Addressing the Need for Board Refreshment and Director Succession in Investee Companies

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Analysis

State Street Global Advisors (SSGA) believes that board refreshment and planning for director succession are key functions of the board. Some markets such as the UK, have adopted best practices on a comply-or-explain basis that aim to limit a director's tenure to nine years of board service, beyond which, investors may question a director's independence from management. Such best practices have helped lower average board tenure, and have encouraged boards to focus on refreshment of director skills and plan for director succession in an orderly manner.

Based on SSGA's analysis of 2013 data, the average board tenure across 1,300 UK listed companies was approximately 6.4 years. In comparison, the average board tenure across 5,600 US listed company board was 8.6 years. As a result, only 6% of UK companies, compared to 20% of US companies, had directors with tenure of 12 years or more. A comparison of average board tenure across countries in Western Europe revealed that Spain (7.7 years) and France (7.4 years) had the longest average tenured boards while German boards (5 years) had the shortest average tenure in the region. The European Commission has recommended a 12 year director tenure as a best practice for EU based companies. We anticipate that average board tenure in EU companies will fall over the coming years. An analysis of average board tenure by market is provided in Figure 1.

SSGA's Policy on Director Tenure

Given the broad range of average tenure in different regions, in 2014, SSGA is evaluating board refreshment and director succession practices at its investee companies through a new director tenure policy. SSGA's policy is designed to identify companies with a preponderance of long-tenured directors, which may indicate a lack of refreshment of skills and perspectives on the board. It may also limit a board's ability to bring on new directors with relevant expertise without increasing the board size. In addition, SSGA believes that long tenure may also diminish a director's independence.

Our policy supports the presence of long-tenured directors in roles appropriate to their status. We do not consider long-tenured directors as ineffective to serve on a board though we discourage their presence on key board committees where independence is considered paramount. The policy is also designed to encourage boards with predominately long-tenured directors to better address director succession planning.

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Figure 1: Analysis of Average Tenure by Country

Country	Number of Profiled Companies	Average Director Tenure	% of Companies with Average Tenure Above 9 years	% of Companies with Average Tenure Above 12 years	% of Companies with Average Tenure Above 15 years
USA	5,641	8.6	39.4	19.7	8.3
United Kingdom	1,304	6.4	18.3	6.1	2.4
France	249	7.4	29.3	13.3	5.2
Germany	162	5.0	6.8	1.9	0.0
Sweden	139	6.0	15.1	4.3	0.7
Switzerland	129	6.7	17.1	7.0	3.1
Italy	96	5.6	11.5	5.2	3.1
Netherlands	90	5.2	4.4	2.2	1.1
Spain	87	7.7	28.7	9.2	3.4
Norway	72	5.1	9.7	5.6	4.2
Finland	64	5.6	9.4	4.7	3.1
Belgium	54	7.0	24.1	11.1	0.0
Denmark	51	6.2	21.6	5.9	2.0
Luxembourg	29	5.7	13.8	6.9	3.4
Austria	26	6.6	15.4	7.7	0.0
Portugal	20	5.8	15.0	10.0	5.0

Source: ISS Proxy Advisory Services.

Figure 2: SSGA's Director Tenure Screen for US and UK Markets

Questions	
Screen One	Is the average board tenure above one standard deviation from the average market tenure?
Screen Two	Do one-third of non-executive directors have tenures in excess of two standard deviations from the average market tenure?
Screen Three	Is the board classified?

Source: SSGA.

SSGA's director tenure policy in the US and UK is multi-layered and takes into consideration the *average market-level board tenure*. Companies are screened on three criteria—average board tenure, preponderance of very long-tenured non-executive directors and classified board structures. Companies are considered to have excessive average board tenures if they exceed one standard deviation above the *average market-level board tenure*. Directors are considered to have long-tenures if their tenure is in excess of two standard deviations above the *average market-level board tenure*. Initially, companies are screened on their average board tenure. Companies with long-average board tenures are then further screened for a preponderance of non-executive directors that have long-tenures; and classified board structures[1] (see Figure 2).

SSGA's tenure policy for companies domiciled in Western European markets classifies directors as non-independent based on the recommendations of the European Commission.

Through its Policy SSGA Expects

1. The chairman of the nominations/governance committee to periodically review the skills and expertise on the board in the context of the company's long-term strategy and to plan for an orderly director retirement/succession process.
2. Long-tenured directors to refrain from serving on the audit, compensation and nomination/governance committees on boards of companies with high average director tenure.
3. Companies to declassify their boards and adopt an annual election cycle.

SSGA has provided guidance questions for directors reviewing board refreshment and director succession practices on company boards in Appendix A.

Actions Taken by SSGA Based on This Policy May Include

Proactively engaging with the chairman of the nominating committee to outline our expectations with respect to tenure and succession and encourage a more progressive approach to board refreshment. SSGA will encourage boards to consider diversity where this will strengthen the board's ability to lead and oversee the company.

The policy may also translate into the following potential voting decisions:

- Voting against ONLY the chairperson of the nominating/governance committee for failing to adequately address board refreshment and director succession at the company;
- Voting against ONLY those long-tenured directors that serve on key committees; OR
- Voting against members of the nominating/governance committee AND long-tenured directors serving on classified boards.

Any questions or comments regarding this policy may be directed to Rakhi Kumar, Head of Corporate Governance, SSGA at Rakhi_Kumar@ssga.com.

[1] Companies that have a classified board structure are held to a higher standard as we believe a classified board structures may further limit the ability for board refreshment.

Appendix A: Suggested Questions for Directors Reviewing Board Refreshment and Director Succession Practices on Company Boards

- Does the board have a process in place that requires it to evaluate its performance and the performance of directors on a periodic basis?
  - How are the results of such an evaluation discussed with the board and individual directors?
  - What actions can the board take to remediate some of the weaknesses (if any) identified through the evaluation process?
- Does the board assess the expertise and skills among its directors that are desirable or needed in the context of the company's long-term strategy and risks facing the business?
  - Does the process help identify gaps in expertise and skills?
  - How does the board address the need for such skills within its director training and succession planning process?
- The ideal composition of a board, in terms of director tenure, would be a third new-tenured, a third mid-tenured and a third long-tenured directors. A board composition of this nature would allow the company to leverage the experience and institutional knowledge of longer tenured directors while limiting the downside risk of high director turnover within a short period.
  - How does the company's board tenure profile compare to this ideal?
  - Does the company have a preponderance of long-tenured directors?
- Does the company have processes in place that helps identify upcoming director turnover?
  - How far ahead does the board identify the pool of potential directors?
  - How long does the evaluation, recruitment and on-boarding process for new board members take to ensure smooth director transition?

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