DUTIES AND RESPONSIBILITIES OF THE NOMINATING COMMITTEE

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Abstract

Many corporate governance codes and reports emphasize the importance of creating nominating committees within boards. Focusing on banks, the Basel Committee on Banking Supervision (2015) recommends that boards of directors should create an internal nomination/human resources/governance committee. In this context, we have analysed the presence and main characteristics of this committee in the 30 systemically important banks (G-SIBs). To the best of our knowledge, this is the first paper describing in depth the activities of the nominating committees. Our analysis shows that the nominating committee is often also a "governance committee". Its main responsibilities towards the full board of directors usually include identifying individuals qualified to become board members, guiding the board in its annual review, reviewing succession plans and, occasionally, monitoring education programs for directors. Most charters also entrust the appointment committee with the role of identifying members, and/or reviewing the composition, of board committees and, in a minority of cases, reviewing the suitability of the charters adopted by each board committee. The nominating committee is also frequently required to oversee for the board corporate governance policies and occasionally required to review policies relating to public/strategic issues, relationships with external entities affecting the bank's reputation and ESG matters. Many charters also entrust the appointment committee with reviewing/appointing directors to the boards of important subsidiaries (9 out of 29) and reviewing/appointing managers (14 out of 29). The nominating committees of G-SIBs are primarily composed of independent directors. The male gender is the most represented. In 2016, the effective average number of meetings of nominating committees in was seven.

Keywords: Nominating Committee, Responsibilities, Board of Directors, Systemically Important Banks (G-SIBS), Independent Directors

1. INTRODUCTION

Sound corporate governance in banking systems is important due to the key economic role of the financial sector, including its role as a channel for monetary policy transmission and a provider of risk protection. In reality, every company needs to practice sound governance, but this is especially critical for banks because they are highly leveraged and rely extensively on deposits, which means that their boards have a responsibility for the sound stewardship of these funds. Moreover, weak governance in banks, which plays an important role in the financial system, may result in problems spreading across the banking sector and the economy as a whole.

During the 2008 financial crisis, many deficiencies in the corporate governance of banks emerged. In 2010 the Basel Committee on Banking Supervision (BCBS) intervened by publishing a set of principles[15] for enhancing sound corporate governance practice in banking organizations. These principles were revised in July 2015. Systematically Important Financial Institutions (SIFIs) are expected to largely follow these guidelines, in such a way as to set in place corporate governance structures and practices suited to their role and their potential impact on national and global financial stability.

The revised guidance (BCBS, 2015) stresses the vital importance of effective corporate governance. Specifically, it states that the board has ultimate responsibility for financial soundness and bank business strategies, key personnel decisions, internal organization, governance practices, management,

15 Basel Committee on Banking Supervision (2015), Guidelines, Corporate governance principles for banks, July.

and compliance requirements. Some of these functions, but not the responsibilities, may be delegated to specialized board committees. The number and nature of these committees will depend on many factors, including bank size, business areas and risk profile.

Boards of directors appoint these specialized committees in order to help them ensure that the bank is being soundly managed. All committees draw their powers from the board of directors. Under the revised governance principles for banks (BCBS, 2015), each committee should have a charter or another instrument setting out its mandate, scope and working procedures, including information on how the committee will report to the full board, what is expected of committee members and any tenure limits for serving on it. The revised principles also recommend that boards of directors at banks should set up an audit committee, a risk committee, a compensation committee, an ethics and compliance committee and a nomination/human resources/governance committee.

This analysis focuses on the effective role of the nominating committee in the 30 systemically important banks (G-SIBs), investigating the mission, duties, and responsibilities entrusted to this committee by different banks.

This paper is organized as follows. Section II reviews some of the earlier literature on the nominating committee, focusing specifically on its role and its relationship with the CEO. Section III presents the results of the analysis, providing some examples of appointment committee charters in grey boxes. Finally, Section IV describes the conclusions.

2. THE NOMINATING COMMITTEE: THE FINDINGS OF EARLIER LITERATURE

Many corporate governance codes and reports emphasize the importance of creating nominating committees within boards. Since 2009 the NYSE's Listed Company Manual requires the publication of the nominating committee's charter, suggesting that the charter should address such issues as the qualifications of directors and members of nominating committees, the operations and structure of the committee, and the oversight of a board member search firm. In related commentary, the NYSE states, "*new director and board committee nominations are among a board's most important functions. Placing this responsibility in the hands of an independent nominating/corporate governance committee can enhance the independence and quality of nominees*".

The main mission entrusted to this specialized committee is to define the director appointment process, identifying the director skills needed on the board and suggesting future director candidates.

