



FRC consultation on proposed revisions to the Corporate Governance Code

Response from: *Changing the Chemistry*

Background

Changing the Chemistry (CtC) is a volunteer-run Scottish-registered charity that works to improve diversity of thought in the boardroom. Diversity of thought for CtC being not just about gender but also ethnicity, age, disability and other types of protected characteristic as well as cognitive and experiential diversity. Evidence shows that increased diversity improves organisational performance.

Further information on Changing the Chemistry can be found in the Appendix to this submission and at www.changingthechemistry.org

Introduction

CtC welcomes this opportunity to respond to the Financial Reporting Council's consultation on the proposed revisions to the Corporate Governance Code. We particularly welcome the seriousness with which the FRC is taking forward issues of diversity in its proposed revised Corporate Governance Code and in the UK Stewardship Code. This is in response to various diversity-themed reports including the Davies Review, the Parker Review, Baroness McGregor's Report, the Hampton-Alexander Review, the Jayne-Ann Gadhia Report, the McKinsey and Company reports, 'Women Matter' and 'Diversity Matters', and the Government's 2016 Green Paper Consultation on Corporate Governance Reform.

Given CtC's raison d'être, we restrict our response to those questions that relate to diversity. In doing so, we draw on the hands-on experience of its Board of Trustees and those of its wider membership who are or have previously been Chairs, NEDs or Executive Board members of public, private and third-sector organisations and on CtC's experience of working with a range of bodies. We also draw on the extensive research literature into the business and societal benefits of diverse workplaces.

We confirm that we are happy for this submission to be published on the FRC's website along with other responses to the Consultation.

CtC would be pleased to respond to any questions on its response and to provide further input to the FRC's work on the promotion of boardroom diversity.

CtC's detailed responses to the Consultation questions

Q1: Do you have any concerns in relation to the proposed Code application date?

NO.

We have no concerns as to the proposed Code application date in respect of those provisions that relate to the encouragement of greater Board diversity and CtC would encourage the FRC to stick to this implementation timetable.

Whilst the proposed implementation window running as it does from early summer 2018 to 1st January 2019 has only just been announced via the FRC's consultation, increased focus on diversity, including from the FRC, has been signalled for more than 5 years e.g. with the 25% target set by Lord Davies in 2011. Thus, well-managed companies, especially those with a 'premium listing', ought already to have enhanced diversity disclosures on their radar and their implementation planning should by now be well advanced.

Insufficient diversity in the Boardroom and Executive teams has been an issue for many years and has been the subject of a plethora of studies and reports. CtC believes that the proposed data collection and disclosure requirements on gender and ethnicity are manageable and we see no reason to delay implementation on practicality grounds.

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?

YES.

Provision 23 of the proposed Revised Code increases the disclosure requirements relating to the work of Nominations Committees, including for the first time a requirement to publish data on the gender balance in the senior management team and their direct reports. This makes a lot of sense.

The main focus in recent years has been on disclosure of data within annual strategic reports on the gender balance within Boards. As the consultation document highlights, there has been a material increase in the proportion of women on boards, especially since the publication of the Davies Report in 2011. It seems reasonable to conclude that disclosure requirements relating to Board-level diversity have played a part here.

However, there has not been anything like the same progress on gender balance at executive level or in the executive pipeline. On the premise that '*what gets measured gets managed*', it seems likely that increased disclosure relating to the gender of executives and in the executive pipeline will lead to better internal focus and facilitate increased external scrutiny which in time ought to lead to better gender balance here too. In the words of Baroness McGregor Smith's report: "*Daylight is the best disinfectant*".

Whilst FRC's focus in its proposed new Corporate Governance Code is on gender and ethnicity, there are other cross-cutting types of diversity e.g. disability, LGBT,

age, that tend not to be monitored at present. We would like to see FRC encouraging companies to do more here.

It is worthwhile observing that the more diverse Boards are on multiple criteria, the better able they are likely to be to address alleged diversity-related improprieties reported via whistleblowing. .

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.

YES.

Since lack of diversity tends to be correlated with under-performance and is unfair to under-represented groups wherever they happen to work, we see no reason to restrict the applicability of the Hampton-Alexander recommendations relating to gender diversity on boards just to the FTSE 350.

