question the working assumptions and the sources and validity of information about the changing internal and external environments on which the Board is working;
- 7.5 The Davies report in 2011 which examined the business case for gender diversity and the obstacles faced by women in seeking to get onto Boards, has helped to increase the number of women on Boards in the UK but it is easy to conclude that the report embarrassed Companies to increase gender diversity rather than seeing them embrace it because it has been shown to improve company performance;
- 7.6 The Davies Report suggests there is a business case for having more gender balanced Boards stating: *"companies with more women on their Boards were found to outperform their rivals with a 42% higher return in sales, 66% higher return on invested capital and 53% higher return on equity"*;
- 7.7 The European Commission adds: *"Various studies suggest that companies with a higher share of women at top levels deliver strong organisational and financial performance,"* it states; *"studies have also shown that where Governance is weak, female Directors can exercise strong oversight and have a positive value-relevant impact on the Company. A gender-balanced Board is more likely to pay attention to managing and controlling risk"*;
- 7.8 Studies by McKinsey, the consultancy have found that the share price of companies with diverse management teams were 17% higher between 2005-2007 than industry averages, while their operating profits were almost double industry norms;

- 7.9 Boards (and the major Search firms) are slowly realising that the traditional old fashioned “generic” Non-Executives are not providing what company Boards require of them – what they have been getting is more of the same Non Execs with little or no diversity. There is a growing need to introduce a variety of types of Non Exec – diversity not just in gender but also in background, ethnicity, experience and most importantly, those who are truly independent and have outside objectivity. An example of the problem is that there are many capable women who could contribute well to a Board with their breadth of experience but as they haven’t had a traditional corporate career they get overlooked;
- 7.10 Fewer roles per Non Exec requires a broadening of the gene pool and the major Search firms are being forced to look at potential Non Exec candidates outside of their existing network – this is long overdue and will help professionalise the role of the Non Exec as well as create more diversity in the Boardroom;
- 7.11 First Flight sees many candidates who have potential as Non-Executive Directors and who have been to major Search Firms only to be told that: “we can’t put you forward for Non Exec roles if you haven’t been a Non Exec” – changes of attitude and approach are required and firms should stop asking: “who do we want on our Board?” and instead ask: “what skills do we need on our Board to complement the skills we already have and bring in the skills that we don’t have?”;
- 7.12 Non-Executives are an excellent way to add different skills, backgrounds and experience that a Board does not currently have;
- 7.13 BP, as assessed in the Cass report, is an example of a major company who suffered because of ineffective Non-Executive Directors. In 2005 at the time of the Texas City Refinery tragedy (followed by the Deepwater Horizon disaster) the BP Board was not a balanced one due to a dominant CEO (who was overly focused on cost cutting), Non Execs who had been in place for a decade so no longer independent and who lacked diversity not just in gender but in skills and experience and failed to challenge the CEO. Following the disaster the US regulator recommended that BP appoint a Non Exec with specific expertise in refinery operations and process safety since no one on the Board had any refining experience and no one on the Board had any safety experience – this was a major omission with disastrous consequences costing BP £40bn; if they got it so wrong other companies can and unfortunately do;
- 7.14 In 2003 Norway passed a compulsory quota law requiring a minimum of 40% of Board members to be of either sex on quoted company Boards; the law passed into action in 2006. Similarly in South Africa the Black Economic Empowerment Law requires 40% black ownership of South African private companies and consequently 40% black Directors on Boards. Two problems have emerged: firstly the pool of suitable talent dried up quickly and secondly the suitable people became overextended so creating another elite group. The result has been that many of these new elites in Norway and South Africa hold down ten and even 30 roles which is why we do not support a quota system;
- 7.15 We do not support the call for quotas but support the call for a more enlightened approach to appointing Non Execs and a move away from the “who do we want on the Board” to “what do we need?” - this approach opens the door for greater diversity and a more “skills based” approach. 75% of products and services are bought by women so why would you not want to have representatives of your customers on your Board?
- 7.16 Most major Search firms focus on potential Non Execs who have been Directors of FTSE companies so they swim in a very small pool. In addition to advocating a broader gene pool for Non Execs, we strongly advocate the representation of stakeholders on Boards. Mothercare is an example, with almost all of their customers’ women and yet they only have one woman Director on a Board of ten. Their mission statement is: *“to meet the needs and aspirations of parents for their children worldwide”* – one might ask: how they can achieve this when they are so under represented by their customers?

