



The voice of corporate governance
in Luxembourg

Deloitte.

Board Evaluation - Effectiveness Survey

Luxembourg practices in focus

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ILA

19, Rue de Bitbourg
L-1273 Luxembourg

+352 260 021 488
WWW.ILA.LU

TABLE OF CONTENTS

FOREWORD	3
INTRODUCTION	5
SURVEY RESPONDENTS	6
SURVEY RESULTS	7
CONCLUSION	16

FOREWORD

On behalf of Deloitte Luxembourg and the Institut Luxembourgeois des Administrateurs (ILA), we are pleased to introduce our inaugural Board evaluation effectiveness survey.

In this, our first edition, we garnered the insights of 82 Investment Funds, Management Companies, Banks, Insurance Companies and Non-Profit Organisations in Luxembourg.

Our aim, in preparing this survey, is to provide boards with insights as to current best practices and to further strengthen the overall board evaluation framework in Luxembourg.

Wherever boards are on the spectrum from no board evaluations or thinking about having a board evaluation through regular periodic evaluations to externally facilitated evaluations, there is always scope for a next step (or further improvement).

From the simple and basic question “How are we doing?” through the formal annual or periodic evaluation process to the externally facilitated triennial board evaluation, board assessments ensure that boards of directors - collectively and individually - continue to fulfil their missions, goals and objectives in the best possible cooperative and forward-thinking environment.

We would like to thank all the respondents who have participated in this survey, the members of the ILA Board Organisation and Effectiveness Committee who devoted a significant amount of time and effort to design the survey and analyse its results, as well as staff from Deloitte Luxembourg who provided their support.

This survey report should be read in conjunction with the publication by ILA on Board Evaluations: Enhancing Board Effectiveness.



Bill Lockwood

Chair, ILA Board Organisation
and Effectiveness Committee



Justin Griffiths

Partner, Deloitte



Yann Mérillou

Director, Deloitte

“Board evaluation is a sound corporate governance practice. The existence of a robust process enabling the board to assess its own composition and effectiveness is often seen as an indicator of good governance by many investors and stakeholders.”

INTRODUCTION

Objective of the Survey

This Board evaluation effectiveness survey reflects the results of a survey undertaken jointly by Deloitte Luxembourg and the Institut Luxembourgeois des Administrateurs (ILA) between July and October 2018.

The primary objective of the survey was to gather unbiased insights on current and evolving practices of board evaluations in Luxembourg. It further sought to identify and evaluate what next steps might be taken to improve board evaluations.

Methodology and sample

The survey has been sent to governance professionals representing 160 of the largest organisations here in Luxembourg. All major industries including Funds, Management Companies, Banks, Corporates, Non-Profit Organisations as well as Insurance Companies are represented in this first edition.

The survey was addressed to executive directors, NEDs and iNEDs. Whilst Luxembourg company law makes no distinction between types of directors (and therefore all directors have the same duties and responsibilities), corporate governance practice tends to divide directors into different groups, usually as follows:

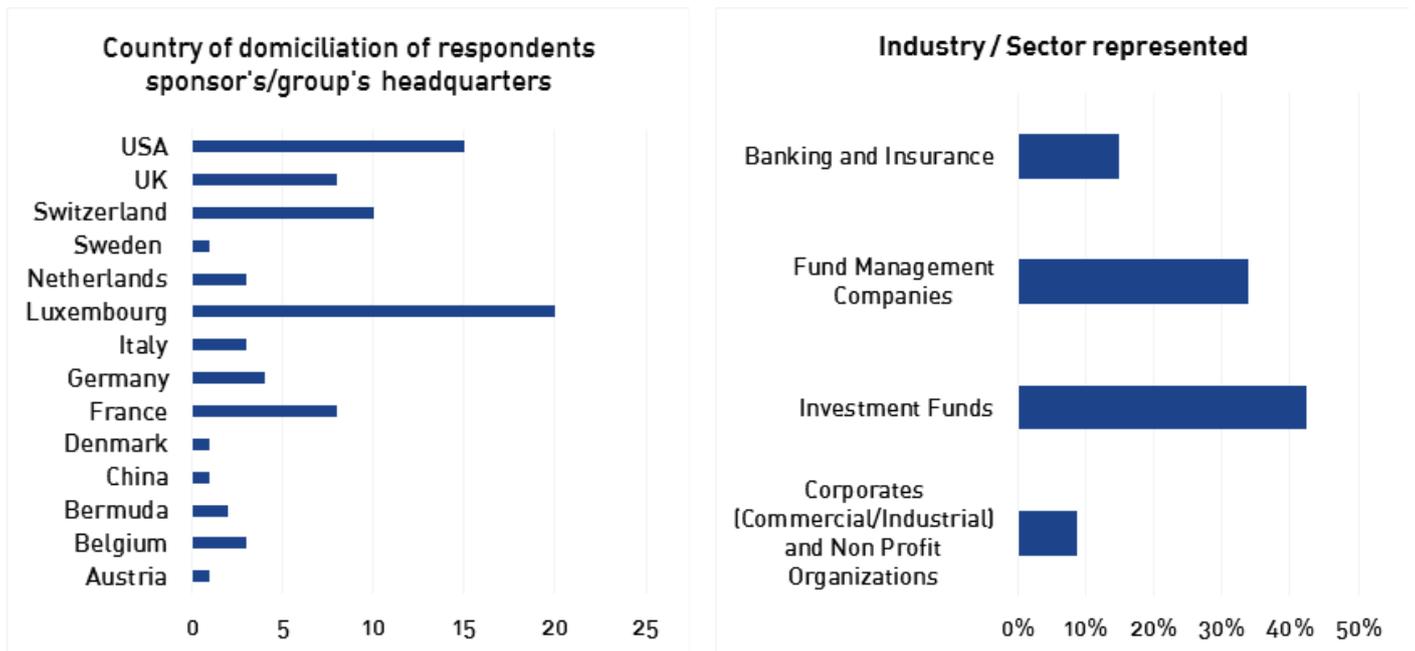
- Director - any member of a Board of directors of a company
- Executive Director - a director who is also an employee of the company
- Non-Executive Director ("NED") - a director who is not an executive director
- Independent Non-Executive Director ("iNEDs") - a NED who is also considered independent.

