

icsa

The Chartered
Governance
Institute

Review of the effectiveness of independent board evaluation in the UK listed sector

Final report



The Chartered
Governance Institute

January 2021

Review of the effectiveness of independent board evaluation in the UK listed sector

Contents

1. Introduction	4
2. Executive Summary	6
3. The review in context	10
The purpose of board evaluation	10
Changes to the UK Corporate Governance Code	12
Assessment of current practice	13
4. Overview of the proposed approach	16
5. Code of Practice for board reviewers	18
The content of the Code of Practice	18
Operation and oversight of the Code of Practice	20
6. Good practice principles and disclosure guidance for listed companies	23
Principles of Good Practice	24
Disclosure guidance	25
Reviewer approval of company disclosures	26

Review of the effectiveness of independent board evaluation in the UK listed sector

7. Independence	28
Independent review process	28
Provision of other services	29
Length of relationships	31
8. Next steps	33
9. Other issues raised by the review	35
Shareholder involvement in appointment of board reviewers	35
Application to other sectors	36
Engagement between board reviewers and policymakers	37
Appendix A – Code of Practice for board reviewers	38
Appendix B – Principles of Good Practice for listed companies using external board reviewers	46
Appendix C – Reporting on board performance results: guidance for listed companies	48
Appendix D – Members of the Steering Group	52

If you have any feedback on the content of these resources, or additional questions that you'd like to discuss, please contact the The Chartered Governance Institute information centre: **020 7612 7035** | informationcentre@icsa.org.uk

© The Chartered Governance Institute, 2021

The information given in this report is provided in good faith with the intention of furthering the understanding of the subject matter. While we believe the information to be accurate at the time of publication, The Chartered Governance Institute and its staff cannot, however, accept any liability for any loss or damage occasioned by any person or organisation acting or refraining from action as a result of any views expressed therein. If the reader has any specific doubts or concerns about the subject matter they are advised to seek legal advice based on the circumstances of their own situation.

Review of the effectiveness of independent board evaluation in the UK listed sector

1. Introduction

The purpose of this review was to assess the quality of independent board evaluation in the UK listed sector and identify ways in which it might be improved. It was carried out at the request of the Department of Business, Energy and Industrial Strategy (BEIS), to whom this report is addressed.

In its feedback statement on its ‘Insolvency and Corporate Governance’ consultation paper, published in August 2018, BEIS noted that:

“Several respondents, particularly institutional investors, suggested that the market for independent board evaluations should be reviewed with a view to introducing minimum standards... Respondents argued that whilst many companies are embracing best practice in dealing with issues identified in evaluations, some do not. Additionally, some respondents pointed out that the standards or thoroughness of these evaluations can vary significantly.

“The Government believes that there is scope to build on the provisions [in the UK Corporate Governance Code]. It is therefore inviting ICSA: The Governance Institute to convene a group including representatives from the investment community and companies to identify further ways of improving the quality and effectiveness of board evaluations including the development of a code of practice for external board evaluations”.

In conducting the review, we considered not only the available evidence on the current state of the market for independent board evaluations in the listed sector, but also the potential impact of the actions taken by the Financial Reporting Council (FRC) in 2018 to strengthen the UK Corporate Governance Code. Board evaluation was also addressed extensively in the FRC’s revised Guidance on Board Effectiveness, published at the same time as the Code.

The Chartered Governance Institute was assisted in this review by a Steering Group consisting of company and investor representatives. A public consultation was held from May to July in 2019 – a summary of the responses received and copies of individual responses have been published alongside this report – and a series of workshops held with reviewers, companies and investors in October 2019. We are very grateful to everyone who contributed their time and insights to the review.

Review of the effectiveness of independent board evaluation in the UK listed sector

The Institute's findings and recommendations are set out in this report. In brief, our view is that – notwithstanding the actions already taken by the FRC, which we fully support – there is scope for broader adoption of good practice and greater transparency on the part of both board reviewers and companies using their services. We believe these objectives should be pursued through voluntary initiatives in the first instance, with appropriate encouragement from BEIS and the FRC.

Peter Swabey

Policy and Research Director, The Chartered Governance Institute
March 2020

Review of the effectiveness of independent board evaluation in the UK listed sector

2. Executive summary

Rationale for the recommendations

1. The primary purpose of regular board performance reviews is to help the board continuously to improve both its own performance and the performance of the company. Engaging an independent reviewer can bring greater objectivity and fresh insights to the process, as well as providing some reassurance to the company's shareholders and other stakeholders that the company takes its responsibility for continuous improvement seriously.
2. Engaging an independent reviewer does not transfer that responsibility to them; nor are these reviewers employed to provide assurance either to the board itself or to its stakeholders as to the board's current or future effectiveness.
3. The Institute's view, shared by most of those we engaged with during the review, is that the role of the reviewer is to identify any issues that the board should consider; the role of the board is to take appropriate action to address them; and the role of shareholders and other stakeholders is to hold the board to account for the effectiveness of those actions.
4. For this reason, any action to improve the conduct and accountability of externally facilitated board performance reviews must look at the role of the board as well as that of the reviewer. This report contains recommendations addressed to both parties.
5. It is possible to identify some elements of what would be widely recognised as good practice in the way independent reviews are conducted, and to capture them in a code. However, it would not be appropriate to be overly prescriptive. The support that is needed by one board may be very different from that needed by another, and while external board reviewing is no longer a fledgling discipline it is one that is still developing. Excess prescription could deter innovation and competition.

Review of the effectiveness of independent board evaluation in the UK listed sector

6. That said, it is legitimate for shareholders and others to seek greater accountability from both companies and reviewers as to how board performance reviews are conducted, and evidence that they are being undertaken robustly. Reviewing the board's effectiveness may not be an exact science, but nor should it be a black box.
7. There are some indicators that the market for external board performance reviews at the top end of the listed sector is becoming more competitive, which could potentially have a beneficial impact. For that reason, in addition to the concern about over-prescription and the fact that the full impact of the FRC's changes to the Code is not yet known, the Institute's view is that any actions expected of board reviewers and companies as a result of this report should be voluntary, at least initially. The effectiveness of those actions, however, should be kept under review by BEIS and the FRC.

Recommendations

- A. The FRC should consider adopting the terminology 'board performance review' instead of 'board evaluation' when it next updates the UK Corporate Governance Code and the Guidance on Board Effectiveness (paragraph 17).**
- B. Any set of actions to improve the conduct and accountability of external board performance reviews must be addressed to companies as well as reviewers and must enhance the ability of shareholders and other stakeholders to hold both to account (paragraph 25).**
- C. Any actions expected of board reviewers and listed companies as a result of this report should be voluntary, at least initially (paragraph 27).**
- D. A code of practice should be published to which all organisations conducting external board performance reviews for FTSE 350 companies, and those that aspire to do so, should be encouraged to become signatories. While the Code would be voluntary, signatories would be expected to demonstrate that they adhere to the standards set out in the code on an 'apply and explain' basis. The proposed code is at Appendix A (paragraph 39).**

Review of the effectiveness of independent board evaluation in the UK listed sector

