Association of British Insurers

Report on Board Effectiveness

Highlighting best practice: encouraging progress

Foreword

As investors holding over £1.7 trillion in assets, over a quarter of the UK's net worth, the insurance industry takes its investment responsibility extremely seriously. The global financial crisis has illustrated the grave consequences of allowing '*group-think*' in the boardroom to go unquestioned without mechanisms for adequate challenge in place.

The ABI's *'Report on Board Effectiveness, highlighting best practice: encouraging progress'* draws together recommendations for maximizing the performance of company boards. It uses practical business examples to illustrate ways in which a variety of leading companies currently implement diversity, succession planning strategies and board evaluation. These are the three key areas we have chosen to focus on as fundamental to improving board effectiveness. Selecting the best individuals from a diverse talent pool, planning for the succession and replacement of key personnel, and regularly evaluating the board's performance to ensure its continued effectiveness are key to the success of any enterprise. The Board Chair is, of course, critical to making sure these happen well.

The insurance industry is committed to supporting and sustaining the UK's long term economic growth on the road back to economic health. Highlighting best practice from across businesses to encourage progress and improve board effectiveness will provide an important input into a firm's wider corporate governance. This will improve the development and execution of strategy, and ultimately contribute to the continued success of a company.

Otto Thoresen
Director General
Association of British Insurers

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Executive Summary and Recommendations

Companies, and the boards that govern them, are facing increasingly complex challenges. These challenges range from the rapid increase in technological innovation to dealing with the changing face of regulation following the financial crisis that began in 2007. To deal with these challenges, the need for an effective board of the highest quality has become even more important.

The FRC Guidance on Board Effectiveness states that for the board to be effective, the board needs to provide leadership and oversight of the company within a framework of effective controls that enables risk to be assessed and managed. The board also needs to develop and promote their collective vision of the company's purpose, its culture, and the behaviours they wish to promote in conducting their business. Central to this is the ability to challenge internal and external assumptions and ideas, and at the same time work as a team[1].

The purpose of this report is to focus on three areas that we believe can help ensure an effective board and ultimately contribute to the success of the company. We set out the issues surrounding each area, and look for best practice as a guide to improving the way companies report on them.

The three areas are:

- Board diversity,
- Succession planning, and
- Board evaluation.

These issues do not stand alone. Selecting the best individuals from a diverse talent pool, planning for succession and replacement, and regularly evaluating the board to determine its effectiveness, cover the lifecycle of a board. That is why they are important.

It is also a matter of communication. The length of an Annual Report is no guide to its quality. Instead, to make reporting useful it needs to be clear, concise and, above all, company specific. A few lines of meaningful insight can replace pages of boiler-plate language and will also act as a catalyst for effective engagement between companies, investors and other stakeholders. That is why we also look for, and set out, examples of best reporting practice in each area.

Overleaf we set out the main findings and recommendations from our analysis.

[1] FRC (2011) Guidance on Board Effectiveness, p. 2

Board Diversity

In light of the challenges and recommendations set out in the Davies Review[2], we have conducted a thorough analysis of FTSE 350 Annual Reports to highlight what companies are doing to address the question of diversity, including gender, in their boardrooms and across the whole organisation. It is diversity of perspective that is paramount, but within this context the ABI supports the increased focus on gender diversity. We find that:

- The number of women in FTSE 100 boardrooms has increased from 13.4% in 2010 to 14.2% in 2011. This data bears comparison to the numbers of senior women in the public sector.
- The overall increase looks slow but of all the new non-executive directors appointed in 2011, 22.7% were women in the FTSE 100 and 17% were women in the FTSE 250.
- Disclosure needs to improve. Currently only 19.2% of FTSE 100 companies provide a material statement on board diversity.

Meaningful disclosures by companies that we found include setting out how they are developing diversity throughout the business, setting targets for female representation, setting up mentoring schemes, and encouraging wider representation in traditionally male-dominated industries. Over time these plans should help to bring more women through executive ranks and therefore increase the pool available for non-executive recruitment.

Our recommendations are:

- Companies should ensure that achieving diversity of perspective is a key objective in appointing board members.
- Companies should provide clear statements on the steps they are taking to achieve diversity in their boardroom and should openly discuss the issues and challenges that they face in their Annual Reports.
- Chairmen should widen the search for non-executive directors, broadening traditional talent pools, when making board appointments.
- Companies should recognise their role in developing the potential of women throughout the corporate pipeline.
- Companies should wherever possible set and report on measurable objectives and other steps being taken to promote gender and other diversity in their organisations, particularly at senior management level.

The ABI will continue to monitor and look for best practice with regards to diversity and report on this in our next review in 2012. We will ensure that when we meet with companies we will engage on these issues and discuss the challenges that they may face in addressing both supply and demand.

[2] Davies (2011) Women on Boards, Department of Business Innovation and Skills

Succession Planning

Our research finds that the majority of companies state that planning for succession is on the board agenda. However, the information provided tends to be minimal and expressed in boiler-plate language. We find that:

- Of the 15 FTSE 100 CEOs appointed in the twelve months to July 2011, 73% were hired from within, a good indicator of effective succession planning.
- 18.9% of FTSE 100 companies identify a need to focus more on succession planning following their board evaluation.

Best practice disclosure includes stating the process of working in partnership with the CEO to ensure the readiness and development of the CEOs successor, and board engagement in planning for succession of all senior management.

Our recommendations are:

- Companies should ensure that they actively engage in planning for the succession of all senior management rather than just board level executives.
- Companies should improve their disclosures on the work they do with regards to succession planning.
- As it is material to investors, companies should disclose this information in their Annual Report, as part of their business review or corporate governance statement, rather than in a standalone document.

The ABI will continue to engage with companies around the vital issue of succession. We will also seek to identify companies where succession appears to be an issue and engage proactively.

Board Evaluation

Following the changes to the UK Corporate Governance Code, the recommendation now is that FTSE 350 companies should conduct an annual evaluation with an external evaluation held at least once every three years. We have found that many companies are concerned they may reveal confidential information when reporting evaluation outcomes. We find that:

- In 2010/11 95.9% of FTSE 100 and 96.2% of FTSE 250 companies stated they conducted a board evaluation.
- Outcomes were reported on by 31.3% of FTSE 100 companies and 10.2% of FTSE 250 companies.

Some of the best examples included discussions around risk management, corporate strategy, geographic markets of operation, and reporting on succession and diversity.

Our recommendations are:

- Companies should explain the methodology used in their board evaluations in line with the recommendations of the UK Corporate Governance Code.
- Companies should report more openly on the key outcomes of their evaluations and the steps they intend to take to address the issues that have been highlighted. We expect the outcomes of these evaluations will be different year on year as the board evolves.
- Companies should report progress on the key remedial actions taken in the following year's Annual Report.
- External evaluations should be carried out by an independent party who is not subject to conflicts of interest. This should preclude those who provide other services, such as search agents who assist in the recruitment of directors and remuneration consultants.

The ABI intends to convene round table discussions with companies to discuss the challenges they face with regard to a range of topics including board evaluations, evaluation outcomes and external facilitators. This will help us to monitor progress around evaluations, and will also enable us to share best practice as it is observed.

We will continue to monitor company statements about board evaluations and the quality of disclosure through the ABI's Institutional Voting Information Service (IVIS).

Methodology

Our sample group consisted of all companies within the FTSE 350. We excluded 53 investment trusts due to the fact that, as the UK Corporate Governance Code states, externally managed investment companies typically have a different board structure which may affect the relevance of particular Code provisions. We reviewed Annual Reports covering company year ends between 1 June 2010 and 30 April 2011.

We reviewed the narrative of Annual Reports to assess how effectively companies have been communicating their approach to diversity, succession planning and board performance evaluation to their shareholders. We believe the Annual Report should contain all material information that is relevant to shareholders, particularly as they relate to governance issues. We therefore did not consider separate sustainability reports, company websites, or any announcements that may have been made throughout the year outside the Annual Report.

For the section relating to board diversity we used the OneSource platform (http://www.onesource.com/) to analyse all director appointments in the 297 Companies in the FTSE 350 between 1st January 2009 and August 2011.

Acknowledgements

We would like to thank Black Sun Plc for their assistance in collating and analysing the data on Board Diversity and for all their input into this report.

Introduction

The evolving regulatory environment, and the financial crisis that began in 2007, has led to increasingly varied challenges facing today's boards, with a composite impact on the factors that make boards effective. In this report we focus on three areas that we believe will help ensure an effective board and ultimately contribute to the success of the company. These areas are:

- Board diversity,
- Succession planning, and
- Board evaluation.

The annual reporting cycle forms the cornerstone of a company's communications with its shareholders. For this communication to be useful, it must be clear, concise and company specific, so that it offers meaningful insight upon which investors can base decisions and properly exercise their responsibilities. It is with this in mind that the Department of Business Skills and Innovation has launched its consultation on narrative reporting. In addition, the discussion on gender diversity in the boardroom has gained increased momentum from a regulatory perspective. Recently, the Financial Reporting Council completed its consultation on Gender Diversity and will be publishing their decision on whether to amend the UK Corporate Governance Code later in 2011.

In Europe, the Commission has asked all listed companies to make a voluntary commitment to ensure that women represent at least 30% of all boards by 2015. They will be assessing whether companies have made significant progress in making credible commitments to gender diversity in March 2012. In light of the progress, the Commission will decide whether or not they should impose mandatory quotas. As strong sceptics of quotas, we hope this guidance document will encourage companies to make voluntary commitments in line with the EU's recommendations, and it sets out examples of good reporting practice as a guide for other companies.

Board Diversity

'I am a strong advocate of the importance of the diversity of Board membership, on which there is currently, particularly in respect of gender diversity, much debate. Securing the right balance of skills, experience and perspectives on the Board is a key responsibility and one to which I continue to devote a substantial amount of time.'