Outputs

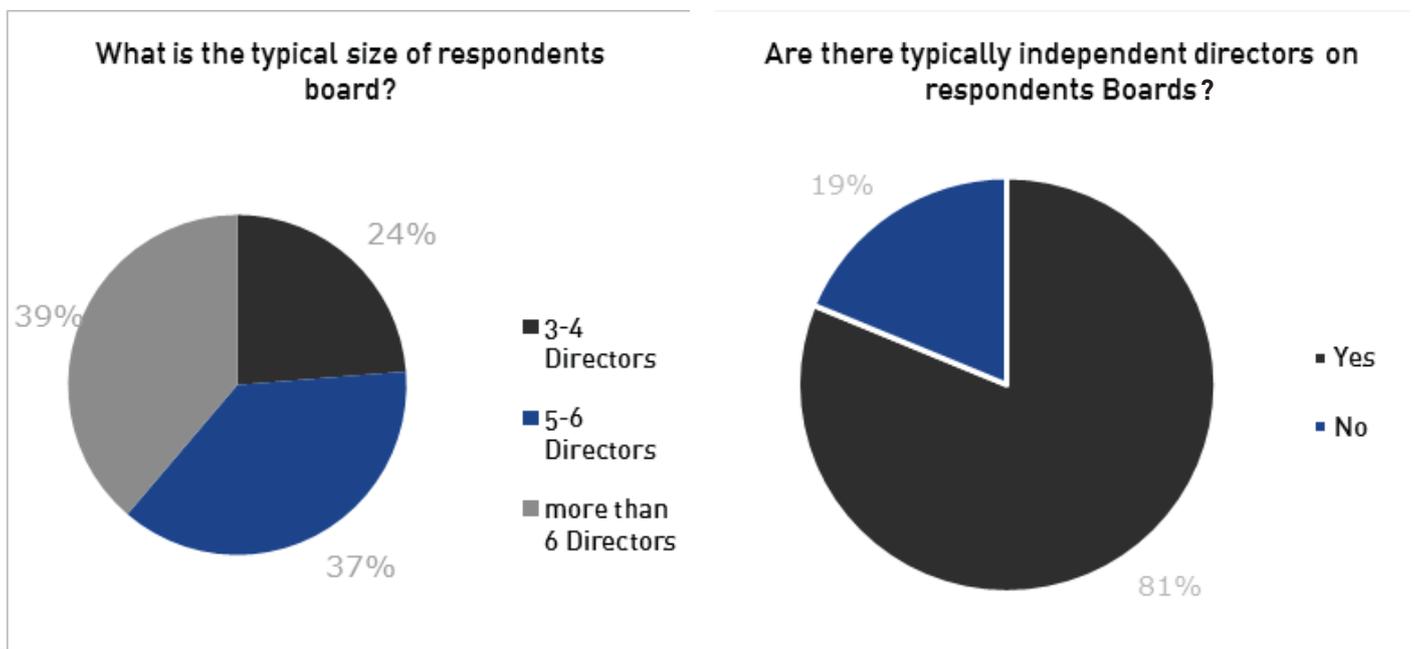
Major companies from all industries participated and we received 82 responses.

SURVEY RESPONDENTS

This survey draws from a sample of 82 respondents who answered as directors on behalf of the organisation they represent. These organisations' headquarters were widely dispersed with a strong representation by those domiciled in Luxembourg, US, UK, Switzerland and France. The industry/sector represented by respondents was primarily those of the financial sector (which reflects the significance of this industry in Luxembourg) and also included not-for-profit organisations.

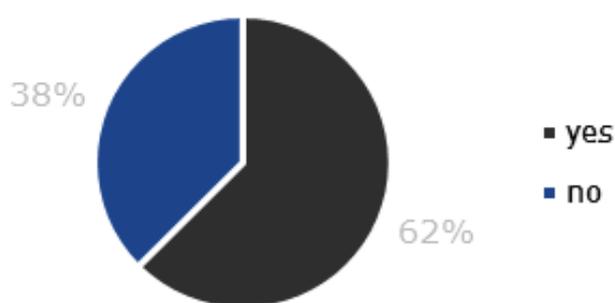


We asked the respondents to share with us the typical features of the Boards of the organisations they represent. The characteristics of the board sizes and engagement of independent directors is reflected below:



SURVEY RESULTS

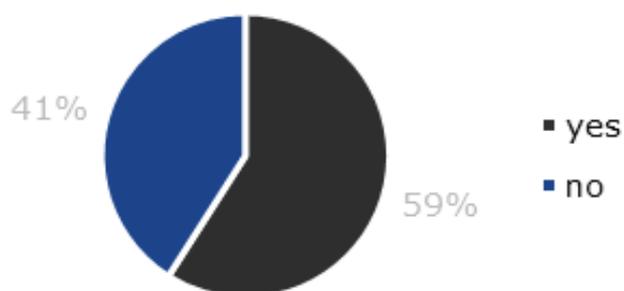
Does your organisation regularly conduct a formal evaluation of the board?



