ICAEW REPRESENTATION 37/16

UK Board Succession Planning

ICAEW welcomes the opportunity to comment on the discussion paper *UK Board Succession Planning* published by the Financial Reporting Council on 29 October 2015, a copy of which is available from this link.

This ICAEW response of 10 February 2016 reflects consultation with the Corporate Governance Committee whose members are drawn from the business and investment communities. The Committee informs our thought leadership and policy work on corporate governance issues and related submissions to regulators and other external bodies.

The Institute of Chartered Accountants in England and Wales
Chartered Accountants' Hall
Moorgate Place
London
EC2R 6EA UK

T +44 (0)20 7920 8100
F +44 (0)20 7920 0547
DX 877 London/City
icaew.com

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ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

For more information, please contact john.boulton@icaew.com.

icaew.com

MAJOR POINTS

1. We appreciate the opportunity to comment on this consultation paper. In drafting our response we have consulted with both investors and non-executive directors who serve on ICAEW committees and we draw on their experience to answer the specific questions.

2. We welcome this initiative to encourage companies to plan in a more structured way for succession. There are opportunities to improve reporting to investors on the criteria that might guide future selection decisions and on the activities of the nomination committee. Developing an appropriate pipeline, both internal and external, can help ensure that the right balance and mix of skills is available to tackle issues as they arise as well as providing a mechanism for improving diversity among board membership.

3. ICAEW has deep experience in assisting with the development of the UK corporate governance framework, and we stand ready to work constructively with the FRC to develop effective workable proposals which support better succession planning. It is important that solutions recognise the needs of investors as primary stakeholders in corporate governance. Nevertheless, to be effective, solutions must be proportionate. It is important to undertake impact assessments for proposals before they are adopted and for their scope to be carefully considered.

Changes to the Code should be minimised

4. In developing further guidance the FRC should be mindful that substantive change to the Corporate Governance Code (‘the Code’) may not be necessary. The Code sets out a principles-based corporate governance framework. Changes to the Code therefore should take place only when this is to change the scope or substance of the framework. We do not believe that a major overhaul is required in order to achieve the improvements the FRC is seeking. Equally, an increasing number of specific requirements could seriously damage the balance and overall integrity of the Code. Detailed guidance on succession planning would be better addressed in a separate document.

Disclosure enhancements

5. In providing non-mandatory guidance, the FRC may wish to consider some specific disclosure enhancements that could help investors better understand succession planning. As the discussion paper suggests, a clearer link could be drawn between a company’s strategy and the human resources decisions likely to be made to deliver these objectives. In this context, more information could be provided about the skill sets that are likely to be required. Moreover, organisational culture could be more informatively described. Understanding how a company views its culture can help investors to appreciate the type of selection decisions that might be made in future. Nomination committee reporting might also be improved. Currently it is often less informative than that of the remuneration or audit committees.

UK companies are making significant progress in improving board diversity

6. Significant progress has been made in improving board diversity since the publication of the revised Corporate Governance Code in 2010. As regards gender diversity, the UK has made great advances under a voluntary, business led framework in just over 4 years. According to the Davies Review’s 2015 Annual Report Women on Boards, women’s representation on FTSE 100 boards now stands at 23.5%, almost double where we started at 12.5% in 2011. For the first time, there are now no all-male boards in the FTSE 100.

7. ICAEW is concerned that supply remains an issue and recognises the importance of facilitating the appointment of board members who enhance diversity by reducing attrition rates as women progress through organisations. As a professional body, ICAEW has developed a number of relevant initiatives in this area, including:
   - the Women in Leadership programme, launched in February 2011 to support female finance professionals with their career progression;

- the Back to the Workplace programme which supports career breakers when they return to work;
- the Women in Finance Network to enable sharing of experience and to help Network members with personal development;
- the Women in Accountancy events programme targeted at female undergraduates, encouraging them to choose accountancy as a career and involving schools and colleges; and
- ICAEW sponsored awards such as the First Women Awards (finance category) and Women in the City Awards (accountancy category) to promote the visibility of role models and mentors and to emphasise the success of female finance professionals and the initiatives of their employers.

8. The inclusion of a requirement to consider and report on diversity within the revised Code in 2010 has undoubtedly been an effective step toward encouraging companies to improve board diversity. We believe that the ‘comply or explain’ approach of the Code, together with peer pressure, continues to be the best mechanism for inducing further positive change. In our opinion, mandating particular actions or introducing sanctions for non-compliance will not convince companies of the benefits of diverse boards or make them want to initiate sustainable changes.

