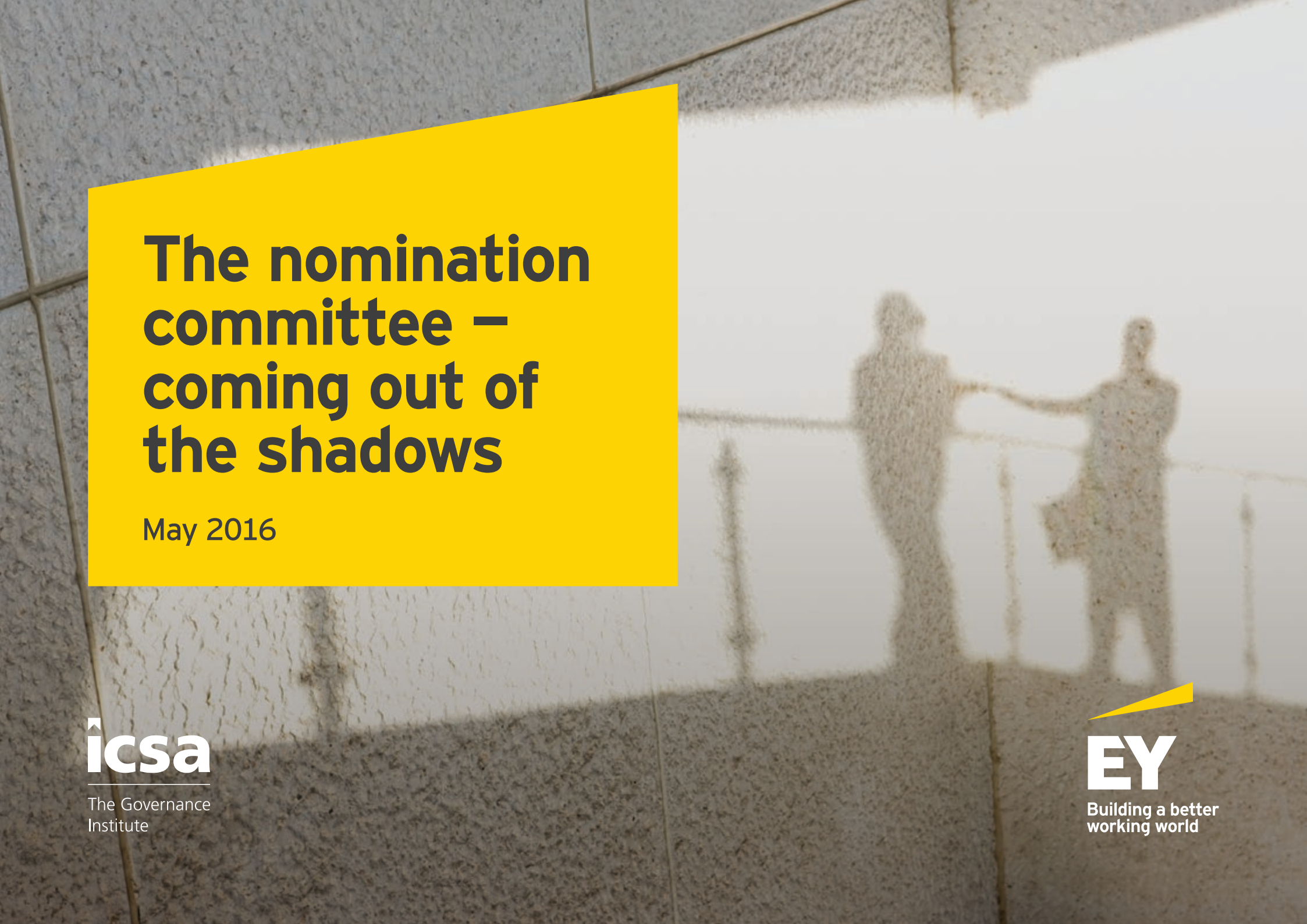

The nomination committee – coming out of the shadows

May 2016

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The Governance Institute

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Building a better working world

" Effective succession planning is very important for the long-term success of a company. There is a clear link between succession planning, strategy and the culture of the company, and the nomination committee plays a vital role. The FRC is currently looking at good practice in this area and this report is a welcome contribution to the discussion. I encourage companies to think about the ideas outlined in this report."