The survey commenced by asking the pivotal question whether or not the organisation conducts a formal evaluation of the Board? For those who responded "No" we asked a single follow-up question to give the reasons why no such evaluation was performed. For those who responded "Yes" we asked them to complete the rest of the survey questionnaire.

Overall 62% of respondents confirmed that the organisation they represent does indeed conduct such formal board evaluations.

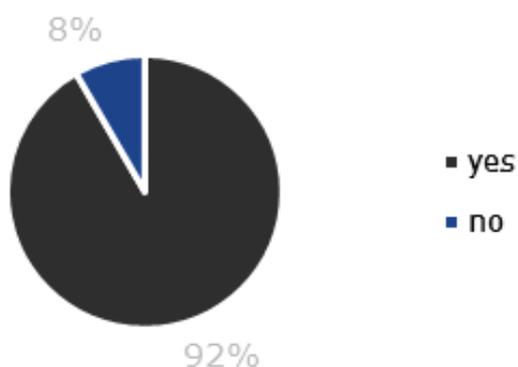
Asset Management (Funds & ManCo)



More than half of the investment funds and management companies responded that they do perform formal board evaluations. Coincidentally when analysing them separately, 59% of investment fund boards responded affirmatively and 59% of management companies responded in the positive.

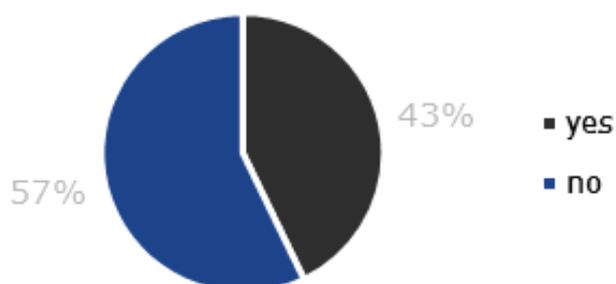
Since 2013 the ALFI Code of Conduct recommends that the Board of investment funds and management companies should conduct a periodic review of its performance and activities. Although CSSF Circular 18/698, issued in August 2018, does not impose any requirement to perform board evaluations there is a heightened focus on the governance of management companies in Luxembourg in terms of experience, skill, reputation and composition of both the governing and managing body.

Banking and insurance



In the Banking and Insurance industry a high proportion responded that they do perform formal evaluations. For banks this is largely driven by the EBA Guidelines on the assessment of the suitability of members of the management body and key function holders that were issued in November 2012 and updated in September 2017.

