

## Response of the Equality and Human Rights Commission to the Consultation:

### Proposed Revisions to the UK Corporate Governance Code

Title:	Proposed Revisions to the UK Corporate Governance Code
Source of consultation:	Financial Reporting Council
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### For more information please contact

Name of EHRC contact providing response and their office address:	
John Sharman	
Telephone number:	
Mobile number:	
Email address:	<a href="mailto:John.sharman@equalityhumanrights.com">John.sharman@equalityhumanrights.com</a>

1. The Equality and Human Rights Commission is a statutory body established under the Equality Act 2006. It operates independently to encourage equality and diversity, eliminate unlawful discrimination, and protect and promote human rights. It contributes to making and keeping Britain a fair society in which everyone, regardless of background, has an equal opportunity to fulfil their potential. The Commission enforces equality legislation on age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex and sexual orientation. It encourages compliance with the Human Rights Act 1998 and is accredited by the UN as an 'A status' National Human Rights Institution. Find out more about the Commission's work at: [www.equalityhumanrights.com](http://www.equalityhumanrights.com)
2. We welcome the opportunity to comment on the proposed revisions to the UK CGC and believe this is a great opportunity to make diversity not just a policy issue but about effective delivery with measurable outcomes. Our comments also include suggested amendments or additions to the proposed revisions. In March 2016 the Equality and Human Rights Commission ('the Commission') published the findings of an inquiry into how the UK's 350 leading companies (the FTSE 350), and the executive search firms they instruct, recruit and select people for board director roles. Our aim was to identify whether recruitment and selection practices were transparent, fair and result in appointments on merit, and to identify areas where companies and their agents could make improvements to these practices to increase the diversity of company boards. We examined how companies used the legal and regulatory framework set out in the Equality Act 2010 and UK Corporate Governance Code, to facilitate fairness, transparency and diversity in their board appointments.

Based on this framework, our inquiry examined the use of board evaluations, diversity policies including aspirational targets, role descriptions, search processes, selection, interview and decision-making processes, the role of nomination committees in leading appointments and activities to improve diversity in the talent pipeline and to widen the pool of candidates for board roles.

The extensive evidence base we gathered informed the inquiry recommendations and informs our response to the proposed revisions of the UK Corporate Code of Governance.

3. The revised Code has five sections:
  1. Leadership and purpose
  2. Division of responsibilities
  3. Composition, succession and evaluation
  4. Audit, risk and internal control
  5. Remuneration

Our comments mainly relate to section 3 (composition, succession and evaluation) and the associated principles and provisions.

**Q9. Do you agree that the overall changes proposed in Section 3 of the revised Code will lead to more action to build diversity in the boardroom, in the executive pipeline and in the company as a whole?**

**EHRC response to Q9.**

We are broadly in support of the principles but recommend revisions to some of the provisions to strengthen requirements on delivery and transparency. We have suggested additional wording to include in the provisions, on succession planning, talent pipeline, advertising, board evaluations and diversity objectives and targets.

- We also recommend the FRC should conduct an annual survey of companies to assess compliance with the provisions, and reporting requirements in the annual report, and publish the results on an annual basis.

**Provision 17.** The board should establish a nomination committee that should lead the process for appointments, ensure plans are in place for orderly succession to both the board and senior management positions, and oversee the development of a diverse pipeline for succession. A majority of members of the committee should be independent non-executive directors, with a minimum membership of three. The chair of the board should not chair the committee when it is dealing with the appointment of their successor.

**EHRC response to provision 17**

- We recommend that provision 17 should be strengthened to include a requirement that the nomination committee should consult on and publish its plans, including objectives and targets, for ensuring diversity in board and senior management appointments and for a diverse pipeline for succession.
- We recommend adding a sentence, after the first sentence, to give this provision greater transparency and an effective delivery mechanism. **‘These plans should be published in the annual report and progress against objectives and targets also monitored and reported on an annual basis. They should include aspirational and measurable gender and ethnicity targets for the board and senior management/ direct report levels. Nomination committees should be responsible for ensuring selection panels have guidance and training on avoiding unlawful discrimination in making board appointments.’**

**Provision 18.** All directors should be subject to annual re-election. The board should set out in the papers accompanying the resolutions to elect each director, specific reasons why their contribution is and continues to be important for the company's long-term success.

