

Chris Hodge
Corporate Governance Unit
Financial Reporting Council
Fifth Floor,
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29th July 2011

Dear Chris

FRC Consultation: Gender diversity on boards

By way of background, Hermes is one of the largest asset managers in the City of London. As part of our Equity Ownership Service (Hermes EOS), we also respond to consultations on behalf of many clients from around Europe and the world, including Lothian Pension Fund. (only those clients which have expressly given their support to this response are listed here).

Hermes welcomes the opportunity to respond to the FRC's consultation on gender diversity on boards, following the publication of the Davies report.

We believe that company boards will be most effective if they reflect the diversity of their businesses and their stakeholders. Companies can only benefit from the inclusion of a variety of experience and perspectives around the boardroom table to assist in the process of guiding and challenging executives and in generating constructive debate and discussion. In our view, such diversity should include not only gender but also ethnicity and other attributes important for a company's particular situation such as a range of professional backgrounds and specialist skills. While Davies focussed on gender in his report, we urge the FRC to take the opportunity to encourage companies to embrace diversity in its widest sense.

The composition of most company boards still fails to reflect the plurality of backgrounds, approaches and viewpoints which, in our view, best support long-term business success. We would strongly prefer that this situation be addressed satisfactorily through best practice initiatives. However we understand that should a best practice or self-regulatory approach fail then the introduction of quotas for board diversity may be necessary.

On behalf of our clients as long term shareholders, we have previously and will continue to strongly challenge companies that appear to be failing properly to address diversity issues, at all levels of their organisation. We enclose a copy of the Hermes EOS Diversity policy for your information.



Below we answer the specific questions in the consultation paper. We would be delighted to expand upon our views if this would be helpful to the FRC. Please do not hesitate to contact me on 020 7680 3777 or at j.walmsley@hermes.co.uk

With kind regards

Yours sincerely

A handwritten signature in black ink, appearing to read 'J Walmsley'. The signature is fluid and cursive, with a large initial 'J' and a long horizontal stroke at the end.

Jennifer Walmsley
Director – Hermes Equity Ownership Services

Possible changes to the UK corporate governance code

Hermes EOS is supportive of changes being made to the UK corporate governance code, notwithstanding its recent publication, due to the importance of this issue and the need for companies to begin working on solutions to the current imbalance on boards as soon as possible.

The FRC welcomes views on whether further changes to the Code should be made.

While we are supportive of the changes proposed to provision B.2.4 with the exception of a few amendments (see below) we also believe that changes are merited in a number of further areas of the code.

We would suggest that provision B1 be strengthened to include the words “**diversity of background and gender**” so the principle would read as follows:

*“The Board and its committees should have the appropriate balance of skills, experience, **diversity of background and gender**, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.”*

We would further suggest that Code provision B.2.2 is amended to include similar wording as follows:

*“The nomination committee should evaluate the balance of skills, experience, **diversity of background and gender**, independence and knowledge on the board and, in the light of this evaluation, prepares a description of the role and capabilities required for a particular appointment.”*

It is important to stress that, while the focus of much of the recent debate has been board diversity, homogeneity at this level is symptomatic of homogeneity at less senior levels. It is impossible, in our view, effectively to address board diversity without considering diversity throughout an organisation. Companies should therefore also take steps to ensure that, in considering external appointments and promotions at any level of the organisation, their human resources policies do not inadvertently discriminate against certain groups.

We therefore believe that the code should be amended to enhance the role of the nominations committee by making it responsible for oversight of the company’s diversity policy as a whole. The intention of this would not be to increase the workload of the nominations committee but to ensure overall responsibility for diversity issues in the same way as the remuneration committee is explicitly required to be “*sensitive to pay and employment conditions elsewhere in the group, especially when determining annual salary increases*”

To this end, we would support the inclusion of a new code provision:

“The nomination committee should have overall responsibility for the company’s high-level policies on diversity. It should take steps to reassure itself that the culture of the organisation is appropriate from a diversity perspective. This is likely to include an assessment of whether human resources policies are aligned with the company’s targets in this area.”

The FRC welcomes views on this wording (Provision B.2.4)

We welcome the expansion of provision B.2.4 to include a consideration of diversity. We do feel, however, that restricting diversity to gender is too prescriptive and a missed opportunity to encourage the incorporation of individuals from a broader range of backgrounds at board level. In our view, diversity should include consideration not only of gender but also ethnicity and other attributes important for a company’s particular situation such as a range of professional backgrounds and specialist skills.