- E. BEIS should either issue the Code itself or identify a suitable organisation to become the ‘owner’ of the Code. Ownership should entail maintaining a public register of signatories and checking that applicants have made the disclosures required by the code before their status as signatories is ratified (paragraph 47).**
- F. Details of how board reviewers can register should be announced as soon as practicable, but reviewers should be given a reasonable period to adjust their practices and update their disclosures as necessary before the register ‘goes live’. Depending on how quickly these arrangements can be agreed, the recommendation is that the register would become active by the end of 2021 (paragraph 47).**
- G. Listed companies, and other organisations using the services of external board reviewers, should be encouraged voluntarily to adopt principles of good practice covering the selection of the reviewer and how the review is conducted and reported on. The proposed Principles are at Appendix B. The Institute will promulgate these Principles with its own members and recommends that BEIS and the FRC consider doing so more broadly (paragraph 54).**
- H. The FRC should issue additional voluntary guidance to listed companies on how to report against Provisions 21 and 23 of the 2018 UK Corporate Governance Code (which require companies to make certain disclosures relating to board evaluation), with the aim that companies should be able to draw on the guidance in their annual reports published in 2022. Proposed guidance is at Appendix C (paragraph 59).**
- I. As part of this guidance, listed companies that used an external board reviewer in the period covered by the annual report should disclose whether that reviewer was a signatory to the new Code of Practice. This could provide an incentive for reviewers to become signatories (paragraph 59).**

Review of the effectiveness of independent board evaluation in the UK listed sector

- J. As a matter of good practice, listed companies should agree with the reviewer any references to the process followed by the reviewer, and any observations attributed to them, and confirm in the annual report that they have done so (paragraph 63).
- K. The Code of Practice for board reviewers should not define 'independent board performance review' in such a way that a reviewer is required to follow prescribed methodologies in order to be accepted as a signatory, nor should it prescribe minimum qualifications. However, it should include a 'de minimis' definition that excludes those firms that simply supply companies with software or other tools that the company then uses as part of its internal review (paragraph 67).
- L. Board reviewers should not be prevented from providing other services to their clients, but both reviewers and companies should explain how any conflicts of interest or threats to the independence of the reviewer are managed in these circumstances, and companies should indicate in the annual report whether the fees paid for the board performance review exceed those paid for other services (paragraph 76).
- M. Board reviewers should disclose their policies relating to the length of their relationship with clients. Companies should disclose whether the relationship exceeds six years and, if so, explain how any conflicts of interest or threats to the independence of the reviewer are managed. An explanation should also be provided by the company where the reviewer has any other connections with the person leading the appointment process for the company (paragraph 81).
- N. The FRC should assess board performance review practice and reporting in the listed sector as part of its regular monitoring of the UK Corporate Governance Code, and report on its conclusions (paragraph 86).
- O. BEIS should conduct or commission a formal review of the impact of these measures three years after the proposed register of board reviewers becomes active. This review should consider whether mandatory measures or enhanced oversight of the Code of Practice for board reviewers are required, as well as whether changes are needed to the content of the Code of Practice, Principles or guidance (paragraph 86).

Review of the effectiveness of independent board evaluation in the UK listed sector

3. The review in context

The purpose of board evaluation

10. In the consultation document seeking input to the review, the Institute asked for views on the primary purpose of board evaluation, and what value is added by involving a third party. We felt it was necessary to have a clear understanding of the purpose in order to establish the extent to which it was currently being achieved.
11. Broadly there are two schools of thought, informed by different views on the purpose of evaluation, and which in turn inform views and expectations about how the evaluation should be carried out and what it is expected to achieve. They are:
 - that the purpose of evaluation is to inform a continual process of self-improvement, which might include making changes to the board, and that disclosure should provide evidence of a robust process and a willingness to act on the outcomes. By doing so, the board can provide some reassurance to shareholders and others that it takes its responsibilities seriously and is endeavouring to carry them out to the best of its ability; or
 - that the purpose of evaluation is to provide an assessment of whether the board is or is not effective, in either absolute or relative terms, and that the purpose of disclosure is to provide assurance as to the future performance of the board and company.
12. The Institute's view is that the primary purpose of a board performance review is the former; that is, to help the board continuously to improve both its own performance and the performance of the company. This view was shared by a large majority of those organisations and individuals who contributed to the review.

Review of the effectiveness of independent board evaluation in the UK listed sector

13. Many respondents to the consultation emphasised that independent board evaluation should not be seen as an assurance function. There were three reasons given for this view: that doing so would result in board evaluation becoming a backwards-looking compliance exercise that generated little value; that it would reduce the board's willingness to be open with the reviewer; and that it would raise unrealistic expectations as to the ability of the review (or reviewer) to prevent future failings.
14. Engaging a third party does not transfer the board's responsibility to take action to improve its own performance to them; nor it is the job of external reviewers to provide an absolute rating or ranking of the board's current effectiveness – either to the board itself or to its regulators, shareholders or other stakeholders – or to provide guarantees or assurance as to the board's future effectiveness.
15. The benefit of engaging an independent board reviewer instead derives from their ability to bring greater objectivity and fresh insights to the process. It also enables the company to signal to its shareholders and other stakeholders that the board takes its responsibility for continuous improvement seriously; although this benefit only materialises if there is sufficient transparency about the process and outcomes.

Terminology

16. During the course of the review it was suggested that the use of the term 'evaluation' had contributed to the perception that externally facilitated reviews were an assurance function, as it implies that there is an objective standard against which all boards can be judged (and, by extension, a single methodology which enables that judgement to be made).
17. The Institute agrees that, while the terminology is not the main cause of this perception, it may be a contributory factor. For that reason, we have used the term 'board performance review' rather than 'board evaluation' in this report and in the proposed Code of Practice for reviewers and Good Practice Principles for companies.

Review of the effectiveness of independent board evaluation in the UK listed sector

Recommendation:

- A. The FRC should consider adopting the term ‘board performance review’ instead of ‘board evaluation’ when it next updates the UK Corporate Governance Code and the Guidance on Board Effectiveness.**

Changes to the UK Corporate Governance Code

18. The UK Corporate Governance Code has played a major role in establishing the practice of external board performance reviews in the UK listed sector, and in creating a market for these services.
19. The concept of regular board performance reviews was first introduced to the Code in 2003, when it stated that “the board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors” and asked companies to describe in their annual reports how that review had been conducted.
20. The first reference to externally facilitated board performance reviews came in 2010, with the introduction of a ‘comply or explain’ provision stating that FTSE 350 companies should undertake such a review at least every three years. The 2010 Code also introduced a requirement for the company to disclose whether it had any other connection to the reviewer.
21. As explained in paragraph 24 below, there is now nearly full compliance with this provision. However, the same concerns about the thoroughness of some external board evaluations and the transparency about process and outcomes that led BEIS to commission this review also prompted the FRC to strengthen the Code when it was updated in 2018.

Review of the effectiveness of independent board evaluation in the UK listed sector

22. Under the revised Code, companies are expected to disclose “how the board evaluation has been conducted, the nature and extent of an external evaluator’s contact with the board and individual directors, the outcomes and actions taken, and how it has or will influence board composition”.
23. The 2018 Code applies to financial years beginning on or after 1 January 2019, with the result that companies are not required to report on the issues specified in the new provision until 2020 (although some did so voluntarily in 2019). This year’s annual reports will be the first opportunity to assess the impact of the revised Code on the quality of reporting. Previous experience when introducing new Code provisions suggests that the impact on how reviews are conducted will take longer to ascertain.

Assessment of current practice

24. As part of this review, the Institute reviewed the available evidence on how the market for the supply of external board performance reviews in the listed sector was functioning, and on the quality of the reviews and reporting thereon. The purpose of doing so was to assess the extent to which there was a need for remedial action. The main findings can be summarised as follows:
 - In their annual reports published in 2019, 38% of FTSE 350 companies reported that they had carried out an externally facilitated evaluation the previous year¹. Extrapolated over the three-year period within which the Code expects such reviews to be carried out, this suggests nearly full compliance. By comparison, only 37.5% of listed companies across Europe carry out an externally facilitated evaluation at least every three years².
 - An analysis of annual reports issued in 2020 identified that 32 different individuals and organisations had been used the previous year³. By comparison, 51 different reviewers had been used in 2012⁴, which might perhaps suggest that some of the less well qualified reviewers have been ‘weeded out’.

