ICSA Review of the Higgs Guidance on behalf of the FRC

Improving board effectiveness

Second stage of consultation
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Background

In its Final Report on the 2009 review of the Combined Code (now called the UK Corporate Governance Code – ‘the Code’ – and published in June 2010), the Financial Reporting Council (FRC) explained that it had ‘...commissioned the Institute of Chartered Secretaries and Administrators (ICSA) to work with others on its behalf to update as necessary the good practice guidance from the 2003 Higgs Report ... in the light of the proposed changes to the Code and economic and other developments’. Elsewhere in the Final Report, the text makes clear that the commission refers to the ‘Higgs Guidance’ (Good Practice Suggestions from the Higgs Report), last reissued in 2006.

As part of this remit, the FRC asked ICSA to consider whether additional guidance should be provided on a number of related issues raised in Sections A (Leadership) and B (Effectiveness) of the Code. Given the focus of these additional areas, and their link to the content of the Higgs Guidance, ICSA called the initial consultation paper Improving board effectiveness, to assemble the various strands of advice under one of the principal themes of the Code review.

Steering group

ICSA established a steering group to assist it in its task. Its members are:

Nilufer von Bismarck Partner, Slaughter and May
Andrew Campbell Director, Strategic Management Centre, Ashridge Business School
John Coombe Chairman, Hogg Robinson Group plc
Sir John Egan Former Chairman, Severn Trent Plc
Philippa Foster Back OBE Director, Institute of Business Ethics
Chris Hodge Head of Corporate Governance, FRC
Simon Lowe Partner, Grant Thornton UK LLP
Ben Mathews Company Secretary, Rio Tinto plc
Peter Montagnon Senior Investment Adviser, FRC
David Paterson† Head of Corporate Governance, NAPF
David Wilson Chief Executive, ICSA

† David Paterson, Head of Corporate Governance at the National Association of Pension Funds, was appointed to the steering group in May as representative of investor interests, to replace Peter Montagnon who originally joined the group as Director, Investment Affairs at the ABI, and who has remained a member.
Initial stage of consultation

ICSA issued its initial consultation paper in March 2010 and sought comments by mid-April. Forty-six written responses were received and ICSA also hosted nine meetings with over 100 chairs, company secretaries and other professionals closely involved with the work of boards of UK plc.

The consultation paper posed three questions:

1. Do you agree with the purpose of the guidance as set out in the paper?

There was overwhelming support for short, non-prescriptive guidance to help boards understand and implement the Code. The consensus was that the new guidance should provide practical advice with sufficient flexibility to allow boards to develop their own thinking on their corporate governance arrangements.

2. Do you agree that the paper has identified the right areas where the existing guidance could be enhanced?

Generally, respondents considered the right areas had been identified in the consultation paper, with several key themes emerging from the submissions.

The most significant conclusion drawn from the consultation exercise was the need to emphasise the importance of the role of the chair in delivering an effective board. Other significant themes included the importance of challenge in the boardroom; understanding and managing the key relationships between members of the board; the need for all board members to understand better their roles and responsibilities on the board; and the necessity for bespoke development of each board member to enhance his or her contribution.

The consultation exercise produced a range of evidence of poor decision making, some of the examples leading to well-documented cases of value destruction. The steering group concluded that the guidance should cover the structure, mechanics and processes which lead to effective decision-making as well as other aspects of a board’s duties and responsibilities.

It was clear from the consultation responses that the guidance should also address the issue of diversity, and the way in which a range of perspectives and experiences in the boardroom can help create an effective dynamic of challenge.

Finally, in relation to the accountability and disclosure agenda, the consultation exercise highlighted the need for companies to demonstrate that their governance arrangements are appropriate to the business model. The Code makes clear in the preface that chairs are encouraged to report personally in their annual statements on issues of board leadership and effectiveness. This should set the tone for the rest of the report. The steering group considers that there remains significant potential for disclosure practices to develop in a more tailored and personalised fashion, thus facilitating greater levels of engagement with institutional investors and other major stakeholders.