We would also propose removing the word “*any*” in this sentence, which suggests that setting objectives in this area is optional rather than a key board responsibility, and replacing it with “*the*”

Finally, we believe the insertion of one word into B.2.4 may make a significant change to the quality of nominations committees' reporting. We suggest inserting "*criteria and*" before "*process*" in the first sentence. We would hope that this change would encourage reporting on the specific skills and experience sought and identified in new appointees to the board. The addition to provision B.2.4 would then read as follows:

"This section should include a description of the board's policy on diversity in the boardroom, including the measurable objectives that it has set for implementing the policy, and progress on achieving the objectives"

The FRC does not consider that this recommendation requires a change to the Code, but welcomes views on whether it would be helpful to set out some of the key elements to be covered by a gender diversity policy - such as the criteria used when recruiting directors, or the steps taken to develop of senior executive talent - and if so, whether this should be done in the Code or elsewhere.

We do not believe that it would be helpful for the FRC to seek to define what should be included within a gender diversity policy – not least because we would sincerely hope that diversity will go beyond gender – but also because to do so would, in our view, encourage more of the boilerplate reporting that clutters many companies' governance disclosures and annual reports.

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

Hermes EOS supports the inclusion of a new supporting principle on board evaluation and is broadly in favour of the wording outlined in the consultation document. In accordance with our comments above, however, we would suggest a small amendment to remove the word "*gender*" and to include a reference to backgrounds and to the broader market so that the principle would read:

*"Evaluation of the board should consider the balance of skills, experience, **backgrounds**, independence and knowledge of the company, its industry and the market in which it operates on the board, the board's policy on **diversity**, how the board works together as a unit, and other factors relevant to its effectiveness."*

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

We see no reason for any changes to the Code not to take effect immediately with the first reports against the new provisions due in June 2012.

Hermes EOS policy on diversity

Jennifer Walmsley 17 June 2011

We believe that company boards will be most effective if they reflect the diversity of their businesses and their stakeholders. Companies can only benefit from the inclusion of a variety of experience and perspectives around the boardroom table to assist in the process of guiding and challenging executives and in generating constructive debate and discussion. Such diversity should include gender, ethnicity and other attributes important for a company's particular situation such as a range of professional backgrounds and specialist skills.

The composition of most company boards still fails to reflect the plurality of backgrounds, approaches and viewpoints which, in our view, best support long-term business success. We would strongly prefer that this situation be addressed satisfactorily through best practice initiatives. However we understand that should a best practice or self-regulatory approach fail then the introduction of quotas for board diversity may be necessary.

On behalf of our clients as long term shareholders, we will strongly challenge companies that appear to be failing properly to address diversity issues. Below we have set out a number of areas that we believe are particularly important for boards to consider.

i. Board composition and evaluation

We encourage boards to undertake a regular and thorough analysis of their composition to ensure that the interests of all relevant stakeholders are effectively represented. This should be part of the annual board evaluation process, which is required or promoted by the corporate governance codes in many countries. We expect that boards will set their own targets regarding diversity and seek to implement necessary changes as part of the process of board renewal. Where boards appear to lack sufficient diversity, we will question the extent to which such analyses and evaluations are being properly carried out.

ii Recruitment of non-executive directors

When considering possible candidates for membership, boards should take account of diversity in its widest sense and as this applies to the individual company. Attracting a suitably broad set of candidates may require looking beyond the mainstream recruitment agencies. We welcome and encourage the trend towards advertising board vacancies in national and international media. Where recruitment agencies are used, boards should ensure that they are given a specific mandate to seek out candidates from non-traditional backgrounds. We will challenge boards where candidates for non-executive directorships appear to have been drawn from a narrow pool. This includes, for example, candidates who serve on other boards with existing board members or who are otherwise already well known to them, former advisers to the company or candidates with a large number of existing board positions. We expect the chair of the nominations committee to be able to explain clearly to shareholders why a proposed candidate was deemed suitable.

iii Development of senior personnel

In order to ensure that sufficient high quality candidates with diverse backgrounds are available to serve on boards, companies should also take steps to ensure that in considering internal promotion or external appointments their human resources policies do not inadvertently discriminate against certain groups. We encourage companies to make their senior personnel, particularly the cadre of executives immediately below the board, available to serve as non-executive directors at other companies. This assists in those individuals' personal development and also in deepening the pool of talented potential non-executives for other companies.