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Catherine Horton
Financial Reporting Council
Via electronic submission: codereview@frc.org.uk

Dear Catherine,

State Street Global Advisors response to the 'Proposed Revisions to the UK Corporate Governance Code'

State Street Global Advisors ("SSGA") welcomes the opportunity to respond to the Financial Reporting Council's (FRC) proposed revisions to the UK Corporate Governance Code. SSGA is the asset management arm of State Street Corporation, one of the world's leading providers of financial services to institutional investors. With over USD 2.8 trillion[1] of assets under management ("AUM") across a range of asset classes and investment styles, SSGA is a large global investment manager.

As a signatory, we fully support the principles of good stewardship embodied in the UK Stewardship Code and endeavour to implement the spirit of the Code across all jurisdictions in which we invest. SSGA's approach towards proxy voting and issuer engagement specifically is premised on the belief that companies that adopt robust and progressive governance and sustainability practices should be better positioned to generate long-term value and manage risk. As near perpetual holders of the constituents of the world's primary indices, we believe that the informed exercise of voting rights coupled with targeted and value-driven engagement is an effective mechanism of creating value for our clients. In 2017, we engaged with 55 UK companies, representing over GBP 20bn* of AUM, on various environmental, social and governance (ESG) issues including board effectiveness and executive compensation. Since 2013, SSGA has had approximately 2900 engagements on ESG issues with over 2500 companies in our global portfolio.

We support many of the FRC's proposed revisions to the UK Governance Code such as placing greater emphasis on corporate culture and diversity as well as the need for companies to engage with all stakeholders, including the wider workforce. Furthermore, the proposed more concise format of the Code will, in our view, allow boards to become more flexible and realistic in their reporting on and compliance with the Code.

Although this consultation deals with a number of important corporate governance matters, we have enclosed detailed comments focused on specific issues such as the Code's interaction with the *UN Sustainable Development Goals*, board independence and tenure as well as gender diversity. Our views are informed by our experience as an institutional investor that engages with a large number of companies globally. Should you wish to discuss this submission further, please do not hesitate to contact me.

Yours sincerely,

Robert Walker
EMEA Head of Asset Stewardship

[1] AUM figure is as of 31 January 2018; * UK AUM figure is as of 1 February 2018

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Detailed comments / recommendations

Explicit reference to the United Nations' Sustainable Development Goals

The *UN Sustainable Development Goals* (SDGs) lay down a framework that allows companies to align their stewardship activities with client values and investment needs: the seventeen SDGs provide a mechanism for investors to measure the real-world impacts of their investments.

The UN SDGs embed a values-based system which we believe companies should view as an aspirational framework that could be explicitly referenced in the revised Code to increase transparency of company reporting on their responsibilities to shareholders, wider stakeholders and how this has affected board decision-making.

It is for this reason that our response[1] to the HM Treasury's 2017 'Green Paper on Corporate Governance Reform' encouraged boards to consider potential impacts of relevant ESG factors on a company's long-term business strategy in addition to economic and financial considerations.

Whilst the inclusion of a specific reference to the UN SDGs in the Code's guidance would be a positive step, we do not believe that this alone would be sufficient to guide corporate thinking on their sustainability objectives. Specific guidance from the FRC would therefore be useful to help companies report on their adherence to the UN SDGs and how their long-term corporate strategy is aligned to them.

Board independence and tenure

Board refreshment and contingency planning for director succession are vital functions of any board. As a global institutional investor, SSGA adopts a holistic approach to board tenure and independence because we understand that companies can have different requirements based on factors such as strategy, business cycle and geographical revenue exposure. This approach is underpinned by careful consideration of each director's contribution to the board, their effectiveness and actual independence.

The existing UK Corporate Governance Code indicates that a tenure lasting beyond nine years may impair the independence of a board director; though companies have the option to retain directors as independent provided that there is a clear rationale for doing so.

We agree with the FRC's view that the absence of a hard-coded tenure limit in the UK has led both companies and investors to adopt a *de facto* tenure period of nine years. However, our practical experience of the UK market suggests that the absence of a codified time limit for independence and maximum tenure period has attributed to a lower average board tenure insofar as boards are encouraged to focus on the refreshment of director skills and plan for director succession in an orderly manner.

Consequently, we do not agree with the FRC's approach to stipulate such a time limit on a director's independence, and would highlight two key concerns:

[1] **SSGA response to HM-Treasury** 'Green Paper on Corporate Governance Response',, https://www.ssga.com/investment-topics/environmental-social-governance/2017/SSGAs-Response-to-Green-Paper-on-Corporate-Governance-Reform.pdf, 16 February 2017

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- Firstly, the introduction of a mechanistic nine year term limit may lead to UK companies seeking to comply with the Code by simply enforcing the new tenure limit, as opposed to retaining those independent directors who they believe provide a valuable contribution via their insights and independence of thought. The rationale to retain such directors could be justified to shareholders.
- Secondly, we believe that the existing suitability requirements imposed upon financial institutions to undertake board assessments are already a solid means of ensuring boards are appropriately focused on industry changes, non-executive director contributions and diversity. These assessments provide assurance around such requirements, with any shortcomings being identified as part of the process, triggering adjustments to the existing board composition as necessary. Imposing a time limit on the criterion for assessing the independence of non-executive directors risks undermining proper evaluation of such directors, resulting in potential detriment of other considerations.