1 Corporate Governance Review 2019¹; Grant Thornton; 2019

2 Regulatory Briefing: Board Evaluation in Europe²; Minerva Analytics; 2019

3 Corporate Governance Review 2020; Grant Thornton; 2020

4 Developments in Corporate Governance³; Financial Reporting Council; 2013

Review of the effectiveness of independent board evaluation in the UK listed sector

- There is quite a high level of concentration, combined with a ‘long tail’ of reviewers with only one or two FTSE 350 clients. Two organisations undertook 40% of all externally facilitated review in the FTSE 350 in 2020, with one of them responsible for more than one in four of all such evaluations. However, as noted in the 2019 Grant Thornton report on application of the Code, “previous market leaders are conducting fewer evaluations and smaller players are getting more, including two newcomers that each picked up several evaluations this year”⁵.
- There is currently no reliable data on the number of successive times reviewers carry out reviews for the same company, or the extent to which they provide their clients with other services.
- A survey carried out for the All-Party Parliamentary Corporate Governance Group (APPCGG) in 2018 suggested that ‘word of mouth’ is still the most common means by which companies identify potential reviewers⁶. However, it should be noted that this is not necessarily incompatible with a formal and competitive selection process.
- Information from listed companies on the process followed when evaluating the board’s effectiveness is variable, although there are some signs that the changes made to the UK Corporate Governance Code in 2018 may already be having a positive effect. While only 51% of FTSE 350 companies provided good or detailed explanations of how the evaluation was carried out in 2020, this was up from 41% in 2018⁷.
- In its 2018 review of corporate governance and reporting, the FRC states that: “in the FTSE 100, 79 commented on methodology, with 45 of these (57%) stating a more in-depth evaluation was conducted. In the FTSE 250, there was a small majority preference for the use of questionnaires.”⁸
- It appears that listed companies themselves are generally satisfied with the quality of the services received from independent reviewers. The APPCGG review found that 85% of respondents were satisfied with their most recent experience of external facilitation⁹, and that “it was felt that reviews had become more professional [in the previous five years]”.

5 Grant Thornton; 2020 and Grant Thornton; 2019

6 ‘15 Years or Reviewing the Performance of Boards’; All-Party Parliamentary Corporate Governance Group; 2018

7 Grant Thornton; 2020

8 Financial Reporting Council; 2018

9 All-Party Parliamentary Corporate Governance Group; 2018

Review of the effectiveness of independent board evaluation in the UK listed sector

- As with reporting on the process followed, reporting on the outcomes of board evaluations is variable. In 2020 annual reports, only 46% of FTSE 350 companies outlined their outputs and actions¹⁰. Unlike reporting on the process followed, there is no evidence of improvement in this area as a result of the updated Code; in fact, the figure has fallen slightly compared to 2018.

¹⁰ Grant Thornton; 2020

Review of the effectiveness of independent board evaluation in the UK listed sector

4. Overview of the proposed approach

25. The impact of any board performance review depends as much – if not more – on the attitude of the board as it does on the ability of the reviewer. The board appoints the reviewer, sets the terms of the review, and decides how to respond to the findings. The role of the external board reviewer is to identify and highlight any issues that the board should consider; the role of the board is to take appropriate action to address them; and the role of shareholders and other stakeholders is to hold the board to account for the effectiveness of those actions.

Recommendation:

- B. Any set of actions to improve the conduct and accountability of external board performance reviews must be addressed to companies as well as reviewers and must enhance the ability of shareholders and other stakeholders to hold both to account.**

26. In the Institute's view, it is not possible to make a reliable judgement about the overall robustness and quality of the work carried out by external board reviewers based on the evidence set out in the previous section. This would be difficult to do even with more complete reporting by companies and reviewers, not least because there is no evidence to suggest that any particular methodology is a reliable indicator of quality; but clearer reporting might at least enable readers to assess where a given individual review appeared to be sub-optimal in terms of either scope or process.
27. However, while there is no doubt room for improvement, the evidence does not suggest that there is a widespread market failure that needs to be corrected; and, in some areas at least, there are tentative signs that the changes made to the UK Corporate Governance Code in 2018 are beginning to have a positive effect. For these reasons, as well as the concerns expressed above about the risks associated with over-prescription, the Institute considers that any actions proposed as a result of this review should be voluntary, at least initially. The impact of those measures, however, should be kept under review.

Review of the effectiveness of independent board evaluation in the UK listed sector

Recommendation:

C. Any actions expected of board reviewers and listed companies as a result of this report should be voluntary, at least initially.

28. In the rest of this report, we set out a series of actions that we believe would be beneficial while being compatible with these recommendations. They are:
- a voluntary code of practice for providers of external board performance reviews to FTSE 350 companies;
 - voluntary good practice principles for listed companies; and
 - guidance for listed companies on how to report on their board performance reviews, in line with the requirements of the 2018 UK Corporate Governance Code.
29. These measures are intended to be mutually reinforcing. By asking companies to disclose to shareholders whether the board reviewer they use is a signatory of the Code of Practice, this will hopefully incentivise companies to appoint reviewers that have committed to the standards in the Code and in turn encourage reviewers to do so. Similarly, shareholders would be able to challenge companies that chose not to adopt the voluntary Principles.
30. The aim is that the package of proposed measures will develop into a market-based mechanism for raising standards and increasing accountability, without the need for regulatory intervention.

Review of the effectiveness of independent board evaluation in the UK listed sector

5. Code of practice for board reviewers

31. When BEIS invited the Institute to undertake this review, it specifically requested that we consider the case for a code of practice for external board performance reviews, “with a view to introducing minimum standards”.
32. The Institute’s view, which is shared by most of the individuals and organisations that contributed to the review, is that such a code can play a useful role in improving the market for independent reviews, but that attempting to impose minimum standards may not be the most effective way of doing so.

The content of the Code of Practice

33. While it is possible to identify some elements of what would be widely recognised as good practice in the way independent reviews are conducted and to capture them in a code, in the Institute’s view it would not be appropriate to be too prescriptive about the methodology to be followed. There are three main reasons for this view.
34. The first reason is that the support that is needed by one board may be very different from that needed by another, and this will be influenced by many different factors including the company’s circumstances and how recently the board has been refreshed.
35. The second and third reasons go together. While external board reviewing is no longer a fledgling discipline, it is one that is still developing, and there is no qualitative evidence to demonstrate that any specific methodology delivers superior results to the others. Excess prescription or premature standardisation of the process could have the effect of deterring innovation and competition without necessarily improving quality.

Review of the effectiveness of independent board evaluation in the UK listed sector

36. Defining minimum criteria in terms of qualifications or prior experience carries a similar risk. One of the interesting features of the market for external board performance reviews is the wide variety of expertise and backgrounds to be found among the reviewers. Potentially this creates greater opportunity for companies to find individuals or organisations with the skills they need.
37. The approach proposed in the Code of Practice at Appendix A is instead to encourage greater transparency about how individual external board reviewers conduct reviews and what their qualifications for doing so are, rather than to prescribe or standardise how reviews are expected to be carried out. This should mean that companies and their stakeholders are able to make a more informed assessment of which reviewers are best suited for their own particular needs.
38. The proposed Code adopts a similar structure to the Wates Principles for private companies, i.e. a relatively small number of high-level principles accompanied by guidance on how they might be applied. The Institute recommends that the signatories to the Code should report against it on an 'apply and explain' basis, as is also the case with the Wates Principles. We consider this strikes the appropriate balance of introducing a degree of rigour into the way signatories address the principles while retaining the necessary flexibility.
39. The principles and guidance cover four broad topics: competence and capacity; independence and integrity; client engagements and client disclosure. The principles are designed to mirror the proposed Principles of Good Practice for listed companies (see Section 6), while the guidance draws on the FRC's Guidance on Board Effectiveness. The Code of Practice also draws on earlier initiatives to establish good practice principles for the sector.