- 7.17 John Argenti's book *Corporate Collapse* demonstrated that if too many of the same sort of people – same age, sex, educational background, professional background, social background, etc – came together at the top of an organisation for any length of time, it was a danger signal of corporate collapse;
- 7.18 Many UK Plc Chairman clearly still feel more comfortable with their own kind on their Board, but a Board should be a dynamic and enlightened organism not a clubby once a month meeting. Historically there has been a tendency for Non Execs to be told to: "turn up and shut up" and "don't rock the boat" – however effective Non Execs are there to "rock the boat" not tip it over but certainly to rock it;
- 7.19 First Flight recommends Boards should have at least one, ideally two Directors with each of these four core skills:
- Strategic – *the big picture* looking to challenge and shape the future;
 - Operational – *the detail* looking to make sure actions and plans are consistent with the strategy and will deliver the required performance;
 - Drive – *the accelerator* and entrepreneurial abilities to drive the organisation forward and overcome obstacles;
 - Monitoring Risk – *the brake* and Governance to be able to identify risk areas and issues and stop the organisation doing the wrong things.

These four areas reflect four separate and independent dimensions of board dynamics which form two opposing pairs in terms of interaction: strategy-operations and drive-monitor and each of these core skills should be provided to the Board by its Directors. Boards that are well represented with each of these skills will be more effective;

- 7.20 Every Board also needs the right balance of types or categories of people to operate effectively and one of the simplest ways to categorise people was developed by David Kolb who categorised people in four ways: activist, pragmatist, theorist and reflector. True for business, and also true for learning how to ride a bike.
- The Activist – tests by trying (and failing, and hopefully learning).
 - The Pragmatist – tests implications: copies, improves.
 - The Theorist – forms abstract concepts. Natural planner.
 - The Reflector – observes and reflects and asks why/why not?
- 7.21 Another choice to evaluate character is psychometric testing which can be very useful in assessing Directors and a method called Personality Profile Analysis which is suited to Board discussions has been developed by Thomas International with DISC:
- Dominance; Influence; Steadiness; Compliance.
- 7.22 An alternative valuable assessment tool which can be deployed is EQ-i (Emotional Quotient Inventory). Boasting a 20 year track record of research and success, an EQ-i test is a psychometric profile which shows what somebody is like to live and work with. The test scores an individual in 5 key areas: Self Perception, Self Expression, Interpersonal, Decision Making and Stress Management. Essential prerequisites for an effective Non-Executive Director are independence of thought, an ability to communicate effectively and an ability to relate to the operating environment. An EQ-i test will identify very clearly whether or not a candidate has these attributes. An EQ-i test will also help to identify candidates whose personality and mindset is not appropriate for a Non-Executive Directorship role;
- 7.23 It is preferable if existing Board members are profiled as well as the incoming candidate and gaps identified and filled;

7.24 The FSA lists (CP/10/3) six core competencies that Boards should have as follows:

1. Strategic Management
2. Risk Management
3. Market Knowledge
4. Governance
5. Financial Management
6. Regulation

A balanced Board should have a mix of all these skills and all types of people (diversity) to enable healthy debate;

7.25 Additional characteristics of good Non Execs are: common sense, persistence, competence, independence of mind (as outlined above) but most importantly a Board needs a balance of different types of independent Non-Executive Directors to encourage different approaches to the key issues faced by the Board;

7.26 When appointing Non Execs they should be assessed not only for their suitability for the role in terms of skills and experience but also on the basis of subjective elements such as personality, values and chemistry;

7.27 With a Non Exec project, First Flight likes to understand the current balance of the Board in terms of skills, diversity and personalities to ensure that the addition of an incoming Non Exec will enable the Board to operate effectively and “the whole being greater than the sum of the parts”;

7.28 A Company’s HR department should have up-to-date CVs for each Director, a job description and an annual assessment for both Executive and Non-Executive Directors to enable the company’s annual evaluation to assess the Board overall and individually for its capabilities and identify any shortcomings;

7.29 It is clearly important for some Board Directors to have knowledge of the market sector in which the company operates although Non Execs should *“never be frightened of asking what might appear to be a dumb question”* as Sir Harry Solomon of Hillsdown Holdings said. Being close to a sector can sometimes prevent this.