3. Are there other areas which the guidance should look at?

Rather than identifying new areas for guidance, the consultation exercise pointed to aspects of the guidance where there should be more emphasis.
Draft guidance

As a result of the consultation exercise, ICSA has prepared draft guidance, called *Improving board effectiveness*. The aim of the guidance – which focuses on the delivery of good governance practice – is to assist boards when they consider how to apply the relevant principles of the Code. The guidance, which should be read in conjunction with the Code, seeks to avoid detail and prescription. Ultimately it is for each board to devise governance arrangements, based on the Code and the guidance, suited to its business model.

Second stage of consultation

Consultation arrangements
This is the second stage of the consultation process. As with the first stage of consultation, ICSA has organised a series of meetings with FTSE chairs, company secretaries and other professionals to comment on the proposed guidance. Members of the steering group will be present at those sessions. Details of the meetings can be obtained from the ICSA website.

Respondents are asked to offer their views on the draft guidance and, in particular, to comment on whether:

i) any areas have not been covered?
ii) any areas covered are considered superfluous or irrelevant, and could therefore be omitted?
iii) there are points of drafting detail?

In addition, some of the detail which formed part of the original Higgs Guidance, and which was developed into more detailed Guidance Notes produced by ICSA, has been removed from the draft guidance. Would respondents find it useful for this material to be updated, and refreshed periodically, and to continue to be made available as Guidance Notes on the ICSA website (see page 19)?

For those replying separately in writing, comments are sought by **14 October 2010**.

How to comment
Responses should be sent by e-mail to policy@icsa.co.uk.

Or in writing to: Seamus Gillen
Policy Director
ICSA
16 Park Crescent
London
W1B 1AH

Completed guidance will be submitted to the FRC for its consideration. The FRC intends to publish the final guidance by the end of 2010.

It is ICSA’s policy to publish on its website all responses to this consultation unless the respondent explicitly requests otherwise. A standard confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure. We do not edit personal information (such as telephone numbers or e-mail addresses) from submissions. Only information you wish to be published, therefore, should be submitted – or else you should clearly mark the top of your response, or the part you wish to remain confidential, ‘not for publication’
Improving board effectiveness

Preface

1.1 The Financial Reporting Council issued the UK Corporate Governance Code (‘the Code’) in June 2010. This guidance offers practical assistance to boards in support of one of the principal themes of the Code – improving board effectiveness. The FRC’s intention is that the guidance should be consulted by boards when they consider how to apply the relevant principles of the Code, and should be read in conjunction with that document.

1.2 The guidance is not intended to be comprehensive – its aim is to focus on the key issues concerning the practical implementation of the Principles in Sections A and B of the Code (Appendix A). The guidance emphasises good governance practice as a business enabler, delivering the outcomes – described in the Code – of transparency, accountability, probity and focus on the sustainable success of the company over the longer term. The guidance makes suggestions on how a company can improve its governance practice.

Introduction

2.1 The board is the cornerstone of the company’s governance framework.

2.2 The chair should lead directors in working to create an effective board which:

- provides direction for management, creating a high-performance culture so as to maximise the opportunities for value creation;
- provides control consistent with Code Supporting Principle A.4 minimising, through checks and balances and holding management to account, the risk of value destruction;
- takes well-informed and high-quality decisions;
- behaves ethically, exhibiting, and promoting throughout the company, behaviours consistent with the culture and values of a high-quality performing organisation;
- creates the right framework for helping directors meet their statutory duties under the Companies Act 2006 (Appendix B).

2.3 A board which demonstrates that it has the necessary governance policies, processes and systems in place is much more likely to generate trust and support among its shareholders and other stakeholders.

2.4 The chair plays the key leadership role in creating an effective board, and managing the relationships between directors. The chair’s relationship with the CEO is particularly critical to the successful functioning of the board, and this relationship should be clearly defined. All directors need to understand their respective roles and responsibilities, and the behaviours required of them to strengthen the quality of board output. Executive and non-executive directors should develop a relationship of mutual respect such that constructive challenge is accepted as an essential aspect of good governance.

2.5 Boards should maintain robust governance arrangements to ensure they always act in a way that will generate sustainable value for the company. The senior independent director can play a key role in helping to achieve this when the board is undergoing a period of stress. The company secretary should ensure that governance systems remain fit for purpose at all times.

