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BEST DISCLOSURE: BOARD EVALUATION

The board of directors is the cornerstone of the U.S. model of corporate governance. An effective board ensures that management runs a company in the long-term interests of shareholders, whom the board is elected to represent.

Over time, a board may become complacent or may need new skills and perspectives to respond nimbly to changes in the business environment or strategy. Regular and rigorous self-evaluations help a board to assess its performance and identify and address potential gaps in the boardroom.

Shareholders value detailed disclosure of the board evaluation process when making voting decisions about directors. Disclosures about how the board evaluates itself, identifies areas for improvement and addresses them provide a window into how robust the board's process is for introducing change. To be clear, shareholders generally *do not* expect the board to reveal the details of individual director evaluations; rather, they want to understand the *process* by which the board approaches the task of continually improving itself.

This report discusses the two main approaches to disclosure of the board evaluation process that members of the Council of Institutional Investors (CII) believe to be especially useful for evaluating a board's overall effectiveness. By highlighting disclosures that investors find meaningful, the report seeks to give companies a better understanding of the information their shareholders need to vote carefully for directors.

Background

Robust disclosure of the board evaluation process is not a common practice in the United States. While most major U.S. companies have a self-assessment process for the board in place, their proxy materials often merely state this fact without elaborating on what the process entails. Some U.S. companies disclose the existence of a board self-evaluation in the proxy and provide a link to their corporate governance guidelines for the details.

Disclosure of the board evaluation process is more common among non-U.S. companies. In Canada, it is required under the Canadian Securities Administrators' corporate governance disclosure requirements, though the guidance provided is not especially prescriptive. In the United Kingdom, Europe and Australia, disclosure of the evaluation process is also common practice, and companies often delve into specific findings from their most recent board evaluations.

Many CII members who vote proxies are eager for details about the board evaluation process at U.S. companies, too. Such disclosure is an indication that a board is willing to think critically about its own performance on a regular basis and tackle any weaknesses. The board evaluation—and disclosure of the evaluation process—can be a catalyst for "refreshing" the board as new needs arise.

At the suggestion of the CII Advisory Council, CII decided to gather a selection of what members consider exemplary disclosures about the board evaluation process. CII surveyed its members for examples from 2013 and 2014 U.S. and non-U.S. proxy statements of what they consider best-in-class disclosure of a board's self-evaluation—and why. This informal survey was not scientific or exhaustive, but it did yield significant overlap in the company disclosures and the specific disclosure elements that members found particularly useful. A discussion of the latter, with examples from company proxy statements, follows.

Two Approaches to Board Evaluation Disclosure

1. Explanation of the mechanics of the evaluation process

This approach focuses on the mechanics of how the board evaluation process is conducted and analyzed. According to CII members, investors value specific details that explain who does the evaluating of whom, how often each evaluation is conducted, who reviews the results and how the board decides to address the results. This type of disclosure does not discuss the findings of specific evaluations, either in an individual or a holistic way, nor does it explain the takeaways the board has drawn from its recent self-evaluations. Instead, it details the "nuts and bolts" of the self-assessment process to show investors how the board identifies and addresses gaps in its skills and viewpoints generally. This kind of disclosure can be an "evergreen" approach that remains the same in proxy materials from year to year, assuming the board's evaluation process does not change.

Particularly strong examples of this type of disclosure are found in the 2014 proxy statements of PotashCorp, Agrium and General Electric.

Potash Corporation of Saskatchewan (PotashCorp) presents an overview of its board evaluation in a table (reproduced in part below) that clearly describes the separate components of the process, including the full board self-review, the review of the board by management and reviews of the board committees, the board chair, committee chairs and individual directors. The chart explains who is involved with each review, the frequency of the assessments, the actions taken to complete them and the outcomes of a typical evaluation. Specific findings of the most recent evaluation are not discussed.

