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Board leadership: A global perspective

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Introduction

Given the increasingly influential role played by the board, there can be few topics with more immediate resonance to the effectiveness of corporate governance than board leadership, and in particular, whether the roles of chairman and chief executive officer (CEO), should be combined or separated. To provide perspective to the debate, the Deloitte Global Center for Corporate Governance (the "Global Center") is pleased to present this publication providing various countries' approaches to board leadership. Board leadership structures vary greatly among countries, primarily due to applicable laws and regulations within each jurisdiction. In some countries, legal mandates require the separation of the roles of chairman and CEO. In other countries, companies are allowed to determine which structure is most appropriate, given current operations and circumstances. Accordingly, company board leadership structures can differ, even within the same country. The decision to combine or separate the roles of chairman and CEO is not the only decision about leadership that boards face — lead or presiding directors are also increasingly common ways to provide leadership for outsiders on the board while providing oversight of management.

Germany has adopted a "rules-based" focus and, as a matter of law, requires the separation of management boards and supervisory boards (supervisory boards do not include the CEO), thus necessitating the need for an independent chairman of the supervisory board. However, some have criticized this structure, arguing that the separation, while helping to provide oversight of the CEO, may unnecessarily isolate the management and supervisory boards from one another.

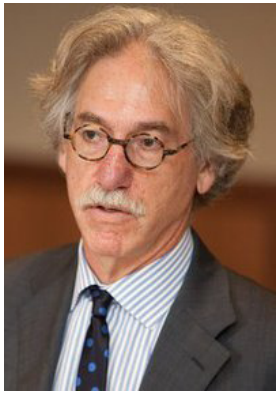
Although the United Kingdom (UK) calls for the separation of the roles, the "comply or explain" provisions of its governance code allow companies to consider their unique circumstances and make the most appropriate determination. Historically, companies in the UK have generally separated the roles. However, between 2009 and 2010, the top 350 companies in the UK seem to have started to reverse the trend — from a sample of 34 of the top 350 companies, there were two companies in 2010 that decided to combine the positions of chairman and CEO, as compared to one company from the sample of 34 companies in 2009. Similar results were found amongst samples from each group for the study — those within the top 350 companies, those within the bottom 350 companies, and those in between.[1]

In the U.S., board leadership continues to be top of mind for directors, investors, and members of management, especially given recent regulation. Proponents of a split chairman and CEO structure assert that this model is the most beneficial for companies and best positions them for strong performance. Opponents argue that there is little reliable data to support this, and further, that the combination of the roles helps eliminate the potential for confusion and duplication of efforts. Further, regulation now requires that if a company combines the roles of chairman and CEO, disclosure about whether the company has a lead director and the functions of that lead director is required within the proxy statement. U.S. regulations are similar to those in Canada. Although Canada calls for the separation of the positions, the national corporate governance policy states that when it is not appropriate to separate, a lead director should play an important role. Further, France, in its corporate governance codes, emphasizes the importance of transparency in its decision-making processes.

For many reasons, including increasing regulations and stakeholder awareness, board leadership structures continue to garner international attention. As such, it is important to consider the requirements, trends, and current developments related to board leadership structures in various countries and jurisdictions. This analysis examines developments in Canada, France, Germany, the United Kingdom, and the United States.

1 Deloitte LLP *Swimming in words – Surveying narrative reporting in annual reports*, 2010

Foreword



Stephen M. Davis, PhD, is executive director at Yale University School of Management's Millstein Center for Corporate Governance and Performance. He oversees global programming on capital markets, fund governance, corporate board chairmanship, board-shareowner communications, and voting standards.

Foreword by Stephen Davis

If we have learned anything about corporate governance in recent years, it is that goalposts are always on the move. Just when you think a feature is immutable, it changes. We are in a particularly volatile period now; the financial crisis and reforms that have come in its wake force market participants from old polarized debates onto new ground. So it is with the critical issue of board leadership.

