

CalPERS Focus on Board Tenure as Measure of Director Independence

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CalPERS is considering changing its proxy voting policies to account for issues of director tenure. New language in its governance principles could state that director independence may be “compromised” at 10 years of service. If implicated, companies are expected to “carry out rigorous evaluations to either classify the director as non-independent or provide detailed annual explanation why the director can continue to be classified as independent.” In addition, boards should fully evaluate their succession planning process surrounding director refreshment to maintain the necessary mix of skills, diversity and experience.

[CalPERS' presentation](#) has several interesting data points around the topic of tenure. Over the last 10 years, the percentage of boards in the S&P 500 with a mandatory retirement age of 70 has decreased from 51% to 11%, while those with retirement ages of 75 has increased from 3% to 24%. The average director age is 68.

7% (347 directors) in the S&P 500 have terms of more than 20 years, 22% (1,225 directors) have sat on their boards for more than 12 years and 35% of directors (1,931 directors) have tenures that exceed 9 years. In the international arena, the UK Corporate Governance Code (London Rule) suggests tenure beyond 9 years poses independence problems, the European Commission recommends limiting director tenure to 12 years and Hong-Kong has a 9 year maximum tenure unless shareholders separately vote for re-appointment.

The presentation explains that the benefits of shorter tenure include (a) strengthening independence, (b) promoting competency if longer-tenured directors do not keep up with current developments, and (c) bringing fresh perspectives. In addition, term limits could increase board refreshment and promote diversity as well as replicate other international markets.

However, CalPERS recognizes the risks that term limits are arbitrary and could keep valuable directors from service, as well as restrict the pool of capable candidates. New directors also require substantial time to gain company knowledge. The optimal director tenure can vary by industry, and longer tenured directors could enhance their boards' oversight due to their experience. Companies could also end up using term limits to avoid rigorous board evaluations.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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