From PotashCorp's 2014 proxy statement:

Review (Frequency)	By	Action	Outcome[1]
Full Board (Annual)	All Members of the Board	• Board members complete a detailed questionnaire which: (a) provides for quantitative ratings in key areas and (b) seeks subjective comment in each of those areas. • Responses are reviewed by the Chair of the CG&N Committee. • The Board also reviews and considers any proposed changes to the Board Charter.	• A summary report is prepared by the Chair of the CG&N Committee and provided to the Board Chair, the CG&N Committee and the CEO. • The summary report is reported to the full Board by the CG&N Committee Chair. • Matters requiring follow-up are identified and action plans are developed and monitored on a go-forward basis by the CG&N Committee.
Full Board (Periodically)	Management	• Members of senior management who regularly interact with the Board and/or its Committees are surveyed to solicit their input and perspective on the operation of the Board and how the Board might improve its effectiveness. • Survey includes a questionnaire and one-on-one interviews between the management respondents and the Chair of the CG&N Committee.	• Results are reported by the Chair of the CG&N Committee to the full Board.
Board Chair (Annual)	All Members of the Board	• Board members assess and comment on the Board Chair's discharge of his duties. The CEO provides specific input from his perspective, as CEO, regarding the Board Chair's effectiveness. • Individual responses are received by the Chair of the CG&N Committee.	• A summary report is prepared by the Chair of the CG&N Committee and provided to the Board Chair and the full Board.
Board Committees (Annual)	All Members of each Committee	• Members of each Committee complete a detailed questionnaire to evaluate how well their respective Committee is operating and to make suggestions for improvement. • The Chair of the CG&N Committee receives responses and reviews them with the appropriate Committee Chair. • The Board reviews and considers any proposed changes to the Committee Charters.	• A summary report is prepared and provided to the Board Chair, the Chair of the CG&N Committee, the appropriate Committee and the CEO. The summary report for each Committee is then reported to the full Board by the appropriate Committee Chair. • The Committee Chair is expected to follow-up on any matters raised in the assessment and take action, as appropriate.

Agrium, another Canadian company, also includes a chart (see below) in its disclosure of its board evaluation process. But its chart centers on the methodology and steps involved in every review (along with a description of each step) rather than on the subject of each review. The chart below and the paragraphs that follow it in the proxy statement clearly explain who conducts the reviews, who is reviewed and how the reviews are conducted. Agrium, like PotashCorp, sticks to the mechanics of the evaluation process and does not include discussion of previous evaluations, other than to note that feedback was positive.

From Agrium's 2014 proxy statement:

Component	Description
Corporate Governance Review	A review is conducted of our corporate governance documents, current literature, and recent developments and trends indicated by corporate governance organizations and institutional investors.
Interviews	Confidential, in-depth, and candid interviews are conducted by the Board Chair and/or the consultant with each of the directors and certain members of senior management.
Director Questionnaires	Tailored questionnaires are developed for the directors with confidential responses provided directly to the Board Chair and/or the consultant.
Component	**Description**
Data Analysis and Preparation of Evaluation Report	The data and feedback provided pursuant to the evaluation process is reviewed and assessed. A written report, based on the data analysis and feedback from the directors and senior management, is compiled and presented to the Board Chair, the CG&N Committee Chair and the Chief Executive Officer for review.
Presentation of Findings and Recommendations to the Board	The final report is discussed by the CG&N Committee, provided to each of the Committees for their review, and then reviewed with the full Board.

General Electric is one of the few U.S. companies to present a thorough disclosure of its board evaluation process. Like its Canadian counterparts, GE's disclosure focuses exclusively on the mechanics of how the evaluation is conducted, without venturing into the results or findings from previous evaluations. However, the detailed explanation of the evaluation process is included in the company's "Governance and Public Affairs Committee Key Practices" document, which is separate from the proxy statement. GE's proxy statement includes a brief high-level overview of how the process is conducted and provides a link to the document where a more detailed explanation (see below) can be found. This separate document clearly states when and by whom the evaluations are to be conducted, and it also enumerates specific areas where the evaluation asks directors for ideas for improvement.

