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DG Market G3
European Commission
B-1049 Brussels

4 June 2003

Dear Sir,

**Recommendation on the role of (independent) non-executive or supervisory directors
Consultation document of the Services of the Internal Market Directorate General
5th May 2004**

The Association of Corporate Treasurers (ACT)

The Association of Corporate Treasurers was formed in 1979 to encourage and promote the study and practice of corporate finance and treasury management and to educate those involved in the field. Today, it is an organisation of professionals in corporate finance, risk and cash management operating internationally. A professional body and not a trade association, it has over 3,000 Fellows, Members and Associate Members. With more than 1,200 students in more than 40 countries, its education and examination syllabuses are recognised as the global standard setters for treasury education. Members of the Association work in many fields. The majority of Fellows work in large UK public companies, responsible for the treasury and corporate finance functions.

The ACT usually comments from the corporate and not the financial services sector standpoint.

Preliminary remarks

On the face of it the proposed Recommendations are reasonable and very much follow the scope of the Combined Code in the UK. As such UK companies should have little problem complying. The paper says “The Recommendation actually aims at inviting Member States to introduce in their national framework, on a comply or explain basis at the minimum, a set of detailed principles to be used by listed companies.”

However at the end of a reading of the paper we have the impression that there is quite a long set of detailed rules and a set of minimum standards which is at odds with the high level stated aim. We would be concerned if the Recommendation became the start of a process of ever tightening regulation and law which does not fit in well with the successful UK system of best practice guidelines and a degree of flexibility. On the other hand, we take a large degree of comfort from the application of the “Comply or Explain” approach, which should allow a degree of flexibility for individual companies where the rules or principles do not fit

well to explain their own circumstances and reasons for non compliance. This is similar to the existing UK approach and we welcome it.

Overall we welcome the Recommendation and the effect it should have on harmonizing best practices in corporate governance throughout the European Union.

The references below refer to the numbering in your consultation

1.2 Addressees

We agree that this topic should be covered by introducing the principles into the national frameworks and that therefore addressing the Recommendation to Member States rather than directly to companies is the right approach. Member States will then be able properly to take into account material circumstances particular to them.

1.3. The Comply or Explain Approach

The comply or explain approach is already adopted in the UK's Combined Code and as such we very much welcome the use of this same approach in the Recommendation. This will allow individual companies to be flexible in what they consider appropriate for their own circumstances and if necessary they can provide explanations as to why the company has decided to depart from the best practice guidelines. Public scrutiny of a company's statements is sufficient pressure for conformity with the recommended approach other than for the most important reasons.

1.4. Implementation and follow-up

We note the follow up process outlined. At this stage this sounds reasonable, but we would be uncomfortable if this Recommendation were ever to be interpreted as or even were intended to be the start of a process of moving to a Directive on the matter.

2.1. Scope

We strongly support the intention that the Recommendation only be applied to Listed Companies. While we hope that the spirit of the Recommendations becomes a routine matter even for non-listed companies it would not be appropriate to move to compulsion. Investors in non listed companies are making a very different sort of investment decision and will have to weigh up for themselves the state of corporate governance in their investments.

Over time, non-listed companies will be influenced in their corporate governance practices by best practice in listed companies. Creditors of such companies will be influential in this too. In this context we believe it is significant that the main credit rating agencies now say that they take into account in arriving at a credit rating the corporate governance practice in the rated entities.

2.2. The need for some board committees

2.2.1. Two systems of board structure

In the UK a one tier board is normal, as opposed to the two tier board with a supervisory board, so we appreciate the fact that the Recommendation does not attempt to express a preference for either form of board.

We agree with the proposal that the board should include a balance between executive and *independent* non executive directors. The independence of those non-executive directors is an important part of the oversight of executive management and helps ensure the protection of the interests of all shareholders. The ACT has taken a consistent view that the definition of independence is crucial and we believe that the provisions of the Combined Code in the UK only set a minimum for this.

However the consultation paper does not address whether the legal responsibility of executive and non executive directors should be in some way different. We believe that all directors have the same fiduciary duties to the company and should have joint responsibility for the decisions of the Board. However it is important that the level of knowledge about the company required from an *independent* non-executive is bound to be less especially given the limited time available from them for the company's affairs.

2.2.2. Composition of the whole (supervisory) board

We note the proposals for board composition are stated to be along the following lines: A number of independent directors should be elected to the (supervisory) board of companies that is adequate in relation to the total number of non-executive or supervisory directors and significant in terms of being representative.

We agree with this section but would go further. We believe that *independent* non-executive should form a majority of the unitary or supervisory board and of certain board committees. We would be happy to supply a summary of our evidence to recent enquiries in the UK on this point if you would find this helpful.

2.2.3. Chairman - CEO

We accept given the divergence of practice within Europe the proposal to remain silent on any need to split the role of Chairman and CEO, but the implication is that the Chairman, if also the CEO, is ipso facto not independent. Under the UK Combined Code the Chairman on appointment must be independent, and therefore a CEO should not go on to be Chairman of the same company. We value the benefits of ensuring that normally no one individual can be the Chairman and the CEO so as to reduce the likelihood that any one person has unfettered powers of decision.

We accept the proposal to remain silent on this question on the basis as stated that the necessary safeguards may be provided through the provisions to do with the definition of independent directors and the composition and role of the committees.

2.2.4. Nomination, Remuneration and Audit Committees

We agree with this proposal. We support the pragmatic approach of the Recommendation in allowing the use of other structures which are functionally equivalent eg combining the committees or fulfilling their functions through the full board itself.

