Spotlight on overboarding

Policies, changing board profiles and shareholder activism could lead to fewer board commitments worldwide

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A series of global corporate governance developments is making directors who typically serve on multiple boards less attractive to companies and suppressing the appetites of directors themselves to take on additional board positions.

As a result, we expect to see a slow but steady decrease in the number of boards on which individual directors serve around the world. We believe a trend of directors serving on fewer boards will emerge over the coming years as proxy advisory firms and institutional shareholders continue to implement internal voting guidelines with respect to 'overboarding' and regulatory organisations roll out new rules and regulations restricting or discouraging service on multiple boards. We also believe this trend could be fuelled by the gradual decrease in demand for directors who typically serve on multiple boards due to the recent explosion of interest in more diverse directors and a growing preference for directors with specific expertise in highly specialised fields. Finally, we believe directors are scaling back on their board commitments in anticipation of heavier time constraints and added investor scrutiny with the globalisation of shareholder activism.

Widespread attention to the issue of overboarded directors, or directors who serve on too many boards, began in the early 2000s in response to concerns raised by investors and academics that 'busier' directors do not have enough time to effectively discharge their duties to the detriment of stakeholders. These concerns spawned numerous studies, digging into various areas of the topic of overboardedness. including the consequences of serving on too many boards, the number of directorships an individual may hold before he or she becomes in danger of being overcommitted and correlations between directors holding multiple board seats and poor company performance. There are also schools of thought challenging the proposition that overboarded directors are detrimental to companies as over-simplistic and arguing that any determination as to a director's time commitments should be considered on a case-by-case basis.

While the merits of this debate are outside the scope of this article, it is quite clear, at least in the US, that the leading proxy advisory firms, the top three index

HOW MUCH IS TOO MUCH?
There are concerns that having directorships in different companies can impact commitment and effectiveness

fund managers and many of the largest publicly traded companies believe that directors who serve on too many boards are bad for business. Indeed, it does appear that directors are spending more time on board matters than a decade ago.

According to the 2016-2017 NACD Public Company Governance Survey, the average director time commitment was 245 hours per year, representing a significant increase from an average of 210 hours per year reported by the NACD in 2008.

Overboarding policies and guidelines

Policies and guidelines adopted by proxy advisory firms, institutional investors and companies themselves that are intended to limit the number of boards on which a director serves could directly contribute to a trend of directors serving on fewer boards, particularly in the US.

In response to concerns that directors are becoming overextended, influential proxy advisory firms have adopted guidelines addressing overboarded directors. The leading firm, Institutional Shareholder Services (ISS), will generally recommend a vote against or withhold from a director nominee of a US company who serves on more than five public company boards or is CEO of a public company who serves on the boards of more than two public companies besides his or her own (ISS will recommend withhold only at their outside boards). ISS first adopted overboarding guidelines in 2004. Since then, in order to address 'evolving market realities', ISS has decreased the cap on the number of boards on which a non-CEO director may serve in the US from six to the current five, beginning in 2017, and has stated that it will continue to evaluate the 'optimal level of directorships' for CEO directors.

ISS's overboarding guidelines for Canadian companies listed on the TSX are substantially the same as the US company guidelines. In the UK, Ireland and many of the countries comprising continental Europe, ISS may recommend a vote against a director nominee who holds more than five mandates at listed companies (with a non-executive chairmanship counting as two mandates and an executive director position counting as three mandates). In addition, a director nominee who holds an executive director position at one company and a non-executive chairman position at another company will be considered overboarded. We would not be surprised if, during the next few years, ISS tightened its overboarding parameters across all jurisdictions. »

The three largest index fund managers in the US, BlackRock, Vanguard and State Street, have also sent a clear message to their portfolio companies that they may vote against the election of directors serving on an excessive number of boards under their respective internal proxy voting guidelines. BlackRock will consider a director candidate to be overcommitted if he or she serves on more than four public company boards (two boards in the case of a CEO director) for its US portfolio companies. For its European, Middle Eastern and African portfolio companies, BlackRock expects companies to provide an explanation where a board candidate is a director serving on more than three other public company boards, a chairman serving on more than two other public company boards (or only one if he or she is chair of both boards) or an executive officer serving on more than one other public company board (BlackRock would vote against election only at the external board).

Just a few months ago, Vanguard adopted a new overboarding policy for its US portfolio companies under which it will consider any director who serves on five or more public company boards to be overcommitted and will vote against the director at each company except one where he or she serves as chair of the board. In the case of a director who is also a 'named executive officer' (NEO) and sits on more than one outside public board, Vanguard will generally vote against the director at each company where he or she is a non-executive but not the one where he or she serves as a NEO.

State Street's policies for its US and Canadian portfolio companies are slightly more lenient than those of its counterparts, stating that it may withhold votes from directors who sit on more than six public company boards and CEO directors who sit on more than three public company boards. For its European portfolio companies, State Street will look at the number of outside directorships held by a non-executive director when considering his or her election.

