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Proxy Advisors Seeking More Than "Male, Pale & Stale" Directors

New report finds a desire for more diversity, communication and integrity

By Eve Tahmincioglu

If proxy advisors – the firms that provide public company research and guidance to large investors – were writing a personal ad for the perfect board director it would probably go a bit like this:

<u>Looking for diverse director with integrity who enjoys face-to-face communication with investors.</u>

At least that's the finding of a new The Conference Board's Governance Center report, *Just What is the Corporate Director's Job?*, to be released later this week. *Directors & Boards* received an advance copy.

The report was gleaned from a The Conference Board roundtable earlier this year of more than 50 proxy advisors, including two of the largest, Institutional Shareholder Services (ISS) and Glass Lewis, & Co. Such firms are often the bane of corporate management because they often influence voting by major shareholders, including on issues of pay for top executives and director appointments.

"Today, as companies face a high risk of crises, the competency and composition of their boards have been called into question by key stakeholders," says Gary Larkin, report author and research associate at The Conference Board. "They were asking, 'Where was the board? What did they know?' So we thought it was time to ask the stakeholders what it is they think boards should do and what they are not doing."

(Related article: Dismantling the Silicon Boys Network.)

While the advisors had a host of must-haves for their perfect director, the group did find consensus when it came to two issues – diversity and communication:

• Many U.S. boards are “male, stale and pale.” The average director tenure of Standard & Poor’s 500 index boards in 2016 was seven years for white male directors versus six years for minorities and five years for women. The average age for those same boards in 2016 was 62.8 for white males, 60.8 for minorities and 60.2 for females.

• Proxy advisors agreed that a company’s engagement with shareholders is now trending toward more in-person meetings that include board members. Until recently, shareholder engagement only included proxy voting, proxy fights and shareholder lawsuits. Now companies and investors are communicating about a whole litany of governance-related topics.

Why is diversity important to proxy advisors?

“They are concerned that such directors used to doing business the way it was 30 years ago are not capable enough to carry out their jobs in today’s more dynamic and technologically-driven world,” Larkin explains. “Also, they believe boards looking to operate in a place like China need younger and more global directors to understand business needs.

But, he stresses, that doesn’t mean “all proxy advisors believe that all older white male directors need to be replaced. Many acknowledge the valuable institutional knowledge of such directors.”

Even though advisors are concerned with board policies regarding age, tenure and refreshment rate, there was little agreement on how to change director composition.

“The solutions ran the gamut from term limits and mandatory retirement age to improved board evaluations and succession planning,” according to the report. “There was little discussion about how these structural items relate to the job description/expectations of a public company director.”

During the roundtable General Electric Co. was held up as a model for board refreshment. The overview below was included in the report.

GE's board uses a combination of tenure limits, retirement age, and annual board evaluations in its board refreshment process.

Here is an excerpt from GE's governance principles, which were updated in 2016:

HOW WE REFRESH THE BOARD

Tenure limits

The board has a 15-year tenure limit for independent directors (with a 2-year transition period for existing directors).

Age limits

With limited exceptions, directors may not be renominated to the board after their 75th birthday.

Board evaluation

Each year, the board assesses its effectiveness through a process led by its lead director.

Source: Governance Principles, GE, February 26, 2016.

As for more communication, Larkin points out that ISS and Glass Lewis "have developed voting recommendation policies that advocate for companies to adopt shareholder engagement policies and respond to shareholder concerns when a proposal vote carries more than 25%. The call for more engagement has come about due to the increase in shareholder proposals to effect environmental, social and governance changes."

"This trend," he continues, "is also driven by the continuing number of governance failures even after the financial crisis."

(Related article: Is the "Fearless Girl" Crying?)

The group in the Center's report also discussed company failures and corporate governance. A representative from one proxy advisory firm who studied 10 recent company crises offered his insights. Some common director attributes at troubled firms such as Wells Fargo, he found, included "high levels of insider control of the board, relatively short tenure, and poor communication and public disclosure during crisis."

His conclusion: "Board behavior is attributable to basic personal character, integrity and leadership qualities." It would have helped the 10 companies, he noted, if they had "interviewed director candidates with a broad background and those who might have had experience dealing with domineering CEOs."

(Related article: Functional Diversity, Not Just Diversity.)

So will companies listen to proxy advisors when it comes to director resumes?

“Companies pay heed to those proxy voting recommendations mainly because they know a large number of large institutional investors rely on the proxy advisor research and recommendations,” maintains Larkin. “While many company boards and management may not agree with how proxy advisors operate, they do acknowledge their influence and power.”