RESPONSES TO SPECIFIC QUESTIONS

Business strategy and culture

Q1-2: By what practical methods can the development of business strategy and company culture be linked to succession planning? How best can the link between strategic planning and effective succession planning be reported?

9. We believe the FRC is right to highlight the link between strategy, culture and succession planning. Given the importance of key selection decisions to the successful execution of strategy, it is helpful to understand the human resources policy and culture the company feels is required to deliver its strategy. There is also the potential that strategy evolves with succession to certain posts and therefore an articulation of the skill sets that a company would be looking for in future selection decisions could help to set investors’ expectations about how succession would be approached. More informative disclosures could also be made about organisational culture, to help anticipate the qualities that are likely to be sought for in succession candidates. These measures could help to avoid surprises without risking making investors insiders by revealing specific selection information to them. This might be achieved through dialogue between firms and investors. In our opinion any enhancements to disclosure guidance in this area should be couched in general terms because prescriptive requirements may simply result in boiler plate.

Nomination committee

Q3: How can nomination committee reporting be enhanced to provide sufficient information about the committee’s work, including its focus on succession planning and talent management?

10. More could be achieved by regular direct personal dialogue between Chairs and leading Shareholders of a regularity not currently enjoyed by FTSE 250 companies. The FRC should be mindful that in these discussions investors may not welcome the disclosure to them of specific information that would risk them becoming insiders. But, more could be done to communicate the skill sets and values that would be sought in future selection decisions.

11. As regards the nomination committee report included in the annual report; some companies already make informative disclosures here, for example about the process followed for recruitment and induction. However, examples can also be found of excessive boiler plate, and in some cases nomination committee reports are not as informative as the reports of the remuneration or audit committees. More could be done to improve the quality of reporting,

although in our opinion this is better achieved through peer pressure and the helpful examples of the Financial Reporting Lab than through prescription. It is certainly not helpful to try and compel companies to disclose sensitive personal matters in their nomination committee reports.

12. Effective nomination committee reporting would provide investors with confidence that the committee was abreast of its responsibilities. Reporting might include a description of the process for nominations and board succession, an explanation of why the committee is comfortable that the board is suitably diverse and a statement of whether succession arrangements are in place for all board members and key management.

Q4: To what extent do you agree with the assertion that those who challenge are sifted out during the recruitment process?

13. The FRC’s Guidance on Board Effectiveness recommends that non-executives support the chairman and executive directors in instilling the appropriate culture, values and behaviours in the boardroom and beyond, which already implies a degree of challenge as well as sufficient alignment to be effective in this role. Executives and chairmen can be expected to prefer individuals who are going to actively contribute to discussion, albeit that this will sometimes entail their views being challenged. Nevertheless, we would expect the selection process to aim to ensure that the values of incoming individuals were appropriate for the organisation and its current situation. For example, a different profile may be desirable in a turnaround than in a sustainably successful business. Unsuccessful appointments can often be attributed to the cultural values of an individual being misaligned with an organisation.

Q5-6: Should the details of the objective criteria used in the search for board candidates be set out in the nomination committee report and if not, why? What is your experience of public advertising for non-executive roles?

14. Yes. Good quality annual report disclosures meaningfully describe the skills and experience of each director. That can help investors to assess why an individual is on the board. Equally, when a new director is appointed, and the process referred to in the nomination committee report, it is helpful to include a description of the skills sought, and the relevance of those skills to the company’s most likely strategy or operational challenges ahead.

Q7-9: Are the responsibilities of the nomination committee made clear in the principles and provisions of the UK Corporate Governance Code? Should there be more clarity about the role of the board? What, if anything, can be done to improve the standing of the nomination committee?

15. We do not believe that there is a need for further clarity in the Code on this point. The only matter that we believe is somewhat ambiguous is how far down an organisation the Board’s purview goes.

Q10: To what extent is the role and operation of the nomination committee a subject for discussion between investors and the board?

16. No, we do not believe this is typically a topic of discussion between investors and the board. There are other topics explored in this paper, such as the criteria for future appointments and the pipeline that may be more fruitful for dialogue. Nevertheless, we feel that there is a general opportunity to improve dialogue around stewardship and this is one example that could be included in such discussions.

Board evaluation

Q11: What practical changes could help ensure boards fully consider succession planning within the annual evaluation exercise?

17. It may be helpful to provide board evaluators with guidance as to the areas they should cover. Nevertheless, it is important to recognise that each company is likely to have different

succession issues and it is unlikely, although not impossible, that a Board evaluation will expose succession issues that are not already under discussion.

Q12-13: Would more detailed reporting on changes to a company's succession planning process which resulted from the evaluation of the board be beneficial? What are the barriers to this and how might they be overcome?