From General Electric's 2014 proxy statement:

1. Method of Evaluating Board and Committee Effectiveness. The committee will oversee the following self-evaluation process, which will be used by the board and by each committee of the board to determine their effectiveness and opportunities for improvement. All of the board and committee self-evaluations should be done annually at the November board and committee meetings. Every October, an independent expert in corporate governance will contact each director soliciting comments with respect to both the full board and any committee on which the director serves, as well as director performance and board dynamics. These comments will relate to the large question of how the board can improve its key functions of overseeing personnel development, financials, other major issues of strategy, risk, integrity, reputation and governance. In particular, for both the board and the relevant committee, the process will solicit ideas from directors about:

a. improving prioritization of issues;

b. improving quality of written, chart and oral presentations from management;

c. improving quality of board or committee discussions on these key matters;

d. identifying how specific issues in the past year could have been handled better;

e. identifying specific issues which should be discussed in the future; and

f. identifying any other matter of importance to board functioning.

The independent expert in corporate governance will then work with the committee chairs and the lead director to organize the comments received around options for changes at either board or committee level. At the November board and committee meetings, time will be allocated to a discussion of - and decisions relating to - the actionable items.

2. Discussion of the most recent evaluation

The second type of best-practice disclosure highlighted by CII members goes beyond a detailed discussion of the board evaluation methodology to also include discussion of big-picture, board-wide findings and any steps for tackling areas identified for improvement. Where the first approach includes charts and explanations that can be reused with little alteration from year to year, this second approach to disclosure focuses on the most recent evaluation. It recaps the key takeaways from the board's review of its own performance, including areas where the board feels it functions effectively, areas where it thinks it can improve and a plan of action to address these points in the coming year. Such evaluation-specific disclosures are most common in the United Kingdom, Europe and Australia.

BHP Billiton (Australia), Dunelm (Britain) and Randstad Holding (the Netherlands) include particularly effective examples of this type of disclosure in their 2013 annual reports.

BHP Billiton's 2013 annual report offers an in-depth disclosure of the board evaluation process in the context of its most recent assessment. The disclosure begins with a general statement regarding its board review framework and lists factors that the board considers when evaluating its activities, including time allocated to various matters considered by the board and feedback from shareholders.

The annual report includes a section discussing the "continuous improvement programs" that the company holds "to maximise the effectiveness of the Directors throughout their tenure and link in with their individual Director performance evaluations." After a general overview of these programs, the report lists specific activities that directors participated in over the past year.

Next, there is a section devoted to explaining the board evaluation, beginning with a general discussion of the frequency and intent of the review process, as well as the mechanics of how each part of the process (individual director reviews, board chair review, etc.) is conducted. A simple chart (see below) explains the frequency of each part of the evaluation process. The disclosure lists the specific criteria against which the performance of individual directors and the overall effectiveness of the board as a whole are assessed (see next page).

About half of the disclosure on the board evaluation recaps the assessments conducted in fiscal year 2013. This section includes a high-level overview of the effectiveness of the entire board, individual directors (without listing specific names) and board committees, as well as agreed-upon improvements that are aimed at enhancing the effectiveness of the board. The summary of these improvements amounts to an action plan for the board for the coming year.

From BHP Billiton's 2013 annual report:

Evaluation process

ASSESSMENT	REVIEW
Year one: Committee and individual Director assessment.* Year two: Whole Board assessment.*	Each year, review of: • Directors for re-election. • Board and committees for compliance with the *Board Governance Document* and committee terms of reference.

*May be internally or externally facilitated assessment. Our approach is to conduct an externally facilitated review of the Board or Directors and committees at least every two years, but no less than every three.

From BHP Billiton's 2013 annual report:

Director evaluation

The evaluation of individual Directors focuses on the contribution of the Director to the work of the Board and the expectations of Directors as specified in the Group's governance framework. The performance of individual Directors is assessed against a range of criteria, including the ability of the Director to:

- consistently take the perspective of creating shareholder value;
- contribute to the development of strategy;
- understand the major risks affecting the Group;
- provide clear direction to management;
- contribute to Board cohesion;
- commit the time required to fulfil the role and perform their responsibilities effectively;
- listen to and respect the ideas of fellow Directors and members of management.

