FRC

Financial Reporting Council

Consultation Document: Gender Diversity on Boards

May 2011

GENDER DIVERSITY ON BOARDS

INTRODUCTION

In June 2010 the revised UK Corporate Governance Code came into effect. It included for the first time a principle recognising the value of diversity in the boardroom (Supporting Principle B.2), which states that "the search for board candidates should be conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender".

Later in 2010 Lord Davies of Abersoch was commissioned by the Government to undertake a review of gender diversity on the boards of listed companies to identify barriers preventing more women from reaching the boardroom, and make recommendations regarding what government and business could do to increase the proportion of women on boards.

Lord Davies' report was published in February 2011[1]. It made a number of recommendations, one of which was that "the Financial Reporting Council should amend the UK Corporate Governance Code to require listed companies to establish a policy concerning boardroom diversity, including measurable objectives for implementing the policy, and disclose annually a summary of the policy and progress made in achieving the objectives".

Lord Davies argued that this addition to the Code was needed because "enhanced corporate governance statements will allow companies to pay attention to, and consider what diversity means within their own organisations. Stakeholders, both investors and customers, will be able to make informed decisions about the diversity of the company and the performance of that company in addressing the diversity challenge".

In this consultation document, the FRC is seeking views on:

- whether further changes to the Code are needed in order to help achieve more diverse and more effective boards;
- if so, what these changes should be. The consultation document includes some draft revisions to the Code, on which comments are sought; and
- if changes are made to the Code, when these should come into effect.

[1] 'Women on Boards'; February 2011. Available at: http://www.bis.gov.uk/policies/business-law/corporate-governance/women-on-boards

While noting that Lord Davies saw changes to the Code as part of a package of measures to address the issue of gender diversity on boards, the FRC believes that changes to the Code need to be considered on their own merits. The FRC is not seeking views on the other recommendations in Lord Davies' report, other than to the extent that respondents feel it necessary to illuminate their views on what, if any, changes should be made to the Code.

The Department of Business, Innovation and Skills will be consulting separately on the recommendation that quoted companies should be required to disclose each year the proportion of women on the board, women in senior executive positions and female employees in the whole organisation.

How to comment

Comments on the proposed changes to the Code set out in this consultation document are requested by 29 July 2011. Responses should be sent by e-mail to coderevie w@frc.org.uk

or in writing to:

Chris Hodge
Corporate Governance Unit
Financial Reporting Council
Fifth Floor
Aldwych House
71-91 Aldwych
London WC2B 4HN

It is the FRC's policy to publish on its website all responses to formal consultations issued by the FRC and/or any of its Operating Bodies unless the respondent explicitly requests otherwise. A standard confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure. We do not edit personal information (such as telephone numbers or email addresses) from submissions; therefore only information that you wish to be published should be submitted.

BACKGROUND

There is a notable absence of women on the boards of UK listed companies. In 2010 women made up only 12.5% of the board members of FTSE 100 companies, compared with 9.4% in 2004, and over half of all FTSE 250 companies have no female board directors at all[2]. It was this lack of progress that led the Government to commission Lord Davies to report on what government and business could do to increase the proportion of women on boards.

The focus of the UK Corporate Governance Code is on improving the quality and functioning of corporate boards, rather than on any wider social objectives. The FRC believes that diversity, in all its aspects, serves an important purpose in connection with board effectiveness. Its potential benefits lie in widening the perspectives on business issues brought to bear on decision-making, avoiding too great a similarity of attitude and helping companies understand their customers and workforces. An insufficiently diverse board risks a weakness in at least one of these respects.

The FRC's specific issues with the low percentages of women directors are rooted in three concerns about board effectiveness:

- that a lack of diversity around the board table may weaken the board by encouraging "group think";
- that such low percentages of women on boards may demonstrate a failure to make full use of the talent pool; and
- that boards with no, or very limited, female membership may be weak in terms of connectivity with, or understanding of, customers and workforce and offer little encouragement to aspiration among female employees.

It was these concerns that led the FRC in its 2010 revisions to the UK Corporate Governance Code to add, for the first time, a reference to the benefits of diversity in general, with specific reference to gender. Lord Davies has now recommended that the Code should go further and require listed companies to establish a policy concerning boardroom diversity, including measurable objectives for implementing the policy, and disclose annually a summary of the policy and progress made in achieving the objectives.

This is not an issue in the UK alone. Many countries are now introducing quotas or disclosure requirements with the same objective (these are summarised in an annex to Lord Davies' report).

[2] 'The Female FTSE Board Report 2010'; Cranfield School of Management; 2010. There is no data currently available on the percentage of female directors on the boards of companies below the FTSE 350.