Review of the effectiveness of independent board evaluation in the UK listed sector

Recommendation:

- D. A Code of Practice should be published to which all organisations conducting external board performance reviews for FTSE 350 companies, and those aspiring to do so, should be encouraged to become signatories. While the Code would be voluntary, signatories would be expected to demonstrate that they adhere to the standards set out in the code on an 'apply and explain' basis. The proposed code is at Appendix A.**

Operation and oversight of the Code of Practice

40. An important factor in making any code of practice effective is putting in place appropriate arrangements of accreditation and oversight; that is, who can become a signatory, what must they commit to do in order to become one, and who will check whether they are abiding by that commitment.
41. That is not straightforward. On the one hand, it is important that the Code and any oversight arrangements are seen as credible by companies, investors and other stakeholders if they are to be of any benefit to signatories or the market as a whole. That will not be achieved if there are no commitments associated with being a signatory.
42. On the other hand, if the conditions to be met in order to become a signatory are too onerous or too prescriptive there is a risk that the Code becomes a means of entrenching the more established providers or benefiting larger organisations at the expense of smaller reviewers, reducing choice and capacity in the market, or that reviewers simply decide not to sign up. Any one of those outcomes would be counterproductive.

Review of the effectiveness of independent board evaluation in the UK listed sector

43. As part of the review, the Institute has assessed the accreditation and oversight arrangements for existing sectoral codes, including those for remuneration consultants, search firms, proxy advisors and private equity, as well as the FRC's Stewardship Code for institutional investors.
44. Most of these existing models include some form of accreditation process which involves, as a minimum, setting specific requirements to which providers must commit before they can state that they are signatories. Some add further eligibility requirements - for example, only remuneration consultants that have worked with at least one FTSE350 company are eligible to become signatories to that code – and some oblige signatories to report regularly to an oversight body as part of its monitoring activities.
45. All these codes have been in place for some years, and the oversight arrangements have developed over time. The Institute's view is that, as an entirely new code, oversight of the proposed Code of Practice should be light touch to begin with, but should be kept under review as the Code becomes more established.
46. We recommend that there should be a central public register of board reviewers that have committed to adhere to the Code and to disclose how they have done so. An organisation would need to be identified to host the register and to carry out whatever checks are required before placing reviewers on the register. Our recommendation is that, at least initially, these should be limited to checking that potential signatories had made the necessary disclosures; this would be a check for completeness not an appraisal of quality. Over time, it might be appropriate for this organisation to take on more functions, for example monitoring and reporting on compliance with, and the impact of, the Code and reviewing and updating the content of the Code.
47. It is for BEIS to consider which organisation should be given ownership of the Code of Practice and register, but in broad terms there appear to be four options:
 - BEIS could undertake this role itself;
 - BEIS could ask the FRC or its successor body to undertake the role;
 - BEIS could ask an existing private organisation to undertake the role; or
 - BEIS could work with the sector to set up establish a new body or mechanism to carry out this function.

Review of the effectiveness of independent board evaluation in the UK listed sector

Recommendations:

- E. BEIS should either issue the Code itself or identify a suitable organisation to become the 'owner' of the Code. Ownership should entail maintaining a public register of signatories and checking that applicants have made the disclosures required by the code before their status as signatories is ratified.**

- F. Details of how board reviewers can register should be announced as soon as practicable, but reviewers should be given a reasonable period to adjust their practices and update their disclosures as necessary before the register 'goes live'. Depending on how quickly these arrangements can be agreed, the recommendation is that the register would become active by the end of 2021.**

Review of the effectiveness of independent board evaluation in the UK listed sector

6. Good practice principles and disclosure guidance for listed companies

48. As explained in Section 4, the Institute's view is that any set of actions to improve the conduct and accountability of external board performance reviews must be addressed to companies as well as reviewers and must enhance the ability of shareholders to hold both to account. These measures should be mutually reinforcing. The aim is that together they will develop into a market-based mechanism for raising standards and increasingly accountability.
49. When considering what measures targeted at listed companies to recommend, the Institute was very conscious of the changes made by the FRC to the UK Corporate Governance Code and Guidance on Board Effectiveness in 2018. The Guidance in particular deals extensively with the issues of how board evaluations should be conducted and the criteria to be considered when appointing an external reviewer. We see no need to produce further guidance for companies on these matters.
50. We do, however, believe there would be some value in a set of good practice principles that go further than the 'comply or explain' provisions of the Code to which listed companies could voluntarily choose to commit. We also consider that there would be value in some guidance to companies on how they might meet the disclosure requirements in the Code, and on some additional disclosures that would be welcomed by investors.
51. The Institute's view is that these measures would provide additional leverage for investors (and other stakeholders) to press for the adoption of good practice. If a company does not adopt the Principles, or engages a reviewer that is not a signatory to the Code of Practice, shareholders could challenge them. If this happens, then in turn it would create an incentive for service providers to adopt the Code of Practice.

Review of the effectiveness of independent board evaluation in the UK listed sector

Principles of Good Practice

52. As noted, the usefulness of an external board performance review is not just determined by the quality of the service provided, but by the attitude of the company as well. It is the company that sets the terms of the engagement, facilitates the evaluation by providing the reviewer with support and access, and decides how to respond to and report on the findings.
53. The Institute considers it is desirable to encourage companies to adopt good practices in the way that they engage with the external board reviewer, and not limit themselves simply to what is required in order to comply with the Code. We propose this should be done through a short set of Principles, which companies should be invited to adopt.
54. The proposed Principles are at Appendix B. They have been designed to mirror the standards expected of board reviewers in the proposed Code of Practice and, in our view and the view of many respondents to the public consultation, they capture existing good practice. Many companies may already meet these standards; for them the main benefit of adopting the Principles would be to send a signal to their shareholders and other stakeholders that they are committed to doing so.

Recommendation:

- G. Listed companies, and other organisations using the services of external board reviewers, should be encouraged voluntarily to adopt principles of good practice covering the selection of the reviewer and how the review is conducted and reported on. The proposed Principles are at Appendix B. The Institute will promulgate these Principles with its own members and recommends that BEIS and the FRC consider doing so more broadly.**

Review of the effectiveness of independent board evaluation in the UK listed sector

Disclosure guidance

55. There are two reasons for recommending publication of the proposed disclosure guidance at Appendix C: to assist listed companies seeking to comply with the Code, and to provide their shareholders and other stakeholders with information that they would find useful in assessing the board's attitude to, and implementation of, board performance reviews.
56. The guidance is somewhat broader in scope than the other measures proposed in this report as the reporting required under the UK Corporate Governance Code applies to all board evaluations, not just to those that have been externally facilitated. It therefore covers both internal and external board performance reviews.
57. For external reviews, the draft guidance recommends that companies disclose additional information on top of that specified in the Code in three main respects:
- whether the external reviewer is a signatory to the Code of Practice, for the reason explained above;
 - information about the length of the relationship between the reviewer and the company and/or the person leading the appointment process, and about the value of any other services being provided by the reviewer. This is explained in more detail in Section 7; and
 - the process by which the reviewer was selected
58. In our discussions with both board reviewers and investors, the process by which companies decide who will undertake the independent review was identified as an indicator of the likely robustness and independence of the review. If a reviewer was selected without a formal process involving at least two bidders, or if only one individual within the company was involved in making the decision, it was considered that this should raise red flags.

Review of the effectiveness of independent board evaluation in the UK listed sector

59. It is for this reason we have recommended that companies provide more information about the appointment process, which is also covered in the proposed Principles of good practice.