First Flight/ShareSoc guidelines regarding diversity:

1. Companies should aim to have Boards with Directors from diverse backgrounds including gender and a variety of skills covering all aspects of the company’s activities and its stakeholders;
2. Boards should do regular evaluations on what core skills and competencies their company requires to operate effectively;
3. Boards should strive to achieve diversity of age, sex, ethnicity, educational and social background, skills, professional training and so on – to move away from the male, pale and stale syndrome;
4. Potential Non Execs should be assessed for “what skills they bring to the Boardroom” rather than “who they are”.

8. Board Evaluations

- 8.1 The UK Corporate Governance Code provision B.6 main principle recommends: *“The Board should undertake a formal and rigorous annual evaluation of its own performance and that of its Committees and individual Directors”.*
- 8.2 We recommend that companies carry out external Board evaluation which will provide a fresh perspective, clarity of purpose, more productive Board meetings (as does reducing the size of Board packs), more effective decision making, better personal relationships and appreciation of individual roles, leading to a more collaborative approach within the Board and with internal and external stakeholders. It should also provide better succession planning and clarity with on-going recruitment.
- 8.3 Supporting principle of the Code:
“The Chairman should act on the results of the performance evaluation by recognising the strengths and addressing the weaknesses of the Board and where appropriate proposing new member be appointed to the Board or seeking the resignation of Directors. Individual evaluation should aim to show whether each Director continues to contribute effectively and to demonstrate commitment to the role (including commitment of time for Board and committee meetings and any other duties).”
- 8.4 Code Provision B.6.1: *“The Board should state in the Annual report how performance evaluation of the Board, its Committees and its individual Directors has been conducted”.*
- 8.5 We recommend that the evaluation should be carried out externally by a specialist Board Evaluation firm and not carried out by an Auditor or a Search firm who will be conflicted and that it should include both a skills/competencies evaluation and a behavioural assessment.
- 8.6 An assessment should also be done on how well prepared each Non-Executive Director is, whether they have read the Board papers and whether they have the time to understand the business and contribute.

First Flight/ShareSoc guidelines on Board Evaluations:

1. Companies should carry out an annual Board evaluation – these should be externally carried out and not by a Search firm or their Auditor who are conflicted;
2. Major shareholders should be invited for their input and the evaluation should be included in the Annual Report with time allocated at the AGM to discuss its findings.

9. Remuneration of Chairs and Non Execs

9.1 Remuneration Committees

- 9.1.1 As per the UK Corporate Governance Code all Quoted Companies should have an effective Remuneration Committee made up of at least three, or in the case of smaller companies, two, independent Non-Executive Directors. In addition the company Chairman may also be a member of, but not Chair, the committee if he or she was considered independent on appointment as Chairman;
- 9.1.2 Remuneration Committees should ideally have representatives of the company's large or representative shareholders. We are strong advocates of shareholders having a "say on pay" (linked to performance) and that they be consulted and involved directly on the Remuneration Committee rather than wait for the AGM.
- 9.1.3 Transparency and accountability should underpin the Remuneration Committee which should produce a clear and concise annual report, covering their recommendations for both Directors and Non-Executive Directors which the shareholders should have an opportunity to approve;
- 9.1.4 Quoted companies should provide detailed and clear disclosures on the emoluments of all Directors covering remuneration, bonus payments, benefits in kind, pension contributions and share options;
- 9.1.5 Remuneration Committee Chairmen are often arbitrarily appointed and therefore may not be best qualified to "manage" remuneration issues which are not an easy task. Effective Remuneration Committee Chairmen require considerable expertise in areas such as: people skills, HR, financial, employment law, legal, tax, pension and options.

9.2 Non-Executive Director remuneration levels have not been increasing to any great extent, for a number of years, in sharp contrast to the remuneration of Executive Directors.