18. This might be helpful. However, we believe the FRC should be careful not to conflate board evaluation and succession planning. It is important that evaluators consider succession and the plans that are in place to deal with future selection, and this might feature in reports where relevant. Nevertheless, the two exercises have different objectives.

Q14: Would retrospective disclosure of previous board evaluations be useful and how might companies go about this?

19. It is not clear whether this question is about retrospective disclosure of previous board evaluations in the annual report or about disclosure of earlier findings to the current evaluator. In principle both can serve a useful function.

20. As regards the former, extensive reproduction of the content of out of date evaluations is unlikely to be helpful. However, specific information about how a board has changed/developed in response to the previous year's board evaluation would be useful. Indeed, many boards feel more comfortable giving such information than disclosing how the board is going to respond to the most recent evaluation.

21. In providing guidance for public disclosures the FRC should be mindful that it is important that the evaluator and the board are able to hold frank and open discussions and if this is compromised then the exercise may be less useful. As regards disclosure to successor evaluators, access to the outputs from previous evaluations is likely to be useful. Such information might include: what had been found; how the board had reacted to such findings; and, what were the obstacles (if any) to improvement.

Pipeline

Q15: We would be interested to learn more about how companies review their internal talent and what development practices they use in support of succession planning. What are the best ways to ensure that board members become more familiar with the work of internal candidates and their skills and attributes?

22. We understand that some companies hold a session, once or twice a year, of either the board or the nomination committee to review non-board level succession options. These sessions are typically led by either the chief executive or the HR director. To be effective it would typically be made clear in these sessions that the non-executive directors, although not taking executive decisions, are expected to actively comment, critically if necessary, on pipeline issues, particularly where a significant gap is apparent.

Q16: How could companies do more to establish an external 'pipeline', tracking and nurturing external candidates – particularly NEDs?

23. For key board positions (primarily chief executives) some boards have an open and continuing mandate with a recruitment firm to continuously monitor potential external replacements. Having such a process permanently in place, avoids sensitivities from incumbents around initiating succession planning.

Diversity

Q17-18: How should a succession plan incorporate and deliver diversity objectives? What more can be done and by whom to encourage greater diversity in the boardroom?

24. As the Corporate Governance Code recognises, diversity can help ensure that the board has access to a range and balance of skills, experience, knowledge and independence as well as a

variety of personal attributes. To achieve such a balance, some companies find it useful to conduct a prospective analysis of the skills needed to address the issues the organisation is likely to encounter over a time horizon of, say five or six years. Once this has identified the diversity of experience that is required, a general commitment to diversity of styles and backgrounds naturally follows to ensure the requisite mix of skill sets is available.

25. We believe that the inclusion of a requirement to consider and report on diversity within the revised Code in 2010 has been an effective step toward encouraging companies to improve board diversity. Peer pressure, combined with the ‘comply or explain’ approach of the Code has helped to make significant progress in this area, and in other aspects of corporate governance, and we believe that this continues to be the best mechanism for inducing positive change. Mandating particular actions or introducing sanctions for non-compliance will not convince companies of the benefits of diverse boards or make them want to initiate sustainable changes.

Q19: Do the current Code provisions relating to non-executive directors’ independence and length of tenure assist with encouraging diversity and progressive refreshment of the board?

26. Yes. We believe that these measures have been effective in stimulating greater mobility, which has provided the opportunity to enhance diversity. The great progress made since 2011 in increasing female representation on boards provides evidence that boards are being refreshed effectively. The FRC should be mindful that board continuity is also an important objective and should be weighted equally with the need periodically to refresh the board.

Q20: It has also been suggested that HR and nomination committees should work more closely with executive search firms to identify more diverse candidates. Can you provide examples of how this has taken place?

27. We understand that some companies already incorporate diversity in the brief provided to recruitment consultants and that these characteristics are actively considered in the search process.

Institutional investors

Q21: What experience have companies or investors had in terms of engagement about the introduction of new talent to a board?

28. We understand that investors would sometimes receive a private, confidential briefing on the most important succession planning issues, specifically those involving the chief executive, other key executives and the chairman. Nevertheless, there is a general reluctance on the part of many investors to receive information that would result in them becoming insiders, and it should be borne in mind that for main market listed companies many investors will have only a small holding and would not expect to be consulted on all such decisions.

Q22: What information can be shared constructively between companies and investors on succession planning and talent development and how?

29. Some shareholders may ask specific questions and it could then be appropriate to share information. See however, our points in paragraph 10 above about inside information. This could be addressed through more informative nomination committee reporting as we discuss in paragraph 5 above.