On the 2019 nom/gov committee agenda

The nominating and governance committee was often viewed as having the lightest agenda and least regulatory (and media) attention of the board's standing committees. That's quickly changing, however, as investors and other stakeholders sharpen their focus on board composition and effectiveness in a complex and fast-moving business environment. Expectations for greater transparency about the board's efforts to continually raise its game and help position the company for the future are putting the nom/gov committee squarely in the spotlight.

Drawing on insights from our work and interactions with nom/gov committee members, board chairs, lead directors, and business and governance leaders, we've highlighted six items we believe nom/gov committees should have high on their agendas for 2019:

- Align the talent in the boardroom with the company's strategy and future needs.
- Focus on onboarding and continuing director education.
- Use evaluations to drive continuous improvement and needed change.
- Enhance the effectiveness of board/committee operations and oversight processes.
- Benchmark the company's corporate governance policies and procedures against industry peers, SEC and investor priorities, leading practices, and governance recommendations.
- Build trust with the company's investors.

Align the talent in the boardroom with the company's strategy and future needs.

Effective board governance begins with the composition of the board. The stakes are high: The pace of change and disruption in the business environment continues to accelerate, institutional investors and other stakeholders are increasingly raising questions about diversity and low board turnover, and activist investors are increasingly seeking to replace individual directors and even entire board slates. Strong leadership from the nom/gov committee is called for in this environment.

Determining the company's current and future needs is the starting point for board composition, and the board can help avoid the potential stigma associated with director turnover by setting expectations up front and clearly linking renomination to future needs. The ongoing work of the committee also includes succession planning for skill sets, diversity, decision-making styles, age, tenure, committee participation, and board and committee leadership. Keeping pace requires periodic assessment of objective turnover policies such as age and term limits, strong leadership to effect needs-based board refreshment as well as evaluation and removal of underperforming directors, and robust disclosure regarding these issues.

Diversity continues to be in the spotlight, with expectations and scrutiny continuing to increase. In a letter to 300 companies with fewer than two women on their board, Michelle Edkins, global head of investment stewardship at BlackRock, wrote, "We believe that a lack of diversity on the board undermines its ability to make effective strategic decisions. That, in turn, inhibits the company's capacity for long-term growth." State Street Global Advisors voted against directors at numerous companies for failing to demonstrate progress on board diversity, and announced that beginning in 2020, it will vote against entire slates of board members on companies' nominating committees for those companies without at least one woman on the board that have not engaged in "successful dialogue" with them for three consecutive years. ISS and Glass Lewis published voting guidelines indicating that they may recommend voting against nom/gov chairs (and possibly other board members) of boards that do not have either a single woman or an appropriate plan to diversify the board (beginning in 2019 for Glass Lewis and in 2020 for ISS). And the recent California law requires publicly traded companies headquartered in the state to have at least one woman on their board by the end of 2019 and more by 2021. In addition to gender, consider board diversity in terms of race, ethnicity, sexual orientation, and age, as well as life experience, decision-making style, and skill sets. In assessing the board's diversity goals, consider these recommendations of the Diverse Corporate Directors Coalition, a coalition of leading organizations whose members represent the nation's major diverse population segments:

— Promote board composition goals that leverage a complementary mix of expertise and diverse experience

— Adopt an inclusive definition of diversity in the board's governance guidelines

— Actively seek director candidates who bring diversity of age, gender, nationality, race, ethnicity, and sexual orientation

— Provide disclosure that demonstrates the diversity of the board.

Focus on onboarding and continuing director education.

The days when new directors were not expected to speak up in their first board meetings are gone—new board members must be prepared to contribute from day 1. Resources for onboarding should be made available, and expectations should be clear. As a student of the company and the business environment, each new director should be expected and enabled to become familiar with the most significant issues facing the company initially, and to deepen his or her understanding over time of company strategy, key industry and competitive considerations, and the relevant issues and trends impacting the company's business environment. The nom/gov committee should collaborate with management and the other committees to develop onboarding processes and learning opportunities and should set clear expectations for director accountability.

For the board as a whole, continuing education should not be optional. As Ram Charan says about board members in *The New Corporation: Reimagining Organizations in the Age of Amazon*, "…your mindset and attitude has to be focused on learning, and you have to make time for it." The nom/gov committee can help create a board culture where ongoing learning is expected and enabled, and board members coordinate to enhance overall board knowledge. What are the key issues the board wants to know more about – Emerging technology? Cyber risk? Geopolitical trends? The future of work? ESG? The committee can identify the top priorities for board education and develop options for a mix of individual and group education to enable the board to develop and share knowledge of substantive issues and trends in board governance.

Use evaluations to drive continuous improvement and needed change.

Board and committee evaluations should be robust and action oriented. And while individual director evaluations are becoming table stakes for public companies, there is room for improvement. In a study by the Rock Center for Corporate Governance at Stanford University and the Miles Group, only 23 percent of the directors surveyed rated their board as highly effective at giving direct feedback to fellow directors, and 54 percent said that if they had sole power to do so they would have one or more of their fellow board members removed.

