Board Refreshment: Investors Respond to Trends in Mandatory Retirement Age and Tenure with More Stringent Voting Policies

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Synopsis

As many institutional investors have concluded, prevailing governance policies and practices have not produced desired board refreshment, which these investors would support in order to strengthen expertise, promote diversity and provide fresh perspectives in the board room. At the same time, companies and investors alike appreciate that term and age limits, as they have been typically applied, may not be the solutions, because they force the arbitrary retirement of valuable directors.

As the mandatory retirement age for directors has continued to increase, and longer tenure remains the norm, certain investors are adopting more explicit voting policies to prompt board refreshment. Companies are being called upon to reexamine whether there are alternative governance policies and practices that can lead to more effective board refreshment, and ultimately, more engaged, dynamic and productive boards. These alternatives may include a more robust application of existing practices, like director evaluations and succession planning. They may also involve more nuanced approaches to term limits, such as adopting a “comply or explain” approach or keying limits off of milestones like retirement from principal occupations.

The average age of directors and mandatory retirement age increased during the past five years.

In keeping with broader demographic trends, the average age of directors serving on S&P 500 boards has increased, and in the same period mandatory retirement ages have also increased. The correlation suggests that these two trends are reinforcing each other, as boards revise their age limits to retain senior members whom they consider too valuable to replace, and in the process allow for the appointment and retention of more senior directors generally. According to the 2015 SpencerStuart Board Index:

- The average age of all S&P 500 independent directors increased from 62.1 to 63.1 between 2010 and 2015.

- Nearly half of all S&P 500 boards (46%) have an average age between 60 and 63.
- The percentage of boards with an average age of 59 or younger declined from 19% to 15% between 2010 and 2015, while the percentage of boards with an average age of 64 and older increased by the same degree, from 34% to 39%.

In 2014 and 2015, average age of directors stabilized at 63.1, perhaps an indication that trends are changing as investors make more explicit demands for board refreshment.

With regard to mandatory retirement age, SpencerStuart reports that:

- 27% of S&P 500 boards either do not discuss mandatory retirement in their proxies or report that they do not have a mandatory retirement age.
- Among the 73% of boards that have established a mandatory retirement age for directors, half set the retirement age at 72, which has remained relatively consistent in the past five years.
- Setting retirement ages at 75 or older is a trend that has accelerated in recent years: 34% of boards have retirement ages of 75 or higher compared with 30% in 2014 and just 19% in 2010.
- Three boards set retirement age at 80.

Average director tenure remained stable during the past five years, and term limits remained unpopular.

Despite the increasing average age of the S&P 500 director, the average tenure of S&P 500 boards has remained roughly stable at 8.5 years for the past five years, demonstrating that average age and average tenure are not always directly related. However, a significant and growing percentage of boards have an average tenure of 11 or more years. SpencerStuart reports that:

- The majority of boards (62%) have an average tenure between six and 10 years.
- 21% of boards have an average tenure of 11 or more years, compared with 19% in 2010.
- 17% have an average tenure of five years or less, compared with 21% in 2010.

The use of term limits declined in the same five-year period, with very few boards using them to promote turnover. SpencerStuart reports that:

- 13 S&P 500 boards (3%) set an explicit term limit for non-executive directors, a decrease from 24 (5%) in 2010.
- 66% of boards explicitly state in their corporate governance guidelines that they do not have term limits, while 31% do not mention term limits at all.
- Of the 13 boards with a specific term limit, five cap director terms at 15 years, two at 10 years, two at 12 years and two at 20 years. The longest term limit is 20 years, and no board has a term limit less than 10 years.

General Electric recently adopted a 15-year term limit policy for directors, which includes a two-year transition period for current directors. The company uses a combination of term limits, retirement ages and annual board evaluations for board refreshment.

Companies are turning to more robust director evaluations and nomination processes, but are these changes sufficient?

As an alternative to term limits or mandatory retirement, boards are relying on more exhaustive director evaluation and nomination processes, but it remains to be seen whether these discretionary processes will result in higher turnover and if they will go far enough to satisfy investors. While according to SpencerStuart, 85% of S&P 500 companies conduct annual evaluations for their boards and key committees, only 33% of S&P 500 companies conduct evaluations for each *individual* director based on feedback from his or her peers on the board. Companies are concerned that individual director evaluations may yield limited insights, while damaging the working dynamics and collegiality of the board. Requiring or counseling a board member to step down, even on the basis of a formal evaluation, is a difficult conversation that should be supported by due process and strong leadership from the board chair, lead director and governance committee chair.

More institutional investors are adopting policies to support reduced director tenure.

Certain institutional investors are adopting more explicit requirements with regard to director tenure and director succession planning which, if not satisfied, may result in votes against long-tenured directors and/or governance committees (see Appendix for a sample of investor policies on tenure, term and age limits). These investors are concerned that above-average board tenure leads to outdated skills and perspectives on the board, limits a board's ability to bring on new directors without increasing its size, and diminishes director independence.