Much of the world may long have moved to a common practice of splitting management from board oversight. Following Cadbury Code recommendations in 1991, for instance, nearly all major UK companies switched to naming a separate chair. The Dey Report spurred similar wholesale change in Canada. This report shows just how different major markets treat this issue. But, precrisis, U.S. corporations stayed solidly behind the tried practice of combining board chair and CEO authorities in a single person. To the extent the matter arose, it was in the form of an occasional, desultory clash between advocates of a split and defenders of fusion. Shareholder resolutions, for instance, sought to impose the model of independent chairmanship. But they rarely won majorities. And directors typically did not press for independent chairs, preferring the option of a lead director as a check on CEOs.

The financial crisis cast fresh doubt on the effectiveness of corporate boards and their leaders. But the truth is that financial institutions with both separate chairs and combined chair/CEOs famously collapsed into the arms of government. Studies have yet to implicate any particular leadership model in the market failures of 2008. Still, many investors chose to place fresh emphasis on the need for independent judgment at the head of a corporate board. And the U.S. Securities and Exchange Commission (SEC) responded, at least in part. It issued a new rule directing listed companies not only to clearly identify their board leadership model, but to explain why they chose it.[2]

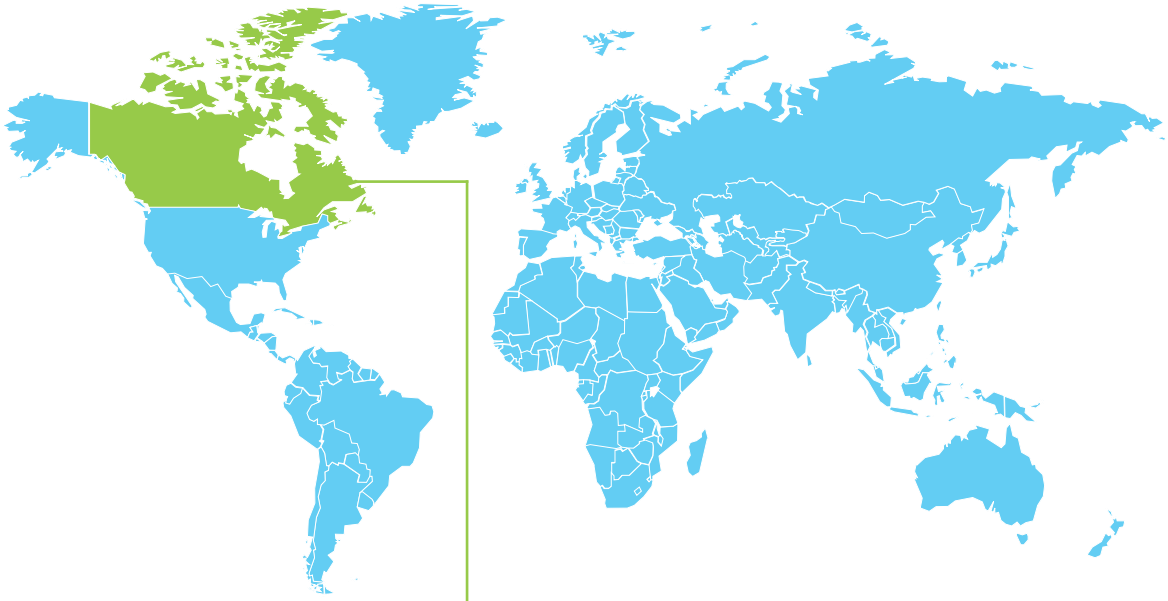
That rule, combined with rising investor support for independent chairs, has contributed to a surprising shift in the governance landscape. Today, as this report shows, as many as 40% of S&P 500 corporations now separate the chair from the CEO. That is a remarkable figure and a record high in modern U.S. economic history. The bottom line: it can no longer be argued that the combined chair/CEO is the overwhelming board leadership model in the U.S. Indeed, the trend may be headed in the near term toward rough parity of the two approaches, at least at larger firms. Moreover, the move to outside chairs has occurred not by regulatory fiat or in response to foreign pressure, but as an organic, voluntary, domestic development.

