

February 26, 2016

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Dear Board Member:

A robust and healthy debate is ongoing about the perils of companies focusing on short-term results at the expense of long-term value creation. As one of the world's largest asset managers working on behalf of millions of investors who receive benefits from pension funds, save for retirement through workplace savings plans or trust an advisor to help them reach their financial goals, we share those concerns. Long-term value creation can happen only when companies have in place effective, independent board leadership. Whether strong independent leadership exists on company boards will be a key focus of our 2016 corporate governance engagement program. With proxy season about to begin, we want to share with you our point of view and guidance on this important matter.

Simply put, we believe effective independent board leadership is needed to oversee a company's long-term strategy, assess management's performance, ensure board and board committee effectiveness and provide a voice independent from management and accountable directly to investors, regulators and other stakeholders. No one element constitutes effective independent board leadership. Rather we believe that an overall board oversight program, tailored to individual companies, must be devised and sustained.

Corporate boards have come a long way since the financial crisis, becoming more actively involved in setting strategy, mitigating risk, and providing guidance on ethical and governance issues. In fact, data show that there has been a positive shift toward more independent leadership on corporate boards since 2008. However, still 23% of S&P 500 companies and 34% of the Russell 3000 have no independent leadership structure – either an independent chair or an independent lead director – and in Europe 86% of the CAC 40 in France, 47% of the DAX 30 in Germany, and 24% of the FTSE 350 in the UK are led by boards without an independent chair. Moreover, many boards have skill gaps. These factors are cause for concern.

Some investors believe that the solution to independent board leadership is dividing the CEO and board chair roles, similar to market practices that exist today in the UK and Australia. However, the act of simply separating the CEO and chair roles does not guarantee independence, effectiveness or long-term focus. As is often the case with simple solutions, it may make some investors feel better, but it does not address the underlying issues and root causes that undermine strong independent board leadership.

We believe attention should be placed on the overall manner in which a company empowers their board to be more independent. This requires us to ask tough questions and truly engage with company leadership and their boards to understand the effectiveness of their governance structures.

We will be looking to confirm that company guidelines and procedures are in place to ensure independent board leadership and a clear articulation of the roles and responsibilities of an independent board leader in overseeing management. For some companies the best independent

leadership model may be an independent board chair and for others it may be a lead independent board director who serves with a combined CEO and chair.

Our preferred approach to drive greater board independence is through an active dialogue and engagement with company and board leadership. In the event that companies fail to take action, despite our best efforts to actively engage with them, we will use our proxy voting power to effect change. In fact, over the last several years we have voted on numerous occasions to separate the CEO and board chair roles and against the re-election of long-tenured board members. Our goal was to create change and force greater board independence where we thought it was necessary. In other cases, after active engagement, we have determined that effective independent leadership exists with a combined CEO and chair and an independent lead director working together.

We want all of the companies we invest in to fully understand our expectation – that companies have sufficient attributes of an effective board and independent leadership in place to convince us that their focus is on long-term value creation. As one of the largest passive managers in the world we feel we have a heightened responsibility to our investors to engage companies on the issue of board independence to ensure long-term focus. Unlike active managers who can sell a company when they do not agree with management, we are required to own companies that are part of an index.

Unless we make independent long-term thinking and leadership the driving force behind a board's mission, no amount of change to management incentives, investor behavior or the like will be sufficient to ensure a focus on the long term. Boards need to look beyond the traditional measures of corporate success such as the quarterly earnings report and accomplishments since the last board meeting. Short-term performance matters, but it should be assessed in the context of a company's long-term goals. Given a company's stated objectives for the next 5, 10 or 20 years, did management execute as well as possible? Did the company meet its milestones and exceed its benchmarks?

We recognize that the role of a board has become more complex and demanding as the challenges companies face in a competitive global economy marked by technological disruption have intensified. Many boards lack the experience and expertise to engage effectively and critically with management with regard to a company's long-term planning. Board recruitment becomes an even more critical function when viewed through the lens of long-term focus. That is all the more reason that boards should continually self-assess the skills and experience of their board members and seek to continually enhance their capabilities by addressing any skill, experience or other gaps.

We believe robust engagement between independent board leaders and their investors will have lasting mutual benefits. In that spirit, we have created the attached guidelines we will be using to evaluate a company's board leadership structure and to help inform our voting decisions.

Finally, we are currently working with some of the world's largest and most sophisticated asset owners and managers to codify principles that address not only independent board leadership, but other important corporate governance matters as well. As this work is finalized, we will ensure that this group shares these principles with you.

Sincerely,



# Guidelines and Attributes for Effective Independent Board Leadership

February 2016

We believe effective independent board leadership is a key component of good corporate governance and long-term value creation. Our guidance below is based on discussions we have had with over 100 independent chairs and/or lead independent directors from multiple jurisdictions over the past two years. In addition to the functions and responsibilities for independent board leaders, we identify the governance structures that can enhance their effectiveness as well as the skills and expertise necessary for effective, independent oversight of management.

## Attributes of Effective Independent Board Leadership

- A skilled independent leader of the board
- Effective board processes
- Rich mix of board skills and experiences, including deep industry expertise
- Clear delineation of roles/accountability between board and management

## Governance Structures That Enhance Effectiveness:

- **Robust Selection Process:** In our experience, very few portfolio companies have institutionalized the process for selecting an independent chair or a lead independent director. We encourage companies and boards to adopt a framework that specifies relevant skills and characteristics.
- **The Position Should Be Sufficiently Tenured:** A reasonable tenure allows an individual time to develop in the role and build good working relations with management and other stakeholders. We believe a minimum of three years is required, with the prospect of additional terms based on performance.
- **Performance Evaluation of the Board Leader:** Independent board members should evaluate the effectiveness of the board leader on a regular basis. Further, the job description should also be periodically reviewed and updated to evolve with market and regulatory expectations.
- **Planning for Succession:** Given the importance of the role, boards should plan for an orderly succession of a director serving in the leadership position.