Corporates and large non-profit organizations

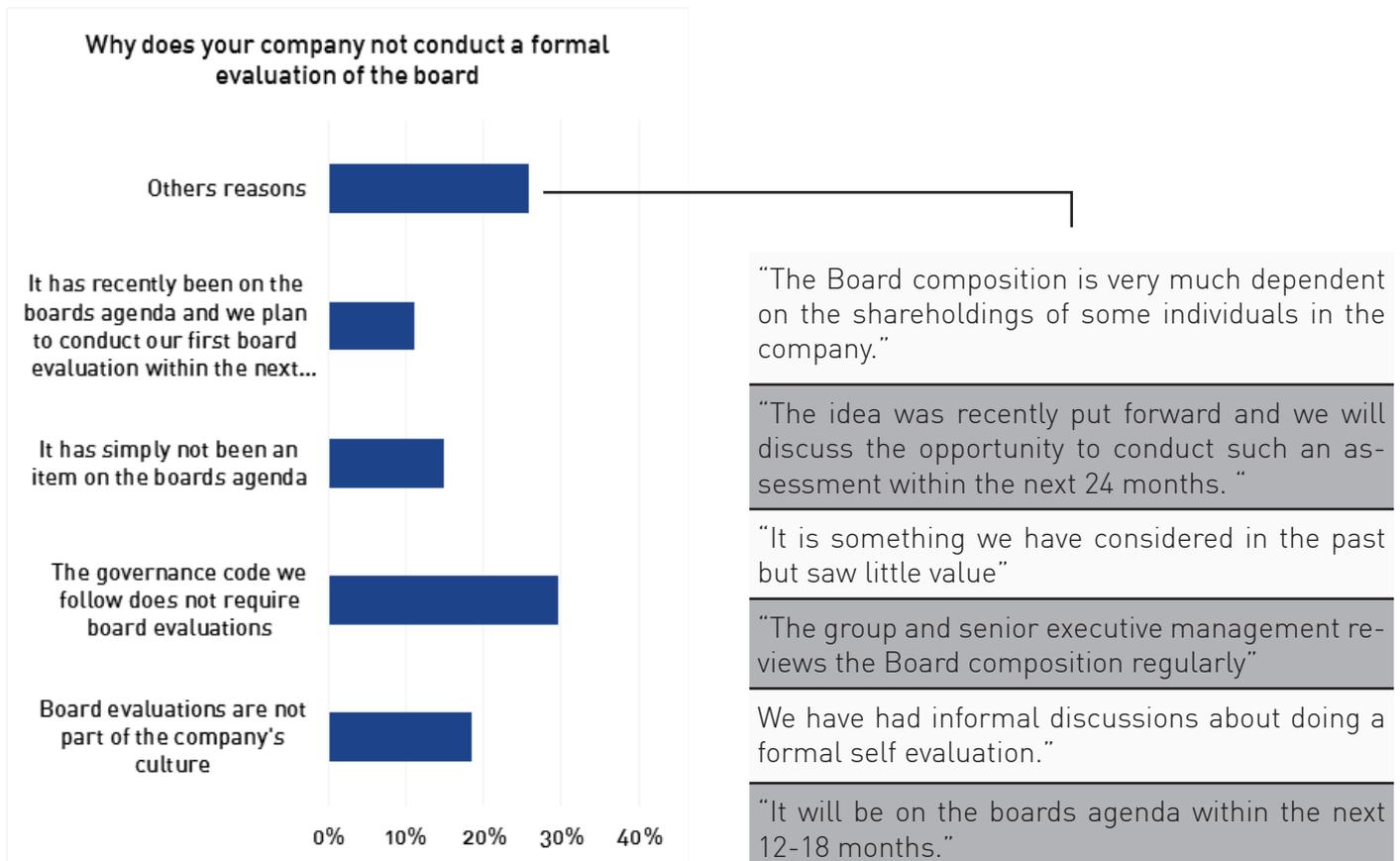


Separately 20% of non-profit organisations' boards responded affirmatively and 100% of corporates responded Yes.

The X Principles of Corporate Governance of the Luxembourg Stock Exchange recommend that the board of a listed corporate assesses the way in which it operates, how it fulfils its role and adheres to the rules and discusses that. All the listed corporates which participated in this survey confirm they were complying with this requirement from the Luxembourg Stock Exchange.

SURVEY RESULTS - THOSE THAT DO NOT CONDUCT FORMAL EVALUATIONS

Board evaluations may initially be challenging for boards and directors may have resisted board evaluations in the past - so evaluations have not been performed. Below are some common reasons given why evaluations do not take place:



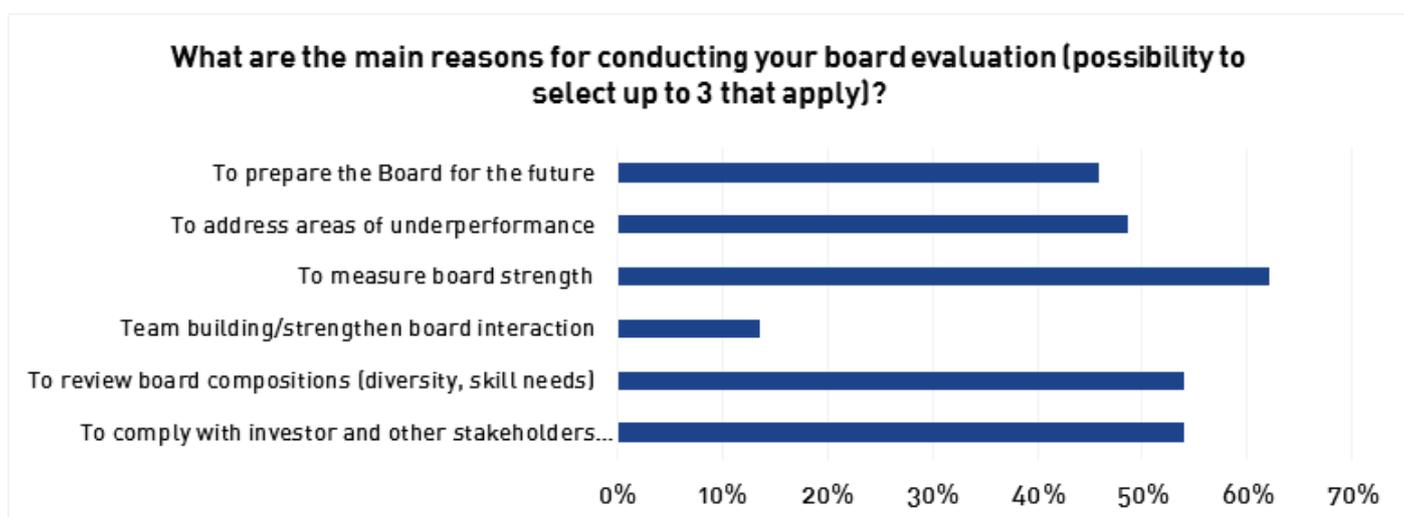
Despite 38% of respondents saying they do not perform board evaluations, many do have this on their radar and are considering undertaking such an assessment in the coming months.

Below are some reasons why boards are reluctant to perform self assessments with suggested responses to such arguments .