The shift brings with it a welcome, parallel transformation of debate on this issue. Old arguments about which model is superior now seem overshadowed by a more relevant question: whatever model a board selects, how can directors make it work best for the company and its shareholders? Further, the question is just as relevant outside the United States as inside. Markets that even for years have embraced the practice of outside chairs are showing an appetite for learning more about how chairmanship and executive leadership can best relate. That is where the goalpost now lies.

Stephen Davis
United States

2 U.S. SEC, *Proxy Disclosure Enhancements*, Release Nos. 33-9089, 34-61175, IC-29092 (December 16, 2009), page 38

Country profile
Canada



The numbers[3]

Year	Split CEO/Chairman (as percentage of CSSBI 100)[4]	Independent, Non-executive Chairman (as percentage of CSSBI 100)[5]
2004	81%	Not Available
2005	80%	Not Available
2006	79%	Not Available
2007	79%	Not Available
2008	83%	Not Available
2009	87%	64%
2010	85%	54%

Requirements and Current Developments

According to the April 2005 Canadian Securities Administrators National Policy 58-201, Corporate Governance Guidelines, part 3, item 3.2:

> *The chair of the board should be an independent director. Where this is not appropriate, an independent director should be appointed to act as "lead director." However, either an independent chair or an independent lead director should act as the effective leader of the board and ensure that the board's agenda will enable it to successfully carry out its duties.*

The disclosure required in Corporate Governance Disclosure Form 58-101F1, effective on June 30, 2005, is as follows:

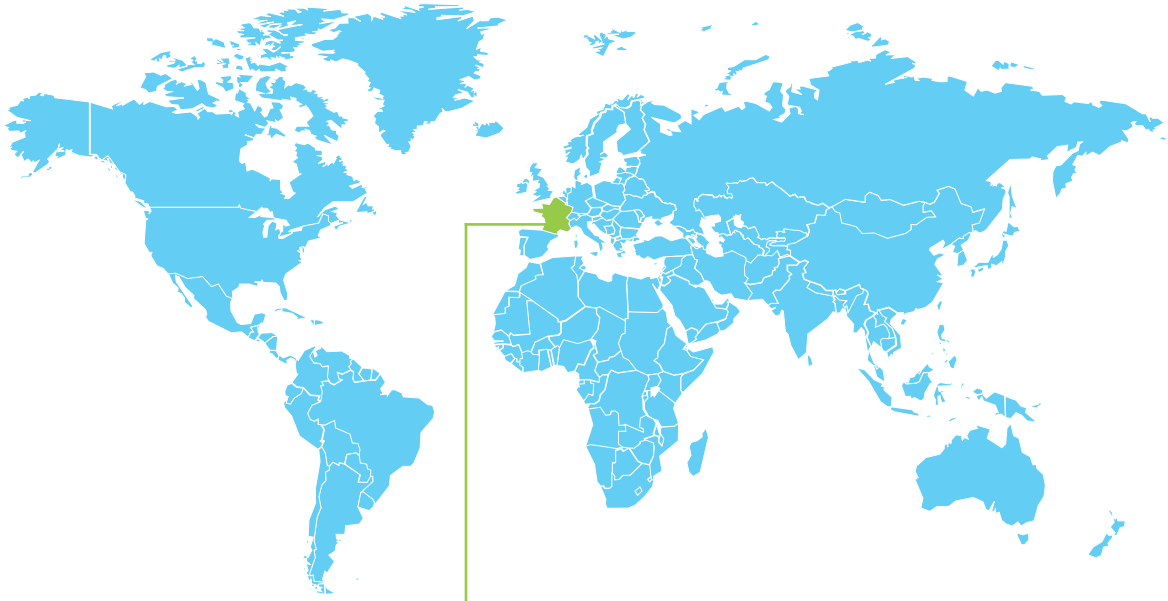
> *Disclose whether or not the chair of the board is an independent director. If the board has a chair or lead director who is an independent director, disclose the identity of the independent chair or lead director, and describe his or her role and responsibilities. If the board has neither a chair that is independent nor lead director that is independent, describe what the board does to provide leadership for its independent directors.*