At EU level the European Commission launched a 'Strategy for Equality between Women and Men 2010 – 2015' in September 2010. As part of this strategy the Justice Commissioner, Viviane Reding, has asked all companies to pledge to have at least 30% female board members by 2015 and 40% by 2020, and has said that the Commission will review progress in March 2012 to decide whether further action is needed.

Separately, in the Green Paper on the corporate governance framework for listed companies[3] published in April 2011, the Commission has asked whether listed companies should be required to disclose whether they have a diversity policy and report regularly on progress and/or required to ensure a better gender balance on boards.

[3] Available at http://ec.europa.eu/internal_market/consultations/2011/corporate-governance-framework_en.htm

POSSIBLE CHANGES TO THE UK CORPORATE GOVERNANCE CODE

The new UK Corporate Governance Code applies to accounting periods beginning on or after 29 June 2010. This means that the majority of companies will only have been required to apply the principle that boards must consider the benefits of gender diversity from 2011.

Some respondents may consider that the new principle should be given time to work before the Code is further strengthened. Others may share Lord Davies' view that, in view of the slow rate of progress in recent years, an explicit disclosure requirement is needed to focus boards' attention on the issue. **The FRC welcomes views on whether further changes to the Code should be made**.

If a change were to be made to the Code to give effect to Lord Davies' recommendation, the FRC would propose to amend Provision B.2.4, which concerns the report of the nomination committee. **The FRC welcomes views on this wording**:

> A separate section of the annual report should describe the work of the nomination committee, including the process it has used in relation to board appointments. ***This section should include a description of the board's policy on gender diversity in the boardroom, including any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives***. An explanation should be given if neither an external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director.

The appendix to this consultation shows how this additional wording would fit into Section B.2 of the Code.

In his report, Lord Davies recommends that "in line with provision B.2.4... chairmen should disclose meaningful information about the company's appointment process and how it addresses diversity in the company's Annual Report including a description of the search and nominations process". **The FRC does not consider that this recommendation requires a change to the Code, but welcomes views on whether it would be helpful to set out some of the key elements to be covered by a gender diversity policy - such as the criteria used when recruiting directors, or the steps taken to develop of senior executive talent - and if so, whether this should be done in the Code or elsewhere.**

The FRC believes that, were the proposed change to provision B.2.4 to be made, the board evaluation process would provide an important opportunity for boards to review progress on implementing their diversity policy, and whether it was contributing to the ultimate objective of increasing the board's effectiveness by ensuring that there was an appropriate balance of skills, experience, independence and knowledge of the company.

It would not be appropriate to single out gender diversity for special attention when there are many issues that boards need to consider when evaluating their effectiveness, as illustrated in the FRC's recent 'Guidance on Board Effectiveness'[4]. But consideration could be given to adding a new supporting principle to Principle B.6 (on board evaluation) which set out some of the most important elements of any review. For example:

> "*Evaluation of the board should consider the balance of skills, experience, independence and knowledge of the company on the board, the board's policy on gender diversity, how the board works together as a unit, and other factors relevant to its effectiveness*."

The appendix to this consultation shows how this additional wording would fit into Section B.6 of the Code.

The FRC welcomes views on whether a new supporting principle on board evaluation is desirable and, if so, on the proposed wording.

[4] 'Guidance on Board Effectiveness'; Financial Reporting Council; March 2011. Available at: http://www.frc.org.uk/corporate/ukcgcode.cfm

THE TIMING OF ANY CHANGES TO THE CODE

Lord Davies has called on the chairmen of all FTSE 350 companies to announce their aspirational targets by September this year. He has also said that companies should meet his various recommendations on disclosure – including the one relating to the Code - in their 2012 Corporate Governance Statement "whether or not the underlying regulatory changes are in place".

For this reason, early implementation of any amendments to the Code may be desirable. Early implementation might also help in the context of the debate taking place in Europe, by demonstrating a workable alternative to quotas.

However, companies may have concerns about changes to the Code being made when they may still be coming to terms with the changes introduced in 2010, and while there is a possibility that further changes to the Code might be needed in due course as a result of developments at the European level.

The options for bringing into effect any changes to the Code that the FRC might decide to introduce are:

- The revised Code would apply to accounting periods beginning on or after 29 June 2011, i.e. twelve months after the current Code came into effect. As this consultation runs until 29 July, the new provisions would have to apply retrospectively. However, companies would not be reporting against these provisions until 2012, and FTSE 350 companies may in any event choose to respond more quickly as requested by Lord Davies.