#### **EHRC response to provision 18**

- The annual election process for directors should also provide an opportunity to consider the diversity of representation and an opportunity to refresh and increase diversity where necessary. We recommend adding a sentence to ensure the board consider the diversity of representation as part of the process of annual re-election and use the opportunity to refresh and increase diversity. **'The board should consider the diversity of representation as part of the process of annual re-election and use the opportunity to refresh and increase diversity.'**

**Provision 19.** A chief executive should not go on to be chair of the same company. If, exceptionally, this is proposed by the board, major shareholders should be consulted ahead of appointment. The board should set out its reasons to all shareholders at the time of the appointment and also publish these on the company website.

**Provision 20.** Open advertising or an external search consultancy should generally be used for the appointment of the chair and non-executive directors. If an external search consultancy is engaged it should be identified in the annual report alongside a statement as to whether it has any other connection with the company or individual directors.

#### **EHRC response to provisions 19 & 20**

- We believe that companies should publicise both board and executive appointments, as well as, using the services of an executive search consultancy. We strongly recommend the wording is amended for provision 20 to state. **'The appointment of the chair and non-executive directors to the board should be publicised as widely as possible and if an external search consultancy is employed they should be required to publicise opportunities to a wide community of diverse talent.'**
- Advertising should aim to open up the candidate pool to a wider community of diverse talent. This should be the norm unless there is genuine concern that the role should not be advertised for reasons of business sensitivity. In the course of our inquiry we were aware that a few companies were working with search consultancies and advertising opportunities on external websites with success. Companies who do instruct search consultancies should encourage them to extend searches to candidates from diverse backgrounds.
- We would support the House of Commons BEIS Committee's recommendation (March 2017) <sup>ii</sup>that the revised Code should state explicitly that the procedure for the appointment of new directors to the board should be by open advertising, and by an external search consultancy, and detailed explanations should be given if one or both of these requirements is not met.

### **Evidence from our inquiry:**

We concluded in our FTSE 350 inquiry that failing to publicise roles widely means that qualified individuals do not have the opportunity to apply for senior and board roles and limits the pool of potential applicants. Advertising roles in a diverse range of media can lead to a more diverse range of applicants and potentially to the appointment of more women and people from ethnic minority groups to boards.

The evidence from our FTSE 350 inquiry indicated that almost all FTSE 350 companies (91%) used executive search firms to search for suitable candidates and did not believe in the open advertising of board roles. However, companies that seek suitably qualified candidates from a wider candidate pool are able to increase the likelihood of appointing a woman (or a candidate from an ethnic minority group) to their board.

Companies that had appointed women with backgrounds from outside the FTSE 350 said that these high-calibre individuals provided the board with different perspectives, wider skill-sets and technical knowledge. This suggests that seeking suitably qualified candidates in sectors outside the FTSE 350 is a way to open up opportunities to a wider and more diverse range of candidates, allowing for a more transparent and merit-based recruitment process.

We found that companies that relied on personal networks to identify potential candidates were most likely to have the lowest number of women on their boards. We also interviewed individuals who had been successful and unsuccessful in applying for board roles. Some candidates said that they were only considered by search firms after their names were put forward by board members. This suggests that targeted search may exclude potential candidates with relevant skills and experience from consideration for the candidate pool.

**Provision 21.** There should be a formal and rigorous annual evaluation on the performance of the board, the chair and individual directors. Companies should have an externally facilitated board evaluation at least every three years. The external facilitator should be identified in the annual report and a statement made as to whether they have any other connection with the company or individual directors.

