



HOUSE OF COMMONS

President of the European Commission
European Commission
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By email: SG-NATIONAL-PARLIAMENTS@ec.europa.eu

7 January 2013

Dear Mr President,

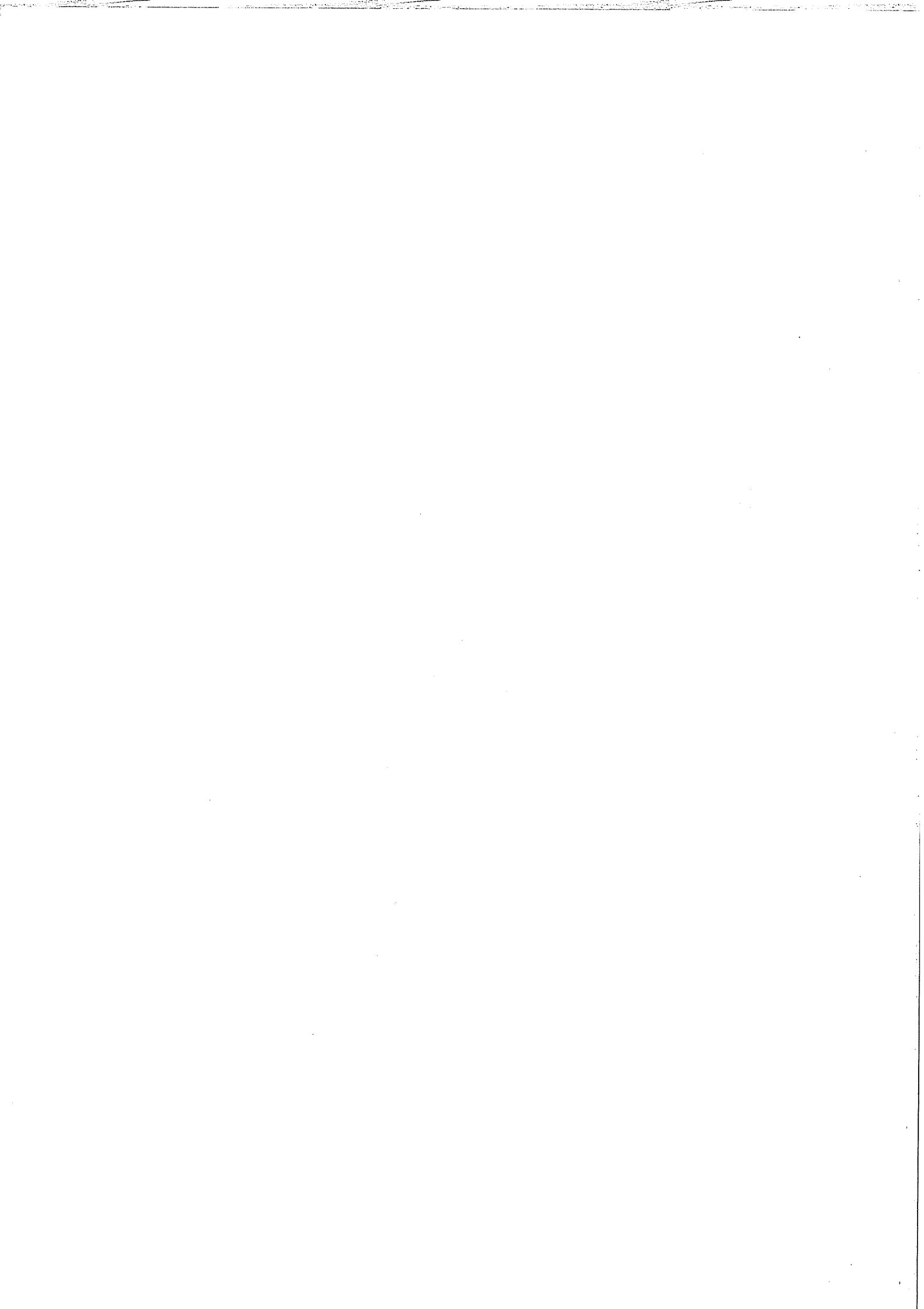
EUROPEAN UNION DOCUMENT NO. 16433/12 AND ADDENDA 1 TO 3, A DRAFT DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL ON IMPROVING THE GENDER BALANCE AMONG NON-EXECUTIVE DIRECTORS OF COMPANIES LISTED ON STOCK EXCHANGES AND RELATED MEASURES

On 7 January 2013, the House of Commons of the United Kingdom Parliament resolved as follows:

That this House considers that the draft Directive of the European Parliament and of the Council on improving the gender balance among non-executive directors of companies listed on stock exchanges and related matters (European Union Document No. 16433/12 and Addenda 1 to 3) does not comply with the principle of subsidiarity for the reasons set out in Chapter 1 of the Twenty-third Report of the European Scrutiny Committee (HC 86-xxiii); and, in accordance with Article 6 of Protocol No. 2 of the Treaty on the Functioning of the European Union on the application of the principles of subsidiarity and proportionality, instructs the Clerk of the House to forward this reasoned opinion to the Presidents of the European institutions.

I enclose the relevant extract of the report.

Yours sincerely,
Robert Rogers



1 Gender balance on corporate boards

(a) (34422) 16428/12 COM(12) 615	Commission Communication — <i>Gender balance in business leadership: a contribution to smart, sustainable and inclusive growth</i>
(b) (34423) 16433/12 COM(12) 614 ADDs 1–3	Draft Directive of the European Parliament and of the Council on improving the gender balance among non-executive directors of companies listed on stock exchanges and related measures Commission Staff Working Documents: Impact Assessments

<i>Legal base</i>	(a) — (b) Article 157(3) TFEU; co-decision; QMV
<i>Document originated</i>	(Both) 14 November 2012
<i>Deposited in Parliament</i>	(Both) 22 November 2012
<i>Department</i>	Business, Innovation and Skills
<i>Basis of consideration</i>	EM of 4 December 2012
<i>Previous Committee Report</i>	None
<i>Discussion in Council</i>	No date set
<i>Committee's assessment</i>	Legally and politically important
<i>Committee's decision</i>	(a) Cleared (b) Not cleared; further information requested; for debate on the Floor on the House on a draft Reasoned Opinion before 15 January 2013

Background

1.1 The 1957 Treaty of Rome establishing the European Economic Community enshrined the principle that men and women should receive equal pay for equal work, and gender equality has since been recognised as one of the founding values of the EU.¹ The EU Treaties establish a general obligation for the EU to seek to eliminate inequalities, and to promote equality, between men and women in all areas where it is competent to act.² In addition, Article 157(3) of the Treaty on the Functioning of the European Union (TFEU) creates a specific competence to adopt measures,

“to ensure the application of the principle of equal opportunities and equal treatment of men and women in matters of employment and occupation, including the principle of equal pay for equal work or work of equal value.”