2.6 Well-informed and high-quality decision making – one of the hallmarks of an effective board – does not happen by accident. Boards need consciously to design and implement decision-making policies and processes to deliver the company’s strategic objectives effectively. Many of the factors
which lead to poor decision-making are predictable and preventable – for those which are not, additional precautions can be taken to avoid decisions that destroy value and damage a company. A board’s committees constitute an important part of the decision-making process.

2.7 A board can optimise the conditions for robust decision-making by ensuring that its membership contains a sufficient spread of business experience. A structured approach to refreshing board membership and succession planning is essential if the board is to attain and retain the required skill-set among its members.

2.8 Creating bespoke induction and tailored development programmes will enhance the value of directors’ contributions. Evaluation processes, including periodic external facilitation, should provide effective feedback to allow a board to achieve continuous improvement. The chair should take a leading role in all issues relating to director development.

2.9 These matters are the essence of good corporate governance, improving the ability of companies to compete effectively, and strengthening their processes to address market risks and access opportunities.

3 The role of the board

3.1 The role of the board, as set out in Principle A.1 of the Code, includes responsibilities for entrepreneurial leadership, risk management, strategy, securing the necessary financial and human resources and performance review. The board is also expected to set the company’s values and standards, and ensure it meets its obligations to shareholders and others. Its members are expected to act in accordance with their statutory duties.

4 The role of the chair

4.1 The Code states that the chair is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role. This requires living and upholding the highest standards of integrity and probity inside and outside the boardroom, through setting clear expectations in terms of culture and values, as well as in terms of the style and tone of board discussions.

4.2 The chair runs the board and sets the agenda – he or she is pivotal in creating the conditions for overall board and individual director effectiveness. The role includes:

- setting a board agenda which is primarily focused on strategy, accountability, competitive performance and value creation;
- ensuring that issues relevant to this objective are reserved for board consideration, including determining the nature and extent of the significant risks the board is willing to embrace in the implementation of its strategy;
- making certain that an effective decision-making process is in place in the board, and that the board’s committees are properly structured with appropriate terms of reference;
- encouraging the active engagement of all board members in board and committee meetings, drawing fully on their skills, experience, knowledge and, where appropriate, independence;
- building effective relationships founded on mutual respect and open communication – both inside and outside the boardroom – between the non-executive directors and executive team, in particular with regard to the identification and oversight of significant risks;
- developing, in particular, a productive working relationship with the CEO, providing support and advice while respecting executive responsibility;
- consulting the senior independent director on board matters consistent with Code Provision A.4.1;
ensuring effective processes are established relating to succession planning and the composition of the board, having regard to the benefits of diversity;
- taking the lead on issues of director development, consistent with supporting Code Principle B.4, and acting on the results of board evaluation consistent with Code Principle B.6;
- being aware of, and responding to, his or her own development needs, including people skills;
- ensuring effective communication with shareholders and other stakeholders and ensuring that all directors are made aware of the views of major investors.

5 The role of the senior independent director

5.1 In normal times the role of the senior independent director includes the following:
- providing support for the chair in the delivery of his or her objectives;
- ensuring the views of the other directors are conveyed to the chair;
- ensuring that the chair is passing on the views of shareholders, and especially that any concerns are being conveyed to the full board, further to Code Provisions A.4.1 and E.1.1;
- ensuring that the chair is paying sufficient attention to succession planning;
- carrying out the evaluation of the chair in conjunction with other non-executive directors, as set out in Code Provisions A.4.2 and B.6.3.

5.2 When the board is undergoing a period of stress the role of the senior independent director is likely to assume a greater degree of prominence. He or she is expected to work with the other directors, shareholders and/or the chair (as appropriate) to resolve the issues. Boards should ensure they have a clear understanding of the type of circumstances in which the senior independent director’s intervention might be appropriate to maintain board and company stability. Examples are:
- where there is a dispute between the chair and CEO;
- where shareholders or non-executive directors have expressed concerns that are not being addressed by the chair or CEO;
- if the strategy being followed by the chair and CEO is not supported by the full board;
- where the relationship between the chair and CEO is particularly close and decisions are being made without the approval of the full board;
- where succession planning is being ignored.

