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International Corporate Governance Network

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ICGN Guidance on Diversity on Boards

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Preamble

The ICGN Guidance on Diversity on Boards (2016) builds upon the ICGN Guidance on Gender Diversity on Boards published in 2013. The original guidance identified the responsibilities of shareholders and companies alike to promote gender diversity on boards ultimately to enhance corporate governance and the overall success of companies.

The new guidance recognises that a range of social and economic factors contribute to a fully diverse board, beyond gender diversity. This promotes directors with experience, social backgrounds and competencies to help enable effective board decision-making and leadership. Moreover, relevant board candidates with the needed skills to promote diversity and board effectiveness should not be discriminated against based on gender, age, nationality, race, sexual orientation or gender identity.

The ICGN encourages companies to develop and disclose board diversity objectives. Boards play a role in fostering diversity and inclusiveness within a company's operations through overseeing recruitment and human capital management strategies. Boards should provide oversight on diversity measures and ensure that there is reporting across the organisation.

The ICGN also encourages shareholders to establish a dialogue with companies and, if necessary, hold the board accountable in instances of company non-compliance with market regulations or deficient disclosure with market protocols. Companies which do not meet such protocols should further expect heightened shareholder interest.

Shareholders may be able to facilitate greater board diversity by submitting their own nominees for consideration to the board. Significant shareholders in some developed country markets are increasingly able to nominate director candidates through equitable proxy access rules allowing them a voice in advocating for qualified, diverse nominees. Where proxy access is not assured, shareholders should consider petitioning their securities regulators for the right to proxy access to facilitate boards more responsive to their shareholder base.

The ICGN believes that diversity is a core attribute of a well-functioning board which supports greater long-term value for shareholders and companies. This guidance identifies principles, policies and practices which promote board diversity in general, such as the adoption of robust board evaluation processes and shareholder engagement to promote good governance practices.

As such, this guidance aims to enhance dialogue on the subject between companies and investors. It also aims to provide a balanced view on the respective roles of companies and shareholders alike in promoting and supporting diversity on boards.

Contents

Part 1: Principles and supporting evidence	9
Part 2: Guidance on Board Responsibilities	11
2.1 Role of board chair	11
2.2 Role of committees	11
2.3 Policies and disclosure	11
2.4 Composition	12
2.5 Evaluation and succession planning	12
2.6 Recruitment	13
2.7 Enterprise diversity	13
Part 3: Guidance on Shareholder Responsibilities	14
3.1 Dialogue with companies	14
3.2 Voting guidelines	14
3.3 Exercising voting rights	14
3.4 Public policy	15
Annex 1: Acknowledgements	16
Annex 2: About ICGN	17
Annex 3: ICGN Principles & Guidance	18

Part 1: Principles and supporting evidence

The ICGN believes that board diversity improves board quality, which aligns with improved company financial performance. Board diversity also promotes effective governance, leadership development and improved reputation.

The ICGN Global Governance Principles refer to board diversity as follows:

“Boards need to generate effective debate and discussion around current operations, potential risks and proposed developments. Effective debate and discussion requires that...there is a sufficient mix of relevant skills, competence, and diversity of perspectives within the Board to generate appropriate challenge and discussion.”

This emphasises the view that diversity and independence are important attributes of high functioning boards.

The business case for diversity on boards increasingly has been recognised as essential for improving a company’s organisational effectiveness, including the time taken to reach critical decisions; the generation of new ideas; the ability of companies to attract new talent; and access to expertise and global experience. Greater diversity in senior executive and board levels is correlated with measures of organisational excellence and stronger financial results, such as operating profitability and

returns on equity, than that exhibited by less diverse peers.

According to several prominent research studies, companies with diverse boards tend to outperform the market as shown by McKinsey & Company, ‘Why Diversity Matters’ (January 2015):

“Our latest research finds that companies in the top quartile for gender or racial and ethnic diversity are more likely to have financial returns above their national industry medians. Companies in the bottom quartile in these dimensions are statistically less likely to achieve above-average returns.”

Furthermore, research studies associating diversity with financial performance support the view that investors should focus attention on diversity at investee companies. For example, studies show that companies with diversity in top management positions scored higher on measures of organisational excellence, showed more distinct returns on equity, more attractive operating results and stronger stock price appreciation than the average of peers in their respective sectors.

A 2016 study, ('Is Gender Diversity Profitable? Evidence from a Global Survey written by Marcus Noland, Tyler Moran, and Barbara Kotschwar', published by the Peterson Institute for International Economics), surveyed 21,980 publicly traded companies in 91 countries and the results demonstrated that the presence of more female leaders in top positions of corporate management correlates with increased profitability of these companies.