Sir Win Bischoff
Chairman, Financial Reporting Council

Introduction

In recent years the nomination committee has been portrayed as the poor relation of the main board committees. While its role may be less clearly defined than that of the audit committee, and its profile lower than that of the remuneration committee, it is arguably the most important of the three. It plays a pivotal role in appointing directors to the board and, if the board lacks the right balance, knowledge, skills and attributes, the likelihood of it and its committees operating effectively is greatly reduced.

While 63% of companies cite people-related risks including staff and skills retention as one of their principal risks – making it the second most common principal risk disclosed by boards[1], only 35% of company secretaries say their executive pipeline has a sustainable pool of talent[2]. It seems appropriate therefore that boards should exercise more oversight and rigour to manage these risks – and the nomination committee would be the natural 'guardian' of such efforts.

Nomination committees have not been the subject of much research or analysis. Furthermore, their reports tend to provide less insight and information than those of other committees contained in the annual report. We therefore sought to find out what is really happening in nomination committees and boardrooms today through a series of roundtable discussions with board chairmen, nomination committee chairmen and members, and company secretaries from over 40 listed companies (predominantly from the FTSE 350) throughout February and March 2016. We would like to thank everyone who participated in these roundtables for their time and willingness to share their experiences and views.

These discussions proved to be a great source of insight. We found that, in practice, nomination committees are currently functioning in a wide variety of ways. The different approaches reflect the size of the company, the size of the board, the sector in which the company operates and the stage of its development.

However, many of the representatives we spoke to said their companies were expanding the role of their nomination committee, as well as adopting a more professional approach to the recruitment and selection of candidates. They were keen not only to share their experiences, but also to learn how others were addressing these issues and identify ideas that might be useful for their own committee. We have produced this report to support them, and others, in improving the effectiveness of their nomination committee and succession planning.

Leading companies are rethinking the role that this committee can play and how it can be improved. Roundtable participants told us that many nomination committees are no longer thinking only about upcoming board changes, but are also now looking deeper into the organisation, casting the net wider and thinking further ahead.

[1] EY, *Annual reporting in 2014: reflections of the past, direction for the future*, September 2015, pg. 22
[2] FT-ICSA, *Boardroom Bellwether: Insights into what boards are thinking from the survey of FTSE 350 company secretaries*, Winter 2015, pg. 10

Reflecting these insights, we have structured our report along three main themes to share how nomination committees are:

Looking deeper into the company to identify and help to develop its future leaders.

While talent development remains primarily the responsibility of management, boards have a duty to secure the long-term health of the company. That long-term health is dependent on a strong executive pipeline from which the future leaders of the company can emerge. Boards, through their nomination committees, are increasingly seeking assurance that a good quality pipeline is in place and are challenging what the executive management team is doing to enhance the pipeline.

Casting the net wider to identify potential directors.

This reflects both a growing awareness of the benefits of, and demand for, more diverse boards, and changes in the skill sets needed. For example, an understanding of digital technology and its potential impact on business models is now considered essential by many companies.

Thinking further ahead than the immediate replacement of a retiring board member.

Leading boards now look much further into the future when developing their long-term strategies for the business. Boards hold ultimate responsibility for delivering those strategies, so they need to anticipate the changes and challenges ahead and take early action to ensure they have the necessary resources to deal with them – including the resources around the boardroom table.

It is encouraging that many companies now interpret the role of the nomination committee as needing to be broader, more rigorous and more proactive than in the past, yet we recognise that fulfilling this enhanced role is no easy task.

Nomination committees have only limited visibility of staff below the most senior levels, so may find it difficult to assess whether potential candidates are ready to step up to senior executive roles or indeed whether senior executives are 'board-ready' or capable of becoming so. In smaller companies the opportunities to develop candidates may be limited. For all companies, recruiting people with different skills and experiences, but with no current track record of either being on a company board or effectively dealing with a board, potentially brings greater rewards, but also increases the risk of choosing the 'wrong' person for the job. Efforts to identify internal and external candidates who would be ideal for the next-but-one business or board cycle can be undermined by changes in the company's circumstances and those individuals' own career plans.