¹ See Article 2 of the Treaty on European Union.

² See Article 8 of the Treaty on the Functioning of the European Union.

Document (a) — the Communication

1.2 The Commission Communication describes how EU legislation, Court of Justice case law, and EU funding and action programmes have helped to advance gender equality. In March 2010, the newly-appointed Commission adopted a Women's Charter in which it pledged to strengthen the gender perspective in all policies introduced during its term of office and to bring forward specific measures to promote gender equality. The Commission's Strategy for Equality between Women and Men, covering the period 2010–15, highlights the need to improve the proportion of women occupying leadership positions. In March 2011, the Council adopted a European Pact for Gender Equality for 2011–20 which calls for action "at Member State and, as appropriate, Union level" to promote women's empowerment in political and economic life, as well as the equal participation of women and men in decision-making at all levels and in all fields, in order to make full use of all available talent. By helping to remove barriers to the participation of women in the labour market, the Pact is one of a number of tools intended to support the Europe 2020 Strategy headline target of increasing the employment rate of women to 75% by 2020.

1.3 Despite these initiatives, and earlier attempts to effect change by means of non-binding Council Recommendations, the Communication notes that persistent gender imbalances in leadership positions remain:

"Across the EU, company boards are currently dominated by one gender: 86.3% of board members are men while women represent just 13.7% (15% among non-executive directors). 96.8% of the chairpersons are men and only 3.2% are women."³

1.4 It highlights the poor response to the Commission's "Women on the Board Pledge for Europe", launched in March 2011, which invited publicly listed companies to enter into a voluntary commitment to increase the representation of women on their boards to 30% by 2015 and 40% by 2020,⁴ as well as pressure from the European Parliament to introduce quotas and binding legislation if voluntary measures failed to produce results. The Commission estimates that, at the current rate of progress, it would take more than 40 years for companies across the EU to achieve balanced gender representation on their boards. It says that a legislative initiative is therefore needed, not only to improve the gender balance on the boards of publicly listed companies, but also to ensure that change is "structural and irreversible."⁵ Other activities to underpin EU legislation will include:

- the preparation of a voluntary code of conduct for executive search firms which addresses gender diversity and best practice;
- policy guidance on measures to reconcile work, private and family life;
- close monitoring of progress made towards the Europe 2020 headline target on female participation in the labour market;

3 See p.5 of the Communication.

4 Only 24 companies have signed the pledge (see p.6 of ADD 1).

5 See p.6 of the Communication.

- raising awareness about the business and economic case for gender equality and disseminating best practice;
- collecting comparable data to help track progress made in achieving balanced participation in decision making positions; and
- promoting the provision of affordable and high quality childcare facilities.⁶

Document (b) — the draft Directive

1.5 The purpose of the draft Directive is to improve the gender balance of corporate boards. Although it is drafted in gender-neutral terms, referring throughout to the under-represented sex, the recitals make clear that the objective is to increase the presence of women on boards for the following reasons:

- to achieve effective equality between women and men and narrow the gender employment and pay gap;
- to ensure the efficient use of human capital (60% of university graduates are female) and to enhance the return on public investment in education; and
- to improve corporate governance, with beneficial spill-over effects for financial performance and profitability, as well as economic growth.

The scope of the draft Directive

1.6 The draft Directive would only apply to publicly listed companies (in the UK, companies listed on the London Stock Exchange), but there is an exemption for small and medium-sized companies.⁷ This is because listed companies “enjoy a particular economic importance, visibility and impact” and have a standard-setting function for the broader economy. The Commission also suggests that the public nature of listed companies justifies more extensive regulation “in the public interest”.⁸

Procedural requirements for the recruitment of non-executive directors

1.7 The draft Directive would introduce new procedural requirements concerning the qualifications criteria and selection procedure for the recruitment of *non-executive* directors which would apply to all board systems⁹ and which seek to ensure that, where there is a gender imbalance on a company’s board, it will endeavour to raise the proportion of non-executive positions held by the under-represented sex to 40% by January 2020 (or

6 See pp.15–17 of the Communication.

7 The exemption applies to SMEs with fewer than 250 employees and an annual turnover or annual balance sheet not exceeding €50 million or €43 million respectively.

8 See recital 17, p.18 of the draft Directive.

9 Unitary systems combine the management and supervisory functions of executive and non-executive directors within a single board structure; dual systems have a separate supervisory board of non-executive directors and a management board of executive directors.

by 2018 for listed companies which are public undertakings). The Commission justifies the distinction made between the roles of executive and non-executive directors on proportionality grounds. It suggests that there is likely to be a larger pool of suitably qualified individuals capable of performing non-executive supervisory functions, and that it will therefore be easier for companies to achieve more diverse boards by focussing their efforts on the recruitment of non-executive directors. By contrast, applying the same obligations for the recruitment of executive directors would constitute excessive interference in the day-to-day management of a company.¹⁰

1.8 The new procedural requirements would only apply to listed companies where the proportion of either sex holding a non-executive board position is below 40%. In such cases, Article 4(1) of the draft Directive specifies that appointments must be based on,

“a comparative analysis of the qualifications of each candidate, by applying pre-established, clear, neutrally formulated and unambiguous criteria.”

1.9 In addition to these qualifications criteria, Article 4(3) introduces a new preference rule. It requires Member States to ensure that,

“in the selection of non-executive directors, priority shall be given to the candidate of the under-represented sex if that candidate is equally qualified as a candidate of the other sex in terms of suitability, competence and professional performance, unless an objective assessment taking account of all criteria specific to the individual tilts the balance in favour of the candidate of the other sex.”