3 Spencer Stuart *Canadian Board Index, series 2009–2010*

4 Canadian Spencer Stuart Board Index (CSSBI), which offers insights into the governance trends and practice of 100 leading publicly traded Canadian companies, with annual revenues exceeding $1 billion.

5 *Id*

Country profile
France



The numbers[6]

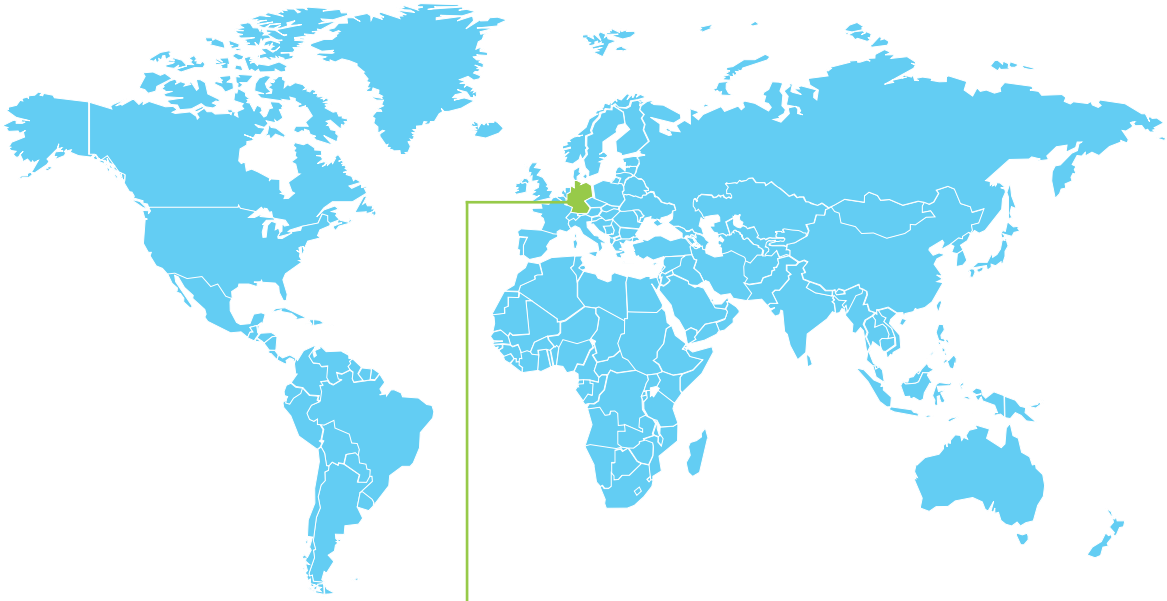
Year	Split CEO/Chairman (as percentage of CAC 40)[7]	Independent, Non-executive Chairman (as percentage of CAC 40)[8]
2008	65%	Not Available
2009	58%	Not Available
2010	55%	Not Available