The creation of nominating committees is in line with agency theory (Fama, 1980; Jensen and Meckling, 1976), which stresses the need to separate management and control functions. As it is costly for shareholders to actively exercise decision control over the management, they delegate their decision control rights to the board of directors. The board of directors, in turn, delegates some of its responsibilities to standing committees, such as the nominating committee.

From the agency theory viewpoint, the appointing committee is a useful control mechanism, as it should reduce the influence of the firm's CEOs over the director selection process. Several empirical studies on the US market (where the board list is presented by the outgoing board) have in fact shown that powerful individual CEOs generally influence the director selection process by pushing for the appointment of directors who are less likely to challenge their decisions and by denying the nomination or re-election of directors who are likely to do so (Lorsch and MacIver, 1989; Zajac and Westphal, 1996; Shivdasani and Yermack, 1999). Such CEOs may also facilitate the appointment of directors having similar sociological and demographic characteristics as themselves since these directors are likely to exercise less stringent control (Westphal and Zajac, 1995). On this point, a recent study (Clune et al., 2014), based on extensive interviews of 20 US public company nomination committee members, shows that there is continuing recognition of CEO influence in the director nomination process, even though this influence appears to be declining.

The existence and independence of nominating committees can reduce the influence of firm CEOs on the director selection process by affecting the extent of rewards and sanctions provided by the labour market to directors, especially when the appointment committee does not comprise the CEO or is dominated by non-executive directors (Vafeas, 1999; Eminet and Guedri, 2010). On this point, however, one strand of literature states that the creation of nominating committees does not necessarily reduce the influence of CEOs over the director appointment process (Shivdasani and Yermack, 1999; Garcia Osma and Gill-de-Albornoz Noguer, 2007; Eminet and Guedri, 2010). The CEO can, in fact, influence the nominating committee's activity by trying to reduce the probability that active directors will be recruited and preventing the monitoring function from increasing in various ways. This influence can be exerted, in cases where the CEO is a member of the nominating committee or the committee is dominated by executive directors.

Some studies show that the external labour market appears to reward directors who exercise their monitoring duty with due diligence, and sanction those who do not accomplish this duty appropriately (Coles and Hoi, 2003) as, for instance, board members accused of fraud (Fich and Shivdasani, 2007). However, other empirical analyses indicate that lax directors (i.e. those facing class action lawsuits) are not always sanctioned by the external labour market (Helland, 2006) and social ties among members of the elite class appear to have a higher predictive power on director appointment than director inclination to increase monitoring and control over management (Mizruchi, 1996; Davis and Greve, 1997; Hermalin and Weisbach, 1998).

Although the main mission of the nominating committees is to define the director appointment process, in line with possible institutional changes, in the last decade some of these committees have rethought their role and modified their charters, as shown by Grace and Haupert (2008) for the US market.

In this context, some companies have created nominating/governance committees, which are entrusted with responsibilities that go even further than identifying the director skills needed on the board and suggesting future director candidates. These additional responsibilities concern different areas, such as establishing, reviewing and continually updating the entire governance process, director education, appointments of directors to the boards of important subsidiaries and proposing candidates for officers and senior management.

Yet, as ICSA-The Governance Institute (2016) indicates, nomination committees have not so far been subject to a great deal of analysis. In order to fill this gap, ICSA conducted a series of roundtable discussions with board Chairmen, nomination committee Chairmen and members and company secretaries from over 40 UK listed companies (predominantly from the FTSE 350) with a view to finding out what is really happening in these committees. The analysis of these discussions shows that appointment committees are currently functioning in different ways, which vary according to the size of the company, the size of the board, the industry in which the company operates and the stage of its development. ICSA also reports that UK nomination committees are adopting a more professional approach to the recruitment and selection of candidates, expanding their role and considering how it can be improved. Our analysis falls within this area, as it seeks to investigate the mission, duties, and responsibilities entrusted to the appointing committee by the 30 systemically important banks (G-SIBs).

3. THE ROLE OF THE NOMINATING COMMITTEE IN THE G-SIBS

The recent growing focus on core board responsibilities has made the nominating committee the centre of much activity, in such areas as CEO succession, board succession, and the wider issue of board effectiveness. The appointment committee's responsibilities are receiving much more attention, with leading companies rightly seeing this as a time to ramp up effectiveness (Griesedieck and Nahas, 2015).

Focusing on banks, the BCBS (2015) recommends that boards of directors should create an internal nomination/human resources/governance committee. The ESMA and EBA Guidelines (2016) also state that important institutions must have a nomination committee, whose members "*should have adequate collective knowledge, expertise, and experience about the business of the institution, in order to be able to assess the appropriate composition of the management body, including recommending candidates to fill management body vacancies*".