### **EHRC response to provision 21**

- We recommend that the provision 21 includes a requirement that board evaluations should routinely assess the balance of skills, experience and knowledge on the board and examine the diversity composition of the board making recommendations for action where appropriate.
- We recommend adding this sentence to the provision 21. **‘Board evaluations should assess the balance of skills, experience, and knowledge and also the diversity composition of the board, making recommendations for action where appropriate.’**

### Evidence from our inquiry:

Our inquiry evidence indicated that although most companies considered gender diversity as part of the board evaluations this did not necessarily translate into targets, policies or objectives. Up to 40% had not assessed gender balance in their evaluations of board effectiveness. Some companies did not consider gender balance in their evaluation as they felt the selection process was open to all.

**Provision 22.** The chair should act on the results of the evaluation by recognising the strengths and addressing any weaknesses of the board. Each director should engage with the process and take appropriate action when development needs have been identified.

**Provision 23.** The annual report should describe the work of the nomination committee and should include:

- a description of how the board evaluation has been conducted, detailing the outcomes, actions taken and how it has influenced board composition;
- the process used in relation to appointments, its approach to succession planning and how both support building a diverse pipeline with reference to Principle J;
- what other actions it has taken to oversee the development of a diverse pipeline for future succession to board and senior management appointments;
- an explanation of how diversity supports the company in meeting its strategic objectives; and
- the gender balance of those in the senior management and their direct reports.

### **EHRC response to provisions 22 & 23**

- We recommend that this provision 23 is amended so that companies describe their approach to succession planning setting out their diversity targets and achievement rates in their annual report, and that this should cover both their approach to diversity on the board and to company policy and approach to building a talent pipeline.
- We recommend the inclusion of this wording to the provision 23. **‘the process used in relation to appointments, its approach to succession planning setting out their diversity objectives and targets, and achievement rates, in their annual report, and that this should cover both their approach to diversity on the board and to building a talent pipeline,** with reference to Principle J;’

Evidence from our inquiry:

To encourage greater diversity in the board room and incorporate diversity into succession planning, our evidence suggests that companies can:

- Set aspirational targets, objectives and policies at board and senior management level
- Review progress towards achieving these targets
- Identify the barriers to improving diverse representation at board level or in the internal pipeline and take action to remedy these

- Consider how to widen the candidate pool, for example, by
  - advertising or targeted publicising of appointments through suitable networks in addition to search activities to encourage applications from suitable candidates;
  - considering candidates from sectors outside the FTSE350 who may have the relevant skills, knowledge and experience that fit the role description;
  - ensuring the role description for executive and non-executive roles contains objective measurable criteria against which to assess potential candidates

Our inquiry findings revealed that men outnumbered women in senior management positions by a ratio of 4:1.

It was evident that too few women were progressing to senior executive roles. Our data showed that increases in the number of women on boards had been achieved almost exclusively through an increase in women in non-executive rather than executive director roles. Companies said one of their greatest challenges to improving the representation of women on their boards was the limited pool or pipeline of suitable female candidates with the required skills and experience.

Tackling this issue requires companies to link their succession planning to their strategies about talent development and company culture and the operational processes that shape this.

Policies and targets help companies to recruit more women and people from ethnic minorities by identifying the obstacles impeding their progress, widening the pool of applicants and making the talent pipeline more diverse. Targets also allow companies to measure their progress, review when further action is needed, or acknowledge when an intervention has been successful.

Our Inquiry found that less than half of companies (47%) had a diversity policy and less than two-fifths (38%) of these had set gender targets at senior management/executive level.

Companies that did not have objectives or targets for their board or senior management were most likely to say that these were incompatible with appointment on merit or they did not believe that setting objectives or targets could help drive improvement.

Some respondents to our Inquiry reported that nomination committees did not manage succession planning effectively and could do more to hold the executive team to account on developing diversity in the talent pipeline.

We found that companies with a higher proportion of women on their boards were more likely to have included diversity as part of their succession and development plans for executive roles. Companies described how their corporate diversity policies were linked to their efforts to create a future pipeline of female leaders. Their development programmes included: talent attraction and development across an employee's career, high potential acceleration programmes, training and mentoring, and encouragement to join other boards. Companies said these programmes were open to men and women, but in some cases they also provided specific female leadership programmes to encourage more women into senior roles and to develop a more balanced pipeline.

Companies also described activities that supported women managing family and caring responsibilities or improved awareness across a company about equality issues.