Requirements and Current Developments

Two prominent codes of corporate governance in France (Association Française de la Gestion Financière (AFG), *Recommendations on Corporate Governance* [January 2011] and Mouvement des Entreprises de France (MEDEF), *Corporate Governance Code of Listed Corporations* [December 2008]) both discuss board leadership structures. The AFG, which represents asset managers, states that "AFG is in favour of the general principle of separation of functions, namely executive and control power, through a separation of the function of chairperson of the board from that of the chief executive officer, or through a supervisory and management board's structure."[9] Per MEDEF, which is an employers association, "French law offers an option between a unitary formula (Board of Directors) and a two-tier formula (Supervisory Board and Management Board) for all corporations, including listed corporations."[10] Further, in regard to disclosure of the option selected, "Without seeking to determine whether one form should be preferred over another, it should be emphasized that the main form of regulation should come from transparency: transparency between the management team and the Board of Directors, transparent management in relation to the market, and transparency in relations with shareholders, in particular at the time of the General Meeting. In this respect, it is essential for the shareholders and third parties to be fully informed of the choice made between separation of the offices of chairman and chief executive officer and maintenance of these positions as a single office."[11]

6 Provided by GovernanceMetrics International (www.gmiratings.com)
7 Benchmark French stock market index
8 *Id*
9 Association Française de la Gestion Financière (AFG) — *Recommendations on Corporate Governance* (January 2011)
10 Mouvement des Entreprises de France (MEDEF) — *Corporate Governance Code of Listed Corporations* (December 2008), 3.1
11 Mouvement des Entreprises de France (MEDEF) — *Corporate Governance Code of Listed Corporations* (December 2008), 3.2

Country profile
Germany



The numbers[12]

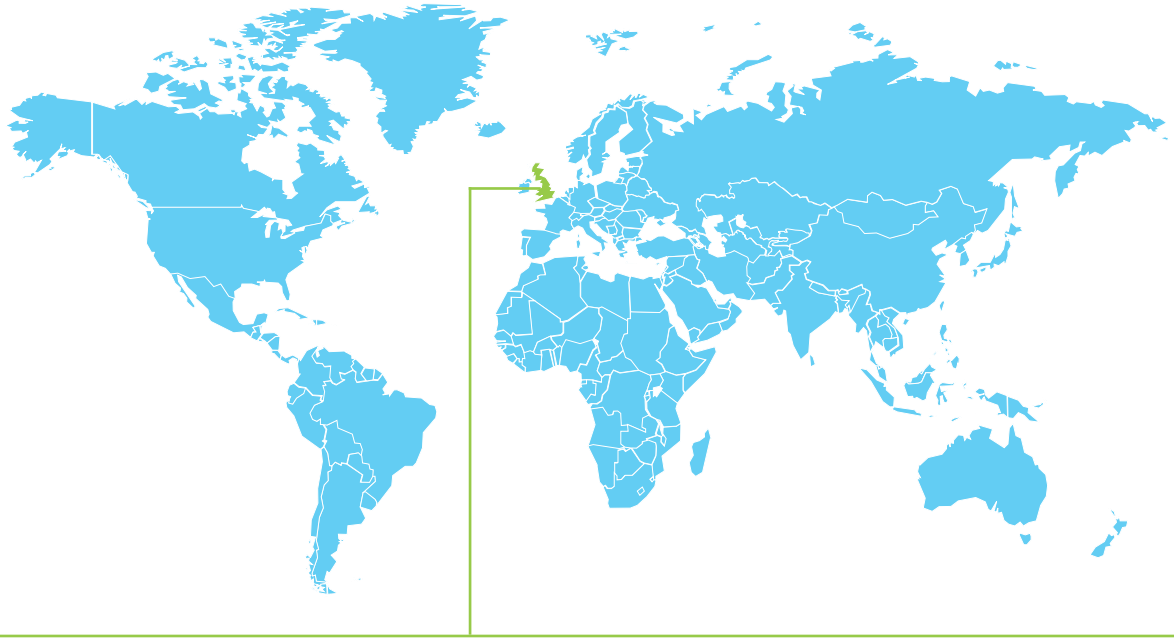
Year	Split CEO/Chairman	Independent, Non-executive Chairman
2010	100%	100%

Requirements and Current Developments

In Germany, law (*Aktiengesetz [German Stock Corporation Act]*) requires companies to have two separate and distinct boards. This two-tiered leadership structure is composed of one management board (known as Vorstand), and one supervisory board (known as Aufsichtsrat). Any board member is either a member of the management board or the supervisory board as, by law, it is not permissible to be a member of the two boards simultaneously (Article 105, Section 1, *German Stock Corporation Act*). As a result, the chairman of the supervisory board is naturally separate, distinct, and independent from the management board.

