Separate CEO and chairman roles:

a board opportunity

- Support for separation of the roles seen as a sign of good governance
- No formal requirement mandating separation of roles under exchange rules
- Board needs to be able to challenge management in constructive way

By Michelle Tan

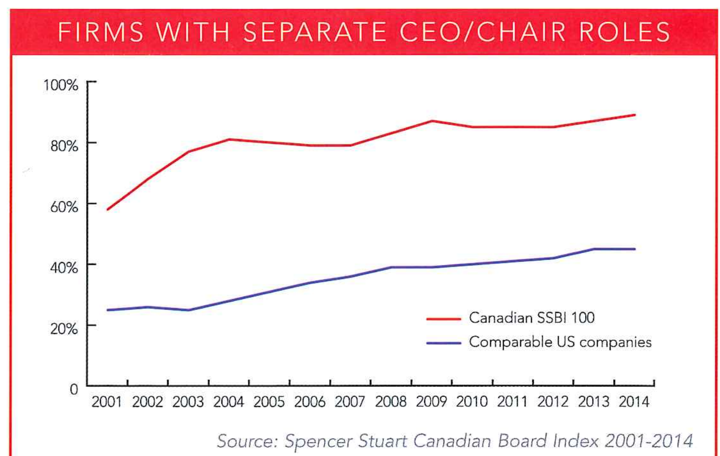
Separating the CEO and board chair roles continues to be a hot topic with fierce proponents on both sides of the debate. It is a contentious governance issue and, to date, there is no clear evidence that a non-executive chair improves financial performance.

Monitoring management's activities creates a potentially adversarial relationship between management and the board. An effective board can turn this into a constructive dynamic. Consider the board's responsibility to hire, evaluate, compensate and eventually replace the CEO: directors must be comfortable asking difficult questions and objectively evaluating the CEO's performance. This critical responsibility can be challenging and political in the best of circumstances, and even more so when the CEO also chairs the board.

Given their limited interaction with directors, shareholders will more likely focus on visible signs, such as board leadership structure, as an indicator of a board's accountability and independence of thought. Across North America, institutional shareholders generally support the separation of these roles as a principle of good governance, and state as much in their published voting policies. It is worth noting that Canadian institutions tend to use stronger language when expressing their expectation for separation of roles and less tolerance for the idea of a lead independent director than their US counterparts. That is likely a result of the higher preponderance of split roles in Canada.

Nevertheless, it is evident there is a desire to avoid forcing a one-size-fits-all approach to board governance. Voting policies are meant to be guidelines and most shareholders are rarely inclined to rock the boat to push for leadership changes, particularly when strong performance mitigates concerns about the combined roles.

Directors, however, often sit on multiple boards and as such are eyewitnesses to effective boards across the full range of board leadership structures. Globally as a group, directors are coalescing around the idea that separation is generally preferable.



Source: Spencer Stuart Canadian Board Index 2001-2014

THE ROAD LESS TRAVELED

In 2009 shareholders of Bank of America (BofA) approved, albeit just barely, a binding resolution to separate the roles of the CEO and chairman. Fast forward to October 1, 2014, when BofA's board announced the unilateral reversal of the bylaw provisions requiring an independent chairman, the appointment of CEO Brian Moynihan as chairman and the appointment of director Jack Bovender to the newly defined role of lead independent director.

Some shareholders publicly defended the move, most notably Warren Buffet, who himself holds a combined CEO/chair role. Others cried foul, particularly those who had supported the 2009 separation. Following the recombination, two shareholder groups were able to leverage their discontent into board commitments to provide a report on BofA's corporate culture and business practices and to adopt proxy access.

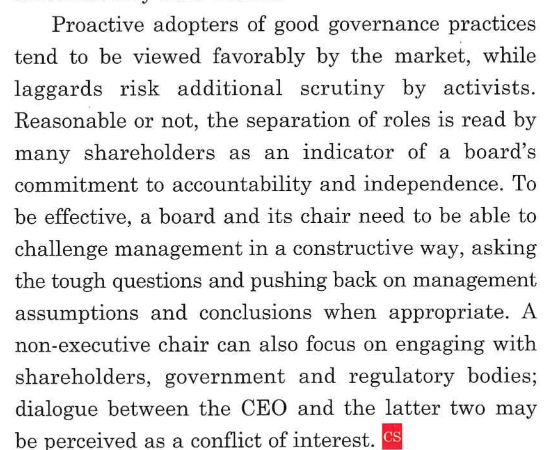
Ultimately, shareholders re-elected the full board, albeit with significantly lower support levels (72 percent) for three of the four members of the corporate governance committee and the committee chair (66 percent). The commotion may be for naught, however, as the board announced at the AGM that the decision to recombine the roles would be submitted to a shareholder vote to be ratified (or not) no later than the next annual shareholder meeting.

Though not always the case, separate CEO and chair roles have become the norm in Canada. In the US, two widely accepted structures for board leadership have emerged: separate CEO and chair, and combined CEO/chair with a lead independent director. Spencer Stuart's annual board indices show that while the pace of separation in recent years is similar in the two markets, there is a big differential in the preponderance of separated roles (see page 39).

One possible reason for this divergence is the different expectations for listed issuers developed by Canadian versus US regulators. In the US the SEC rules require companies to disclose their board leadership structure and explain why it is appropriate, given their specific characteristics or circumstances. By contrast, Toronto Stock Exchange rules, which took effect in 1995, take a slightly harder stance, advocating for (but not mandating) separate roles and requiring disclosure on why a non-executive chair was not an appropriate structure for a company. Under the comply-or-explain regime, it is conceivable many companies simply found it easier to comply than to explain their preference for another leadership structure.

A second factor followed in the late 1990s when shareholder proposals targeting big banks advocated the idea of an independent board chair. While the proposals were soundly defeated, the issue continued to gain traction in Canada's shareholder community. An opportunity arose for the bank boards in the early 2000s as several of their CEOs retired. Four successors were appointed to a CEO role that did not include the title of chairman. Shortly thereafter the CEOs of the two remaining big banks gave up their chairman titles. This solidified the banks' position as early governance leaders and legitimized the notion that a CEO could run the business without also being chairman.

Despite the widespread practice of separated roles in Canada, there remains no formal requirement mandating the separation of roles under exchange rules or corporate law. The Canadian Business Corporations Act (CBCA) is currently silent on whether the CEO and chair roles should be held by separate individuals, but this may soon change. As part of a consultation process, the issue of board accountability, including the idea of separate roles, was raised and Industry Canada has asked for stakeholder input 'on whether the provisions of the CBCA adequately balance the respective roles of boards and shareholders and enable shareholders to require appropriate levels of accountability from boards.'



Proactive adopters of good governance practices tend to be viewed favorably by the market, while laggards risk additional scrutiny by activists. Reasonable or not, the separation of roles is read by many shareholders as an indicator of a board's commitment to accountability and independence. To be effective, a board and its chair need to be able to challenge management in a constructive way, asking the tough questions and pushing back on management assumptions and conclusions when appropriate. A non-executive chair can also focus on engaging with shareholders, government and regulatory bodies; dialogue between the CEO and the latter two may be perceived as a conflict of interest. CS

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