9.3 Director's pay has become a hot topic in the press with much criticism for excessive pay and excessive increases not justified or linked to performance. However Chairmen and Non Execs are in a different category and are perhaps leading by example by keeping their remuneration down. But we suggest that Non Execs might justifiably (although not in all cases) be paid more so as to reflect greater levels of professionalism, the increased time input required, the obligation to have fewer roles and the increased scrutiny by them of strategy and risk.

9.4 The level of pay of Non-Executive Directors should reflect:

- Company size and ownership.
- His/her track record, skills and ability.
- How much he/she is paid in their other roles in other companies.
- The role and contribution he/she is expected to make and the value this will add to the company.
- The time commitment.
- The amount that the Chairman and other Non Execs are paid.
- The amount Executive Directors are paid and how this compares on a per day basis.
- Shareholders views about what is acceptable.
- Market data for rates of pay for Non Execs in similar companies (benchmarking).

There is no simple formula in setting Non Exec fees.

9.5 Types of remuneration structure

The most usual practice for quoted companies is that the Non Exec is paid a fixed fee and in some cases some of the fee is paid in shares. The remuneration structure should reflect the time and nature of the role and are usually similar to those of the Chairman, i.e.:

- i. Paid only fees (monthly);
- ii. Paid a mixture of fees in cash and in shares;
- iii. Awarded a number of shares on appointment which vest at a rate of x% per year, plus an annual fee;
- iv. Awarded a number of options on appointment plus an annual fee;
- v. An annual fee, plus annual awards of options or LTIPs or other types of share awards.

9.5.1 Non Execs need to be seen as independent of the company and therefore receive fees, not a salary.

9.5.2 Pluralist Non Execs with several roles will often have set up a service company to which these fees are paid gross. If their fees are not paid to their service company other Non Execs should have their fees paid via the company payroll with National Insurance and tax deducted, but not as a salary.

9.5.3 Chairman and Non Execs will have a letter of appointment (First Flight can provide a template); research on Non Exec appointment lengths indicate 10% are for one year, 8% are for two years and 80% are for three years.

9.6 Non Execs are always entitled to resign immediately if he or she has a disagreement with the Board or feels there is a point of principle involved; in fact they should be encouraged to do so and they should require their reasons to be recorded in the Board minutes.

9.7 Companies should provide Directors and Officers Insurance (D & O) to Directors including Non Execs. For Non Execs this is one of the most important issues before taking on a role.

9.8 The UK Corporate Governance Code Guidance on Remuneration:

9.8.1 Code Provision D.1.3:

Levels of remuneration for Non-Executive Directors should reflect the time commitment and responsibilities of the role. Remuneration for Non-Executive Directors should not include share options or other performance-related elements. If, exceptionally, options are granted, shareholder approval should be sought in advance and any shares acquired by exercise of the options should be held until at least one year (after the Non-Executive Director leaves the board. Holding of share options could be relevant to the determination of a Non-Executive Director's independence (as set out in provision B.1.1)), as required for UK incorporated companies under the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008.

9.8.2 Remuneration Procedure Main Principle:

No Director should be involved in deciding his or her own remuneration.

9.8.3 Code Provision D.2.3:

The Board itself or, where required by the Articles of Association, the shareholders should determine the remuneration of the Non-Executive Directors within the limits set in the Articles of Association. Where permitted by the Articles, the Board may however delegate this responsibility to a committee, which might include the Chief Executive.

9.9 **Payment in shares and options:**

At the time of writing:

- Data from MM&K shows about 20% of UK quoted companies include options in Non Exec remuneration. Where options are awarded, they can be very significant.
- The survey also confirms that options in private and AIM listed companies are a key component of reward in many cases.
- 15% of Chairmen and 10% of Non Execs receive part of their fees in shares.
- The prevalence of share options in AIM-listed companies is high with around half of Non Execs benefitting.
- MM&K data also shows that 17% of companies are paying Non Execs in shares (as opposed to options), but when they do the amounts are typically quite substantial - about half of the total. Not surprisingly, option holding is more prevalent among Directors of smaller companies.

9.9.1 The UK Corporate Governance Code states that the remuneration for Non Execs should not include share options. The ABI and NAPF guidance are also against awarding options to Non Execs.

