A Surprising Definition of Board Independence

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BlackRock's decision to appoint a 17-year board veteran as its new lead independent director has raised questions among some of its investors.

The world's largest asset manager, which has used its clout to push for corporate governance improvements at many of the companies in its portfolio, has tapped Murry Gerber for the important role, at a time when several large pension funds have started to worry about the effectiveness of such longstanding directors.

To those of us steeped in British corporate governance norms, the idea of someone who has been on a board since 2000 qualifying to be lead independent director is surprising. The UK Corporate Governance Code assumes that directors lose their independence after nine years of service, on the theory that they become too defensive of the status quo or too close to management to effectively fulfil their oversight role after that. Most stand down before that point.

That is not the presumption in the US, where BlackRock is listed. There is no equivalent US governance code, and the New York Stock Exchange's rules on independence require only that a director has not recently worked for the company. It is not remotely surprising, then, that the average US board director has been in post for more than two years longer than a UK director and is five years older.

The prevailing view in the US has been that independence is a state of mind. Which of course it is. Mr Gerber is a former chief executive of EQT Corporation, the natural-gas explorer, and has been reelected to BlackRock's board in recent years with over 98 per cent shareholder support. He was chosen by the rest of the company's independent directors for his judgment, leadership skills and knowledge of the company, according to its proxy statement.

Since BlackRock is still run by its powerful founder, Larry Fink, who combines the chief executive and chairman roles, Mr Gerber's ability to act as a counterweight to Mr Fink is a critical qualification for the role. Some investors will worry about his independence, given that the two men have worked side by side in the boardroom for so long. Others will fear that a director less well versed in the company's history and business would not have the gravitas to challenge Mr Fink.

This is the debate BlackRock must now have with its shareholders. Calpers, the Californian pension fund, sets a cut-off of 12 years, after which it deems directors to lose their independence, while another fund, Calstrs, has also started focusing on board longevity.

"Choosing a lead director is more art than science," says Anne Sheehan, head of corporate governance at Calstrs. "With such a long-term director, we need to know why they feel that would be the best person. We would want a little bit more information."

Rakhi Kumar, head of asset stewardship at State Street Global Advisors (SSgA), one of BlackRock's top 10 shareholders, also said such an appointment would trigger questions, such as, "Does that person have integrity? Why was that individual chosen?" She declined to comment on Mr Gerber or BlackRock.

SSgA has been particularly muscular among large institutional investors when it comes to making boards fresher and more diverse. In fact, it singles BlackRock out as a case study of how its engagement programme can bring about change.

“We called on the company to enhance its public disclosure on the role of its lead independent director,” SSgA says in its newly released annual stewardship report. “In September 2016, the company published its ‘Lead Independent Director Guidelines’, which provide a more robust description of the role and responsibilities than previously disclosed.”

If that sounds incredibly polite, there is steel behind SSgA’s engagement with BlackRock and hundreds of other portfolio companies. It has been screening corporate boards for those where the average tenure of directors is well above their national average, and threatening to vote against directors at those companies. In all, SSgA voted against 731 directors globally last year because of poor board refreshment practices.

The average tenure of BlackRock’s directors is not above the norm, for the record, since it has brought on six new directors in five years to serve alongside long-timers such as Mr Gerber. There is also no particular reason to think that shareholders will object to his appointment.

But the argument for standardising the rules on independence remains a powerful one, since it removes the need to have sensitive and subjective conversations, in which asking for a fresher board can be misconstrued as an attack on individuals and put companies on the defensive. Not all ultra-long tenured directors lose their independence, but US corporate governance would be better served if there were fewer.