Jon Aisbitt, Chairman's Review,
Man Group

Board diversity is an essential driver of board effectiveness. We believe that ensuring the board is composed of members from different backgrounds, with a wide range of skills and experiences, introduces a diversity of perspective that will help to promote the company's long-term success. This is due to the fact that board members with diverse perspectives are more likely to challenge previously held assumptions and break down the tendency towards 'group-think' that can arise where a board is composed solely of like-minded individuals.

The Davies Review, *'Women on Boards'*, has highlighted the role that women can play in introducing this diversity of perspective into the boardroom. There are, of course, women achieving the highest qualifications and experience in leadership positions across a range of different sectors. However, overall, women remain poorly represented in corporate boardrooms. The Davies Review notes there are complex challenges to achieving gender diversity. These include challenges around demand, where women who are capable of serving on boards are not being appointed to the roles, and challenges around supply, where there are fewer women than men rising to the top level of their organisations.

The Davies Review sets out practical recommendations aimed at addressing this imbalance. They include:

- FTSE 100 boards should aim for a minimum of 25% female representation by 2015 and all Chairmen of FTSE 350 Companies should set out the percentage of women they aim to have on their boards by 2013 and 2015.
- Quoted companies should be required to disclose each year the proportion of women on the board, in senior executive positions, and female employees in the whole organisation.
- The FRC 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 the progress made in achieving the objectives.
- Companies should report on the three recommendations above in their 2012 Corporate Governance Statement whether or not the regulatory changes are in place.
- In line with the UK Corporate Governance Code provision B.24, which requires companies to report on the work of the nominations committee, 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.

In light of the challenges and recommendations highlighted in the Davies Review, we have conducted a thorough analysis of FTSE 350 Annual Reports to highlight what companies are doing to address the question of diversity, including gender, in their boardrooms and the whole organisation. Given the current spotlight on gender diversity in particular, we also focus on what companies say they are doing, or will do, to ensure they appoint more women to their boards. In addition, we focus on the steps they are taking to ensure that more women rise through the executive ranks and receive the training and development necessary to allow them to serve on corporate boards in the future.

Diversity of Perspective

There is broad agreement that a board made up of individuals with a variety of skills and experiences has a positive effect on corporate performance. Ensuring that board members are drawn from different backgrounds introduces a wider range of perspectives. This is integral to effectively overseeing company strategy, risk mitigation and management performance.

The Tyson Report highlighted a number of benefits from board diversity for companies which should ultimately benefit their shareholders[3]. First, companies stand to gain substantial benefits to their reputations by building more diverse boards of qualified individuals. This is because a healthy mix of backgrounds and perspectives among non–executive directors can enhance a company's sensitivity to a wider range of possible risks to its reputation. The Tyson Report also states that diverse boards have been found to help companies manage key constituencies including shareholders and employees.

In addition to this, it is our view that as companies grow in size and complexity and increase their business activities in the global arena, the significance of boardroom diversity is increased. In order to achieve long-term success in a competitive international environment, companies need to draw upon a diverse range of perspectives and competencies that are relevant in a globalised business world. A diverse board, therefore, sends a robust and positive signal to investors that companies are confronting this challenge by ensuring they have the guidance needed in the boardroom to steer them through every stage of their development.

It is within this context that the ABI supports the increased focus on gender diversity in recognition of the different perspectives that women bring to the boardroom.

Women on Boards

Since the publication of the Davies Review, the discussion on gender diversity has gained momentum. The Financial Reporting Council (FRC) has now completed its consultation on *Gender Diversity* in the Boardroom, following Lord Davies' recommendations, and they will publish their decision on whether to amend the UK Corporate Governance Code later in 2011.

The EU Justice Commissioner has also asked all listed companies to make a voluntary commitment to have at least 30% female board members by 2015 and 40% by 2020, as part of the European Commission's '*Strategy for Equality between Women and Men 2010-2015*'. In March 2012, the Commission will assess whether there has been significant progress and whether companies have made credible commitments to diversify their boardrooms. In light of the progress, the Commission will decide on whether or not to take action at EU level.

[3] Tyson (2003), The Tyson Report on the Recruitment and Development of Non-Executive Directors: A report commissioned by the Department of Trade & Industry following the publication of the Higgs Review of the Role and Effectiveness of Non-Executive Directors in January 2003, London Business School

The ABI supports the FRC's proposed changes to the UK Corporate Governance Code recommending that companies *'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 the progress on achieving the objectives.'*

Research has found that boards with better gender balance pay more attention to audit, and risk oversight and control. They also appear to be better at explicitly identifying criteria for measuring and monitoring the implementation of corporate strategy as compared to all male boards. In addition they play a more active role in setting the strategic direction and weighing long-term priorities of the company[4].

Whilst we support the move for companies to boost gender diversity, we are strongly sceptical of quotas. A quota would not necessarily create more effective boards nor deliver the individuals with the best skill set. Promoting greater diversity in any form is not just a numbers game or an exercise in political correctness. It is about improving corporate governance and company performance by accessing the widest pool of talent available to the company at all levels.

We are concerned that imposing quotas would lead to tokenism in the boardroom, creating two tier boards at the expense of performance whilst failing to address the issue of how women progress through organisations. For instance, in Norway, though quotas have increased the number of women in the boardroom, women still only make up 2% of CEOs and 10% of executive committee members[5]. Also, as strong proponents of the *'comply-or-explain'* system of governance, we do not believe that a *'one size fits all'* approach captures the requirements of each individual board.

Percentage of Women on Boards

Our analysis finds that the number of women on boards is increasing:

- *Board members in 2011:*
  - 14.2% of FTSE 100 and 8.4% of FTSE 250 board members are women–up from 13.4% and 7.6% respectively in the previous year.
  - 17.3% of FTSE 100 and 11.1% of FTSE 250 non-executive directors are women.

- *Board appointments in 2011:*
  - 18.5% of FTSE 100 and 11.9% of FTSE 250 of all board appointments were women.
  - 22.7% of FTSE 100 and 17% of FTSE 250 non-executive directors were women.

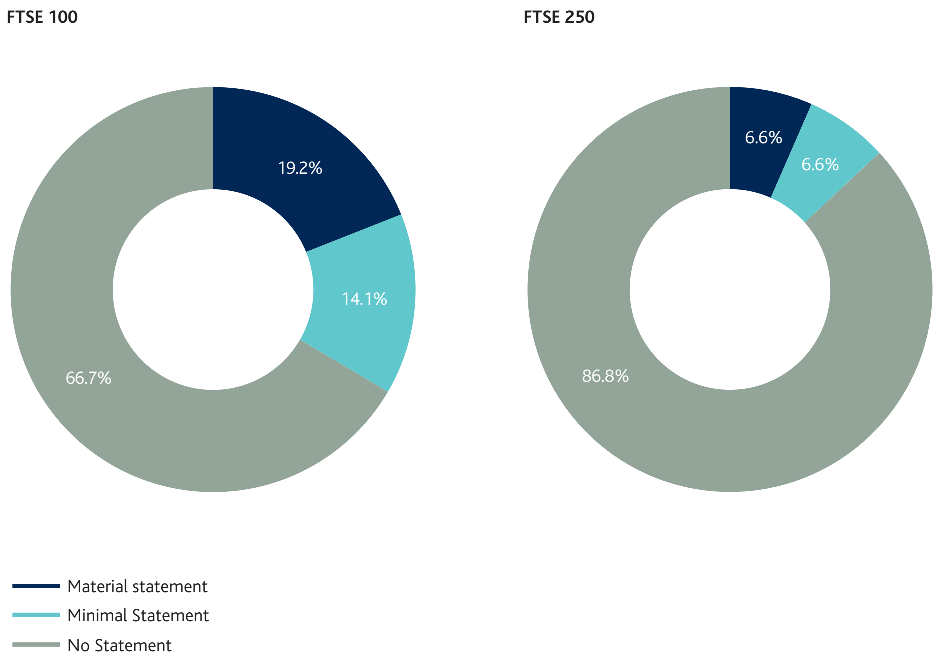
- *25% representation of women on boards:*
  - 12.9% of FTSE 100 and 6.8% of FTSE 250 company boards have at least 25% of women on their boards.
  - 13.9% of FTSE 100 and 47.8% of FTSE 250 companies have no women on their board.

[4] Brown D., Brown, D., and Anastasopoulos V. (2002) Women on Boards: Not Just the Right thing... But the Bright Thing, The Conference board of Canada, Ottawa
[5] Davies (2011) p.26

The Davies Review recommended that all Chairmen of FTSE 350 companies should now set out the percentage of women they aim to have on their board by 2013 and 2015 and that these statements should be published by September 2011. Although our analysis covers periods well before this date, we looked for Annual Reports which already contained a material statement on this issue. A material statement is one that is detailed and company specific. Many companies made a minimal reference to board diversity but did not provide any detail as to the steps they were taking to address the issue.

The Davies Review was published in February 2011. As the majority of companies have a calendar date year-end, many of the reports will have been in the process of publication when the Review came out. This gives some background to the fact that only 19.1% of FTSE 100 and 6.6% of FTSE 250 companies provide a material statement in their Annual Report on the steps that they have taken, or will be taking, to address gender diversity in the boardroom. However, progressive companies will already have considered diversity to be a boardroom issue. As more companies meet the September 2011 deadline for announcing their aspirational goals, we would expect these figures to increase significantly.

Figure 1: Quality of Diversity Statements in Annual Reports between 1 June 2010 and 30 April 2011



Barriers to Gender Diversity in the Boardroom

There are a number of reasons for the low representation of women on boards. The Davies Review noted that part of the challenge was demand. There are women in the UK capable of serving on boards who are not being appointed to the roles. He also noted the challenge of supply. Despite relatively equal male and female graduate entry, fewer women than men are feeding through the corporate pipeline to the top executive levels within organisations.

