

Board Effectiveness Reviews: Guiding Principles

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An effective board is central to any successful company. A board should promote diversity of thought and succession planning to ensure it has the skills and experience required to be best positioned for its future direction. Moreover, it creates and fosters a culture of openness and transparency to build trust and encourage rigorous debate between the executives and non-executives. However, the quality of the debate and interaction inside companies is difficult for investors to determine from the outside.

LGIM is a strong proponent that board effectiveness reviews are a powerful way to help a company’s board improve and evolve. This gives shareholders confidence that the board is striving to be the best it can be.

As a significant investor, we want all companies in the market to undertake board reviews that are rigorous and a value-added exercise. We do not want them to undertake a review ‘because they have to’ or ‘to tick a box’. In 2014, we published our views on board effectiveness reviews in our **Fundamentals** article*. At present, there is a range of practitioners and no minimum standards in place for reviews. This has inevitably resulted in variability of methodologies and, ultimately, quality of reviews.

We have been a strong advocate for a set of principles to be established. The principles provide a framework that helps to ensure a minimum standard of board review is upheld, as well as provide transparency with regards to the methodology undertaken. Moreover, potential conflicts of interest for evaluators are appropriately managed and disclosed.

BOARD EVALUATION PRINCIPLES

Introduction

These guiding principles have been designed to standardise best practice for Board evaluation. Created by three leading evaluators, and in consultation with shareholders and companies, they are intended to set professional standards for evaluators, regardless of methodology, and align expectations between shareholders and companies with regard to quality and integrity of process.

Summary

There are four guiding principles for evaluators, and three for companies, that will standardise the quality, credibility and legitimacy of the field, and have relevance across a number of different methodologies.

Evaluators	Companies
Independence	Cooperation
Confidentiality	Transparency
Competency	Approval
Follow-up	

Four Guiding Principles for Evaluators

- Independence** - the evaluator must be able to exercise independent and objective judgement. Existing commercial relationships, and other conflicts of interest, should be avoided, and/or disclosed and managed.
- Confidentiality** - the evaluator must keep all information confidential. The only exception to this is the discovery of unlawful practices or company demands.
- Competency** - the evaluator will disclose the skills and competences of each individual involved in the evaluation, and provide appropriate references. There must be alignment of expectation between the company and the evaluator with regard to quality, value and longevity of service.
- Follow-up** - the evaluator will discuss progress on agreed outcomes with companies (to include the Chairman, Senior Independent Director and/or Board) within 6-12 months of the evaluation.

*Fundamentals October 2014: Active ownership: driving the change

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Three Guiding Principles for Companies

- Cooperation** - there must be full cooperation between the company and the evaluator in order to ensure integrity of process. This will include transparency of, and appropriate access to, Board and Committee information, participants, and meetings.
- Transparency** - all disclosures, including the Annual Report, must identify the evaluator (and any conflicts), the methodology (including the use of interviews and observation), final outcomes (with reference to accepted and rejected recommendations), and the approval process.
- Approval** - the evaluator should agree and approve any formal disclosures, including the Annual Report, which describe the evaluation.

LGIM believes these principles are a positive step forward for board reviews and we will be discussing them with company Chairmen and continue to help best practice and standards evolve.

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