BOARD EVALUATIONS AND DISCLOSURE

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Introduction: What are board director evaluations and why are they important?

Board director evaluations are reviews performed by a company's board of directors to determine the effectiveness and efficiency of its members. These evaluations help to ensure that the board is fulfilling its responsibilities in the best interest of the company and all its stakeholders. The results of these evaluations can also help to identify areas for improvement and provide guidance for future development. “When done properly and effectively, board evaluations can provide a vital tool for directors to review and improve board performance”, state Mark Fenwick and Erik P.M. Vermeulen (European Corporate Governance Institute). This effect has been recognized globally – the G20/OECD Principles recommend the inclusion of regular board evaluations in a country’s corporate governance framework, and the World Economic Forum’s “The New Paradigm” recommends that boards evaluate their own performance, as well as that of the individual directors and board committees.

However, when it comes to the disclosure of board director evaluations in company reports, there is often a debate about how much information should be made public. Some argue that complete transparency is necessary to build trust and credibility with stakeholders, while others believe that too much information can compromise the confidentiality of the evaluations and may even undermine the board's effectiveness.

Purpose and benefits of board evaluation disclosures

Disclosures play an important role in the wider context of corporate governance as they provide stakeholders with important information about a company's governance practices and performance. In particular, disclosures about board evaluations provide stakeholders with information about how a company's board is being held accountable and how its performance is being assessed. This information is often useful in helping stakeholders make informed decisions about the company and its governance practices.

In the context of corporate governance, disclosures help to promote transparency and accountability by allowing stakeholders to see how well a company is being run. This information can help stakeholders assess whether the company is acting in its best interests and may also help identify areas where the company needs to make improvements.

Additionally, disclosures can help to improve governance practices by providing companies with information about what stakeholders expect from them. This can help companies to identify areas where they can improve their practices and ensure

that they are meeting the needs and expectations of their stakeholders.

Overall, disclosures play a critical role in the wider context of corporate governance by promoting transparency, accountability, and trust between companies and their stakeholders. Companies that provide comprehensive and accurate disclosures about their governance practices are more likely to be trusted and seen as responsible and effective stewards of their stakeholders' interests.

The sensitivity of disclosure

Board evaluation disclosures can be sensitive for several reasons:

1. Confidentiality: Board evaluations often involve the confidential assessment of individual directors, which raises concerns about privacy and the potential for sensitive information to be leaked.

2. Reputation: Disclosing information about board evaluations could reflect poorly on directors or the company if the evaluations reveal areas for improvement or weaknesses in governance practices.

3. Conflict of interest: There may be concerns around conflicts of interest when directors are evaluating their own performance or the performance of other directors.

4. Legal implications: There may be legal implications if sensitive information is disclosed that could be used in future legal proceedings.

5. Board dynamics: Board evaluations can have an impact on the dynamics of the board, particularly if evaluations reveal areas for improvement or if directors feel that their performance has been unfairly assessed.

Researchers Mark Fenwick and Erik P.M. Vermeulen believe that the requirement to disclose information about the board evaluation process itself does have a positive effect – but not the disclosure of the individual assessments of board members!

This is backed by a study conducted by audit firm EY's "Centre for Board Matters" – almost half of the Fortune 100 companies disclose that they have assessed the performance of individual directors (but not the specific results).

Disclosure in company reports

Disclosure practices vary; there is no global "best practice" yet. The Council of Institutional Investors (CII), via its Research and Education Fund, published a guidebook about proper disclosure of board evaluation processes ("CII Guide"). Glenn Davis and Brandon Whitehill provide a

framework (“Seven Indicators of Strength”) that describe elements of evaluation processes that boards should consider and communicate in their disclosure.

The Toronto Stock Exchange (TSX) has reviewed the corporate governance disclosure of over 700 of its issuers and explicitly provides examples of both good and bad disclosure. The manual “Corporate governance - A guide to good disclosure”, provides very practical advice on how to respond to the 14 guidelines of its corporate governance code, with a special section on “How to communicate effectively”.

Some companies are starting also to disclose the actual assessment topics representing stakeholder interest, for example diversity and inclusion, ESG, purpose, crisis preparedness, culture, innovation, cyber-security, and geopolitical risk.

“The pressure for more disclosure regarding board, committee, and individual director evaluation processes is likely to continue to increase”, says Holly Gregory of Sidley Austin, the U.S. law firm.

Proxy advisors

Proxy advisors typically advocate for increased transparency and disclosure in the area of board evaluations. They believe that clear and detailed information about the process, results, and follow-up actions taken by the board in response to the evaluation is important for shareholders to assess the effectiveness of the board and make informed voting decisions. They often recommend companies to publicly disclose their board evaluation processes, methods, and results, as well as their efforts to improve board performance. This includes disclosure of the board's goals and criteria for evaluation, the process for conducting the evaluation, the extent to which directors participated in it, and the extent to which the results of the evaluation were used to inform changes in the composition and practices of the board.