5.3 These issues should be considered when defining the role of the senior independent director which, as required by the Code, should be set out in writing.

6 The role of executive directors

6.1 The CEO is the most senior representative on the board with operational responsibility for delivering the company’s strategy. The CEO’s relationship with the chair is the key dynamic that underpins the effectiveness of the board. Code Provision A.2.1 states that the differing responsibilities of the chair and the CEO should be set out in writing and agreed with the board. Particular attention should be paid to areas of potential overlap.

6.2 The CEO will, with the support of the executive team, have primary responsibility for communicating to the people working within the business the expectations of the board in relation to the company’s culture, values and behaviours, and for ensuring that the appropriate standards of governance permeate down to all levels of the organisation.

6.3 The CEO will encourage directors to express their views frankly and challenge constructively in order to improve the standard of discussion in the boardroom.
6.4 For their part, executive directors should view themselves in the boardroom as representatives of the owners of the business, rather than as responsible purely to the CEO in their executive management capacity. The chair should ensure that executives are aware of their wider responsibilities on joining the board, and ensure they receive appropriate induction and training to enable them effectively to fulfil the role. This should be augmented by ongoing training on a regular basis to keep them up to date.

6.5 Executive directors should have the most intimate knowledge of the company and its capabilities when making proposals and exercising judgement, particularly on matters of strategy. They should appreciate, however, that constructive challenge from non-executive directors is an essential aspect of good governance and should encourage their non-executive colleagues to probe proposals, especially when issues of judgement are concerned. The chair and CEO have a role to play in ensuring that this process is properly followed.

7 The role of non-executive directors

7.1 Code Main Principle A.4 indicates that non-executive directors should constructively challenge and help develop proposals on strategy, and Code Main Principle B.1 states that there should be an appropriate balance of skill, experience, independence and knowledge on the board and its committees.

7.2 Code Main Principle B.3 makes clear that non-executive directors need to make sufficient time available to discharge their responsibilities effectively. Inevitably this will involve being well-informed about the company, and having a strong command of issues relevant to the business. A new non-executive director should therefore insist on a comprehensive, formal and tailored induction which, to be effective, should extend beyond the boardroom. Once in post, effective non-executive directors should seek constantly to develop and refresh their knowledge and skills to ensure that their contribution to the board remains informed and relevant. The letter of appointment should state the time the non-executive director will be required to spend on the company’s business, and indicate the possibility of additional time commitment when the company is undergoing a period of particularly increased activity, such as in the case of an acquisition or takeover, or as a result of some major difficulty with one or more of its operations.

7.3 As part of the process of learning more about the business and of becoming effective boardroom contributors, non-executive directors – supported by the chair and CEO – need to build recognition among executive directors of their contribution in order to promote mutual respect. This, in turn, will allow them to support executive directors in their management of the business while monitoring their conduct.

7.4 Non-executive directors have a responsibility to maintain confidence in the governance of the company by upholding high standards of integrity and probity, and supporting the chair and executive directors in the embedding of the appropriate culture, values and behaviours in the boardroom and beyond.

7.5 Because of the importance of the process of decision-making to the work of the board, non-executive directors should insist on accurate, clear and comprehensive information being provided sufficiently in advance to enable thorough consideration of the issues prior to, and informed debate and challenge at, board meetings.

7.6 Non-executive directors should supplement their knowledge of the business with the views of shareholders and other stakeholders – either directly or as conveyed to them by the chair, CEO or, in special circumstances, the senior independent director. Such opinions and judgements may be valuable in providing different perspectives of the company’s progress and performance.
8 The role of the company secretary

8.1 The company secretary has a key role to play in facilitating the effective functioning of the board through the timely presentation of board information which – by being accurate, clear and comprehensive – assists high-quality decision making. The company secretary can also add value by delivering, or procuring the delivery of, the matters required by the Code – in particular induction and development – in a way which suits the needs of the directors on the particular board.