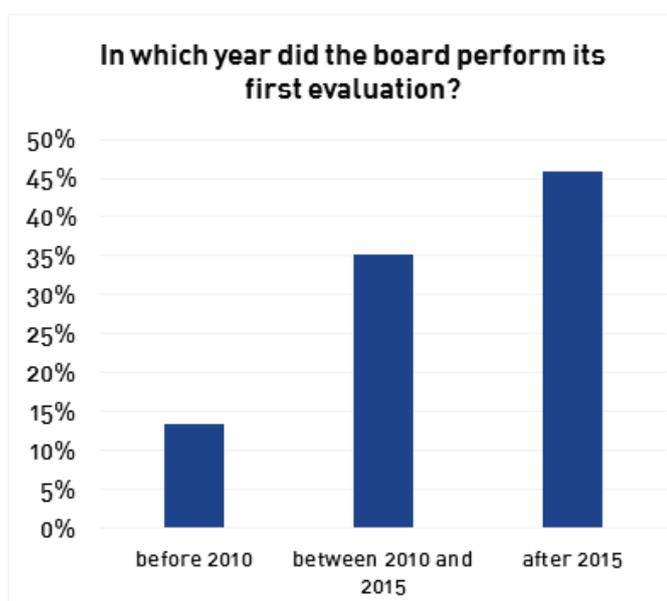
Reason	Response
Board evaluations are just fault finding undertakings	The evaluation process can be made more engaging by treating it as a forward-looking process with the goal of improving the board's performance, rather than as an implicit critique.
Our chairperson is reluctant or is not interested in performing a board assessment	This raises the key issue of board culture, which is an important factor not only in a board's ability to attract and retain good directors but also in its trickledown effect within the organisation it governs as a whole. It takes a strong chairman to make any changes to the board's culture and make it one that accepts and encourages continuous feedback. Continuous improvement is something that Boards expect of management and should do so of themselves.
It will alienate individual directors	It is important that the Chairman, or whoever is leading the board evaluation process, ensures that the exercise is framed as a collective effort by the Board to assess and improve its effectiveness. The objective is to enhance the functioning of the Board as a team rather than focusing on possible shortcomings of any individual directors.
Our shortcomings will be on public record	The evaluation process is to be treated confidentially amongst board members and the governance staff. There is no need to detail the results in board minutes. A simple mention in the minutes that an evaluation was undertaken and the process followed will suffice.
There is no legal requirement to undertake board assessments	Many stakeholders, such as investors & D&O Insurers, consider board self-evaluation as one criterion in their governance and due diligence ratings of corporations and investment funds.

SURVEY RESULTS - THOSE THAT DO CONDUCT FORMAL EVALUATIONS

62% of respondents say they do conduct formal evaluations and indicated below the top three reasons why they do so. There are multiple objectives that drive the performance of a board assessment and these should be considered at the outset when planning to do a board evaluation.

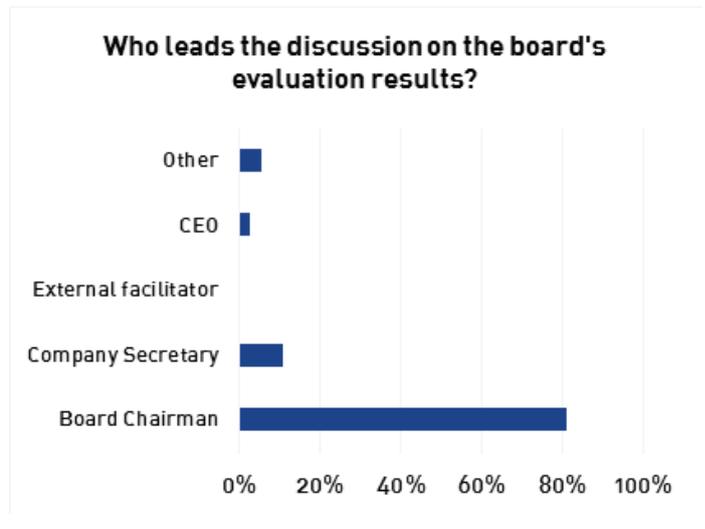
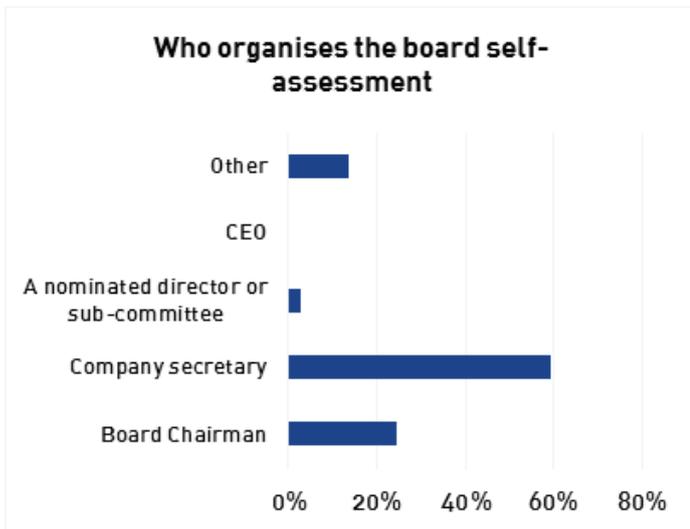


An interesting observation here is that very few directors saw the objective of performing a board evaluation as a “team-building” exercise. A valid question on the back of this is whether the Board can be considered as a “Team”? This evokes analogies to sport where the performance of the individuals contributes to the success of the team provided their effort is directed towards the goals of the team within the rules of engagement. It remains a governance dilemma that needs to be carefully managed on how to maintain an environment of collegiality in the board while avoiding the danger of creating harmonious but dysfunctional “group think”.