The study analyses the presence and the main characteristics of this committee in the 30 G-SIBs. The official global list of the 30 G-SIBs considered in the study is provided in Table 1

Table 1. 2016 G-SIB list

Banks	***Countries***
Agricultural Bank of China	China
Bank of America Corporation	United States
Bank of China Limited	China
Bank of New York Mellon Corporation	United States
Barclays PLC	UK
BNP Paribas	France
China Construction Bank	China
Citigroup Inc.	United States
Credit Agricole SA	France
Credit Suisse Group AG	Switzerland
Deutsche Bank	Germany
Goldman Sachs	United States
Groupe BPCE	France
Hsbc holdings Plc	U.K.
Industrial and Commercial Bank of China Limited	China
ING Groep NV	Netherlands
JP Morgan Chase	United States
Mitsubishi UFJ FG	Japan
Mizuho FG	Japan
Morgan Stanley	United States
Nordea Bank AB	Norway
Royal Bank of Scotland Group	United Kingdom
Santander	Spain
Societe Generale	France
Standard Chartered PLC	United Kingdom
State Street	United States
Sumitomo Mitsui FG	Japan
UBS	Switzerland
Unicredit Group	Italy
Wells Fargo	United States

The investigation focuses on 29 banks, however, not 30. Nordea Bank AB is in fact not considered in the sample, as its nomination committee is external to the board of directors, as required by the Norwegian corporate governance code. This code suggests indeed that the majority of the committee should be independent of the board of directors and the executive personnel, and that at least one member of the nomination committee should not be a member of the corporate assembly, committee of representatives or the board. Moreover, no more than one member of the nomination committee of Norwegian companies should be a member of the board of directors (executive directors are excluded anyway), and any such member should not offer himself/herself for re-election to the board.

We started the analysis by looking into the name given to the nominating committee by the 29 banks in the sample. Table 2 shows that most banks (45% of the global sample) use the term "corporate governance and nominating/ nomination/ appointments committee". About 31% of G-SIBs prefer the simple title "nomination, nominating or appointments committee", while 2 financial companies choose the name "nomination and remuneration/compensation committee". Generally speaking, the "appointment and governance committee" tends to have a broader remit than a committee with a purely nomination focus.

Table 2. Name of the committee

	Number	*%*
Nomination/nominating/appointments committee	9	31%
Corporate governance committee	1	3%
Corporate governance and nominating/nomination/appointments committee	13	45%
Nomination, governance and public affairs committee	1	3%
Chairman's and governance committee	1	3%
Nomination and remuneration/compensation committee	2	7%
Personnel and remuneration committee	1	3%
Corporate governance, nomination and sustainability committee	1	3%
Total	*29*	*100%*

The BCBS (2015) indicates that the nominating committee should provide recommendations to the board for new board members and members of senior management, and analyse the role and responsibilities of board directors and the knowledge, experience, and competence implicit in the role. In cases where a supervisory board or board of directors is formally separate from a management board, the financial regulator envisages that objectivity and independence are ensured on the basis of an appropriate selection of board members. In this context, the study analyses the responsibilities assigned by different charters to the nominating committee in relation to the full board of directors.

Table 3. Mission, rules, and responsibilities: board of directors

a) board of directors	*Number*	*%*
Identifying individuals qualified to become board members	29	100%
Guiding the board in its annual review	24	83%
Reviewing succession plans	16	55%
Monitoring education programs for directors	9	31%
b) board committees	***Number***	***%***
Identifying members/reviewing the composition of board committees	20	69%
Reviewing the suitability of the charters adopted by each board committee	7	24%

Table 3, Section a), shows that for 100% of the banks considered in our analysis the nominating committee is responsible for identifying individuals qualified to become board members and recommending director nominees to the board for the next annual meeting of stockholders.

The activity of some appointment committees also includes periodically verifying the status of directors for presentation by the board to the shareholders at the general shareholders' meeting and/or for publication in the annual corporate governance report. This is the case of Santander, where the nomination committee in 2016 proposed that the board should submit for approval at the general shareholders' meeting the re-election of some board members and commence selection processes for new directors. On this point, in liaison with an external firm, the appointment committee identified the competencies and skills that needed strengthening on the board, analysed the various candidates and their curricula vitae, examined the assessment of the skills and suitability of the pre-selected candidates, and proposed to the board the appointment of a number of directors.

