



FINANCIAL REPORTING COUNCIL

FEEDBACK STATEMENT: GENDER DIVERSITY ON BOARDS

OCTOBER 2011

Introduction and Conclusions

In June 2010 the revised UK Corporate Governance Code came into effect. It included for the first time a principle recognising the value of diversity in the boardroom (Supporting Principle B.2), which states that “the search for board candidates should be conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender”.

Later in 2010 Lord Davies of Abersoch was commissioned by the Government to undertake a review of gender diversity on the boards of listed companies to identify barriers preventing more women from reaching the boardroom, and to make recommendations regarding what government and business could do to increase the proportion of women on boards. Lord Davies’ report was published in February 2011.

In May 2011 the FRC issued a consultation document seeking views on whether the UK Corporate Governance Code should be amended as recommended by Lord Davies. The FRC consulted on a proposal that boards should be required to report annually on their boardroom diversity policy, including any measurable objectives they had set for themselves, and on the progress they had made in delivering that policy and those objectives.

As well as consulting on this recommendation, the FRC also sought views on:

- Whether the Code should be amended to set out some of the most important issues, including the board’s diversity, to be addressed as part of the board effectiveness review;
- Whether some of the elements of a gender diversity policy should be set out, either in the Code or separate guidance; and
- The timing of any changes to the Code.

Consultation closed on 29 July 2011. This paper summarises the main points from the responses, the decisions taken by the FRC and the reasons for those decisions.

In accordance with the views of the vast majority of respondents, the FRC intends to implement the two amendments to the Code on which it consulted. Minor changes to the wording will be made to make it consistent with the existing wording on diversity in the Code. The revised wording of the relevant sections of the Code is shown in the Appendix.

The FRC does not propose to make any other changes to the Code as a result of this consultation; nor does it currently intend to produce further guidance on how boards might develop diversity policies.

The changes will be incorporated in an updated version of the Code to be published in 2012, following consultation on proposed changes to other parts of the Code, which will apply to financial years beginning on or after 1 October 2012.

The formal implementation of these changes is being deferred because the FRC believes it is unhelpful to companies and investors for the Code to be amended when it is already the intention to consult on further changes. Changing the content of the Code too frequently creates confusion and does not allow time for the impact of new elements of the Code to be fully understood. In the normal course of events, the FRC would seek to allow a period of at least two years between each edition of the Code.

An implementation date of 1 October 2012 should also mean that the new requirements apply from the same date as the Government's proposed regulations requiring companies to disclose information about the percentage of women at different levels of the organisation.

However, in view of the importance of diversity to the effective functioning of boards, the FRC would echo Lord Davies and strongly encourage all companies voluntarily to apply and report on the intended additions to the Code with immediate effect.

Financial Reporting Council
October 2011

Summary of Responses

The FRC received 75 responses to the consultation¹. Of these, 18 responses were from listed companies, nine from institutional investors and the same number from advisers such as audit firms and executive search consultants. There were 18 responses from representative and professional bodies. The remainder came from a mixture of individuals, special interest groups and other organisations, including the 30% Club (whose members have voluntarily committed to having at least 30% female directors on the boards they chair).

The vast majority of respondents supported some amendment to the Code, but there were different views on the extent of the changes and when they should be implemented. Those who opposed any amendment considered that the impact of the existing reference to diversity, added to the Code in 2010, was not yet known and should be assessed after a reasonable period of time before further changes were considered.

Responses on the specific questions asked in the consultation document are summarised below.

Disclosure of the board's diversity policy

Lord Davies recommended that “the Financial Reporting Council should amend the UK Corporate Governance Code to require listed companies to establish a policy concerning boardroom diversity, including measurable objectives for implementing the policy, and disclose annually a summary of the policy and the progress made in achieving the objectives”.

The proposed amendment to provision B.2.4 in the consultation document differed from this recommendation in two respects: it referred specifically to gender diversity rather than diversity more generally; and said that companies should disclose “any measurable objectives”. It was these two points that attracted most comment.

Approximately one-third of all respondents felt that companies should explain their policy on boardroom diversity generally, not just gender diversity. About 20 per cent of these respondents (mostly listed companies), argued that explicit references to gender should be deleted because, to quote one company, “we are concerned that the current focus on gender diversity will not help boards address in a holistic manner their own imperatives to improve board diversity and effectiveness”.

