

# DIRECTOR NOMINATION PROCESS: DISCUSSION PAPER\*

PART II:  
RESEARCH ON GOOD PRACTICES ACROSS SEVEN MARKETS



# THE SIX PRINCIPLES

- 1** We will incorporate ESG issues into investment analysis and decision-making processes.
- 2** **We will be active owners and incorporate ESG issues into our ownership policies and practices.**
- 3** **We will seek appropriate disclosure on ESG issues by the entities in which we invest.**
- 4** We will promote acceptance and implementation of the Principles within the investment industry.
- 5** **We will work together to enhance our effectiveness in implementing the Principles.**
- 6** We will each report on our activities and progress towards implementing the Principles.



This report focuses on supporting signatories implement Principles 2, 3 and 5 of the Principles for Responsible Investment (PRI). The Principles for Responsible Investment (PRI) Initiative was launched by the United Nations in 2006 after former UN Secretary-General Kofi Annan brought together a group of the world's largest institutional investors, academics and other advisors to draft a set of sustainable investment principles. At the heart of the six Principles for Responsible Investment is the premise that investors have a duty to act in the best long-term interests of their beneficiaries; this means taking into account environmental, social and governance factors.

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***Please note that additional information and background to the project can be found in the Discussion paper/Part I, along with an engagement framework for the director nomination process. Part I is available on the PRI website at <http://www.unpri.org/publications/>***

## MARKET RESEARCH

The second part of the discussion paper on the director nomination process includes, authored by members of a PRI investor steering committee (SC) members,<sup>1</sup> includes detailed reviews of the nomination process in seven national jurisdictions: Australia, Canada, France, Italy, Sweden, the United Kingdom and the United States.

Each market's approach is illustrated in a dedicated chapter through a basic overview, a case study example and a list of good practice recommendations. Information included in this document is based on materials available in 2013 unless indicated otherwise.

Under each chapter the *market overview* outlines any local regulations, listing rules and best practice recommendations that reference the director nomination process. It also covers individual market characteristics that influence corporate governance to provide relevant context.

The market overview is supplemented by a *company case study*. These examples are generally from companies that demonstrate good practices on director nominations within their local market; where appropriate, areas for improvement have also been identified.

Finally, each chapter concludes with a list of *good practice recommendations* that investors could use in their engagement dialogue with companies. The purpose of these recommendations is to promote a standard of good practice that takes into account at the same time existing state of play, realistic expectations for the market and globally accepted standards of corporate governance.

The good practice recommendations formed the basis for the development of a list of indicators employed to benchmark company practices in two of the markets covered in the paper: the US and France.<sup>2</sup>

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<sup>1</sup> Director nominations SC members: Chris Anker, Church of England; Anne Kirkeby, previously with Governance for Owners; Bram Hendriks, ING Investment Management; Zineb Bennani & Stephanie Roussillon, Mirova; Kimberly Ryan, Nelson Capital Management; Ian Quigley, Qube Investment Management; Tim Bolton Carter, Rathbone Brothers plc; Frank Curtiss, RPMI Railpen.

<sup>2</sup> For more information on the research please see the new PRI publication Director nomination process: research on company disclosure and practices in the US and France available at <http://www.unpri.org/publications/>

# 1. AUSTRALIA

*Chris Anker, Church of England*

## 1.1 MARKET OVERVIEW

The boards of listed companies in Australia are unitary, comprising both executives and non-executives. On the whole, the equity market is well diversified and shareholders tend not to have highly concentrated positions.

A variety of guidance and support for directors has been issued on nomination related matters, issued by such organisations as The Australian Institute of Company Directors<sup>3</sup> and the Australian Shareholders Association.<sup>4</sup> However, the three key source documents that drive corporate governance and the practice that applies to the director appointment/nomination process are:

- the Corporations Act 2001<sup>5</sup> as amended, which provides the legal basis for directors to be appointed, although it does not mandate listed companies to establish nomination committees;
- the ASX Corporate Governance Council's Best Practice Recommendations<sup>6</sup> (CGCBPR) last revised in March 2014, which are applied on a 'comply or explain' basis, and
- the Guidance Note No. 2.00 "Corporate Governance: A Guide for Fund Managers and Corporations"<sup>7</sup> issued in 2009 by the Institute for Investment and Financial Services Association (since renamed as the Financial Services Council).

Principle 2 of the CGCBPR states that "a listed entity should have a board of an appropriate size, composition, skills and commitment to enable it to discharge its duties effectively." In the associated commentary, it is recommended that a company's board is of "sufficient size so that the requirements of the business can be met and changes to the composition of the board and its committees can be managed without undue disruption. However, it should not be so large as to be unwieldy."

Recommendation 2.1 of the CGCBPR suggests that boards should create nomination committees for the purpose of making recommendations regarding:

- the necessary and desirable competencies of directors;
- the appointment and re-election of directors;
- the process used to evaluate the performance of the board, its committees and directors;
- the continued suitability of board and CEO succession plans.

To ensure it operates effectively, the nomination committee itself is recommended:

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<sup>3</sup> <http://www.companydirectors.com.au>

<sup>4</sup> <http://australiashareholders.com.au>

<sup>5</sup> <http://www.comlaw.gov.au/Details/C2014C00519>

<sup>6</sup> <http://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-3rd-edn.pdf>

<sup>7</sup> [http://www.fsc.org.au/downloads/file/IFSAGuidanceNotes/2GN\\_2\\_Corporate\\_Governance\\_2009.pdf](http://www.fsc.org.au/downloads/file/IFSAGuidanceNotes/2GN_2_Corporate_Governance_2009.pdf)

- to develop a charter formalising the committee's role and responsibilities;
- to be formed of a minimum of three directors with the majority being independent, one of whom should chair the committee.

Amongst other recommendations, the CGCBPR also encourage boards and nomination committees:

- to be transparent about the processes adopted when searching for and appointing directors - e.g. the use of professional intermediaries (i.e. recruitment specialists), the use of a board skills matrix to identify skills gaps,<sup>8</sup> and the steps taken to ensure diversity in the range of candidates;<sup>9</sup>
- to regularly review the extent to which directors can demonstrate they have an appropriate mix of skills, knowledge, experience, independence and diversity on the board, and to provide for the continuing professional development of directors;<sup>10</sup>
- to review regularly the time required from a non-executive director, and whether non-executive directors are meeting that requirement;
- to provide sufficient information to shareholders allowing them to make an informed decision on director elections (e.g. biographical details, a statement in support of the candidates election, a statement on material relationships between the candidate and the company, other directorships held, and particulars of other positions which require significant time commitments).<sup>11</sup>

With regard to individual director candidates (whether proposed by a board, by the candidate themselves, or by one or more shareholders), the CGCBPR state that the nomination committee should require individuals to support their candidature by presenting not only the specific information described above, but also by providing details of their other pre-existing commitments and an indication of the time involved to fulfil them. In addition, they must specifically acknowledge to the committee that they will have sufficient time to fulfil their obligations to the company as a director. If elected, they must also commit to inform the chair of the nomination committee and the chair of the board before accepting any new appointments as director.

Although the CGCBPR advise that board should be comprised of a majority of independent non-executives, the Financial Services Council's Guidance Note goes further, saying that:

"it is vital that the board consists of a majority of directors who are independent from company management. If the majority of the board is genuinely independent, it is more likely that board decisions will be implemented even if they are contrary to the wishes of management or a major shareholder. This power creates a more effective board culture and imposes a responsibility on the independent majority to be competent and diligent in carrying out their role in the decision-making process."<sup>12</sup>

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<sup>8</sup> *ibid*, Recommendation 2.2

<sup>9</sup> *ibid*, Recommendation 1.5

<sup>10</sup> *ibid*, Recommendation 2.6

<sup>11</sup> *ibid*, Recommendation 1.2

<sup>12</sup> *ibid*, p. 17

As such, the standard used to define the characteristics of independent non-executives is that set out by the Financial Services Council<sup>13</sup> which requires the individual concerned to:

- not be a substantial shareholder of the company or an officer of, or otherwise associated directly or indirectly with, a substantial shareholder of the company;
- not, within the last three years, have been employed in an executive capacity by the company or another group member, or have been a director after ceasing to hold any such employment;
- not, within the last three years, have been a principal or employee of a material professional adviser, or a material consultant to the company, or another group member;
- not be a material supplier or customer of the company or another group member, or an officer of, or otherwise associated directly or indirectly with, a material supplier or customer;
- have no material contractual relationship with the company or another group member, other than as a director of the company; and
- to be free from any interest and any business or other relationship which could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interests of the company.

Whilst, by law, employees have no entitlement to representation on the board, individual shareholders or groups of shareholders can recommend directors for nomination or seek nomination themselves. In these circumstances, the nominating group must represent either 100 or more shareholders, or own at least 5 percent of votable share capital. In practice, wide use is made of this facility, although nominees are rarely elected.

Taken together with the documents discussed above, it can be seen that a comprehensive framework exists to help inform the Australian nominations process despite there being no formal requirement for listed companies to establish a nomination committee.

## 1.2 CASE STUDY

### **Australia and New Zealand Banking Group Limited (ANZ)**

With operations spread across Australia, New Zealand, Asia-Pacific, the Middle East, Europe and the US, ANZ's principle business is the provision of "a broad range of banking and financial products and services to retail, small business, corporate and institutional clients."<sup>14</sup> Specific business operations relate to retail and commercial banking within the 'international and institutional banking' and the 'global wealth and private banking' segments, mortgage provision, life insurance, and fund management.

In 2007, ANZ set a strategic objective to become a super-regional bank, whilst maintaining a regional focus and achieving its target of deriving more than 20 percent of revenue from operations outside Australia and New Zealand by 2012. With Asia considered to be a key driver of revenue growth, China remains the company's largest market after Australia and New Zealand. ANZ also recently entered the Malaysian market.

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<sup>13</sup> *ibid*, p. 18

<sup>14</sup> [http://www.shareholder.anz.com/sites/default/files/event\\_files/2013%20Annual%20Report%20Final.pdf](http://www.shareholder.anz.com/sites/default/files/event_files/2013%20Annual%20Report%20Final.pdf)

ANZ is widely considered to be a market leader in corporate governance; the company's reporting on governance arrangements is clear and comprehensive. The ANZ board comprises one executive director and seven independent non-executive directors (including the chairman), representing an independence level of 89 percent. The board has an established governance committee to provide oversight of the nomination process and the need for board refreshment. The committee is itself comprised entirely of independent non-executives.

Furthermore, the company corporate governance statement<sup>15</sup> confirms that the board may appoint a person to be a director at any time. Any director so appointed must automatically retire at the next annual general meeting (AGM), whereupon he/she is eligible for re-election by shareholders at that meeting. All non-executive directors must seek re-election at least once every three years and can serve no more than three terms, although the board reserves the right to extend a director's tenure in 'special circumstances'.

In terms of diversity, the board's non-executive directors currently demonstrates a range of skills and experience, with 20 percent of non-executive directors being female. The age of directors ranges from 50 to 70.

### **Director nomination practices**

Under the ANZ Board Charter<sup>16</sup> ('the Board Charter'), a governance committee is required. The work of the company's governance committee is driven in large part by the governance committee Charter<sup>17</sup> ('the Governance Charter') and the Board Renewal and Performance Evaluation Protocol<sup>18</sup> ('the Protocol').

### **Independence of decision making**

The Board Charter<sup>19</sup> requires that the board is comprised of a majority of independent non-executives and that the chairman is also an independent non-executive. Independence is defined within the Board Charter and encompasses definitions provided by the ASX in the CGCBPR. In practice, the committee also takes into consideration the Australian Prudential Regulation Authority Standards<sup>20</sup> and US director independence requirements. The fact that the governance committee is comprised solely of non-executives who are independent according to various national and international standards would suggest a high degree of integrity within the director evaluation and nomination process. Reinforcing this point, none of the present members of the committee has benefited from an extension to their tenure due to 'special circumstances'; in fact, none have served as a director for more than seven years.