While these obstacles cannot be eliminated, they can be mitigated. In our discussions we heard many examples of practical steps being taken to achieve this, some of which are identified in this report. We hope these examples will be useful to other nomination committees in considering what their own remit should be and how best to discharge their responsibilities.

Context

The impetus for this project, a collaboration between EY and ICSA: The Governance Institute, came from a shared view that the nomination committee plays a crucial role in the effective functioning of boards and yet has so far not been afforded the same amount of analysis and guidance as the other committees. Indeed ICSA has referred to it as the Cinderella committee. Similarly, in 2014 EY described the need for the committee to come out of the shadows. A highly effective board is essential if companies are to produce sustainable returns for their shareholders, stakeholders and wider society.

This report is a natural follow-on to EY's April 2015 report on board effectiveness produced with The Investment Association[3]. That report touched upon some of the same themes, such as succession planning and diversity, and found that there was more work to be done. The Financial Reporting Council (FRC), investors and others are now also focusing their attention on this area, with the FRC having consulted on succession planning in October 2015[4]. We have discussed this report with the FRC and hope that its insights will help, as it considers its next steps.

The starting point: role, membership, reporting

Role of the nomination committee

The nomination committee's core responsibility is to manage the appointment process for new board directors – the exception being the appointment of a new chairman. Roundtable participants told us that this is usually carried out by the whole board, led by the Senior Independent Director (SID), unless the SID is in contention for the role.

This primary responsibility may have resulted in the nomination committee traditionally being more reactive than other committees – perhaps meeting only when a director is leaving the board for the purpose of identifying a replacement.[5]

This may also help to explain why (apart from the fact that it deals with 'softer' issues) the nomination committee operates differently from other board committees. The activities and outputs of other committees are subject to more regulation and scrutiny (e.g. are required under the UK Corporate Governance Code or law to report externally, or their reports are subject to a vote etc.). Regulatory triggers therefore drive their activities. For example, the audit committee's cycle is driven by the annual financial reporting process.

Although there is no natural regulatory trigger for nomination committee activity, its work should be co-ordinated with existing board discussions about company strategy, board evaluations and succession planning. This could lend more rigour to its approach.

Companies recognise that they can make better use of their nomination committees. Boards are responsible for a series of related activities, but these are not always approached in a joined-up way:

- Linking the company's strategy to future changes on the board
- Evaluating board effectiveness, the performance of individual directors and how the results affect the rest of the board's work
- Induction, training and continuing development of directors
- Overseeing the executive pipeline and talent development

Nomination committees rarely have responsibility for all these different elements but it is important that companies clarify who is responsible for each area at board (or board committee) level and how these different activities are approached in a co-ordinated manner. The role of the nomination committee itself should be clearly laid out in its terms of reference, both in relation to the specific activities for which it is responsible and the processes to be followed.

Nomination committees are not process-bound in practice, however. Repeatedly we heard about the role of informal, one-to-one and 'corridor' discussions in addition to formal committee discussions. These were thought helpful because of the sensitivities of some of the issues being considered and to make progress in an appointment process, many of which are lengthy and intense. However, it was recognised that these are to supplement the formal processes and criteria.

Our roundtables revealed the wide variation in how companies determine the right nomination committee structure and approach for their business. For example, some attendees said that they have remodelled their nomination committee into a Nomination and Governance Committee. These committees tend to have a broader remit than those with a purely nomination focus and meet more regularly.

[5] Spencer Stuart's report *2015 Board Index* found that the nomination committee of FTSE 150 companies meets less frequently that the other board committees. It states on page 35 that "the range [per year] for audit committees was three to 13 meetings…for remuneration committees the range was two to 13 meetings…for nomination committees the range was zero to 10…"

In other companies, particularly those with smaller boards, all NEDs are represented on the nomination committee or board succession discussions are seen as a matter for the whole board rather than the nomination committee. We also heard from companies in specific sectors with largely outsourced business functions (such as in property and infrastructure funds) where the board or nomination committees deliberate the succession plans of key individuals at those service providers.

Regardless of precise structures, it is important that companies plan for both emergency and steady-state situations so they are prepared for an unexpected board change, particularly of the CEO. Forward-thinking companies also seek to identify individuals several years out from taking on a board role.