The other respondents who commented on this point either identified other aspects of diversity which they felt needed also to be highlighted - for example, a number of respondents commented on the benefit of having foreign nationals on the board when a company is entering new geographical markets - or, more commonly, argued that the Code should refer to “diversity,

¹ Copies of the responses can be found at: <http://www.frc.org.uk/corporate/responseConsultationDocument.cfm>

including gender”. As well as capturing other aspects of diversity, it was argued that this wording would be consistent with the existing reference to diversity in supporting principle B.2 of the Code.

As indicated in the consultation document, the FRC shares the view of those respondents that considered that a lack of gender diversity around the board table may weaken the board by encouraging “group think”; that low percentages of women on boards may demonstrate a failure to make full use of the talent pool; and that boards with no, or very limited, female membership may be weak in terms of connectivity with, or understanding of, customers and workforce and offer little encouragement to aspiration among female employees. For these reasons, the FRC does not consider it would be appropriate to remove any reference to gender.

On the other hand, the FRC agrees that companies should not focus purely on gender at the expense of other aspects of diversity. However it considers that adding specific reference to other aspects of diversity could result in the Code provision becoming a long, unhelpful, list of such attributes. **The FRC therefore has instead decided to mirror the wording used in the existing supporting principle B.2.**

A small number of respondents, mostly from listed companies, argued that the reference to “any measurable objectives” - or at least the word “measurable” - should be dropped. It was argued that “the emphasis on measurable objectives may detract from underlying efforts and achievements made by companies which operate in different market sectors”.

These respondents were outnumbered by the quarter of all respondents who felt that this reference should be strengthened. Some of these respondents felt that the word “any” should be deleted, so that companies would be required to set and disclose measurable objectives, or to explain why they had not done so. A smaller number argued that the Code should specify a minimum target for the percentage of female directors on the board.

The FRC does not believe it would be appropriate to specify a minimum target in the Code. No matter how it was qualified, embedding a specific figure would inevitably be viewed as a quota. The FRC also considers that an absolute requirement to set a measurable objective for only one aspect of diversity is not entirely consistent with an encouragement to consider all aspects of diversity in determining the optimum composition of the board; nor would it be sensible to require companies to set a series of targets for all aspects of diversity. Rather boards should report on what steps they are taking to achieve the diversity necessary to maximise the effectiveness of the board, and as part of that what consideration they have given to gender balance.

On the other hand, the FRC believes that removing entirely any reference to measurable objectives would invite bland, generic disclosures. **On balance, therefore, the FRC considers it is appropriate to retain the wording “any measurable objectives”.**

The revised provision B.2.4 will therefore read:

“A separate section of the annual report should describe the work of the nomination committee, including the process it has used in relation to board appointments. This section should include a description of the board’s policy on diversity, including gender, any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives. An explanation should be given if neither an external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director.”

The board effectiveness review

In the consultation document the FRC sought views on whether to add a new supporting principle to Principle B.6 (on board evaluation) setting out some of the key issues to be addressed in the board effectiveness review. The suggested wording of the new supporting principle was: “Evaluation of the board should consider the balance of skills, experience, independence and knowledge of the company on the board, the board’s policy on gender diversity, how the board works together as a unit, and other factors relevant to its effectiveness”.

80 per cent of respondents commented on this question. Of these nearly a quarter were opposed to adding a new supporting principle. Many of these were opposed to any changes to the Code, while others considered, in the words of a listed company, that “the board evaluation process is most valuable when a board can tailor it to its specific needs and circumstances at the time of the evaluation”.

Listed companies were the only category in which a significant minority of respondents were opposed to the proposed new supporting principle. Investors in particular were strongly in favour, with all those that commented supporting the proposal.

Among all supporters, views were fairly evenly divided between those who agreed with the wording on which the FRC consulted, and those who felt that it needed to be amended to refer to broader aspects of diversity. A small number of respondents felt that the new principle should go further, for example by referring explicitly to the need for boards to assess progress in achieving their diversity objectives.

The FRC has decided to proceed with this proposal, but to amend the wording so that it is consistent with the intended change to Provision B.2.4. The new supporting principle B.6 will therefore read:

“Evaluation of the board should consider the balance of skills, experience, independence and knowledge of the company on the board, its diversity, including gender, how the board works together as a unit, and other factors relevant to its effectiveness”.