12 According to German law (*Aktiengesetz [German Stock Corporation Act]*)

Country profile
United Kingdom



The numbers[13]

Year	Split CEO/Chairman (as percentage of Deloitte sample of 34 from top 350 companies)[14]	Independent, Non-executive Chairman (as percentage of Deloitte sample of 34 from top 350 companies)[15]
2009	97%	Not Available
2010	94%	Not Available

Requirements and Current Developments

Per the June 2010 Financial Reporting Council's *The UK Corporate Governance Code, Section A: Leadership, A.2 Division of Responsibilities:*

Main Principle

There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision.

Code Provision

A.2.1 The roles of chairman and chief executive should not be exercised by the same individual. The division of responsibilities between the chairman and chief executive should be clearly established, set out in writing and agreed by the board.

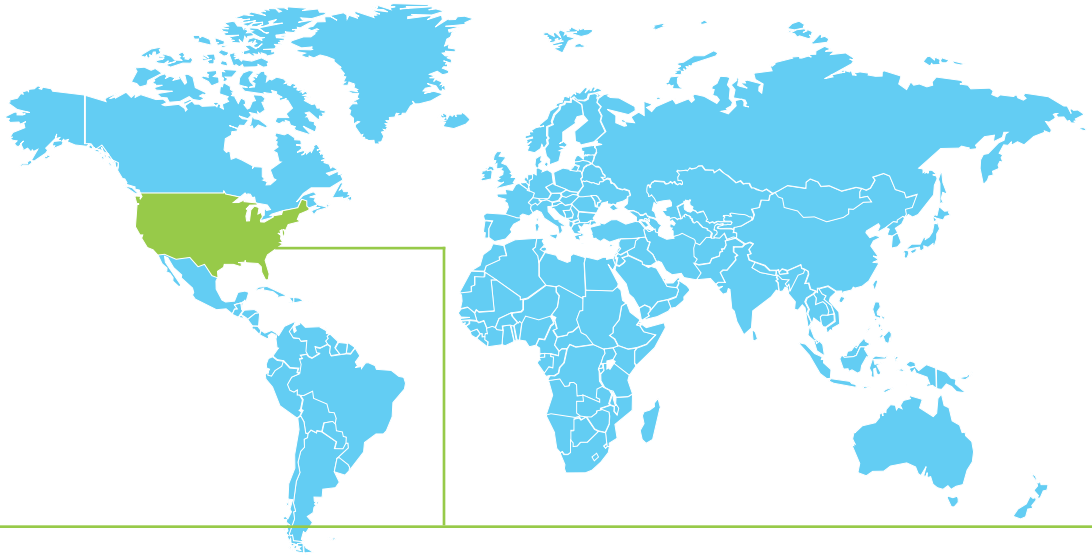
Further, per *The UK Corporate Governance Code*, companies are allowed to either comply with the policies, or explain why they have opted for a different approach: "The 'comply or explain' approach is the trademark of corporate governance in the UK. It has been in operation since the Code's beginnings and is the foundation of the Code's flexibility."[16]

13 Deloitte LLP *Swimming in words — Surveying narrative reporting in annual reports*, 2010

14 Deloitte LLP *Swimming in words — Surveying narrative reporting in annual reports*, 2010. The annual reports of 130 listed companies were surveyed to determine current practice. The companies were split into two groups being 30 investment trusts and 100 other companies. Categories included those companies included in the top 350 companies by market capitalization at June 30, 2010 (34 companies), those in the smallest 350 market capitalization (33 companies), and those that fall in between those two categories (33 companies).