Membership of the committee

Our roundtables debated who is best placed to chair the nomination committee. Traditionally, this role has been held by the chairman of the board. However, some companies said they have chosen to appoint the SID or another NED as the chair of the committee due to demands on the chairman's time. Determining the appropriate chair may partly depend on the committee's remit, for example, how much time is spent on wider succession planning and talent management rather than just nominations to the board. Whichever the chosen approach, it is essential that the chairman ultimately oversees board succession as they are responsible for the smooth running of the board.

As already noted, companies with smaller boards tend to have all their NEDs as members of the nomination committee. While there are obvious benefits, our roundtables also highlighted a risk of this approach – the potential lack of questioning and challenge from a director who had not been party to the deliberations. For larger boards it is not possible (and in some cases not desirable) for all NEDs to belong to the nomination committee, so these companies need to make sure that cross-committee conversations take place. Communication is particularly important between the remuneration and nomination committees, which both need to understand performance in the organisation and how it is rewarded. Regardless of the composition of the nomination committee, it is usual to offer the full board the opportunity to meet with a potential new board candidate.

Most companies see value in CEOs attending some nomination committee meetings as it is important for committee members to understand their views, particularly on internal talent. However, it is unusual for a CEO to be an official member of the nomination committee, and investors have raised concerns in some cases where this has happened.

Supporting the committee

Chairmen told us that, when thinking about board succession planning and composition, the company secretary is their first port of call because of their insights and understanding of good practice. The importance of the company secretary also came through in other discussions. For example, we were told that when company secretaries have responsibility for nomination committees, those committees tend to meet more frequently and to be more proactive, particularly in relation to those aspects of their remit that extend beyond the appointment of individual directors.

The support that the company secretary gives to the nomination committee varies depending on the appointment being considered. The company secretary usually supports the committee in appointing NEDs, but the HR director will typically take the lead for executive appointments. The HR function traditionally facilitates discussions around the talent pipeline, talent management and executive succession planning.

Reporting by the committee

Both EY and ICSA[6] view nomination committee reports as less informative than audit and remuneration committee reports. The richness of debate in our roundtables regarding the expansion in role, practices, reach and breadth of the committees is not evident in the annual reports we read. One roundtable attendee also noted that he found the discussion informative as it is difficult to get a picture (from annual reports) of how nomination committees operated and what they covered.

There are, undoubtedly, some constraints on the committee's ability to report more meaningfully, due to the sensitivity of issues under consideration. The general lack of any regular or regulatory cycle, as noted earlier, and the more ad hoc nature of its work, may also mean that its activities cannot be reported as fully as those of the audit or remuneration committee. There was much resistance at our roundtables to the idea of adding more reporting. **We believe in the need for 'better' not 'more' reporting, so as to convey assurance that issues are being addressed and to provide insight into the outcomes of activities e.g., the performance of a skills analysis by the committee[7].**

[6] The judges at last year's ICSA Awards described many nomination committee reports as 'rather boilerplate'

[7] For hallmarks of leading practice nomination committee reporting see EY's reports:
- *Reflections on the past, direction for the future*, September 2015, pg. 32 and;
- *Out with the Old, in with the new: Observations from EY's review of December 2013 annual reports in the FTSE 350*, September 2014, pg. 27

When reporting on new appointments made during the year, better information on the process and selection criteria used could help to dispel the concern – expressed most recently by the Equality and Human Rights Commission[8] – that the recruitment process remains 'shadowy and opaque'. Investors have commented that a description of the skills that individual directors bring to the board – perhaps in their biographies, focussing on why that individual should be appointed, rather than their CV – could help them assess the overall strength of the board and we have seen some improvement in this area in recent reporting.

