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Board Leadership: The Split CEO/Chairman Structure Debate

Board leadership structure continues to be a hot topic in the 2012 U.S. proxy season for directors, investors and members of management. Calls for an independent chairman remain a priority on the list of proposals put forth by shareholders. According to a publication from Deloitte Touche Tohmatsu Limited's Global Center for Corporate Governance, ***Board Leadership: A Global Perspective***, there are several causes of disparities in international board leadership structures.

While the regulatory framework can dictate the board leadership structure, investor expectations also play an important role. In jurisdictions where investors can apply pressure through voting practices, separation of the chairman and CEO roles may be more common. In the United States, proponents of a split CEO/chairman structure assert that this model is the most beneficial for companies and best positions them for strong performance. Opponents of this structure emphasize that there is no irrefutable data demonstrating that companies that split the roles fare better than companies that combine them and further, that the combination of the roles helps to eliminate the potential for confusion and duplication of efforts.

With the increased focus on board leadership structure, more companies are discussing the decision to combine or separate the roles of chairman and CEO within the context of CEO succession planning. Once the structure is defined, it is also important to ensure there is a process in place for evaluation as well as ensuring that other leadership roles, such as lead director, or unique roles, such as chairman emeritus, are defined as well.

Board Leadership

Board leadership structures continue to be top of mind around the world, particularly as they relate to whether the roles of chairman and CEO should be combined or separated. As noted above, board leadership structures depend on applicable laws and regulations, as well as on company circumstances, all of which vary among countries. As noted in the "Board leadership: A Global Perspective" publication, there are several issues that remain unaddressed in this area, including the future of board leadership structures internationally and whether country policies will converge with each other.

One example of varying practices in board leadership structures in different national jurisdictions is the prevalence of independent board chairs. Using data from 2011 proxies, Deloitte conducted an analysis of the large publicly held companies in four countries—Canada, Germany, the United Kingdom and the United States—to determine the extent to which they have independent board chairs in place. The analysis revealed the following:

- In Canada, 55% of companies in the Toronto Stock Exchange 60 have independent board chairs.
- In Germany, 50% of companies in the Deutscher Aktien Index (DAX 30) have independent board chairs.
- The United Kingdom had the greatest frequency of independent board chairs, with 76% of companies in the Financial Times Stock Exchange (FTSE) 100 Index having them.
- The presence of independent board chairs was least prevalent in the United States, with only 20% of companies in the Standard & Poor's (S&P) 500 Index having them.

In addition, Deloitte analyzed whether and how the companies in the analysis sought to counterbalance the power of an independent board chair through evaluation of the individual's performance; the existence of a vice-chair, lead director, or similar role; and whether the individual was also the chairman of the compensation and/or nominating committee. Consistent with the findings related to the prevalence of an independent board chair, the results of the analysis varied across the four countries, which is not surprising given the variation in regulatory requirements and business environments. This helps to demonstrate that there is not generally a "one size fits all" answer to governance issues.

Trends in Board Leadership

The information presented below represents the trends of the two types of structures from 2003 to 2011 and is based on an analysis of proxy statement disclosures of S&P 500 companies, as performed by Spencer Stuart and featured in its *US Board Index* (series 2003–2011)[1].

These statistics demonstrate that the number of S&P 500 companies separating the CEO and chairman roles has risen significantly since 2003. The percentage of companies with an independent non-executive chairman has also increased, from 9% in 2004 to 21% in 2011. Additionally, according to the *2011 Spencer Stuart U.S. Board Index*, 18 companies from the S&P 500 population have a formal policy to separate the positions of chair and CEO (up from six companies in 2010).

Year	Combine CEO/Chairman (as % of S&P 500)	Split CEO/Chairman (as % of S&P 500)	Independent, Non-executive Chairman (as % of S&P 500)
2003	77%	23%	Not Available
2004	73%	27%	9%
2005	71%	29%	9%
2006	68%	32%	10%
2007	65%	35%	13%
2008	61%	39%	16%
2009	63%	37%	16%
2010	60%	40%	19%
2011	59%	41%	21%

In looking at the trends, it is important to consider shareholder proposals in this area. According to ProxyMonitor.org, sponsored by the Manhattan Institute's Center for Legal Policy (May 2012), proposals for independent chairman ranked third in the type of proposals put forth this proxy season, with 1% of all proposals relating to chairman independence (note: political spending/lobbying type proposals make up 21% of the total followed by executive compensation proposals at 15%).

According to the Institutional Shareholder Services' (ISS) *2012 Proxy Season Scorecard* (as of 6/15/2012)[2], for 2012, for independent chair proposals, there were 48 vote results available with an average rate of support of 35.6%. This is compared with 2011 results, for which 26 vote results were available, with an average rate of support of 36.8%. With regard to shareholder proposals dealing with board issues and takeover defenses, the "independent board chairman" category had the highest number of results available for 2012 according to the ISS *2012 Proxy Season Scorecard*, demonstrating the importance of board leadership structures to shareholders. As the data show, there is no one-size-fits-all approach to board leadership structure, and there does not appear to be consensus regarding which practice is best.

Independent Chair Evaluation

Each board should consider the optimal board and board committee leadership structure and how to go about implementing those roles. What is optimal will depend on the company's circumstances at a given time, and it will be impacted by matters such as the business and

regulatory environment, as well as the costs, benefits and challenges involved. Challenges in making changes—including board members' personalities and relationships among themselves and with the CEO—should not preclude a board from considering which leadership structure will best support its governance role.

