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Strengthening the role of Lead Independent Directors: an essential counterbalance to boardroom imperialism

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Plenary 3: Strengthening the role of Lead Independent Directors: an essential counterbalance to boardroom imperialism
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Pedro Navarro Martínez, Senior Independent Director, Renta4 Banco, Spain

George Dallas, Policy Director, ICGN, UK
The subject of this plenary discussion is ‘Strengthening the Role of Lead Independent Directors’. I’m sure everybody here in this room has read, the ICGN Global Governance Principles. There are two salient positions for this discussion. Firstly, ICGN encourages a separation of the CEO/chair role – it doesn’t mandate it in all cases, but it encourages it. As a corollary, ICGN recognises there are many cases in which the CEO and the chair may be a combined role, and this is something that might call for a lead independent director to balance things out. So the Principles advocate the presence of a lead independent director to complement the board and to provide another voice.

Pedro Navarro Martínez, Senior Independent Director, Renta4 Banco:
We have a new law in Spain on the subject of corporate governance as well as a new set of recommendations on the subject issued by the Spanish Securities Commission, (Comisión Nacional del Mercado de Valores).

The laws and the recommendations state that when a listed company’s chairman and CEO are the same person, there is an obligation to elect a lead independent director. The executive directors cannot participate in this election – only the independent directors. The lead independent director is responsible for giving voice to the concerns of independent directors as a whole. He is also responsible for relations with shareholders on matters of corporate governance, and defining and planning the chairman’s succession.

There are no recommendations from the Spanish SCC on the subject of separating positions of chairman and CEO. However, there is a major exception to that as Central Bank of Spain (Banco de España) has ruled that all banks in Spain have to separate the positions of CEO and chair as per the regulations at the European level.

What is going to happen in Spain with the role of the lead independent director in practical terms? We don’t know yet. Companies are just starting to understand them; it’s too early to know what’s going to happen.

Is it going to improve governance in Spain? Yes, in many cases, but it depends on the independent directors. Let me share with you my personal definition of ‘independent director’. Rule number one is that he or she must be able to maintain the same standard of living if she or he resigns from the board. The second rule is that the board member must not have a personal problem in arguing or voting against the chairman’s proposals. He or she should not a personal friend or owe any favours to the chairman and so on. As long as the directors who are truly independent the collective wisdom of the board will elect the best lead independent director to improve the quality of board governance.

This is not the only way. I am on the board of another IBEX 35 company where there is no lead independent director. We haven’t even discussed naming a lead independent director. We don’t have to because we have a chairman and a CEO instead. We have six independent directors, two directors representing ownership and one executive director – the CEO. The independent directors were all recruited.
professionally. That means they had not had any prior, personal contact with the chairman or with the CEO. They were totally unknown to the company.

This board works exceedingly well without a lead independent director. Sometimes the independent directors meet to discuss company matters, but we didn’t need a lead independent director to do this. Four of the six independent directors are women. I believe that women, generally speaking of course, make excellent independent directors because they are more outspoken than men.

**Lars-Erik Forsgardh, Chairman, ecoDa:**

I will give you a European perspective on this as chairman of ecoDa.

As you probably know, there are many board and management models in Europe. This being said, this new Spanish Corporate Governance model, is a unique model. ecoDa recently performed a study of board and management models in our 15 member countries. We found 20 board models in 15 countries.

Out of these 20 models, we have seven two-tier models, and 13 one-tier models. In Germany and Poland, there are only two-tier models; in five other countries, we have both models. The two-tier model is straightforward, with a supervisory board, consisting of non-executive people and a management board consisting of executive people. You can’t be a member of both boards at the same time. There is a separation between management power and strategic power. Of course, the CEO can’t be the chairman in the two-tier model – that’s impossible.

We also have two-tier models in France, though the one-tier model is predominant there. We also have two-tier boards in Luxembourg, in the Netherlands, Croatia and Macedonia, with the one-tier model as well. Eight countries solely use the one-tier model: Belgium, Finland, Denmark, Italy, Norway, Sweden, the UK and Spain.

Four countries in this latter group are from the Nordic part of Europe. In three of those four countries, it’s forbidden by law for the CEO to also be the chairman. The governance code of the fourth Nordic country, Finland, does not recommend it either.

It’s also characteristic of the Nordic countries that hardly any executives are members of the board. Only the CEO can be a member of the board in the Nordic companies. That is different to the situation in Belgium, Italy, UK and Spain, where you have a mix of executives and non-executives on the board. That’s also the situation in France, Luxembourg and the Netherlands.

With the addition of Spain, we now have three countries in Europe that recommend a lead, senior or co-ordinating independent director. Even the names are different! The Nordic countries, have something similar to the lead independent director: at least, the functions are pretty much the same. Most Nordic appoint a vice chairman or deputy chairman with the same responsibilities as the lead independent director.