1.10 An unsuccessful candidate is entitled to request the disclosure of the qualifications criteria on which the selection was based, the objective comparative assessment of those criteria and (where relevant) the factors tilting the balance in favour of a candidate of the other sex. If, based on this information, there is sufficient factual evidence to create a presumption that the unsuccessful candidate was equally qualified for the position, the onus shifts to the company to demonstrate that it has properly applied the preference rule.

1.11 The Commission emphasises that the preference rule set out in Article 4(3) is compatible with the case law of the Court of Justice on positive action, which requires the following cumulative conditions to be met:

- one sex is clearly under-represented in the relevant sector (in this case, women);
- the female candidate is equally qualified in terms of suitability, competence and professional performance;
- priority given to a female candidate is not automatic and unconditional, but may be overridden if reasons specific to a male candidate tilt the balance in his favour; and
- all candidates are assessed against objective criteria.

¹⁰ See recital 20, p.18 of the draft Directive.

Why a 40% objective?

1.12 The Commission cites academic studies which suggest that a critical mass of at least 30% of women must be achieved to overcome perceptions of “tokenism” and to effect fundamental and sustainable changes to boardroom culture. It adds, however, that this can be too crude a measure if applied without regard to the size of the board (which averages 6.89 non-executive members in listed companies, if SMEs are excluded) and the absolute number of female directors represented on it. A target of 40% should help to ensure that a critical mass is reached both in relation to the percentage share and the absolute number of women on a company board. However, the Commission adds:

“[T]he appropriate target level achieving the objectives identified and reaching at least the critical mass level of 30% is left to political judgment in view of the [...] proportionately varying impacts.”¹¹

1.13 The Commission’s Impact Assessment shows that, where Member States have introduced laws establishing national quotas, 40% is at the top end of the range.¹²

1.14 Article 4(7) of the draft Directive introduces a degree of flexibility by allowing Member States to provide that the 40% objective has been met if listed companies are able to demonstrate that the under-represented sex holds at least one-third of *all* director positions (executive and non-executive).

Exceptions to the application of the procedural requirements for the recruitment of non-executive directors

1.15 There are two notable exceptions. First, Article 4(6) allows Member States to exempt listed companies whose workforce has fewer than 10% of one sex (on the grounds that there are likely to be fewer suitably qualified candidates amongst the under-represented sex). Second, Article 8(3) allows Member States to suspend the application of the procedural requirements for recruitment (including the preference rule) if they are able to demonstrate that they have already taken measures at a national level to ensure a more balanced representation of male and female non-executive directors *and* that these measures will meet the 40% objective by 2020 (or 2018, in the case of listed public undertakings). Suspension of the application of the rules would be for a temporary period — until 2018 for listed public undertakings and 2020 for other listed companies — and Member States would be required to submit periodic reports (the first in 2017) demonstrating that national measures are yielding “concrete results”.¹³

11 See p.9, 16, 37 and 38 of ADD 1.

12 See pp.49–53 of ADD 2. France and Spain have introduced a 40% quota; Belgium, Italy and the Netherlands have opted for 30% or 33%.

13 See Article 9(2) of the draft Directive.

Measures to increase the gender balance amongst executive directors

1.16 The draft Directive requires Member States to ensure that listed companies enter into individual commitments with a view to achieving “gender-balanced representation of both sexes among executive directors” by 2020 (or 2018 for listed public undertakings).¹⁴ Listed companies must describe the progress made in meeting these commitments, as well as the 40% objective for non-executive directors, in annual reports submitted to their competent national authorities, and publicise the information on their company websites. Although the draft Directive does not prescribe the nature or content of the commitments, the recitals suggest that they must be set at a level which allows a company to demonstrate “tangible progress from [its] current position”.¹⁵ If progress is inadequate, companies must explain why and set out the measures they intend to take to ensure compliance.

1.17 The draft Directive envisages that national equality bodies (the Equality and Human Rights Commission in the UK) will have a role to play in carrying out analyses, promoting and supporting gender balance on the boards of listed companies, and monitoring progress.

Sanctions

1.18 The draft Directive requires Member States to introduce effective, proportionate and dissuasive sanctions. These may include administrative fines or annulment by a judicial body of the appointment or election of a non-executive director if the procedural requirements for recruitment and selection set out in national implementing measures have been infringed.

Other provisions

1.19 The draft Directive seeks to introduce a minimum level of harmonisation to ensure more balanced gender representation on corporate boards. It expressly contemplates that Member States may wish to go further, provided that more favourable national measures do not create unjustified discrimination or hinder the proper functioning of the internal market.¹⁶

1.20 The draft Directive would enter into force two years after its formal adoption, and Member States would be required to submit their first progress reports on the effectiveness of measures taken to implement it in January 2017. A “sunset clause” specifies that the Directive will expire at the end of 2028. However, the Commission may recommend extending the deadline for expiry as part of a comprehensive review of the Directive to be completed by the end of 2021.

14 See Article 5(1) of the draft Directive.

15 See recital 33, p.21 of the draft Directive.

16 Article 7 of the draft Directive.

The justification for EU action

1.21 The Commission advances three reasons to justify EU action. First, it says that EU action is necessary because Member States acting individually “will not achieve sufficiently significant progress towards a more balanced gender representation on company boards by 2020 or at any point in the foreseeable future”.¹⁷ Taking into account current trends in Member States, the Commission estimates that the EU as a whole would not achieve 40% of women on boards by 2040. The Commission highlights growing discrepancies in the approaches taken by Member States, and adds:

“Whilst Member States have the legal possibility to act in order to counter the under-representation of women in economic decision making, many of them do not show any willingness or face resistance from the business community to act at their own initiative.”¹⁸

1.22 The divergent approaches taken by Member States provide the second justification for EU action. The Commission suggests that different regulatory approaches can have a negative impact on the internal market and lead to “practical complications”. It cites, as examples, the difficulties which a listed company may encounter if it wishes to establish a subsidiary in another Member State, enter into a merger or acquisition, or bid for a public procurement contract.¹⁹ Lack of transparency in selection procedures and qualification criteria for board positions may deter potential candidates from exercising their free movement rights within the internal market and also affect investor decisions.²⁰ Moreover, common minimum standards help to ensure “a competitive level playing field”.²¹ The Commission adds:

“Member States may indeed hesitate to regulate in this area on their own, as they could perceive a risk of putting their own companies at a disadvantage with companies from other Member States. This perception, reinforced by pressure from the business community, represents a major obstacle preventing Member States from taking adequate action. An EU-level initiative in this area is needed to ensure a comparable level of promotion of gender equality throughout the Union, as required by the EU Treaties.”²²

1.23 The third justification for EU action places gender equality within the broader social and economic context of the Europe 2020 Strategy. The Commission suggests that a clear commitment to gender equality is essential to remove barriers to the participation of women in the labour market and to meet the Europe 2020 headline target of a 75% employment rate for men and women aged between 20 and 64 by 2020. The Commission also anticipates that enhanced participation of women at the highest levels of economic

17 See p.25 of ADD 1.

18 See p.26 of ADD 1.

19 See recital 12, p.17 of the draft Directive.

20 See recital 13, p.17 of the draft Directive and pp.27 and 28 of ADD 1.

21 See recital 14, p.17 of the draft Directive.

22 See p.26 of ADD 1.

decision-making will have beneficial spill-over effects for the wider economy, boosting the competitiveness of European companies and stimulating economic growth.²³ It says:

“The under-utilisation of the skills of highly qualified women constitutes a loss of economic growth potential. Fully mobilising all available human resources will be a key element in addressing the EU’s demographic challenges, competing successfully in a globalised economy and ensuring a comparative advantage vis-à-vis third countries.”²⁴

1.24 The Commission concludes, from this analysis, that the objective of achieving greater gender balance on the boards of listed companies,

“can be better achieved through coordinated action at EU level rather than through national initiatives of varying scope, ambition and effectiveness.”²⁵

Proportionality

1.25 The Commission points to the failure of non-binding Council Recommendations and other initiatives at EU and national level to promote gender equality in economic decision-making as the justification for proposing a limited harmonisation measure designed to achieve quantifiable and sustainable progress without, however, “impinging on the functioning of private companies and the market economy”.²⁶ It highlights, in particular:

- its targeting of a sector in which the under-representation of women is significant and widespread;
- the limited scope of the draft Directive (which only seeks to establish a quantitative 40% objective for non-executive board members in listed companies);
- the exemption for small and medium-sized companies;
- its selection of a 40% objective which is sufficiently ambitious to achieve *de facto* equality (rather than absolute parity) without unreasonably constraining the flexibility of shareholders and companies to select their candidate of choice;
- flexibility for Member States to take into account national company law and company board recruitment practices in determining how to achieve the 40% objective and implement the rules on company reporting;
- a realistic timeframe for achieving the gender equality objective;
- the avoidance of rigid quotas — companies are able to justify non-compliance with the 40% objective if there is a lack of suitably qualified candidates; and

23 See recital 15, pp.17 and 18 of the draft Directive.

24 See p.3 of the Commission’s explanatory memorandum.

25 See p.28 of ADD 1.

26 See p.10 of the Commission’s explanatory memorandum accompanying the draft Directive.

- the inclusion of a sunset clause to underline the temporary nature of the Directive.²⁷

The Government's view

1.26 The Minister for Employment Relations and Consumer Affairs and Minister for Women and Equalities (Jo Swinson) notes that the Commission has presented a revised proposal following reports that its original intention to propose mandatory quotas for the representation of women on corporate boards proved to be divisive amongst the College of Commissioners. She says that a large number of Member States explicitly opposed the introduction of mandatory EU quotas when the matter was first discussed at the Employment and Social Affairs Council in February 2012. By contrast, European Parliament Resolutions agreed in July 2011 and March 2012 have highlighted the lack of progress in achieving gender-balanced representation on corporate boards and called for a binding quota of 30% by 2015, rising to 40% by 2020.

1.27 The Minister expresses the Government's commitment to increasing the number of women appointed to director positions in order to create more diverse and effective boardrooms. She continues:

“We have been working with business to break down the barriers that prevent women from reaching their true potential and to bring about a culture change at the heart of business. We recognise that business needs to understand and embrace the need for change and fear that heavy handed measures, such as mandatory targets, regulation and legislation will be counter-productive to our objective, creating more, not fewer, barriers for women and less effective boardrooms.”²⁸

1.28 Although the Minister welcomes the Commission's decision not to impose mandatory quotas for women on boards, she expresses concern that.

“[T]his Directive effectively amounts to the same thing, quotas, in essence.”²⁹

1.29 She continues:

“[The] UK Government believes that quotas or mandatory objectives will fail to fix the problem and could be counterproductive.

“The majority of women are not in favour of quotas, fearing that they will be considered mere tokens or sidelined within the boardroom. They want to be there on merit, they want their hard work recognised and know that they got the job because they are the best person for the job and they want everyone else to understand that that is why they got the job. Quotas risk undermining women and their contribution.”³⁰

27 See pp.28, 29, 61 and 62 of ADD 2.

28 See para 24 of the Minister's Explanatory Memorandum.

29 See para 38 of the Minister's Explanatory Memorandum.

30 See paras 39 and 40 of the Minister's Explanatory Memorandum.

The Government's assessment of the content of the draft Directive

1.30 The Minister estimates that approximately 950 UK companies would fall within the scope of the draft Directive, and adds:

“In the UK we have made great strides in the number of women non-executive appointments, since the 1 March 2012; 49% of newly appointed FTSE 100, and 44% of FTSE 250 non-executive directors have been women. We are now working to encourage the development of the executive pipeline to ensure the supply of female executives is sustainable.”³¹

1.31 She welcomes the inclusion of an exemption for small and medium-sized companies, but says that the Government has not yet assessed how many listed companies in the UK would benefit from this exemption.