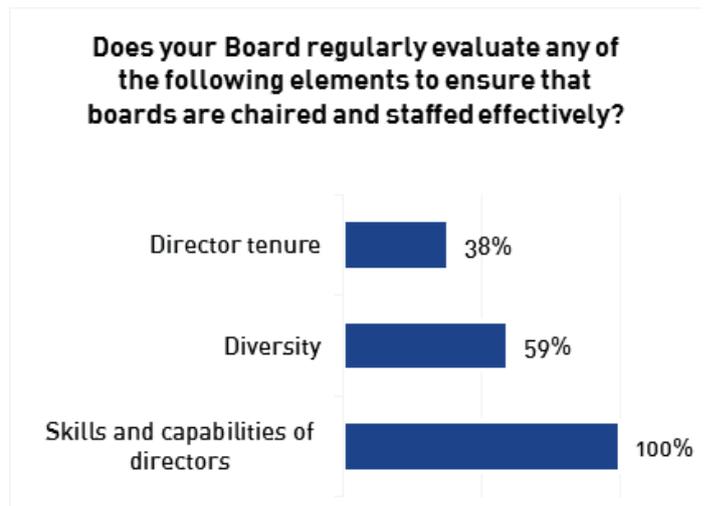
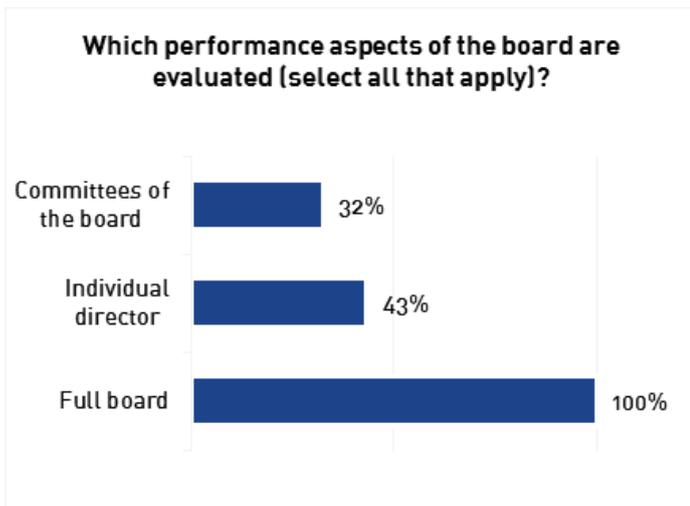
We note that nearly 50% of boards have only started to conduct formal evaluations in the last three years and 35% of boards started in the period between 2010 and 2015. Potential explanations for this recent uptick may be driven by the issuance of the following guidance applicable to certain organisations in Luxembourg:

- EBA Guidelines on the assessment of the suitability of members of the management body and key function holders were issued in November 2012 and updated in September 2017.
- ALFI Code of Conduct updated in 2013 which for the first time included a recommendation for board evaluations.
- ILA Board evaluation guidance was first issued in 2013.



The organisation of the board's evaluation process is primarily facilitated by the company secretary or governance officer appointed by the board.

The chairman plays a key role in developing and ensuring approval of the board evaluation process. The person leading the process should provide the board with a full report and develop an action plan for agreed improvements.



All respondents answered that when a board evaluation process is implemented, the whole board is evaluated.

How to effectively evaluate skills and capabilities of Directors?

However, we noted that individual director feedback is a natural step to take after self-evaluation of the board as a whole.

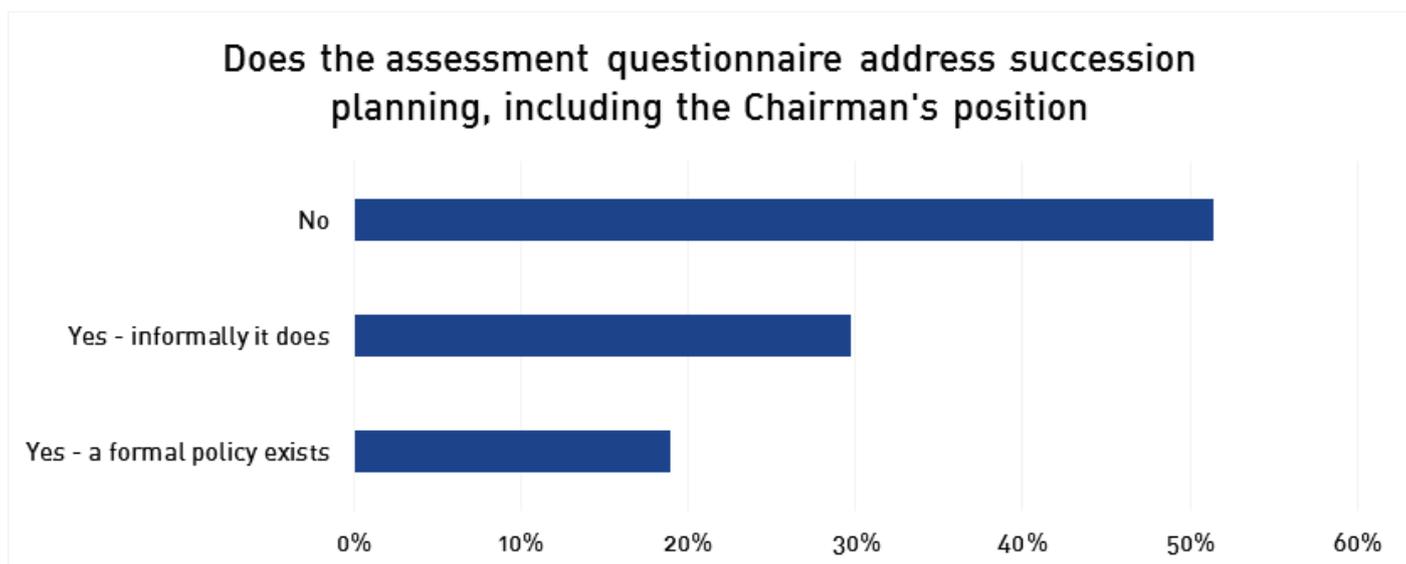
Creating a board skills matrix provides a company with a defensible and visible process of evaluating what each director brings to the board and how those skills and capabilities assist the organisation achieve its purpose.