Our research has therefore focussed on these two issues, demand and supply, to understand what statements companies are making about their approach. Viewing the evidence, we believe there are good examples of best practice, and disclosure, which will help other companies to meet these challenges.

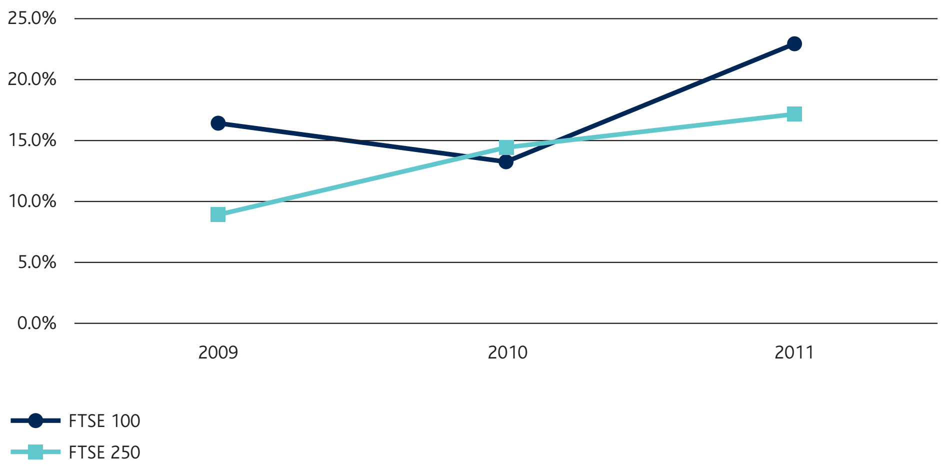
Addressing the Challenge of Demand

Some of the barriers identified in the Davies Review include the lack of access for women to the informal networks which are influential in board appointments and the lack of transparency surrounding selection criteria. We find anecdotal evidence to support this. The Annual Report of a natural resources company states that due to the complexity of its industry, the board decided that candidates for board membership would be best identified through personal contacts. They therefore did not advertise for a particular non-executive director position nor did they use an external search agency. This closed approach to board appointments will compromise the independence of the individuals. It can also encourage group-think in the boardroom and is a potentially significant barrier to the improvement of diversity of all kinds.

Our analysis finds that, since 2009, the rate of change in the appointment of female non-executive directors has been slow. However, there is a marked increase in 2011 as compared to 2010 (see figure 2). This appears to be due to the increased focus on gender diversity in the boardroom, resulting in an increase in demand. Nonetheless, we also find that 14% of FTSE 100 and 47.8% of FTSE 250 companies still have no women on their boards. We are concerned that these companies are failing to maximise the available talent pool in the UK of which women represent 46% of the economically active workforce[6]. Being slow to respond to the challenge may be detrimental to long-term performance by limiting the diversity of perspective available on the board.

[6] Ibid p.9

Figure 2: Rate of Change in Female Non-Executive Director Appointments as of August 2011



Although our analysis finds that 47.8% of FTSE 250 companies do not have any women on their boards, we are encouraged to note that some FTSE 250 companies, as the examples at the end of this section highlight, are actively addressing the issue.

We appreciate that FTSE 250 companies face a greater challenge in attaining better gender balance on their boards. As the boards are smaller, attrition, and therefore the natural opportunities to refresh the board, will be lower. We do not believe that it is appropriate to increase the size of the board in order to address diversity. Larger boards do not necessarily translate into more effective boards. Therefore it may take FTSE 250 companies longer to improve board diversity. All FTSE 350 companies should report on the steps they have taken to address their board diversity, but this needs to be a greater priority for FTSE 250 companies.

Quality of Reporting

The UK Corporate Governance Code recommends that appointments to the board should be made, '*on merit against objective criteria and with due regard for the benefits of diversity, on the board including gender.*' In addition it recommends that companies should include in their Annual Report a separate section that describes '*the work of the nomination committee, including the process it has used in relation to board appointments.*'[7]

Our analysis finds that, in adhering to the recommendations of the Code, some companies simply state that, '*Appointments are made on merit with due regard for the benefits of diversity on the Board including gender.*' Statements such as these fail to provide any insight into the board approach and are therefore simply boiler-plate statements which do not encourage dialogue. Companies should provide clear statements on the steps they are taking to achieve diversity in their boardroom and should openly discuss the challenges and opportunities they face.

[7] Section B.2

For example the Chairman of ***Man Group*** in the Nomination Committee report provides a clear insight into how they take into account the need for diversity of perspective and gender in appointing a new non-executive director. He states:

> *An independent consultant was appointed to conduct the search and a long list of names was shared with Committee members. I interviewed a number of shortlisted candidates and some were further interviewed by both the Chief Executive and Finance Director. Although several had the capability to discharge the role, it was felt that they were very similar in experience, career profile and outlook to existing Board members and might not, therefore, bring sufficient diversity of thinking to the Board.*
>
> *It was also disappointing, given our wish to capture value from gender diversity, that only 10% of the names put forward were female and that one candidate with relevant experience withdrew from the process as she wished to gain non-executive experience in a different sector.*

In light of some of the challenges in recruitment that the ***Man Group*** report highlights, we welcome the Voluntary Code of Conduct that has been drawn up by executive search firms addressing gender diversity in line with Lord Davies' recommendations.

This Voluntary Code of Conduct includes the commitment for search firms to ensure at least 30% of the candidates on their long lists are women. Where this is not the case they commit to justifying to their clients why there are no other appropriate female candidates, by demonstrating the scope and rigour of their research. We believe this will help to provide chairmen with visibility of a wider range of candidates and open up the pool of talent from which non-executive directors are traditionally drawn. This approach may also help to identify where the shortfalls in demand are.

Examples of Best Practice

We are encouraged by the range of statements in Annual Reports responding to the challenge of demand. Where the issue is relevant to the business, many companies are also highlighting the importance of other diversity issues such as international perspective. A few examples follow:

RENTOKIL INITIAL: *Gender and international diversity*

The report noted that the board currently lacked gender diversity and had limited international diversity in its membership although acknowledged that the board contained substantial international operational experience which gave the board the appropriate international reach and experience.

The report also drew out a number of areas where some changes in board and audit committee oversight of the risk management and internal control framework could be improved, on which the chief financial officer was giving attention. The board acknowledged that gender diversity would be an active consideration when changes in the board's composition were next contemplated.

Corporate Governance Statement

MOTHERCARE: *Current position of gender diversity across the group*

The importance of improving the gender balance on boards is increasingly recognised and in February of this year Lord Davies made a series of recommendations in his report 'Women on Boards' which are now being considered by the Financial Reporting Council. Currently the Mothercare plc board (excluding the executive directors) has one woman and four men, and the senior executive management team (including the executive directors) has three women and six men. The Company believes it is well positioned to meet the challenge of improving gender diversity.

Corporate Governance Report

NATIONAL GRID: *Target setting*

The Board and I welcome the findings and recommendations of the Davies Review 'Women on boards', of which I was a member. The review has set targets for the appointment of women to Boards and Executive Committees. We are already in a stronger position than many companies on gender diversity with two female Non-executive Director members of the Board. We also have two female members of the Executive Committee. We intend to take steps to improve this position further and be well positioned to meet the 2015 target of 25%.

Chairman's Statement

VEDANTA RESOURCES: *Nominations committee responsibility*

The Nominations Committee is aware of the new requirements introduced by the UK Corporate Governance Code which fall within the Committee's remit. This includes the requirement for the search for Board candidates to give due regard to the benefits of diversity, including gender. In addition the Davies report ('Women on Boards') has made a series of recommendations to encourage recruitment of women to the Boards of companies. The Nominations Committee will be reviewing its succession planning and selection procedures to ensure that these requirements are built into its processes.

Nomination's Committee Report

ANGLO AMERICAN: *Skills and target for female representation*

The Nomination Committee has defined the skills and experience profiles required of future NEDs over the next few years. This includes our aim to increase the representation of women on the Board (excluding the Chairman) from 20% to 30% within two years.

Corporate Governance Report

NORTHUMBRIAN WATER GROUP: *Development and succession planning for women below senior levels*

The NWG Board supports the findings of Lord Davies' recent review, 'Women on Boards'. Over the coming months the Board will review its procedure for the appointment of directors (including the impact of the approach taken to management development at a less senior level) and consider which of the Davies recommendations should be adopted, whether or not they become formally binding on companies.

Corporate Governance Statement

HALMA: *Wider diversity*

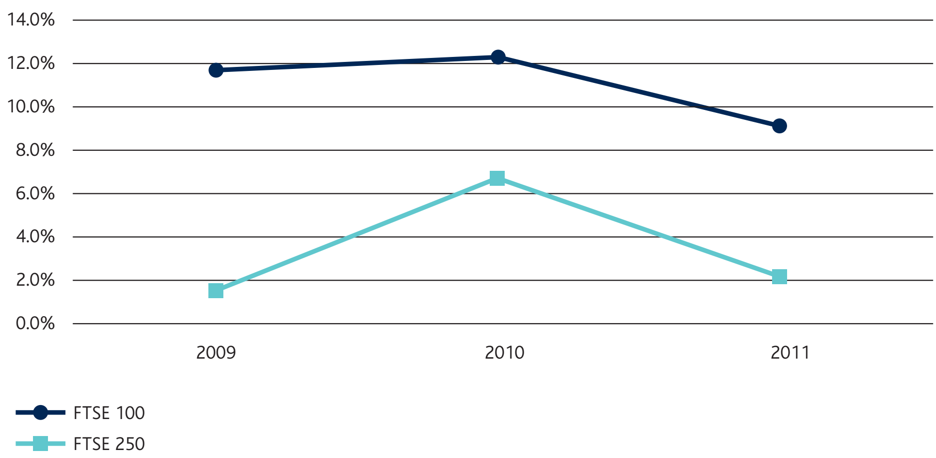
Following publication of the FRC's Consultation Document: Gender Diversity on Boards, we are reviewing our own position and contributing to the consultation process. We intend to explore the establishment of wider diversity targets and report annually on our progress.