Points for boards and nomination committees to consider:

- Whether your nomination committee terms of reference, annual report and website reflect the actual remit and practice of the committee.
- What the appropriate role of the committee should be. For example, if the committee does not look at executive talent, should it? Would your board benefit from combining the committee into a nomination and governance committee?
- In light of the chairman's workload, whether another NED would be more appropriate to chair the committee.
- Whether the following processes are clearly linked:
  - Discussion of current board composition and future composition in light of the company strategy
  - Executive and senior talent succession planning and company strategy
  - The outcome of the board evaluation exercise and board succession plans
  - The link between board evaluations and development and training plans.
- If the entire board constitutes the nomination committee, how you ensure that there is appropriate challenge, questioning and debate.
- Whether your nomination committee report in the annual report provides enough assurance to investors that relevant issues are being addressed.
- The existence of a two-pronged approach to identify succession plans in both emergency and steady-state situations.

[8] Equality and Human Rights Commission, *Inquiry into fairness, transparency and diversity in FTSE 350 board appointments*, March 2016

Looking deeper into the company for executive talent

Executive succession and the talent pipeline

During the roundtable discussions we heard that the nomination committee will usually play a role in CEO succession, and that this can be one of the most difficult issues to deal with because of the obvious sensitivities and the costs of failure. The longer the CEO is in post, arguably the greater the impact of their departure and the greater the transition challenge faced by their successor. The nomination committee therefore needs to monitor CEO succession risks and opportunities closely. Leading boards look across the market and within the company to identify four or five people who could take on the CEO role.

Companies have traditionally distinguished between board succession and management succession (excluding the CEO and CFO) when defining the role of the nomination committee. We heard that this distinction is becoming blurred. **There is a growing view that the board (through the committee) has to take some responsibility for ensuring not only that potential future board members are being identified and developed, but also that there is adequate 'bench strength' in management to run key parts of the company.** Throughout our roundtables we heard that there is a movement towards nomination committees looking deeper into the organisation, in some cases several levels below board.

As is always the case with the board and board committees, NEDs need to achieve balance in their role – providing oversight of management activity, rather than being involved themselves in the management of the talent pipeline. There is a particular question over whether the nomination committee should involve itself in the appointment process of senior executives (those immediately below board level). Should the committee do so, it is important that this is managed appropriately, since many CEOs want to take responsibility for appointing their own teams. Any involvement by the nomination committee in this area needs to be discussed with the chairman and CEO beforehand.

Our roundtables highlighted the variation in the degree of visibility that committees and boards have below board level. Some companies' nomination committee or board receive an annual presentation about the 'top' talent in the company, for example by the HR director presenting a talent review tool such as a '9-box-grid'[9]. At this point the committee is able to ask questions about why certain individuals have not progressed since the previous year. In some companies the board will consider the 'top' 50-200 individuals, hearing about their targeted development areas and development plans. Companies also find ways to expose the board to talent, either through site visits, away days or through presentations to the board, when individuals cover their area specialism or an alternative area of interest to the board. This approach has the added benefit of giving NEDs insights into the business and the culture that exists below board level. Some companies give their NEDs more free rein, encouraging them to visit offices in different locations independently, without being accompanied by senior executives or being part of a planned programme of meetings. This enables the NEDs to get a better feel for the business and gives them greater opportunities to meet executive talent. One chairman said that he carries a list of the top talent in the company, making sure he speaks to everyone on the list at least annually.

This is a delicate area requiring sensitive handling. Companies are aware of the risks in giving high visibility to 'talent lists', which can leave peers feeling side-lined. There is also the risk, as noted, of over-stepping the line between executive management and NED oversight. Some former CEOs felt that this was a management responsibility rather than a board one, although all accepted that the board has a responsibility to satisfy itself that appropriate management development and 'talent spotting' is taking place and that this may usefully be delegated to the nomination committee.

[9] A '9-box-grid' is a tool commonly used to discuss employee strengths and development needs. It helps leaders identify talent as it marks out individuals who have the potential and performance to move up within the organisation to take up senior roles.

Executive development

Developing executives so that they are 'board ready' is a challenge for all companies. Some nomination committees discuss whether there are 'board ready' individuals – and if not how they can bridge the shortfall – as part of the assessment described above.

Executive development is a particular challenge for smaller companies. Many FTSE 250 participants said that the skills gap between operational executives and the CEO in their companies was too large to bridge. Operational executives are unlikely to have the opportunity to develop the skills needed to deal with investors, regulators and other stakeholders in their daily roles. Companies of this size therefore sometimes have to rely on 'boomerang recruitment', where an executive takes up a role elsewhere in order to gain skills and experience before – hopefully – coming back to the company to assume the CEO position.