Board effectiveness

The effectiveness of the Board as a whole and of its committees is assessed against the accountabilities set down in the *Board Governance Document* and each committee's terms of reference. Matters considered in evaluations include:

- the effectiveness of discussion and debate at Board and committee meetings;
- the effectiveness of the Board's and committees' processes and relationship with management;
- the quality and timeliness of meeting agendas, Board and committee papers and secretariat support;
- the composition of the Board and each committee, focusing on the blend of skills, experience, independence and knowledge of the Group and its diversity, including geographic location, nationality and gender.

The process is managed by the Chairman, but feedback on the Chairman's performance is provided to him by Dr Schubert.

Information about the performance review process for executives is set out in section 5.15.

Evaluations conducted in FY2013

During the year under review, the Board conducted a Board performance assessment, an assessment of each Director and reviewed the work and performance of the committees in accordance with the processes outlined above, all of which were internally facilitated.

Board assessment

The internal review, conducted over three meetings, covered effectiveness of Board meetings, the nature and the format of Board materials, as well as training and development. A range of improvements to the Board's work and effectiveness were agreed, including:

- introducing formal strategy days to the Board program to support the discussions of strategy that currently take place between management and the Board at each meeting;
- implementing an updated plan for Board engagement on strategy, execution and monitoring;
- effective methods for engaging on the increasing number of Board matters considered out of session;
- increased use of the committee report-out process, which is used for committee chairmen to summarise the key discussions;
- new items for the training and development of Directors;
- updating the format of materials provided to the Board.

The review of the Board as a whole also indicated that the Board is continuing to function effectively and in accordance with the *Board Governance Document*.

Director assessment

As reported last year, an externally facilitated assessment of each Director was completed in FY2012. Therefore, the FY2013 review was internally facilitated and the overall findings were presented to the Board and discussed. Each Director was provided with feedback on their individual and collective contribution to the Board and its committees. This review supported the Board's decision to endorse all retiring Directors standing for re-election.

Committee assessment

The assessment conducted this year focused on matters assessed against terms of reference, time spent by the committees in considering matters, quality of information received, time management and composition, the work of each committee, quality of Board and committee interface, and compliance with corporate governance requirements. These reviews utilised an electronic survey tool provided by Lintstock and were focused to draw out views on work, overall effectiveness, decision-making and other processes. Outcomes and recommendations from each committee will be considered and approved by the Board prior to implementation.

In addition, as part of the process for reviewing the *Board Governance Document*, the opportunity was taken to review each committee's terms of reference to ensure the Group's existing practices remain appropriate. A summary of the changes made to the terms of reference of each committee is set out under the relevant committee report in section 5.13.

Enhancements following previous evaluations

Board and committee evaluations conducted in recent years have led to a number of enhancements to Board meeting processes:

- **Chairman's matters:** For some time, the Board has held a closed session at the end of Board meetings. An additional closed session has been incorporated so that all Board meetings start with a closed session of all Directors (there are no members of the GMC present other than the Executive Director and the President Governance and Group Company Secretary). This allows the Chairman to outline matters to be considered by the Board and set the context for the meeting. It is also an opportunity for Directors to raise the items of business they believe warrant particular attention or any other relevant issues.
- **Assurance items:** The Board agenda provides more time for reports from the committee chairmen to the Board. This ensures that the Board is properly and formally informed of the work of its committees and relevant committee papers are also provided to the Board. Where appropriate, presentations made to committees are also presented to the Board during its meeting.
- **Training and development:** Sessions are scheduled during the Board meeting program.
- **Closed session:** Directors continue to have the opportunity to raise matters during the closed session at the end of each Board meeting, which is attended only by the Non-executive Directors.

Similarly, Dunelm's disclosure in its 2013 annual report (see below) is clear and concise, briefly explaining who was evaluated and how the evaluations were conducted. The disclosure is broken down into subsections relating to the results of the most recent board evaluations, including a clear distinction between actions implemented as a result of the findings from the 2012 evaluation, key findings from the 2013 evaluation and plans to address those findings in the coming year. The disclosure even identifies the third party appointed to carry out the 2013 board evaluation, with the assurance that there was no conflict of interest.