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

You note that the creation of the committees is not intended to remove the matters considered from the purview of the board itself. However, boards should not be precluded from delegating part of their decision-making powers to committees when they consider it appropriate and when this is not against applicable law.

We agree that this is a sensible approach. The Board is ultimately responsible but if they wish to delegate specific powers to the committees this is both a practical and a reasonable approach.

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

2.3.1. Qualifications

We agree that the (supervisory) board should ensure that it is composed of members who, as a whole, have the required diversity of knowledge, judgement and experience to properly complete their tasks.

The proposed Recommendation goes on to describe the need for an annual assessment of the competencies of the board members and the reporting of this in the annual report, in respect of individual members of the board. We believe that this aim is absolutely correct in that individual members must have suitable qualifications or experience and show an individual commitment, but for external reporting it should be sufficient to describe the process of review and the overall result for the board taken as a whole. There is a danger that in going into too much detail in the report the overall aim and message of having a balanced and competent board gets lost behind the specifics.

With respect to the members of the audit committee, it is proposed to include a statement clarifying that a) at least one audit committee member must have recent and relevant experience which results in the individual's sophistication in finance and accounting, and b) all other members of the audit committee should be able to read and understand financial statements at the time of their appointment.

We fully support these requirements for suitably qualified people. In line with the concept that the Recommendations should cover only the general principle we hope that that the final Recommendations will not attempt to stipulate exactly what qualifications are required, but this will be left to the companies themselves, and perhaps National guidelines, to interpret.

It is obviously important that at least one person has recent and relevant experience so as to be sophisticated in finance and accounting. To avoid undue responsibility and influence falling on this individual it is in some ways good to see that you have added the requirement on all the other members to be generally financially literate. However this is a very strong requirement as worded and few people other than financial professionals would really fit the description. We believe that it is important that audit committees include some savvy businessmen with a non-financial background if they are really to play a proper role within a company. The audit committee's brief extends beyond reported financial figures to internal

control and risk management and other matters which are at heart *business* rather than financial.

2.3.2. Commitment

Most corporate governance codes seek to make sure that directors will devote sufficient time to their duties. It is proposed to include in the Recommendation a general statement about the need for availability of all directors: each director should apply to his duties the necessary time and attention, and should undertake to limit the number of any directorships held in other companies to such an extent that the proper performance of his duties is assured. Such a statement would be supported with provisions aimed at ensuring a proper flow of information. When the appointment of a director is proposed, this other significant commitments should be disclosed, with a broad indication of the time involved. The board should be informed of subsequent changes. Every year, the board should collect data on such commitments, and make the information available in its annual report.

This section, which covers the need for directors to devote sufficient time to their duties, seems totally appropriate. It is well drafted to allow the flexibility to cater for the varying degrees of complexity and hence time required to fulfil the role of non executive director in different companies.

2.3.3. Independence

The ACT fully supports the general principle stating the general nature of independence. We agree with the approach that if a director fails a test he ceases to be considered independent rather than being required to resign.

The current list of criteria would be improved by addition of two further items:

- Not to be in receipt of a pension or similar income funded or contingently funded by the company
- Not to be the beneficiary of deferred or contingent remuneration or un-exercised “executive share options”

2.4. The board committees: common features

We note that for all 3 committees the proposal is to have a majority of independent directors, and for the Audit and Remuneration committees should be exclusively made up of non executive directors. In this context we believe that the important element is that the non-executive directors referred to are independent. An audit Committee exclusively made up of non-executive directors, but with some of them **not** independent is a strange mixture that does not capture the benefits of independence nor the hands on experience of executive directors. We recommend that in the drafting references to non-executive directors here are changed to “independent non- executive directors”. We also refer to our comments above (2.3.1) on qualifications of audit committee members.

In defining the roles of the three Committees the Recommendation goes into quite some detail. Our preference is that the Recommendation should avoid such detail and allow national codes to cover this, having already established at an EU level the principles of having committees to cover the three areas, as explained in 2.2.4 of the consultation paper.

2.5 The nomination Committee

2.5.1 Composition

We strongly support the Recommendation that the nomination committee should be composed of a majority (at least) of *independent* non-executive or supervisory directors. However, for a UK-style unitary board it is inappropriate that the CEO “must be among the members of the nomination committee”. If any mandatory person is to be recommended it would normally in the UK be the Chairman whose involvement is important in succession etc. planning. If the CEO is to be referred to here, a provision for consultation is all that is needed in such a system. Accordingly, the Recommendations could allow the Chairman *or* CEO according to national practice as a member of the Nominations Committee.

2.5.2 Role

We believe that accommodation of National laws for self-selecting boards of *listed* companies would be a weakness in the Recommendations. Boards should be able to nominate and to fill casual vacancies until the next shareholders’ meeting but shareholders generally should also be able to nominate and to vote on unitary or supervisory board members at general meetings. We are also concerned that where worker co-determination is involved, the ability of boards to have a majority (or even a “sufficient number”) of *independent* non-executives is compromised and we believe that accommodation of such distortions would be a significant weakness of the Recommendations if included.

We note that you may wish to make public all responses to formal consultations. These comments are on the record and may be freely quoted and made available for public inspection.

We hope these responses are helpful for your deliberations and if you need any further information or clarifications please contact any of the people listed below.

Yours faithfully,

Richard Raeburn
Chief Executive

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