ICGN POSITION PAPER on GENDER DIVERSITY

In recent years, the public discussion of board diversity has focused principally on gender. Boards around the world are overwhelmingly comprised of men, and the small percentage of female directors has increased only modestly despite the extraordinary gains of women in the workplace in recent decades.

For many years, women have represented a large proportion of the college-educated workforce and female representation continues to grow as a proportion of graduates with advanced degrees. Women occupy an increasing percentage of leadership positions in business, government and the professions. Companies that fail to draw from the ever deepening talent pool of well-educated and high achieving women will fall behind in an increasingly competitive world. This is as true for the boardroom as it is for employee recruitment and retention. The challenge and opportunity of embracing gender diversity extends to all levels of the corporation.

This paper focuses on the roles of both institutional investors and companies in promoting and supporting gender diversity on boards. It should be viewed in the context of the ICGN Global Corporate Governance Principles, (2009) and other guidance such as non-executive director remuneration, corporate risk oversight and non-financial business reporting. It sets out ICGN's view on diversity as an important governance issue in contributing towards the effectiveness of boards and, ultimately, the long term sustainability of companies.

This paper has been structured into three sections: (a) investor responsibilities; (b) board responsibilities; and (c) reporting responsibilities. We recognise many other broader areas for discussion within this subject. For the purpose of this paper we have highlighted the areas likely to be most constructive in enhancing dialogue between companies and investors and therefore most likely to help improve gender diversity on corporate boards. It has been developed by a working group of the ICGN Shareholder Responsibilities Committee and takes into account ICGN members' views from a survey on the subject conducted in October 2012, in addition to other sources.

Boardroom reforms and diversity

Countries around the world have enacted reforms to set higher standards of accountability for corporate boards, to strengthen the authority of independent directors, and to increase transparency into board recruitment processes and director qualifications. Many of these reforms were driven, to an extent, by failures in corporate governance practices which in turn contributed to significant investor losses in the early years of the last decade and more recently, during the financial crisis of 2008-2009.

Corporate boards were criticized for their failures of attitude and competence due to a propensity towards 'group think' and an inability effectively to rein in management and oversee risk. Such criticisms were bolstered by the observation that board composition remains highly homogeneous. Diversity of thought and experience are essential contributions towards counterpoint and independence within boardrooms, allowing boards better to fulfill their expansive oversight responsibilities. These objectives can be accomplished more effectively by recruiting a board diverse in the broadest sense of gender, race, national origin, culture, expertise and thought. Diversity is fundamentally a governance issue.

In this regard, a number of countries have introduced legislation imposing gender quotas for boards of publicly traded companies. Other countries have adopted a 'comply or explain' approach encouraging development and disclosure of diversity policies and objectives and ensuring that explanations are provided for non-compliance. For example, Norway enacted a law in 2003 requiring companies to have 40% female directors by 2008. Spain has also introduced the same quotas to be reached by 2015. The French Parliament passed a law in January 2011 imposing 20% gender quotas on boards within three years and, 40% after six years. On the other hand, Australia has introduced a regime for extensive disclosures on diversity policies across the board, management and the workforce with stated objectives and an explanation of progress made, if any, to meeting those objectives.

Academic research

Prominent research studies associating gender diversity with financial outperformance support the view that investors should focus attention on diversity at investee companies. For example, studies conducted by McKinsey & Co. (such as that sampling 101 large companies around the world and another sampling 89 European-listed companies), found that companies with the most significant level of gender diversity in top management positions scored higher on measures of organizational excellence, showed more distinct returns on equity, more attractive operating results and stronger stock price appreciation than the average of their respective sectors. The American non-profit, Catalyst, has conducted two similar studies. In both cases, companies with three or more women on the board outperformed their peer companies in terms of return on sales, return on invested capital and return on equity. The Credit Suisse Institute published a study that found that a sample of companies with women on their boards outperformed peers that lacked female directors by 26 percent over a period of six years.

In 2011, the law firm Eversheds published a study examining the relationship between board composition and share price performance for 241 large global sample companies during the financial crisis. The study found a powerful correlation between overall performance and the percentage of female directors. Such studies highlight the fact that although the correlation between female directors and firm performance does not imply causation, it does however support the proposition that companies which promote women to top management and governing roles may have a number of attributes that lead to organisational excellence and to better share price performance. Conversely, an absence of diversity may signal ineffective management. As the National Association of Corporate Directors has remarked, "…a lack of diversity can be an apparent sign that the board is not engaging in a rigorous search for the most qualified people."

