

INVESTMENT ASSOCIATION RESPONSE

ICSA: REVIEW OF THE EFFECTIVENESS OF INDEPENDENT BOARD EVALUATION IN THE UK LISTED SECTOR

JULY 2019



ABOUT THE INVESTMENT ASSOCIATION

The Investment Association (IA) is the trade body that represents UK investment managers, whose 250 members collectively manage over £7.7 trillion on behalf of clients.

Our purpose is to ensure investment managers are in the best possible position to:

- Build people's resilience to financial adversity
- Help people achieve their financial aspirations
- Enable people to maintain a decent standard of living as they grow older
- Contribute to economic growth through the efficient allocation of capital

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks & shares ISAs.

The UK is the second largest investment management centre in the world and manages 37% of European assets. IA members hold in aggregate one third of the value of UK publicly listed companies. More information can be viewed on our [website](#).

EXECUTIVE SUMMARY



We welcome the opportunity to respond to ICSA's review of the effectiveness of independent board evaluation in the UK listed sector.

Board evaluations provide an important mechanism in ensuring board effectiveness. They are a proven and valuable way to help the board and individual directors assess their effectiveness, and provide a mechanism for future improvements.

We support ICSA's proposed package of guidance for listed companies and a Code for service providers. The guidance will help companies report on their evaluations in line with the new UK Corporate Governance Code, and improving the quality of company disclosures will give greater visibility to investors and other stakeholders as to how the board intends to improve. The Code for service providers will increase the level of information available to companies when choosing a provider. In taking forward these proposals, ICSA should ensure that neither measure leads to a compliance-based approach, as some members had concerns that some companies will be "forced" into a certain approach to reporting on their board evaluations.

We have a number of specific areas of feedback, including the following:

- Some boards have historically viewed evaluations as a compliance exercise rather than an opportunity to improve. This mindset negatively impacts the board evaluation appointment process; how the review is conducted, and the quality of disclosures made to shareholders. Defining the purpose of board evaluations, and emphasising the importance of continued board improvement, will help challenge this misconception. We agree that the primary purpose of board evaluation is to help the board improve its performance. Evaluations should demonstrate more than that the board is "committed" to improving; they should help boards set out how they intend to improve, resulting in disclosure of the actions they will take in response.
- The content of the proposed Code of Practice for evaluators is comprehensive. To help service providers report against it, there could be clearer differentiation between the principles and required disclosures/action. For example, for 'Competence and capacity', the Principles cover both the expectations of evaluators and disclosures required by the evaluators, it might be helpful to separate the Principles from the reporting requirements.

Our answers to all the questions raised are set out in the answers below.

ANNEX: RESPONSES TO QUESTIONS



THE PURPOSE OF BOARD EVALUATION

Q1. DO YOU AGREE THAT THE PURPOSE OF INDEPENDENT BOARD EVALUATION IS TO HELP BOARDS IMPROVE THEIR PERFORMANCE AND TO DEMONSTRATE THAT THEY ARE COMMITTED TO DOING SO? IF NOT, WHAT DO YOU CONSIDER THE PURPOSE SHOULD BE?

We agree that the purpose of board evaluation should be defined, and that this should focus on the potential for continuous board improvement.

Some boards have historically viewed evaluations as a compliance exercise rather than an opportunity to improve. This mindset negatively impacts the board evaluation appointment process; how the review is conducted, and the quality of disclosures made to shareholders. Defining the purpose of board evaluations, and emphasising the importance of continued board improvement, will help challenge this misconception.

We agree that the primary purpose of board evaluation is to help the board improve its performance. Evaluations should demonstrate more than that the board is “committed” to improving; they should help boards set out *how* they intend to improve, resulting in disclosure of the actions they will take in response. Investors expect that companies revisit these actions in subsequent Annual Reports and provide progress updates against them.

To reflect this, we consider that the purpose should be amended from:

“To help boards improve their performance and to demonstrate **that they are committed to doing so**”.

to

“To help boards improve their performance and demonstrate **how they intend to do this**.”

OVERVIEW OF SUGGESTED ACTIONS

Q2. WILL THE CHANGES MADE TO THE UK CORPORATE GOVERNANCE CODE IN 2018 BE SUFFICIENT ON THEIR OWN TO IMPROVE THE STANDARD OF BOARD EVALUATION AND REPORTING BY LISTED COMPANIES, OR WOULD ADDITIONAL ACTIONS BE HELPFUL?