Recommendations:

- H. The FRC should issue additional voluntary guidance to listed companies on how to report against Provisions 21 and 23 of the 2018 UK Corporate Governance Code (which require companies to make certain disclosures relating to board evaluation), with the aim that companies should be able to draw on the guidance in their annual reports published in 2022. Proposed guidance is at Appendix C.**
- I. As part of this guidance, listed companies that used an external board reviewer in the period covered by the annual report should disclose whether that reviewer was a signatory to the new Code of Practice. This could provide an incentive for reviewers to become signatories.**

Reviewer approval of company disclosures

60. One of the issues raised during this review was whether companies should obtain the agreement of the board reviewer to the disclosures made about the process and outcome of the external board performance review.
61. We were told that many companies already do this as a matter of course, and that at least some reviewers insist that this is included in the terms of engagement agreed with the client. While there is no suggestion that there is widespread misreporting, anecdotally we were told by reviewers of a few cases where they felt that the company had represented their views in a way that was not entirely accurate. They were concerned that this created a reputational risk for them, as well as calling into question the reliability of the published information.

Review of the effectiveness of independent board evaluation in the UK listed sector

62. Most contributors with whom we discussed the issue considered that it would not be appropriate to require board reviewers formally to approve all disclosures made by the company about the board performance review. There were two related reasons given for this view: that decisions on what action to take as a result of the review were the responsibility of the board not the reviewer, and that certification might create the misleading impression that the reviewer was providing some form of assurance.
63. The Institute accepts these points, but nonetheless considers that the reviewer should be given the opportunity to ensure they are content that relevant disclosures are accurate and balanced. 'Relevant disclosures' for these purposes include the description of the process followed and any statements that purport to represent the opinions of the reviewer. They do not include a description of the actions that the board has decided to take as a result of the review.

Recommendation:

- J. As a matter of good practice, listed companies should agree with the external board reviewer any references to the process followed by the reviewer, and any observations attributed to them, and confirm in the annual report that they have done so.**

Review of the effectiveness of independent board evaluation in the UK listed sector

7. Independence

64. The remit of this review was to assess the market for independent board performance reviews. In doing so, one of the central questions has been: 'What does 'independent' look like?'.
65. There are three elements to the answer, none of them straightforward: the process by which the review has been conducted; whether the reviewer provides other services to the board or company; and the length of the relationship between them. In this section, we summarise the decisions reached on each of these issues, which have been reflected in the Code of Practice for board reviewers and the Principles and guidance for listed companies.

Independent review process

66. The approach taken in the Code of Practice for board reviews has been to encourage greater transparency about how individual external board reviewers conduct reviews rather than to prescribe or standardise how independent reviews are expected to be carried out.
67. The draft Code of Practice contains a definition of 'independent board performance review', the sole purpose of which is to establish who is and is not eligible to become a signatory. In the Institute's view, the determining factor of whether the process is independent is whether the analysis of the board's performance has been carried out by an independent third party, rather than whether a specific methodology has been followed. The proposed definition is therefore relatively broad, but it would rule out, for example, reviews that are carried out by purchasing software packages with standard questionnaires that companies then use without any further independent input.

Review of the effectiveness of independent board evaluation in the UK listed sector

Recommendation:

- K. The Code of Practice should not define an ‘independent board performance review’ in such a way that a reviewer is required to follow prescribed methodologies in order to be accepted as a signatory, nor should it prescribe minimum qualifications. However, it should include a ‘de minimis’ definition that excludes those firms that simply supply companies with software or other tools that the company then uses as part of its internal review.**

Provision of other services

68. As with other third-party services provided to companies, most notably external audit, there are potential sensitivities when a board reviewer also provides other services to the board or company. There is a perception that the reviewer might be tempted either to ‘go easy’ on the board rather than jeopardise other current or potential earnings, or that they might skew their findings in the hope of generating future work.
69. These sensitivities are already well understood in principle in the listed sector - it is notable, for example, how rarely search firms are now used to conduct board performance reviews as a result of voluntary self-denial on the part of the firms and their listed clients. They are also recognised in the UK Corporate Governance Code, which requires companies to disclose any other connections with the reviewer.
70. Attempting to define exactly which other services can and cannot acceptably be provided, however, is much more complex.

Review of the effectiveness of independent board evaluation in the UK listed sector

71. In the consultation document, the Institute suggested that there should be a voluntary ban on companies employing their external board reviewers for any services not directly related to the reviews. This was opposed by many respondents. The most commonly expressed concern was that, if interpreted narrowly, it could prevent board reviewers from undertaking follow up work to the review, including reviewing or addressing in more depth specific aspects of board performance highlighted in the initial review. It was argued that this was not necessarily to the benefit of the company, and we accept that argument.
72. At the subsequent round table meetings we discussed with board reviewers, companies and investors whether a 'blacklist' of barred services or a 'white list' of approved services should be drawn up. While some participants felt that this was desirable in principle, in practice it was not possible to reach agreement on what services should be included on either list. In addition, some investors said that they were concerned less about the specific services that were being provided and more about the value of those services in comparison with the fee for conducting the board performance review (in other words, whether the review might be perceived as a 'loss leader').
73. Consequently, the approach we have recommended is that listed companies should not be forbidden to use the board reviewer to provide any other services, nor should board reviewers be barred from providing any other services as a condition of being accepted as signatories to the Code of Practice. Nor do we consider there is a need at this stage for either a 'blacklist' or a 'white list', although the need for such a list should be considered as part of the recommended follow-up review to be conducted or commissioned by BEIS.
74. Instead, our recommendation is that listed companies should disclose in their annual reports whether the board reviewer has any other connection with the Company (as required under Provision 21 of the UK Corporate Governance Code) and explain how their independence is safeguarded in these circumstances. Where the board reviewer is supplying other services, the company should also indicate whether the fees paid for the board performance review exceed those paid other services.

Review of the effectiveness of independent board evaluation in the UK listed sector

75. In addition, the proposed Principles of Good Practice for listed companies invite companies voluntarily to commit not to use the board reviewer for any other services that might be perceived to create a conflict of interest.
76. In turn, board reviewers that are signatories to the Code of Practice who provide other services should explain on their websites how they manage potential conflicts of interest.

Recommendations:

- L. **Board reviewers should not be prevented from providing other services to their clients, but both reviewers and companies should explain how any conflicts of interest or threats to the independence of the reviewer are managed in these circumstances, and companies should indicate in the annual report whether the fees paid for the board performance review exceed those paid for other services.**

Length of relationships

77. The other aspect of independence considered as part of the review was the length of the client-reviewer relationship. While many of the board reviewers and companies we consulted rejected the inference that a reviewer's critical faculties became dimmer the longer they were employed by a company, we were also told that many of them had chosen to limit themselves to no more than two or three full reviews (typically carried out on a three-year cycle).
78. There was strong support from respondents to the consultation to the proposal that there should be a recommended upper limit, although views were divided as to what that limit should be. Although we initially proposed nine years (or three annual reviews), our view now is that, as both the Code of Practice for board reviewers and Principles for listed companies are intended to be voluntary, the recommended limit should be six years. We recognise that this will not be appropriate for all companies, but it will be open to them to explain why that is the case.

Review of the effectiveness of independent board evaluation in the UK listed sector

79. One additional, related issue that was raised during the review was the relationship between board reviewers and chairs or other board members who employ them to conduct reviews at more than one company. While we have not been able to find any reliable data on how frequently this occurs, anecdotal evidence gathered during the review suggests it is not uncommon.
80. The chair's motivation for appointing the same reviewer is a matter of speculation only. It may perhaps be that they know from experience that the reviewer will provide them with a robust and insightful assessment; it may perhaps be the exact opposite. Whatever the reason, it would be more transparent for any such connections to be made public.
81. For that reason, we recommend in the proposed disclosure guidance that the statement required under the UK Corporate Governance Code when the company has other connections with the reviewers should also be made when the chair, or the person leading the appointment process, has other connections with them as well.

