

UK board succession planning

Submission from The Association of Investment Companies

The Association of Investment Companies (AIC) welcomes the opportunity to respond to the Financial Reporting Council's (FRC) discussion paper on UK board succession planning.

The AIC represents 346 closed-ended investment companies with assets under management of over £123 billion. Investment companies have their shares admitted to trading on public stock markets. The AIC's members are predominantly listed on the Main Market of the London Stock Exchange. Some have shares admitted to trading on the Specialist Fund Market; others are quoted on AIM.

The AIC's members include UK investment trusts, Venture Capital Trusts, UK REITs and non-EU companies. Our non-EU members are primarily Channel Islands domiciled.

The majority of our members report against the AIC's Code of Corporate Governance (the AIC Code) which has been tailored to reflect the characteristics of the sector. The AIC Code is endorsed by the FRC as an alternative means for members to meet their obligations in relation to the UK Corporate Governance Code (the UK Code).

Most investment companies do not fit the standard governance model. Typically, their boards are entirely comprised of non-executive directors, with virtually all of the executive functions contracted to third party service providers. The main responsibilities of the investment company non-executive directors are setting the company's strategy, oversight of its service providers and promoting the success of the company for the benefit of its members as a whole.

Nomination committee

Question 3 - *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?*

The UK Code provisions and supporting principles in sections B.1 and B.2 provide a suitable framework to determine the work of the nomination committee, both in terms of succession planning and talent management.

The AIC considers that nomination committees are already suitably encouraged to consider succession planning and talent management. This is achieved by the supporting principles to B.2.

The AIC is not aware of any particular concerns from stakeholders in relation to clarifying the roles and responsibilities of the nomination committee. Nor is it aware of any situations where "some 'natural challengers' are sifted out by the nomination process." One of the roles of a non-executive director is to challenge and ask questions. For the investment company sector, these questions are asked of the investment manager, the administrator and other outsourced functions as part of the normal operation of the board. The nomination

committee will seek to identify candidates able to perform this role as an integral element in advising on the composition of the board.

The AIC **recommends** that no changes are made to the UK Code. However, the FRC could provide a guidance note to assist companies in considering both:

- The work of nomination committees, see question 7; and
- Best practice for boards considering succession planning within the annual evaluation process, see question 10.

Question 5 - *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?*

Companies are required by UK Code principle B.1 to ensure that boards and committees have the “*appropriate balance of skills, experience, independence and knowledge of the company*”. Public disclosure on the objective criteria used in a search may be sensitive. It may be taken (wrongly) to highlight any potential or perceived lack of skills or experience on the current board.

The objective criteria could also be price sensitive information. For example, where a company seeks to acquire another company it could look to recruit a board member with previous acquisition experience. Also, it could highlight the intention of a director to stand down before the company is ready to disclose this to the market.

The AIC **recommends** that no details on the objective criteria should be required to be disclosed in nomination committee reports. Boards should continue to conduct their searches in line with the principles set out in the UK Code.

Question 6 - *What is your experience of public advertising for non-executive roles?*

The AIC is aware that some of the board positions within its membership companies are publicly advertised. Many are not.

The AIC **recommends** that companies are not placed under pressure to publicly advertise positions. The investment company sector is a specialised one. For some companies there may be a very limited pool of candidates with the requisite experience and knowledge, particularly if they are looking for investment company sector experience alongside another specialism. If it becomes, in effect, mandatory to publicly advertise positions, some companies will be faced with unnecessary administrative and cost burdens. However, not requiring public advertising does not remove boards from their obligations to fully consider skills and discuss issues and take appropriate steps to address them.

Question 7 - *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?*

Yes, the responsibilities of the nomination committee are clearly set out in the principles and provisions of the UK Code. These are covered, in particular, in principles B.1 and B.2.

For small companies, it is likely that the nomination committee is formed of all the board members. This ensures that directors have a say in board appointments. It reduces the administrative burden of having to convene separate meetings. Larger boards may prefer to delegate the early stages of discussions to a smaller group before the full board takes a decision based on the advice of the nomination committee.

It is important to retain the flexibility about the role of the board to be able to meet the requirements of different companies. The current principle of 'comply or explain' ensures that the role of the nomination committee can be appropriately tailored to the size and complexity of individual companies.