In our [response](#) to the FRC’s initial consultation on a new UK Corporate Governance Code we called for improvements to board evaluations. We stated that:

“In particular, board evaluations, when executed well, provide an important mechanism in ensuring board effectiveness. Many boards take their board evaluations very seriously and are supported by board evaluation providers who add value to the process. However even among the FTSE 350, the quality and uptake of meaningful board evaluation is mixed. In extending the board evaluation process to smaller companies, there needs to be a focus on improving board evaluations more generally. Investors want companies to develop board evaluation strategies that align with the needs of their businesses, and that are forward-looking, not just retrospective. We provided some key questions for Boards to ask themselves in order to improve board evaluations in our 2015 joint paper with EY, [“Board Effectiveness: continuing the journey”](#).”

We welcomed the increased emphasis on board evaluation in the new Code. However, it is currently too early to evaluate the impact the new Code will have in improving standards and disclosures on board evaluations, given the Code only comes into force this year.



While the new Code should improve the approach taken by companies, one area not addressed is the quality and standards of individual board evaluators. A complementary Code, such as the proposed Code being consulted on by ICSA, will help assure both companies and investors that minimum standards are being met and will help them to understand the approach of the evaluator.

Q3. IF FURTHER ACTION IS DESIRABLE, DO YOU SUPPORT THE PROPOSED PACKAGE OF A CODE FOR BOARD REVIEWERS AND PRINCIPLES AND DISCLOSURE GUIDANCE FOR LISTED COMPANIES? IF SO, SHOULD THEY BE MANDATORY OR VOLUNTARY? ARE THERE ANY PARTS OF THE PACKAGE YOU CONSIDER TO BE UNNECESSARY OR INAPPROPRIATE?

Some of our members feel that the proposed disclosure guidance for companies could actually drive the wrong behaviours and force companies into a compliance driven mind-set, by being too prescriptive about how to report on board evaluations. They feel that companies should have the flexibility to report on their evaluations which makes most sense for the company and outcomes. However, many of our members agree with ICSA that board evaluation disclosures are currently not good enough, making it difficult for investors and other stakeholders to judge the quality of board evaluations and assess whether the process followed is robust. They also feel that companies need to be more explicit about the outcomes and actions to be taken by company as a result of the evaluation process. We therefore, support the introduction of principles and disclosure guidance for listed companies to help drive up reporting standards. The principles and guidance should not be prescriptive. Instead they should allow stakeholders to better assess the quality of evaluations and actions being taken by the Board.

We also support the proposed Code for service providers. We note ICSA's findings that while many board reviewers provide information on their websites about their approach to board evaluation, qualifications and track record, the level of detail is variable. This could cause difficulties for companies selecting the reviewer most appropriate for their board and business model. Introducing a Code would set common minimum standards expected of the evaluator and expectations on disclosures in the marketplace and provide a framework for reviewers to provide more information to clients. It will help ensure that companies and their shareholders are fully aware of the experience and approach which evaluators will follow when making appointment decisions or are reviewing the approach to the Board evaluation of a particular evaluator.

We support the proposed package of a Code for board reviewers and principles and disclosure guidance for listed companies being applied on a voluntary basis.

The content of the proposed Code is comprehensive. However to help service providers report against it, there could be clearer differentiation between the principles and required disclosures/action. For example, for 'Competence and capacity', the Principles currently cover both the expectations of evaluators and disclosures required by the evaluators. It might be helpful to separate the Principles from the reporting requirements.

Q4. ARE THERE OTHER ACTIONS THAT SHOULD BE TAKEN TO IMPROVE INDEPENDENT BOARD EVALUATION IN THE LISTED SECTOR AS WELL AS OR INSTEAD OF THESE SUGGESTED MEASURES? IF SO, PLEASE SPECIFY.

We do not consider that there are further actions which should be taken.

Q5. SHOULD SHAREHOLDERS HAVE MORE DIRECT INFLUENCE ON THE APPOINTMENT OF THE INDEPENDENT BOARD EVALUATOR? IF SO, WHAT FORM SHOULD THIS TAKE?



We do not consider there to be a need for shareholders to have more direct influence on the evaluator's appointment at this time.

The primary purpose of board evaluations is to help the board improve its performance. As the client, it is appropriate that the decision regarding the appointment of the evaluator lies with the board. Boards need to choose the Board evaluator that would work most effectively with the board and which will deliver the type of evaluation which the Board needs at that particular time. These are decisions for the board not shareholders.

Shareholders benefit from well-conducted board evaluations, and it is therefore important that companies disclose the process and outcomes of evaluations. Investors also expect that boards proactively address any concerns expressed by shareholders over the effectiveness or independence of the board evaluator. The evaluator and board should have the discretion to contact shareholders, prior to the appointment or while the evaluation is underway, to seek their views.

If the disclosure of board evaluations works effectively, shareholders will be able to use the disclosure made in the Annual Report as the basis of engagement with companies on particular issues or concerns.

