

DR Abstract

Board Performance and Evaluation

J.P. Morgan's Depositary Receipts Group recently held a roundtable lunch discussing the critical issues involved in measuring and evaluating FTSE Board performance. Oliver Ziehn, a Partner at the corporate advisory firm Lintstock, presented on the subject.

An effective Board of directors is essential to the long-term success of any company. The revised UK Corporate Governance Code concluded that whilst many good governance practices were in place, "Boards need to think deeply, thoroughly and on a continuing basis about their overall tasks". The Code makes provision for annual self-assessment of Board effectiveness and external facilitation of the process at least every three years.

The following are highlights from the roundtable:

The evaluation process

Among governance experts, there is broad agreement on the correlation between the quality of a Board of directors and long-term shareholder value. However, the process of evaluating the performance of a Board remains in its formative stages and there is a wide diversity of views as to how, when and by whom this should be done. Effective evaluations seek to:

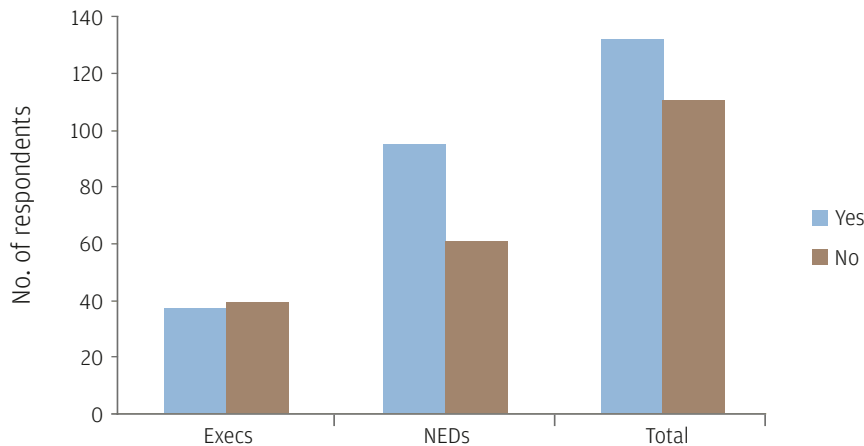
- Highlight opportunities for improvement within the Board's processes and assist with establishing new, measurable goals.
- Foster a forward-momentum in the Board's work if conducted regularly. If a Board is unaware of some areas of concern, it cannot have the opportunity to address them.
- Shift their focus from year to year as priorities change depending on the critical issues facing directors.
- Help directors to air concerns constructively when everyone is aware of problems but no one feels comfortable raising them.

“Boards need to think deeply, thoroughly and on a continuing basis about their overall tasks”

- Be most helpful, when there has been a period of transition or internal division, to independently appraise whether the appropriate working processes were followed.
- Encompass self-evaluation, external review and peer observation. Input from key executives below Board level can inject a fresh and informed perspective.

According to a recent Lintstock study of 250 FTSE All-Share Board members on behalf of the All-Party Parliamentary Corporate Governance Group, non-executive directors (NEDs) in particular are supportive of ‘upward evaluation’ methods.

Do you think that it would be beneficial to engage in an ‘upward evaluation’ of the Board to understand how it is perceived by, and interfaces with, management?



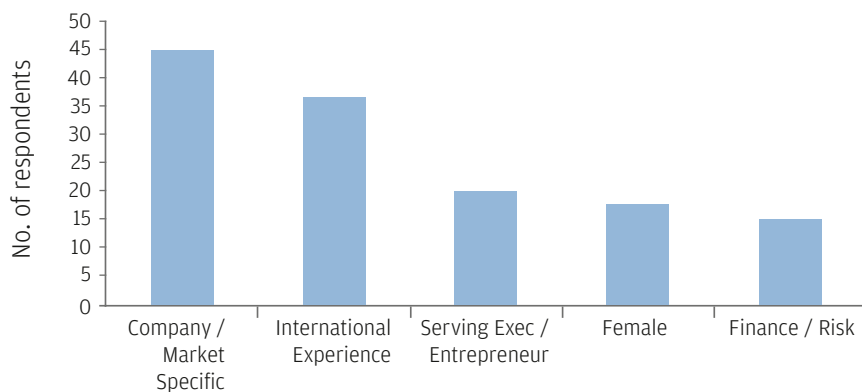
Source: Reconnecting the Board to the Business, 2011

What makes a Board effective?