Chairman's Statement

Addressing the Challenge of Supply

The second challenge to improving gender diversity in the boardroom that the Davies Review identified is the limited supply of women coming through the corporate structure in executive roles. *'The Women Matter 2010'* Report by McKinsey has found that this challenge in supply is due to persisting barriers that women face on their way to the top. These include the so-called 'double burden' syndrome - the combination of work and domestic responsibilities which can be difficult to reconcile with the 'anytime, anywhere' demands often associated with senior management, as well as the greater geographical mobility required at the higher executive levels. In addition, there are differences in the way men and women network and are mentored[8]. These effects lead to a lower number of women progressing through an organisation than could be expected given entry rates.

Figure 3: Rate of Change in Female Executive Appointments as of August 2011



The lack of female executives has a subsequent impact on the number of individuals who become non-executive directors as the vast majority come from executive roles in the corporate sector. It is therefore important for companies to consider other talent pools for non-executive roles – not all directors need to be drawn from executive roles in publicly listed companies. We therefore believe there are several sources of talent in the broader non-commercial sectors that traditional non-executive recruitment processes may overlook.

[8] McKinsey & Company (2010), Women Matter-Women at the top of corporations: Making it happen

Individuals with successful leadership careers in the non-commercial sector are likely to have the attributes, skills and experience relevant to non-executive director roles and these pools may in turn help deliver greater representation of women on boards. A study by the Equality and Human Rights Commission found that the average representation of women in the UK in politics was 26.2%, with 26.1% in the public and voluntary sector as a whole in 2010/11. We note for instance that approximately half of the chief executives in the voluntary sector are women, a trend that has been on the rise since 2006. Similarly, women in civil service top management and those serving as local authority chief executives have also been on the rise and could add significantly to the available talent pool for corporate boards.

However, it is important not to overstate the number of women at the top of the political, public and voluntary sectors. A closer analysis of the numbers finds that the low percentage of women at the top is not specific to the corporate sector. Only 13.2% of local authority council leaders, 14.3% of university vice chancellors, and 12.9% of the senior judiciary currently serving are women (see figures 3 and 4). This bears comparison with the statistic that 14.2% of FTSE 100 and 8.4% of FTSE 250 board members are women.

Figure 4: Women in Politics

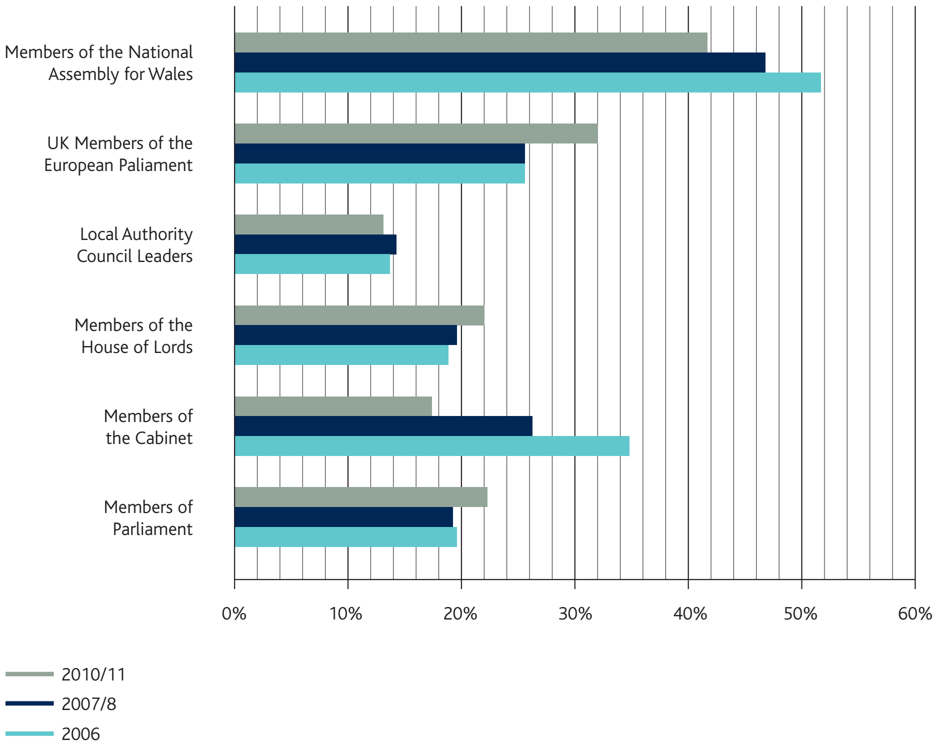
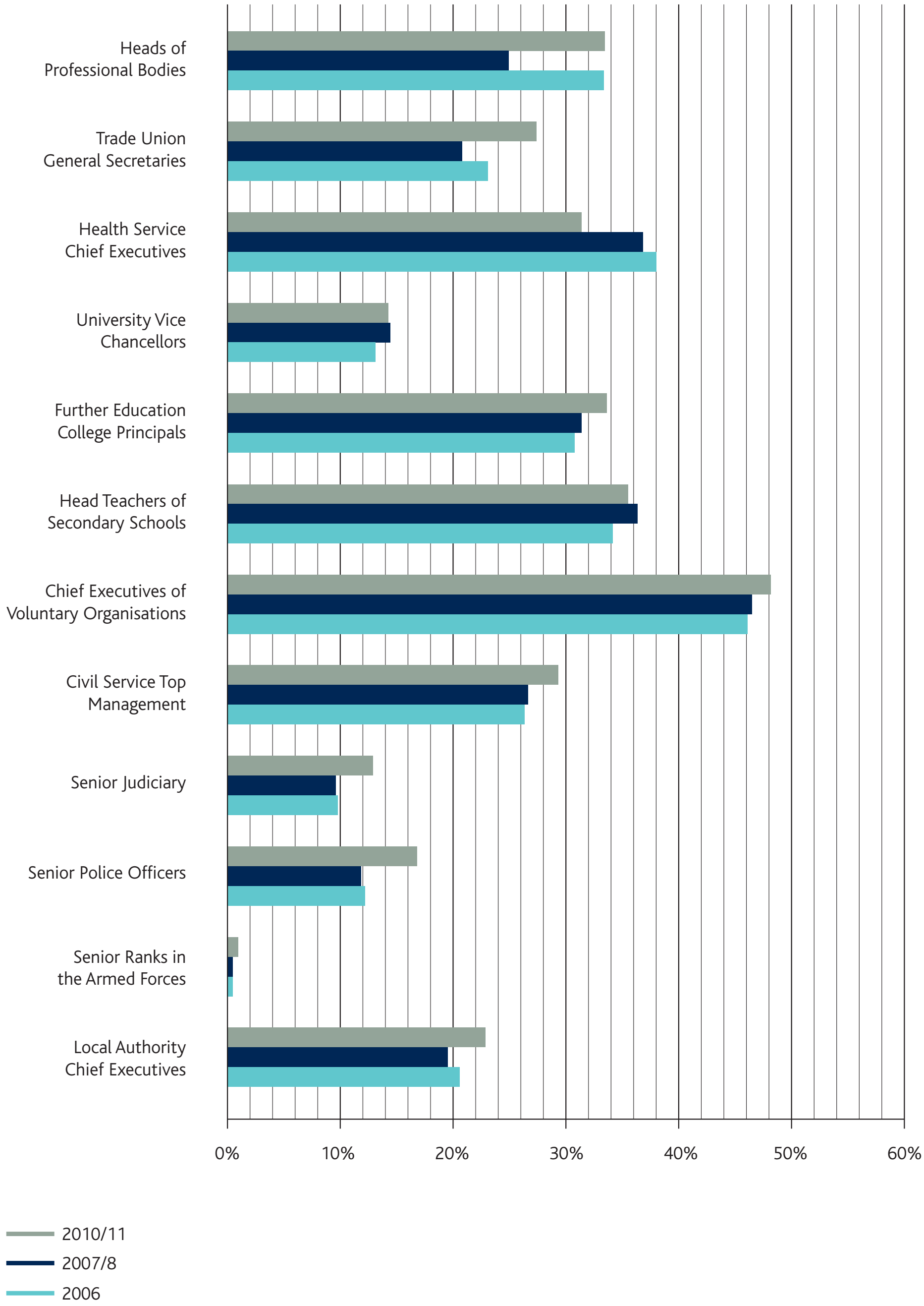


Figure 5: Women in Public and Voluntary Sectors



This relatively low level of female representation in listed companies, and in other sectors, suggests that the reasons for women not making it to the very top are not specific to the business world. We would, therefore, suggest that the most effective solutions to promote significantly greater female representations at the top levels will primarily be societal rather than enforced through legislation and quotas.

However, this does not preclude the need for gender diversity in the boardroom. The current availability of board-ready candidates outside the corporate sector further reinforces the argument for widening the search for non-executive directors away from traditional talent pools, when making board appointments.

Examples of Best Practice

Once again we have found a number of useful examples of company disclosure from across the FTSE 350. We welcome these initiatives and encourage all companies to set out their diversity policy, both in the boardroom and below board level, and to report on any measurable objectives and other steps being taken to actively promote gender diversity in their organisation. A few examples follow:

ASTRAZENECA: *Research on policies needed for female promotion*

Fifty one percent of our global workforce are women and twenty five percent of senior managers reporting to the SET [Senior Executive Team] are women. As part of developing a global diversity and inclusion strategy, we have identified the need to look more closely at the advancement of women within AstraZeneca. Working with an external expert, we completed an extensive research project involving employees across a wide range of countries to understand what is preventing a greater number of women from reaching more senior levels in the business. Findings were shared with the Board and the SET, which resulted in the formation of a global steering group chaired by our CEO and made up of senior leaders from across the business.