On top of all these board models in Europe, we have the ICGN recommendation to separate the roles of the CEO and the chairman. This is the situation in Belgium, UK, Italy and in the Netherlands. In many other countries – like Spain, France, Luxembourg and so on – there is no recommendation to separate the roles.

At the same time, ICGN says ‘if you have a combined CEO and chairman, you should have a lead independent director.” The same recommendation comes from the Global Network of Directors Institutes (GNDI), so there are two global organisations making the same recommendation.
The European Commission has been very interested in this subject too. In 2005, it presented proposals to introduce rules and safeguards if a company choose to combine the roles of the CEO and the chairman. It fought for this proposal for a time, but they were turned down by the member countries due to the variety of models in Europe. ecoDa’s position is that, given the different conditions, it’s unrealistic to legislate in this area: but, given the important role of the chair, ecoDa stresses the importance of having a distinct delineation between the responsibilities of the board and management. If the chairman of the board is an executive, there should be a lead independent director. We have pretty much, the same recommendation as ICGN and GNDI in this respect.

To summarise, there is a tendency towards a one-tier model and a tendency to separate the roles of CEO and chairman. If you haven’t done that, maybe the lead independent director is a way to avoid all the risks of having the same person in the position of CEO and chairman.

George Dallas:
One point worth making, is that the Spanish Code is very careful in establishing a position of neutrality vis-à-vis the combined chair/CEO role on the basis that there really is no firm evidence that this produces good or bad results or outcomes. So it’s taking a position, but it also is recognising the evidence base is fairly limited.

Jonathan Feigelson, Senior Managing Director, General Counsel and Head of Corporate Governance, TIAA-CREF:
First of all, I’ll tell you TIAA’s official position in our policy statement on corporate governance. We prefer a split between the chairman and the CEO but it’s not required if you can disclose the reasons why you have chosen not to. That works for us.

The more important question is about the quality of the board overall. That’s where we believe the focus should be, not on whether or not you have a lead independent director or whether the chairman/CEO roles are split. That’s where you get the best value and oversight of a company – when all of your directors are committed, knowledgeable, outspoken and willing to state their views without fear of repercussion.

With that in mind, there are certain things that we do feel it’s important that independent directors have authority over, including succession planning, board evaluations, annual appraisals and engagement strategy. When I say engagement strategy, I mean the board’s engagement strategy with shareholders as opposed to the other way round. If you have those responsibilities, either embedded in one lead independent director or spread out amongst other directors, you usually will end up with a reasonable balance of power and therefore a better-run and more transparent company.

You probably know that in the US, post-Enron and other scandals, the balance tipped very dramatically in favour of independent directors generally. The boards of all companies, are virtually entirely independent – save the CEO – but it’s not the case all the time. Is independence a good thing? Is too much independence not in the interests’ of shareholders because you don’t necessarily have the knowledge base that you would want in a director to effectively oversee the company. Again, the answer here is yes and no. I think you certainly want at least one or two directors who have specific expertise in the industry that the company is engaged in. But if you have a board of ten experts in the industry, none of them ever show up to meetings, none of them ever prepare and none of them ever speak their mind, it’s not really going to be that helpful that they happen to be experts. We put our stock behind the
commitment and outspokenness of the directors, and not necessarily whether they have expertise and diversity.

To give you a personal example from the TIAA board, we have a Professor of Demographics from Princeton University. Clearly, we’re not a demographics company – it really doesn’t pertain to anything that we do – but this particular director is brilliant, devoted, committed and very outspoken. She has taken the time to learn the company’s business and has no concern or fear about expressing her views when they differ from the chair or the rest of the board. That’s what we look for in our directors. I think it’s incumbent upon all of us as investors to ensure that we have boards that are fully committed, whether they’re independent or not.

**Pedro Navarro:**
Listening to Jonathan is very interesting. I fully agree that the independence of the board directors, is the critical factor in having an effective board. If every board member is very independent and acts as such, then the role of the lead independent director becomes less important. I’m not saying that it doesn’t help, but it’s less important.

I think I am the only lead independent director in this panel, and one of the few in Spain. Has my life changed at board level since becoming lead independent director? I have to say yes and no. No in general terms; yes in the sense that other independent directors come to me and say: ‘Listen, Pedro, you should tell the chairman, so and so and so’. Or: ‘You should ask for so and so for the board meeting’. At the beginning, I used to ask ‘why don’t you say that at the board meeting or ask directly’? The answer is: ‘No, you are the lead independent director, so it’s your role’. So I am in favour of the lead independent director role.

The culture in the Latin countries also plays an important role. In Spain, Italy and France in particular, the chairman’s title is interesting. It is Presidente in Spanish and Italian, and it’s Président-Directeur Général in French – which means everything, it’s chairman and CEO and general manager. The culture is that the person who is at the top of the company, has full power and maximum authority; nobody argues with that level of authority. Even today, many people recognise the names of the chairmen of the large corporations in Spain and usually those corporations also have a CEO. However, few people recognise the name of the CEO.