## Effective Board Leaders Must:

- **Be Good Communicators:** Since the role requires facilitating discussions among board members, between directors and the CEO/management, and engaging with shareholders/stakeholders, strong communication skills are necessary.
- **Have the Required Time Commitment:** Given the key functions of the position, we estimate that the role requires a significant time commitment to execute responsibilities effectively. Based on our engagement sample, the time commitment can range from one day a month (about 100 hours a year) to 2 days a week (over 800 hours a year). On average, the time commitment is between 300–400 hours a year.
- **Have Relevant Industry Expertise:** Independent board leaders tend to act as sounding boards to CEOs. Relevant industry expertise enhances the effectiveness of the individual and reduces the risk of a “management-knowledge-captured board.”<sup>1</sup>
- **Have Personal Effectiveness:** This includes personal integrity and professional credibility; ability to earn the support of other directors and management; good problem-solving skills; sound judgment and leadership.

## SSGA Engagement and Proxy Voting Focus

Independent board leadership will be a key focus in 2016 for our engagement with our global portfolio companies, especially in North America and Europe. In particular we will examine:

- Board leadership philosophy and structure
- Responsibilities of the independent/executive chair and/or lead independent directors as the case may be
- Attributes and measures of independence and whether the leadership structure allows for independent oversight of management and execution of key board responsibilities
- Processes in place to empower independent board leaders

In addition, over the past five years in the US, we have seen a steady increase in the number of shareholder proposals that require a company to adopt an independent chair structure. We will evaluate a company’s board leadership structure against the guidelines laid out in this paper and engage with the independent leader of the board to help inform our voting decision in each particular case.

We hope board members of our portfolio companies find this guidance useful. Any questions or comments may be directed to Rakhi Kumar, Managing Director and Head of Corporate Governance, at [Rakhi\\_Kumar@ssga.com](mailto:Rakhi_Kumar@ssga.com)

<sup>1</sup> Ann. C. Mulé and Charles M. Elson, “A New Kind of Captured Board,” Weinberg Center, University of Delaware, Q1 2014.

## Key Functions and Responsibilities for Independent Board Leaders

Function	Description	Responsibilities
Board Leadership	Leads group of independent directors and acts as a liaison between independent directors and the CEO/senior executives.	<ul style="list-style-type: none"> <li>Acts as liaison between independent directors and the CEO.</li> <li>Acts as a sounding board and advisor to the CEO.</li> <li>Has the authority to call for a meeting of independent directors.</li> <li>Sets the agenda for the meeting of independent directors with inputs from other directors.</li> <li>Leads meetings of independent directors.</li> <li>Oversees conflicts of interest of all directors including the CEO.</li> <li>Authorizes retention of outside advisors and consultants who report directly to the board.</li> <li>Leads or contributes to annual performance review of the CEO.</li> <li>Leads or participates in CEO succession planning and talent retention/development of senior executives.</li> <li>Leads board in time of crisis.</li> </ul>
Board Culture	Fosters an environment of open dialogue and constructive feedback; encourages independent director participation at board meetings.	<ul style="list-style-type: none"> <li>Assists in promoting corporate governance best practices.</li> <li>Encourages director participation by fostering environment of open dialogue and constructive feedback among independent directors.</li> <li>Helps ensure efficient and effective board performance and functioning.</li> <li>Establishes code of conduct for directors on the board including the CEO.</li> </ul>
Board Oversight of Strategy	Ensures board ownership of strategy and provides guidance to the CEO on execution of the strategy, when needed.	<ul style="list-style-type: none"> <li>Ensures that the board develops and periodically reviews the company's long-term strategy.</li> <li>Ensures that the board oversees management's execution of the long-term strategy.</li> <li>Assists in aligning governance structures with the company's long-term strategy.</li> <li>Provides guidance to the CEO on executing the long-term strategy.</li> </ul>
Board Meetings	Plans, reviews and approves board meeting agendas; follows up on meeting outcomes and management deliverables.	<ul style="list-style-type: none"> <li>Ensures effective functioning of key board committees and provides inputs on functioning of the committee, when required.</li> <li>Coordinates activities of board committees and receives feedback from the chairs of board committees.</li> <li>Leads or provides guidance on director succession and development.</li> <li>Facilitates cross-committee feedback and provides inputs on committee meeting agenda, if required.</li> <li>Leads or participates in ad-hoc committees established to deal with extraordinary matters such as investigations, M&amp;As etc.</li> </ul>
Board Committee Coordination and Effectiveness	Ensures effective functioning of board level committees and facilitates communication coordination across committees.	<ul style="list-style-type: none"> <li>Plans, reviews and approves board meeting agendas and schedules in coordination with the CEO.</li> <li>Advises the CEO of the board's information needs and approves information sent to the board.</li> <li>Follows up on meeting outcomes and management deliverables.</li> </ul>
Shareholder and Stakeholder Engagement	Meets with shareholders and stakeholders such as regulators, employees and clients when needed.	<ul style="list-style-type: none"> <li>Engages and consults with major shareholders, when requested.</li> <li>Engages with key regulators to discuss board process and oversight of management and company, when necessary.</li> <li>Represents independent board members with other stakeholders, when necessary.</li> <li>Attends shareholder meetings as representative of the board.</li> </ul>

Source: SSGA's Corporate Governance Team and Russell Reynolds.

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