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<sup>15</sup> *ibid*, p.57

<sup>16</sup> [http://www.anz.com/resources/6/0/601467004d2bd4db821e9b69785e67b9/ANZ\\_Board\\_Charter.pdf](http://www.anz.com/resources/6/0/601467004d2bd4db821e9b69785e67b9/ANZ_Board_Charter.pdf)

<sup>17</sup> [http://www.anz.com/resources/c/5/c59689804d2bd83485609d69785e67b9/Governance\\_Committee\\_Charter.pdf](http://www.anz.com/resources/c/5/c59689804d2bd83485609d69785e67b9/Governance_Committee_Charter.pdf)

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[http://www.anz.com/resources/2/e/2ee37a00419ebc268132d36bc18dd1dc/Board\\_Renewal\\_and\\_Performance\\_Evaluation\\_Protocol\\_July2012.pdf](http://www.anz.com/resources/2/e/2ee37a00419ebc268132d36bc18dd1dc/Board_Renewal_and_Performance_Evaluation_Protocol_July2012.pdf)

<sup>19</sup> *ibid*

<sup>20</sup> <http://www.apra.gov.au/CrossIndustry/Documents/Prudential%20Standard%20CPS%20510%20Governance.pdf>

## Effectiveness and selection

Under the terms of the Governance Charter<sup>21</sup> and the Protocol,<sup>22</sup> the committee has a number of dedicated responsibilities and amongst other things undertakes to:

- Make recommendations to the board as to the changes that the committee believes to be desirable for the size and composition of the board taking into account:
  - relevant guidelines/legislative requirements in relation to board composition;
  - Board membership requirements as articulated in the Board Charter; and
  - other considerations including ANZ's strategic goals and the importance of having appropriate diversity within the board in relation to matters such as skills, tenure, experience, age and gender.
- Identify individuals believed to have relevant qualifications for becoming Board members and to recommend such candidates to the board.
- Monitor the effectiveness of the Gender Balance and Diversity Policy to the extent that it relates to board diversity.

It also requires that succession planning for the chairman of the board is reviewed on a regular and continuing basis, making recommendations to the board as appropriate, and reviews and approves:

- Measurable objectives for achieving gender diversity on the board, and review annually both those objectives and progress toward achieving them.
- Procedures for the oversight and evaluation of the performance of the board and the standing committees of the board.
- The Charters for the board and each standing committee, with the exception of the committee's own Charter which is reviewed and approved by the board.
- The process for evaluating the performance of each director.

In fulfilling its responsibilities, the governance committee has discretion to obtain any professional advice required at ANZ's expense. For instance, the annual report discloses the use of an 'independent external facilitator' to assist with triennial assessment of board performance. In addition, during the course of a year, the governance committee considers assessment criteria from various independent bodies regarding the board and its performance. Any material issues or findings from these evaluations are reported by the chairman of the governance committee to the board.

The framework used by the governance committee when evaluating performance is described within the Protocol; distinctions are drawn between the processes used to evaluate the performance of the board chairman, board committees and individual directors.

## Role of institutional investors and shareholder rights

Under the terms of the company's Constitution, explicit provision exists for the nomination of directors by shareholders. The company requires that notice of such a nomination is received at the company's registered office at least 45 business days before the date of the meeting at which the election is to occur (unless the Listing Rules require otherwise), as well as a declaration of

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<sup>21</sup> *ibid*

<sup>22</sup> *ibid*

consent to act as a director signed by the nominee. Shareholders are entitled to nominate other individuals as well as themselves.

Evidence of the use of this provision can be seen from many of the company's recent AGMs. In each of the last four years, the board has given shareholder nominees access to the proxy in order to seek election as a director. To date, neither of the two individuals concerned has been successful in their efforts.

### **Disclosure and transparency**

In terms of disclosure, the scope of the governance committee's work is clearly described within the ANZ annual report, and the various governance documents defining its operations are available online. For instance, the 2013 annual report describes the committee's policy approach on such topics as:

- board composition, selection and appointment
- documentation provided to newly appointed directors
- induction training
- ANZ "Fit and proper" person test
- director independence
- tenure / retirement restrictions
- continuing education
- performance evaluation

Work carried out during the year by the governance committee, and the number of meetings held, is also described in the annual report and covers:

- Board succession planning – the committee monitored the existing process used to identify potential candidates to replace the non-executive directors who were scheduled to retire in late 2013 (together with the succession planning process for the chairman of the board).
- Diversity – the committee reviewed progress against the measurable objective for board gender diversity set for 2012/2013 and approved a new objective.
- Board governance framework – the committee conducted its annual review of the board's governance framework and principles in relation to board composition and size, director tenure, outside commitments, board and committee education, nomination procedures and director independence criteria.
- Performance evaluation processes – the committee reviewed existing processes relating to the annual performance reviews of the board, chairman of the board, non-executive directors and board committees.
- Board and committee performance evaluations – the committee reviewed the major themes arising from the annual board performance review process and received a report on the outcome of the board committee review process.
- Review and approval of Group policies – the committee reviewed and, where appropriate, approved amendments to existing Group policies including the Continuous Disclosure Policy, board Renewal and Performance Evaluation Protocol, Fit and Proper Policy, and director Independence Criteria.

## Key takeaways

- The company offers:
- clear guidance as to how director performance is evaluated and the factors considered by the relevant committee to evaluate this;
- high level of disclosure and clarity within relevant documents on how the appropriate committee is required to operate;
- a clear statement on the definition of independence for the purposes of determining eligibility of candidate directors, and to offer clear guidance on board composition;
- exemplary distinction between the processes used to evaluate the performance of the board chairman, board committees and individual directors.

## 1.3 RECOMMENDATIONS

<b>GOOD PRACTICE RECOMMENDATIONS - AUSTRALIA</b>
<b>1. The nomination committee charter and/or policy on nominations and succession planning should be publicly disclosed</b>
<b>2. Annual reporting on the work of the nomination committee should include:</b> <ul style="list-style-type: none"><li>■ Detailed disclosure on the specific processes adopted and services used when searching for, and selecting, new directors</li><li>■ Disclosure of actions taken to canvas shareholders prior to board candidates being nominated for election</li><li>■ Discussion of the outcomes arising from the nomination committee's evaluation of directors' performance</li></ul>
<b>3. Provision of clear disclosure of the process followed by shareholders when seeking to nominate candidates for election to the board</b>
<b>4. The link between the work of the nomination committee and achieving the company's long-term strategy (e.g. to support company's international ambitions) should be clearly demonstrated</b>
<b>5. The nomination committee should be fully independent</b>
<b>6. The nomination committee should meet at regular - but not necessarily frequent - intervals throughout the year</b>
<b>7. Company directors should enjoy the broad support of shareholders, as evidenced by voting results</b>
<b>8. There should be sufficient female representation on the board</b>

## 2. CANADA

*Ian Quigley, Qube Investment Management*

### 2.1 MARKET OVERVIEW

Canadian corporate governance is influenced by the relatively small size of the Canadian capital market, its large number of small-cap companies and the high concentration of share ownership. Canadian companies have the unique opportunity of accessing US public markets using only Canadian disclosure documents (which are only subject to review by Canadian Security regulators) and without becoming subject to the US domestic registration and reporting systems. In many cases, Canadian reporting obligations can also be used to satisfy the same US reporting requirements, which lead to a similar compliance regime between Canadian companies and their US counterparts.

#### **Company Law and Listing Requirements**

Securities rules and regulations in Canada can be found in a number of locations including Provincial and Territorial Security Commissions. Canada has ten Provinces and three Territories, so the efforts of the regional regulators are coordinated through the Canadian Securities Administrators (CSA). Canada does not have a National Securities Regulator and it is work through the CSA that unifies rules across the country. These efforts are seen through published guidelines called the National Instruments.

The CSA recently released a series of national instruments and policies, called the “CSA Rules”, to more closely bring the Canadian markets into alignment with the American Sarbanes-Oxley Act and the recent rules and guidelines issued by the US Securities and Exchange Commission (SEC). These consist of new requirements that include the audit committee having at least three directors, all of whom must be independent and financially literate. The audit committee must also disclose corporate governance practices and their alignment to non-prescriptive practices recommended by the CSA (comply or disclose) for directors. These include:

- having a majority of independent directors;
- appointing a chair who is an independent director or, where this is not possible, a lead director who is an independent director;
- adopting a charter that sets out the responsibilities and operating procedures of the board of directors;
- adopting a written code of business conduct and ethics.

Canada also has Provincial, Territorial and Federal corporate statutes. The Canadian Business Corporations Act (CBCA) sets out the legal and regulatory framework for nearly 235,000 federally incorporated corporations, including close to half of Canada's largest publicly traded companies which are governed by the Act. Many of these corporate governance provisions contained in the CBCA overlap with parallel provisions in provincial securities laws, such as the process for selecting directors and the rights of shareholders to participate in key corporate decisions.

Industry Canada, the Government of Canada's department responsible for fostering the national economy and centre of microeconomic policy expertise, recently conducted public

consultations on the CBCA to ensure that the governance framework for its corporations remained effective, fostered competitiveness, and instilled investor and business confidence.

While many capital market similarities can be found between Canada and the US, the Canadian philosophy is less prescriptive in its requirements. Relevant rules include the requirement of a general meeting of shareholders every 15 months to elect directors, appoint auditors and to authorise auditor remuneration. Shareholders in Canada holding more than 5 percent of shares may call a special meeting of shareholders for any purpose, and a shareholder of any size may nominate a director at a shareholder meeting. Nevertheless, given that management controls the proxy process and solicitation, shareholder led nominations are a challenging and impractical exercise with board directed nominees actually elected in almost all cases. Currently, Industry Canada has called for comments on proxy access<sup>23</sup> in cases where a minimum of 5 percent of voting shares has been reached for CBCA governed companies.

It is not uncommon to see dual-class share structures in Canada, with one class having multiple voting rights and giving the holders of those shares voting control. Shareholders are entitled to obtain lists of other shareholders in order to solicit proxies at general meetings. Typically, directors are elected for one-year terms, but staggered multi-year term structures can still be found. Slate elections<sup>24</sup> still exist in Canada, but are rapidly disappearing. Canadian regulatory bodies, as well as the Toronto Stock Exchange (TSX) have indicated movement toward regulatory abolishment of slate and plurality voting as well as multi-year director terms.

While theoretically possible, it is very uncommon to see floor nominations of directors in Canada, i.e. directors being nominated for election during the AGM. As many of the proxies have already been voted before the AGM, the practice of a floor nomination would rarely succeed. When shareholders attempt to nominate a director it is done through a dissident proxy circular (proxy battle), and not through floor nominations. However, while less of a concern at large companies, floor nominations can threaten the boards at smaller companies with less concentrated shareholders. According to the Globe and Mail newspaper, over 560 Canadian companies adopted, or announced, so-called "advance notice provisions" in 2012/13. These provisions require shareholders to provide at least 30 days' notice before the AGM of any director nominations and such provisions have been supported by proxy advisory firms ISS and Glass Lewis. As shareholder challenges have been unsuccessful in provincial courts, floor nomination opportunities are likely to disappear in the coming years.

Canada also has what are called non-prescriptive best practices defined by the CSA. For example, expectations related to corporate disclosure are covered in National Instrument 58-101. This document reviews disclosures related to director nominations including reporting of director independence, meeting attendance, the nomination process and the existence and composition of a nomination committee. According to this document, further disclosure is expected to explain how 'objectivity' is assured when the nomination committee is not considered independent. A

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<sup>23</sup> Proxy Access is a mechanism by which management of the corporation allows shareholders to post their nominees for the board on the official proxy circular. Without proxy access, the shareholder is left to print his or her own proxy card and mail to all of the shareholders of the corporation at his or her own cost.