The formation and effective functioning of a team of executive and non-executive directors is a considerable challenge. The Board must act as a whole to ensure the company achieves its stated goals. However, since Board members should bring independent judgement to bear on issues of strategy, performance, and resources, they should also be diversified. Board members should be chosen on a variety of criteria including technical and other skills that will suit strategic priorities and ensure organisational performance. According to the Lintstock study of 50 Board reviews conducted in 2010, key priorities for Board composition and expertise are as follows:

Priorities for Board Composition.

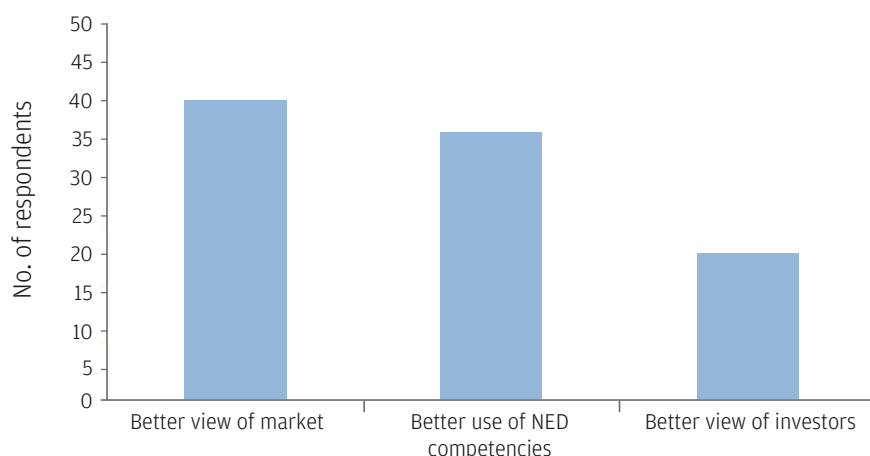
What are the key attributes which are required in new Non-Executive Director recruits?



Source: Lintstock Board Development Review, 2011

Priorities for Board Expertise.

In what areas could the Board benefit from more information or expertise?



Source: Lintstock Board Development Review, 2011

A critical element in Board effectiveness is a thoughtful nomination and recruitment process that is viewed as part of a broader effort to identify and develop Board leadership. A process that is ad hoc in nature can prove disruptive and costly, and increase risk. Accordingly, there is a growing trend to succession planning that entails:

- Mapping out future requirements to recruit more competitively from a shrinking pool of candidates who offer the appropriate skill and diversity profiles.
- Preparedness to readily interact with promising company insiders who are likely to be more familiar and compatible with the organisational culture.

Director independence is, of course, important to issuers and their stakeholders. The official role of the non-executive director involves corporate governance, monitoring executive activity and providing strategic advice. But investors believe that their expertise is currently under-utilised by Boards. The UK Corporate Governance Code places a new emphasis on constructive challenge by NEDs, and there will be an expectation on them to exert greater influence.

How the evaluation process is reported and acted upon

It is important that assessment results are communicated in a thoughtful, sensitive and constructive manner to encourage positive Board action and continuous improvement.

The real value of the assessment exercise is derived when the Board evaluates the findings and discusses what measures, if any, to act upon. The process is most beneficial if it lays a foundation for the Board to chart a targeted course for follow-up action and assigns responsibilities. In this regard, the motivating aspect of evaluation for both non-executive and executive directors is important – it should be answering ‘what are the company’s future challenges’, rather than ‘what do you think of the Board?’

Investor engagement and disclosure also needs careful consideration. Investors need to have a clear expectation of what might be communicated to them as a result of the Board evaluation. With this in mind, an increasing percentage of companies are systematically reporting on the action plan emerging out of their evaluation process.

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Please note that this abstract is a summary of discussions at the J.P. Morgan Depositary Receipts Group's roundtable 'Board Evaluation and Performance' and is presented for general informational purposes only. It is not a complete analysis of the matters discussed herein and should not be relied upon as legal advice.

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