1.32 The Minister explains that the UK does not distinguish in law between executive and non-executive directors, and that introducing such a distinction for the first time would have “significant legislative implications”, not least in terms of the role shareholders play in determining who runs “their” company. She notes that the draft Directive makes provision for a Member State to apply the recruitment and selection processes to all director appointments. In so doing, the UK would be able to rely on Article 4(7) of the draft Directive which deems the 40% objective to have been met if women occupy one-third of *all* director positions. However, the Minister considers that there is considerable uncertainty and lack of clarity as to how Article 4 as a whole will affect UK company law. She continues:

“[T]hough we understand that the purpose is not to introduce quotas *per se* it is not clear from the text that companies cannot be sanctioned if they fail to meet the 40% target despite following all the appropriate procedures.”³²

1.33 The Minister suggests that the 40% objective for all non-executive director positions, set out in Article 4(1) of the draft Directive, would create “real issues” for Government and business. She continues:

“Under current UK equality law companies ‘may’ choose to appoint an equally qualified candidate of the under-represented sex but this is discretionary and must not be done as a matter of policy (section 159 of the Equality Act 2010 on positive action in recruitment and promotion). This proposal goes much further, stating that companies ‘must’ take this positive action and is therefore a real departure from UK law which was designed to follow the jurisprudence from the European Court of Justice on positive action by explicitly stating what is permissible without invoking unlawful discrimination. We also have concerns as to how shareholders opinions can be accommodated under this model.”³³

31 See para 26 of the Minister's Explanatory Memorandum.

32 See the Minister's Explanatory Memorandum dated 4 December 2012, on the impact on United Kingdom law.

33 See para 29 of the Minister's Explanatory Memorandum.

1.34 The Minister says that the requirement in Article 5 for Member States to ensure that listed companies set targets for achieving a better gender balance amongst executive directors is a departure from the voluntary approach so far pursued in the UK, following publication of the review led by Lord Davies of Abersoch in 2011 on the barriers preventing women from reaching senior business positions. Although some companies already publish information on gender diversity, she expects that more detailed implementing legislation would be needed. Article 6 on sanctions would also require legislation. The Minister highlights ambiguities in the scope of this provision, which fails to make clear whether the breach to be sanctioned concerns non-compliance with the procedural requirements for recruitment and selection of candidates for board positions, or failure to meet the 40% objective (even if the correct procedures are followed).

1.35 The Minister notes that Article 8(3) allows a Member State to suspend the application of elements of the draft Directive on recruitment and selection procedures if it has already introduced equally effective national measures. She adds:

“It may be that only Member States which have measures written in law would be able to satisfy the Commission in this respect because Member States have to show that the national measures ‘enable members of the under-represented sex to hold at least 40% of non-executive director positions’ by 2020/2018 (article 8(3)) and when reporting to the Commission under article 9 these Member States have to include information ‘demonstrating concrete results obtained by the national measures’ with the Commission ascertaining whether the 40% objective will be met. According to Cranfield School of Management the UK is on a current trajectory to achieve 26.7% women on FTSE 100 boards by 2015 and 36.9% by 2020. On current trajectory, this would therefore fall short of the Commission’s objectives and further efforts might be needed to clearly demonstrate compliance with a 40% objective. The FTSE 100 are the UK’s top 100 companies, we estimate that around 950 companies would fall in scope of the Commission’s Directive, the majority of these are likely to have very low female representation on their boards.”³⁴

1.36 Moreover, the Minister anticipates that, even if the UK were to rely on the efficacy of its own domestic measures to enhance female representation on corporate boards, the Government would still have to introduce legislation transposing the Directive as it would take immediate effect in January 2020 (2018 for public undertakings) in relation to those companies which failed to meet the 40% objective.

The Government’s assessment of the justification for EU action

1.37 The Minister acknowledges the EU’s right to act on matters concerning gender equality in employment, but contests the reasons advanced by the Commission to justify action at EU, rather than national, level. She highlights the commitment in the Coalition Agreement to promoting gender equality on the boards of listed companies, as well as the recommendations made by Lord Davies of Abersoch to pursue “a business-led strategy to

34 See para 35 of the Minister’s Explanatory Memorandum.

bring about the necessary change” and cites the following evidence to demonstrate that national level solutions are working:

“Women currently account for 17.3% of FTSE 100 and 12% of FTSE 250 boards (as of 15 November 2012), up from 12.5% and 7.8% respectively prior to Lord Davies’ report;

“Importantly, women have accounted for 38% of all newly appointed FTSE 100, and 36% of FTSE 250, directorships (executive and non-executive) since 1 March 2012;

“Within the FTSE 100, the number of all-male boards has fallen to 8, from a starting point of 21 in 2010, and for the first time all male boards are a minority amongst the FTSE 250 with 94 all-male boards (37.6% down from 52.4%);

“Research by Cranfield School of Management shows that, should the current momentum and current pace of change be maintained we are on a trajectory to achieve 26.7% women on FTSE 100 boards by 2015 and 36.9% by 2020.”³⁵

1.38 The Minister suggests that national level solutions are more effective,

“allowing Member States to work with companies within their own specific cultural contexts to bring about the necessary culture change at the heart of business to ensure that talented women are recognised more fully, and ensuring that the solution is sustainable and long-term.”³⁶

1.39 She continues:

“We believe that we need to see a real culture change taking place at the heart of business if progress is going to be sustainable and long-term. Companies need to understand, and believe, that diverse boards are better boards. Voluntary measures, which businesses can truly buy-in to, such as the business-led approach that the UK is taking, can help to bring about this change in a way that forceful measures never can, creating a business environment where women can take their seat on merit and without the spectre of tokenism.

“Mandatory quotas or objectives also assume that all businesses are starting from the same place. In business there is no “one size fits all” and companies need a degree of flexibility, to do what is best for their business. Businesses, and business structures, need to retain a flexibility which allows them to respond to changing circumstances and to the varying needs of the sector, size and type of business.

“Moreover, Member States are very different, they have different cultures, characteristics, corporate governance regimes, workforce compilation, education standards and they are all starting from a different place. There are also different company and board structures which may make it difficult to apply pan-European targets in a meaningful way.

35 See para 20 of the Minister’s Explanatory Memorandum.

36 See para 21 of the Minister’s Explanatory Memorandum.

“Individual countries, like business, need to be able to respond to the changing environment and the varying needs of the sector, size and type of business, and it is crucial that they retain the flexibility to do so. Member States must retain the ability to work with the business community to develop solutions which take account of their own economic and labour market conditions. And the evidence suggests that this is happening across EU Member States.

“For UK companies we believe that the voluntary, business-led approach to improving the representation of women on corporate boards is the right one.”³⁷

1.40 The Minister also cites the conclusions of the Commission’s own Impact Assessment Board which noted, in August 2012, that a number of Member States had taken measures which appeared to have achieved significant progress, and that the evidence base to demonstrate the need for, and proportionality of, binding EU action was very weak.