<sup>24</sup> Slate elections occur when the entire board is put on the proxy card as one vote. The shareholder votes for or against the entire board at the same time.

summary of board meetings and attendance records is required in annual disclosure documents as well as compliance with recommended corporate governance practices.

### **Corporate Governance Code & Best Practices**

Many Canadian companies have been using a 'plurality' scheme for director elections. Different from a majority system, plurality allows shareholders a "for" or "withheld" vote leading to an election based on the most "for" votes. The idea is that all required director positions would be filled even in an election where "for" votes did not constitute the majority. Members of the S&P/TSX Composite Index created a coalition in 2003 called The Canadian Coalition for Good Governance (CCGG), which prepares numerous best practice recommendations - including the directive to adopt majority voting for directors. Under this recommended practice, directors receiving 50 percent +1 withheld votes would be expected to submit a resignation. It would then be up to the board, or a subcommittee, to reject or accept the resignation. In 2014, TSX created majority voting as a listing requirement, while Industry Canada also called for comments on regulating majority voting for CBCA governed corporations. As such, it appears the transition to majority voting in Canada is well underway.

A "governance" or "nomination" committee most often conducts the selection process for new director nominees in Canada. The committee is tasked with ensuring that board membership represents a diversity of backgrounds, experience and skills and is generally expected to recruit independent directors. The committee, through the use of referrals and/or executive search firms, is vetted by third party experts and finds candidates. Upon recommendation by the committee, the board affirms the candidacy and submits it to shareholders for election.

Most regulatory and listing requirements call for the majority of directors to be "independent." CCGG has formally called for a minimum two-third of directors on Canadian boards to be independent. This has also been requested for comment by Industry Canada on CBCA governed public companies.

According to a study by Davis Ward Phillips & Vineberg,<sup>25</sup> women are gaining leadership participation on Canadian boards, but the progress is slow. On both Canadian exchanges, a woman chaired only 53 of more than 1,500 committees and women held only 10.5 percent of the indices board seats. In 2013, the Ontario Securities Commission (OSC) requested feedback from investors on how to increase participation of women on Canadian boards.

Also according to Davies Insights, dual-class voting structures are on the decline in Canada. In 2013, there were only five TSX60 companies and 12 in the Small Cap Index holding dual class shares. This continues to be an area of contention, especially when it comes to director nominations. It appears practice guidelines will call for a limitation on board seats commensurate to the ownership, not voting, position.

In conclusion, the Canadian market has shown significant movement towards more progressive governance standards with good expectations communicated from the CSA and industry working groups like the CCGG. Nevertheless, there remain a number of areas where Canadian

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<sup>25</sup> Davies Governance Insights 2013

companies have yet to adopt these standards. For example, the existence of an independent chair, according to the CCGG,<sup>26</sup> has only been implemented by part of the Canadian marketplace. While slate voting is near extinct, as are staggered board terms, many Canadian companies have yet to transition to majority voting methods and eliminate contentious dual-class voting structures. Finally, shareholder sourced director nominations with access to the proxy solicitation do not exist in Canada at this time.

## 2.2 CASE STUDY

### **BCE Inc.**<sup>27</sup>

BCE is Canada's largest communications company, providing broadband and wireless communication services, information and communications technology solutions, and television, radio, and digital media content to Canadian business, wholesale and residential customers. BCE was ranked among the top 50 best corporate citizens in Canada by Canadian Corporate Knights and is recognised by the FTSE4Good and the Jantzi Social Index. BCE is also a component of the TSX35 index. BCE's board of directors recently received two awards for excellence in corporate governance from the Canadian Society of Corporate Secretaries (CSCS) for best overall corporate governance, and the CCGG for best corporate governance disclosure.

BCE uses individual director voting, as opposed to slate voting, and each director is up for election on an annual basis (with no staggered terms). They also use a majority voting process and in uncontested elections, if the vote falls below a majority, nominees are asked to resign within 10 days of receiving the audited and final scrutineer's report.

### **Independence of Decision Making**

BCE uses a governance committee to make decisions regarding director nominations. This committee must meet independence standards (as per NYSE standards), and is comprised solely of independent directors. The governance committee's functions include:

- developing and implementing BCE's corporate governance guidelines;
- identifying individuals qualified to become members of the board;
- determining the composition of the board and its committees;
- determining the director's remuneration for board and committee service;
- developing and overseeing a process to assess the chair of the board, the board, committees of the board, chairs of committees, and individual directors, and,
- reviewing and recommending for board approval BCE's policies concerning business conduct, ethics, public disclosure of material information and other matters.

The board's Governance Guidelines currently limit the number of public company boards on which directors may serve concurrently to six other public company boards, including BCE's board. These same guidelines anticipate that the CEO will also serve as a director on the board.

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<sup>26</sup> CCGG Shareholder Democracy Study Updated 2012

<sup>27</sup> Case study as of March 2013

They also state that if the chair of the board is not an independent director, the board must designate one of its members as the lead director, whereby ensuring that the board can function independently of management.

In regards to board interlocks, no more than two directors can sit on the same public company board. These interlocks are published with the names of the companies, along with the committee memberships of the named directors. The board determines if the interlocks impair the ability of the directors to exercise independent judgment in their service to the board.

### **Effectiveness & Selection**

The governance committee uses a 'competency' matrix as an assessment tool that sets forth the skills and experience of directors individually and collectively, with respect to core competencies and related skills and experience that are central to the proper functioning of the board. The skills matrix highlights varied experience and capabilities, including expertise in telecommunications, technology, retail and customer experience, accounting and finance, investment banking, mergers and acquisitions, governments and regulatory affairs and management/CEO experience. BCE also adds to the table each director's age range, tenure at BCE, linguistic abilities in Canada's two official languages, and the region of Canada or the U.S. they are from.

The committee's process of identifying potential director candidates has historically been to accept suggestions from individual board members, the President and CEO, shareholders and professional search organisations. The governance committee does not appear to maintain a list of potential directors in the event a vacancy may arise, but rather the board considers director appointments in accordance with the ongoing needs of the corporation.

The governance committee uses questionnaires with scaled questions to solicit responses related to; the performance of individual directors, their assessment of board performance as a whole (including the chairman), as well as the performance of each board committee on which they serve and the respective chair. This self-evaluation is reviewed annually. As far as term limits, BCE strikes a balance between depth of experience from its members and the need for new perspectives and renewal. There is no arbitrary retirement age limit, but the term limit guideline is a maximum of 12 years of service on the board. However, the governance committee is able to extend this 12-year limit in certain circumstances.

### **Role of Institutional Investors and Shareholder Rights**

Meetings are regularly held between BCE's executive officers and institutional shareholders. The chair of the board, the chair of the compensation committee, the chair of the governance committee or members of management regularly meet with shareholder advocacy groups to discuss governance issues. The board states that BCE's current practices with regards to shareholders achieve essentially the same results as the CCGG's *Model Policy of the Board of Directors On Engagement with Shareholders on Governance Matters*.

BCE's governance committee will consider director candidates recommended by shareholders, but does not provide guidelines or details on how to nominate them in their public materials. Contact information is given for general issues, but specific information for the shareholder director nomination process is not given, such as nomination deadlines and precise contact information.

## Disclosure & Transparency

General procedures on the nomination process are published in BCE's proxy materials including a table completed in accordance with expectations covered in Canadian NI 58-101 – *Disclosure of Corporate Governance Practices* and NP 58-201 *Corporate Governance Guidelines*.

### Key takeaways

- The company employs individual director voting, as opposed to slate voting, and a majority voting process. Each director is up for election on an annual basis without staggered terms.
- The Company provides good disclosure of candidate biographies, skills and competencies and, thanks to regulatory expectations, one can find a thorough matrix of desired skills needed on the board and how each candidate can be placed to fulfil these needs.
- Unfortunately candidate statements do not exist, nor a solid explanation of the search process used to source the candidate. This information would be invaluable in assessing whether the board is truly renewing and refreshing itself through the director nomination process.
- The process and requirements of shareholder director nominations is not codified, which limits the opportunity for greater shareholder participation.

## 2.3 RECOMMENDATIONS

GOOD PRACTICE RECOMMENDATIONS – CANADA
1. Elections should take place annually for all directors
2. Companies should adopt majority voting
3. A policy should be set on how the board will respond to resignations from “under-voted” directors and at what level of dissent a resignation would be expected
4. Proxy access for eligible shareholder nominations of director candidates should be in place
5. Board responsiveness to shareholder proposals on director nomination issues should be clearly demonstrated (transparency on shareholder requests and subsequent action by the board) and rules and processes for shareholder-led director nominations should be publicly available
6. A charter that sets out the responsibilities and operating procedures of the board of directors should be in place <sup>28</sup>
7. Disclosure and clarity on the rationale behind director nominations in the proxy circular should be provided
8. A robust and transparent definition of independence should be published by the company (beyond minimum requirements of the listing exchange)

<sup>28</sup> As per the new CSA rules

**9. The board should have a clear policy on succession planning for both executive and non-executive positions**

**10. Policies should be in place detailing the promotion of diversity on the board**

## 3. FRANCE

*Zineb Bennani & Stéphanie Roussillon, Mirova*

### 3.1 MARKET OVERVIEW

While two board systems exist in France, the most common corporate governance structure is to have a board of directors, with the CEO and chairman positions combined. This characteristic makes the balance of power and the board nomination process all the more important. The board must therefore publish information about the candidates in advance of the AGM<sup>29</sup> to allow shareholders to cast a responsible vote. Although a director can be replaced by the board before the AGM where a vacancy arises (for resignation or death matter), the co-option must still be ratified by the shareholders at the next general meeting to protect the shareholders' interests. In addition to this transparency requirement, there are also recommendations outlined by regulators or industry players<sup>30</sup> concerning board composition to ensure good corporate governance practices, such as independence and diversity guidelines.

#### Legal Framework

The main legislative rules dictating French corporate governance standards are outlined in the Commercial Code and in the code issued by the 'Association Française des Entreprises Privées' and the 'Mouvement des Entreprises De France' (AFEP-MEDEF)<sup>31</sup> based on the 'comply or explain' principle<sup>32</sup>. However, some provisions are also adapted from laws or mentioned in the Monetary and Financial Code. For example, a law was passed on gender diversity in January 2011, requiring the presence of at least 20 percent women on boards by 2014 and of 40 percent by 2017,<sup>33</sup> while the Commercial Code also addresses more specific issues (maximum director terms' duration (six years),<sup>34</sup> maximum number of mandates (five)<sup>35</sup> etc.).

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<sup>29</sup> Identity, past and present professional activity, outside board mandates and number of company shares

<sup>30</sup> These include Association Française de la Gestion financière (AFG) and Institut Français des Administrateurs (IFA)

<sup>31</sup> two organizations representing the private sector

<sup>32</sup> The Middledenext code also exists, but the one written by the AFEP-MEDEF is the most largely referred to. The obligation to refer to a corporate governance code is mentioned in the Commercial code.

<sup>33</sup> This concerns listed companies as well as companies with more than 500 employees and a revenue over 50 million euros during 3 years in a row. This requirement has been transposed in the Commercial Code.

<sup>34</sup> The maximum duration is 4 years in the AFEP-MEDEF code, with a staggered renewal of the directors.

<sup>35</sup> The maximum number is 5 mandates in listed companies (French and international) in the AFEP-MEDEF code and only 2 outside boards for the CEO.

It also states that if employees hold three percent or more of the capital,<sup>36</sup> at least one director must represent them, while a law published in June 2013 requires that companies headquartered in France, consisting of at least 5,000 employees (for two years in a row), or companies which manage 10,000 employees globally and have to set up a works council, are requested to elect employee representatives at the board.<sup>37</sup>

The Commercial Code also requires that the chairman's report on the company's implementation of the corporate governance code is public. The Monetary and Financial Code requires the French Financial Market Authority (AMF) to publish an annual "report on the governance and corporate officers' remuneration" of listed companies to identify and encourage best practices.