Furthermore, as a global investor, we have in place internal policies and procedures to engage with investee companies that would lead SSGA to challenge a director's independence where their tenure extends beyond nine years. Our director tenure policy[2], covering the UK and US, is multi-layered and takes into consideration the average market-level board tenure. Companies are subsequently screened against three criteria: average board tenure, preponderance of long-serving non-executive directors and classified board structures.

The need for effective independent Board leadership

Effective independent board leadership is a key component of good corporate governance and long-term value creation. This is integral to our guidance on attributes of effective independent board leadership, published in February 2016. We believe that strong independent board leadership is essential to oversee a company's long-term strategy and to assess management's performance in the context of those longer term goals, recognising that the role of the independent board leader is becoming ever more complex and demanding. Strong communication skills, time commitment, relevant industry expertise and strong leadership qualities are necessary traits for board leaders to demonstrate efficacy.

However, in our experience very few portfolio companies have adequately institutionalised the governance structures required for effective independent board leadership, particularly with regard to tenure and succession planning. This further reinforces our view that a maximum tenure limit for independent directors could introduce an overly mechanistic approach into the appointment process of board Chair that would not necessarily guarantee their independence, effectiveness or long-term focus.

A serving non-executive director who is appointed to the Chair should not in our view be limited to a maximum total tenure of nine years for reasons that we have already mentioned. Moreover, unforeseen scenarios based on specific market events (for example, the unexpected departure of the CEO) may lead to a need for the existing board Chair to be retained for a period beyond nine years in order

[2] **SSGA policy**, 'Addressing the Need for Board Refreshment and Director Succession in Investee Companies, https://www.ssga.com/investment-topics/general-investing/2015/Addressing-the Need-for-board%20Refreshment-in-Investee-Companies.pdf, February 2015

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to maintain stability and effective board leadership. The current provisions of the UK Corporate Governance Code allow companies to give effect to this with minimal difficulty, but the proposed revisions to the Code may introduce additional complexity to this process, which we do not believe would ultimately benefit investors.

We believe that attention should be placed upon the overall manner in which a company empowers the board Chair to be more independent. This approach requires institutional investors to challenge and truly engage with company leadership and their boards in order to understand the effectiveness of their governance structures and their ongoing appropriateness.

Extending gender diversity below board level

Gender diversity is one of the many ways in which a board can bring together a varied set of skills and expertise among its directors to help improve financial performance. Research[3] shows that companies with greater gender diversity have historically had stronger financial performance and fewer governance-related issues such as bribery, corruption, shareholder battles and fraud.

We agree with the FRC that while gender diversity at board level has grown steadily since 2011, such progress at the executive committee level of FTSE 100 companies is less advanced. Relaying the importance and actively seeking to improve gender diversity within the management structure has thus been a thematic engagement area for SSGA since 2014. As a response, SSGA published guidance on enhancing gender diversity on boards[4] in March 2017. This guidance presented a framework to increase the level of diversity at board level and support boards to cascade similar expectations to senior management and the broader organisation.

Growing the pipeline of women at executive level is important because it can serve as the pathway to increasing board diversity for external non-executive board positions. However, our ability to exert influence and vote to effect positive change around gender diversity is hampered by the lack of relevant company disclosure and transparency.

For example, Bloomberg data on gender diversity within the UK FTSE 350 highlights that there is a wide gap between women on the board and within senior management. In the FTSE 350 companies there is on average 22.5% compared to just 13.5% senior women executives. Increased diversity at board level does not appear to have led to a subsequent rise in diversity within senior management levels.

However, publicly available data on this issue is limited and companies do not systematically report on diversity levels within management. Accordingly, while we support the FRC's proposal to require FTSE 350 companies to disclose within their annual report the gender balance on the Executive Committee and its direct reports, we do not believe it goes far enough. In our view, FTSE 350 companies should be required to report to investors not only the current gender balance at

[3] Several **research papers explore diversity as a means to improve financial performance**:
- "Why Diversity Matters?" McKinsey, Feb 2015
- "Women on Boards: Global Trends in Gender Diversity on Corporate Boards", MSCI, Nov 2015
- "Is Gender Diversity Profitable?" Peterson Institute for International Economic, Feb 2016

[4] **SSGA Policy**, 'Guidance on Enhancing Gender Diversity on Boards', https://www.ssga.com/investment-topics/environmental-social-governance/2017/guidance-on-enhancing-gender-diversity-on-boards.pdf , Mar 2017

all levels of the organisation, but also on their strategic plans to increase the number of women at Executive Committee level.

These plans should include clear objectives and timeframes, any obstacles that prevent these objectives being met as well as potential initiatives that could be deployed to overcome these.