FRC guidance on the work of nomination committees could be considered to help companies to:

- Increase understanding of appropriate terms of reference for the nomination committee. Guidance on such terms of reference could include:
 - The purpose of the committee and its membership;
 - The regularity with which it meets;
 - The duties of the committee (this should specifically include its role in succession planning); and
 - The duty to report the committee's recommendations back to the board (this should include disclosure on whether any external agency has been used in the process);
- Clearly define the roles of the Chairman and Senior Independent Director, which the FRC has identified as a contributing factor in having a properly functioning nomination committee; and
- Formulate succession plans. This could cover planning for certain executive/non-executive roles, both through "foreseen departures" and "sudden emergencies".

Board evaluation

Question 10 - *What practical changes could help ensure boards fully consider succession planning within the annual evaluation exercise?*

Succession planning could be included in the terms of reference for the board/committee which conducts the annual evaluation exercise. The AIC **recommends** the FRC issues guidance on best practice for undertaking the annual evaluation exercise.

Whilst succession planning matrices may be a useful starting point to assist in the succession planning debate, they should not be mandatory. Succession planning discussions should not become process driven. This would result in 'tick box' practices developing which restrict boards from carrying out a full evaluation, bespoke to the

company's circumstances which also take into account the subtleties of board culture and dynamics.

Question 12 - *Would retrospective disclosure of previous board evaluations be useful and how might companies go about this?*

No. The UK Code, principle B.6, requires boards to undertake an annual evaluation of its own performance, that of its committees and individual directors, and to report to shareholders on how this has been conducted. The chairman should act on the results of the performance evaluation.

This is sufficient to give investors' confidence in a company's overall evaluation and know that the chairman is acting on the results.

Retrospective disclosure of previous board evaluations is likely to discourage directors from conducting full and rigorous board evaluations. Although the discussion paper indicates that there is no need to reveal sensitive findings, this position is difficult to reconcile with the notion that there should nonetheless be disclosure. Arguably any negative findings would be sensitive. Board discussions on these issues should be confidential. Board evaluations should be carried out in an environment which encourages directors to challenge and question both fellow board members and those reporting to them. Any public disclosure on board evaluations may hinder such practice.

The 'pipeline'

Question 15 - *How could companies do more to establish an external 'pipeline', tracking and nurturing external candidates – particularly NEDs?*

It is important to consider how to develop the next generation of directors from a wide range of backgrounds. One of the ways to do this is via initiatives such as the "[Board Apprentice](#)" scheme. This not-for-profit organisation aims to increase the number and diversity of candidates for non-executive directors.

Under this scheme, the apprentice spends a year attending board meetings and gaining experience. At the end, the apprentice will have gained considerable experience and will be a credible candidate. This will help to provide an external 'pipeline' and it may also help to increase diversity in the boardroom by giving opportunities to different groups of people. Take up of schemes such as this may be one option to some companies, although they are unlikely to be suitable for all.

Diversity

Question 19 - *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?*

The UK Code, provision B.1.1, requires that where a director has served on the board for more than nine years, the board should state its reasons for determining that the director continues to be independent.

To address this, the AIC Code, principle 4, states that “*The board should have a policy on tenure, which is disclosed in the annual report*”. This makes the companies’ policy on tenure clear for investors and other stakeholders. As highlighted in the AIC Code, many boards function best when they have some long serving directors. Setting out length of service of in the context of overall board balance and skills helps avoid the perception that length of service is, in itself, problematic.

Non-executive directors serving more than nine years are subject to annual re-election. If shareholders disagree with the assessment of the board, they can make a decision to vote against the re-election of a director.

The AIC does not believe that there is any evidence that lengthy service on a board will, in itself, automatically compromise independence. The AIC **recommends** that long-serving directors should not be prevented from forming part of an independent majority.

The role of institutional investors

The FRC discussion paper raises the involvement of institutional investors in succession planning. It states “*For the most senior roles, investors would prefer to be in a position to suggest the particular attributes they believe candidates should have*”. Although institutional investors can of course make suggestions, the AIC cautions against any presumption that they should have a significant role in the process. It is the board’s responsibility to act in the best interests of all shareholders and different investors may have different agendas. The board also has the fullest insight into its future succession needs.

Investors interested in the structure and responsibilities within the board for succession planning can consider whether or not a board/nomination committee is appropriately addressing these issues from the terms of reference of that committee. The AIC **recommends** the FRC provides a guidance note with some examples about how companies can consider succession planning and the types of issues to be addressed in the terms of reference of the board/nomination committee considering this.

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