### **Corporate governance code provisions and other recommendations**

The corporate governance code has set many guidelines on the transparency of board structure and operation (i.e. senior independent director's role, annual report on the nomination committee's activity, self-assessment of the board) and also on board independence<sup>38</sup> to prevent conflicts of interests<sup>39</sup> and promote a good balance of powers.

The board should take into account the capital structure, the industry and context of the company, and be composed of a mix of skills, professional experiences, genders and nationalities.<sup>40</sup> The code also requires the existence of a nomination committee,<sup>41</sup> whose main objective is to map out succession planning. However, the committee must also define a nomination process and, once elected, directors should participate in a training programme where needed, as recommended by the French Asset Management Association (AFG) – an organisation which offers guidelines often referred to by investors.<sup>42</sup> Finally, the French Institute of Directors (IFA) also publishes recommendations including that during the AGM the board should explain the criteria used to select the candidates, ensuring directors' skills and coherence are complementary to the board's composition.

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<sup>36</sup> In France, it is very common that employees hold shares in the company through employees saving funds.

<sup>37</sup> The number of employee representatives cannot exceed 5 directors or 1/3 of the board and they are different from "employee shareholder representatives" as they are elected by all employees. At least 1 employee representative must be elected when the board is composed of 12 or less directors, while companies with a board composed of more than 12 directors have to elect 2 employee representatives.

<sup>38</sup> The code also provides a definition of the independence required for 50% of the directors (or 33% for controlled companies) and mentions that the independence of each director should be assessed by the nomination committee and discussed every year by the board, which has to report its work to the shareholders when nominations occur (either in the annual report or at the AGM). In addition, non-executive directors should be able to meet on a regular basis in order to enhance the balance of powers.

<sup>39</sup> A declaration is mandatory and a director cannot participate in a vote in which he could be concerned by a conflict of interest

<sup>40</sup> The AMF also asks that the board composition's needs identified during the board assessment (in terms of nationalities, international experience, gender etc.) be disclosed, as well as the individual attendance rate.

<sup>41</sup> The nomination committee does not necessarily have to be separated from the remuneration committee.

<sup>42</sup> For instance, the AFG is not in favour of having the chairman and CEO positions combined, and if so, it recommends the election of a LID and lists the missions that should apply to the LID.

## 3.2 CASE STUDY<sup>43</sup>

### **Technip**

TECHNIP is an energy company, headquartered in Paris, with activities related to project management, engineering and construction. The Group is present in 48 countries and active in three segments: subsea, offshore and onshore. 38,000 employees work for the company which generated a revenue of more than €9.3 billion in 2013 .

Technip is a non-controlled company with a well-positioned board in terms of independence and diversity, as indicated by comparative governance ratings in this area. The company also provides a comprehensive amount of information on the director nomination process.

### **Independence of decision making**

Technip has a board of directors with the chairman and CEO positions combined; a very common corporate governance structure for a French company. Therefore a senior independent director (SID), whose nomination is proposed by the ethics and governance committee, chairs the nomination and remuneration committee in order to ensure its independence. His/her mandate runs for two years and can be renewed. Moreover, the chairman/CEO is the only executive of the board, since it is composed of 75 percent independent directors and two shareholder representatives (from the Banque Publique d'Investissement and IFP Energies Nouvelles). Although present at the nomination committee sessions, the current chairman/CEO is not a member of any committee; the nomination committee itself is composed of three independent members.

As part of his mission, the SID identifies any potential conflict of interests, while individual directors are also responsible for alerting the board of such conflicts. In such cases, a board member would not be allowed to vote on the resolution or participate in the discussion concerning the matter of potential conflict of interest, as stated in the directors' charter which highlights their independence.

The director's charter which sets out the rules governing the behaviour of directors, limits the number of positions directors can hold in other listed companies' boards to four (either in France or abroad), to ensure their availability. Incidentally, the attendance rate for the nomination committee of Technip was 100 percent in 2012.

This committee is charged with presenting its recommendations concerning the composition of the board, and selecting an external consultant to establish a list of potential candidates. The committee then interviews them and submits a short list for board approval, after the chairman/CEO has interviewed them. The position of the SID, as well as the independence of board members, are therefore crucial to ensuring a good balance of powers in the nomination process.

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<sup>43</sup> The analysis was based on materials available in 2013.

### **Effectiveness & selection**

The board evaluation is completed every three years by an external consultant and addresses the needs identified by the board in terms of skills, diversity and expertise. For instance, in 2011 the board expressed interest in having more women and more members with strong international experience to match the company's geographical expansion. This led to the selection of a Norwegian and an Indian female director.

The current composition of Technip's board is characterised by high diversity of gender (42 percent of women) and nationality (50 percent). In addition, every director is trained on the company and industry specific issues. The staggered renewal of the board also helps refresh composition, since half of the directors are elected every two years for a four year mandate. As a result, the average tenure is four years and the average age is 57.

The nomination committee is in charge of establishing a succession plan with the help of a specialised consultant and assists the board in selecting and evaluating its chairman/CEO. In addition, the non-executive directors meet once a year in order to evaluate his performance and think about the future management of the company.

### **Disclosure & transparency**

The board and nomination committee rules of procedure, its bylaws, and the directors' charter are available on the company's website. The committee's mission and activity report are disclosed in the annual report, while the candidates' resumes are published before the AGM. All these documents are available in both French and English.

### **Key takeaways**

- the company ensures a good balance of powers through the existence of an SID (whose mission is included in the annual report) and through the ability of the non-executive directors to meet and discuss the evaluation and succession planning of the executives;
- the procedure rules of the nomination committee and the board, and the directors charter are all publicly available.
- the board is highly diversified.

## **3.2 RECOMMENDATIONS**

### **GOOD PRACTICE RECOMMENDATIONS - FRANCE**

- 1. There should be annual evaluation to define the board's needs and disclosure of how the board composition has been reviewed to ensure those needs are met**
- 2. Reporting should explain the rationale behind selecting the candidates, with particular focus on how they meet the needs of the board in relation to company strategy**

**3. Disclosure of the nomination process should include:**

- description of the selection process
- definition of the directors' profile
- selection criteria
- the role of the CEO in the process
- the value added by the directors
- the interaction of the board with other players during the nomination process

**4. The company should provide disclosure of the succession planning policy and provide annual updates on how the policy was implemented**

**5. Appropriate disclosure of the information needed on the candidates to cast a responsible vote should be made available in advance of the AGM and should include as a minimum identity, past and present professional activity, outside board mandates and number of company shares owned**

**6. Information should be provided on the role of third-party consultants in the nomination process, and an assessment of their independence should be made to ensure the absence of any conflicts of interest**

## 4. ITALY

*Bram Hendriks, ING Investment Management*

### 4.1 MARKET OVERVIEW

The Italian market is characterised by concentrated share ownership of listed companies. This makes it important for institutional investors to adequately safeguard their position as minority shareholders against the interests of the controlling shareholders. The director nomination and election process is therefore a crucial means for the non-controlling shareholders to ensure the presence of independent representatives on the board, who are able to challenge management's decisions and protect the interests of shareholders and other stakeholders.

Italian corporate law states that the election of the board of directors and the board of statutory auditors of listed companies must take place using a slate voting system, known as 'Voto di Lista' – a technical mechanism, aimed at guaranteeing minority shareholders the ability to appoint one or more independent representatives to the corporate bodies of listed firms. Slate voting enables minority shareholders to nominate at least one member for the board of directors, or the board of statutory auditors, thereby counterbalancing the presence of any controlling shareholders and that the interests of the minority shareholders are adequately represented.

#### **Legal framework**

The main legislative rules of Italian corporate governance consist of statutory provisions (Consolidated Financial Act - Act n. 1998/58, Testo Unico della Finanza), regulations issued by

the national capital market authority (CONSOB), and private regulations issued by Borsa Italiana S.p.A. (Corporate Governance Code - Codice di Autodisciplina).

Compliance with the Corporate Governance Code which is approved and reviewed by the Corporate governance committee of Borsa Italiana, takes place on a voluntary basis. Listed companies that adopt the Corporate Governance Code must inform the market annually of the extent to which they comply with the principles and the criteria set out in the Corporate Governance Code. The Association of Italian Corporations (Associazione fra le Società Italiane per Azioni / Assonime), takes the lead in monitoring the adoption of the Corporate Governance Code as stated in their annual report published on their website. Following the 2003 reform of Italian Corporate Governance,<sup>44</sup> Italian listed companies can opt for three different corporate governance systems:

- I) the traditional model<sup>45</sup> with a board of directors and statutory auditors
- II) a two-tier board system<sup>46</sup>
- III) the one-tier board system<sup>47</sup>

According to the Assonime, the vast majority of Italy's listed companies have kept the traditional model which applies to all corporations with the legal form S.p.A. (i.e. Società per Azioni) which have articles of association that do not explicitly provide otherwise. Within this management and control system, three different corporate bodies govern the company:

- (I) the shareholders' meeting (*assemblea degli azionisti*);
- (II) the board of Directors (*consiglio di amministrazione*) and
- (III) the board of statutory Auditors (*collegio sindacale*).

The shareholders' meeting appoints all members of the two corporate bodies for three years and an external auditor.

### **Corporate governance code provisions**

In 2011, an amended version of the Italian Corporate Governance Code (the Corporate Governance Code or *Codice di Autodisciplina*) for listed companies was published.<sup>48</sup> In the amended Code, additional best practices were introduced in relation to:

- board of directors composition;

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<sup>44</sup> Legislative Decrees Number 5 and 6 of January 17 (2003) were implemented in January 2004

<sup>45</sup> The board of directors co-exists with a board of statutory auditors elected separately by the shareholders. The duties of the statutory auditors consist traditionally of: a) Compliance with the law and the Articles of Association; b) Observance of the principles of correct administration; and c) The adequacy of the company's organisational structure for matters within the scope of the board's authority, the adequacy of the internal control system and the administrative and accounting system, and the reliability of the latter in correctly representing the company's transactions.

<sup>46</sup> Two tier system: supervisory board appointed by shareholders and management board appointed by the supervisory board.

<sup>47</sup> One tier system: requires a board of directors (appointed by shareholders) and its own committee (formally, Management Control Committee). The committee is composed of at least three directors.

<sup>48</sup> The previous version of the corporate governance code was published in 2006.

- role and functioning of the board of directors; and
- organisation and duties of the board of directors' internal committees.

Several of the newly introduced best practices are directly related to the director nomination process, board evaluation procedures and disclosure and transparency. Companies are recommended to:

- provide appropriate disclosure in the report on corporate governance on the composition of the board of directors by indicating each member's status as executive, non-executive or independent director, his/her respective role within the board of directors, as well as his/her professional experience and duration of office;
- conduct self-evaluation of the board of director's performance and its internal committees at least annually;
- adopt the following internal committees: internal audit and risk management, nomination and remuneration;<sup>49</sup>
- evaluate whether to adopt a succession plan for executive directors. In 2012, FTSE Milano Italia Borsa (MIB) index companies in particular were asked to disclose in their corporate governance report some information about any succession plans that were already in place.

According to the latest Assonime report on implementing best practice as recommended in the corporate governance code, choosing to evaluate boards is still an infrequent practice among external facilitators of Italian listed companies. Only some of the large corporations are making use of the services provided by external consultants in this process. Similarly, succession plans are rarely in place.

The Italian corporate governance code recommends all issuers to 'evaluate whether to adopt' a succession plan for executive directors. FTSE MIB companies were asked to disclose, in their 2012 corporate governance reports, information about any succession plans that were already in place.

### **Board composition**

In July 2011 new legislation was introduced, requiring the introduction of by-law provisions aimed at preserving a quota of at least one third of the appointed directors and statutory auditors for the least represented gender within the administrative and control bodies of Italian listed companies.

According to the Corporate Governance Code,<sup>50</sup> directors are not considered independent in the event that they have served as a director of the issuer for more than nine of the past twelve years. This means that after nine years in office, directors are no longer included as independent candidates in both the majority and minority slate(s). This practice ensures an appropriate board turnover.