Q6. SHOULD THE CODE AND PRINCIPLES BE APPLIED TO OTHER SECTORS AS WELL?

The Code and Principles should complement the UK Corporate Governance Code in scope, which applies to listed companies. They may also be useful to companies in other sectors. The IA has previously supported initiatives to raise the standard of corporate governance disclosures in private companies, such as the [Wates Principles](#). The Principles recommend that private companies regularly undertake board evaluations, to "help individual directors contribute effectively and highlight the strengths and weaknesses of the board as a whole." ICSA's Principles may also be useful to private companies in conducting these evaluations.

ACTIONS FOR SERVICE PROVIDERS

Q7. DO YOU AGREE WITH THE PROPOSED DEFINITION OF 'INDEPENDENT BOARD EVALUATION'?

We agree with the proposed definition.

Q8. DO YOU AGREE THAT A DISCLOSURE APPROACH TO UNDERSTANDING A SIGNATORY'S COMPETENCE AND CAPACITY IS APPROPRIATE? SHOULD THE CODE IDENTIFY SPECIFIC PROCESSES THAT MUST FORM PART OF EVALUATIONS CARRIED OUT BY SIGNATORIES?

We support the use of a disclosure approach to understanding a signatory's competence and capacity. We note ICSA's finding that while many board reviewers provide information on their websites about their approach to board evaluation, their qualifications and their track record, the level of detail provided is variable. Introducing a Code with required disclosures from service providers will set common standards for disclosures in the marketplace and provide a framework for reviewers to provide more information to clients and prospective clients so that Boards can make the appropriate decision on whether a evaluator has the right skills and approach to conduct their evaluation.

The Code should not identify specific processes that must form part of evaluations. Service providers should have the flexibility to accurately disclose their own approach to evaluations

against the Code. This will help companies choose the evaluator with the approach best suited to their board, strategy, business model or particular area of focus that they want from the evaluation.



Q9. SHOULD THE CODE SET OUT MINIMUM STANDARDS IN RELATION TO THE INDEPENDENCE AND INTEGRITY OF THE REVIEWER? IF SO, ARE THE SUGGESTED STANDARDS THE RIGHT ONES?

We support the Code setting out minimum standards on independence and integrity, and agree that these are the right ones. Investors have noted some instances in which the independence of the service provider could be questioned. This undermines the confidence shareholders place in board evaluators and outcomes of the review. As such we welcome actions to address the independence and integrity of board evaluators.

To further increase accountability over the independence of the reviewer, the board evaluation disclosures in the Annual Report should include a statement affirming the independence of the reviewer.

Q10. DO THE CODE OF PRACTICE AND THE PRINCIPLES FOR LISTED COMPANIES DEAL ADEQUATELY WITH POTENTIAL CONFLICTS OF INTEREST?

We agree that the Code of Practice and Principles for listed companies adequately deals with conflicts of interest.

As set out in Q9, the disclosures made by the company in the Annual Report should include a statement affirming the independence of the evaluator. This should outline how any potential conflicts have been dealt with.

Q11. ARE THERE ANY OTHER ISSUES THAT SHOULD BE ADDRESSED IN THE CODE?

As set out in Q3, we support ICSA restructuring the Code for service providers to more clearly distinguish between guidance and required actions and disclosures.

Q12. IS THERE A NEED FOR OVERSIGHT AND/OR ACCREDITATION, OR SHOULD SERVICE PROVIDERS BE ABLE TO SELF-CERTIFY THAT THEY ARE MEETING THE STANDARDS SET OUT IN THE CODE OF PRACTICE?

To ensure that disclosures made against the Code are of high quality, we support the appointment of an oversight body. This body should proactively seek to drive up the standard of disclosures.

Q13. IF THERE IS A NEED FOR A FORMAL OVERSIGHT BODY, WHICH OF THESE FUNCTIONS SHOULD BE INCLUDED IN ITS REMIT – ACCREDITATION, MONITORING OF COMPLIANCE, DEALING WITH COMPLAINTS, REVIEWING AND REVISING THE CODE?

We support the introduction of an oversight body to ensure the quality of disclosures. The body should undertake the following activities:

- Monitoring of compliance
- Dealing with complaints
- Reviewing and revising the Code

An example of effective oversight of industry led standards is the Remuneration Consultants Group. This group has a strong governance structure and process in place to ensure independent oversight with an independent chair and independent non-executive directors as well as representatives from the remuneration consultants industry. While not all signatories are represented on the board at any one time, the independent governance

means that signatories and other stakeholders can trust in the robustness of independent oversight and governance which the independent chair and NEDs bring.