We expect to see other asset managers in the US continue to adopt similar overboarding policies. Asset managers outside the US are beginning to adopt such policies based on similar concerns with expanding time commitments of directors serving on multiple boards. Just recently, Legal & General Investment Management, the UK's largest fund manager, stated that it would encourage executive directors not to hold more than one external non-executive directorship of a listed company and encourage non-executive directors not to hold more than five public company directorships. In France, BNP Paribas Asset Management will not vote for the election of non-executive directors who have five or more director mandates or three or more director mandates in the case of executive directors.

As the influence of institutional investors on the election of directors around the world continues to grow, the implementation of their overboarding policies could play a key role in reducing the number of board positions held by directors.

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SERVING ON DIFFERENT BOARDS
Fund managers are cracking down on directors spreading themselves too thin

publicly traded companies have adopted such limitations within their internal corporate governance guidelines. According to a study entitled Corporate Board Practices in the Russell 3000 and S&P 500 (2019 Edition) issued by The Conference Board in collaboration with Debevoise & Plimpton, Russell Reynolds Associates and the John L. Weinberg Center for Corporate Governance, 77 per cent of S&P 500 companies had such overboarding policies in 2018. This represents a significant increase from 27 per cent of S&P 500 companies in 2006, according to consulting firm Spencer Stuart in its 2016 Board Index. According to The Conference Board, such policies have a standard limit of three to four outside directorships.

Similar policies are maintained by companies outside the US with varying frequency, depending on the country. In France, most companies listed on the SBF 120 have adopted governance standards developed by the French Association of Large Companies (AFEP) and the Movement of the Enterprises of France (MEDEF) known as The AFEP-MEDEF Code 2018 (the AFEP-MEDEF Code), which contains specific overboarding recommendations. Under the AFEP-MEDEF Code, a director should not hold more than four other directorships in listed companies and an executive officer should not hold more than two other directorships in listed companies. And in Ireland, for example, the multinational Johnson Controls' policies prohibit directors from serving on more than three other public company boards and further limit the CEO to one other public board in addition to the company board. While such internal overboarding policies are not nearly as prevalent outside the US, we would not be surprised to see a gradual increase in the adoption of such policies on a global basis.

The adoption of these internal overboarding policies reflect a desire by boards, particularly in the US, to ensure their memberships have sufficient bandwidth to effectively perform their duties, but it could have a direct impact on reducing the number of outside boards on which their directors serve.

Overboarding rules and regulations

Governments around the world are beginning to address concerns with overextended directors by introducing overboarding rules and regulations. We are not aware of any federal or state overboarding rules in the US. However, advances in this area are being made in Europe.

Although the UK does not have mandatory overboarding requirements, concerns with directors who are spread too thin on time and other commitments are clearly reflected in the UK Corporate Governance Code (July 2018). The UK Code recommends that non-executive directors should have 'sufficient time to meet their board responsibilities' and that prior to appointing new directors, the board should 'take into account other demands on directors' time' and 'significant commitments should be disclosed with an indication of the time involved'. In addition, the UK Code advises that full-time executive directors should not accept more than one non-executive directorship in a FTSE 100 company or 'other significant appointment'.

In Germany, the German Stock Corporation Act has a relatively permissive overboarding provision, limiting the number of positions an individual may serve on mandatory supervisory boards of commercial enterprises to a maximum of 10. However, the current draft of the German Corporate Governance Code, which would only go into effect after the act (ARUG II) for implementing the Second EU Shareholder Rights Directive is enacted, contains clearly defined overboarding provisions that would replace the general recommendation under the existing code that the supervisory board should satisfy itself that director candidates are able to devote the expected amount of time to discharge their duties.

Under the draft code, it is recommended that a supervisory board member who is not a member of any management board of a listed company may not accept more than five supervisory board mandates at outside listed companies (with a chairmanship counted as two mandates). Moreover, the draft code recommends that a member of a management board of a listed company may not have more than two supervisory board mandates at outside listed companies and may not serve as chair of a supervisory board of an outside listed company.

Thirst for diverse and 'next-gen' directors

Public companies all over the globe are exhibiting an insatiable thirst for more diverse and highly specialised directors whom we believe could contribute to a reduction in the number of board positions taken on by directors.

The push to promote board diversity is a global phenomenon that shows no signs of abating. In addition to highlighting the inequality engendered by the lack of diversity of many public company boards, there is abundant research showing a correlation between diverse boards and improved financial performance, corporate governance and accountability to stakeholders. As a result, it should come as no surprise that the same proxy advisory firms, such as ISS, and the large institutional investors, including BlackRock, Vanguard and State Street, who are combatting overboarding with their voting policies have also endeavoured to foster greater diversity, particularly gender diversity, in the boardroom.

