

Traditionally the Chairman and Company Secretary have had sole domain over Board evaluations, but since the advent of the Walker Review and the subsequent regulatory repercussions this is no longer the case. Now, senior compliance professionals have a more significant and influential role to play. You can help develop your Board and positively affect the bottom line, in addition to ensuring that FSA requirements and best practice are met through the effective use of Board evaluations.

Where's your mandate? As recently as May, Jon Pain, Managing Director of FSA Supervision stated in a speech on intensive supervision and regulatory outcomes: *"...although poor governance was only one of many factors that contributed to the financial crisis, it was an important one. We are therefore looking closer at behaviour and culture in firms, particularly ensuring two key things:*

- One – that good culture and behaviours in firms is being driven by senior management; and
- Two – that good culture and behaviours are being reinforced by effective corporate governance and the role of the boards.

*"Through the crisis we have also seen examples where boards did not sufficiently challenge the executive or understand their firms' business models and their inherent risks, and where boards did not simply receive the relevant management information to be able to carry out their important oversight role. Boards need to make sure they have the right people, asking the right questions, informed by the right information... **where this is not the case we will take action...**"*

Over the next few months we'll be writing a series of articles based on our experience of working with financial services Boards and will include some 'how to' articles that address the FSA's concerns and include: getting your Board to define and understand strategy, ensuring your Board understands financial analysis and controls, ensuring your Board is up to speed on the regulatory framework and controls, turning a 'tick-box' Board Review exercise into an opportunity, getting the Boardroom balance right, getting the best from Committees, and finally ensuring the Board has the right flows of information. This first piece is on Board evaluations.

Why undertake a Board evaluation? Board evaluations have been a hot topic since the Walker Review and other initiatives. Many recommendations have been made internationally and regulation tightened as a result. In the UK, the Combined Code has been updated as the UK Corporate Governance Code, and the Higgs Guidance is still under review with an update due later this year.

If your organisation is a FTSE company then you are expected to undertake an external evaluation at least every three years (or explain why not) with the anticipation that some form of internal evaluation will be undertaken in the intervening years. However, if your firm does not fit the official criteria for evaluations does that mean that there is nothing to be done? The reality is that the FSA is including evidence of good governance, such as the conduct of Board evaluations, during ARROW visits.

European Internal Markets Commissioner, Michel Barnier is also involved with his Governance Green Paper. His recommendations include a compulsory annual external evaluation. His office has gone even further to suggest that perhaps having a regulator sitting in on Board meetings is the way forward. Whatever the outcome, Board evaluations are here to stay and your organisation may as well get the most from your Board evaluation as possible.

How do you get the most from your Board evaluation? Setting clear objectives is key to the success of the evaluation, and whereas this has traditionally fallen within the remit of the Company Secretary we

are increasingly seeing Compliance Directors and Internal Audit involved in specifying deliverables, including the all important regulatory requirements, Board development and stakeholder needs. Setting good measurable objectives is crucial to the usefulness of the evaluation.

Who will lead the initiative? Traditionally the Company Secretariat has been heavily involved with the co-ordination of internal/external resources and administration. However, it is imperative that leadership comes from the Chairman to ensure that any resulting actions required are followed through and the Board evaluation is of value. If, for some reason, this is not appropriate then the Senior Independent Director is ideally placed to lead the initiative.

What do you focus upon? For a thorough evaluation pay particular attention to those issues that have come to the fore through the various reviews and investigations that have followed the global economic crisis:

- The role of Chairman
- How the Board spends its time
- Suitable challenge on issues
- The role, responsibilities, suitability and contributions of Board members
- Board member support and ongoing development
- Board composition and diversity

What techniques are available? An internal, externally-facilitated or full external evaluation can contain a whole range of evaluation tools, including:

- Review of Board documentation
- Review of Board Control Manual
- Individual questionnaires
- Individual interviews
- Review of Board meetings
- Review of Sub-Committees

Whatever tools you choose, we'd recommend that you use questionnaires every year, whether you undertake a full evaluation or not as this will enable you to benchmark and identify trends. It really depends on what you want from your Board evaluation. Is there a problem you are trying to surface? Is it a box-ticking exercise? Do you want to use the opportunity to develop your Board?

How do you construct your evaluation? It's always worth taking a pulse-check amongst other senior management and key personnel, including those interfacing with external stakeholders, to find out any concerns people may have about the Board. This valuable piece of research will help inform your objectives and what techniques are the most suitable in the circumstances. If there are known problems always opt for an external evaluation, whether or not you intend to make the full results public. This is by far the easiest way to get to the heart of the matter and avoid the evaluation 'back-firing'.

What do you do with the results? Apart from the obvious need to state the Board evaluation result in the next annual report and advise the FSA on your next ARROW visit, it's important to follow-up on any recommendation that your external evaluator has provided in an action plan. With an internal evaluation this is more difficult and will need to be handled very diplomatically. Occasionally an evaluation will show the need to replace a director, which will need to be carefully handled by the Chairman or SID in conjunction with HR. More often an evaluation will show an opportunity to further develop the Board as a team, strengthen leadership, tighten Board support, or provide further training

and encourage challenge from NEDs. Once the Board has seen the results it's important to take action on the follow-up immediately while you still have the momentum. Making the changes and developing the Board in whatever way is appropriate will avoid the evaluation being a box-ticking, 'self-congratulatory' task, make your Board more effective, and your regulator confident in you.

In the next article we will cover 'Getting the Board to define and understand strategy'.

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