Recommendation:

- M. Board reviewers should disclose their policies relating to the length of their relationship with clients. Companies should disclose whether the relationship exceeds six years and, if so, explain how any conflicts of interest or threats to the independence of the reviewer are managed. An explanation should also be provided by the company where the reviewer has any other connections with the person leading the appointment process for the company.**

Review of the effectiveness of independent board evaluation in the UK listed sector

8. Next steps

82. Determining the next steps is a matter for BEIS, not the Institute. The Department will need to consider whether it agrees with the recommendations made in this report and, if so, the timetable for implementing them. It will also wish to consult with the FRC, as some of the recommendations could fall to the FRC or its successor body to implement if they are accepted.
83. However, assuming the recommendations are accepted, the immediate next steps would be as follows:
- BEIS would identify a suitable 'owner' for the Code of Practice for board reviewers and agree with them precisely what 'ownership' entails. We have recommended that initially this function should be limited to maintaining a public register of signatories and assessing whether potential signatories have made all the disclosures required by the Code (as opposed to applying any qualitative criteria).
 - The owner of the Code would announce the details of how board reviewers can register and the date at which the register will 'go live', allowing reviewers a reasonable period to adjust their practices and update their disclosures as necessary. Depending on how quickly these arrangements can be put in place, our recommendation is that the register would become active in by the end of 2021.
 - The FRC would issue the disclosure guidance for listed companies. The timing would depend on whatever procedures the FRC needs to carry out before adopting the guidance, but our recommendation is that this should be done in time for companies to be able to draw on the guidance in their annual reports to be published in 2022.
84. We recognise that, on the proposed timetable, it would be unreasonable to ask companies to report in 2022 on whether their external reviewer was a signatory to the Code of Practice on appointment, as there is a strong likelihood that they will have made the appointment before the register of signatories is published. However, we do not consider that to be a reason to delay adoption of the guidance for a further twelve months, when there is a clear demand from investors for the other information that the guidance recommends be disclosed.

Review of the effectiveness of independent board evaluation in the UK listed sector

85. In due course it will be important for BEIS formally to conduct or commission a review into the impact of these arrangements to determine whether they are having the desired effect and if further action is required. Experience with other codes and reporting standards is that the full impact of changes usually takes a few years to be felt, so a full review of this nature should not be carried out too quickly.
86. In the interim, however, there should be some ongoing assessment of the impact of these measures. As the FRC will in any event be reviewing how companies are complying with the relevant provisions in the UK Corporate Governance Code as part of its regular monitoring of the Code, it would seem sensible for it to look at the use made of the Code of Practice and Principles at the same time.

Recommendations:

- N. The FRC should assess board performance review practice and reporting in the listed sector as part of its regular monitoring of the UK Corporate Governance Code, and report on its conclusions.**
- O. BEIS should conduct or commission a formal review of the impact of these measures three years after the proposed register of board reviewers becomes active. This review should consider whether mandatory measures or enhanced oversight of the Code of Practice for board reviewers are required, as well as whether changes are needed to the content of the Code of Practice, Principles or guidance.**

Review of the effectiveness of independent board evaluation in the UK listed sector

9. Other issues raised by the review

87. In addition to the matters addressed in the earlier sections of this report, a few other issues were raised during the course of the review on which the Institute does not wish to make formal recommendations but that we consider are worthy of further consideration.

Shareholder involvement in the appointment process

88. In its statement commissioning this review, BEIS said it would consider whether shareholders should have a role in the appointment of the external reviewer. While it did not specify what form any such role might take, obvious options would be for shareholders either to vote to confirm the appointment of the review, as they do for the external auditor, or for them to participate directly in the selection process in some way.

89. The Institute sought views on these options as part of the public consultation. There was little support for either of them, including from investors. Most of those respondents who commented argued that the appropriate role for shareholders was to use their ability to engage with the board – and, in extremis, to vote against the election of directors – to encourage good practice.

90. The Institute agrees with this view and considers that the measures recommended in this report should help investors to engage with investee companies when they wish to do so. For this reason, we have not made a recommendation on this matter in this report. However, BEIS may wish to revisit this issue when carrying out the recommended review of the impact of our proposals.

Review of the effectiveness of independent board evaluation in the UK listed sector

Application to other sectors

91. The remit of the review was to look at practice in listed companies, and for that reason we have limited our recommendations to the listed sector, and particularly FTSE 350 companies in light of the provisions of the UK Corporate Governance Code. However, in our view some of the proposed measures might be beneficial in other sectors as well.

92. As far as board reviewers are concerned, the Institute's view is that good practice should be encouraged across all sectors; and that while it would not have been appropriate to extend a mandatory code to other sectors as this would impact on many small and sole reviewers who do not have or aspire to have listed company clients, this consideration does not apply to the same extent with a voluntary code. For that reason, the proposed Code of Practice states that:

“Signatories should ensure that any engagements with FTSE 350 companies are conducted in accordance with the Code. Signatories are encouraged also to follow the Code when carrying out engagements with other clients and should indicate on their website whether or not this is the case.”

93. Similar arguments can be used for board reviewers' clients. The Institute's view is that the Principles of Good Practice are suitable for organisations in all sectors, and we will be promoting them to all our members, not just those in listed companies. We would encourage other professional and membership bodies to do so as well. In addition, we consider that much of the disclosure guidance is relevant to any organisation that reports publicly on its governance.

Review of the effectiveness of independent board evaluation in the UK listed sector

Engagement between board reviewers and policymakers

94. At the round table meeting the Institute hosted for board reviewers, a number of participants commented that it was the first occasion at which they had been able to discuss matters of common interest with their peers, and that there was no mechanism for collective discussions with regulators and policymakers such as the FRC and FCA, or with organisations representing investors such as the Investment Association.
95. If true, this contrasts with other service providers such as search firms, remuneration consultants and proxy advisors, all of whom have mechanisms in place to enable discussions of this nature to take place. In many cases, this has been associated with the development of sectoral codes or standards, and it may be that this will be a side effect of the establishment of the recommended Code of Practice.
96. While it is clearly a matter for the sector itself, the Institute would encourage board reviewers at least to establish a forum with which policymakers and others with an interest in good governance could engage. Board reviewers collectively can provide considerable insight into the way in which boards operate, and it would benefit everyone involved with improving governance were their voice to be heard more loudly. The Institute would be happy to be involved in facilitating an initial meeting.

Review of the effectiveness of independent board evaluation in the UK listed sector

Appendix A

Code of Practice for board reviewers

Eligibility

All providers of independent board performance reviews can become signatories to the Code, subject to them agreeing to abide by the commitments set out below.

For the purposes of this Code, an 'independent board performance review' is defined as one where the assessment of the board's performance and the provision of appropriate feedback to the board has been undertaken or facilitated by a third party independent of the company. The definition does not include providing proprietary material to companies undertaking their own evaluations.

Commitments

The Code operates on an 'apply and explain' basis. In order to be a signatory to the Code of Practice, service providers must commit that they will apply all the Principles of the Code and describe on their website how they have done so. This statement should be reviewed, and if necessary updated, at least annually.

In addition, signatories should commit to discuss the Code with clients on appointment to ensure that the terms on which they are hired are compatible with the Code.

Coverage

Signatories should ensure that any engagements with FTSE 350 companies are conducted in accordance with the Code. Signatories are encouraged also to follow the Code when carrying out engagements with other clients and should indicate on their website whether this is the case.

Where signatories are firms or partnerships, all individuals conducting reviews on their behalf should act in accordance with the Code.

Review of the effectiveness of independent board evaluation in the UK listed sector

Principles

Competence and capacity

Signatories should have - and be able to demonstrate to potential clients - the expertise, experience and capacity necessary for each engagement they undertake. They should only accept work that they are qualified to perform and in which the client can be served effectively.