8.2 Given the importance of governance processes in delivering a high-performing board, the company secretary should consider whether board and other governance procedures are fit for purpose and advise the chair of any improvements and initiatives which could add value to the governance of the company.

8.3 The company secretary should be independent and impartial in his or her capacity as an adviser to the board on issues of process and the Code.

9 Decision-making

9.1 Decision-making is an important board activity. Boards should have clear policies about which decisions need board approval, and the processes required for each type of decision. These policies should be reviewed annually.

9.2 In addition to clear policies, good decision-making can be facilitated by:

- ensuring directors are afforded time to prepare for meetings;
- allowing time for debate and challenge, especially for complex, contentious or business-critical issues;
- achieving timely closure; and
- providing clarity for executives on the actions required.

9.3 However, appropriate policies and processes, even when combined with well-intentioned and competent boards, are still not necessarily sufficient. It is important to beware of:

- the effects of a dominant personality or group of directors on the board;
- a reluctance to involve non-executive directors, including the existence of ‘no-go’ areas;
- complacent or anchored attitudes;
- a weak organisational culture, including inadequate information or analysis;
- weak ethical standards; and
- poor line of sight to all areas of significant risk.

9.4 Flawed decisions can be made with the best of intentions. Competent individuals can believe passionately that they are making a sound judgment when they are not. Factors known to distort judgment include conflicts of interest, emotional attachments, and inappropriate reliance on previous experience and previous decisions. For significant decisions, therefore, a board may wish to consider extra steps, for example:

- including in board papers a description of the process that has been used to arrive at and challenge the proposal prior to presenting it to the board. This allows directors not involved in the project to assess the appropriateness of the process as a precursor to assessing the merits of the project itself;
- where appropriate, putting in place additional safeguards aimed at reducing the risk of distorted judgements. Safeguards may include commissioning an independent report, seeking advice from an expert, challenge from a devil’s advocate, establishing a sole purpose sub-committee,
or additional meetings. Some chairs favour, for example, three separate discussions for important decisions – concept; proposal for discussion; proposal for decision. This gives executive directors more opportunity to put the case at the earlier stages, and all directors the opportunity to share concerns or challenge assumptions well in advance of the point of decision.

9.5 Committees constitute an important aid to board decision making, and should be given sufficient time to report back after meetings. A board should take full responsibility for the work of its committees and of their recommendations to the board. Boards can improve the effectiveness of committees by clarifying and regularly reviewing the remit of each committee, the processes of interaction between each committee and the board and among the committees, and the nature and content of discussions and follow-through.

10 Board composition

10.1 Directors will be more likely to make good decisions, and maximise the opportunities for the company’s success in the longer term, if the right skill-sets are present in the boardroom – including the appropriate range and balance of skills, experience, independence and knowledge. Non-executive directors should possess critical skills and knowledge of value to the board, for example direct experience of the sector.

10.2 As Supporting Principle B.2 of the Code indicates, the appointment process should have due regard for the benefits of diversity on the board, including gender.

10.3 Diversity of psychological type is important, requiring board directors who have the intellectual capability to listen carefully and suggest change to a proposed strategy, with the ability potentially to build open debate around a different approach if the original proposal is thought to be wrong. It is important also to consider a diversity of personal attributes among board candidates, including qualities relating to intellect, critical assessment and judgement, courage, openness, honesty and tact, as well as the ability to listen, forge relationships and develop trust.

10.4 The chair’s vision for achieving the optimal board composition will help the nomination committee review the skills required, identify the gaps, develop transparent appointment criteria and inform succession planning. The nomination committee can also assess the degree of success in achieving the desired outcomes and propose changes.

10.5 Companies may choose to look externally to recruit executive directors, but they should also pay attention to the benefits of developing internal talent and capability by initiatives such as middle management development programmes, facilitating engagement from time to time between middle management and non-executive directors, and through partnering and mentoring schemes. For non-executive directors, the route onto the board will generally be through a process of external recruitment.

10.6 Establishing, and perhaps publicising, the objective criteria against which recruitment to the board will be assessed and delivered will demonstrate how the chair and the nomination committee are achieving a balance between new/fresh input and thinking, and establishing a cohesive board.