ICGN position on board diversity

The ICGN Corporate Governance Principles, (2009) state:

> *"2.2 Boards need to generate effective debate and discussion around current operations, potential risks and proposed developments. Effective debate and discussion requires:*

…

(c) that there is a sufficient mix of relevant skills, competence, and diversity of perspectives within the board to generate appropriate challenge and discussion;…".

These principles clearly state that ICGN views diversity, broadly defined, and independence, as important attributes of a high functioning board. In addition, a recent survey of the ICGN found that the majority of its membership believes that corporate boards have a role to play in overseeing human capital strategy which embeds diversity and inclusiveness within a corporate structure.

Boards which draw on a wide range of relevant skills, competence, and diversity of perspectives are better able to generate appropriate challenge and discussion thereby, generating and preserving enhanced value for investors. It is the role of the chair to ensure that such diverse boards contribute effectively to an active debate. Board diversity is as much about the culture within the boardroom and acceptance of a diversity of views, as it is about having a diversity of gender around the board table.

ICGN advocates a principles-based approach acknowledging that gender diversity is a key strategic issue, encouraging disclosure of objectives and, in cases of non-compliance, holding companies accountable for explaining their reasons. Boards constructed with the aim of effectiveness, with diversity being seen as an element to help deliver that effectiveness, are likely to perform better than those constructed with compliance in mind.

In your opinion, which action would be most effective in improving gender diversity on boards, binding quotas, or a 'comply or explain' approach?

Emisores Españoles is in favour of the imposition of measures within the EU to ensure sufficient female representation on boards. It believes that that would be a happy medium between legal quotas and self-regulation. It would focus on selection processes within companies, prioritising the presence of women and ensuring processes are professional and fair between the sexes. It agrees however with the "clause of flexibility" which stipulates that a company should not have to include women on its boards provided it can demonstrate sufficient efforts to find a suitable woman.

Emisores Españoles believes that self-regulation is a good path, since it prevents from excessive interference in private businesses, provided however, that companies themselves are transparent and fair in their processes. Corporate government ought to implement measures to ensure this should be potentiated and moreover it should provide more recommendations regarding the selection processes and how they should be carried out effectively and professionally.

Emisores Españoles does support the "comply or explain" system mandate of the CNMV, Spanish regulator, to explain in the annual report the ratio between men and women on its boards, and in cases where female representation is low, companies have to explain what they are doing to change that. Notwithstanding, the importance of new legislation and government recommendations is stressed again, even in connection with self-regulation and the "flexibility clause."

SECTION A: Investor responsibilities in improving board diversity

Shareholders have an economic interest in ensuring that corporate boards of directors are structured to function at the most effective level. Increasing the representation of women on corporate boards will accelerate the cultural changes needed to improve corporate governance globally.

Shareholders have several tools to monitor and ensure that companies are increasing gender diversity at board level as well as within the corporation, thereby creating an environment for better performing companies and investments. As well as seeking the development and implementation of gender diversity policies by the investee companies, other steps shareholders can take to influence gender diversity at investee companies include:

1. Engaging in regular dialogue on governance practices with the boards of investee companies to seek the development and implementation of gender diversity policies.

Gender diversity is a competitiveness issue for a company as a whole and a critical dimension of governance, both in the board's oversight of the enterprise and in the board's own composition and talent management. Increasing the representation of skilled and competent women on corporate boards will strengthen the corporate governance culture and ultimately contribute to value for all stakeholders.

Shareholders should include discussions around gender diversity in their regular engagement with the boards and management of investee companies. This gender diversity policy should apply to boards as well as the workforce as a whole.

Companies should be challenged by investors to consider actively the way in which human resources are being developed within their organization and how this incorporates gender diversity. This includes encouraging companies actively to communicate their aims and achievements in implementing gender diversity policies.

2. Advocating high corporate governance standards including those involving gender diversity.

Shareholders should advocate best practice governance standards among the companies in which they invest and ensure that consideration of these standards is integrated into the decision-making process for investment. Shareholders should seek the development and implementation of gender diversity policies among investee companies, and require investee companies to disclose these policies and adherence to them in their annual reports.

Furthermore, shareholders should communicate the importance of gender diversity to regulators and exchange providers, encouraging them to establish their own policies on gender diversity on boards. Regulators or exchange providers should require boards to report annually to shareholders on whether the company achieves these benchmark policies and, if not, to explain why the company has not met the benchmark or is not seeking to meet that benchmark.