The CEO is perceived more like a powerful general manager, not a like a US-style CEO – more in charge of the day-to-day operations, but not so critical to the medium-term and long-term strategy or shareholder relations. Having said that, we in Spain generally accept that the US model or the model of separating chairman and the CEO produces better governance and that we should move towards it.

If you read the law or the recommendations from the SCC, not everybody agrees on that because they were not even capable of providing a recommendation in favour or against one or the other model. But, personally, I believe that the model of separating chairman and CEO produces better governance and that we should move towards it.

Will we get there? Probably, yes but not in the short or medium term. We have another problem when we reach that point, in that the ambitions for a CEO is to become the chairma, either of that company or another one. As long as CEOs expect that as the next career move, that means that they’re going to behave as an executive chairman and the model is not going to change.

**Jonathan Feigelson:**
Pedro, I’d like to comment on your remark about some of your co-directors coming to you and feeding to you their concerns and asking you to express them on behalf of
the rest of the board. More generally and philosophically, that is one of the potential, unintended consequences of having a lead independent director. There can be the tendency to turn over all controversial viewpoints and expressions of disagreement with the chairman to the lead. That's why I said that the focus really should be on the quality of every director, lead or not. I you've got a terrific lead independent director, but nobody else is going to say what they think, that's not a great situation to end up in either.

George Dallas:
One dimension of the lead or senior independent director position, at least in the UK, is that they often play role with investors. Now that we are dealing with Stewardship Codes and investors are being encouraged to engage with company directors, having some point of board access is important. Shareholders have the right to elect directors and having a dialogue with the board is an important dimension of this. How do you see the role shaping up vis-à-vis the internal balance of power dynamics versus the need for directors to be more externally facing towards shareholders?

Lars-Erik Forsgardh:
I don't think there is a simple answer on all these questions and I don't think there is one single best corporate governance model either. I think it depends on the people who are elected to the board. The board selection process is critical. It may be the most critical part of shaping a good board, regardless, of whether you have executives or non-executives or independent or non-independent directors on the board.

It all depends on the circumstances, on the development stage of the company, and on the industry or type of industry the company is representing. You also have differences because of country size and differences because of the evolution of the capital market in respective countries. The reason why we have all these types of models in Europe, and the differences between the US and UK and the other Anglo-American countries, depends on the fact that every country has developed its own model after the circumstances prevailing in each country. Each country has done their best to find a model that works for that country and the type of companies they have there.

George Dallas:
Europe is a jurisdiction where there are many different forms of ownership structure – concentrated and also widely held. Would a Lead Director arguably have a more important role to play if there is a controlling shareholder – for example, to make sure that there is an alignment of interest between the controlling shareholders or minorities?

Lars-Erik Forsgardh:
A lead or senior independent director could have a more important role in a board where the owners are the chairman or other members of the board. In Europe, and especially in Central Europe and in the Nordic countries, we don't have a dispersed ownership structure. On the contrary, we have a very concentrated ownership structure. That's also why there are different corporate governance models in the Nordic countries or in Germany when compared to the Anglo-Saxon models.

Pedro Navarro:
With respect to the lead independent director or even the independent directors, I have mixed feelings about taking that relationship role with the investors.

I have interacted with investors sometimes as the chairman of a remuneration committee, because the investors in that company were not happy with our system of
remunerating the executive member of the board. The chairman, the secretary of the board and the CEO told me it was my ‘baby’ because I was the chairman of the remuneration committee, we designed the system, so I had to go and convince them. I went and I convinced some; some others I didn’t convince at all. Still, I think it was healthy for the company to present the face of an independent director who was directly responsible for that remuneration scheme, whether they liked it or not. I think it helped in the relationship with investors.

At the same time, if independent directors go to talk to investors, we lose the tremendous value of having a single voice in the market. When you have more people talking to investors, you lose control over your messages to the market.

Questions from the audience

Teresa Maria Alarco Tamayo, Director, Esade Business School:
Do you recommend having a lead independent director in a smaller company?

Lars-Erik Forsgardh:
It all depends on a number of factors – I couldn’t say or no. You have to look at the conditions, the reasons for and against having a lead independent director and see what’s best for the company.

Jonathan Feigelson:
I agree. I would analyse what result will produce the most differences of opinion that will be expressed by the board. If that is with a lead independent director, then you should have a lead and if it’s not, then you shouldn’t.

Lars-Erik Forsgardh:
It also depends on the number of board members. If you only have four or five or six people on the board, I don’t see any reason to have a lead independent director.

George Dallas:
Something you may want to look at, Teresa, is the UK Quoted Companies Alliance, which looks at corporate governance through the lens of small and medium sized enterprises. Its broad philosophy is that there has to be a sense of proportionality, and we don’t necessarily want to impose unduly complex systems on small companies.