10.7 Good board appointments do not depend only on the nomination committee. The prospective director has a responsibility to conduct sufficient due diligence to ensure an understanding of the organisation being joined, and the likelihood he or she will be able to make a significant contribution.

10.8 Once on the board, a director will wish to be sure that he or she is complying with the duty to exercise reasonable care, skill and diligence owed to the company.
11 Establishing directors’ skill base – induction

11.1 Once appointed, a new director’s skills, experience, and knowledge should be deployed in the work of the board as quickly as possible. The company should not underestimate the time needed, and the effort involved, in preparing the new director to make a contribution from the outset.

11.2 The chair, the new director and the company secretary should work closely together to devise an effective induction programme which is suited to the needs of the individual. The induction programme may extend over a period of time, and may involve a combination of presentations, seminars, face-to-face meetings including with shareholders and other major stakeholders, and other activities. Consideration should be given to visiting important business locations and meeting senior and middle management to develop a meaningful ‘line of sight’ into the business, and particularly those areas that carry significant risk.

12 Maintaining directors’ skill base – development

12.1 A successful development programme will help the individual become more effective and work to the benefit of the board as a whole.

12.2 All directors, even those who have been on the board for some time, need to consider how effectively they are contributing to the work of the board and whether their levels of skill and knowledge require refreshment and development. Code Provision B.4.2 recommends that the chair should hold regular development reviews with all directors.

12.3 Development programmes should be appropriate for the company, its culture and the individual. Development opportunities may be a mixture of formal and informal initiatives, ranging from technical and operational briefings and updates, through to attendance at seminars and mentoring. Code Principle B.1 emphasises the need for all directors to have appropriate knowledge of the company. This may be acquired by access to its operations and staff, and visits to relevant business locations, whether accompanied or unaccompanied, play an important part in achieving this objective.

12.4 For some executive directors, joining a board for the first time may involve learning how to exercise influence without wielding operational power, and a similar consideration can apply to a former CEO who becomes, in due course, the chair or a non-executive director on another board. Developing skills of persuasion can help executives become more rounded performers. Becoming a non-executive director on the board of another company may help an executive director develop a wider perspective and an understanding of the importance of executive and non-executive directors working together.

12.5 All development activities will require some structuring, assessment, and feedback, and the company secretary might assume responsibility for the programme, on behalf of the chair, to ensure its effectiveness.

13 Evaluating the performance of the board and directors

13.1 Board evaluation processes, including in relation to the chair, individual directors and committees, can constitute a powerful and valuable feedback mechanism to improve board effectiveness, maximise strengths and highlight areas for further development. The results of a board evaluation should be shared with the board as a whole and fed back, as appropriate, into the board’s work on composition, the design of induction and development programmes, and other relevant areas.
13.2 Like induction and board development, evaluation should be bespoke in its formulation and delivery. It is the responsibility of the chair to select an appropriate process and to act on its outcome, although it may be the senior independent director who assumes responsibility for running the exercise.

13.3 Evaluation may be conducted by some companies on an ongoing basis, or deployed periodically according to an agreed timetable over the course of one or several years. For example, a board may wish to evaluate the board one year and its committees in the following year. In each case, feedback to the board will likely include action points to enhance the board’s effectiveness.

13.4 Code Provision B.6.2 recommends that larger listed companies have externally facilitated board evaluations at least every three years. Factors which may trigger the need to involve external facilitators might include the arrival of a new chair; a known problem requiring tactful, impartial handling (and gentle probing); or external/institutional perception of the need to refresh the board membership.

13.5 Whether facilitated externally or internally, evaluations should explore how well the board is functioning as a unit as well as the contribution of individual directors. Below are some issues which should be considered, although they are neither prescriptive nor exhaustive. Companies will wish to tailor the questions to suit their specific needs and circumstances:

- overall composition to confirm that the board has the right mix and currency of skills and experience and is suitably diverse; whether the board is undertaking adequate succession planning;
- the contribution and effectiveness of the chair, individual directors and committees, including the committee chairs;
- how the board works together; key board relationships (chair/CEO; board/chair; board/CEO; and board/committee chairs); how the board manages relationships with the executive team; the effectiveness of the company secretary and the support from the secretariat;
- how the decision processes work; the planning and effectiveness of the board’s strategy discussions; how the board oversees the management of risk and internal controls;
- the ability of the non-executive directors as a group to modify or reject proposed initiatives which they do not consider to be in the company’s interests; whether there is unhealthy domination by an individual or group;
- how the board communicates with shareholders and other stakeholders and responds to their concerns.