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<sup>49</sup> Note that the nomination committee was not included as a best practice in the 2006 corporate governance code

<sup>50</sup> article 3.C.1 lett. e)

## **Slate voting mechanism for electing the board of directors and Statutory Auditors**

Slate voting is a mechanism that gives minority shareholders the opportunity to appoint one or more independent representatives to the governance bodies of listed firms.

According to Italian law, a shareholder, or a group of shareholders, have the right to present a list of candidates, if they hold between 0.5 percent and 4.5 percent of share capital (depending on the market capitalisation, percentage of free float and other parameters) in accordance with thresholds established by CONSOB every year. According to the findings of Assonime, the average submission of slates for the board of directors by Italian listed companies was 2.33 percent.

Italian asset managers, members of the association Assogestioni<sup>51</sup> - frequently organise themselves to present a minority slate of candidates. This process, organised by the Assogestioni, enables minority shareholders with a relatively small stake in the company's share capital, but with an interest in the company's governance, to contribute to the director nomination process.

Listed firms are required to include a set of rules governing the election process in their by-laws, which must be based on the submission of lists of candidates (slates) to the AGM. These rules are informed by the company's decision on:

- The percentage required in order to present the lists of candidates (but only in cases where it is lower than the minimum requirement established by CONSOB);
- The number of candidates for election on the basis of:
  - the voting method (single-winner with quotas for minorities vs. multi-winner proportional system);<sup>52</sup>
  - the size of the minority quota, i.e. the number of board seats "reserved" in the by-laws to minority candidates.

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<sup>51</sup> Assogestioni is a voluntary, non-profit, membership association of institutions engaged in asset management including investment managers, banks and insurance companies

<sup>52</sup> Election of corporate bodies usually takes place according to a single-winner voting method, with only a quota reserved for minorities. According to this system, the slate that receives the highest number of votes becomes the "Majority" slate and takes all but a pre-determined number of seats (set out in the by-laws), which are left for candidates taken from the minority slate who receive the next highest number of votes, thereby becoming the "Minority" slate entitled to appoint the remaining members. However, some (mostly financial) companies adopt a "proportional" multi-winner voting method, with no majority premium assigned to the slate receiving the highest number of votes. Consequently, a slate receiving only a "relative majority" vote may well elect less than 50% of board members. This happens, rather frequently, in widely held firms and also in companies where multiple block holders exist, none of which is strong enough to dominate the AGM.

## 4.2 CASE STUDY

### **SNAM S.p.A.**

Snam is one of Europe's leading companies in creating and managing integrated natural gas infrastructure. With a workforce of 6,000 employees, it is active in the transportation, storage, regasification and distribution of natural gas. Headquartered in San Donato Milanese, Snam manages a national transportation network of over 32,000 km, eight storage sites, one regasification plant and a local distribution network of around 53,000 km.

Snam shares have been listed on the Italian stock market since December 2001. In the same year, it also adopted the principles expressed in the various versions of the Self-regulatory Code.<sup>53</sup>

Snam S.p.A. is considered one of the leaders in the Italian market when it comes to ESG disclosure (based on the findings of ESG research firms such as GMI & Sustainalytics). The proxy research firm ISS also indicates that SNAM S.p.A. has very low governance risk indicating adherence to generally accepted corporate governance best practices.

### **Board of directors**

Snam S.p.A has adopted the Italian traditional model (board of directors, board of statutory auditors and shareholders' meeting).

Based on provisions in Italian corporate law the company elects its board of directors through a slate voting system. This is especially important when taking into account that Snam S.p.A. has a controlling shareholder.

According to the company's by-laws, the board of directors should consist of a minimum of five directors and a maximum of nine directors. There should always be a minimum of three independent directors, which is in line with the best practice provision that at least one third of the directors should be independent.

In order to comply with applicable regulations on gender representation, the company also included in its by-laws that the slate lists should include candidates of each gender. In particular, the company specifies that in cases where the number of the least represented gender must, by law, be at least three, the lists presented for the appointment of the majority of the board of directors' members must include at least two candidates of said least represented gender.<sup>54</sup>

Snam S.p.A's current board of directors consists of one executive director, CEO Carlo Malacarne, and eight non-executive directors, of which 50 percent are women. The company also provides detailed information for each director on age, tenure and their participation in the 3 current board committees (audit, remuneration and nomination). According to the company's by-laws, new directors will be appointed as follows: six from the most voted slate and three from the second most voted slate.

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<sup>53</sup> The Self-regulatory Code which has been approved by the corporate governance committee, as recently revised in December 2011.

<sup>54</sup> Pursuant to Article 13.3 of the company's' By-laws.

During the AGM in March 2013, the company's main shareholder, Cassa Depositi e Prestiti (CDP), which holds 30 percent of the company's outstanding share capital, presented a majority slate. As a result, five directors were nominated through the majority slate. The additional three non-executive directors were elected from the minority slate presented by a group of institutional investors, coordinated by Assogestioni.

In line with the Italian Governance Code, the company also established a nomination committee (the "Appointments Committee") composed of 3 members. Two out of three members are classified as being independent, including the committee's chair. The other two committees (Compensation and Control and Risk) are also setup in accordance with the best practice recommendations of the Corporate Governance Code.

As the company applies the slate voting system, the nomination committee cannot fully control which candidates are being nominated. However, the company provisions mentioned above ensure that an adequate portion of the board is independent.

## **Effectiveness & Selection**

### Board evaluation

In accordance with the provisions of the Corporate Governance Code, the nomination committee is responsible for formulating and proposing procedures for the annual self-evaluation of the board and its committees.

The board of directors has evaluated the size, composition and functioning of the board and its committees on an annual basis since 2006. The company has made use of the services of a consultancy firm for this evaluation process. In its 2012 corporate governance and ownership structure report,<sup>55</sup> the company reported some of the findings that resulted from this assessment and included qualities the majority of the directors wish to see in new board members including:

- strategic and market-based direction;
- knowledge of the energy business;
- an international scope.

In 2013, following a competitive process and after consulting the nomination committee, the board decided to engage another leading external consulting firm to assess the size, composition and functioning of the board and its committees.

As a result of the slate voting system that is applied by the company, the nomination committee cannot fully control which director candidates are being nominated. At the same time, the company has adequate provisions in its by-laws to ensure that at least one third of the director candidates are independent non-executives.

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<sup>55</sup> The Report on Corporate Governance and Ownership Structure, providing the information required by Article 123-bis of the Legislative Decree No. 58 of 24 February 1998, shall be published by the company each year.

### Succession planning

Snam S.p.A. does not have any succession plans for executive directors in place 'due to the nature of the company's shareholder structure, and the fact that, by law and pursuant to the by-laws, directors are appointed by the Shareholders' Meeting on the basis of lists submitted by shareholders.'<sup>56</sup>

### Board refreshment

According to the corporations' by-laws, directors may be appointed for a period not exceeding three financial years, and their term expires on the same date as the shareholders' meeting which is called to approve the financial statements for the last year of their term in office. They may be re-elected.

All directors on SNAM S.p.A.'s board currently serve less than nine years as (non-executive directors. As suggested by the Italian Governance Code, the company's current board tenure does not impact director independence. During the AGM in March 2013, three new non-executive directors were appointed, demonstrating an adequate focus on board renewal through both the majority (Cassa Depositi e Prestiti) and the minority (Assogestioni) slate of director candidates.

The board of directors currently consists of 44 percent female directors, which meets legislation requirements introduced in recent years regarding the least represented gender.

### Role of institutional investors and shareholder rights

According to SNAM S.p.A.'s by-law provisions, seven tenths of the directors to be elected are drawn from the list receiving the majority of the shareholders' votes. This is normally the list of director candidates filed by the company's 30 percent shareholder, Cassa Depositi e Prestiti (CDP). The remaining directors shall be taken from the other lists, which may not be associated in any way, even indirectly, to shareholders who have submitted or voted for the list that received the most number of votes.

According to the company policy, shareholders who represent at least 2 percent of the company's outstanding share capital alone, or together with other shareholders, are entitled to submit director slates.

The election of the board of directors takes place on a triennial basis. In 2013 Assogestioni organised the presentation of a minority slate of director candidates on behalf of minority shareholders whose collective holdings equated to 2 percent of SNAM's outstanding share capital.

### **Disclosure & Transparency**

The information on the director nomination process and all related requirements are made available in the company's by-laws in both Italian and English.

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<sup>56</sup> <http://reports.snam.it/2013/corporate-governance-report/corporate-governance-system/board-of-directors/succession-plans.html>

In accordance with the national law, all slates need to be presented 25 days before the AGM and have to be made available to the public at least 21 days prior to the AGM. The two slates with director candidates are to be made available on the company's website in a timely fashion to allow proxy voting agencies to scrutinise the director profiles and provide adequate advice. However, in the case of SNAM S.p.A, this information was only included in Italian on their website and was not easily accessible to international shareholders.

The regulations setting out the duties and responsibilities of the company's nomination committee are also available on the website in both Italian and English.

Snam Spa publishes an annual report on corporate governance and ownership structure, in which more information is provided about the specific activities of the board of directors and its committees during the year under review. In 2013, for example, the nomination committee met eight times, with 95.8 percent of members present.

In 2014 the board of directors, based on proposals from the nomination committee, issued additional guidelines regarding the maximum number of offices held by both its executive and non-executive directors,<sup>57</sup> specifically in relation to potential conflicts of interest, with reference to the financial sector.<sup>58</sup>

If the maximum limit on important positions held is exceeded, the directors must promptly inform the board of directors, which shall evaluate the situation in light of the company's interest and ask the interested directors to comply with its decisions on the matter.

### **Key takeaways**

- the company has a nomination committee which consists of a majority of independent directors;
- board evaluation processes are facilitated by external consultants;
- good information is provided in all aspects related to the director nomination process;
- the company does not however have any succession plans for executive directors in place due to its shareholder structure and existing slate voting system;
- the original information about the majority and minority director slates is only available in Italian.

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<sup>57</sup> Criteria 1.C.2 and 1.C.3 of the Code.

<sup>58</sup> For the purposes of calculating the maximum number of offices, positions held within the Snam Group and on Snam Committees are not relevant.

## 4.3 RECOMMENDATIONS

GOOD PRACTICE RECOMMENDATIONS – ITALY	
1. Available slate voting mechanisms should include:	<ul style="list-style-type: none"><li>■ A proportional voting system</li><li>■ Reservation of more than one seat for minority slates, whilst distributing those seats within different minority slates (to ensure that in cases when more than one minority slate is presented, representatives of both slates can be elected)</li></ul>
2. Board evaluation procedures should be in place	
3. There should be timely public disclosure of the desired qualities for new directors, clearly linked to the outcome of board evaluation, in order to inform investors' nomination of a minority director slate and/or voting decisions	
4. A succession plan for the board of directors should be in place	
5. Board appointments should consider geographical diversity and international experience where appropriate for the business model	
6. The duties and responsibilities of the nomination committee should be set out in the by-laws, and the committee's charter should be made publicly available in both English and Italian	
7. All information about both the majority as well as the minority slate and directors' bios should be made available in English	

## 5. SWEDEN

*Anne Kirkeby (formerly of Governance for Owners)*

### 5.1 MARKET OVERVIEW

The Swedish ownership structure is generally quite concentrated with a small number of major shareholders in each company often accounting for more than 20 percent of the votes, sometimes as a result of unequal voting rights. Historically, companies also have a relatively stable shareholder base. These shareholders often play an active ownership role which may involve taking a seat on the board or on the nomination committee, which is entirely independent from the board.

Swedish society takes a positive view of major shareholders engaging in active ownership by participating in, and exercising influence at, shareholders' meetings as long as they act in the

interest of all shareholders. According to the Swedish Corporate Governance Code (the Code); "Active shareholder participation promotes a healthy balance of power between owners, the board and the executive management."

