

MEMO# 17530

May 14, 2004

DRAFT INSTITUTE COMMENT LETTER TO EU ON THE ROLE OF INDEPENDENT DIRECTORS

ACTION REQUESTED [17530] May 14, 2004 TO: INTERNATIONAL COMMITTEE No. 27-04 RE: DRAFT INSTITUTE COMMENT LETTER TO EU ON THE ROLE OF INDEPENDENT DIRECTORS

Attached is the draft Institute comment letter on the EU Commission's consultation document regarding the recommendation on the role of independent directors (Consultation Document).¹ Comments on the Consultation Document are due by June 4, 2004. If you have any comments on the draft letter, please provide them to me by May 25, 2004 at jchoi@ici.org or at (202) 326-5810.

Form and Scope of the Commission's Recommendation The draft letter supports the Commission's approach of making a recommendation to Member States and agrees that the recommendation should cover EU-listed companies having their registered office in a Member State. The draft letter also agrees that Member States should have flexibility to introduce binding requirements if appropriate.

Board Composition The draft letter suggests that, at a minimum, the Commission state in the recommendation that the number of independent directors should be adequate in relation to the total number of directors (both executive and non-executive) on the board rather than in relation to the total number of non-executive or supervisory directors as suggested by the Commission. The letter argues that a significant number of independent directors vis-à-vis the number of executive or managing directors is necessary to ensure independence and effective oversight of corporate management. The draft letter also recommends that the Commission request Member States to consider whether independent directors should constitute a majority of the board. The draft letter states that having at least a majority of independent directors on boards would help to assure that independent directors have the ability to control the voting process, particularly on matters involving potential conflicts of interest with management.

¹ Memorandum to International Members No. 27-04 [17468] (May 6, 2004).

2 Profile of Independent Directors The draft letter states that the Institute agrees with the Commission's approach not to limit the number of directorships. The letter argues that directors have varying commitments both inside and outside the boardrooms, and the ability of a director to serve adequately on a board will depend on a variety of factors. The letter recommends that it would be more appropriate for the Commission to remind directors of their responsibilities and the time commitment that such responsibilities would likely entail and to require greater transparency in this area. The draft letter also takes issue with one of the nine minimum criteria for independence – that to be independent, a director may not have served on the board for more than 12 years. The letter states that the length of service on the board in itself is not indicative of a lack of independence. In fact, a long-serving independent director may know more about the company and be able to appreciate more readily conflicts of

interest situations. Board Committees The draft letter agrees with the Commission that the nomination committee should be composed of a majority of independent directors and urges the Commission to recommend that the nomination of independent directors be entirely in the hands of independent directors. The letter disagrees, however, with the Commission that companies should be required to have the CEO be closely involved in the nomination process. The letter takes the position that allowing some executive directors to participate in the nomination committee (i.e., only a majority of the committee has to be independent) would ensure proper input from executives and would be sufficient to permit CEOs to be a member of the nomination committee if it is appropriate under the specific circumstances. With respect to the role of the remuneration committee, the draft letter questions whether it is the proper role of a board committee to make specific proposals to the board regarding the remuneration policy for executive or managing directors, the individual remuneration to executive or managing directors, and the standard form of contract for executive or managing directors. The letter argues that, given that the Commission envisions this committee to be composed exclusively of non-executive or supervisory directors, it may be more appropriate for the external directors to provide proper oversight of, rather than to undertake, these responsibilities. Jennifer S. Choi Associate Counsel Attachment (in .pdf format)

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