The Government’s assessment of the financial implications of EU action

1.41 The draft Directive has no implications for the EU budget, but the Government, citing figures in the Commission’s Impact Assessment, estimates that the aggregate cost to listed companies in the UK of ensuring compliance is likely to be in the region of £9 million for the period to 2020. Additional costs will be associated with monitoring the gender composition of boards and taking enforcement action against non-compliant listed companies.

Conclusion

1.42 **We do not doubt that there are significant structural and cultural obstacles which continue to impede efforts to achieve more balanced and diverse corporate boards. Lack of diversity does not only affect women, but gender equality is an area in which the EU has a clear competence to act. The slow rate of progress in increasing the gender diversity of corporate boards is telling, with the Commission projecting that it would take another 40 years or more to achieve balanced representation. We note, moreover, that notwithstanding recent efforts in the UK, the Commission estimates that, on current trends, only 17% of UK listed companies within the scope of the Directive will have at least 40% of women directors (executive and non-executive) by 2020.³⁸ However, the fact that the EU is competent to act, and that the Commission is anxious to do so, does not mean that EU action is necessarily justified.**

1.43 **We share the Government’s concern that the action proposed by the Commission comes very close to the introduction of a binding quota for the proportion of women represented on corporate boards, even though it is expressed in terms of a quantitative objective. The first limb of the subsidiarity test provides that the EU may only act “if and insofar as the objectives of the proposed action cannot be sufficiently achieved by**

37 See paras 41–5 of the Minister’s Explanatory Memorandum.

38 See pp.45 and 46 of ADD 2.

the Member States”.³⁹ The Commission highlights the divergent approaches taken by Member States — with some introducing binding quotas, some setting non-binding targets, some proposing voluntary, business-led initiatives, and some taking no action at all — and suggests that progress towards more balanced gender representation on corporate boards will be too slow. We note, however, that many national measures have been introduced within the last year or two and consider that it is too soon to write them off as ineffective. We think that a further period of reflection and evaluation is needed to assess what does (or does not) work and how much tangible progress has been made before concluding that Member States are unwilling to act or that the measures they introduce will be ineffective.

1.44 The Commission cites resistance from the business community as a possible factor explaining why some Member States may be reluctant or unwilling to act, and advocates action at EU level in order to ensure “a competitive level playing field”. However, much of the analysis underpinning the Commission’s proposal rests on the strength of the business case for introducing more diverse boards as a means of improving corporate governance and performance. There would therefore appear to be more, rather than less, reason for Member States to take action individually to promote greater gender balance on corporate boards as a means of securing competitive advantage.

1.45 The Commission advances two further reasons to justify action under the second limb of the subsidiarity test, which requires evidence that action at EU level would be more effective in achieving greater gender balance. First, it says that different regulatory approaches may give rise to “practical complications” which can have a negative impact on the internal market. Examples cited include the possibility that a company with too few female directors may be excluded from public procurement contracts or may find it difficult to establish a subsidiary in another Member State. Lack of transparency in the recruitment and selection procedures for corporate board positions may also constitute a restriction on freedom of movement within the internal market and affect the basis on which investor decisions are made. Whilst we accept that these are all theoretically possible, we think that the Commission needs to establish a far stronger evidence base of problems actually encountered within the internal market before asserting that EU action is justified to reconcile divergent national approaches.

1.46 Second, we accept that increasing the participation and visibility of women in senior economic decision-making positions may well have a positive spill-over effect on women’s participation in the labour market and contribute to the Europe 2020 Strategy headline target on employment. However, as indicated above, we think it is too soon to conclude that the type of EU action proposed by the Commission is necessarily the only, or the best, way of achieving this.

1.47 We welcome the efforts made by the Commission, both in its explanatory memorandum accompanying the draft Directive, and in the recitals to the proposal, to set out in some detail the basis for EU action. Indeed, the justifications in the recitals,

39 See Article 5(3) TEU.

running to nine pages, are significantly longer than the operational provisions of the draft Directive, which number 11 Articles and run to five pages. We think this testifies to the unease within the Commission itself regarding both the justification for legislation, and the nature of the legislation proposed. We recognise that the Commission has attempted to give some indication of the quantitative and qualitative impact of action at EU level, as compared to what might be expected if the EU took no action, but we question whether it has adduced sufficient evidence of transnational effects or of any meaningful impact on the functioning of the internal market. We therefore recommend that the House sends the attached Reasoned Opinion to the Presidents of the EU institutions before 15 January 2013, following a debate on the Floor of the House.

1.48 Meanwhile, we intend to hold the draft Directive under scrutiny but are content to clear the Communication. We would welcome the Minister's views on the accuracy of the Commission's projection that only 17% of UK listed companies within the scope of the Directive will have at least 40% of women directors (executive and non-executive) by 2020. We also ask the Minister, given this slow rate of progress, to explain why she considers that the measures proposed by the Commission would be "counter-productive" and create "more, not fewer, barriers for women and less effective boardrooms".⁴⁰ Finally, we look forward to hearing the outcome of the Government's consultations with stakeholders and ask the Minister to provide progress reports on the negotiations.

40 See para 24 of the Minister's Explanatory Memorandum.



Reasoned Opinion of the House of Commons

Submitted to the Presidents of the European Parliament, the Council and the Commission, pursuant to Article 6 of Protocol (No 2) on the Application of the Principles of Subsidiarity and Proportionality

concerning

Draft Directive of the European Parliament and of the Council on improving the gender balance among non-executive directors of companies listed on stock exchanges and related measures

16433/12¹

Treaty framework for appraising compliance with subsidiarity

1. The principle of subsidiarity is born of the wish to ensure that decisions are taken as closely as possible to the citizens of the EU. It is defined in Article 5(3) TEU:

“Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level.”

2. The EU institutions must ensure “constant respect”² for the principle of subsidiarity as laid down in Protocol (No. 2) on the Application of the Principles of Subsidiarity and Proportionality.

3. Accordingly, the Commission must consult widely before proposing legislative acts; and such consultations are to take into account regional and local dimensions where necessary.³

4. By virtue of Article 5 of Protocol (No 2), “any draft legislative act should contain a detailed statement” making it possible to appraise its compliance with the principles of subsidiarity and proportionality. This statement should contain:

- some assessment of the proposal’s financial impact;
- in the case of a Directive, some assessment of the proposal’s implications for national and, where necessary, regional legislation; and

¹ COM(12) 614.