The steering group is focused on driving change in three key areas that emerged as themes from the research: 'Leadership & Management Capability', 'Transparency in Talent Management & Career Progression' and 'Work Life Challenges'. This work will continue to inform the development of our diversity and inclusion strategy.

Business Review

MAN GROUP: *Review of senior management diversity*

The Committee took time to review, in the context of the current focus on the value of gender diversity, Man's approach to the diversity of its management and a specific analysis of the representation of women in senior roles. They discussed and endorsed, for implementation through the Executive Committee, a range of actions proposed to create an environment which would support the development of female talent and maximise women's contribution to the business.

Nominations Committee Report

WM MORRISON SUPERMARKET: *Targets for women in senior management roles*

We are also committed to more than doubling our number of female senior managers, so that by 2014 we will have increased the female representation on the company's Senior Management Group from 13% to 30%. We have established a Steering group to drive our detailed action plans which, along with coaching and mentoring, will help more women maximise their careers at Morrisons.

Strategic Review

RIO TINTO: *Targets and reporting for the development of women into senior roles*

Priorities for 2011 include five year programmes to:

- Improve the representation of women in senior management roles and the pipeline of female talent; and
- Improve the number of individuals from under-represented nationalities in professional and leadership roles, especially people from emerging regions in which Rio Tinto is developing business.

Corporate Governance Report

Rio Tinto on Targets and Progress
Our diversity goal is to employ people based on job requirements that represent the diversity of our surrounding communities.

We are targeting:

- Women to represent 20 per cent of our senior management by 2015.
- Women to represent 40 per cent of our 2015 graduate intake.
- 15 per cent of our 2015 graduate intake to be nationals from regions where we are developing new businesses.

Progress to date

- Women represented 14 per cent of our senior management in 2010.
- Women represented 27 per cent of our 2010 graduate intake.
- Eight per cent of our 2010 graduate intake were nationals from regions where we are developing new businesses.

Sustainable Development Review

TESCO: *Mentoring*

We want the women in our teams to achieve their full potential. Back in 1997 in the UK, we had only 31 female store Managers, we now have almost 150. In the last four years in the UK the number of female directors has increased by nearly 70% across the Group and we have three women on our Board. There is still work to do. Our Women's Network provides skills development, mentoring and networking opportunities for our female managers and directors, and this year we're launching our new Women in leadership programme. Over 50 women from our UK and European businesses have been nominated based on their potential to undertake bigger and broader roles. The programme consists of seminars and courses focusing on confidence, strategic career planning and building personal authority.

Three women in Tesco are currently being coached as part of the FTSE 100 cross-company Mentoring programme. The programme, launched in 2003, involves FTSE 100 chairmen and CEOs acting as mentors to senior women just below board level in other FTSE companies. The mentors guide and advise women in the management of their careers so that they are better positioned to be considered for board appointments. Our Chairman... will begin working with his third mentee from outside Tesco in June 2011.

Business Review

LONMIN: *Encouraging wider representation in industry*

Although the revised mining charter does not have specific targets for women in the workforce, we have continued to set relevant targets:

- 10% women in core mining operations and applicable to certain employment categories; and
- 11.6% women in all operations by 2014.

As at 30 September 2010, 7.04% of our mine employees were women a year on year improvement of 0.24%. We employed 3.22% of women in core mining positions. Women in mining exclude those women who work in support functions. Together with the International Finance Corporation (IFC), we developed a guide to integrating women into the workforce, which we presented and shared with other mining houses at the Mining Indaba in Cape Town held in February 2010.

Business Review

BAE SYSTEMS: *Diversity and remuneration*

Developing the quality of the senior management 'pipe-line' – which ultimately leads to the Board – is an area that chairmen and boards do get involved in. As part of this activity, the Board and our Nominations and Corporate Responsibility committees have been monitoring how we manage diversity and inclusion across the Group, and it is good to see progress being made, particularly in developing the behaviours and culture that in the long term will be the main determinants of success in this area. Quotas and tokenism could superficially solve the diversity issue – at least at board level. However, that would not be good for companies and equally would not be good for women. I believe that the best way forward is to set the right behavioural expectations at the very top of the company and encourage management to develop appropriate solutions to meet that challenge. In terms of Board governance, the Corporate Responsibility Committee undertakes a specific role in monitoring progress against our diversity and inclusion objectives (as it does with other non-financial performance measures), and makes recommendations to the Remuneration Committee for reward purposes based on actual achievement.

Corporate Governance Report

Recommendations

- Companies should ensure that achieving diversity of perspective is a key objective in appointing board members.
- Companies should provide clear statements on the steps they are taking to achieve diversity in their boardroom and should openly discuss the issues and challenges they face in their Annual Reports.
- Chairmen should widen the search for non-executive directors, broadening traditional talent pools, when making board appointments.
- Companies should recognise their role in developing the potential of women throughout the corporate pipeline.
- Companies should wherever possible set and report on measurable objectives and other steps being taken to promote gender and other diversity in their organisations, particularly at senior management level.

The ABI will continue to monitor and look for best practice with regards to diversity and report on this in our next review in 2012. We will ensure that when we meet with companies we will engage on these issues and discuss the challenges that they may face in addressing both supply and demand.

Succession Planning

'Good succession planning recognises that you can mitigate succession risk through well informed and timely decisions being made by experienced and knowledgeable people.'

Dick Olver Chairman,
BAE Systems

The UK Corporate Governance Code recommends that *'the board should satisfy itself that plans are in place for the 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 the board to ensure progressive refreshing of the board.'*[9] Further, the FRC Guidance on Board Effectiveness, in addition to providing guidance for non-executive director appointments, states that although executive directors may be recruited from external resources, companies should ensure that they are developing internal talent and capability. This can be done through initiatives that include middle management development programmes and facilitating engagement with non-executive directors[10].

Succession planning is, in essence, the process of preparing people to meet the organisations leadership needs over time. It is the responsibility of the Board of Directors to promote the long-term success of the company. We believe therefore, that in order to ensure this success the board need to safeguard the pipeline of talented employees who have the capability to succeed the current executive management team. This is regardless of whether management change is expected in the short, medium or long-term. To do this, companies need to ensure that they are investing in their employees below senior management level and providing them with the opportunities to develop the talents and capabilities required for the long term.

The Davies Review notes that the low number of women on boards is in part symptomatic of insufficient numbers of women emerging at the top level of the management structure. Whilst the reasons for female attrition from the workforce are complex, and replicated across society as a whole, we believe that some reasons, such as disillusionment at a lack of career progression, can be resolved. One solution is for companies to put in place adequate succession plans and talent development programmes and regularly reviewing these processes. It is within this context that succession planning plays a vital role in promoting gender diversity in the boardroom. Companies have a major role to play in developing initiatives that allow women to develop the skills and attributes necessary to progress in their careers. This will also prepare them to serve as executive directors within their own organisation and as non-executive directors elsewhere.

Planning for the future is essential to business success. For shareholders, the requirement for the board to ensure that a company has the best quality management, now and in the future, is of paramount importance. The departure of a member of the management team can be a highly disruptive period for a business. Depending on how this disruption is managed, it can have a positive or negative impact of on a company's long term performance and ultimately on shareholder value.

[9] Section B.2
[10] Ibid 1 at p. 10

Research has found that investors are becoming increasingly concerned at companies' lack of CEO succession planning. Poor succession planning can increase market uncertainty, particularly in the short-term, where the board does not ensure a smooth transition[11]. In addition, the ability of the board to handle the succession process provides a valuable insight into the board's quality and carries implications for the credit quality of the company on a forward looking basis[12]. We believe therefore that succession planning is vital for managing the risks to the business and preventing instability in the company. This is made more important as the average CEO tenure has become shorter. Although tenures of 10 to 15 years were not unusual in the latter half of the 20th century, the global mean tenure of departing CEOs has dropped from 8.1 years to 6.3 years during the past decade. We believe therefore that succession planning is vital for managing the risks to the business and preventing instability in the company[13].

However, in our experience, when companies report on their succession planning processes, they mainly refer to refreshing the board in terms of non-executive director succession planning. There is often little or no mention of what they are doing with regard to executive directors and below board level. Where companies do report on executive succession plans, they often fail to provide any real insight into their strategy. As a result, we have noticed a high level of boiler-plate statements in relation to the work of the nomination committee.

It is with this in mind that we conducted an analysis of FTSE 100 Annual Reports, paying particular attention to the statements provided in terms of executive succession planning and talent development below board level. We highlight best practice examples of overall succession planning.

Succession Planning in Practice

Our research finds that the majority of companies state that planning for the succession of executive directors and other senior executives is on the board agenda. Yet the information provided by most companies about succession issues tends to be minimal and expressed in boiler-plate language. Given the importance of succession planning, there is a need for companies to step up their disclosures on the actions they are taking in this regard.

For this section we analysed FTSE 100 company reports to identify best practice examples of what companies report on with regard to succession planning.

[11] Walker (2011), Succession Planning, Europe Corporate Governance: Sustainability Research, Credit Agricole Cheuvrex
[12] Christian, P., (2008) Analysing Credit and Governance Implications of Management Succession Planning - Moody's Corporate Governance, Moody's Investor Service
[13] Favaro, K., Karlsson, P., and Neilson, G., (2010) CEO Succession 2000–2009: A Decade of Convergence and Compression, Strategy+Business, Issue 59, Booz & Co

We found that:

- Of the 15 FTSE 100 CEOs appointed in the twelve months to July 2011, 73% were hired from within. This suggests that boards are putting in place succession plans for their executives without necessarily communicating this in their Annual Reports.
- 32% of FTSE 100 companies identify the loss of key personnel across the organisation as a key operational risk that can mitigated by succession planning.
- 18.9% of FTSE 100 companies identify a need to focus more on succession planning following their board evaluation.