Some investors like CalPERS and State Street are generally taking a “comply-or-explain” approach, which is similar to the approach taken under the UK Corporate Governance Code in enforcing a nine-year director tenure limitation, while others like Legal & General, have more absolute prohibitions on director tenure. Consequences of not satisfying director tenure policies may include votes against the governance committee chair, key committee members and/or the lead director. Long-tenured directors may also be exposed to challenges mounted by shareholder activists.

While investors in the past have focused on *average* board tenure, they are beginning to pay attention to *individual* director tenure as well, particularly for directors serving in board leadership roles like lead director or key committee chairs. However, most of the investors listed in the Appendix continue to oppose individual term and age limits for directors.

Institutional Shareholder Services (ISS) has yet to alter its voting policy on director candidates such that tenure can lead to an adverse voting recommendation, and in fact, ISS recommends that shareholders vote against proposals for mandatory retirement ages or term limits. However, ISS will scrutinize boards where the average tenure of all directors exceeds 15 years for independence from management and for sufficient turnover to ensure that new perspectives are being added to the board.

Glass Lewis states in its 2016 proxy guidelines that term and age limits typically are not in shareholders’ best interests, and that there is no evidence of a connection “between either length of tenure or age and director performance.” Nevertheless, Glass Lewis supports “periodic board refreshment to foster the sharing of new perspectives in the boardroom and the generation of new ideas and business strategies.” If a company does have an age or term limit, Glass Lewis will consider recommending that shareholders vote against the nominating and/or governance committees if the limit is waived absent circumstances such as a merger.

Conclusion

Companies should take steps now to reexamine whether there are alternative governance policies and practices that can lead to more effective board refreshment, and ultimately, more engaged, dynamic and productive boards.

APPENDIX: INSTITUTIONAL INVESTOR POLICIES ON DIRECTOR TENURE

Institutional Investor	Director Tenure Policy
AllianceBernstein LP	Taking into consideration local market practice, AllianceBernstein generally believes that a director's qualification, not length of service, should be the primary factor considered. Accordingly, it generally opposes proposals that seek to either limit the term which a director may serve on a company's board or force a director's retirement at a certain age.
American Century Investment Management	American Century believes that age and term restrictions are not necessarily in the best interests of shareholders and therefore will vote against such proposals, unless they have been recommended by management.
BlackRock Institutional Trust Company, NA	BlackRock may vote against a board's longest-tenured directors for reasons including "where we observe a lack of board responsiveness to shareholders on board composition concerns, evidence of board entrenchment, insufficient attention to board diversity, and/or failure to promote adequate board succession planning over time in line with the company's stated strategic direction.'' BlackRock may vote against the nominating committee member with the longest tenure "where the board is not composed of a majority of independent directors" or "where board member(s) at the most recent election of directors have received withhold votes from more than 30% of shares voting and the board has not taken appropriate action to respond to shareholder concerns." A BlackRock representative stated that long tenure will depend on a company's industry and business cycle. "While we support regular board refreshment, we are not opposed in principle to long-tenured directors nor do we believe that long board tenure is necessarily an impediment to director independence. We believe that a variety of director tenures within the boardroom can be beneficial to ensure board quality and continuity of experience; our primary concern is that board members are able to contribute effectively as corporate strategy evolves and business conditions change over time, and that all directors, regardless of tenure, demonstrate appropriate responsiveness to shareholders over time." "As a result of the nominating committee's responsibility for board composition and refreshment over time, we typically oppose shareholder proposals imposing arbitrary limits on the pool of directors from which shareholders can choose their representatives. However, where boards find that age limits or term limits are the most efficient and objective mechanism for ensuring periodic board

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	refreshment, we generally defer to the board's determination in setting such limits."
California State Teachers' Retirement System (CalSTRS)	An effective board should have both short- and long-tenured directors ensure that fresh perspectives are provided and that experience, continuity and stability exist on the board. CalSTRS does not support limiting director tenure but believes the board should review the director's years of board service as part of the annual board review.
California Public Employees' Retirement System (CalPERS)	In March 2016, CalPERS' Investment Committee approved revised Global Governance Principles that require companies to take a comply-or-explain approach on the issue of long-tenured directors: "Boards should consider all relevant facts and circumstances to determine whether a director should be considered independent – these considerations include the director's years of service on the board – extended periods of service may adversely impact a director's ability to bring an objective perspective to the boardroom. We believe director independence can be compromised at 12 years of service – in these situations a company should carry out rigorous evaluations to either classify the director as non-independent or provide detailed annual explanation why the director can continue to be classified as independent. Additionally, there should be routine discussions as part of a rigorous evaluation and succession planning process surrounding director refreshment to ensure boards maintain the necessary mix of skills, diversity, and experience to meet strategic objectives."
Columbia Management Investment Advisers, LLC	Columbia generally will vote against proposals seeking to establish a limit on director terms of mandatory retirement.
JP Morgan Asset Management	JPMorgan will vote against shareholder proposals to limit the tenure of outside directors. Term limits pose artificial and arbitrary impositions on the board and could harm shareholder interests by forcing experienced and knowledgeable directors off the board. JPMorgan will take the length of tenure into consideration when a director is subject to reelection. In particular, when a director who has served for a long period is offered for reelection, they will take factors such as the company's performance during that time into consideration.
Legal & General Investment Management	Beginning 2017, Legal & General Investment Management (LGIM) will vote against portfolio company board Nominating Committee chairs if the average tenure of the board is 15 years or longer or if