- The revised Code would take effect at the same time as any regulations made by the Government to implement Lord Davies' recommendation on reporting the percentage of women of boards, in senior management and throughout the organisation. Although BIS has not yet given an indication if or when such regulations might be introduced, all changes to company law requirements take effect on one of two dates during the year, so the earliest possibilities would be either 1 October 2011 or 1 April 2012. While this would bring a degree of consistency in implementing the Davies recommendations, it could be disruptive for companies who are accustomed to the Code changing on the same date when it is updated.

- The revised Code would apply to accounting periods beginning on or after 29 June 2012. This would avoid concerns associated with the previous two options but would mean that companies were not required to report against the revised Code until 2013, although they could be encouraged to report on a voluntary basis in 2012 as suggested by Lord Davies.

- Postpone the implementation of any changes until after the FRC’s next formal review, in order to avoid making piece-meal changes to the Code. The timing of the next review has yet to be decided, and will be determined in part by whatever action might be taken at EU level to follow up the European Commission’s recently published Green Paper, but would not begin until 2012 at the earliest.

The FRC welcomes views on when any changes to the Code that might be introduced should take effect.

APPENDIX

POSSIBLE CHANGES TO SECTION 2 OF THE CODE

*[**Note**: possible revisions are shown in italics and underlined.]*

<u>B.1: The Composition of the Board</u> [*no change*]

Main Principle

The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.

Supporting Principles

The board should be of sufficient size that the requirements of the business can be met and that changes to the board's composition and that of its committees can be managed without undue disruption, and should not be so large as to be unwieldy.

The board should include an appropriate combination of executive and non-executive directors (and in particular independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision taking.

The value of ensuring that committee membership is refreshed and that undue reliance is not placed on particular individuals should be taken into account in deciding chairmanship and membership of committees.

No one other than the committee chairman and members is entitled to be present at a meeting of the nomination, audit or remuneration committee, but others may attend at the invitation of the committee.

Code Provisions

[B.1.1. Tests of independence]

[B.1.2. Number of independent directors]

B.2: Appointments to the Board

Main Principle

There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.

Supporting Principles

The search for board candidates should be conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender.

The board should satisfy itself that plans are in place for orderly succession for appointments to the board and to senior management, so as to maintain an appropriate balance of skills and experience within the company and on the board and to ensure progressive refreshing of the board.

Code Provisions

B.2.1. There should be a nomination committee which should lead the process for board appointments and make recommendations to the board. A majority of members of the nomination committee should be independent non-executive directors. The chairman or an independent non-executive director should chair the committee, but the chairman should not chair the nomination committee when it is dealing with the appointment of a successor to the chairmanship. The nomination committee should make available its terms of reference, explaining its role and the authority delegated to it by the board.

B.2.2. The nomination committee should evaluate the balance of skills, experience, independence and knowledge on the board and, in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment.

B.2.3. Non-executive directors should be appointed for specified terms subject to re-election and to statutory provisions relating to the removal of a director. Any term beyond six years for a non-executive director should be subject to particularly rigorous review, and should take into account the need for progressive refreshing of the board.

B.2.4. A separate section of the annual report should describe the work of the nomination committee, including the process it has used in relation to board appointments. ***This section should include a description of the board's policy on gender diversity in the boardroom, including any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives***. An explanation should be given if neither an external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director.

[**B.3: Commitment** – *no change*]

[B.4: Development – *no change***]**

[B.5: Information and Support – *no change***]**

B.6: Evaluation

Main Principle

The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

Supporting Principles

Evaluation of the board should consider the balance of skills, experience, independence and knowledge of the company on the board, the board's policy on gender diversity, how the board works together as a unit, and other factors relevant to its effectiveness.

The chairman should act on the results of the performance evaluation by recognising the strengths and addressing the weaknesses of the board and, where appropriate, proposing new members be appointed to the board or seeking the resignation of directors.

Individual evaluation should aim to show whether each director continues to contribute effectively and to demonstrate commitment to the role (including commitment of time for board and committee meetings and any other duties).

Code Provisions

B.6.1. The board should state in the annual report how performance evaluation of the board, its committees and its individual directors has been conducted.

B.6.2. Evaluation of the board of FTSE 350 companies should be externally facilitated at least every three years. A statement should be made available of whether an external facilitator has any other connection with the company.

B.6.3. The non-executive directors, led by the senior independent director, should be responsible for performance evaluation of the chairman, taking into account the views of executive directors.

[**B.7 Re-Election** – *no change*]

Financial Reporting Council
5th Floor
Aldwych House
71-91 Aldwych
London WC2B 4HN
Tel: +44 (0)20 7492 2300
Fax: +44 (0)20 7492 2301
Website: www.frc.org.uk