Companies that avoid boiler-plate disclosure discuss a wide range of issues about succession. Prior to discussing the 'who' we find that companies are coming to an agreement as to the leadership needs of the organisation informed by their long term strategic objectives. These criteria are then used to influence employee development throughout the organisation subject to regular review.

We also find that some boards are disclosing the process of working in partnership with the CEO to ensure the readiness and development of the CEO's successor. In their reporting they reassure shareholders that there is an effective CEO succession planning process in place with sufficient candidates in the pipeline to takeover, should the CEO leave.

Additionally, we find that some boards are actively engaged in planning for the succession of all senior management positions, rather than just their top executives. This has enabled them to develop the quality of candidates within the company to take up leadership roles when they become available. A number of reports state that the board is well acquainted with those people within their organisations that they believe are capable of being future leaders. Some go as far to disclose how the board interacts with these individuals. This might be through management being invited to speak at board meetings, or through actively seeking opportunities to interact with their key talent in different environments to enable them to observe their skills and knowledge.

As part of their succession planning, companies are not only seeking to develop leaders that fill specific positions but are also developing their employees' general competencies to create flexibility and leadership potential at all levels of the company structure. Additionally, they ensure that the future leaders of the company are exposed to all aspects of the company's business.

Succession planning should be interlinked with the strategic objectives of the company. Given that businesses and markets change, we find that companies are regularly reviewing their succession plans to reflect how the company is evolving in order to meet its strategic objectives, and in some cases the issue is linked to executive remuneration. We find that other companies are also providing feedback on the steps taken to review succession plans during the course of the year.

Overleaf are some examples of these different approaches.

Examples of Best Practice

EXPERIAN: *Strategy*

Succession planning ensures that appropriate senior leadership resources are in place to achieve Experian's strategic objectives. The plans are regularly reviewed by the Board's Nomination and Corporate Governance Committee.

For the broader leadership, plans are reviewed twice-yearly by the Experian executive team. The most recent review highlighted the following:

- 70% of senior leadership appointments are internal promotions. This ratio is in line with best practice and corporate governance guidelines.
- 11% of the senior leadership team are occupying developmental roles outside their home market and geography. This mobility of talent continues to be a key focus, especially across Experian's biggest markets.
- Approximately 80% of senior leadership roles within Experian have successors ready to cover these roles in the short, medium and long-term.

In order to achieve increasingly strong levels of bench strength for all key senior leadership roles, Experian is planning to further develop its 'Employer Brand' proposition. This will define and differentiate the attractions of working for the organisation, in order to support the recruitment and retention of talented individuals.

Introduction: Key Resources

WPP: *CEO involvement in succession*

Your Board and the Group's chief executive have exchanged candid, specific, current opinions about the candidates, internal and external, best qualified to succeed him; and on several structured and informal occasions, the non-executive directors, have separately addressed the appropriate selection process and succession candidates. Although we have every expectation of [the CEO's] continued, vigorous and effective leadership of the Group, the Board's responsibility for succession planning is taken extremely seriously. We continue to adhere to the position, however, that – lest public discussion of this subject foster speculation and distraction – the content of these on-going deliberations should remain strictly confidential.

Directors Report: Corporate Governance

STANDARD CHARTERED: *Developing bench strength*

Building our leadership capabilities
In the last two years, our leadership population has grown over 40 per cent, with almost two-thirds (64 per cent) of new leaders coming from inside the Bank. This indicates the level of effort we put into developing our leadership capabilities across the business.

We aim to have possible successors in place for all of our leaders. Succession plans for our top executives are reviewed on behalf of the Board by our Nomination Committee twice during the year, and this process is replicated through all senior management levels. This helps us to ensure that our high-performing employees are fully prepared for opportunities as they become available.

All our leaders receive one-on-one coaching and team support, provided by in-house leadership coaches. In 2010, we supported over 160 leaders and 30 senior teams and provided targeted coaching for newly-hired senior leaders during their first 100 days with us.

In addition, we have a special development programme for our most senior leaders, Leading the Journey. The programme provides a forum for senior leaders to come together across markets and functions to discuss issues affecting our business. This helps our most senior leaders work together as a cohesive group and demonstrate Group-wide leadership going beyond their individual functions.

Business Review

PEARSON: *Board engagement with internal candidates*

Your board is keenly aware that a creative business like Pearson is acutely dependent on its internal talent – not just of a small group of senior directors, but of a wide pool of writers, editors, educators, publishers, technologists, marketers and sales experts.

Each year we devote one full board meeting to talent, succession planning and organisational structure. We look in detail at the 20 most senior jobs in Pearson, ensuring that there are several credible candidates for each role, that they are well known by the board and that we have development plans in place to round out their experience and skills and to give them every possible chance of progressing their careers at Pearson.

Chairman's Statement

GLAXOSMITHKLINE: *Interaction with key employees*

Business awareness and succession planning

Each year the Board seeks to further develop its knowledge and understanding of the business and to gain greater visibility of executive talent and management succession. In 2010 the Board made several visits to some of the Group's sites and met with key talent and senior executives.

[Omitted section]

In addition to these planned visits, our Non-Executive Directors are encouraged to attend [Corporate Executive Team] CET meetings and R&D related executive meetings. This provides them with a good perspective of how management operates and gives a greater insight into key business issues. It also provides a further opportunity for Board members to observe the skills, knowledge, integrity and behaviour of our senior management cadre and key executive talent, whilst enabling our employees to give direct feedback to Board members.

Corporate Governance

RECKITT BENCKISER: *Leadership development*

The supply of strong management for the Group remains more than adequate. This is attributable to the Group's culture and its highly performance-oriented remuneration policy which is based on paying for excellent performance. The Group believes that its ability to attract and retain the excellent management it needs to continue its success depends critically on this system. The Group trains and develops its management pipeline through formal training programmes focusing on three areas – leadership skills, functional skills and general skills – and through a deliberate policy of training on the job. The Group has 22 formal training modules for middle management and Top 400 managers. During 2010, the Group ran over 80 courses on these modules, training over 1,000 people. Management is international, and is trained through rotation in international postings both in countries and in the Group's central functions. Succession planning is a critical management discipline and is reviewed at least annually at the full Board and the Executive Committee.

The Group closely monitors and tracks its Top 400 international managers (T400), the core management team of the business. This is a diverse group, consisting of almost 40 nationalities. Over 60% of the T400 is working in a country that is not their original domicile, consistent with the Group's policy to develop a multi-national management team. Turnover within this T400 group in 2010 was 11.6%, which the Group considers satisfactory given the need to retain high-quality management offset by the benefits of refreshing the team with new talent. 2010 saw 59 promotions, 56 moves and ten external recruits. The Group ended the year with a low level of vacancies within the T400 of 15, or around 3.4% of the measured group.

Business Review

BAE SYSTEMS: *Proactive and continuing process*

Executive succession planning
The Committee is responsible for reviewing the plans and processes aimed at ensuring that the Company has a senior executive resource with the necessary skills and experience to meet the Group's future needs, with a particular interest in long-term succession planning for the executive membership of the Board. As in past years, the Committee reviewed the output from the Group's executive development and succession planning processes. This review looked at threats to achieving the desired resource plans, and the overall health of the plans in terms of depth of resource across readiness categories and positions, average age profiles across readiness categories, gender diversity, and attrition rates. In addition, the Committee reviewed individual succession plans for the most senior executive positions in the Company (including existing executive director appointments).

Nominations Committee Report

PETROFAC: *Succession planning and remuneration*

The extent to which the individual has met personal objectives, which are agreed at the start of each year with the aim of achieving the group's business strategy. Each executive director's personal objectives include health and safety targets. In addition, some executive directors have targets in relation to succession planning, risk management and the development and implementation of the group's CSR programme.

Directors' remuneration Report

BARCLAY'S: *Nomination Committee terms of reference*

The results of the annual Committee effectiveness review undertaken in late 2010 demonstrated that the Committee felt it had operated effectively. However, during our discussions on succession planning, we agreed that the Board would benefit from having even greater visibility of the senior executives below Board and Group Executive Committee level, to increase the Board's awareness of those senior executives within the Group who have the potential to become future leaders of the organisation. As a result, we have reviewed our terms of reference so that, from 2011, we will consider the overall succession planning process for key senior executive positions and, in particular, will look at the succession plans that are in place for the heads of our principal business units.

Nominations Committee Chairman's Report

TULLOW OIL: *Succession plan reviews*

2010 Board objectives *Succession planning*	**2010 Board performance**
Appoint external advisers	External advisers were appointed during the year.
Consider matters within Nominations Committee terms of reference	Consider matters within Nominations Committee terms of reference
Develop a clear roadmap for non-executive director refreshment and Chairman succession	These were reviewed and revised appropriately.
Increase African profile of Tullow Board	A suitable roadmap was devised and its implementation has already begun successfully...Tutu Agyare's appointment during the year has increased the Board's African expertise and within the, organisation we have continued to recruit Africans to senior management positions
Consider development plan for each of the Executives and senior management	Development plans for the Executives and senior management have been discussed and are now being implemented. The Board performance report identified the need to formalise and continue these efforts and to ensure they cover general compliance training as well as sector-specific training.

Governance Highlights

Recommendations

- Companies should ensure that they actively engage in planning for the succession of all senior management rather than just board level executives.
- Companies should improve their disclosures on the work that they do with regards to succession planning.
- As it is material to investors, companies should disclose this information in their Annual Report, as part of their business review or corporate governance statement, rather than in a standalone document.