3. Developing governance and voting guidelines on appointment and re-election of board members.

Shareholders should actively consider their expectations in relation to gender diversity on boards and include this within their own governance and voting guidelines. By way of example, the Australian Council of Superannuation Investors includes the following statement in relation to gender diversity in its Governance Guidelines[1]:

"4. Board structure

a) The board should be comprised of individuals:

- *Who are able to work together effectively to lead a viable, profitable and efficient company*
- *With diverse backgrounds (e.g. age, gender, core expertise) who have a high degree of competency, integrity, skill, capacity, experience and commitment to discharge their duties and responsibilities. Companies must ensure that these factors are considered in the director nomination processes."*

Similarly, the National Association of Pension Funds in the UK recognizes the importance shareholders should place on gender diversity in its Corporate Governance Policy and Voting Guidelines[2], recommending that:

"B.2: Appointments to the Board
B.2.2. Shareholders will expect companies to explain what steps they are taking to bring diversity to their boardroom, particularly gender diversity. This section should include a description of the board's policy on diversity – including professional, international and especially gender diversity - any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives."

4. Using voting rights to effect improvements at board level of investee companies.

Shareholder participation in the nomination and election of the board is a key responsibility. Where appropriate, shareholders are encouraged to make use of their voting rights to incite change in gender diversity practices within investee companies. This may, among other things, include the nomination of directors to boards where gender diversity is found to be lacking and the companies concerned have not embraced the gender diversity agenda.

What other, if any, steps can investors take in order to galvanize gender diversity on boards?

Emisores Españoles believes that more recommendations regarding the selection processes and how they should be carried out effectively and professionally might be provided.

Shareholders should advocate for best selection processes among the companies in which they invest and require them to establish real polices on gender diversity on boards and explain this polices in their annual reports.

Shareholders have the key to encourage the companies to improve gender diversity on boards using their voting rights. They should expect companies to explain what steps they are taking to make gender diversity real, advocating for high corporate governance standards.

[1] ACSI Governance Guidelines, July 2011, p11
[2] NAPF Corporate Governance Policy and Voting Guidelines, November 2012, p23

SECTION B: Board responsibilities in improving board diversity

Every company should disclose specific and measurable targets for achieving greater female representation within its senior management and board, and appropriately measure and report on progress in achieving such targets. The board is encouraged to develop such targets and to promote gender balance as one of the key aspects of good governance. In this regard, the board's responsibilities are as follows:

1. Recruit directors with the knowledge and experience to discharge the board's responsibilities and the independence of judgment to do so free of any external influence. Studies indicate that greater gender diversity helps achieve this goal.

The skills and experience necessary to oversee a company's strategy and risk will evolve along with the company's business. Boards should periodically update the desired skills matrix as the company's business develops. Boards should acknowledge that board composition might need to be refreshed on a frequent basis to achieve the optimal mix of director experience. To this end, boards should consider director tenure and limiting terms of service.

Within a skill-based framework, the board should seek to achieve diverse membership in terms of gender, age, background, and experience. Gender diversity promotes independence and different perspectives in boardrooms. According to several prominent research studies, greater gender diversity in senior executive and board ranks is correlated with measures of organizational excellence and stronger stock price appreciation than that exhibited by less diverse peers. Boards should set objectives to improve their overall diversity and to increase their percentage of women.

When recruiting non-executive directors, competence and fit with the skills and experience the board is seeking should be the conclusive components. However, within the skill-based framework, boards should strive for greater gender diversity. It is each board's responsibility to ensure that it possesses and maintains the right balance of independence, skills and diversity, including gender.

2. The nomination committee should conduct a structured evaluation of the board of directors on an annual basis to identify ways to strengthen the board's effectiveness, to assess gender balance, and to highlight gaps between the skills and background of existing directors and the optimal mix.

This exercise will help inform the recruitment of new directors whose diversity of skills and experience should address the gaps. The nomination committee should also develop a succession plan for the board, recognising that new director recruitment should be conducted strategically to help replace the skills sets of retiring directors.

The nomination committee has an especially important role to play in new director recruitment. In identifying and recommending candidates for new board members, the committee should seek a gender diverse candidate slate, alongside age, background and experience. This will ensure that new directors are chosen from the widest possible group of qualified candidates.

3. The nomination committee should challenge recruitment agencies to look outside the common channels and existing networks to source female candidates.

