Ms Catherine Woods
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**By email: successionplanning@frc.org.uk**

Dear Catherine

**UK BOARD SUCCESSION PLANNING**

I am writing to comment on the above consultation paper on behalf of Railpen Investments, the investment monitoring arm of the Railways Pension Trustee Company Limited, the corporate trustee of the UK railway pension funds with approximately £21 billion of assets under management and 350,000 beneficiaries, from our perspective as a long term pension fund asset owner.

We are long standing supporters of better corporate governance as one of the first UK pension funds to introduce a corporate governance and voting policy back in 1992 and share the FRC's view that good succession planning contributes to a company's long term success. It is essential that boards have the correct skills, balance and diversity in order to make sound decisions. This is perhaps obvious but it is still helpful to reiterate it as there are legitimate concerns about the effectiveness of retrospective disclosure by companies and their nomination committees on succession planning. It follows that we welcome the FRC's initiative in seeking to ensure that companies have robust succession plans in place that extend to the executive and non-executive cadres of the board as well as the pipeline below and beyond the board.

It is probably helpful at the outset to explain that we, as an investor, rarely hold a major stake in UK listed companies and do not expect to be consulted routinely in advance by companies contemplating board changes other than when the issue arises through engagement discussions on remuneration issues in relation to key executives and/ or other discussions about board governance more generally.

We do sometimes raise concerns where we feel there is a specific risk with, say, over reliance on a key individual, and we have also participated in some collective engagement initiatives as in the case of the chairman succession at Marks & Spencers some years ago. However, this is relatively rare and, like most investors, we normally hear about personnel changes after the fact.

Company recruitment processes are conducted largely in private and are generally not visible to most shareholders. It follows that we are not in a position to answer some of the questions in the consultation paper which are more appropriately addressed to companies. We have only sought to answer those questions where we have direct experience of the process or have strong views such as on diversity.

However, we recognise that the communication process between companies and their shareholders on succession is sensitive and we appreciate that it is often difficult for companies to disclose beyond the general and many investors are understandably concerned about inadvertently becoming insiders. Nevertheless, we do feel that companies can do more in giving greater reassurance about the process and that nomination committee reporting could be improved. In addition, we consider it is of utmost importance that independent directors of the Board 'own' the process of succession planning for the Chief Executive, as it is a concern to shareholders when there is the perception, real or otherwise, that the Chief Executive is leading his/her own succession plan.

We set our views in more detail below in our comments on specific questions.

**Business Strategy and Culture**

The FRC has highlighted organisational culture as a major factor in board effectiveness. We particularly welcome the market-led initiative that the FRC is currently undertaking to gather practical insights into corporate culture, in which we are participating. As Peter Drucker is said to have remarked "Culture eats strategy for breakfast." In our view the two are closely interlinked but the right strategy is unlikely to succeed without the right supporting culture yet company reporting on culture, as distinct from setting out corporate values, is very limited. Investors need to know how these values are embedded in the day to day behaviour of staff and companies need to report more effectively on how they achieve this.

**The Nomination Committee**

We agree that nomination committee reporting could and should be improved. We note the reference in the consultation paper to the findings in the Grant Thornton Corporate Governance Review for 2014 that the quality of nomination committee reporting was markedly inferior to that of other committees. This is borne out in Grant Thornton's recently published report for 2015 which noted only a slight improvement. This suggests that companies are not taking this sufficiently seriously.

Nomination committees now generally do report on the succession of particular individuals during the year. This is helpful but not enough. Investors need more on how the nominations committee assesses the current skills sets, strengths and weaknesses, and how specific skills and experience could be assist in delivering the strategy of the business. Although the UK Corporate Governance Code requires nominations committees to confirm that they have the necessary skills on the Board, it would be helpful to provide more detail on the skills of individual director to justify their re-election to the Board. It would also be helpful if nomination committees gave some indication of the existence and review of contingency plans to deal with sudden and unexpected changes in directors.

We note the comments of the Parliamentary Commission on Banking Standards on the apparent removal of more critical personalities in the recruitment of directors who might challenge group thinking. As the recruitment process is largely private and not visible to outsiders, it is very hard for investors to judge whether challengers are sifted out other than in a few well publicised high profile cases.

