Canadian Insights

TERM LIMITS AND BOARD DIVERSITY: DEVELOPING POLICIES THAT WORK

In January, 2014, the Ontario Securities Commission proposed disclosure rules that will require TSX-listed issuers in Ontario to annually disclose the combination of term limits and gender diversity

Posted by Christina Medland and Phil Yores on October 22, 2014

In January, 2014, the Ontario Securities Commission (OSC) published proposed disclosure rules that will require TSX-listed issuers in Ontario to annually disclose:

1. Any policies they have regarding the representation of women on the board (and other details respecting women on boards and in executive positions)
2. Whether they have director term limits

The combination of term limits and gender diversity suggests that the OSC may view insufficient board turnover as one of the obstacles to greater board diversity.

Meridian Comment

We anticipate that the disclosure requirements will prompt companies to consider director retirement policies, age limits and term limits as well as policies around board diversity.

On balance, the approach to diversity is likely to be fairly straightforward and we expect many companies to introduce "soft" diversity policies with a simple statement that the board values diversity and makes efforts to ensure that directors have diverse skills and experience and reflect diverse gender and ethnic backgrounds.

The approach to director tenure and mandatory retirement is more complex and we expect to see varying approaches as companies try to promote appropriate turnover without losing key contributors, industry experience and institutional knowledge at the board table.

Approaches to Director Tenure

There are five relatively common approaches to effectively manage director tenure:

1. Term limits;
2. Mandatory retirement age;
3. Director evaluation and assessment;
4. Simple disclosure of director tenure and age; and
5. Loss of independence status for long serving directors.

Term limits and a mandatory retirement age ensure director turnover, but they are a blunt instrument that may force turnover of valued directors. Director evaluation can be very effective for identifying directors who are not making a significant contribution, but boards may be reluctant to use an approach that seems less collegial. Disclosure of director tenure and age may be used to demonstrate that the board has a healthy level of turnover and that its approach is working, without the need for term limits. Treating a director as no longer independent (after a long period of service, usually 9 to 12 years) is common in Europe but rare in Canada and the U.S.

Market Practice Information

Director Tenure and Term Limits

While the "comply or explain" model prevails worldwide, there seems to be a link between shorter director tenure and term limits or loss of independent status.

Canada (TSX 60)	
Average Tenure 8.3 Years	60% have retirement policy 32% have term limits

U.S. (S&P 500)	
Average Tenure 8.6 Years	Majority have retirement policy 3% have term limits

U.K. (FTSE 350)	
Tenure less than 5 Years	Deemed non-independent after 9 years (UK); 12 years (France)

Benefits of Term Limits and Retirement Policies

Studies of ideal director tenure are contradictory, some demonstrating significant benefits, while others highlight the detriments of longer-serving directors. However, there is a fairly common view that too little and too much director turnover are both correlated with low corporate performance and that reasonable director turnover is correlated with higher corporate performance. Mandatory retirement ages (e.g., a director cannot stand for re-election after reaching age 72) enable board members to "retire" with dignity.

Director Tenure/Retirement	
Advantages	**Disadvantages**
Tenure and retirement policies force board turnover, but not based on contribution level	Directors take 2 to 5 years to maximize effectiveness and value add
Older, longer serving directors may no longer be current on industrial and technological developments	There is real value in the institutional memory and industry experience/contacts of long serving directors, especially those who have seen multiple business cycles
A long tenured board can create a culture of undue deference to management, particularly where there is a long standing CEO	Long serving directors can provide deep context for corporate strategy, experience and connections in the relevant industry and often are best at standing up to the CEO
A tenure or retirement policy can avoid the need for a difficult discussion with a director who has ceased to be an active contributor to the Board	Long serving directors are important for companies that have long-term projects, particularly given the continued decrease in CEO tenure. Some studies have found that long serving directors are more (not less) likely to challenge a CEO

Meridian Comment

Rigid rules like term limits or mandatory retirement ages are often viewed as too limiting to boards trying to ensure their membership is comprised of a diverse group of directors with both long- and short-tenures, rather than being viewed as a useful tool that can help facilitate a refresh process among board members. Retaining some flexibility to apply their professional judgment, coupled with a strong board evaluation process will give boards the ability to ensure that they attract and retain the directors they need to support the long-term business strategy.

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