9.9.2 The Quoted Company Alliance (QCA) has produced useful guidance on fees for Non Execs stating:

- The result of increasing demands on Non-Executives may lead to higher fees. Payment either partly or fully in shares, held during the Director's term of office and for a significant period afterwards sends a good signal about the alignment of the Director's interests to those of shareholders.
- On the rare occasion Non-Executive Directors participate in performance related remuneration, investors should be consulted and their support obtained.

9.9.3 We support the position given in the QCA's Guidelines for Smaller Quoted Companies which states that a Non-Executive Director may not be independent if he/she has a "significant participation in the company's share option or performance-related-pay scheme". The key issue being the size of the options - as it is only when they become "significant" that they might lead to a Non Exec behaving in a way that may not be in the company's best long-term interests.

9.9.4 We feel that although the Code may be appropriate for large companies, more flexibility should be permitted for smaller companies; including many AIM companies particularly those in an early stage of development and share options could be made available in certain situations to, particularly, the Chairmen of smaller companies who may well spend two or more days per week on their responsibilities.

9.9.5 A certain number of companies are now making it clear that they would like their Non Execs to purchase a shareholding, but very few companies make this a condition. We recommend that Non-Executive Directors hold shares in the companies of which they are Directors, of a non trivial value. They should either have an obligation to purchase such shares or they should take part of their fees in share grants.

9.9.6 Fewer than 10% of Non Execs have share options but we believe that they should be made available to help smaller, start-up and fast growth companies to keep costs down and still enable them to attract high-calibre and interested Non Execs.

9.9.7 Share options should be subject to specific shareholder approval (as indicated in the QCA guidelines) and should not be valued at more than 200% of the typical fixed fee of a Non Executive Director and should only replace a part of that fee (not be additional).

9.10 Time commitment:

The role of the Non Execs has changed significantly. In the 1980s, most British boards were primarily made up of insiders and Robert Boothby, a former Conservative Member of Parliament, described what being a Non Exec was like in that era: *“No effort of any kind is called for, you go to a meeting once a month, in a car supplied by the company, you look grave and sage, on two occasions say ‘I agree,’ say ‘I don’t think so’ once, and if all goes well you get £500 a year.”* He added, *“If you have five of them, it is total heaven, like having a permanent hot bath.”*

9.10.1 In 1991, the average time spent by Non Execs was 17 days per company, when Tiny Rowland notoriously compared Non Execs to trinkets on Christmas trees, many Boards would have a Knight and a Lord and Board meetings were amiable affairs often followed by a good lunch.

9.10.2 Today the role of the Non Exec is much more professional. They must gain a detailed understanding of the company, so it is not surprising that the time commitment has increased to an average of 46 days per year for FTSE companies and 31 days pa for AIM companies.

9.10.3 The average time commitment for a Chairman has increased since the Walker report to 3-4 days per week for FTSE 100 companies due to the growing complexity of the role plus the number of sub-committees such as Audit, Nomination, Remuneration, Risk and Strategy committees.

9.10.4 The average time commitment for a Non Exec is 24-30 days p.a., increasing for larger companies.

9.10.5 Board meetings, including preparation, tend to take up about 40% of the time, with strategy and planning meetings taking 10% and sub-committees 20%.

9.11 FTSE remuneration:

At the time of writing:

- The average pay for the Chair of FTSE companies is between £1,500 and £2,000 per day for smaller companies (£50k pa) and £2,000 to £3,000 for larger companies (£100k pa).
- The average pay for a Non Exec in a FTSE company is around £2,000 a day for smaller companies (£50k pa) and £3,000 a day for larger companies (£75k pa).

For example, the Chairman of Barclays was on a remuneration package in 2011 of £750k p.a. and their ten Non Execs earned between £98-188k p.a.

9.11.1 FTSE350 Non-Executives are paid differently to those in the US. Exxon, for example, pays its Non Execs \$100,000 pa plus 2,500 shares, which at recent share prices were worth slightly less than \$200,000. Importantly, their Non Execs cannot sell these shares until after they retire and there are rules for the phased sale of their shares. This remuneration package is designed to create long term alignment with shareholders.