² Article 1 of Protocol (No. 2).

³ Article 2 of Protocol (No. 2).

- qualitative and, wherever possible, quantitative substantiation of the reasons “for concluding that a Union objective can be better achieved at Union level”.

The detailed statement should also demonstrate an awareness of the need for any burden, whether financial or administrative, falling upon the EU, national governments, regional or local authorities, economic operators and citizens, to be minimised and to be commensurate with the objective to be achieved.

5. By virtue of Articles 5(3) and 12(b) TEU national parliaments ensure compliance with the principle of subsidiarity in accordance with the procedure set out in Protocol (No. 2), namely the reasoned opinion procedure.

Previous Protocol on the application of the principle of subsidiarity and proportionality

6. The previous Protocol on the application of the principle of subsidiarity and proportionality, attached to the Treaty of Amsterdam, provided helpful guidance on how the principle of subsidiarity was to be applied. This guidance remains a relevant indicator of compliance with subsidiarity. The Commission has confirmed it continues to use the Amsterdam Protocol as a guideline for assessing conformity and recommends that others do.⁴

“For Community action to be justified, both aspects of the subsidiarity principle shall be met: the objectives of the proposed action cannot be sufficiently achieved by Member States’ action in the framework of their national constitutional system and can therefore be better achieved by action on the part of the Community.

“The following guidelines should be used in examining whether the abovementioned condition is fulfilled:

- the issue under consideration has transnational aspects which cannot be satisfactorily regulated by action by Member States;
- actions by Member States alone or lack of Community action would conflict with the requirements of the Treaty (such as the need to correct distortion of competition or avoid disguised restrictions on trade or strengthen economic and social cohesion) or would otherwise significantly damage Member States’ interests;
- action at Community level would produce clear benefits by reason of its scale or effects compared with action at the level of the Member States.”⁵

“The form of Community action shall be as simple as possible, consistent with satisfactory achievement of the objective of the measure and the need for effective enforcement. The Community shall legislate only to the extent necessary. Other things

⁴ See, respectively, pages 2 and 3 of the 2010 and 2011 Reports on Subsidiarity and Proportionality (COM(10) 547 and COM(11) 344).

⁵ Article 5.

being equal, directives should be preferred to regulations and framework directives to detailed measures”.

Proposed legislation

Purpose

7. The purpose of the draft Directive is to improve the gender balance of corporate boards. Although it is drafted in gender-neutral terms, referring throughout to the under-represented sex, the recitals make clear that the objective is to increase the presence of women on boards for the following reasons:

- to achieve effective equality between women and men and narrow the gender employment and pay gap;
- to ensure the efficient use of human capital (60 per cent of university graduates are female) and to enhance the return on public investment in education; and
- to improve corporate governance, with beneficial spill over effects for financial performance and profitability, as well as economic growth.

Operation

8. The draft Directive is based on Article 157(3) of the Treaty on the Functioning of the European Union (TFEU) which creates a specific competence to adopt measures “to ensure the application of the principle of equal opportunities and equal treatment of men and women in matters of employment and occupation, including the principle of equal pay for equal work or work of equal value.” It would require Member States to ensure that publicly listed companies in which women occupy fewer than 40 percent of non-executive director positions or one third of all director positions (executive and non-executive) base the appointment of non-executive directors on “a comparative analysis of the qualifications of each candidate, by applying pre-established, clear, neutrally formulated and unambiguous criteria.” It would also introduce a new preference rule to ensure that a female candidate would be given priority, provided that she is equally qualified as a male candidate in terms of suitability, competence and professional performance *and* that there are no other factors specific to the male candidate which should tilt the balance in his favour.

9. The objective of these new procedural requirements is to achieve 40% representation of female non-executive directors (or 30% of all directors) on the boards of publicly listed companies by 2020 (or 2018 in the case of listed public undertakings). There is an exemption for small and medium-sized enterprises (SMEs) and for companies whose workforce has fewer than 10% female employees. Where national measures have already been introduced with a view to increasing the level of female representation on corporate boards, companies need not apply the new recruitment and selection procedures, but they will be required to do so from 2018/20 if they have not reached the 40% target. The draft Directive also introduces specific monitoring and reporting requirements for listed companies with a view to ensuring

that there is tangible progress towards achieving a higher proportion of executive board positions occupied by women.

10. The draft Directive requires Member States to introduce sanctions which may include administrative fines or annulment by a judicial body of the appointment or election of a non-executive director if the procedural requirements for recruitment and selection set out in national implementing measures have been infringed. It is not clear whether sanctions are intended to apply to a listed company which applies the procedural requirements but falls short of the 40% objective by 2018/20.

Subsidiarity

11. The Commission advances three reasons to justify EU action. First, it says that EU action is necessary because Member States acting individually “will not achieve sufficiently significant progress towards a more balanced gender representation on company boards by 2020 or at any point in the foreseeable future.”⁶ Taking into account current trends in Member States, the Commission estimates that the EU as a whole would not achieve 40 per cent of women on boards by 2040. The Commission highlights growing discrepancies in the approaches taken by Member States, and adds:

“Whilst Member States have the legal possibility to act in order to counter the under-representation of women in economic decision making, many of them do not show any willingness or face resistance from the business community to act at their own initiative.”⁷

12. The divergent approaches taken by Member States provide the second justification for EU action. The Commission suggests that different regulatory approaches can have a negative impact on the internal market and lead to “practical complications.” It cites, as examples, the difficulties which a listed company may encounter if it wishes to establish a subsidiary in another Member State, enter into a merger or acquisition, or bid for a public procurement contract.⁸ Lack of transparency in selection procedures and qualification criteria for board positions may deter potential candidates from exercising their free movement rights within the internal market and also affect investor decisions.⁹ Moreover, common minimum standards help to ensure “a competitive level playing field.”¹⁰ The Commission adds:

“Member States may indeed hesitate to regulate in this area on their own, as they could perceive a risk of putting their own companies at a disadvantage with companies from other Member States. This perception, reinforced by pressure from the business community, represents a major obstacle preventing Member States from taking adequate action. An EU-level initiative in this area is needed to ensure a

⁶ See p. 25 of the Commission’s Impact Assessment (ADD 1).