If it's done, then individual directors should be evaluated not only on the knowledge and expertise that they bring but also on the manner in which they contribute. Poor performance - lack of contribution or insufficient engagement - needs to be addressed.

Importantly, a skills matrix brings clarity about the skills and capacities an organisation has and allows it to plan how it will fill any gaps.

Individual director feedback is arguably the most important tool that can help to change individual director behaviour.

Less than 20% of boards performing a board evaluation have a formal policy in place for director and chairman succession planning.



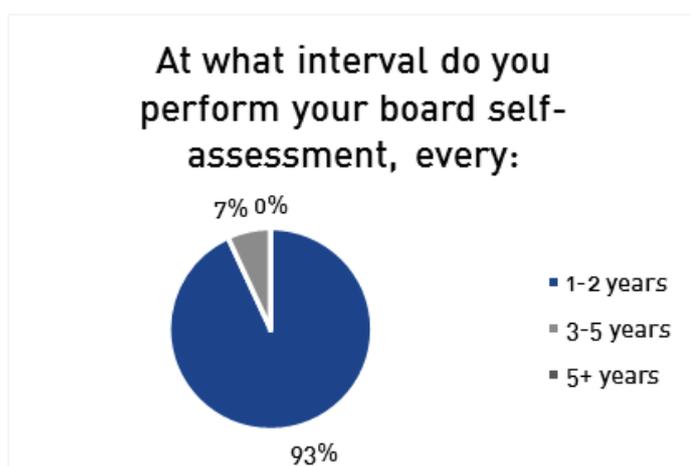
Board evaluations cover many aspects of the functioning of the board - board meetings, board culture, board responsibilities etc as well as board composition and succession planning.

Board tenure is an important issue for independent non-executive directors which should not be allowed to bubble below the surface unaddressed (as was argued in an ILA paper last year). Board tenure has an impact on the independence of board directors - directors are widely regarded as less independent after long service.

One question in the independent director's self evaluation questionnaire asks: "As an independent board member - and considering how long you have been on the board - do you consider yourself independent?"

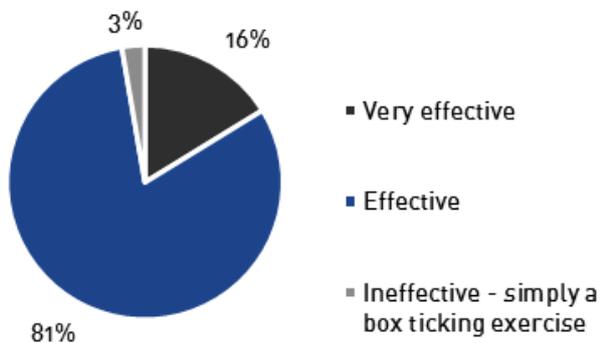
Addressing board succession planning / tenure through the board evaluation creates a regular process for considering whether the board needs fresh eyes, removes the personal element from the discussion when a director reaches the end of their stay on the board and can help additionally with the discussion around diversity and the need for new director skill sets and capabilities.

A board chair review can also be incorporated into the board evaluation process.

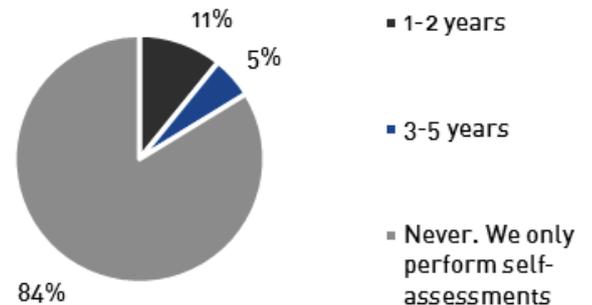


If done, the vast majority of board self-assessments are performed on an annual or a bi-annual basis. The regular assessment allow each board to evaluate the implementation of actions which may have been decided to address previously identified weaknesses.

How effective do you think your board evaluation process is?



At what interval do you engage an external facilitator or consultant to conduct your board evaluation?



A vast majority of respondents assessed their board evaluation process as effective. A key question now is how to get the process from “effective” to “very effective”?

A well-designed board evaluation process is an essential tool for the board to clarify roles and expectations, as well as to prompt ongoing improvements.

The purpose, objectives, process and outcomes need to be explained and discussed with all concerned parties.