Larger companies have more opportunities to develop their executives. They can move executives into roles on subsidiary or joint venture boards or to head up a region or division. Some companies pair NEDs with top talent to help develop them. Such relationships also benefit the NEDs, who gain greater insights into the business.

Another way of developing board-level skills is for executives to take up roles as NEDs on other company boards. There was a broad consensus about the benefits of this approach, not only for the individual and the 'home' company[10], but also for company on whose board they sit, which gains the benefit of a director with current management experience. Attendees observed that when CEOs take up NED positions, this can have a positive impact on how they view and approach their own board. Company secretaries also stated that taking up roles on either corporate or charity boards helped them to understand the NED role more and in turn serve their boards better.

Most of our roundtable participants said that this approach is now widely accepted and that their companies support their executives in becoming NEDs of other entities (including organisations outside the listed sector). However, from a practical standpoint, taking up NED roles is becoming more of a challenge for executives as NED responsibilities expand. For example, it was commented that CFOs with a December year-end would find it highly challenging to serve on the audit committee at a company which also had a December year end due to likely clashes of time commitments. One company representative reported that their default position remains against executives taking external NED roles on the grounds that they should not have the time to fulfil them.

[10] The 'home' company refers to the company at which someone is a full time employee.

Points for boards and nomination committees to consider:

- The extent to which you look across the market and internally to identify four or five potential successors to the CEO.
- How deeply into the organisation the committee should be looking to identify future talent.
- For executive appointments, the balance between providing oversight and execution – especially in how the committee gets exposure to talent.
- The best way to develop the skills of future executive leaders in the business.
- If supporting executives in taking up NED roles will enable them to better carry out their role.
- Where executives take NED roles outside the company, the practical impact, time commitment and support they may need to fulfil both roles.

Casting the net wider for non-executive directors

The changing nature of business due to increasing globalisation, rapid technological change and the introduction of more disruptive start-ups, challenges the more traditional approaches of many established businesses. Companies need to consider the impact on their board and to look at a wider pool of candidates in order to identify people with the skills needed for them to meet the challenges they face in this new environment.

In parallel, there has been much more recognition in recent years of the benefits of diversity. As well as gender, companies are now paying attention to increasing BAME (Black, Asian, and minority ethnic) representation on their boards. Geographical or international diversity is also important for businesses operating across many different markets and, once a board or nomination committee has embraced diversity and is itself diverse, it is likely to be more open to bringing in others from more diverse backgrounds.

For all these reasons, companies are looking beyond the 'usual suspects' to find people with different experiences and backgrounds. This includes those who have not served on a listed company board before and it may be that 'risks around inexperience can be overstated'[11]. New NEDs can adapt reasonably quickly. NED mentoring and coaching has also become more common, usually provided by another board member (sometimes the chairman). Tapping into wider talent pools can still be difficult, however, especially for smaller FTSE companies which can struggle to identify and attract the individuals they want.

Specific skill sets

Our roundtables revealed that an increasing number of companies, when looking at the make-up of their board, consider the competencies and skills of current board members alongside their future strategy and the competencies and skills that will be required to deliver it. In this way they seek to identify current and future gaps. One approach is to use a documented skills matrix to identify potential longer-term as well as emergency successors.

Companies are also using other techniques. We heard how one company had carried out psychometric profile tests and found them useful in explaining the differences between individual directors. The social style or psychological profile of individuals can be used as a proxy for diversity of thought, since people with different styles will approach issues in different ways.

Such analyses can also be useful when considering the induction, training and ongoing development of directors. We heard that the induction of directors is generally the province of the company secretary and that induction programmes will generally be arranged around the known competencies and skills of each individual director. We also heard that many companies provide formal training opportunities for directors – one devotes the first hour of each board meeting to training activities or continuing professional development. Most companies spoke about the periodic feedback given by the chairman to board members on their individual performance. We have also seen the rise of formal board evaluations, which are useful not only for providing feedback on the performance of individual directors, but also an independent assessment of the competencies and skills of existing board members for use in a skills matrix.