Nomination committees frequently use professional recruitment agencies to identify and screen prospective director candidates. They should encourage recruitment firms to take advantage of the numerous, recently created databases of board-qualified women and they should expect recruiters to broaden their own proprietary databases to include more female candidates. These candidates should include women with senior operating and executive backgrounds, even though they may not have served as CEOs.

4. **The board should include an annual assessment of its own performance in achieving greater female representation within its own ranks as well as within senior management**.

Given the important strategic value of gender diversity, the board should assess the performance of management in implementing gender diversity policies not just within senior management but across the company's entire operations. The board should consider requiring the relevant board committee, such as a Human Resources Committee, to address gender diversity and talent management

5. Companies should establish programmers to address any failures to deliver levels of diversity which reflect the relevant wider society.

A gender diverse board established over the head of a non-gender diverse company is unlikely to be wholly effective. Investors will certainly be somewhat cynical about gender diversity grafted on only at the very highest level of a company as this may appear cosmetic and management's ability to listen effectively to a full range of views may be in doubt.

In order to be an effective and open organization which draws on the skills and talents of all members of society, companies need to have in place approaches to gender diversity throughout their business. Doing so will deliver confidence to investors that this is an issue which management takes with genuine and appropriate seriousness. This will make it more likely that investors will also have confidence that gender diverse boards are actually enabled to be effective.

Disclosures of programmer to enable and encourage gender diversity throughout the organization should encompass:

- Appropriately tailored recruitment policies
- Ongoing skills development and mentoring
- Human capital strategy overall
- Flexible working and telecommuting opportunities

The natural development of gender diverse staff through the organization will help lead in due course to gender diversity at executive board and full board levels. This will provide further skilled and able non-executive women directors for other boards. Making female executives available for non-executive roles in other companies should be part of their development programme to accelerate the visibility and board-level skills of these executives.

What other, if any, board responsibilities are material for the promotion of gender diversity?

The board should oversee the promotion of equality through the Committee of Appointments and Remunerations and the Committee of Corporate Governance. It should watch over the corporative culture of the company, ensuring the promotion of equality, especially within HR policy.

The board has the responsibility to establish best selection processes prioritising the presence of women and ensuring that the processes are professional and fair between the sexes. In cases where the number of female representatives are low or null, the board should have to explain why and what measures it is adopting to remedy the situation. In this respect, inadequate selection processes for board members contribute to perpetuating the selection of members with similar profiles. The transparency of the recruitment process and reporting obligations as regards gender diversity of boards are therefore necessary.

The general culture of a company is the most important aspect in achieving female equality. And this culture has to be developed by the board improving gender balance.

SECTION C: Reporting responsibilities

In terms of reporting, the ICGN advocates that the following principles be applied:

- Regulators and exchange providers should establish a reporting policy on the number of women on boards. At a minimum, this policy should provide for timely benchmark targets for achieving gender diversity on boards and in senior management, as well as within policies across corporate operations, including those on career and work-life flexibility, management development processes, and mentoring and networking. Regulators or exchange providers (as the case may be), should require boards to report annually to shareholders on whether the company meets these benchmark policies and, if not, to explain why the company has not achieved the benchmark or is not seeking to meet that benchmark.

- Companies should disclose their gender diversity policies for the board, senior management and across all operations, which should include policies on flexible talent management and encouragement of female representation in hiring and promotion.

- Companies should aspire to communicate their aims and achievements in implementing gender diversity policies with shareholders.

- In each annual report to shareholders, companies should disclose their progress in effecting female representation across all operations, including stating what specific policies have been put in place to develop gender diverse talent at all ranks of the company.

- The nomination committee should report to the full board on how it takes gender diversity into account when nominating candidates to the board.

What other, if any, notable policies in terms of reporting, would you include?

The under-representation of women on boards is a key element of a broader lack of board diversity in general. The transparency of the selection processes must be explained in the annual reporting. It is important to give priority to equally qualified female candidates over male candidates, but not an unconditional priority; to such effect a “safeguard clause”, which provides for exceptions in justified cases, might be included.

Investors have different investment strategies that require information, which may be extracted, among other sources, from the profile (i.e. expertise and competence) of the board members of the companies. Therefore, more transparency in the selection procedure for designating board members enables investors to better assess the company´s business strategy. This idea has been taken up in the Proposal for a Directive of the European Parliament and of the Council on improving the gender balance.

The ICGN Position Paper on Gender Diversity does not make any reference to the abovementioned Proposal for a Directive. We believe it would be important to assess its approach and the consequences of its approval in the near future.

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