The ABI will continue to engage with companies around the vital issue of succession. We will also seek to identify companies where succession appears to be an issue and engage proactively.

Board Evaluation

'The Board continues to pursue high standards of governance with rigorous annual Board evaluation reviews. The adoption of a disciplined process has continued to ensure a culture of openness and transparency where the strengths of the Board are identified and areas for improvement clearly highlighted.'

Roger Carr, Chairman
Centrica

Since the publication of the Higgs Review and the subsequent changes to the UK Corporate Governance Code, board performance evaluation has become an integral part of corporate governance in the UK. The Code requirement now is that FTSE 350 companies should conduct an annual evaluation with an external evaluation held at least once every three years[14]. However, even though the Codes that underpin our corporate governance regime have given us the form of good governance, they cannot ensure the substance of it. As Sir David Walker's report into the governance of banks highlights; governance is primarily about behaviours[15].

Board Evaluation has been found to be an effective way to keep behaviours in check both for the collective board and individual members. It is not a negative mechanism for identifying failings, but a positive tool to encourage development and further improvement. For instance, it provides the board with an opportunity to review the balance of skills, experience and diversity both of gender and perspective. Additionally, from a succession planning perspective, it provides the board with an opportunity to openly discuss whether the plans in place are adequate for the long term success of the company. On top of these issues it also allows the board to evaluate the processes of board support and decision making.

In our conversations with companies on corporate governance issues, we have found that most are concerned that they may reveal confidential information when reporting their evaluation outcomes. We believe that this, in part, is the reason the majority of companies use boiler-plate statements to describe their evaluation outcomes. These statements fail to provide a real insight into the board's agenda looking forward or how the board is evolving and becoming more effective. They also therefore fail to provide useful information to investors or to act as starting points for engagement.

Given these concerns, and the challenge around what to disclose, we considered it would be useful to analyse FTSE 350 Annual Reports to highlight what current best practice looks like and the kind of material statements companies are making.

We are not in favour of prescribing how companies should conduct their board evaluations. As all companies are different they should develop review processes that best suit their circumstances, paying due regard to the recommendations set out in the UK Corporate Governance Code. Therefore our analysis focussed on:

- Comply-or-explain: explanations for not conducting an evaluation
- External evaluations and
- The disclosure of evaluation outcomes.

[14] Section B.6.2
[15] Walker (2009), A Review of Corporate Governance in UK Banks and Other Financial Industry Entities: Final Recommendations, HM Treasury

We hope that this will encourage companies to comply with the spirit of the code and to move away from boiler-plate language by discussing the outcomes of their evaluations more openly. This does not mean disclosing commercially or individually sensitive information, but does require meaningful disclosure.
Our analysis was based on those companies that were in the FTSE 350 in both the 2009/10 and 2010/11 financial years. We found:

- Board evaluations were conducted by 99% in of FTSE 100 companies in 2009/10 and 95.9% in 2010/11. Those few companies that did not conduct an evaluation stated that this was due to significant board changes during the year.
- 96.2% of FTSE 250 Companies conducted some form of board evaluation in both financial years.

'Comply-or-Explain'

We believe that the 'comply-or-explain' principle is the most effective means of promoting best practice in corporate governance. As investors, ABI members pay close attention to the explanations provided so as to facilitate engagement with companies. Therefore the quality of the explanations given by companies is paramount. The following section considers some of the explanations for non-compliance. All of the FTSE 100 companies and half of the FTSE 250 companies that did not conduct external evaluations stated that this was due to changes in the board composition during the year.

- A small minority of companies are providing repetitive explanations year on year.
- One company provided no explanation.
- Of the newly listed companies, 53.8% conducted internal board evaluations and 46.2% stated that they did not conduct a board evaluation due to their newly listed status.

When a company undergoes significant change in its business or board structure, the board evaluation is often postponed. However, some boards use this period of change as an opportunity not to postpone the review, but to have a fresh look at overall effectiveness.

As proponents of the comply-or-explain approach, we urge companies to ensure that there are always good processes underpinning the effectiveness of the board. This not only helps the Chairman to identify and address the strengths and weaknesses of the board, but also allows consideration of whether the board has the right balance of skills for the future. It also reassures shareholders that the board is constantly evaluating its ability to promote the success of the company by ensuring they are able to lead and direct the company's affairs.

External Evaluations

Following the 2009 review, the UK Corporate Governance Code recommends that FTSE 350 companies should conduct an externally facilitated evaluation at least every three years. There are clear benefits in having externally facilitated board reviews. Not only can the board gain a fresh and objective view on how they are performing, but they can benefit from the evaluators' exposure to best practice from outside the organisation.

Our analysis finds that for those companies listed both in 2009/10 and 2010/2011;

- External evaluations in the FTSE 100 and FTSE 250 increased by 7.2% and 9.8% respectively
- 16.2% of FTSE 100 companies and 5.1% FTSE 250 companies conducted external evaluations in both years

Figure 6: FTSE 100 – 2009/10 and 2010/11 Board Evaluations

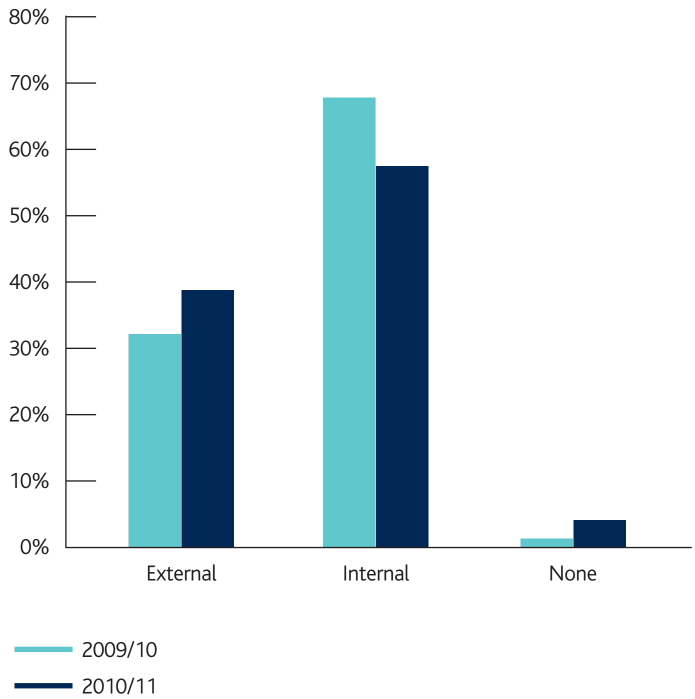
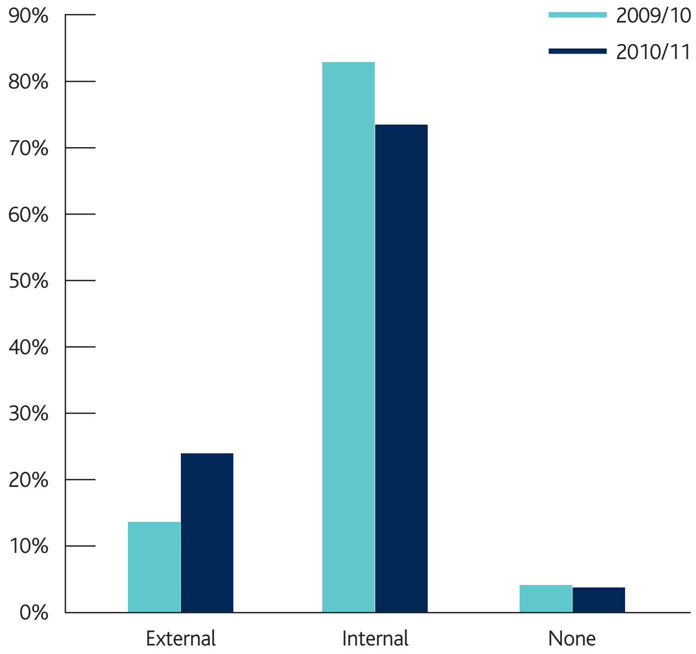


Figure 7: FTSE 250 – 2009/10 and 2010/11 Board Evaluations



Companies should ensure that when carrying out an externally facilitated evaluation, they take all the steps necessary to ensure that the facilitator is independent. This would preclude those who provide other services, such as search agents who assist in the recruitment of directors and the remuneration consultants. Many companies have expressed a wish to appoint independent external advisors to help in the evaluation of the board, but complained of a shortage of supply. This issue was also raised in Sir David Walker's Review into the governance of banks. We hope that the supply side issue will be corrected as the market develops.