From Dunelm's 2013 annual report:

Evaluation

Each of the Directors receives a formal evaluation of their performance during the year.

The Board and Committees are also formally evaluated as a whole.

Actions implemented during the period as a result of our 2012 evaluation included:

- Board agenda was refocused on significant strategic and decision items.
- We reviewed how the Board communicates with our stakeholders and considered it to be appropriate.
- Succession planning below Board level was considered.

This year Condign Board Consulting, an independent third party provider of Board evaluation services, was appointed to carry out our first external evaluation. Condign had no previous business relationship with the Group or any of the Directors and it is not intended that they be engaged to provide services of any other type to the Company in the future. The evaluation consisted of individual interviews with each Director and the Company Secretary, attendance at a Board meeting as an observer and review of Board packs.

The evaluation confirmed that:

- The Board is operating effectively and is closely aligned to the culture of the business.
- Appropriate balance is being achieved between governance, strategic and operational matters.
- NED succession planning is still an important area of focus.

Agreed actions planned as a result of the evaluation include:

- The Board succession plan will remain a regular Board agenda item (alongside formal Nominations Committee meetings).
- More time to be spent defining the Board's risk appetite.
- Contacts between NEDs and between NEDs and Executive Directors/Executive Board members, to be timetabled formally.

Randstad Holding's board evaluation disclosure in its 2013 annual report (see next page) enumerates the items that the board assessed as part of its review and summarizes the main findings. It also includes several suggestions for improvement to the board's functioning, essentially an action plan for enhancing the board's effectiveness in the coming year.

From Randstad Holding's 2013 annual report:

At a separate annual meeting, the Supervisory Board discussed at length its composition, its own performance and that of its three committees. In preparation for this annual self-assessment, each member completed an open-answer questionnaire. Items assessed and subsequently discussed included:

- the Board's composition, size, profile, mix of skills and experience;
- the meeting cycle, decision-making, follow-up and discussion;
- induction, training and performance;
- the performance of and reporting to the full Board by the three standing Committees;
- the relationship with the Executive Board; and
- the performance of the Supervisory Board Chairman.

An anonymized summary of the main findings, prepared by the company secretary, was used as the basis for the self-assessment discussion. The Supervisory Board concluded that all of the items were assessed positively. Team spirit is considered strong, encouraging open discussion and clear understanding of each board member's role. Several suggestions for further improving the functioning of the Supervisory Board were raised and will be followed up during 2014. These suggestions relate, among other things, to:

- taking more time for in-depth discussion, jointly with the Executive Board, and for reflection on topics such as strategy, innovation, sustainability, competition, geographic mix, the impact of new business ideas, the Internet and social media;
- planning the succession of the Supervisory Board's Chairman (who retires in 2015) and Vice-Chairman (who retires in 2014) in light of the mix of skills, competencies and experience required; and
- further optimizing the role of the Strategy Committee to increase understanding and contribution of the full Supervisory Board in setting the strategic direction. Although good progress was made in 2013, more time will be spent in 2014 on strategy outside the regular meeting cycle.

At year-end, the Chairman also conducted one-on-one meetings with each member to discuss their personal performance.

Bibliography

CII thanks its members and Eumedion, which represents institutional investors on corporate governance and related sustainability performance issues in the Netherlands, for providing the examples of best disclosure used in this report and listed below:

Agrium
http://www.agrium.com/includes/2014_Proxy_Circular2.pdf

BHP Billiton
http://www.bhpbilliton.com/home/investors/reports/Documents/2013/BHPBillitonAnnualReport2013.pdf

Dunelm
http://www.cii.org/Files/publications/misc/Dunelm%202013%20Annual%20Report.pdf

General Electric
http://www.ge.com/proxy2014/pdf/GE_2014_Proxy_Statement.pdf

Potash Corporation of Saskatchewan
http://www.cii.org/Files/publications/misc/PotashCorp%202014%20Proxy%20Circular.pdf

Randstad Holding
http://www.afm.nl/registers/fv_documents/12982.pdf