It is encouraging that a number of organisations that are not obliged to adopt the FRC Governance Code choose to do so, in some cases with appropriate adaptations, for example the Annotated Corporate Governance Code for mutual insurers. The more widely adopted the revised Governance Code is amongst companies with a primary listing, the more likely it is that these best governance practices will be adopted by other public, private and third-sector organisations. This too points towards extension of the Hampton-Alexander recommendations beyond the FTSE 350.

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.

WE SUPPORT SUCH PIPELINE DISCLOSURE

The headline principle of the Baroness McGregor Smith report into Race in the Workplace is:

“Every person, regardless of their ethnicity or background, should be able to fulfil their potential at work. That is the business case as well as the moral case. Diverse organisations that attract and develop individuals from the widest pool of talent consistently perform better.”

We agree wholeheartedly. As with gender diversity, better ethnic diversity in the Boardroom and on Executive teams is likely to happen faster if there is a better ethnic mix in the executive pipeline. Measurement increases internal focus as too does the accepted norm of complying with the FRC Code, rather having to explain any non-compliance.

The publication of data also creates greater transparency enabling comparisons to be made by external parties, including shareholders and other interested parties such as CtC, Equate Scotland, Women on Boards and the Diversity Project. The “Comply or Explain” regime also enables pressure to be brought to bear on under-

performing organisations. Following this logic, the case for monitoring and reporting on ethnicity in the executive pipeline is just as strong as for gender monitoring.

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

YES.

To quote from the FCA's Stewardship Code:

'In publicly listed companies responsibility for stewardship is shared. The primary responsibility rests with the board of the company, which oversees the actions of its management. Investors in the company also play an important role in holding the board to account for the fulfilment of its responsibilities.'

For those institutional investors that have signed up to the Code, Principle 3 states that when monitoring companies, they should:

'..... satisfy themselves that the company's board and committees adhere to the spirit of the UK Corporate Governance Code, including through meetings with the chairman and other board members'.

Thus, there is already an implicit requirement on institutional investors to monitor the compliance of their investee companies with the spirit of the Corporate Governance Code, and we believe it is axiomatic that this should in future include the provisions relating to board and executive pipeline development. We see no reason at all why matters relating to board and pipeline diversity should be excluded from such monitoring.

Whilst we assert that the Stewardship Code already demands this oversight, society at large is also increasingly looking for investors, particularly the powerful institutional investors who are in effect the ultimate owners of companies, to play more proactive roles in the monitoring of investee companies. To date, this has been evident most prominently in relation to executive remuneration and the election or re-election of members of Boards. We would expect this societal pressure in relation to diversity monitoring to increase and rightly so in CtC's view.

In any event, setting aside the moral and Code compliance arguments, as previously stated there is a proven positive correlation between boardroom diversity and business performance. Thus, it is already in the interests of the investors themselves that they monitor and encourage board, executive and pipeline diversity in their investee companies.

The understanding of this was well-demonstrated by Larry Fink, CEO of Blackrock (the world's biggest investor) stating in January this year that Blackrock:

"..will continue to emphasize the importance of a diverse board. Boards with a diverse mix of genders, ethnicities, career experience and ways of thinking have, as a result, a more diverse and aware mind-set. They are less likely to succumb to groupthink or miss new threats to a company's business model. And they are better able to identify opportunities that promote long-term growth."

For further information please contact:

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Appendix

Changing the Chemistry (CtC) operates as a peer-support network charging no membership fee but expecting members to contribute to help individuals from diverse backgrounds secure board roles and then supporting them to perform in those roles.

In addition to developing the supply side of board recruitment, CtC is also working to influence the demand side by making those hiring board members more aware of the biases and stereotypes impacting their decision-making and reiterating the business case that diverse teams perform better.

Membership is open to anyone aged 18 or over who supports the charity's aims and is willing to commit to contribute to its objectives in some way. CtC currently has over 300 members, mostly in Scotland but with a small and growing number in London and the south-east.

CtC has filled over 120 board roles from our membership across all three sectors – from FTSE 250 companies to a broad range of public-sector and other private-sector boards to a wide variety of charities. CtC has also had great results working with organisations to help them make significant shifts in the diversity of their Boards by attracting a more diverse range of candidates and supporting these candidates through the recruitment process.

CtC's membership is made up of those seeking board roles, those on boards with a desire to continuously improve their boardroom skills and those who want to support the cause of diversity of thought in the boardroom.

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