### **Legal Framework**

Corporate governance in Swedish listed companies is regulated by a combination of written rules and generally accepted practices. The framework includes the Swedish Companies Act and the Swedish Annual Accounts Act, supported by the Swedish Code of Corporate Governance and the rules guiding the regulated markets on which shares are admitted to trading, as well as statements by the Swedish Securities Council on what constitutes good practice in the Swedish securities market.

### **Corporate governance code provisions**

#### The board

The Code sets out that a "board is to have a composition appropriate to the company's operations, phase of development and other relevant circumstances' and that 'the board members elected by the shareholders' meeting are collectively to exhibit diversity and breadth of qualifications, experience and background... The company is [also] to strive for equal gender distribution on the board."

In terms of independence, no more than one member of the (unitary) board may be a member of the executive management or a subsidiary, and the majority of the directors elected at the shareholders' meeting are to be independent of the company and its management. Finally, a minimum of two members of the board, who are independent of both the company and its executive management, are also to be independent of the company's major shareholders. In this context major shareholders are defined as those controlling ten percent or more of the shares or votes in the company. Members of the board are appointed for a period extending no longer than to the end of the next AGM.

#### Nomination committee and nomination process

The Code is equally prescriptive in its recommendations for the composition of the nomination committee and makes a number of recommendations with regard to its work, including the following:

- it must consist of at least three members, one of whom is an appointed committee chair;
- the majority of the members are to be independent of the company and its executive management;
- neither the chief executive officer nor other members of the executive management are eligible as members of the committee, and at least one member is to be independent of the company's largest shareholder;
- members of the board of directors may be members of the committee but may not constitute a majority thereof;
- neither the company chair nor any other members of the board may chair the committee;
- if more than one member of the board is on the committee, no more than one of these may be dependent of a major shareholder in the company.

The Code also suggests that the sole task of the committee is to propose appropriate candidates for the board and the remuneration of said candidates at the AGM. Where applicable, the committee should also recommend a process for determining the following years' nomination committee. Most importantly, the Code prescribes that "regardless of how they are appointed, members of the nomination committee are to promote the interests of all shareholders."

Over the last 15 years the concept of a nomination committee predominantly comprised by shareholders has developed. While the Code does not require this composition in its recommendations it is indirectly implied, especially given that the model is well aligned with the Swedish history of active shareholders.

The process for appointing members to the nomination committee must be approved by the AGM on an annual basis. However, Swedish listed companies tend to stipulate that the committee has to be comprised of shareholders representing the four or five largest investors based on their holdings in the company on the last day in August. Usually the non-executive chairman of the board is also a member of the committee. The committee is chaired by one of the major shareholders, typically the one with the largest holding.

The shareholder based nomination committee is different from a sub-board committee because recommendations for board candidates are made to shareholders and not to the board. As such, there is a stronger ethos of shareholder accountability further emphasised by the guidelines in the Code which suggest that a nomination committee should promote the interests of all shareholders. In light of this, the contact details of the nomination committee are always available on the company's website should other investors would wish to make a recommendation to the committee.

#### Board evaluation and recommendations to the AGM

In line with the Code, most Swedish boards undertake an annual evaluation of their work, which is made available to the nomination committee, and forms the starting point for the director nomination process. Once a nomination committee has reached a conclusion, its recommendations are presented in the notice to the AGM and on the company's website. The committee also publishes a statement on the website explaining and justifying the recommendations and providing information on the candidates.

As most nomination committees are representing investors who account for up to 20 percent or more of the votes to be cast, they can act with confidence that their recommendations are likely to receive sufficient support at the AGM. The ultimate decision lies with the AGM. If other shareholders are not satisfied with the recommendations, they can make counter proposals at the AGM, as Swedish company law only requires the ownership of one share to propose a shareholder resolution. However, in practice this rarely happens.

#### Potential weaknesses

Arguably the larger a stake an investor has in a company, the greater their financial incentive, and obligation to ensure the sound running of the company. However, certain potential weaknesses with this model exist, such as:

- shareholders might lack the kind of experience in board membership, executive management or large-scale operations that are necessary skills to assemble a successful board;
- shareholders can sometimes have insufficient knowledge of the operation and expansion plans of the investee company;
- some asset managers will be among the top four shareholders in many of the companies in their domestic market which raises issues as to time commitment needed, as well as the potential for too much power over candidates appointed to the boards in a whole market.

International investors may also be discouraged by the unfamiliarity of this type of director nomination process. However, this nomination process is becoming increasingly familiar to the international shareholder community, who may eventually find that they trust the judgement of their peer investors because they have a greater financial incentive to succeed.

The level of disclosure by the OMXS30 on nomination committee procedures and recommendations is generally in line with what is recommended by the Code with very little variation. Where many committees fail, however, is in making the link between the results of the board evaluation, the development and circumstance of the company, and the skills and experience of the candidates proposed for the board.

## 5.2 CASE STUDY

### **Electrolux**

Electrolux is a Swedish multinational household and professional appliances manufacturer headquartered in Stockholm. It is the world's second largest household appliance maker by revenues. Electrolux products sell under a variety of brand names including its own name, and are primarily major appliances and vacuum cleaners intended for consumer use. The company has a primary listing on the Stockholm Stock Exchange and is a constituent of the OMX Stockholm 30 index.

### **Independence of decision making**

In line with market practice, Electrolux has a nomination committee which is comprised of representatives from the four largest shareholders, as well as the chairman of the board (who may not chair the nomination committee) and one other board member. The additional board member shall be appointed by the board of directors among those directors who are independent in relation to the company. Unless the members of the nomination committee agree otherwise, the chairman of the nomination committee shall be that member who represents the largest shareholder with regard to the number of votes held. Thus, the committee is independent of the company with the chairman of the board and the independent non-executive director as the only links to the company. The main tasks of the committee are to propose appropriate candidates for the board to the AGM, including the chairman and the remuneration of said candidates. Information setting out the process for appointing the committee, as well as its tasks in full, is readily available on the company website. Here shareholders can also find the contact details for the committee members should they want to submit a recommendation.

The current board of directors is in full compliance with the Swedish Code of Corporate Governance and is comprised of 12 board members, of whom three are employee representatives appointed by the employees. Apart from the employee representatives, the board is comprised of eight non-executive directors and the president of the company. Of the non-executive directors, five are considered independent of the company and its largest shareholders.

### **Role of investors**

The process for appointing the nomination committee is formally approved annually at the AGM in March. The members of the nomination committee are determined based on ownership information from Euroclear Sweden AB's register as per the final day of trading in August. The names of the members and the shareholders they represent are announced as soon as they are appointed. This gives shareholders sufficient time to submit recommendations prior to the AGM. The nomination committee's recommendations to the AGM are presented in the notice of the shareholders' meeting, and a statement is available on the company's website explaining its proposals regarding the board of directors.

### **Effectiveness, selection and board evaluation**

The company's corporate governance report states that the board evaluates its activities annually with regard to working procedures and the working climate, as well as the focus of the board's work. This evaluation also focuses on access to and requirements of special competencies on the board. This evaluation is a tool to develop the board's work and to serve as input to the work of the nomination committee. According to this report, a separate annual evaluation of the chairman's work is also performed under the leadership of the deputy chairman of the board.

The nomination committee's explanatory statement to the AGM explains that, prior to the meeting, the nomination committee also makes an assessment on the composition of the current board, as well as the Electrolux Group's operations. Areas of particular interest for the committee have been the Group's strategies and goals, and the demands placed on the board by the Group's positioning for the future. The statement goes on to explain that the nomination committee has found that the board functions well, and that the different fields of competence and experience considered important to Electrolux are well represented on the board. The nomination committee also considers that an appropriate level of diversity, including; gender, age, nationality, educational background and the term of office, is represented among the board members.

Presumably, the committee assessment has been based on the formal annual board evaluation process as described in the corporate governance report; however, this is not entirely clear from any of the reporting. Equally it is unclear how the committee has reached its conclusions with regards to the strategies, goals and demands of the board in the future, but it must be assumed that some consultation with the board has taken place prior to reaching these conclusions.

### **Nomination committee's proposals to the AGM**

In the nomination committee's explanatory statement regarding the proposals to the AGM, the committee proposes the appointment of a new candidate for the board. According to the statement, the proposed candidate has extensive knowledge within Electronics, Marketing and Communication, and many years' experience at a global company. Furthermore, he has valuable experience from integration of acquired companies from his time within the Ericsson Group.

The statement also goes on to explain how his experience and qualification will meet the demands of the company in the future, in light of the global transformation that the Electrolux Group will continue to go through in the coming years. Since Electrolux has recently worked on larger company acquisitions, the nomination committee has also considered his previous experience on integration of acquired companies as valuable. While succinct, this makes a convincing case for the appointment of the candidate.

### **Disclosure and Transparency**

The Corporate Governance section of Electrolux's website has a sub-section which sets out the committee's nomination process, as well as the names of the members of the current nomination committee and which organisations they represent. As mentioned before, this section also includes the contact details for the nomination committee, allowing shareholders to make recommendations to the committee. However, according to the corporate governance report no one has used the opportunity this year.

The corporate governance section also contains links to a number of related resources including:

- the report of previous nomination committees outlining their work and motivation for their proposals to the AGM;
- the nomination committee's recommendations from the last AGM;
- the committees explanatory statement (regarding the proposals to the AGM);
- the corporate governance report.

The corporate governance report discloses little more than the rules of appointment for the nomination committee. While it mentions that a board evaluation takes place, it does not disclose any of the results of this evaluation. This makes it difficult to access if the nomination committee is using these results in its recruitment of new members to the board.

The nomination committee's explanatory statement regarding proposals to the AGM presents shareholders with its reflections on the skills needed on the board prior to the recruitment process, the skills of the individual proposed and how these fit in with the needs of the organisation.

### **Key takeaways**

- The company assesses the specific skills of the proposed candidate well, and how these match the identified needs of the board now and in the future, by taking into account the planned developments for the company.
- The company does not however disclose the number of meetings held by the nomination committee since its appointment in August, nor does it describe in great detail the work undertaken during this period.
- While the focus of the board evaluation is described in the corporate governance report, no information is disclosed with regard to the results of the evaluation or the nomination committee's assessment and usage of these results.
- The company discloses that the nomination committee has found that the board functions well. However, it is never described how this conclusion has been reached and whether

this is a result of the formal board evaluation process or whether the committee has had meetings with members of the board.

- The company also never discloses its justification for having a nomination committee that is comprised of one more board member than what is generally the norm.

### 5.3 RECOMMENDATIONS

GOOD PRACTICE RECOMMENDATIONS - SWEDEN	
1.	<b>The company should have a shareholder based nomination committee</b>
2.	<b>A board evaluation should take place on an annual basis, being sure to include an annual gap analysis to identify the skills currently present at board level and the skills needed in the short to mid-term so as to support the current circumstances of the company, as well as the strategy going forward (including developments in the pipeline)</b>
3.	<b>Disclosure on the nomination process should be made readily available on the website and in the annual report, and should include:</b> <ul style="list-style-type: none"><li>• <b>The nomination committee’s charter;</b></li><li>• <b>The members of the nomination committee, the organisations they represent and the number of other nomination committees on which they are a member;</b></li><li>• <b>The number of committee meetings held by the nomination committee during the year, as well as a description of the issues dealt with;</b></li><li>• <b>The type and process of the board evaluation including the nomination committee’s level of access to the board and its use of consultants;</b></li><li>• <b>The results of the board evaluation, the specific set of skills that each board member (both incumbent and new) brings to the board as identified in the gap analysis and the resulting action points.</b></li></ul>
4.	<b>The nomination committee should disclose the identified skills needed at board level prior to the start of the recruitment process to allow other shareholders to submit suggestions</b>
5.	<b>Companies should ensure that communication on the nomination committees’ work can be found in the same place on the company website even if this creates duplicate content<sup>59</sup></b>

<sup>59</sup> This would include bringing together information from a) the nomination committee section of the website; b) work during the year and board evaluation information from the corporate governance report; c) recommendations and explaining comments from the AGM section of the website; and d) the members of the current nomination committee listed in the AGM documents

## 6. UNITED KINGDOM

*Tim Bolton Carter, Rathbone Brothers plc*

### 6.1 MARKET OVERVIEW

The UK main market is characterised by dispersed share ownership of listed companies, based on a one-tiered board structure. However, in London's market for smaller companies (AIM), concentrated ownership structures are not uncommon. An independent nomination committee is entrusted with selecting potential directors and recommending them to the board. The board then makes appointments to the committee of which the majority must be independent non-executive directors.