Guidance on developing a boardroom diversity policy

In the consultation document the FRC asked whether it would be helpful to set out some of the elements that might be covered by a policy on boardroom diversity and if so, whether this should be done in the UK Corporate Governance Code or elsewhere.

Just over half the respondents commented on this issue, and views were divided. There was little support for additional requirements to be added to the Code. The remaining responses were fairly evenly divided between those who felt that guidance in some form would be helpful, and those who felt it unnecessary and inappropriate. All agreed that any guidance needed to avoid being prescriptive.

The FRC applies three tests when considering whether to issue guidance to supplement its codes and standards: that there is a clearly-defined issue; that the proposed material is the most appropriate way to promote the achievement of high standards in the relevant aspect of governance or reporting; and that the FRC is the most appropriate body to issue the proposed material. **The FRC is not persuaded that all of these tests are met in this case and therefore does not currently propose to issue further guidance, but it will keep this position under review.**

Other suggestions

A number of respondents recommended changes to other principles or provisions of the Code. The FRC has not adopted any of these suggestions.

The most common suggestion was that the contribution of diversity to an effective board should be referred to in Principle B.1 (which states that “the board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively”). While sympathetic to the point being made, the FRC considers that the amendments it intends to make, together with the existing reference in Principle B.2, are sufficient.

The 30% Club put forward a number of additional proposals including requirements for the nomination committee to disclose whether it uses a board skills matrix to identify gaps within the board and to set and publish a target for female representation at senior management level. While the FRC does not propose to incorporate these proposals in the Code, companies can of course choose to make such disclosures on a voluntary basis.

Implementation of Changes to the Code

The consultation document sought views on a number of different options for implementing any changes to the Code. These were: applying the changes retrospectively to financial years beginning on or after 29 June 2011 (i.e. twelve months after the current Code came into effect); applying them to financial years beginning on or after 29 June 2012; implementing the updated Code at the same time as any regulations made by the Government to implement Lord Davies' recommendation on reporting the percentage of women of boards, in senior management and throughout the organisation; and postponing the implementation of any changes until after the FRC's next formal review of the Code.

In his report Lord Davies stated that in his view companies should report on the matters covered by the recommended regulations and Code changes in the corporate governance statements contained in their reports published in 2012 "whether or not the underlying regulatory changes are in place."

80 per cent of respondents commented on this issue. There was a significant difference between the views of listed companies and other respondents. Almost all listed companies supported one of the options that would result in the new requirements applying from June 2012 or later. Among other respondents, two-thirds of those who expressed an opinion favoured retrospective or immediate application of the revised Code.

The main arguments given for immediate or retrospective implementation were that it would maintain the momentum generated by the Davies Report; that most boards should already be aware of the issue and discussing their own approach to diversity; that many will already be expecting to have to report on their approach in 2012; and that early implementation will reduce the risk of regulatory intervention at EU level, which most respondents considered undesirable.

The main arguments given for later implementation were that it was wrong in principle to impose retrospective requirements; that later implementation would give companies time to develop their policies and practices, where they were not already in place; and that it could help to ensure consistency with the proposed BIS regulations and any EU requirements. Some of those supporting later implementation felt that companies could and should be encouraged to adopt the changes voluntarily in advance of formal implementation.

There have been further developments since the end of the consultation period that impact on the proposed timing.

In September the FRC published a feedback statement on its discussion paper, 'Effective Company Stewardship: Enhancing Corporate Reporting and Audit', which had been issued for

consultation earlier in the year². In that statement the FRC confirmed that it intends to consult on further changes to the Code in relation to audit committees and audit tendering. At present the intention is to begin consultation on these changes in early 2012.

Separately the FRC has asked Lord Sharman of Redlynch to undertake an inquiry to identify lessons for companies and auditors addressing going concern and liquidity risks³. As part of that inquiry he is considering whether changes to the Code might be appropriate. If he reaches that conclusion the FRC will consult on whether to implement his recommendations.

Also in September the Department for Business, Innovation and Skills published a consultation document on narrative reporting which contained proposals to overhaul the current framework⁴. The Government is proposing to implement Lord Davies' recommendation that companies should report on the proportion of women on the board, at senior executive level and across the organisation (where this information is available). The Government's intention is that these proposals should take effect on 1 October 2012.