Signatories should publish on their website sufficient information about their experience, expertise and resources and how they would typically undertake a board performance review to enable potential clients and their shareholders and other stakeholders to assess how well suited they are for a specific engagement.

Independence and integrity

Signatories should disclose on their website what other services they provide, if any, and their procedures for addressing potential or actual conflicts of interest that may arise in connection with the provision of other services to clients for whom they undertake board performance reviews.

Signatories should disclose on their website their policies relating to the length of their relationship with a client.

Client engagements

Signatories should ensure that the terms of engagement for each board performance review have been clearly and unequivocally agreed in writing with the company before the review commences.

Signatories should commit to keeping all information received during the engagement confidential, with the exceptions of the discovery of unlawful practices or where information is demanded by regulators or a court of law.

Where a signatory is not able to agree with a potential client a scope for the review that it believes will provide a fair and balanced assessment of the board's performance, it should decline the appointment.

Review of the effectiveness of independent board evaluation in the UK listed sector

Client disclosure

When a client discloses details of the process or outcomes of the board performance review either publicly or to a regulator, signatories should ensure they are given the opportunity to agree the description of the process followed and any statement that purports to represent the reviewer's opinions before it is published.

Guidance

This guidance is provided to assist board reviewers decide what actions they should take and what policies and procedures they should have in place in order to demonstrate how they apply the Principles. The guidance is not mandatory and is not intended to be prescriptive or comprehensive.

Competence and capacity

While the range of topics and skills required will vary depending on the assignment, reviewers undertaking a full board performance review should have the ability to:

- assess the degree to which the board and its directors display rigorous thought processes leading to breadth, depth and independence of thinking, in addition to attributes such as skill, experience, knowledge, diversity and capability;
- assess the behavioural dynamics of the board;
- conduct deep-dive observations and reviews across the board and its committees;
- assess the contribution of individual directors;
- assess wider succession issues, such as that of the senior executive team;
- analyse the effectiveness of the board's decision-making processes, for example by reviewing specific decisions which were critical to the success of the business;

Review of the effectiveness of independent board evaluation in the UK listed sector

- review board and committee documentation, such as the list of matters reserved for the board, terms of reference for board committees, and a sample of board and committee papers;
- solicit and understand external perspectives on the board's performance, including those of the company's major shareholders and stakeholders;
- advise the board on how to address the issues identified by the review; and
- provide and present a full report and recommended actions to the board.

A 'full' review is one that looks comprehensively at all aspects of the board's performance and is typically undertaken every three years, as opposed to the narrower reviews focused on specific issues that are frequently carried out during the intervening period. As the scope of such reviews will be determined in part by the needs of the client, it is not possible to provide a precise definition. Signatories should take account of the guidance in this Code and the Financial Reporting Council's 'Guidance on Board Effectiveness' (2018) when determining whether an engagement constitutes a 'full' review.

While there are no minimum qualifications for signatories, they should display the required levels of competence to ensure their contributions are informed and constructive. Areas of capability might include, but are not limited to:

- a track record of carrying out independent board performance reviews;
- direct experience of board practice – derived from being a director, company secretary or other professional;
- knowledge of, and expertise in, governance and behavioural issues;
- management and commercial experience;
- financial expertise;
- communication, personal and interpersonal skills including tact and discretion; or
- possession of relevant professional qualifications and up-to-date professional knowledge.

Review of the effectiveness of independent board evaluation in the UK listed sector

In addition to their qualifications and resources, signatories should describe on their website in broad terms the process or processes they would typically follow when carrying out a board performance review (while recognising that all individual reviews will be tailored to the needs of the client). This might include, for example:

- whether and how they make use of questionnaires;
- the extent to which they have direct contact with board members individually and collectively (for example, one-to-one interviews or attending board and committee meetings);
- whose views they seek on the board's performance, in addition to those of the board members; and
- whether they review board papers and other documentation, including on previous board performance reviews.

When considering what information to provide on their website, signatories may also find it helpful to look at the guidance for companies on externally facilitated board evaluations contained in the FRC Guidance.

Independence and integrity

The value to the company and to its investors of an externally facilitated board performance review is that it brings an independent perspective to the process. This value is undermined if the reviewer is perceived as being conflicted or too close to the client.

The possibility for conflicts of interest can arise in all businesses. While conflicts cannot always be eliminated, they can be declared, managed and mitigated. The overriding objective is to ensure, as far as reasonably possible, that business conduct is independent, fair, clear, not misleading and free from possible bias or undue influence. The perception that a review lacked independence can be reputationally damaging for both the client and the reviewer.

Signatories should disclose on their website what other services they provide, if any. Where they provide other services, they should explain their policy on providing different services to the same client and describe their procedures for managing potential or actual conflicts of interest that may arise before, during or after any engagement.

Review of the effectiveness of independent board evaluation in the UK listed sector

Independence can be undermined if a service provider becomes over-familiar with, or overly dependent on, a particular client. For that reason, it is considered good practice for a reviewer not to extend their relationship with any individual client beyond six years (a period which would typically include two consecutive full board performance reviews and associated follow up work).

Client engagements

Terms of engagement

The terms of engagement will differ for each assignment, but should usually include:

- The identity of the lead contacts at the company and the service provider, the identity of the board reviewer if different, and the process for consultation between them.
- The identity of the contact at the company with whom the service provider can discuss in confidence any concerns about how the review is being managed – this would normally be one of the independent board members.
- Agreement on the process which will be followed to deliver the assignment – what will be in or out of scope and what access the service provider will have to directors, staff and other parties, and to documentation. This should include the process by which the board will receive and review the service provider's report.
- Agreement on deliverables, the timescale for completion and remuneration.
- Arrangements, if appropriate, for any follow-up work to be undertaken by the service provider. Where a full board performance review has been undertaken, it can be good practice for the service provider to hold follow up discussions with the company within twelve months to review progress on the agreed outcomes.

Review of the effectiveness of independent board evaluation in the UK listed sector

- Agreement on the arrangements for the service provider to comment on disclosures by the company about the performance review, for example in its annual report.
- A confidentiality agreement to cover all aspects of the engagement, including all interviews, for the period of and after the engagement.
- How the insider status of the service provider will be managed by the company and what obligations are placed on the service provider and/or its individual staff.

The agreement should also cover how the service provider should treat particularly sensitive information or information about differences of view, attitude and approach that should be respected and not included in the main report, for example whistle-blowers, and how this should be brought to the chair or board's attention in a way that ensures matters are aired without compromising the information or individual(s) concerned.

Where the service provider has a potentially conflicted business this should be specifically addressed in the terms of engagement.

Scope and conduct of the engagement

For each engagement, signatories should use their knowledge and experience to recommend a scope and methodology that they consider appropriate in the client's circumstances, guided by an objective view of the client's best interests. They should explain clearly to the client what access they will require to individuals and resources, the topics they will cover and how they will report their findings, in order to help the client manage the process and reduce the risk of misunderstandings at any stage.

There may be instances where clients attempt to constrain the reviewer's ability to make a robust and independent assessment, either when agreeing the methodology to be followed or during the course of the review. Examples have included limiting the reviewer's access to individual board members or other parties during the review and asking them to alter their findings.

Review of the effectiveness of independent board evaluation in the UK listed sector

If a signatory is faced with such circumstances, they should give careful consideration to the risk to their own reputation of agreeing to the client's requests. In the first instance, they should raise their concerns with the appropriate contact at the company to see whether they can be resolved. Ultimately, a signatory should be willing to withdraw from an engagement if they consider they are being asked to act in a way that is unethical or damaging to their own reputation.

Client disclosure

Some clients will be required to disclose information about the conduct and outcome of the board performance review either publicly (for example, listed companies that apply the UK Corporate Governance Code) or to a regulator. While responsibility for these disclosures rests with the client, they are also important for the reviewer. If disclosures are found to be inaccurate or unbalanced, that can have an adverse impact on the reviewer's reputation.