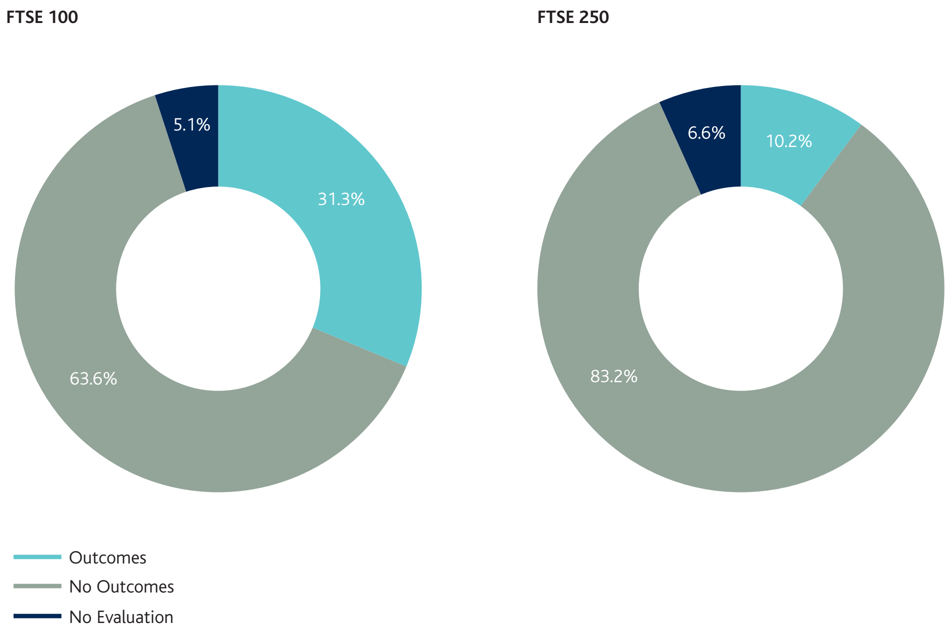
Disclosing Evaluation Outcomes

Some companies have expressed to us their concerns about revealing confidential information when discussing board evaluation. This is perhaps why the majority of companies provide boiler-plate statements such as, 'the evaluation found the board to be effective.' However, it is also possible that the poor disclosure reflects the poor average quality of current board evaluations. It is therefore imperative companies take the opportunity to prove their processes are robust and to offer reporting that allows for engagement and communicates relevant insight into the operation of the board and its processes.

There are a number of companies who are already offering useful disclosure. Our analysis finds that:

- 31.3% of FTSE 100 companies provide evaluation outcomes.
- 35% of these companies conducted internal evaluations, and 65% conducted external evaluations.
- 10.2% of FTSE 250 companies provide detailed evaluation outcomes.
- 37% of these conducted internal evaluations, and 63% conducted external evaluations.

Figure 8: Disclosure of Board Evaluation Outcomes in Annual Reports between 1 June 2010 and 30 April 2011



We do not expect companies to reveal information that is confidential or commercially sensitive, nor do we believe that it is necessary for them to do so for the reporting to be useful. It is clear many companies have disclosed their evaluation outcomes without breaching confidentiality, and this is regardless of whether the appraisals were internally or externally facilitated. Such disclosure proves it is the quality of the evaluation and its subsequent communication that is paramount.

The most useful disclosures on evaluation are those that discuss the outcomes in one year and follow up in the next years report. This year on year progression provides a meaningful assessment of the challenges the board faces as it evolves and provides an insight into how well the board is responding to those challenges over time. This allows shareholders to understand the board’s agenda for the year ahead. It is also a useful starting point in the engagement process for shareholders and the companies in which they invest.

Examples of Best Practice

The information provided was varied, as were the issues that companies highlight for additional focus. These include:

JOHNSON MATTHEY: *Board and committee performance evaluation*

Following the appointment of [the] Chairman Designate on 29 March 2011, the Board instigated a formal external facilitated evaluation of its performance and that of its Committees and individual Directors. This evaluation is being led by [the Chairman Designate] and is being externally facilitated. The evaluation will allow [the Chairman Designate] to gain an objective view of the workings of the Board and of its Committees. The evaluation includes detailed interviews with each directors covering the following key areas:

- overall board effectiveness
- board composition and balance
- succession planning
- strategy process
- financial and non-financial monitoring
- risks and management systems and
- the board development plan (including training and site visits)

This evaluation is process is on-going and will reported on further in next year's Annual Report.

No Evaluation

In other companies, even though the overall board evaluation has been postponed they ensure that their executive directors are evaluated as part of their on-going development.

DAIRY CREST: *On-going evaluation of director performance*

Evaluation of Executive Director performance for 2010/11 was conducted in April 2011 in accordance with the Company's normal performance and development review procedures.

Given the changes to the composition of the Board during the year, the Board decided that evaluation of the Chairman and the Board in March 2011, consistent with normal practice, would be premature and of little meaningful value. It was felt that time would be much better spent establishing relationships and working practices amongst the Directors with a view to a full review to be conducted with the aid of external facilitation later in the year once the new Directors had been given sufficient time to experience the operation of the Chairman and the Board for a suitable period of time. Once an externally facilitated review, focused on identifying ways to further enhance the efficiency and effectiveness of the Board, has been concluded, we will report on the outcome of that review in the Company's next Annual Report and accounts.

No Evaluation

LAND SECURITIES: *Risk management*

- Formalising at more frequent intervals a review of the interaction of the Group's assets and liabilities. This was addressed by the formation of an Asset and Liability Management Committee which meets three times a year.
- Exploring ways of framing the Board's risk appetite in more explicit terms and communicating it to the business.

External Evaluation

GLAXOSMITHKLINE: *Strategy*

- Given the fundamental strategic challenges facing the pharmaceutical industry, the Board will seek to continue to allocate more time on a regular basis to focus on strategic issues and the significant challenges facing the industry, with the direct aim of further enhancing returns to shareholders.
- R&D will continue to be a major expense to the company and the board will be seeking to assess to the extent to which the new policies implemented in recent years have added value.

Internal Evaluation

CENTRICA: *Geographic market of operation*

- a greater focus on the North American market;
- a deeper understanding of the markets, in particular the competitive landscape and the political and regulatory environment, within which the Group operates;
- additional in-depth discussions on selected key risks and internal control issues;

Internal Evaluation

TAYLOR WIMPEY: *Reporting*

- changes and improvement in the way that certain operational matters are reported to the Board
- additional reporting on specialist topics related to house building.

Internal evaluation

MORGAN CRUCIBLE: *Succession planning*

- Continued emphasis on succession planning and risk management and
- On ensuring the composition of the Board and the balance of skills and experience of the Directors continues to be appropriate.

Internal Evaluation

SERCO GROUP: *Diversity*

The gender imbalance of the Board, following the retirement of [a female NED], was noted as part of the evaluation. The Board is fully supportive of the emphasis placed on diversity, in particular gender diversity, within the Governance Code and this is a focus in the current recruitment of Non-Executive Directors to the Board.

Internal Evaluation

TATE AND LYLE: *Year on year disclosure*

Performance Evaluation
Review of the Board's Effectiveness is undertaken each year. The main outcomes of the 2010 evaluation that was led by the Chairman are summarised below.

Recommendation: More specialist presentations and training sessions to be included in the board agenda
Action: Directors received detailed presentations during the year and also training on areas including food technology and the UK Bribery Act.

Recommendation: More opportunity to interact with a broader range for employees
Action: A programme of independent visits was implemented during the year which enables the directors to meet more employees around the Group.

Recommendation: A Corporate Responsibility should be established.
Action: the CR Committee was established on 1 July 2010 and met for the first time in September 2010.

The board agreed that he 2011 board effectiveness review be externally facilitated… The main themes and observations of the Board's effectiveness were summarised in a report to the Board. It concluded that the Board Continued to operate in an effective manner but made a number of recommendations for improvements including those recommendations for improvement summarised below. Progress on agreed actions is being monitored by the Company Secretary and will be reported in the Annual Report in 2012.

Recommendation: In light of the Company's strategic future, future Board composition should be the subject of a detailed review during 2011.
Action: The review is underway and output from that review will be reported in the Annual Report in 2012.

Recommendation: A board diversity strategy should be developed.
Action: The Chairman is leading the project to develop the board diversity strategy in 2011.

Recommendation: Personal development plans should be developed for each of the non-executive directors and the Chairman.
Action: Personal development plans are being established.

Recommendation: It would be useful for the Board to have a series of 'deep dive' sessions every year.
Action: Deep dive topics are being identified and will be included in the board agenda.

External Evaluation

BARCLAYS: *Year on Year Disclosure*

Evaluation Statement
Before I describe the 2010 evaluation process and its general outcomes, I provide below a summary of the Board's progress against its 2009 action plan:

Key Themes	Actions
Board size and diversity	The Board has reduced in size and is more diverse.
Holding additional Board meetings overseas, particularly given the increased size of our US operation	The Board held one meeting overseas in 2010 and plans to hold two meetings overseas in 2011.
Increasing visibility of senior executives below Board and Group Executive Committee level	Directors have had more opportunities to interact with senior executives below Board level via briefing sessions, attendance at management conferences and post-Board meeting lunches. The remit of the Board Corporate Governance and Nominations Committee is being extended to cover succession planning at business unit level.
Improving the format of strategy presentations to the Board	The form and content of strategy presentations has been revised to include enhanced financial and risk information. In addition to the regular mont hly management accounts, the Board receives more detailed financial information on a quarterly basis.

The key themes arising from the 2010 evaluation and which will form the basis of the action plan for 2011 are:

- Ensuring that Board dynamics remain effective following recent membership changes, including the appointment of the new Chief Executive;
- Ensuring that a wide range of skills, experience, background and diversity on the Board is maintained;
- Continuing the focus on strategic decision making in light of the evolving regulatory environment; and
- Revising the format of Board meetings to allow the Board to devote more time to discussion of key strategic issues, including discussions the evening before Board meetings.

External Evaluation

Recommendations

- Companies should explain the methodology used in their board evaluations in line with the recommendations of the UK Corporate Governance Code.
- Companies should report more openly on the key outcomes of their evaluations and the steps that they intend to take to address the issues that have been highlighted. We expect that the outcomes of these evaluations will be different year on year as the board evolves.
- Companies should report progress on the key remedial actions taken in the following year's Annual Report.
- External evaluations should be carried out by an independent party who is not subject to conflict of interest. This should preclude those who provide other services, such as search agents who assist in the recruitment of directors and remuneration consultants.

The ABI intends to convene round table discussions with companies to discuss the challenges that they face with regard to a range of topics including board evaluations, evaluation outcomes and external facilitators. This will help us to monitor progress around evaluations, and will also enable us to share best practice as it is observed.

We will continue to monitor company statements about board evaluations and the quality of disclosure through the ABI's Institutional Voting Information Service.

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