15 *Id*

16 June 2010 Financial Reporting Council's *The UK Corporate Governance Code, Comply or Explain* section, paragraph 1



The numbers[17]

Year	Split CEO/Chairman (as percentage of S&P 500)[18]	Independent, Non-executive Chairman (as percentage of S&P 500)[19]
2003	23%	Not Available
2004	27%	9%
2005	29%	9%
2006	32%	10%
2007	35%	13%
2008	39%	16%
2009	37%	16%
2010	40%	19%

Requirements and Current Developments

U.S. SEC, *Proxy Disclosure Enhancements*, December 2009:

> *Under the amendments, a company is required to disclose whether and why it has chosen to combine or separate the principal executive officer and board chairman positions, and the reasons why the company believes that this board leadership structure is the most appropriate structure for the company at the time of the filing. In addition, in some companies the role of principal executive officer and board chairman are combined, and a lead independent director is designated to chair meetings of the independent directors. In these circumstances, the amendments will require disclosure of whether and why the company has a lead independent director, as well as the specific role the lead independent director plays in the leadership of the company. As we previously stated in the Proposing Release, these amendments are intended to provide investors with more transparency about the company's corporate governance, but are not intended to influence a company's decision regarding its board leadership structure.*[20]

In addition, the Dodd-Frank Wall Street Reform and Consumer Protection Act requires the SEC to further enhance the rules related to board leadership structure disclosure. The Dodd-Frank Act provision appears similar to the SEC rules described above.

Absent a formalized ruling on the matter by the SEC, various proxy advisory and voting firms, including Institutional Shareholder Services Inc. (ISS) and Glass, Lewis & Co. LLC, have issued their own voting policies related to board leadership structures. Both advisors, in general, advocate for the split of the chairman and CEO roles.[21]

17 Spencer Stuart *US Board Index, series 2003–2010*
18 Standard & Poors 500 index
19 *Id*
20 U.S. SEC, *Proxy Disclosure Enhancements*, Release Nos. 33-9089, 34-61175, IC-29092 (December 16, 2009), page 38
21 ISS *2011 U.S. Proxy Voting Guidlines Concise Summary*; Glass, Lewis & Co. LLC *2011 Proxy Paper Guidelines*

Concluding thoughts

Many people assume that European countries have long resolved the question of whether to separate the roles of chairman and CEO. Many countries do seem to have reached consensus on the issue, and promote separation, either through mandates, or through incentives to change or suggestion. On the other hand, the European Commission green paper (*The EU Corporate Governance Framework,* April 2011) included a question related to whether the European Union should "seek to ensure that the functions and duties of the chairperson of the board of directors and the chief executive officer are clearly divided." Additionally, as the statistics show, trends of French companies in the CAC 40 have shown an increase in the combination of chairman and CEO, as have a sample of UK FTSE 350 companies. In the U.S., although the SEC issued its *Enhanced Proxy Disclosure* rules in December 2009, Congress included a provision in the Dodd-Frank Wall Street Reform and Consumer Protection Act, requiring disclosure of the company's decision to either split or combine the roles of CEO and chairman, along with reasons for such decisions.

Taken together, the regulations and principles show that each country has taken steps to frame the issues and focus on the topic; some countries taking large steps, and others, smaller steps. Whether a country has implemented a specific requirement, or introduced principles to be evaluated further based on company-specific details, board leadership structures will continue to attract attention.

There are many questions that remain unaddressed — what is the future of board leadership structures internationally? Will countries' policies converge with each other? Will companies use the lead or presiding director role where the positions are combined? Will further research show a correlation between board leadership structures and company performance, especially during times of crises? Why have some countries remained conflicted on this issue? This topic continues to be relevant and of importance, and it will be interesting to see how new developments unfold on the international stage.

A special thank you to Nolan Haskovec, Deloitte LLP, Visiting Research Fellow at the Millstein Center for Corporate Governance and Performance at Yale University's School of Management, for his contribution to this publication.

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