



The critical role of the Senior Independent Director

Derek Higgs's "Review of the role and effectiveness of non-executive directors" published in January 2003 led to the recommendation that boards should identify a senior independent director (SID). Higgs explained that SIDs play an important role in facilitating the relationship between major shareholders and the board, stating "The SID should be available to shareholders if they have reason for concern that contact through the normal channels of Chairman and Chief Executive has failed to resolve. The SID should also chair meetings between the non-executive directors where the Chairman does not attend." Higgs also highlighted that SIDs must meet a test of independence. The Combined Code maintains that the majority of non-executive directors should be independent of management and free from any business or other relationship that could materially interfere with the exercise of their independent judgement, leaving it to boards to identify which of its non-executives are considered to meet this test.

The Higgs Review was considered quite controversial and was met with some criticism. One issue that attracted criticism was the perception that he was proposing the creation of a 'trinity' at the top of a company, with a particular concern being that holding separate discussions between the SID and shareholders could result in inconsistent messages being sent to the board. Others held the view that the SID's role could be unnecessary or divisive, and that shareholders should make use of their own connections with non-executive directors, or contact the chairmen of board committees if they had concerns. Most shareholders were broadly supportive of the concept of a SID while noting the importance of sensitivity in conducting the role.

Insight's view

At the time of the Higgs Review, Insight did not have particularly strong views on the creation of the role of SID. However, we felt that Higgs may have made a mistake in recommending that SIDs should meet with shareholders. We felt that it may have been more appropriate and important for shareholders to meet with company chairmen.

However, over time, we have come to support the concept of SIDs. We believe SIDs serve to strengthen companies' relationships and interactions with institutional investors and provide a complementary channel, alongside the chairman, executives and other non-executives, to reassure investors that they are able to communicate effectively with the whole board. The SID's role is principally reactive, and, therefore, the importance of the role is particularly highlighted where issues arise, for example, in situations when dialogue has broken down, transparency is lacking, governance issues arise or simply where a chairman is non-independent. In addition to being independent, it is important that SIDs are up-to-date with current board, management and operational issues, and be able to react appropriately in certain situations,

Board appraisals and succession planning are two important areas within the SID's role. Where the board has a non-independent chairman, the SID's role is critical. These three roles are discussed below in more detail.

Board appraisals

The principal responsibility for appraising the board of directors lies with the chairman. However, SIDs can make an important contribution by conducting an annual performance evaluation of the chairman. In 2003, the Higgs Review found that over three-quarters of non-executive directors and over half of Chairmen had never had a formal personal performance review. However, we believe that the majority of companies within the FTSE 350 are now conducting annual performance appraisals for both the board as a whole and for individual board members.

Succession planning

SIDs are also in a position to lead succession planning for the replacement of chairman (providing they are not a candidate themselves). In our view, SIDs should not be considered a chairman designate. There may be exceptional circumstances, such as the death of a chairman or even the separation of chairman and chief executive roles, that may lead to a SID becoming an interim chairman. An example of the latter is Misys, where Sir Dominic Cadbury joined the board as a SID in May 2000 and held that role until November 2005 when he was appointed as an Interim Chairman. This was due to the role of Kevin Lomax being split into Chairman and Chief Executive. Insight and other shareholders were consulted by the board on the proposal for Sir Dominic Cadbury to become a Chairman on a permanent basis. The company did not assume that this would be an automatic appointment. From March 2006, it was confirmed that he would be a Chairman on a permanent basis.

The role of SIDs in companies with non-independent chairmen

Chairmen may be considered non-independent for several reasons. They may have held an executive position within the company, have close family ties with directors or receive additional remuneration apart from fees. For example, we do not consider the Chairman at Cable & Wireless independent due to his highly geared remuneration package. Within the FTSE 100, there are 24 chairmen that Insight does not consider to be independent (as at March 2007). In these instances, we try to ensure that we have dialogue with the SID (i.e. that we meet them rather than the Chairman).

Insight has placed particular importance on the role of the SID at Informa. The Chief Executive recently stepped up to become Chairman, which meant that the

company no longer had an independent chairman. The company accepted that this was not best practice and wrote to and met with shareholders, including Insight, to present the Board's justification. We re-iterated to the company that, when a chairman is not independent at appointment, we believe it is important for a significant number of board members to be independent. The company confirmed that the SID's role would be strengthened significantly to include:

- Ensuring the Board remains independent
- Ensuring the SID has time available to meet institutional shareholders
- Leading the Board agenda's including strategy discussions
- Chairing the Audit Committee
- Being available to meet senior management, including those below board level, should problems arise.

Man Group is another example of a company where the Chairman is the ex-Chief Executive. However, in this instance, the SID has had greater involvement with the executive directors, ensuring shareholders' interests are represented.

Family control is one issue that has been of concern to shareholders at BritishSkyBroadcasting. Rupert Murdoch is the Chairman, and his son James is the Chief Executive. Prior to the appointment of a SID, investors wanted to ensure that the board has sufficient oversight, and therefore, wanted an individual who was not connected to the family to take on the role. Lord Rothschild was appointed to the role, a move that has re-assured investors due to his extensive experience from other directorships at publicly listed companies.

Access to the SID

It should be clear that SIDs are not the first point of call for dialogue with investors on governance issues. We believe it should normally be the chief financial officer, chief executive, chairman, company secretary or investor relations director. Where an issue is confidential or sensitive, shareholders may need to contact the SID without the company being aware. In these instances, Insight would approach the SID through the route of the company's advisors. Ease of access to the SID may be even more important for UK shareholders where the respective chairman of the company resides overseas, e.g. BritishSkyBroadcasting and Amvescap.

Rewards

Ninety-six percent of FTSE 350 companies, excluding investment trusts have appointed a SID (as at 30 June 2007). Fifteen percent of these SIDs hold the position of deputy chairman, who in general, receives higher fees than other non-executive directors. However, the role of a deputy chairman is not well defined. The fees for the SID are typically about 10% higher than other non-executive directors, which we believe is quite low when the additional responsibilities of the role are taken into consideration.

Conclusion

Four years since the publication of the Higgs report, nearly all FTSE 350 companies, excluding investment trusts, now have a SID. While at first Insight was not convinced of the need for the creation of this position, over time we have found that it has been a valuable addition to UK boards. The performance of boards has no doubt been improved by the evaluation of chairmen's performance by SIDs, as has succession planning for chairmen. We will continue to encourage the appointment of SIDs and recognise their contribution towards good corporate governance.

¹ Source: Deloitte, forthcoming September 2007. Board structure and non-executive directors' fees report.

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