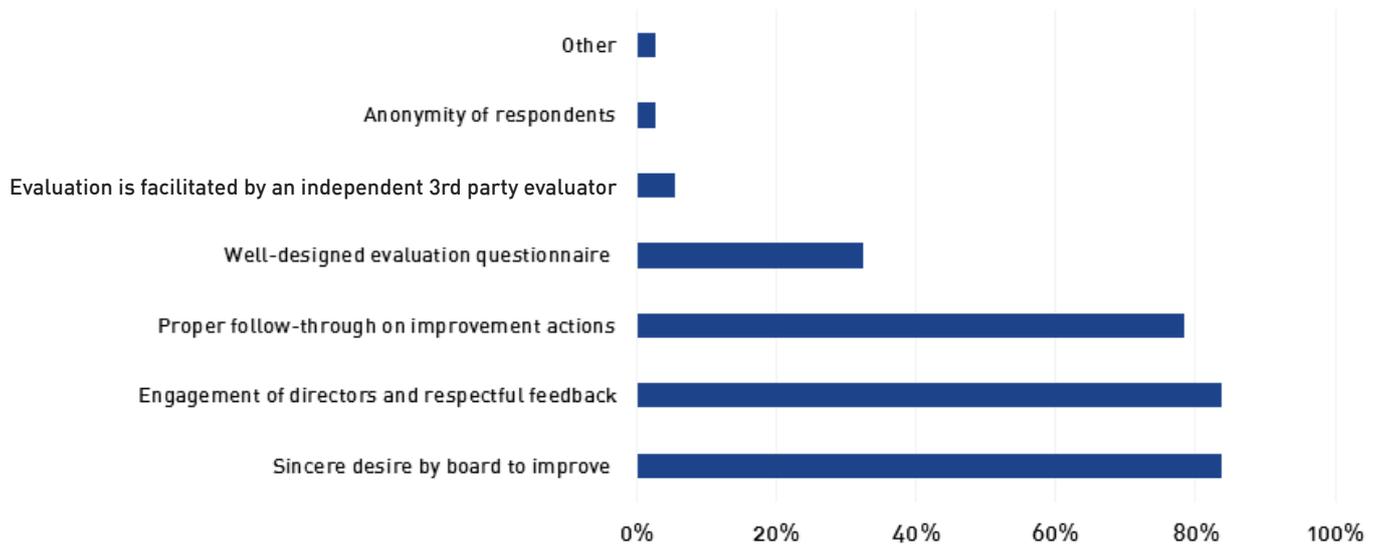
It is recommended that boards:

- manage confidentiality during and after the board evaluation process;
- choose whether to keep the process internal or engage an independent evaluator to assist;
- decide whether to evaluate individual directors as well as the board itself;
- develop an action plan building on strengths and addressing weaknesses emerging from the board evaluation process;
- decide on the frequency of the board evaluation process

Broadening the scope of the evaluation by incorporating the perspective of managers, employees and stakeholders who regularly interact with the board can also contribute to the quality of the review.

Involving an outside facilitator or consultant in the board evaluation process remains a limited practice. However, even if no strict regulatory requirement for external evaluators exists in Luxembourg, certain corporate governance codes such as the X Principles of Corporate Governance of the Luxembourg Stock Exchange include guidelines that the Board may appoint an external expert to carry out the board assessment.

What do you consider are the critical conditions for an effective board evaluation process



It is clear that the success of a board evaluation process is driven by the internal motivation for the board to want to be more effective and how engaged the directors are in that process. It is less about the design and content of the questionnaire itself, and more about the actions proposed to improve board performance.

CONCLUSION

On October 17, 2018 the preliminary results of the survey were presented and discussed at the Deloitte/ILA conference “Board Evaluation - Next Steps” How are we doing? Where to next?

At the same time, revised ILA guidance was issued in a new brochure form “Board Evaluations - Enhancing Board Effectiveness” as well as online on the ILA.lu website.

The guidance highlights the benefits of board evaluations and how these might be performed covering topics such as: managing confidentiality during and after the board evaluation process; choosing between an internal self-evaluation and an independent external evaluation exercise; evaluating individual directors; building a board action plan and how frequently to perform the evaluation.

The guidance also outlines when board evaluations are required in Luxembourg distinguishing between Luxembourg listed companies; Luxembourg credit institutions and investment firms; and Luxembourg investment funds, and Luxembourg non-profit organisations.

The guidance closes with a sample board self-evaluation questionnaire.

Throughout the guidance there are practical tips on how best to perform the evaluations to obtain the most benefit recognising that each board’s circumstances may be different (e.g., listing rules may apply; EBA guidelines; internal and external codes of conduct).

The Deloitte/ILA conference concluded with the question: “How do board evaluations evolve from ‘somewhat effective’ to ‘very effective’ ?” It was generally agreed that this could only come with board and director engagement and with a process which has to be seen as meaningful and providing tangible results.

We look forward to future developments in this area.

ILA MISSION STATEMENT

The mission of ILA is to promote the profession of Directors by developing its members into highly qualified, effective and respected Directors.

In parallel, it will promote best practices in Luxembourg in the field of Corporate Governance of companies and institutions by actively engaging with those institutions charged with the introduction, application and oversight of those Corporate Governance rules and practices. It will achieve this through high quality training, forum discussions, research, publications and conferences.

ILA aims to be the premier interlocutor in Luxembourg on issues affecting Directors.

Deloitte.



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Email : events@ila.lu

Web : www.ila.lu



Phone : +352 260 021 488

Fax : +352 260 021 395



ILA
19, Rue de Bitbourg
L-1273 Luxembourg