Institutional Shareholder Services (ISS) is one of the largest and most influential proxy advisory firms in the world, and they generally support increased disclosure around board evaluation practices. They advocate for companies to provide more transparency about the process used for evaluating the board and its individual members, as well as the results of these evaluations. This information can help investors make informed decisions about director elections, board composition, and company governance practices. Some of the key considerations for ISS when evaluating board evaluation disclosure practices include the independence of the interviewer, the use of objective criteria and metrics, and the level of detail provided about the results of the evaluation.

International examples

Disclosure practices regarding board director evaluations can vary greatly across different countries and regions. Some countries have specific laws and regulations that require companies to provide certain information about their board evaluations.

In the United States, the SEC has issued guidance encouraging companies to provide information about their board evaluation processes in their annual proxy statements. However, the level of detail provided can vary widely from company to company.

In Japan, the corporate governance code encourages companies to conduct regular evaluations of their directors, but there is no requirement to disclose the results.

In Australia, the ASX Corporate Governance Council's Principles and Recommendations encourage companies to disclose information about their board evaluation processes but do not yet require it.

In Italy, there is a legal requirement for companies to conduct regular board evaluations, but the level of disclosure in company reports can vary. Listed companies are required to carry out an annual performance evaluation of their board of directors. This evaluation should assess the board's performance and effectiveness, as well as that of individual directors. The results of the evaluation should be taken into consideration when determining director remuneration and when making decisions about the composition of the board.

However, the level of disclosure about these evaluations in company reports is not specifically regulated by Italian law. Some companies may choose to provide detailed information about their evaluation processes and results in their annual reports, while others may only provide brief information.

In general, the level of disclosure about board director evaluations in Italy is lower compared to other countries with more developed corporate governance regimes. While the general practice of disclosures tends to become more widespread, the focus of the disclosure often leans towards the board’s strengths, while its weaknesses are often featured less prominently.

In Singapore, the level of disclosure about board director evaluations in company reports is relatively high, reflecting the emphasis on good corporate governance practices in that country.

The Singapore Exchange (SGX) requires listed companies to provide information about their board evaluation processes in their annual reports, as part of the SGX Listing Rules. This information should include a description of the scope and frequency of the evaluations, as well as any changes made to the evaluation process.

Additionally, the Code of Corporate Governance, issued by the Monetary Authority of Singapore (MAS) and the Singapore Exchange (SGX), recommends that companies should conduct regular evaluations of their boards, including individual directors, and disclose the results in their annual reports. The Code also states that companies should provide a description of the evaluation process used, including the scope and frequency of the evaluations.

In Singapore, transparency and accountability in corporate governance are considered to be important for promoting investor confidence and enhancing the reputation of the country's capital markets. Nonetheless, while the ten largest listed companies in Singapore conduct board evaluations internally once a year, only five (50%) mentioned the usage of an external evaluator – with two doing so annually and three doing so once every three to four years.

For all companies listed in Malaysia, the Malaysian Code on Corporate Governance issued in 2017 ("MCCG") states that the board should undertake a formal and objective annual evaluation of its effectiveness. Furthermore, for Large Companies, the board should engage independent experts periodically to facilitate objective and candid board evaluations. The code also requires companies to disclose in their annual reports how the evaluation was conducted, including whether it was done internally or with the support of an external party, and the parameters used, such as the assessment of 'fit and properness'.

In the United Kingdom, there is a general expectation that listed companies will conduct regular evaluations of their board and disclose information about these evaluations in their annual reports. The UK Corporate Governance Code, applicable to listed companies, states that they should establish a formal and transparent procedure for evaluating the performance of the board as a whole, its committees, and individual directors. As a general rule, external independent reviewers are preferred.

The Code also recommends that companies should provide a brief description of the evaluation process used, including the scope and frequency of the evaluations, in their annual reports. This information can help shareholders understand the steps taken by the company to ensure that the board is working effectively and making informed decisions.

While the UK Corporate Governance Code is not legally binding, companies are expected to comply with its provisions or explain any deviations in their annual reports. The Financial Reporting Council, the UK's regulator for corporate governance, can take enforcement action against companies that do not comply with the Code or provide inadequate disclosures.

In summary, in the UK, there is a clear expectation for companies to conduct regular evaluations of their board and to disclose information about these evaluations in their annual reports, as part of a broader commitment to transparency and accountability in corporate governance.

When comparing UK and Italy, for example, researchers Donatella Busso, Alain Devalle, and Fabio Rizzato from the University of Turin analyzed the largest 40 constituents of both Italy's MIB index and the UK's FTSE 100 index. Their view is that UK companies have a stronger "forward-looking" approach when compared to Italian companies, whereas disclosure provided by Italian companies is too often insufficient to enable stakeholder understanding of the process and its outcome.

Conclusion

In conclusion, the level of disclosure about board director evaluations varies widely across the world, reflecting different cultural, legal, and regulatory frameworks. However, in more developed markets, there is a growing link between the quality of Board evaluation, transparency of disclosure, and stakeholder confidence to make better-informed investment decisions.

Chairs and board members should be courageous – conducting and openly disclosing a thorough board evaluation sends a strong message to a company's stakeholder landscape. It creates a "tone from the top" that is self-critical, responsible, and accountable.

References

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