Moreover, 24 banks out of 29 entrust the committee with the mission to guide the board in its annual review of the board's performance. This was expected, given that the Capital requirements regulation and directive (CRR/CRD IV) amended in 2013 specifically requires bank nomination committees to "*periodically, and at least annually, assess the knowledge, skills, and experience of individual members of the management body and of the management body collectively, and report to the management body accordingly*".

Boards are currently recognizing the need for an ongoing board succession process, on a basis parallel to the process they may already have for CEO succession. This entails identifying the knowledge, experience, and skills required on the board that tally with the strategies and plans for anticipated vacancies (Griesedieck and Nahas, 2015). In this context, our analysis shows that the nominating committees of about 55% of G-SIBs are also responsible for reviewing and reporting to the board on senior management talent planning and succession. This result is compliant with the requirements of the BCBS (2015) to the effect that the nominating committee should be involved in assessing board and senior management effectiveness and in overseeing the bank's personnel or human resources policies.

Another recent change in the role of the appointment committee includes responsibility for director education (Griesedieck and Nahas, 2015). Our evidence, in fact, shows that the nominating committee often has the duty of overseeing the induction program for directors.

Moreover, we have investigated the responsibilities assigned by different charters to nominating committees in relation to board committees. Table 3, Section b), shows that about 69% of G-SIB appointment committees are responsible for identifying members of board committees and/or for reviewing committee composition. Only 24% of the banks in the sample also entrust the committee with responsibility for reviewing the suitability of the charters adopted by each board committee.

The nominating committee is also entrusted with duties inherent in overseeing corporate governance policies and, sometimes, reviewing policies concerning public and strategic issues, decisions affecting firm reputation and practices regarding environmental, social and governance (ESG) matters.

Table 4. Mission, rules, and responsibilities: governance and strategic issues

	Number	*%*
Overseeing corporate governance policies	18	62%
Reviewing policies that relate to public/ strategic issues	6	21%
Reviewing relationship with external entities that affect firm reputation	4	14%
Reviewing practices regarding ESG matters	3	10%

Specifically, about 62 % of G-SIB nomination committees are responsible for reviewing and assessing the suitability of the company's policies and practices in corporate governance (this often includes the company's corporate governance guidelines) and recommending any proposed changes to the board for approval, as shown in Table 4.

The nominating committee can also ensure that the company has a sound code of ethics, by establishing a regular review of the code (Grance and Haupert, 2008).

Moreover, some appointment committees are assigned strategic responsibilities in reviewing policies that relate to public issues (6 banks out of 29), relationships with external entities that affect firm reputation (4 banks out of 29), and practices regarding environmental, social and governance (ESG) matters (3 banks out of 29), as shown in Table 4.

The nomination committee is sometimes also responsible for reviewing/appointing directors to the boards of important subsidiaries (9 banks out of 29) and officers and/or senior management (14 banks out of 29), as reported in Table 5. On this point, there is a particular question today 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, and any involvement by the appointment committee in this area needs to be discussed with the chairman and CEO beforehand*" (ICSA, 2016).

Table 5. Mission, rules and responsibilities: subsidiaries and managers

	Number	*%*
Reviewing/appointing directors to the boards of important subsidiaries	9	31%
Reviewing/appointing managers	14	48%

Some codes and reports on corporate governance best practices recommend and underline the creation of appointment committees which exclude executive directors and CEOs (NYSE's Listed Company Manual, 2009) or which are mainly composed of independent directors (UK corporate governance code, 2014; Italian corporate governance code, 2015). The BCBS (2015) suggests that banks should have in place a nomination committee or similar body, composed of a sufficient number of independent board members. On this point, our evidence shows that about 52% of G-SIB nomination committees are composed entirely of independent directors, as shown in Table 6.

Table 6. Composition of nominating committee: independence

Percentage of independent members	*Number*	*%*
0%	1	3%
between 0% and 25%	1	3%
between 25% and 50%	1	3%
between 50% and 75%	6	21%
between 75% and 100%	5	17%
100%	15	52%
Total	*29*	*100%*

We have also analysed the composition of G-SIB nominating committees in terms of gender. Our results show that about 93% of G-SIB nomination committees are composed mainly of men (Table 7). The male gender is the most represented also in the audit and remuneration committees, as in the full board of directors.