⁷ See p. 26 of the Commission’s Impact Assessment (ADD 1).

⁸ See recital 12, p. 17 of the draft Directive.

⁹ See recital 13, p. 17 of the draft Directive and pp. 27-28 of the Commission’s Impact Assessment (ADD 1).

¹⁰ See recital 14, p. 17 of the draft Directive.

comparable level of promotion of gender equality throughout the Union, as required by the EU Treaties.”¹¹

13. The third justification for EU action places gender equality within the broader social and economic context of the Europe 2020 Strategy. The Commission suggests that a clear commitment to gender equality is essential to remove barriers to the participation of women in the labour market and to meet the Europe 2020 headline target of a 75 per cent employment rate for men and women aged between 20 and 64 by 2020. The Commission also anticipates that enhanced participation of women at the highest levels of economic decision making will have beneficial spill-over effects for the wider economy, boosting the competitiveness of European companies and stimulating economic growth.¹² It says:

“The under-utilisation of the skills of highly qualified women constitutes a loss of economic growth potential. Fully mobilising all available human resources will be a key element in addressing the EU’s demographic challenges, competing successfully in a globalised economy and ensuring a comparative advantage vis-à-vis third countries.”¹³

14. The Commission concludes from its analysis that the objective of increasing the proportion of women on the boards of listed companies,

“can be better achieved through coordinated action at EU level rather than through national initiatives of varying scope, ambition and effectiveness.”¹⁴

Aspects of the Regulation which do not comply with the principle of subsidiarity

15. The House of Commons considers that the draft Directive of the European Parliament and of the Council on improving the gender balance among non-executive directors of companies listed on stock exchanges and related measures does not comply either with the procedural obligations imposed on the Commission by Protocol (No 2) or with the substantive principle of subsidiarity in the following respects.

i) Failure to comply with essential procedural requirements

16. By virtue of Article 5 of Protocol (No 2) “any draft legislative act should contain a detailed statement making it possible to appraise compliance with the principles of subsidiarity and proportionality”. The requirement for the detailed statement to be within the draft legislative act implies that it should be contained *in the Commission’s explanatory memorandum*, which forms part of the draft legislative act and which, importantly, is translated into all official languages of the EU. The fact that it is translated into all official languages of the EU allows the detailed statement to be appraised for compliance with subsidiarity (and proportionality) in all Member States of the EU, in conformity with Article 5 of Protocol (No 2). This is to be

¹¹ See p. 26 of the Commission’s Impact Assessment (ADD 1).

¹² See recital 15, pp. 17-18 of the draft Directive.

¹³ See p. 3 of the Commission’s explanatory memorandum.

¹⁴ See p. 28 of the Commission’s Impact Assessment (ADD 1).

contrasted with the Commission's impact assessment, which is not contained within a draft legislative act, and which is not translated into all the official languages of the EU.

17. The presumption in the Treaty on European Union¹⁵ is that decisions should be taken as closely as possible to the EU citizen. A departure from this presumption should not be taken for granted but justified with sufficient detail and clarity that EU citizens and their elected representatives can understand the qualitative and quantitative reasons leading to a conclusion that "a Union objective can be better achieved at union level", as required by Article 5 of Protocol (No 2). The onus rests on the EU institution which proposes the legislation to satisfy these requirements.

18. The Commission's explanatory memorandum and the recitals to the draft Directive do set out in some detail the justification for EU action. However, for the reasons given below, we do not consider that the Commission has provided sufficient qualitative and quantitative substantiation of the necessity for action at EU level, given that a number of Member States have already taken measures to increase the presence of women on corporate boards. This omission, the House of Commons submits, is a failure on behalf of the Commission to comply with essential procedural requirements in Article 5 of Protocol (No 2).

ii) Failure to comply with the principle of subsidiarity

19. The first limb of the subsidiarity test provides that the EU may only act "if and insofar as the objectives of the proposed action cannot be sufficiently achieved by the Member States."¹⁶

20. The Commission highlights the divergent approaches taken by Member States – with some introducing binding quotas, some setting non-binding targets, some proposing voluntary, business-led initiatives, and some taking no action at all – and suggests that progress towards more balanced gender representation on corporate boards will be too slow. The House of Commons notes, however, that many national measures have been introduced within the last year or two and considers that it is too soon to write them off as ineffective. We think that a further period of reflection and evaluation is needed to assess what does (or does not) work and how much tangible progress has been made before concluding that Member States are unwilling to act or that the measures they introduce will be ineffective.

21. The Commission cites resistance from the business community as a possible factor explaining why some Member States may be reluctant or unwilling to act, and advocates action at EU level in order to ensure "a competitive level playing field." However, much of the analysis underpinning the Commission's proposal rests on the strength of the business case for introducing more diverse boards as a means of improving corporate governance and performance. There would therefore appear to be more, rather than less, reason for Member States to take action individually to promote greater gender balance on corporate boards as a means of securing competitive advantage.

¹⁵ Article 5.

¹⁶ See Article 5(3) TEU.

22. The second limb of the subsidiarity test requires evidence that the objective of achieving gender balance on corporate boards can be better achieved, by reason of its scale or effects, by action at EU level. The Commission suggests that EU action is justified because different regulatory approaches may give rise to “practical complications” which can have a negative impact on the internal market. Examples cited include the possibility that a company with too few female directors may be excluded from public procurement contracts or may find it difficult to establish a subsidiary in another Member State. Lack of transparency in the recruitment and selection procedures for corporate board positions may also constitute a restriction on freedom of movement within the internal market and affect the basis on which investor decisions are made. Whilst we accept that these are all theoretically possible, we think that the Commission needs to establish a far stronger evidence base of problems actually encountered within the internal market before asserting that EU action is justified to reconcile divergent national approaches.

23 The Commission also suggests that increasing the participation and visibility of women in senior economic decision making positions may well have a positive spill over effect on women’s participation in the labour market and contribute to the Europe 2020 Strategy headline target on employment. It is far from clear that the European Council contemplated that legislation of this nature would be necessary or desirable to meet the headline target. Moreover, as indicated above, we think it is too soon to conclude that EU level action of the type proposed by the Commission is necessarily the only, or the best, way of achieving the headline target.

Conclusion

24. For these reasons the House of Commons considers this proposal does not comply with the principle of subsidiarity.