In evaluating the optimal board leadership structure, companies should consider the following in addition to local regulatory requirements or guidelines:

- Splitting the CEO and board chair roles between two different individuals, one who manages the business (the CEO) and one who leads the board in overseeing management (the board chair). If the company decides to split the roles of chair and CEO between two individuals, the company will need to make the determination of either having a non-executive chair or an independent chair.
- Establishing a second-in-command for the board through the appointment of a lead, presiding or senior independent director or a deputy or vice chair of the board. Such a position can counterbalance the power of the board chair, whether or not combined with the CEO position.
- Appointing the lead, presiding, or senior independent director or the deputy or vice chair to chair the nominating and governance committee or the compensation committee, or both committees concurrently.
- Considering whether board committee leadership appointments create a separation of powers and checks and balances as a safeguard against conflicts of interests that may arise due to the board chair's and committee chairs' authorities and responsibilities.
- Defining the board chair's responsibilities and qualifications, both of which should be used in recruiting and evaluating the board chair.
- Defining the responsibilities and qualifications of board committee chairs for similar use.
- Conducting periodic evaluations of the board at the group and individual levels including the chair; if the board chooses self-evaluations, these should be supplemented with periodic, but less frequent, externally facilitated evaluations.
- Specifying in the bylaws or board and committee charters the terms of service for the board chair, committee chairs and board members, and making renewal of their positions subject to review, evaluation and reconfirmation. Consider avoiding automatic renewal of incumbents.

A good time to establish a mechanism for evaluating the independent board chair is when the role is created. The evaluation criteria will stem from the responsibilities of the position, which should typically be defined when the role is established. Responsibility for defining the role and duties of the independent chair would typically fall to the nominating and governance committee. However, in some companies this committee chair is also the board chair. In such instances, consideration should be given to an objective party—such as the lead, presiding or deputy or vice-chair—managing the process to outline the board chair's responsibilities.

Stakeholder concerns, regulatory change, the economic climate and business imperatives demand continuous improvement in governance today. That demand will increasingly shape CEO and board member roles and responsibilities, as well as the related disclosures. Boards are able to effectively serve shareholders when they proactively address governance concerns. Thus, corporate leaders should consider whether now is the ideal time to assess their board and committee leadership structures, along with the roles and responsibilities of the board and

committee chairs. Properly conducted, such an assessment will position the board to consider which changes may be useful and how those changes may best be implemented.

Chairman Emeritus

As demonstrated by the Spencer Stuart *US Board Index* data, there is a continued U.S. trend toward separating the board chairman and CEO roles. With this trend, companies may consider whether the board should designate a chairman emeritus. This role may be filled by a former chairman as the new chairman assumes the formal responsibilities.

To obtain more details with regard to the chairman emeritus role and the number of companies that employ a chairman emeritus as part of their board composition, Deloitte researched the practices of all S&P 500 companies that issued proxy statements between January 1, 2012, and March 20, 2012. The results showed that only 20 companies from the S&P 500 that filed proxy statements within these parameters had a current chairman emeritus designation. Two had a chairman emeritus within the past year but not at the time of the proxy was issued, and two had provisions for a chairman emeritus but the position was unfilled. The position of chairman emeritus is often not unique to public companies, but is also seen in companies such as not-for-profits.

It is noted that the board may often grant a former chairman with the honorary title of chairman emeritus as a way to acknowledge his or her contribution to the organization. In these cases, the retired chairman holds a professional title and maintains a relationship with the organization, and the company benefits from the individual's experience and institutional knowledge. The chairman emeritus may or may not be an officer of the organization, or may remain affiliated with the company during a transitional period. Typically, the title can be rescinded by the board at any time with or without cause.

According to Deloitte's search of all S&P 500 proxy statements filed between January 1, 2012, and March 20, 2012, the duties of a chairman emeritus differ among companies, but may include:

- Representing the corporation at the request of the chairman of the board.
- Attending board, committee, or stockholders' meetings as requested—with no right to vote at directors' meetings.
- Providing advisory services on appropriate matters.
- Participating in external public relations activities and events.

In certain circumstances, when the chairman emeritus is not an officer, he or she may be given access only to public information from the organization.

To the extent boards include a chairman emeritus, the role should be clearly defined to ensure, again, no overlap or misunderstanding with regard to responsibilities. The board should further determine if the chairman emeritus should receive compensation, a retainer or meeting fees. Corporations that have elected to establish this position may include the designation and its duties in their proxy statements and related documents.

Ongoing Discussion and Debate

Issues related to board leadership structure are being discussed increasingly in boardrooms, including as part of the succession planning process. With a heightened focus on shareholder proposals in this area and with CEO turnover increasing, discussion and debate will likely continue.

Although historically, a majority of S&P 500 companies have combined the roles of CEO and chairman, there is clearly an increasing trend toward greater independence for the role of chairman. Though there are many individuals and thought leadership organizations on both sides of the issue, most agree that the particular leadership structure selected by a company is largely dependent on the individual company, individuals in the respective positions and its circumstances; no one structure may best serve all companies in all situations and circumstances.

Additionally, while still a relatively rare practice among the S&P 500, for boards that include chairman emeritus, the board should make sure to define the position's duties, compensation and qualifications. Companies should consider including information on the chairman emeritus in their filings, proxy statements and related documents to provide stakeholders with appropriate insight into overall board leadership and related roles.

—From Hot Topics, a feature in each issue of Corporate Governance Monthly, a newsletter with the latest information for boards of directors and their committees from the Center for Corporate Governance (www.corpgov.deloitte.com).

End Notes

1 Obtained from Spencer Stuart *US Board Index* (series 2003-2011)

2 Institutional Shareholder Services (ISS) *2012 Proxy Season Scorecard* (as of 6/15/2012)