Table 7. Composition of nominating committee: gender

Percentage of women	*Number in the nominating committee*	*%*	*Number in the remuneration committee*	*%*	*Number in the audit committee*	*%*	*Number in the full board*	*%*
0%	5	17%	6	23%	8	28%	0	0%
between 0% & 25%	11	38%	8	31%	11	38%	13	45%
between 25% & 50%	13	45%	11	42%	7	24%	15	52%
between 50% & 75%	-	-	1	4%	3	10%	1	3%
100%	-	-	-	-	-	-	-	-
Total	*29*	*100%*	*26*	*100%*	*29*	*100%*	*29*	*100%*

Only 7% of bank appointment committees (2 out of 29, i.e. BNP Paribas and HSBC Holdings PLC) consist 50% of women and 50% of men. In the other committees, the percentage of female presence is a little more encouraging. In fact, 3 (BNP Paribas, Societe Generale, and UBS) out of 29 G-SIB audit committees are composed mainly of women and 2 (Credit Agricole SA and Santander) equally of men and women, respectively. As regards the remuneration committees, on the other hand, only in one case (BNP Paribas) is the female gender the most represented.

Finally, we have analysed the indicated minimum number of meetings required by G-SIB nominating committee charters, comparing it with the effective number of meetings held by these committees. Our results show that most banks do not specify a mandatory minimum number of meetings. Some appointment committee charters, however, require at least two (17% of the sample), three (7% of the sample), four (21% of the sample) or 12 (3% of the sample) meetings per year, as shown in Table 8.

Table 8. Meetings of nominating committees

Number of meetings	*Effective number of meetings in 2016*	*%*	*Minimum number required per year by the charter*	*%*
n.a.	3	10%	15	52%
2	0	0%	5	17%
3	1	3%	2	7%
4	3	10%	6	21%
5	4	14%	0	0%
6	4	14%	0	0%
7	6	21%	0	0%
8	3	10%	0	0%
9	2	7%	0	0%
10	1	3%	0	0%
12	1	3%	1	3%
13	1	3%	0	0%
Total	*29*	*100%*	*29*	*100%*

The effective average number of meetings of nominating committees in 2016 was seven.

4. CONCLUSIONS

The importance of the nominating committees within boards is recognized by most corporate governance codes with which the 30 G-SIBs intend to comply.

Previous literature shows that the main mission of these committees is to define the director appointment process. In the last decade responsibilities of the committee have often been expanded to different areas, such as creating, reviewing and continually updating the entire governance process, director education, appointments of directors to the boards of important subsidiaries and proposing candidates for officers and senior management.

The analysis of the 30 G-SIBs shows that the nominating committee is often (17 out of 29) become a "governance committee". Its responsibilities towards the full board of directors are:

- to identify individuals qualified to become board members;
- guide the board in its annual review;
- review succession plans and,
- occasionally, monitor education programs for directors.

Most charters also entrust the appointment committee with identifying members and/or reviewing the composition of board committees and, in a minority of cases, reviewing the suitability of the charters adopted by each board committee.

The nominating committee is often also required to oversee corporate governance policies and, occasionally, review policies relating to public/strategic issues, relationships with external entities affecting firm reputation and ESG matters. Many charters also entrust the appointment committee with reviewing/appointing directors to the boards of important subsidiaries (9 out of 29) and reviewing/appointing managers (14 out of 29).

Our analysis shows a wide variation in how appointment committees structure themselves and approach their business. Different approaches reflect the size of the company, the size of the board and the stage of its development. There are probably no "standard solutions" for the manner in which the nomination committee functions. The appointment committee of each company can in fact improve its activity according to its specific features, especially in changing times.

The nominating committees of G-SIBs are mainly composed of independent directors. The male gender is the most represented. The effective average number of meetings of nominating committees in 2016 was seven.

This analysis provides evidence on the roles and responsibilities of the appointment committees of G-SIBs, based on the information available in the committee charters. Unfortunately, it was not possible to evaluate the activities effectively carried out, as most corporate governance reports (with some exceptions, e.g. Barclays, Royal Bank of Scotland, Santander, Standard Chartered, Unicredit) do not explicitly address this issue. Even where required, as in the UK context, the reports of nomination committees tend to provide less insight and information than the reports of other committees contained in the annual report (ICSA, 2016).

In future it would be desirable for banks to issue a specific and detailed report on the activity of the appointment committee, in such a way as to convey assurances that the issues are being addressed. As recommended by ICSA (2016), when reporting on new appointments made during the year, improved information on selection criteria could go towards dispelling concerns that the recruitment process continues to be opaque, as required by the Equality and Human Rights Commission.

This paper shows some limitations. First, the sample size is small, and this makes it difficult to generalize our results. Second, the analysis is conducted only on banks and does not take into account other industries. Finally, we used self-reported corporate information that cannot be independently verified. Future research could improve existing literature on nominating committees by concentrating on larger samples of banks and considering also industrial and service companies.

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