9.11.2 A mix of fees and shares has great merit. Smaller companies may want more performance linkage; for them, a mixture of fees and options may be more appropriate.

9.12 AIM remuneration:

At the time of writing:

- The average pay for the Chair of AIM-listed companies is between £1,200 and £1,700 per day for smaller companies (£40k pa) and £2,000 to £3,000 for larger companies (£100k pa).
- The average pay for a Non Exec in an AIM-listed company is around £1,300 a day for smaller companies (£25k pa) and £1,800 a day for larger companies (£50k pa).
- The remuneration for Chairmen and Non Execs has fallen well behind the remuneration levels of CEOs with the average FTSE 100 CEO receiving £4.8m pa and a FTSE 250 CEO receiving £1.5m pa.
- Fees paid to Non Execs, when calculated on a per day basis, are well below (in the region of 50%) the daily rate charged by professional advisers.

- 9.13 Companies get what they pay for with their Non Execs and if you want committed, effective Non-Executive Directors who understand the business, the risks and the long term strategy, think carefully about what skills you need from them which will enable them to contribute to the company's long term success, but in return they should be paid accordingly.

First Flight/ShareSoc guidelines on the remuneration of Chairs and Non Execs:

1. As per the UK Corporate Governance Code all Quoted Companies should have an effective Remuneration Committee made up of at least two independent Non Execs for smaller companies and three independent Non Execs for larger companies. In addition the Chairman of the Company may be a member of the Committee but should not Chair it;
2. The Remuneration Committee should seek the views of the Chairman, the Chief Executive, internal management, the shareholders and external advisors to assist them in making the best decisions;
3. Transparency and accountability should underpin the Remuneration Committee which should produce a clear and concise annual report, covering their recommendations for both Directors and Non-Executive Directors which the shareholders should have an opportunity to approve;
4. Quoted companies should provide detailed and clear disclosures on the emoluments of all Directors covering remuneration, bonus payments, benefits in kind, pension contributions and share options;
5. AIM and unquoted companies should provide details of their highest paid Directors which should include remuneration, bonus payments, benefits in kind, pension contributions and share options;
6. We believe that Non-Executive Director fees should increase (although not in all cases) in return for greater professionalism, increased time commitment (fewer roles) and better understanding and more scrutiny of strategy and risk;
7. The level of pay for Non Execs should be linked to their abilities, performance, time commitment and market conditions. Shareholders should be consulted and approve remuneration packages;
8. Companies should remunerate their Non Execs in a combination of fees, shares and share options;
9. Non-Executive Directors should hold shares of significant value in the companies of which they are Directors;
10. There should be more flexibility in the use of share options in smaller, early-stage companies, including many AIM companies as one element of remuneration and under specific conditions.

Some information in this remuneration section is taken from First Flight's Survey of Non-Executive Directors with further data provided by Cliff Weight at remuneration consultants MM&K: www.mm-k.com - Cliff Weight is also the author of the Directors' Remuneration Handbook published by Bloomsbury; to order your copy visit www.amazon.co.uk

Current research suggests the role of the Non Exec needs addressing:

- Only 29% of companies are able to declare their Non Execs meet standards of independence.
- Courtts research found that 10% of Non Execs have more than 10 roles.
- The Walker Report recommends that Non Execs should have no more than 5 roles if they are to be truly effective.
- Korn Ferry discovered that Non Execs who serve on 3+ boards show a noticeable fall off in their contribution to their '3rd board'.
- Courtts research reveals that 56% of companies do not feel confident of getting good performance from their Non Execs.
- "Most NEDs are appointed through personal contacts and only 4% are interviewed formally"
- *Opus*

First Flight/ShareSoc Key Beliefs:

- Non Execs should have no more than 4 to 5 roles (to ensure they have time to be effective).
- Independent Non-Executive Directors are the cornerstone of effective Boards.
- The Non-Executive Director gene pool needs to be broadened (there are too many generic Non Execs).
- Not enough attention is paid to ensuring that Non Execs add value (the current Board composition and skills balance often need improving).
- Stakeholders should be well represented, and diversity improved.

The three C's of a good Non-Executive Director

1. Curiosity
2. Commitment
3. Courage

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