#### **Legal Framework**

The crucial piece of UK legislation determining corporate governance is the Companies Act (CA) 2006, which codifies and replaces certain Common Law duties of directors. The Financial Reporting Council (FRC) UK Corporate Governance Code (2012) outlines key recommendations for best practice at UK companies. Although the Code does not have any statutory power in and of itself, companies are required to include a statement in their annual report explaining how they have upheld the main principles of the Code (Listing Rules 9.8.6 R and 9.8.7 R). Furthermore, the FRC acknowledges that companies may deviate from the Code, provided they stay within the boundaries of the CA. The CA requires companies to comply or explain in their annual report, giving reasons for the deviation where they have not complied. This approach is the trademark of corporate governance in the UK, and is the foundation for the Corporate Governance Codes' flexibility.

#### **Corporate governance code provisions**

The Code, most recently updated in 2012, helps establish principles of good governance, many of which relate to the director nomination process in the following ways:

- It seeks to create a transparent and objective culture through stating the need for "open and rigorous procedures for the appointment of directors from a wide pool of candidates, with due regard for the benefits of diversity."
- It emphasises the need for an independent nomination committee, of which the majority should be independent non-executive directors.
- It reiterates the role of non-executive directors in constructively challenging strategy and scrutinising performance.
- It strengthens recommendations for the formal evaluation of board performance and internal committees.
- It recommends that all directors of FTSE 350 companies be subject to annual re-election.
- It states that there should be a dialogue with shareholders, particularly by non-executive directors who should develop an understanding of the views of major shareholders.
- It recommends that the annual report include a separate section describing the work of the nomination committee, including the process it has used in relation to board appointments, a description of the board's policy on diversity, including gender, any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives. An explanation should be given if neither external search consultancy nor open advertising has been used in the appointment of a chairman or a

non-executive director. Where an external search consultancy has been used, it should be identified and a statement should be made as to whether it has any other connection with the company.

- It states that the board should set out in the papers accompanying a resolution to elect or re-elect directors: sufficient biographical details to enable shareholders to make an informed decision on their election or re-election; why they believe an individual should be elected to a non-executive role; and, on re-election of a non-executive director, confirmation from the chairman that, following formal performance evaluation, the individual's performance continues to be effective and to demonstrate commitment to the role. It emphasises the need for diversity within board composition, as Lord Davies's report on gender equality (2011) recommends that boards target one quarter female membership.
- It states that directors cease to remain independent if they have held a position on the board for a period of nine years or more. The CA (2006) also established that a company must not enter into a director's service contract containing a guaranteed term of employment longer than two years, unless authorised by a shareholder resolution.

### **Ordinary Resolution Mechanism for election of board directors**

Shareholders can appoint directors to the board by means of an ordinary resolution. Furthermore, the Code holds that directors of FTSE 350 companies should be subject to annual re-election by shareholders; however, at present not all FTSE 350 companies have amended their Articles of Association to require directors to do so.

Overall, the UK comply or explain approach has been imitated internationally, and has strong support from both companies and shareholders. The Code is a set of principles, not a rigid set of rules, but the challenge remains for satisfactory engagement between boards and investors.

## **6.2 CASE STUDY**

### **Astra Zeneca**

AstraZeneca was formed on 6 April 1999, through the merger of Astra AB of Sweden and Zeneca Group PLC of the UK. It is a global biopharmaceutical company operating in over 100 countries, specialising in the discovery, development, manufacturing and marketing of prescription medicines. It employs over 50,000 people worldwide and reported sales of around US\$ 28 billion (38 percent in the US, 23 percent in Western Europe, 21 percent in emerging markets and 18 percent in the rest of the world) in 2012.

### **Board of directors**

Astra Zeneca's board of directors is comprised of two executive directors (the CEO and the CFO) and ten non-executive directors. All directors are collectively responsible for the success of the company but the non-executive directors are further responsible for exercising objective judgements regarding board decisions and for scrutinising management, in accordance with the UK Corporate Governance Code. The board makes appointments to an independent nomination committee.

The independent nomination and governance committee is headed by the non-executive chairman of the board and chairman of the nomination & governance committee. It is comprised of three other members, all of whom are non-executive directors and considered to be independent by the board. The board follows the policies outlined in the UK Corporate Governance Code regarding their definition and test for independence.

The committee continually reviews the composition of the board using a matrix system, which records the skills and experience of current board members against the desired skills and experience it believes are appropriate to the company's long term strategic needs. In relation to making nominations and recommendations to the board, the committee makes use of a search firm to carry out desktop exercises to identify potential external candidates, whilst the committee undertakes the search for internal candidates. The consultant firm was noted to have played an active role in the appointment of the CEO in 2012. Together, the employment of external support, the regular internal review reliant upon the impartial matrix system, and the totality of non-executive committee members, help to ensure that independence in the director nomination decision making process is achieved, whereby safeguarding against potential conflicts of interest.

## **Effectiveness and Selection**

### Board Evaluation

In accordance with the UK Corporate Governance code, which states the need for "formal evaluation of the performance of the board, committees and individual directors", Astra Zeneca's nomination and governance committee constantly monitors board performance using the aforementioned matrix system. Furthermore, as part of every board meeting, the CEO submits a progress report detailing the extent to which the board has met the long term objectives of the company. Following this, at the end of board meetings, the non-executive directors meet without the executive directors to discuss any matters that may have arisen, in an attempt to further enhance the objectivity of board evaluation. The process ensures that the performance of both the board as a whole and each individual member is properly evaluated. This relates to the director nomination process through the succession planning of the nomination and governance committee, should any lack of competence be detected.

### Succession Planning

The nomination & governance committee regularly reviews the composition of the board, which entails an annual review of the status of succession to both senior executive management and board level appointments. The committee has access to, and regular contact with, succession candidates for senior executive management, and therefore has a detailed knowledge of potential succession candidates internally. Moreover, independent search firms aid research regarding external candidates. This means that the committee is well prepared for both planned and unplanned successions, as evident in the case of the CEO's earlier than expected retirement in 2012, to which the committee responded effectively with a new appointment, after the identification and assessment of both internal and external candidates. It should be noted however, that it is the mandate of the board to decide whether or not to act upon the recommendations of the committee and it is the board that makes the final decision regarding director nominations to shareholders.

### Board Diversity

Astra Zeneca states in the annual report that the committee views gender, nationality and cultural diversity as important considerations in their nomination process, with particular focus attributed to gender diversity. Currently, 30 percent of the company's non-executive directors are women and they make up 25 percent of the full board. Although no specific targets have been set, the annual report states that the committee intends to continue its current approach to diversity and maintain a balance of experience and skills in each individual board member.

### Board refreshment

In the case of Astra Zeneca, all non-executive directors hold board tenure of less than nine years, with three new non-executive directors appointed during the 2012 AGM.

### **Role of Institutional Investors and Shareholder Rights**

The CA dictates that Shareholders must be notified of a general meeting, involving the passing of a special resolution or a resolution appointing a person as a director, at least 14 days beforehand. Article 66 of the company's Articles of Association states that every director should retire at each AGM and may then put themselves forward for election/re-election; therefore shareholders are invited to vote on the composition of the board each year at the AGM. Shareholders pass a separate ordinary resolution regarding the election/re-election of each director nominated.

### **Disclosure and Transparency**

In accordance with UK law, the information regarding the director nomination process is made available in the company's annual report, specifically the corporate governance report, which is available as a PDF download on the company's website.<sup>60</sup>

The report describes how Astra Zeneca has upheld and applied the main principles of good governance as outlined in the UK Corporate Governance Code. The annual report contains details of the policies surrounding the director nomination process, which are based upon the UK Corporate Governance Code and the CA (2006). In 2012, the nomination and governance committee met six times - primarily to identify a potential succession candidate for the role of CEO - but also to focus on broader succession plans relating to board and senior executive management decisions. The annual report provides sufficient information concerning the composition of the committee, the criteria used to identify new candidates, information regarding board evaluation, and insights regarding succession planning. Moreover, Astra Zeneca discloses sufficient information on each individual director, through a detailed personal profile on each individual, to allow for informed voting decisions. The annual report states that the board intends to comply with the Code's suggestion that board evaluation should be externally facilitated every three years.

### **Key takeaways**

- The company provides good detail and transparency of information in the annual report which reflects their legal obligation to comply with UK law, as well as the intent of Astra

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<sup>60</sup> [http://www.astrazeneca-annualreports.com/2012/download\\_centre](http://www.astrazeneca-annualreports.com/2012/download_centre)

Zeneca to apply good practices of corporate governance, as set out in the UK Corporate Governance Code (2012).

- The corporate governance report is long and comprehensive, and confirms that engagement with shareholders takes place for any that have ad-hoc queries on top of the detail referred to therein. It provides clear and comprehensive explanations for the value added by the directors.
- The corporate governance report also directs readers to the terms of reference of the nomination committee, in a separate section of the website. In the report "a number of areas were identified for improvement. The importance of shareholder engagement and succession planning were highlighted by the performance evaluation. The board's visibility of major shareholders' views will be improved. The engagement of the new chairman and, more recently, the new CEO with the company's largest investors is contributing to this but, in addition, more structured and regular discussion on this topic and greater analyst/broker insight at board-level will be implemented."

### 6.3 RECOMMENDATIONS

GOOD PRACTICE RECOMMENDATIONS – UNITED KINGDOM
<b>1. The policy on succession planning for non-executive directors and key management roles should be made publicly available</b>
<b>2. The company should disclose the role and responsibilities of the nomination committee, and a summary of activities during the year</b>
<b>3. The company should provide an analysis of the board skills needed, or the criteria used to select board members</b>
<b>4. The company should provide detailed personal profiles of directors/candidates, giving sufficient information to judge time commitments, independence, relevant skills, and links to the performance evaluation process</b>
<b>5. Details of the board evaluation process should be made available including:</b> <ul style="list-style-type: none"> <li>• Who it was performed by, especially if third parties were involved</li> <li>• The process followed</li> <li>• Significant outcomes and actions arising</li> <li>• A report on progress following on from previous outcomes</li> </ul>
<b>6. Actions taken to reach out to shareholders, particularly with regard to canvassing opinions prior to board nominations should be disclosed</b>
<b>7. Where the company has not complied with the corporate governance code provisions on nominations, a clear and meaningful explanation for non-compliance should be provided</b>
<b>8. The company's approach to board diversity should be disclosed</b>

## 7. US

*Kimberly Ryan, Nelson Capital Management*

### 7.1 MARKET OVERVIEW

In the United States, corporate governance rules and practices for director nominations are shaped by state and federal regulations, exchange listing requirements, as well as industry group guidelines.

#### **Regulation**

State corporate law and federal securities laws are the primary regulators. Delaware General Corporation Law (DGCL) is the main reference point when discussing state regulations, as numerous corporations are registered in the State. Under DGCL, section 216, shareholders have the right to elect directors. Delaware law denies shareholders the right to call special meetings – a right that is granted, in differing capacities, by most other states. In effect, shareholders wishing to propose any action must do so only at AGMs. However, Delaware law permits shareholders to take any action which may be taken at any annual or special meeting, including the election of board members, if the consents are in writing and not prohibited by the company's certificate of incorporation. Delaware law does not mandate a majority vote requirement in director elections. Consequently, many companies operate on a plurality basis, which means that in an uncontested election, a director will always be elected even if the candidate does not receive majority

On the federal level, both the Securities Act of 1933 (Securities Act) and the Securities Act of 1934 (Exchange Act) regulate all securities' offerings. They also govern the disclosure of materials used to solicit shareholder votes in annual or special meetings held for the election of directors and the approval of other corporate actions.