14 Communicating with shareholders and other stakeholders

14.1 Communicating to shareholders and other stakeholders the steps a company is taking to strengthen its governance arrangements helps generate greater levels of trust and confidence. The Code makes clear in the preface that chairs are encouraged to report personally in their annual statements on issues of board leadership and effectiveness. The Annual Report and Accounts should be seen as the single most important communication between a company and its shareholders, and not simply as a marketing document. While much of its content is dictated by regulation, there remains considerable scope for a company to use the Report to set out for shareholders a clearer picture of its governance arrangements, including overseeing the delivery of its strategy and the key risks associated with its implementation, as well as developments during the year.

14.2 A particular challenge for boards is to ensure that the disclosures around non-financial matters, including remuneration and environmental and social risks, are balanced and informative as well as relevant to the business.
14.3 Evidence of the steps the board takes to assess continually its governance performance and that of its committees and directors, the principal outcomes of the board evaluation process, and how the board proposes to implement the resulting recommendations is also of value to shareholders and other stakeholders.
Appendix A
The main principles of the UK Corporate Governance Code

Section A: Leadership
Every company should be headed by an effective board which is collectively responsible for the long-term success of the company.

There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company’s business. No one individual should have unfettered powers of decision.

The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role.

As part of their role as members of a unitary board, non executive directors should constructively challenge and help develop proposals on strategy.

Section B: Effectiveness
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.

There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.

All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively.

All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.

The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties.

The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.

Section C: Accountability
The board should present a balanced and understandable assessment of the company’s position and prospects.

The board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.

The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles and for maintaining an appropriate relationship with the company’s auditor.
Section D: Remuneration
Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors’ remuneration should be structured so as to link rewards to corporate and individual performance.

There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.

Section E: Relations with Shareholders
There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.

The board should use the AGM to communicate with investors and to encourage their participation.
Appendix B
General duties of directors – Companies Act 2006 SS.170–177

Introductory

170 Scope and nature of general duties

(1) The general duties specified in sections 171 to 177 are owed by a director of a company to the company.

(2) A person who ceases to be a director continues to be subject—
(a) to the duty in section 175 (duty to avoid conflicts of interest) as regards the exploitation of any property, information or opportunity of which he became aware at a time when he was a director, and
(b) to the duty in section 176 (duty not to accept benefits from third parties) as regards things done or omitted by him before he ceased to be a director. To that extent those duties apply to a former director as to a director, subject to any necessary adaptations.

(3) The general duties are based on certain common law rules and equitable principles as they apply in relation to directors and have effect in place of those rules and principles as regards the duties owed to a company by a director.

(4) The general duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties.

(5) The general duties apply to shadow directors where, and to the extent that, the corresponding common law rules or equitable principles so apply.

The general duties

171 Duty to act within powers

A director of a company must—
(a) act in accordance with the company’s constitution, and
(b) only exercise powers for the purposes for which they are conferred.

172 Duty to promote the success of the company

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—
(a) the likely consequences of any decision in the long term,
(b) the interests of the company’s employees,
(c) the need to foster the company’s business relationships with suppliers, customers and others,
(d) the impact of the company’s operations on the community and the environment,
(e) the desirability of the company maintaining a reputation for high standards of business conduct, and
(f) the need to act fairly as between members of the company.

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

173 Duty to exercise independent judgment

(1) A director of a company must exercise independent judgment.

(2) This duty is not infringed by his acting—
(a) in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors, or
(b) in a way authorised by the company’s constitution.
174 Duty to exercise reasonable care, skill and diligence

(1) A director of a company must exercise reasonable care, skill and diligence.
(2) This means the care, skill and diligence that would be exercised by a reasonably diligent person with—
   (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and
   (b) the general knowledge, skill and experience that the director has.