**Board Evaluation**

We welcome the changes in recent years to the Code which have extended the frequency, scope and importance of board evaluation and we believe that sound evaluation practice can assist better succession planning. However, they are separate activities and boards should be encouraged to consider succession planning on its own with reference to the pipeline below and beyond the board.

**Pipeline**

Boards and nomination committees need to consider how they identify potential internal and external candidates for appointment as executives and non-executives. The pipeline should not be confined to the level immediately below the board but should extend much further down the organisation. Investors do not necessarily expect to be consulted on individual candidates but may expect to be consulted on the skills and experience that the board wishes to find in a successor. Succession planning matrices, as described in the consultation paper, are clearly a useful tool and should assist discussions between boards and investors on the key attributes of a new director.

**Diversity and Tenure**

An effective succession plan for both executives and non-executive directors should consider all aspects of diversity, to avoid ‘groupthink’. We agree that the avoidance of ‘groupthink’ is the major benefit of both a diverse board and a diverse workforce. On this latter point, there has been much focus on diversity at board level but we observe that efforts are now being targeted towards diversity across the workforce, and to ensure that the pipeline of talent being managed in an organisation is diverse. These considerations are important for succession planning more generally, and as the consultation notes, developing serving executives of either gender will be beneficial to increase the pool of talent that can serve as either executives or as outside non-executive directors.

There is much more that can be done to encourage greater diversity in the boardroom and a focus just on appointing ‘board ready’ directors is too narrow a consideration. There are many potential directors of both genders and of all ethnicities who would be effective directors but do not necessarily meet the criteria of being board ready. However, we would argue that potential directors can make valuable and effective contributions precisely because they have not previously had board experience elsewhere. The risks of unconscious bias are particularly acute in the consideration of previous board experience as the main factor in considering whether a candidate is suitable for a board position.

We take a pragmatic approach to the consideration of tenure on boards and do not apply the 9 year rule dogmatically in terms of whether this compromises the independence of an individual director. We consider longer serving directors can bring valuable insights into the boardroom. However, it is about balance and, from a shareholder perspective, if all outside directors are long serving, this is often an indicator of both a failure of proper succession planning at board level but also an inability of the board to recognise the value of diversity and therefore the board may at risk of the dangers of groupthink.

We consider that the current Code requirements do assist in encouraging diversity and progressive refreshment of the board but it is the responsibility of both shareholders and board members to ensure that applying the provisions of the Code do ensure diverse boards that are effective in their oversight and decision making.

Our UK Corporate Governance & Voting Guidelines refer to our endorsement of the work of Lord Davies work to promote gender diversity on boards and further notes that "we support the UK Corporate Governance Code requirement to report annually on boardroom diversity policy, including gender, and on any measurable objectives that the Board has set for implementing the policy and the progress it had made in achieving the objectives15. We also encourage disclosure of below Board level diversity policies, and initiatives to develop a talent pipeline. Companies should report on the application and progress of their diversity policies within the annual report, and we encourage companies to meet the goals they have set through such annual disclosures and Board appointments."

**Role of Investors**

We outline our experience of engagement on succession in more detail in our opening remarks above. We rarely hold a sufficiently large stake in UK listed companies to expect to be consulted routinely in advance by companies contemplating board changes. However, succession frequently arises as a related topic in engagement discussions on remuneration issues in relation to key executives and/or on discussions about board governance more generally. For example, flawed pay structures or poor pay outcomes can often be caused by ineffective succession planning processes.

Whilst we recognise that the communication process between companies and their shareholders on succession is sensitive and that it is often difficult for companies to disclose beyond the general, we do feel that companies can do more in giving greater reassurance about the robustness of succession planning arrangements and that nomination committee reporting could be improved without having to disclose commercially sensitive or otherwise confidential information.

We trust you find our comments helpful and please do not hesitate to contact me should you wish to discuss our response further.

Yours sincerely

**Deborah Gilshan**
Head of Sustainable Ownership
Railpen Investments