The nom/gov committee in conjunction with the board chair/lead director can set a productive tone for evaluations—openness and candor, and a sense of urgency with respect to critical improvement initiatives. Consider the evaluation process and questions. One-on-one interviews and honest input from management and other stakeholders can add valuable insight and different perspectives. Some companies use outside facilitators every three years for additional insight. In addition to general assessment questions, consider a deeper dive into a selected topic—for example, how well is the board overseeing culture or cybersecurity and what can be done to improve? Varying the process and focus areas can help keep evaluations fresh and relevant, and can help avoid "assessment fatigue." Once evaluations are completed, the committee should work with the full board to develop specific, measurable follow-up plans and monitor progress against established goals throughout the year.

Enhance the effectiveness of board/committee operations and oversight processes.

Enhancement of board operations and oversight processes, including coordination across committees, can help bring focus and attention to the issues that are most critical to the company's success and long-term value creation—such as strategy, innovation, disruption and other strategic risks and opportunities, capital allocation, performance, leadership, and talent.

To devote more time to these issues, while also remaining focused on compliance, operations, and so-called rear-view mirror items, many boards have significantly increased their time commitment. But that alone is insufficient. Lead directors and nom/gov committees are focused on improving board operations and oversight processes—and the nature of their engagement with management and among directors—in order to devote more time to these critical issues. Among the steps nom/gov committees and lead directors are taking:

— Crafting board agendas to devote more time to key issues such as strategy, disruption and innovation—and ensuring those discussions are not pushed to the end of the meeting

— Improving communication processes between and among the board and its committees

— Working with management to optimize the quality and relevance of board materials (taking a "clean sheet" approach if needed)

— Reassessing committee structure and scope—considering, for example, whether the audit committee is taking on too much, whether oversight of talent and culture should be included in the charter of the compensation committee, or whether the work of the board would benefit from the creation of a new committee such as finance, technology, risk, innovation, or sustainability

— Setting expectations for greater director engagement between board meetings, often with individual directors taking the lead for a deeper dive on specific issues

— Developing an effective process to "connect the dots" and help promote the alignment of talent, compensation, culture, risk appetite, and controls with strategy

Benchmark the company's corporate governance policies and procedures against industry peers, SEC and investor priorities, leading practices, and governance recommendations.

The nom/gov committee should have a process for receiving information about governance changes that may require action (new laws or regulations, relevant SEC activities, shareholder proposals, and proxy voting trends, etc.) as well as consideration of recommendations and trends relevant to continuous improvement. As part of its assessment and benchmarking, the committee may consider a variety of sources and viewpoints including:

— The SEC's 2019 priorities, as summarized by Chair Jay Clayton in a speech at Columbia University, which include review and a potential major overhaul of the proxy process ("proxy plumbing"), focus on proxy advisory firms, shareholder proposal ownership thresholds, the potential impact of regulations on driving short-termism, as well as company disclosures regarding the market risks of cybersecurity, Brexit, and the transition away from LIBOR.

— The *Commonsense Principles of Corporate Governance 2.0*, which represent a collaboration by representatives of some of the U.S.'s largest companies and investors, and references and endorses other thought pieces on governance that might also be considered: the Investor Stewardship Group's *Framework for U.S. Stewardship and Governance* (and be prepared for investor questions regarding alignment with this); the Business Roundtable's *Principles of Corporate Governance*; and *The New Paradigm* published by the International Business Council of the World Economic Forum. While not every one of the Commonsense Principles will be applicable (or applied consistently) across companies, the stated purpose is to guide thinking and help move forward a discussion regarding "the responsibilities of corporations to move away from short-termism toward a long-term vision of growth and prosperity."

— The *2018 Report of the NACD Blue Ribbon Commission on Adaptive Governance: Board Oversight of Disruptive Risks* includes recommendations and resources to enhance the board's adaptability, guidance, and oversight of disruptive risk.

— The *Women Corporate Directors 2018 Thought Leadership Commission Report on Decision-making in the Visionary Boardroom* includes recommendations to address the boardroom impact of cognitive biases such as overconfidence, groupthink, and confirmation bias.

Consider a periodic review of governance practices and disclosures among the company's peers as well as companies commonly viewed as leaders in governance. The committee and board may choose to take an approach that differs from a relevant benchmark but should do so on an informed basis and consider what, if any, disclosure or engagement regarding the issue would be needed.

Build trust with the company's investors.

While the full board owns oversight of the company's investor strategy, the nom/gov committee plays a pivotal role. Institutional investors are increasingly seeking transparency to help them understand how well the board is doing its job. Proxy disclosures can be a useful means of communicating the board's governance story: describing evaluation processes and follow-up plans for continuous improvement; and providing information about board composition including the board's skills matrix, diversity (gender, race, ethnicity, sexual orientation); and the average and range of director tenures. Some companies are also disclosing the company's approach to environmental, social, and political issues in light of the importance of these topics to investors. In addition, 82 of the 100 largest noncontrolled U.S. public companies disclosed their investor engagement practices, according to Shearman & Sterling's *2018 Corporate Governance & Executive Compensation Survey.*

Building trust with institutional investors typically includes strategic, value-add engagement outside of the busy proxy season period. Begin with an understanding of key investor priorities, including their proxy voting guidelines, voting record, and who (portfolio manager versus governance staff) makes their proxy voting decisions. Understand the company's vulnerabilities, how its practices and disclosures align with each investor's expectations, and where investors may want more information; then develop a strategic engagement plan. Determine who will participate on behalf of the company, recognizing that for governance-related issues an appropriate member of the board will often be expected to take the lead. Engage in a process that will enhance investor understanding of the company and the board, and also make clear that the board takes seriously and seeks to ensure it understands the concerns of key investors.

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