Though it is common for companies in markets around the world to allow for shareholders of sufficient critical mass (generally holding between 3-5 percent) to put forward director candidates on the company's proxy card, this has not been the tradition in US law, in part given concerns that rogue shareholders may try to influence company boards along the lines of 'special interests' that are not shared by other company shareholders. A US Security and Exchange Commission rule to allow for investor proxy access was approved, and facilitated by the Dodd-Frank Act in 2010. However, the proxy access rule was reversed in a subsequent legal challenge, with the result being that US companies remain in a position to refuse shareholder access to the proxy for director elections.

#### **Listing requirements**

In addition to state and federal securities laws, the three major listing exchanges – the New York Stock Exchange (NYSE), Nasdaq Stock Market (NASDAQ), and the American Stock Exchange

(AMEX) –have listing requirements, which include certain corporate governance guidelines. The NYSE requires that:<sup>61</sup>

- (a) Listed companies must have a nomination/corporate governance committee composed entirely of independent directors.
- (b) The nomination/corporate governance committee must have a written charter that addresses:
  - i) The committee's purpose and responsibilities - which, at minimum, must:
    - identify individuals qualified to become board members;
    - be consistent with criteria approved by the board;
    - select, or recommend that the board select, the director nominees for the next annual meeting of shareholders;
    - develop and recommend a set of corporate governance guidelines for the corporation to the board;
    - oversee the evaluation of the board and management;
  - (ii) an annual performance evaluation of the committee.

In its commentary section, the NYSE further argues with regard to the nomination/corporate governance committee charter that:

- The charter should also address committee member qualifications, committee member appointment and removal, committee structure and operations (including authority to delegate to subcommittees), and committee reporting to the board.
- The charter should give the nomination/corporate governance committee sole authority to retain and terminate any search firm to be used to identify director candidates, including sole authority to approve the search firm's fees and other retention terms.
- A listed company must make its nomination/corporate governance committee charter available on or through its website.
- Should any function of the nomination/corporate governance committee be delegated to any other committee, the charter of that committee must also be made available on or through the listed company's website.

Nasdaq and the American Stock Exchange both agree with these general requirements.

### **US investor and service provider guidelines**

Several non-regulatory investor groups and local market participants have also issued guidelines on how to approach director nominations. These include the National Association of Corporate Directors, the Council of Institutional Investors, Teachers Insurance and Annuity Association – College Retirement Equities Fund (TIAA-CREF), the California Public Employees' Retirement System (CalPERS), Institutional Shareholder Services and Glass Lewis.

In its "Global Principals of Accountable Corporate Governance", CalPERS addresses several issues related to director nominations. It recommends disclosure of nominees, including core

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<sup>61</sup>[http://nysemanual.nyse.com/LCMTTools/PlatformViewer.asp?selectednode=chp\\_1\\_4\\_3\\_4&manual=%2Ficm%2Fsections%2Ficm-sections%2F](http://nysemanual.nyse.com/LCMTTools/PlatformViewer.asp?selectednode=chp_1_4_3_4&manual=%2Ficm%2Fsections%2Ficm-sections%2F)

competencies, backgrounds, prior board experience, and overall ownership in the company. Directors should be elected by majority vote when uncontested. Plurality of vote should be the standard when elections are contested. Resignations should be required for nominees that receive a withholding vote of greater than 50 percent. Incumbent directors without a contingent resignation shall serve no more than 90 days thereafter.

CalPERS do not specifically suggest term limits for board directors but believes that continuing director tenure should be considered, to ensure the board remains open to new ideas. It states that director nomination committees (as well as audit and compensation committees) should consist entirely of independent directors. It also covers proxy access for long-term investors. CalPERS believes that investors owning (in aggregate) at least three percent of a company's voting stock should be permitted to nominate less than a majority of the directors. Eligible investors must have owned the stock for at least two years. Company proxy materials and related mailings should provide equal space and equal treatment of nominations by qualifying investors. Each share of common stock should have one vote. While the majority of companies in the United States have a single class of shareholders, a dual-share class structure is possible. In these cases, one share class may have significantly less or no voting rights at all.

In contrast, TIAA-CREF published its own "Policy Statement on Corporate Governance" which covers many of these same topics. It requires disclosure of a nominee's qualifications and encourages diversity of backgrounds and experience. Directors should be elected by majority vote, including "withholds" but not "abstains", when uncontested. Plurality of vote should be the standard when elections are contested. Directors who do not obtain a majority of the vote should be required to tender their resignation, and the company should be required to respond in a timely manner. TIAA-CREF does not support term limits but encourages companies to establish a retirement policy for directors. According to TIAA-CREF, boards should establish and disclose the process by which shareholders can submit nominations. Proxy access should be granted to shareholders in accordance with applicable law or where reasonable conditions are met. The policy statement does not expand on this point.

### **Trends**

The trend among U.S. companies is to elect directors annually and to eliminate "classified" or "staggered" boards. Historically, it has been the case that only a plurality of shareholders is needed in order to be elected, although majority voting is increasingly becoming the norm. In the absence of a contested election, director candidates nominated by the board may be automatically elected regardless of the majority of shareholder votes. Following the enactment of Dodd-Frank, the Securities and Exchange Commission (SEC) passed the 'proxy access rule' in August 2010 which requires companies to include director nominees from long-term shareholders beside company nominees in proxy materials. Eligible shareholders are those who have owned at least 3 percent of a firm's total voting power continuously for three years. Shareholders may nominate the greater of one board member or up to 25 percent of the total board. Previously, investors who wanted to replace directors had to mail separate ballots and wage a potentially costly campaign. As mentioned above, this 'rule' never went into effect. In mid-2011, it was voted down by a federal appeals court; the SEC did not appeal. A different amendment allows shareholders the right to include proposals on the adoption of proxy access procedures in company proxy materials.

The board typically conducts the search and selection process for nominees – a majority conduct this through a nomination committee, although there are instances where other committees (e.g. Corporate Governance and Nominating Committee, Governance and Social Responsibility Committee, etc.) carry out this function. Executive search firms may play a role in the selection of nominees and provide some assurance of independence and expertise

## 7.2 CASE STUDY

### **Intel Corporation (INTC)**

Intel Corporation designs, manufactures, and sells computer components and related products. Its microprocessors, chipsets, and connectivity products are sold primarily to original equipment manufacturers within the computing and communication industry. The company is based in Santa Clara, California. It ranks number five in “CR’s Top Corporate Citizens 2013” list and has been a member of the Dow Jones Sustainability Index for 14 years. It is a component of several indices, including the S&P 500 Index, and falls under the semiconductor industry.

Intel’s board is elected annually and is composed of ten directors – seven of whom could be considered independent. The CEO and chairman are the board’s executive directors. Another director is not independent as she is a partner at the law firm that provides legal counsel to the company. The company’s lead director is a former Yahoo! executive and DLJ Head of Equity Research.

Intel’s corporate governance and nominating committee is responsible for oversight of the company’s director nomination process. The company discloses the age, position in the company, and a broad outline of past careers for all of its directors. While *prima facie* the board appears to be primarily independent, this has been called into question as there are a number of directors with long tenures. The trade-off between independence and industry knowledge/expertise is therefore questionable. The committee also reviews the requirements for its membership including diversity, age, skills (business background) and international experience with the board.

Each director must be elected by a majority of votes cast in favour in uncontested elections. Under the company’s bylaws and Corporate Governance Guidelines, each director annually submits an advance, contingent, and irrevocable resignation that the board may accept if the director fails to be elected through a majority vote. This practice is evident in many companies in the US market. Typically the board follows the recommendation of the corporate governance and nominating committee’s recommendations, and issues its decision within 90 days of the election results.

Intel’s board does not have term limits. It has a retirement policy for directors and corporate officers. Independent directors may not stand for re-election after age 72, and management may not stand for re-election after age 65. Corporate officers may not continue to serve after age 65. Directors are limited to serve on four public company boards (three if they are CEO of one). Intel does not disclose whether it consults with shareholders or stakeholders in the nomination process. It also does not disclose whether an external search firm is used to screen candidate nominees.

## Key takeaways

- Intel's website includes a section on corporate responsibility which discloses the company's Code of Conduct and governance guidelines, among other policies. Each board committee, including the Corporate Governance & Nominating Committee provides its charter on the site.
- In a number of areas, Intel has instituted best practices:
  - its directors are predominantly independent
  - the board has a lead independent director
  - there are limitations on the number of boards a member may serve on
  - majority vote with contingent resignation is standard practice
- However, the company falls short in other areas. Like most US companies, it does not provide proxy access to shareholders for board nominations. Nor does the Board have any term limits for its directors.
- Some of the biggest areas of opportunity for Intel are in the disclosure of the Committee's activities and the criteria by which it evaluates candidates and current members. The Committee does review and report on the skills and characteristics of the Board from time to time but this process is opaque to investors. The Board and its members are also evaluated periodically but any information on the procedure or outcome of these assessments is not made available.

## 7.3 RECOMMENDATIONS

<b>GOOD PRACTICE RECOMMENDATIONS - US</b>
<b>1. Elections should take place on an annual basis for all directors</b>
<b>2. All companies should adopt majority voting</b>
<b>3. The company should establish a policy in response to nominees who do not receive a majority of votes, including contingent resignation letters and time frame for board action</b>
<b>4. There should be proxy access for eligible shareholder nominations of director candidates</b>
<b>5. Boards should be more responsive to shareholder proposals on director nomination issues (e.g. transparency on shareholder requests and subsequent action by the board).</b>
<b>6. The nominating committee should identify and report on the qualifications, attributes, skills, and experience to be represented on the board</b>
<b>7. Reporting on nominations should include an annual summary of the work of the nomination committee, and specific qualifications for each candidate (both incumbent and new)</b>
<b>8. A description of the nomination committee's duties should be made publicly available</b>

**9. The role of all board members in sourcing and evaluating nominees should be disclosed**

**10. Information should be provided on outside resources used to identify and evaluate board candidates (e.g. name of consultant, potential conflicts of interest)**

**11. There should be a clear policy on succession planning for both executive and non-executive directors**

## The Principles for Responsible Investment (PRI) Initiative

The PRI Initiative is a UN-supported international network of investors working together to put the six Principles for Responsible Investment into practice. Its goal is to understand the implications of sustainability for investors and support signatories to incorporate these issues into their investment decision making and ownership practices. In implementing the Principles, signatories contribute to the development of a more sustainable global financial system.

The Principles are voluntary and aspirational. They offer a menu of possible actions for incorporating ESG issues into investment practices across asset classes. Responsible investment is a process that must be tailored to fit each organisation's investment strategy, approach and resources. The Principles are designed to be compatible with the investment styles of large, diversified, institutional investors that operate within a traditional fiduciary framework.

The PRI Initiative has quickly become the leading global network for investors to publicly demonstrate their commitment to responsible investment, to collaborate and learn with their peers about the financial and investment implications of ESG issues, and to incorporate these factors into their investment decision making and ownership practices.

More information: [www.unpri.org](http://www.unpri.org)



## The PRI is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact.

### United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information: [www.unepfi.org](http://www.unepfi.org)



### UN Global Compact

Launched in 2000, the United Nations Global Compact is both a policy platform and practical framework for companies that are committed to sustainability and responsible business practices. As a multi-stakeholder leadership initiative, it seeks to align business operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to catalyse actions in support of broader UN goals. With 7,000 corporate signatories in 135 countries, it is the world's largest voluntary corporate sustainability initiative.

More information: [www.unglobalcompact.org](http://www.unglobalcompact.org)