#### *Widening the candidate pool*

To address the under-representation of women on boards, companies can try to widen the pool of potential candidates by encouraging applications from diverse candidates with relevant experience gained from their careers in companies outside the FTSE 350, as well as in the not-for-profit or public sectors, academia, or the professions.

However, many companies did not regard applications from outside FTSE 350 companies as an effective way of widening the candidate pool for executive and board roles. These companies said candidates from other sectors were unlikely to have the appropriate skills, experience or cultural fit they required.

To increase the diversity in executive positions, employers should consider setting diversity policy and targets for the company, improving their recruitment process, and widening the pool of applicants for senior and board roles so they are more likely to access the best talent from which to select on merit.

**Q10. Do you agree with extending the Hampton-Alexander recommendation beyond the FTSE 350? If not, please provide information relating to the potential costs and other burdens involved.**

#### **EHRC response to Q10.**

- We support the recommendations of the Hampton – Alexander Review<sup>iii</sup> and in particular the call for greater and quicker progress at board level and in the progression of female talent to the levels of the executive committee and senior management. We agree that the recommendations of Hampton- Alexander and the provisions of the revised corporate code of governance should apply to all listed companies.

**Q11. What are your views on encouraging companies to report on levels of ethnicity in executive pipelines? Please provide information relating to the practical implications, potential costs and other burdens involved, and to which companies it should apply.**

#### **EHRC response to Q11**

- Increasingly companies are looking at ways of measuring the progress of people from ethnic minorities in their workforce. We are currently carrying out research into the most effective ways of doing so and how companies can report on this. We are keen to share the findings and recommendations with FRC in due course. This will include views on what the barriers are to collecting the necessary data and how these can be overcome.
- The revision of the Code provides a great opportunity to encourage companies to take steps to greater ethnic and other diversity in the pipeline for succession and of senior management teams and boards over time.

- The Parker Review<sup>iv</sup> recommended to FTSE 350 companies that they should identify, develop and promote diversity within their organisations in order to ensure over time that their managerial and executive ranks appropriately reflect the importance of diversity to their organisation. The Parker review's recommendation that a description of the Board's policy on diversity, and how it will be delivered, be set out in the company's annual report seems to be an important first step and should be included in the code and the revised guidance on board effectiveness.

#### **4. Initial consultation on the UK Stewardship Code**

##### **Q28: Should board and executive pipeline diversity be included as an explicit expectation of investor engagement?**

##### **EHRC response to Q28**

- We believe that board and executive pipeline diversity should be an explicit requirement and recognises the value and potential impact of investor engagement and scrutiny on gender diversity on company boards and in the leadership ranks of FTSE 350 companies. It is and should remain a key corporate governance issue when Investors are considering their responsibilities under the UK Stewardship Code. Investors who engage with corporate boards about their diversity policies are demonstrating sound financial judgement.
- There is a range of actions including exercise of ownership rights such as voting and engagement, to effect change on company boards and within senior management teams.
- Investors should be encouraged to engage on the issue of diversity with chairs of boards and senior management teams. As asset owners and asset managers they are responsible for the stewardship of the investments made on behalf of members and clients. Part of that responsibility includes the assessment of the boards and senior management teams of investee companies.
- Our engagement with investor organisations in the course of the inquiry indicated that a number were collectively engaging with listed FTSE companies on gender and broader diversity as a stewardship and governance issue and the companies had responded well to the constructive dialogue. We want to encourage more companies to engage on this issue and the Stewardship code is an important mechanism to enable this to happen.

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<sup>i</sup> <https://www.equalityhumanrights.com/en/publication-download/inquiry-fairness-transparency-and-diversity-ftse-350-board-appointments>

<sup>ii</sup> House of Commons Business, Energy and Industrial Strategy Committee Corporate governance Third Report of Session 2016–17

<sup>iii</sup> Hampton – Alexander review FTSE Women Leaders. Improving gender balance in FTSE leadership November 2017

<sup>iv</sup> Beyond one by '21. A Report into the Ethnic Diversity of UK Boards Sir John Parker The Parker Review Committee Final Report. October 2017