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	there have not been any new board appointments for at least 5 years, and will vote against key committee members and/or the lead independent director if they have been serving for 15 years or longer. LGIM expects: • The Lead Independent Director (LID) along with the Nominating Committee chair to periodically review the independence, expertise and skills on the board in the context of the company's long term strategy. • Companies to illustrate through disclosure how board tenure is actively managed and assessed. • Companies to demonstrate a robust succession planning process including how potential directors are identified and on-boarded. • Key board committee memberships and the LID role to be held by directors who have not served on the board for an extended number of years. • Companies to declassify their boards to allow for the annual election of directors According to LGIM, boards should be comprised of approximately 1/3 relatively new directors, 1/3 mid-tenured directors, and 1/3 longer-tenured directors. The UK Corporate Governance Code's 9-year director tenure comply-or-explain threshold is cited to illustrate "longer tenure."
Massachusetts Financial Services Company	MFS will continue to watch the development of approaches to addressing tenure in a more general way, but for the 2015 proxy season, it believed that its clients are better served by addressing the issues associated with long-tenured boards via the following proxy voting and engagement mechanisms: • Incorporate board tenure data into MFS's analysis of certain issues, such as contested board elections, contentious votes on executive pay and certain shareholder proposals; • Encourage boards to review board tenure as part of their board self-assessment and succession planning procedures; and • Increase MFS's review of company disclosure relating to director tenure, board succession planning and board diversity as part of MFS's engagement program.
New York State Common Retirement System (NYCERS)	The Fund will not support proposals that ask a company to provide for age limits for directors. The Fund also will not support proposals

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	that request that a company support director term limits. The Fund will scrutinize Boards more closely in terms of independence and overall performance where the average tenure of all directors exceeds 15 years. Arbitrary limits on director tenure will not necessarily ensure that a director will be more qualified to serve in shareholders' best interests. The Fund believes that Boards should continually evaluate director tenure as part of its comprehensive review of the Board and encourages Boards to establish mechanisms that promote periodic refreshment of the Board.
Northern Trust Global Investments	Northern Trust generally votes against shareholder proposals to limit the tenure of outside directors.
State Street Global Advisors	For State Street, the ideal composition of a board would be a third new-tenured, a third mid-tenured and a third long-tenured directors. As needed, they will proactively engage with the chairman of the nominating committee to outline their expectations with respect to tenure and succession and encourage a more progressive approach to board refreshment. State Street's director tenure policy in the US and UK is multi-layered and takes into consideration the *average market-level board tenure*. Initially, companies are screened on their average board tenure. State Street screens companies whose directors have an average tenure past one standard deviation of the average for 4,000 US companies. Companies with long average board tenures are then further screened for a preponderance of non-executive directors that have long tenures and classified board structures. If a third of directors fall past two standard deviations, State Street may take actions including: • Voting against ONLY the chairperson of the nominating/ governance committee for failing to adequately address board refreshment and director succession at the company; • Voting against ONLY those long-tenured directors that serve on key committees; or • Voting against members of the nominating/governance committee AND long-tenured directors serving on classified boards. State Street expects: • The chairman of the nominations/governance committee to periodically review the skills and expertise on the board in the

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	context of the company's long-term strategy and to plan for an orderly director retirement/ succession process. • Long-tenured directors to refrain from serving on the audit, compensation and nomination/governance committees on boards of companies with high average director tenure. • Companies to declassify their boards and adopt an annual election cycle. Generally, State Street will vote against age and term limits unless the company is found to have poor board refreshment and director succession practices, and has a preponderance of non-executive directors with excessively long-tenures.
TIAA-CREF Global Asset Management	Although TIAA-CREF does not support arbitrary limits on the length of director service, they believe boards should establish a formal director retirement policy. A director retirement policy can contribute to board stability, vitality and renewal.
The Vanguard Group, Inc.	Vanguard has no formal policy. However, Vanguard's chairman and CEO has noted that if a board has a director with tenure considered excessive by State Street, it is conceivable that Vanguard might have similar questions as to why that board member is still serving.