Best Practices in Board Composition

What makes a good board of directors? It is a question often posed to investors, stakeholders, and sometimes directors themselves. It is also a question not easily answered. Shareholders are not privy to the conversations and debates that occur inside the boardroom. They can only observe the outcomes and decisions made by the collective group that makes up their representatives in the boardroom. This is why CalSTRS works to ensure that the composition of the board is of the highest standard. It is vital that boards of directors are structured to ensure there is proper oversight of company management, strategy and risk.

1. Independent Leadership

CalSTRS believes that independent leadership is best when companies have an independent chair that is separate from the Chief Executive Officer. The roles of chair and CEO have fundamentally different and often conflicting responsibilities: the chair serves as leader for the board to provide independent oversight of management and the CEO serves as leader of the company. It is vital that the leadership is structured to ensure there is adequate flow of information to the board, and that management does not control which issues are elevated to the board.

We believe any leadership structure that does not include an independent chair does not provide for the appropriate balance of power in the boardroom.

2. Diversity

Diversity of thought and experience are crucial for constructive dialogue inside the boardroom. Boards should embrace diversity in the broadest sense, considering gender, age, culture, sexual orientation and identification, and ethnicity, while also having a sufficient mix of relevant skills and industry experience. A diverse range of perspectives and expertise will make the board most effective.

3. Board Refreshment/Succession Plan

The board should have a process to assess the evolving needs of the company and a mechanism to ensure there is periodic board refreshment. While tenure and age limits can force board turnover, they do not ensure a regular evaluation of the company's current and long-term business needs. Boards should establish and disclose the process used to evaluate board composition and director performance, including a periodic third-party evaluation. Along with board refreshment, the board should be transparent about its recruitment process and disclose a board succession plan that addresses future company and board needs.

4. Board Tenure

Varying director tenure is also important to board composition. Just as new ideas are an integral contribution inside the boardroom, so is the experience that being a director brings to the board. Companies need directors who have been through multiple business and market cycles and who understand the company's operations, customers and shareholders. An effective board should have short- and long-tenured directors to ensure that fresh perspectives are provided and that experience, continuity and stability exist on the board.

5. Board Accountability

Directors are representatives of a broad shareholder base and they must be held to the highest standard of accountability. CalSTRS believes these four governance structures contribute to this high level of accountability:

1. **Director attendance:** Directors need to make the substantial time commitment required to adequately fulfill their responsibilities and duties to the company and its shareholders.
2. **Annual board elections:** Directors should be accountable to the shareholders they represent and therefore should stand for election every year.
3. **Director election standards**: Directors, as shareholder representatives, should be required to garner the support of at least a majority of their shareholders.
4. **Director time commitment:** The responsibilities of being a public company director are increasingly complex, demanding and time-consuming. CalSTRS believes that CEOs should not serve on more than one other public board, and that directors should not serve on more than four public boards.