National securities regulators and an increasing number of governments are recognising board diversity as necessary to properly reflect changes in the workplace, in companies' customer base, and to engender corporate cultural change. To increase board diversity, regulators and many governments have adopted policies which include mandatory quotas, voluntary targets or a disclosure requirement particularly in relation to gender.

Part 2: Guidance on Board Responsibilities

2.1 Role of board chair

It is the role of the chair to ensure diversity of opinions and active debate. Board diversity is as much about the culture within the boardroom and acceptance of a diversity of views as it is about having diversity (of gender or otherwise) around the boardroom table.

While all board members have a role to foster effective debate, the chair of the board has the overarching responsibility for the board agenda and for supporting board diversity.

He or she shall ensure that new, independent and diverse directors are able to contribute effectively to the dialogue.

He or she should be aware of board dynamics and work to achieve a collegial and productive environment.

The Nomination/Governance Committee should, when identifying candidates to recommend for appointment/election to the board:

(a) consider only candidates who are highly qualified based on their experience, functional expertise, and personal skills and qualities;

(b) consider diversity criteria including gender, age, ethnicity and geographic background, among other factors;

(c) engage (in addition to its own search) qualified independent external advisors to conduct a search for candidates that meet the board's skills and diversity criteria to help achieve its diversity aspirations;

(d) aspire towards board composition in which each gender comprises at least one-third of the independent directors.

2.2 Role of committees

The Nomination/ Governance Committee play a vital role in the recruitment of diverse candidates for board seats and in developing and facilitating compliance with board policies and procedures.

2.3 Policies and disclosure

The Board should:

Develop and disclose policies and/or protocols for board refreshment and succession planning which contain specific and measurable targets for

achieving diversity and appropriately measure and report on progress in achieving objectives.

Develop policies for reviewing and reporting on board diversity objectives. Progress should be reviewed by the board and reported to shareholders on a regular (i.e. annual) basis.

Maintain and disclose the evaluation methodology and tools used to assess current board and prospective board members.

Provide oversight over executive management as they develop and implement policies on human capital management, hiring and promotional processes that will lead to greater diversity.

Report to shareholders and stakeholders on diversity considerations in the director recruitment process.

Board composition should ideally be refreshed periodically to achieve the optimal mix of director experience, diversity and independence to align with the skills matrix. To promote the conditions for board diversity, boards should develop succession plans and consider introducing policies regarding (or limiting) director tenure.

When recruiting non-executive directors, a candidate's skills, experience and fit with the skills and experience the board is seeking should be primary factors for consideration. However, within the skills-based framework, boards should strive for greater diversity. It is a board's responsibility to ensure that it possesses and maintains the right balance of independence, skills and diversity.

2.5 Evaluation and succession planning

Board evaluations should be conducted on an annual basis. Evaluations can be used to assess board group dynamics, identify areas for improvement and highlight gaps between the board skills matrix and director incumbents and nominees. This process can inform the recruitment of prospective board candidates. Board evaluations should be free of insider influences and provide board members with the discretion to identify areas for discussion and improvement.

The Board should periodically update its board member evaluation metrics as the company's business and strategy evolve. This will allow the skills and experience necessary to oversee the company's

strategy and risk to develop alongside the company's business.

As part of the annual evaluation, the board should include an annual self-assessment of its performance in achieving its board diversity goals.

There should be a board succession plan that addresses prospective retirements, committee chair rotations, non-executive board chair and/or lead director rotations and existing and prospective diversity gaps. New director recruitment should be conducted strategically using the board succession plan and skills matrix as a roadmap.

2.6 Recruitment

The director selection criteria should be broad in order to expand the talent pool and should include individuals with senior and executive backgrounds, rather than limiting the candidate pool to those who currently or previously have served in executive officer positions. Selection criteria should reflect the fundamental business competencies required to serve as a director.

Potential director nominees should be identified and recommended from a diverse candidate pool that takes into consideration gender, race, age, social background, sexual orientation, ethnicity and experience. Only candidates who are highly qualified based on their experience, functional expertise, and personal skills and qualities should be considered.

The board should discuss the inclusion of diversity when hiring an external search firm to ensure that there are qualified diverse candidates on the short-list.

The creation of a potential recruitment pipeline is helpful for consideration of future director nominees and relationships should be built with prospective board candidates prior to board seats becoming available. This practice can help boards develop relationships with diverse director candidates who might not be part of sitting directors' existing networks.