175 Duty to avoid conflicts of interest

(1) A director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company.
(2) This applies in particular to the exploitation of any property, information or opportunity (and it is immaterial whether the company could take advantage of the property, information or opportunity).
(3) This duty does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company.
(4) This duty is not infringed—
   (a) if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest; or
   (b) if the matter has been authorised by the directors.
(5) Authorisation may be given by the directors—
   (a) where the company is a private company and nothing in the company’s constitution invalidates such authorisation, by the matter being proposed to and authorised by the directors; or
   (b) where the company is a public company and its constitution includes provision enabling the directors to authorise the matter, by the matter being proposed to and authorised by them in accordance with the constitution.
(6) The authorisation is effective only if—
   (a) any requirement as to the quorum at the meeting at which the matter is considered is met without counting the director in question or any other interested director, and
   (b) the matter was agreed to without their voting or would have been agreed to if their votes had not been counted.
(7) Any reference in this section to a conflict of interest includes a conflict of interest and duty and a conflict of duties.

176 Duty not to accept benefits from third parties

(1) A director of a company must not accept a benefit from a third party conferred by reason of—
   (a) his being a director, or
   (b) his doing (or not doing) anything as director.
(2) A “third party” means a person other than the company, an associated body corporate or a person acting on behalf of the company or an associated body corporate.
(3) Benefits received by a director from a person by whom his services (as a director or otherwise) are provided to the company are not regarded as conferred by a third party.
(4) This duty is not infringed if the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest.
(5) Any reference in this section to a conflict of interest includes a conflict of interest and duty and a conflict of duties.

177 Duty to declare interest in proposed transaction or arrangement

(1) If a director of a company is in any way, directly or indirectly, interested in a proposed transaction or arrangement with the company, he must declare the nature and extent of that interest to the other directors.
(2) The declaration may (but need not) be made—
   (a) at a meeting of the directors, or
   (b) by notice to the directors in accordance with—
      (i) section 184 (notice in writing), or
      (ii) section 185 (general notice).
(3) If a declaration of interest under this section proves to be, or becomes, inaccurate or incomplete, a further declaration must be made.

(4) Any declaration required by this section must be made before the company enters into the transaction or arrangement.

(5) This section does not require a declaration of an interest of which the director is not aware or where the director is not aware of the transaction or arrangement in question. For this purpose a director is treated as being aware of matters of which he ought reasonably to be aware.

(6) A director need not declare an interest—
   (a) if it cannot reasonably be regarded as likely to give rise to a conflict of interest;
   (b) if, or to the extent that, the other directors are already aware of it (and for this purpose the other directors are treated as aware of anything of which they ought reasonably to be aware); or
   (c) if, or to the extent that, it concerns terms of his service contract that have been or are to be considered—
      (i) by a meeting of the directors, or
      (ii) by a committee of the directors appointed for the purpose under the company’s constitution.

Note: The above statutory statement is a codification of directors’ common law duties and does not cover all of the obligations that a director may owe to a company. Other duties may be found throughout the Companies Act 2006 and other legislation, for example, the Insolvency Act 1986.

ICSA Guidance Notes

Some of the detail in the original Higgs guidance was developed into more detailed Guidance Notes produced by ICSA. These have not been included in the draft guidance on Improving board effectiveness. They are as follows:

- Summary of the principal duties of the remuneration committee
- Summary of the principal duties of the nomination committee
- Pre-appointment due diligence checklist for new board members
- Suggested information pack/induction programme for new non-executive directors
- Sample appointment letter for new non-executive directors (currently unavailable as being updated)

Separately, as a result of formulating the draft guidance on Improving board effectiveness, ICSA intends to issue additional Guidance Notes covering:

- Summary of the principal duties of the audit committee
- Summary of the principal duties of the risk committee
- Sample wording for inclusion in executive directors’ contracts of employment
- Director’s duty to exercise care, skills and diligence

As part of this second round of consultation, respondents are asked to state if they would find it useful for these existing (and new) Guidance Notes to be updated and refreshed periodically, and to continue to be made available on the ICSA website. Details of how to respond to the consultation are set out on page 5.