In the US, California became the first state to require public companies headquartered in California to comply with certain gender quota requirements for boards, including having a minimum of one female on the board no later than the end of this year. Similar legislation is in the works in other states. Countries outside the US are also busy adopting board diversity rules and policy recommendations for their local companies.

In the meantime, a new breed of highly specialised directors, referred to by Spencer Stuart as 'next-gen directors,' are playing an expanding role in the refreshment of boards across the globe. These next-gen directors, who are typically younger than the average director and have highly coveted expertise in areas such as cybersecurity, social media and other high-tech and digital fields, are being recruited heavily by boards.

In its 2018 US Board Index, Spencer Stuart discusses this trend: "Recognising the strategic imperative for new perspectives and experience in the boardroom, boards are increasingly adding directors with backgrounds in tech, digital, consumer marketing and other areas of emerging importance. They are casting a wider and deeper net to identify director talent who are available and interested in taking on board roles". Indeed, in a Spencer Stuart survey of 177 nominating/governance committee members of US companies between May and June of 2018, 48 per cent of respondents considered technology experience to be a high priority board recruiting profile.

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The increasingly high demand for diverse and next-gen directors is making traditional directors, particularly those of the 'male, pale and stale' profile who serve on multiple boards, less attractive to companies. We believe contracting demand for non-diverse candidates who lack these specialised skill sets could also contribute to a gradual drop in the number of board positions held by directors.

The impact of shareholder activism

The explosion of shareholder activism in the US and Canada during recent years and its burgeoning expansion into Europe and Asia could also contribute to a trend of directors scaling back on their board commitments. In the first half of 2019 alone, according to Activist Insight Online, more than 570 companies worldwide were publicly subjected to an activist demand.

As the leading law firm to shareholder activists in the US, we have observed first-hand how directors become much busier after an activist has surfaced. After a company is targeted by an activist, directors who may have spent the average 200 to 300 hours a year on board matters could spend double that amount engaging with the activist, exploring and implementing value-enhancing initiatives suggested by the activist or taking reactionary measures, such as adopting anti-takeover provisions.

We believe directors who have personally been on the receiving end of an activist campaign and experienced the spike in working hours required to respond to the activist, begin to think twice about taking on additional board positions out of fear of being spread too thin. In addition, understanding that no company is immune to activism, many boards are being their own 'activists' in an effort to make themselves less vulnerable as targets. This typically involves undertaking rigorous, time-consuming initiatives, such as periodic evaluations of the company's strategies, operational efficiencies and capital structure, focussing on board optimisation and refreshment and corporate governance best practices and in engaging stakeholders proactively. Separate and apart from the formidable time commitment directors around the world are experiencing engaging with and preparing for activists, we believe directors are also becoming more reluctant to serve on multiple boards out of fear that doing so increases the odds of becoming the subject of public scrutiny by an activist.

Perfect storm of global trends

A perfect storm of overboarding policies and regulations, shifting board profiles and shareholder activism could lead to a gradual reduction in the number of board positions taken on by directors.

Evidence of this is beginning to crystalise in the US. While a vast majority of directors of Russell 3000 companies serve on one board, there has been a very slow yet steady decrease in the average number of board positions held by directors during the past five years. According to ISS, the average number of board positions held by directors of Russell 3000 companies decreased during each of the past five years (see Figure 1, below). During this time period, according to ISS, the number of directors of Russell 3000 companies that held three or more board positions began to steadily decrease after 2016 (see Figure 2).

FIG 1: AVERAGE DIRECTORSHIPS HELD BY DIRECTORS (RUSSELL 3000 COMPANIES)

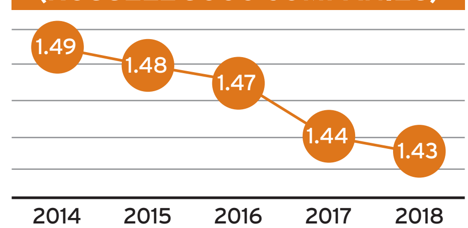
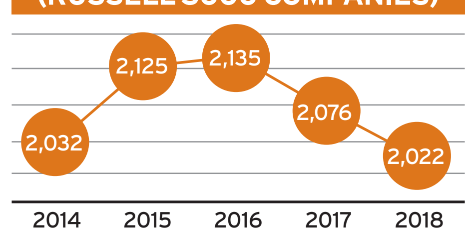


FIG 2: NUMBER OF DIRECTORS THAT SERVE ON 3+ BOARDS (RUSSELL 3000 COMPANIES)



It would not surprise us to see similar trajectories for directors outside the US, given the global scope of these governance trends. What will be interesting to see is whether fierce competition for a smaller pool of diverse and next-gen directors will actually result in an increase in the number of board positions held just by this subset of directors, despite an overall trend of fewer board commitments among all directors.