Board Accountability in Europe: A Review of Director Election Practices Across the Region

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Key Takeaways

- State Street Global Advisors believes that board accountability is fundamental to strong corporate governance; annual director elections provide increased accountability and encourage board members to be more responsive to shareholder interests thereby improving board quality.
- There is still significant variation in director election terms in Western Europe which ultimately impacts board quality. Within Europe, board accountability is weakest among German companies, where directors stand for election only once every five years.
- Other European markets with weak board accountability include France, Spain, Netherlands and Belgium, where board terms are 4-year but due to staggered board elections, at least a portion of the board is up for election in any given year.
- The excessive terms of office in Germany and other European markets is a key area of focus for our Asset Stewardship Team. In our view, the problem of excessive terms of office would best be addressed at market level. Investors, companies and regulators need to work together to promote change and we aim to push for positive systemic market-wide change on this issue.

Board Accountability: Why Annual Elections Matter

Recent high profile corporate governance controversies involving some of the largest European companies have prompted us to review and compare board accountability and election systems for board directors across countries in Western Europe.

We believe that well-governed companies are better positioned to navigate challenging economic conditions while protecting shareholder interests. Therefore, we have been focusing our stewardship efforts on improving board quality in our portfolio companies. Annual director elections strengthen our ability to hold boards accountable and encourage board members to be more responsive to shareholder interests.

Board accountability is fundamental to strong corporate governance. Without an annual director election process, shareholders are limited in their ability to hold directors accountable and improve board quality. This is the case in some European countries. No matter how dissatisfied shareholders are, they have to wait several years to hold board members accountable. Changing these rules would provide shareholders with an effective mechanism to fulfil our stewardship responsibilities and improve the quality of board oversight and company performance in the long-term.

Director Terms in Western Europe

In most European countries, corporate law sets limits on the term that board members can serve before seeking re-election (board terms). These are often too long and do not meet shareholder preferences for shorter election cycles. As a response most European corporate governance codes have introduced requirements that go beyond what is required by law, imposing shorter terms of office to align with investor interests.

Our comparison of board terms reveals that Germany (with 5-year terms) followed by France, Netherlands, Spain and Belgium (all with 4-year terms), have the longest terms of office, while the UK, Ireland, Switzerland and the Nordics have the shortest (all with 1-year terms).

In Figure 1, we have compared the national corporate governance code recommendations and legal limits for the terms of office for board members for countries in Western Europe.

Our research suggests that national corporate governance codes have a strong influence and help establish best market practices with regards to director terms of office in Western Europe. For example while the legal maximum for a director's term of appointment in France and Belgium is six years, the corporate governance codes recommend that the terms be limited to four years and the vast majority of companies within these markets comply with this recommendation.

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Figure 1: Terms of Office for Board Members in Western Europe by Country

	Terms of Office (in Years)			
Country	Common Practice	Corporate Governance Code Recommendation	Legal Limit (up to)	Staggered Boards — Common Practice
United Kingdom	1	1	N/A*	No
Ireland	1	1	N/A*	No
Switzerland	1	1	1	No
Finland	1	1	1**	No
Sweden	1	1	1**	No
Norway	1	1	2**	No
Denmark	1	1	4	No
Italy	3	N/A*	3	No
Spain	4	N/A*	4	Yes
Netherlands	4	4	4	Yes
France	4	4	6	Yes
Belgium	4	4	6	Yes
Germany	5	N/A*	5	No

As of 11/30/2017.

* No recommendation or restriction provided.

** The terms of office in these countries can be extended to more than one year if provided in the company's articles of association.

Source: State Street Global Advisors — based on information that was collected from corporate governance codes and national company laws of the countries under review.

However, in Germany, Spain and Italy where the corporate governance codes are silent on board terms, the standard practice for companies is to use the maximum term permitted by law for board appointments.

We also note that staggered board elections, where only a portion of the board is up for election in any given year, are still common practice in several European countries including France, Netherlands, Belgium and Spain. Whereas in markets such as the UK, Ireland, Switzerland and the Nordics, directors are elected annually.

While our preference is for annual election cycles, in countries where board terms are long, staggered board structures are preferable as it increases board accountability by allowing shareholders to hold at least a portion of directors accountable in a year.

Here again, Germany lags its European peers as shareholders need to wait for five years before they can hold any director accountable versus being able to hold at least some directors accountable in France, Netherlands, Belgium and Spain.

Why is Germany Such an Outlier?

Our analysis, found that in Germany only two companies in the DAX 30 have terms of office for their board members of less than five years (Deutsche Börse-3-years and Henkel-4-years).

From 2002, when the first version of the German Corporate Governance Code was created, to 2008 company boards in Germany held staggered director elections with one-fifth of directors standing of elections every year. However, in 2008, the government commission in charge of the German Corporate Governance Code removed the staggered board provision from the Code citing that this provision was "rarely observed in business."[1] This was contrary to the 2007 survey[2] results from the Berlin Center of Corporate Governance that was commissioned by the Code Commission, which found that approximately half of German listed companies complied with the staggered board provision.

After the removal of the staggered board provision almost all German companies phased out staggered board terms, significantly weakening board accountability in the country. Today, shareholders in German companies have to wait for five years before they can take any action against directors and hold them accountable for poor oversight of management.

Improving Board Accountability in European Countries

In our experience, we find that the shift to annual election of directors in markets such as the US or UK has had a positive impact by encouraging board members to be more responsive to shareholder interests. Codes in some European countries such as France recommend having staggered board "so as to avoid replacement of the entire body and to favor a smooth replacement of directors." The Dutch Corporate Governance Code also recommends that terms should be staggered.

However, the majority of Western Europe now has annual board elections. Therefore, we believe investors in the outlier European countries would be better served if the terms of office for board members were limited to one year. Consequently, we strongly encourage that all European Corporate Governance Codes be amended to require annual board elections.

In Germany, we suggest a transition period where companies could choose to first shift from the current 5-year term of office to a 3-year staggered term before moving to annual elections. This would allow time for the market to adjust and help companies make a smooth transition.

Conclusion: Changing the Code is Key to Driving Positive Change

The excessive terms of office in Germany and other European markets will be a key area of focus for State Street Global Advisors' Asset Stewardship Team for the following year. In our view, the problem of excessive terms of office would best be addressed at market level. Investors, companies and regulators need to work together to promote change and we aim to push for positive systemic market-wide change on this issue. This guidance was initially published March 2018.

1 Source: German Corporate Governance Code Commission — press release — 6 June 2008.

2 Source: Berlin Center of Corporate Governance — Kodex Report 2007.

Contact Us

We hope you find this guidance useful. Any questions or comments may be directed to:

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