2.7 Enterprise diversity

Boards should hold management accountable for establishing internal diversity programmes to foster an inclusive culture. Internal diversity programs can focus on inclusive culture and help to develop high-potential talent for future board director positions to increase the number of diverse candidates in the director candidate pool. Program examples include:

- Appropriately tailored recruitment policies;
- On-going skills development and mentoring;
- Leadership training;
- Human capital strategy development; and
- Flexible working and telecommuting opportunities.

Diversity policies, programmes, and objectives are more effective with clear endorsement and support from the Board and senior management.

2.4 Composition

The Board should be comprised of a majority of independent directors with the knowledge and experience to discharge the Board's responsibilities and the independence of judgment to do so free of any external influences.

The Board should periodically update its skills framework as the company's business and strategy evolve. This strategically positions the company to refresh its director candidate pool to reflect changes in its business approach.

Part 3: Guidance on Shareholder Responsibilities

3.1 Dialogue with companies

Shareholders have a key role in expressing their views on the implementation of diversity policies and should hold boards accountable for making progress on their policies.

Shareholders should include discussions about diversity in their regular engagement with boards and company management, to cover board composition as well as the workforce as a whole.

Shareholders should seek the development and implementation of diversity policies among investee companies and call for companies to disclose these policies and their degree of adherence to them in their annual reports.

Shareholders should encourage companies to consider how human capital management is managed within their organisations and how their policies support diversity. This includes encouraging companies to communicate their goals and achievements in developing and implementing diversity policies.

Shareholders should advocate high standards of corporate governance practices, including diversity, among

the companies in which they invest and integrate consideration of board diversity reflective of companies stakeholder base and market protocols into investment decision-making processes.

3.2 Voting guidelines

Shareholders should disclose their expectations in relation to board diversity in their governance and proxy voting guidelines.

Shareholders should disclose their proxy voting guidelines to investee companies, particularly with regard to how diversity factors may affect shareholder votes for board candidates.

3.3 Exercising voting rights

Participation in the nomination and election of the board is a key shareholder responsibility. Where appropriate, shareholders should use their voting rights to promote change in diversity practices at investee companies. This may include the nomination of directors to boards where diversity is found to be lacking.

If shareholders are unable to nominate directors to boards through proxy access or a contested election, changes can be pursued by filing a relevant shareholder proposal, commenting on proposed rules with regulatory agencies and/or listing entities, or by participating in shareholder advocacy with policy makers.

3.4 Public policy

Shareholders should communicate the importance of diversity to regulatory agencies and exchange providers and encourage them to establish targets, legislation, or listing standards for board diversity.

Regulators and exchange providers should establish a reporting policy for companies on diversity standards, including the number of women, diverse and independent directors on boards. The rules or listing policy should require companies to develop and disclose their benchmark targets for diversity on boards and in senior management, as well as relevant policies across their operations.

Shareholders should, where appropriate contribute to market-wide research and benchmarking studies that support more diversity on company boards.

Shareholders should, where appropriate, share research on the business case for board diversity with investee companies and encourage companies to adopt board diversity policies and objectives.

Annex 1: Acknowledgments

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Annex 2: About ICGN

Established in 1995, ICGN Members include investor's responsible for assets under management of US\$26 trillion. ICGN's mission is to promote effective standards of corporate governance and investor stewardship to advance efficient markets and sustainable economies world-wide. This sets the tone for our work programme which is centered around:

- Influencing policy by providing a reliable source of investor-led opinion and experience around governance and stewardship;
- Connecting peers at global events to provide a forum for dialogue between companies, investors and other stakeholders; and
- Informing debate through knowledge and education to enhance the professionalism of corporate governance and investor stewardship.

For more information, contact the ICGN Secretariat by telephone: +44 (0) 207 612 7011, email: secretariat@icgn.org or visit www.icgn.org.

Annex 3: ICGN Principles & Guidance

Principles

Global Stewardship Principles (2016)

Global Governance Principles (2015)

Guidance

Anti-corruption Practices (2012)

Corporate Risk Oversight (2015)

Diversity on Boards (2016)

Executive Remuneration (2016)

Gender Diversity on Boards (2013)

Integrated Business Reporting (2015)

Model Mandate: Contract Terms between Asset Owners and Managers (2012)

Non-executive Director Remuneration (2016)

Political Lobbying and Donations (2012)

Securities Lending (2016)



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