[11] EY and The Investment Association, *Board effectiveness - continuing the journey*, April 2015, pg. 10

One challenge companies face is to find individuals with specific skills, but who are also capable of contributing across the range of issues the board faces. The full board is responsible for all decisions, regardless of the expertise or knowledge of an individual director in that area. For this reason, experience and judgement are highly-valued qualities in a director. Companies also accept that there are limitations on the skills and personal qualities that single board members can be expected to offer. We heard how one company with a large board identified that it needed a range of skills and attributes in new board members. Rather than expecting one individual to offer them all, headhunters were briefed to find two or three individuals who between them embodied the range of desired skills and attributes.

Some companies seeking international candidates employ a UK-based search firm with knowledge of the governance environment alongside a regional firm with knowledge of local talent. While we heard how having a wide variety of nationalities on a board can be challenging for the chairman due to their different approaches and business cultures, in our view, these are challenges worth overcoming in pursuit of board effectiveness. Another challenge is the ability of these international candidates to commit the necessary time to the role.

During our roundtables we also learnt that some skills gaps are widely recognised but hard to fill. For example, we were told that younger people with desirable skill sets in areas such as technology may prefer to work for a private equity-backed business than serve on the board of a listed company. Given this situation, we heard from several participants about an emerging trend, whereby some companies have introduced an advisory board or committee alongside their main board. These contain experts in specific fields who offer their advice to the board, but do not need to join it. Such advisory roles are less onerous in terms of time commitment and legal responsibilities, potentially making them more attractive to niche candidates.

Personal attributes

As well as specific skills and areas of expertise, an individual's character is also an important consideration for board appointments. We heard about the importance of ensuring new members would add to the 'mix' on the board and be willing to provide thoughtful challenge in a constructive way.

Most roundtable participants felt that a degree of 'fit' is important, so that the board operates as a team. However, one chairman felt it important to have 'some grit in the oyster'. He explained that, although some directors are more 'annoying' to work with, in practice they bring a great deal to their boards. Although having a challenging personality does not mean that an individual is always right, it does encourage boards to consider issues fully before making decisions.

Once a candidate has been selected for a board role through a formal process, for smaller boards, the individual will typically meet all the NEDs. Larger companies tend to offer meetings to the whole board, though anticipate that some board members will not take up the opportunity.

Through our roundtables we heard that NEDs don't only rely on their own instincts, but sometimes turn to their network for feedback on how a candidate has behaved in other roles. Similarly, company secretaries will ask their counterparts who have worked with a certain director what it was like to deal with that person in practice. One chairman asks the company secretary and any assistants who came into contact with a candidate about how that individual behaved towards them. Much can be learnt about an individual's character through this route.

Although a rarer occurrence, we also heard that in special circumstances, where a company is seeking very specific skill sets such as international experience, the board may draw upon its network in order to identify potential candidates. Any individuals identified in this way would then be subject to the formal selection process.

Roundtable participants recognised that relying solely on their networks, together with the desire for the new director to 'fit' the board, could favour 'known quantities' with previous board experience – and therefore individuals with similar backgrounds to the existing board members. More companies are therefore beginning to look for new ways to supplement these approaches.

For example, a recent report from the Equality and Human Rights Commission[12] was helpful in addressing some of the steps that a company can legally take to help increase the diversity of its board and, perhaps more importantly, identified some of the well-intentioned steps that a board might take that are actually illegal. One of the recommendations of this report was advertising board roles in order to increase awareness of such opportunities. However, attendees at our roundtables did not feel that this would be the effective solution that some might expect. Although the Centre for Public Appointments has indicated that it has not received large numbers of applications from inappropriate individuals, a view was expressed to us that the people who might apply for NED roles are less likely to be the sort of candidates that are being sought.

Attendees at our roundtables highlighted the importance of briefing headhunters in a clear and unambiguous manner. It was felt that when chairmen and company secretaries challenge headhunters to provide a more diverse list of candidates and are specific about the skills and attributes required, they often receive a better long list of candidates. Some nomination committees invite headhunters to present the long list of candidates to them, but not all NEDs are involved in rationalising the long list to a short list. Sometimes this is the responsibility of the chairman, the company secretary and/or the HR director. Whichever approach is chosen, it was agreed that shortlisting is best done against objective criteria as far as possible.