It is recommended that reviewers ensure that disclosures describing the process by which the review was conducted and any statements that purport to represent the reviewer's opinions are agreed with them before they are made public. If this is not possible, they should at least ensure that they have the ability to comment on the factual accuracy of any such disclosures before they are finalised. This should be covered when agreeing the terms of engagement.

If, having commented on the relevant disclosures, a reviewer has concerns that the client still intends to make a statement that the reviewer considers to be misleading, they should raise their concerns with the appropriate contact at the company in the first instance to see whether they can be resolved. If not, they should write to the client formally recording their concerns.

Review of the effectiveness of independent board evaluation in the UK listed sector

Appendix B

Principles of Good Practice for listed companies using external board reviewers

Selection

1. The company will not delegate the decision on the appointment of a reviewer to a single board member or employee. It will ensure that the decision is ratified by either the full board or the nomination committee.
2. The company will not appoint reviewers with which it has other commercial relationships that might create a conflict of interest. The company will not have a relationship with the same reviewer for more than six years.

Scope and process

3. The company and reviewer will agree terms of engagement before the review commences. These must specify the objectives and scope of the evaluation, and the process to be followed. The company will not subsequently seek to amend the terms of engagement without the agreement of the reviewer.
4. The company will provide the reviewer with direct access to the board collectively and directors individually as part of the review process. It will also provide access to board papers, board committees, management and other internal and external stakeholders where the reviewer considers this essential to meet the agreed objectives of the review.
5. The company will provide the reviewer with an opportunity to present their findings directly to the full board.

Review of the effectiveness of independent board evaluation in the UK listed sector

6. The company will identify a contact with whom the reviewer can discuss in confidence any concerns they have about the way the process is being managed. This would normally be one of the independent board members.

Disclosure

7. In the annual report, the company will state whether it has followed these Principles, and whether the reviewer is a signatory to the Code of Practice for reviewers.
8. The company will agree with the reviewer the description of the process followed and any opinions attributed to the reviewer contained in the annual report or other disclosures.

Review of the effectiveness of independent board evaluation in the UK listed sector

Appendix C

Reporting on board performance reviews: Guidance for listed companies

- 1. The 2018 UK Corporate Governance Code states that listed companies should include in their annual report information about:**
 - **how the board evaluation¹¹ has been conducted (with further disclosures requested when the evaluation has been externally facilitated – see paragraph 6); and**
 - **the outcomes of the evaluation and the actions taken as a result, including how the evaluation has or will influence board composition.**

How the board evaluation has been conducted

2. The annual report should describe the objective and scope of the evaluation, including: whether it was a comprehensive review of all aspects of the board's effectiveness or focused on particular factors (for example, board composition and dynamics, or the quality of the information the board receives); whether the effectiveness of all or some board committees were evaluated; and whether the performance of individual directors was assessed.
3. The annual report should identify the different processes that were used to carry out the evaluation. These might include, for example, face to face interviews, observing board or committee meetings (where an external reviewer has been engaged), reviewing board and committee papers or procedures, and questionnaires.

¹¹ The term 'board evaluation' rather than 'board performance review' is used in the draft guidance in order to be consistent with the language in the UK Corporate Governance Code and Guidance on Board Effectiveness.

Review of the effectiveness of independent board evaluation in the UK listed sector

4. The annual report should also identify whose views were sought as part of the evaluation. As well as the board members this might include senior management, the company secretary and other employees, the external auditor and other advisors, or shareholders and external stakeholders.
5. The annual report should identify who in the company oversaw and undertook the evaluation or, where the evaluation was externally facilitated, who within the company was responsible for providing the external reviewer with the necessary access and support.

Externally facilitated evaluations

6. **Where an external reviewer has been used, the UK Corporate Governance Code states that the company should disclose:**
 - **the name of the individual or organisation that carried out the evaluation;**
 - **whether they have any other connection with the company or individual directors; and**
 - **the nature and extent of their contact with the board and individual directors.**
7. In addition, the annual report should describe the process by which the reviewer was selected (for example, whether a formal tender process was followed and/or shortlisted candidates were interviewed before the decision was taken). It should identify who in the company was involved in taking the decision (for example, the chair, nomination committee or full board).
8. The annual report should state the length of time for which the reviewer has undertaken board performance reviews for the company, and whether they have other connections with the company or the person leading the appointment process. If the length of time exceeds six years, or if other connections exist, the annual report should explain how independence and objectivity are safeguarded. Where the reviewer provides other services to the company, the annual report should state whether the fees paid for those services are higher or lower than those paid for the board evaluation.

Review of the effectiveness of independent board evaluation in the UK listed sector

9. The annual report should explain why the company believes the reviewer is qualified to carry out the review and state whether the reviewer is a signatory to the Code of Practice for independent board reviewers.

The outcomes and actions taken

10. It is recognised that some findings of the board evaluation, and some actions to be taken as a result, will relate to issues that raise commercial or other sensitivities for the company which it might understandably be reluctant to disclose publicly.
11. On the other hand, boards that can demonstrate that they have carried out a robust evaluation of their effectiveness and that they are intent on delivering continuous improvement of their performance will have greater credibility with investors and other stakeholders.
12. Companies will need to balance these considerations in deciding what to disclose about the results of their evaluation. The annual report should at least identify those aspects of the board's performance which they have concluded need to be improved. Wherever possible, the specific actions should be identified and a timetable for completing them given.
13. Where companies have identified in previous annual reports specific actions that they intend to take as a result of the evaluation carried out in that reporting year, they should report on whether those actions have been implemented, and if not explain why not.

Review of the effectiveness of independent board evaluation in the UK listed sector

Board composition

14. The UK Corporate Governance Code specifically states that companies should explain how the findings of the board evaluation have or will influence board composition. Where this was reviewed as part of the evaluation, companies should summarise the assessment of whether the board has the necessary mix of skills, knowledge and expertise, and of its diversity; this should be done whether or not the company has concluded that some refreshment of the board is required.
15. Where the company has concluded that changes to the board composition are needed it should indicate, as a minimum, what specific needs those changes are intended to address, and the time frame over which the changes are intended be made.

Externally facilitated evaluations

16. Where an external reviewer has been used, the company should state whether the sections of the report that describe the process followed or attribute opinions to the reviewer have been agreed with the reviewer, and if not explain why.

Review of the effectiveness of independent board evaluation in the UK listed sector

Appendix D

Members of the Steering Group

(Positions at the time the Steering Group was active.)

Peter Swabey (The Chartered Governance Institute) – Chair

Roger Barker (Institute of Directors)

Claire Davies (Solicitor and Chartered Company Secretary)

Philippa Foster Back CBE (Institute of Business Ethics)

Jessica Ground (Schroders Investment Management)

Alison Kennedy (Aberdeen Standard Investments)

Ben Mathews (BP plc)

Andrew Ninian (Investment Association)

David Parkes (BAE Systems plc)

Will Pomroy (Hermes Investment Management)

Sacha Sadan (Legal & General Investment Management)

Tim Ward (Quoted Companies Alliance)

Victoria Whyte (GlaxoSmithKline plc)

Secretary: Chris Hodge (The Chartered Governance Institute)

icsa

The Chartered
Governance
Institute

The Chartered Governance Institute is the professional body for governance. We have members in all sectors and are required by our Royal Charter to lead 'effective governance and efficient administration of commerce, industry and public affairs'. With over 125 years' experience, we work with regulators and policy makers to champion high standards of governance and provide qualifications, training and guidance.

The Chartered Governance Institute

Saffron House
6–10 Kirby Street
London EC1N 8TS

January 2021



The Chartered
Governance Institute