In the light of these developments, the FRC has decided to defer implementation of the changes set out in this document. They will be incorporated into an updated edition of the Code, which will also incorporate any changes agreed following the further consultations outlined above, which will apply to financial years beginning on or after 1 October 2012.

The FRC believes it is unhelpful to companies and investors for the Code to be amended when it is already the intention to consult on further changes. Changing the content of the Code too frequently creates confusion and does not allow time for the impact of new elements of the Code to be fully understood. In the normal course of events, the FRC would seek to allow a period of at least two years between each edition of the Code.

An implementation date of 1 October 2012 should also mean that the new requirements apply from the same date as the Government's proposed regulations requiring companies to disclose information about the percentage of women at different levels of the organisation.

The FRC's decision to defer implementing these changes to the Code should not be viewed by companies as a signal that they do not need to think seriously about diversity, and in particular gender diversity, over the next twelve months. In view of the importance of diversity to the effective functioning of boards, the FRC would strongly encourage all companies voluntarily to apply and report on the intended additions to the Code with immediate effect.

² The feedback statement can be found at: <http://www.frc.org.uk/press/pub2632.html>

³ Details of the inquiry can be found at: <http://www.frc.org.uk/about/sharmaninquiry.cfm>

⁴ 'The Future of Narrative Reporting: Consulting on a new reporting framework', September 2011

Looking further ahead, the FRC considers that there is merit in aligning future changes to the Code with changes to company law in order to help companies manage their implementation. Changes to company law are always introduced either from 1 April or 1 October. For that reason, it is the FRC's intention that all future editions of the Code should apply to financial years beginning on or after 1 October in any given year. Implementing changes from 1 October rather than 29 June each year – as has been the case for previous editions of the Code - should have little impact in practice as few companies have year ends in the third quarter.

Appendix

Revisions to Section 2 of the Code

[Note: revisions are shown in italics and underlined.]

B.1: The Composition of the Board [no change]

B.2: Appointments to the Board

Main Principle

There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.

Supporting Principles

The search for board candidates should be conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender.

The board should satisfy itself that plans are in place for orderly succession for appointments to the board and to senior management, so as to maintain an appropriate balance of skills and experience within the company and on the board and to ensure progressive refreshing of the board.

Code Provisions

B.2.1. There should be a nomination committee which should lead the process for board appointments and make recommendations to the board. A majority of members of the nomination committee should be independent non-executive directors. The chairman or an independent non-executive director should chair the committee, but the chairman should not chair the nomination committee when it is dealing with the appointment of a successor to the chairmanship. The nomination committee should make available its terms of reference, explaining its role and the authority delegated to it by the board.

B.2.2. The nomination committee should evaluate the balance of skills, experience, independence and knowledge on the board and, in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment.

B.2.3. Non-executive directors should be appointed for specified terms subject to re-election

and to statutory provisions relating to the removal of a director. Any term beyond six years for a non-executive director should be subject to particularly rigorous review, and should take into account the need for progressive refreshing of the board.

B.2.4. A separate section of the annual report should describe the work of the nomination committee, including the process it has used in relation to board appointments. *This section should include a description of the board's policy on diversity, including gender, any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives.* An explanation should be given if neither an external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director.

B.3: Commitment [no change]

B.4: Development [no change]

B.5: Information and Support [no change]

B.6: Evaluation

Main Principle

The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

Supporting Principles

Evaluation of the board should consider the balance of skills, experience, independence and knowledge of the company on the board, its diversity, including gender, how the board works together as a unit, and other factors relevant to its effectiveness

The chairman should act on the results of the performance evaluation by recognising the strengths and addressing the weaknesses of the board and, where appropriate, proposing new members be appointed to the board or seeking the resignation of directors.

Individual evaluation should aim to show whether each director continues to contribute effectively and to demonstrate commitment to the role (including commitment of time for board and committee meetings and any other duties).

Code Provisions

B.6.1. The board should state in the annual report how performance evaluation of the board, its committees and its individual directors has been conducted.

B.6.2. Evaluation of the board of FTSE 350 companies should be externally facilitated at least every three years. A statement should be made available of whether an external facilitator has any other connection with the company.

B.6.3. The non-executive directors, led by the senior independent director, should be responsible for performance evaluation of the chairman, taking into account the views of executive directors.

B.7 Re-Election [no change]



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