Points for boards and nomination committees to consider:

- How to challenge headhunters to look beyond the 'usual suspects' by providing more specific job specifications.
- The value of carrying out social style tests on the board to better understand its make-up and approach to decision making.
- Potential benefits of setting up an advisory board to access more niche skill sets and expertise.
- Obtaining informal feedback from your and your company secretary's network on how candidates operate or behave in practice.

[12] Equality and Human Rights Commission, *Inquiry into fairness, transparency and diversity in FTSE 350 board appointments*, March 2016

Thinking further ahead to prepare for future challenges

There was widespread agreement at our roundtables that nomination committees should be considering succession planning and, if appropriate for their role, executive talent management on an ongoing basis, regardless of whether or not there is likely to be a change on the board in that year.

The more forward-looking strategic element of the nomination committee's role is an emerging one. During our roundtable discussions we heard how important it is for nomination committees to develop a clear view of the needs of the business over a range of time horizons, informed by the company's strategy, and plan accordingly. As noted earlier on page 18 when considering specific skill sets, some companies are using skills matrices to help them identify current and future skills gaps and develop plans for filling them.

The nomination committee's role in identifying future challenges in order to ensure the company has the talent it needs can also be supported in other ways already identified in this report. For example, we heard how nomination committee members can gain insight into the business through site visits, mentoring or coaching executives and communicating with members of other committees. Some companies set aside one nomination committee meeting each year as a strategic session to which they invite members of the board who are not on the committee.

Recruitment agencies or headhunters can also be used in a long-term strategic manner. During our roundtables we heard how one company has a recruitment agency on retainer to assess the skills of the board and search for new candidates for future board appointments on an ongoing basis. There was some discussion of the merits of such an approach – some participants thought it gave the headhunter greater insight into the longer term needs of the company, but others felt that companies may end up placing too much reliance on one service provider.

Alongside addressing emerging talent challenges in an ever-changing business environment, more predictable succession planning is also a vital part of the nomination committee's role in preparing the company for the future. Our roundtable discussions highlighted the need for boards and/or nomination committees to look ahead in order to understand when individuals are due to leave the board. This is important to prevent 'cliff edge' situations when a number of directors are planning to leave at the same time. We heard that traditional tenure patterns can no longer be relied upon. Traditionally NEDs could be appointed for three terms of three years, with many completing the full nine years. There is now an emerging trend for NEDs to leave the board earlier, perhaps after six years. Considerations of the changing NED membership also need to be made in the context of the requirement for the annual re-election of directors.

We were also told that some companies consider sequencing succession plans. For example, if a CEO is likely to leave in three years, the chairman may choose to leave in one year's time in order to allow a new chairman to be involved in the recruitment of the new CEO.

Points for boards and nomination committees to consider:

- How to link longer-term strategy to succession plans.
- Having open conversations about future career plans as a board in order to sequence board succession appropriately.

Twelve questions for boards and their nomination committees to consider:

1

What skills does the board need to deliver the company's strategy (over the relevant period) and deal with changes in the business environment?

2

If the board needs new skills, when will they be needed and what is the plan for acquiring them?

3

How will you manage the next cycle of board appointments and reappointments, and how do board and director evaluations feed into that process?

4

What is your contingency plan for dealing with unexpected departures?

5

What assurance do you need from management about the nature and quality of their executive and senior management development programmes? How involved does the board or individual directors want to be in those programmes?

6

How visible are potential executive directors to you and what role might you play in their development (for example, through mentoring)?

7

What is your policy on executive directors and senior managers serving as NEDs on other boards?

8

What is your plan for ongoing training and development of directors after they have joined the board and how do the results from your board evaluation feed into this?

9

What criteria are used by the board and its advisors to identify potential NEDs? How objective are they and how are you satisfied they will not rule out individuals who have the necessary skills but may, for example, be lacking board experience?

10

What processes do you have for assessing the character and behaviours of potential new directors?

11

How could you improve your reporting and terms of reference to give shareholders and other stakeholders better insight into and assurance on how the nomination committee is exercising its responsibilities?

12

How could the nomination committee's interactions with other committees, e.g., the remuneration committee, be improved?

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