

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

May 2018

Key Takeaways

- State Street Global Advisors ('SSGA') 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 will be a key area of focus for SSGA's 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.

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.

SSGA believes 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.

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

Country	Terms of Office (in Years)			
	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: SSGA — 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 survey² 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 SSGA's 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.

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

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

ssga.com

Marketing communication.

State Street Global Advisors Worldwide Entities

Australia: State Street Global Advisors, Australia, Limited (ABN 42 003 914 225) is the holder of an Australian Financial Services Licence (AFSL Number 238276). Registered office: Level 17, 420 George Street, Sydney, NSW 2000, Australia. T: +612 9240 7600. F: +612 9240 7611. **Belgium:** State Street Global Advisors Belgium, Chaussée de La Hulpe 120, 1000 Brussels, Belgium. T: 32 2 663 2036. F: 32 2 672 2077. SSGA Belgium is a branch office of State Street Global Advisors Limited. State Street Global Advisors Limited is authorized and regulated by the Financial Conduct Authority in the United Kingdom. **Canada:** State Street Global Advisors, Ltd., 770 Sherbrooke Street West, Suite 1200 Montreal, Quebec, H3A 1G1, T: +514 282 2400 and 30 Adelaide Street East Suite 500, Toronto, Ontario M5C 3G6. T: +647 775 5900. **Dubai:** State Street Bank and Trust Company (Representative Office), Boulevard Plaza 1, 17th Floor, Office 1703 Near Dubai Mall & Burj Khalifa, P.O Box 26838, Dubai, United Arab Emirates. T: +971 (0)4 4372800. F: +971 (0)4 4372818. **France:** State Street Global Advisors Ireland Limited, Paris branch is a branch of State Street Global Advisors Ireland Limited, registered in Ireland with company number 145221, authorized and regulated by the Central Bank of Ireland, and whose registered office is at 78 Sir John Rogerson's Quay, Dublin 2. State Street Global Advisors Ireland Limited, Paris Branch, is registered in France with company number RCS Nanterre 832 734 602 and whose office is at Immeuble Défense Plaza, 23-25 rue Delarivière-Lefoullon, 92064 Paris La Défense Cedex, France. T: (+33) 1 44 45 40 00. F: (+33) 1 44 45 41 92. **Germany:** State Street Global Advisors GmbH, Brienner Strasse 59, D-80333 Munich. Authorized and regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht ("BaFin"). Registered with the Register of Commerce Munich HRB 121381. T: +49 (0)89 55878 400. F: +49 (0)89 55878 440. **Hong Kong:** State Street Global Advisors Asia Limited, 68/F, Two International Finance Centre, 8 Finance Street, Central, Hong Kong. T: +852 2103 0288. F: +852 2103 0200. **Ireland:** State Street Global Advisors Ireland Limited is regulated by the Central Bank of Ireland. Registered office address 78 Sir John Rogerson's Quay, Dublin 2. Registered number 145221. T: +353 (0)1 776 3000. F: +353 (0)1 776 3300. **Italy:** State Street Global Advisors Limited, Milan Branch (Sede Secondaria di Milano) is a branch of State Street Global Advisors Limited, a company registered in the UK, authorized and regulated by the Financial Conduct Authority (FCA), with a capital of GBP 62,350,000, and whose registered office is at 20 Churchill Place, London E14 5HJ. State Street Global Advisors Limited, Milan Branch (Sede Secondaria di Milano), is registered in Italy with company number 06353340968 - R.E.A. 1887090 and VAT number 06353340968 and whose office is at Via dei Bossi, 4 - 20121 Milano, Italy. T: 39 02 32066 100. F: 39 02 32066 155. **Japan:** State Street Global Advisors (Japan) Co., Ltd., Toranomon Hills Mori Tower 25F 1-23-1 Toranomon, Minato-ku, Tokyo 105-6325 Japan. T: +81-3-4530-7380 Financial Instruments Business Operator,

Contact Us

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

Philip Vernardis, *Assistant Vice President, Asset Stewardship* — Philip_Vernardis@ssga.com

Robert Walker, *Managing Director, Head of EMEA Asset Stewardship* — Robert_Walker@ssga.com

Rakhi Kumar, *Senior Managing Director, Head of ESG Investments and Asset Stewardship* — Rakhi_Kumar@ssga.com

Kanto Local Financial Bureau (Kinsho #345), Membership: Japan Investment Advisers Association, The Investment Trust Association, Japan, Japan Securities Dealers' Association. **Netherlands:** State Street Global Advisors Netherlands, Apollo Building, 7th floor Herikerbergweg 29 1101 CN Amsterdam, Netherlands. T: 31 20 7181701. SSGA Netherlands is a branch office of State Street Global Advisors Limited. State Street Global Advisors Limited is authorized and regulated by the Financial Conduct Authority in the United Kingdom. **Singapore:** State Street Global Advisors Singapore Limited, 168, Robinson Road, #33-01 Capital Tower, Singapore 068912 (Company Reg. No: 200002719D, regulated by the Monetary Authority of Singapore). T: +65 6826 7555. F: +65 6826 7501. **Switzerland:** State Street Global Advisors AG, Beethovenstr. 19, CH-8027 Zurich. Authorized and regulated by the Eidgenössische Finanzmarktaufsicht ("FINMA"). Registered with the Register of Commerce Zurich CHE-105.078.458. T: +41 (0)44 245 70 00. F: +41 (0)44 245 70 16. **United Kingdom:** State Street Global Advisors Limited. Authorized and regulated by the Financial Conduct Authority. Registered in England. Registered No. 2509928. VAT No. 5776591 81. Registered office: 20 Churchill Place, Canary Wharf, London, E14 5HJ. T: 020 3395 6000. F: 020 3395 6350. **United States:** State Street Global Advisors, One Lincoln Street, Boston, MA 02111-2900. T: +1 617 786 3000.

This document contains certain statements that may be deemed forward-looking statements. Please note that any such statements are not guarantees of any future performance and actual results or developments may differ materially from those projected.

The information provided does not constitute investment advice and it should not be relied on as such. It should not be considered a solicitation to buy or an offer to sell a security. It does not take into account any investor's particular investment objectives, strategies, tax status or investment horizon. You should consult your tax and financial advisor. All material has been obtained from sources believed to be reliable. There is no representation or warranty as to the accuracy of the information and State Street shall have no liability for decisions based on such information.

All information has been obtained from sources believed to be reliable, but its accuracy is not guaranteed.

There is no representation or warranty as to the current accuracy, reliability or completeness of, nor liability for, decisions based on such information and it should not be relied on as such.

The whole or any part of this work may not be reproduced, copied or transmitted or any of its contents disclosed to third parties without SSGA's express written consent.

The trademarks and service marks referenced herein are the property of their respective owners. Third party data providers make no warranties or representations of any kind relating to the accuracy, completeness or timeliness of the data and have no liability for damages of any kind relating to the use of such data.