The oversight body should initially prioritise Code uptake above disclosure quality, and as such should not employ an accreditation system. This could exclude some providers from becoming signatories. Instead, after a couple of years of operation, the body could implement a review of disclosures to help improve quality.

Q14. DO YOU HAVE ANY SUGGESTIONS FOR HOW OVERSIGHT ARRANGEMENTS MIGHT OPERATE IN PRACTICE (INCLUDING WHO MIGHT UNDERTAKE THEM AND HOW THEY MIGHT BE FUNDED)?

To avoid potential conflicts of interest, we support the oversight arrangements being operated by a body that is independent of the board evaluation market. This body should clearly disclose the governance arrangements for oversight. As noted above, the Remuneration Consultants Group with independent Chair and Non-Executive Directors could be an appropriate model to replicate.

ACTIONS FOR LISTED COMPANIES

Q15. IS THERE A NEED FOR SOME GOOD PRACTICE PRINCIPLES AIMED AT LISTED COMPANIES CONDUCTING EXTERNALLY FACILITATED BOARD VALUATIONS? IF THERE IS A NEED FOR SUCH PRINCIPLES, DO YOU AGREE THAT ADOPTION BY COMPANIES SHOULD BE VOLUNTARY?

Overall, we support the introduction of good practice principles for listed companies. Whilst some members consider that this could lead to more compliance approach to reporting rather than companies thinking about the disclosures for themselves, others agree with ICSA that the quality of disclosures made by companies is variable and this is preventing stakeholders assessing the quality of evaluations. We therefore believe the introduction of such principles will be helpful.

The proposed Principles should be applied on a voluntary basis. These will set best practice standards for companies in these areas, and investors and other stakeholders will be able to use the disclosures made by companies against them to scrutinise the company's approach to the evaluation and the review outcomes. Stakeholders will also be able to use the Principles to question companies about any departures from best practice.

Q16. DO THE DRAFT PRINCIPLES COVER ALL THE RELEVANT ASPECTS OF THE RELATIONSHIP BETWEEN THE COMPANY AND EXTERNAL REVIEWER? ARE THEY REASONABLE AND APPROPRIATE? DO THEY GO FAR ENOUGH?

The IA supports the draft principles and considers their scope to be appropriate.

Q17. SHOULD THE PRINCIPLES INCLUDE A REQUIREMENT THAT COMPANIES SHOULD ONLY ENGAGE BOARD REVIEWERS THAT HAVE SIGNED UP TO THE CODE OF PRACTICE FOR REVIEWERS?

We do not support the principles including a requirement that companies only engage board reviewers that have signed up to the Code. Companies should have the flexibility to appoint the evaluator best suited to their business model. The disclosures made by service providers against the Code will help companies determine this. Investors may question

companies why they have appointed an evaluator who is not a signatory to the code. In such cases it is appropriate for companies to explain why they have made such an appointment.



Q18. IS THERE A NEED FOR GUIDANCE ON HOW COMPANIES SHOULD REPORT ON BOARD EVALUATIONS IN ORDER TO COMPLY WITH THE PROVISIONS OF THE UK CORPORATE GOVERNANCE CODE?

We agree with ICSA's analysis that the quality of reporting on board evaluation is mixed. Many companies are not reporting effectively on the process and outcomes of evaluations.

We therefore support the introduction of guidance to help companies report in line with the UK Corporate Governance Code. This will set reporting expectations and help stakeholders challenge companies where insufficient information is disclosed.

Q19. DOES THE DRAFT GUIDANCE COVER ALL THE RELEVANT ISSUES OF INTEREST TO INVESTORS AND OTHER USERS OF ANNUAL REPORTS? ARE THE EXPECTATIONS IT PLACES ON COMPANIES APPROPRIATE?

The guidance covers the relevant issues of interest, and is appropriate in the expectations it places on companies.

As with the Code for service providers, after a set period ICSA should review the impact of the principles and guidance and consider whether further changes are needed.

Q20. SHOULD THE INDEPENDENT REVIEWER BE EXPECTED TO CERTIFY THAT THE DISCLOSURES MADE BY THE COMPANY ARE ACCURATE? IF SO, WHAT FORM SHOULD THIS TAKE?

We support the reviewer being expected to certify company disclosures relating to the board evaluation. We have previously heard that in some instances, the Chair has wanted to filter the report before it is seen by the whole Board. While we have no evidence that this is a widespread approach for companies on their public disclosures, for shareholders and evaluators the level of assurance provided by companies confirming that the evaluator has checked the disclosures will be welcomed by all stakeholders.

As such, we support the recommendation that the evaluator certify the accuracy of any disclosures relating to the board evaluation made by the company.