In Practice

Who is in the Boardroom?

Would the situation at America’s financial institutions be different if shareholders knew exactly how many directors possessed expertise and experience in risk management and complex derivative products and how many did not? Would they have pushed harder for boards to get this expertise if they knew more about how shallow many financial services boards were in this area?

What if General Motors was required to disclose much more about which directors possess skills in risk management, labor relations, marketing, and other key competencies and attributes required of the auto industry, and integral to GM’s strategy?

What if American corporations assessed their boards, committees, and individual directors, and disclosed with sufficient granularity the key outcomes and processes, in order to inspire confidence in shareholders that a robust self-assessment regime was instituted and the results were acted upon? What if directors were explicitly recruited on the basis of the competencies and skills necessary to direct the company’s strategy and monitor management?

The answer is that things would be different. More transparency in the way of skills and backgrounds of corporate directors might not have led us to avoid the financial crisis or the collapse of the auto industry, but it might have alleviated some of the pressure that directors now find themselves under. It also might have caused boards to look more closely at their collective skill sets and fill in talent gaps, giving them a better chance at avoiding some of the problems or responding to them more adequately.

To be sure, disclosure in this area is remarkably thin. GM notes in its 7th corporate governance committee charter, only that it will "formally review each director's continuation on the board every five years." Exxon Mobile’s corporate governance guidelines, amended last October, include just one sentence under the heading "Board Self-evaluation," which reads: "At least annually, the board will evaluate its performance and effectiveness." It is not clear exactly what that means.

This is not to say that directors at these companies don’t possess the relevant competencies and skills, only that we don’t know, because we simply don’t have the necessary data. However, qualitative data suggests competencies and skills may be lacking in any number of boards. Take the area of risk management, for example. Recent director survey revealed startling comments on the lack of required skills by some of their director peers:

- "We need a seminar on executive behavior and how to objectively evaluate risk."

More transparency about skills and backgrounds of corporate directors might not have led us to avoid the financial crisis, but it might have alleviated some of the pressure that directors are now facing.

Why boards need to do a better job of assessing and disclosing their skills.

By Richard Leblanc

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Northern Disclosure
Since 2005, the law in Canada has required the recruitment, education, and assessment of individual public company directors, on the basis of competencies and skills, and disclosure of these activities. Position descriptions are also required for key board leadership roles.
Currently, it is possible in the United States to sit on a risk committee of a public company board and not be risk-literate, or sit on a compensation committee and not possess compensation expertise. It is also possible to sit on these committees without having been recruited for these skills. Regulators do not require boards to disclose whether one or more directors possess such attributes. And the fact that a director may have significant experience—as a former CEO, for example—does not necessarily mean that he or she possesses certain specific competencies. As one director recently remarked: "I believe that our analysis focuses too much on experience and not enough on the actual skills and competencies that directors bring to the table. It may be said that experience and background are a short-cut to determination of skill, but it does not always mean the candidate possesses the skills."
Chairman Mary Schapiro at the Securities and Exchange Commission is reported to be studying proposals for greater disclosures of the qualifications of board members, particularly those involved in assessing risks and setting executive compensation.

A Checklist for Assessing Director Leadership, Competencies, and Effectiveness

- **THE BOARD CHAIR HAS AN EFFECTIVE PERSONAL LEADERSHIP STYLE**
  Sets a good example; is courteous, inclusive, sensitive, yet decisive; and establishes and holds directors and management accountable to high standards.

- **THE BOARD CHAIR CARRIES OUT THE ROLE WELL**
  Sets agendas; ensures appropriate information is available; marshals resources and expertise; and ensures that the boundaries between board and management responsibilities are clearly understood and respected and that relationships between the board and management are conducted in a professional and constructive manner.

- **THE BOARD CHAIR BUILDS A HEALTHY BOARDROOM DYNAMICS**
  Relates well with directors and management, deals effectively with dissent, and works constructively towards consensus.

- **THE COMPETENCIES (FINANCIAL LITERACY, EXPERIENCE, SKILLS, KNOWLEDGE OF THE BUSINESS) OF ALL MEMBERS OF THE AUDIT COMMITTEE ARE APPROPRIATELY MATCHED WITH THE REQUIREMENTS OF THE COMMITTEE**
  All members, at a minimum, have a full understanding of how the company earns income and how these transactions impact the accounting judgments made by management.

- **THE FINANCIAL EXPERTISE ON THE AUDIT COMMITTEE AS A WHOLE MATCHES THE COMPANY'S FUTURE FINANCIAL OVERSIGHT NEEDS**
  Capital and balance sheet management; accounting, financial control and assurance; financial markets, treasury, funds management, investment banking, taxation; and risk management, as required.

- **INADEQUATE PERFORMANCE OR LACK OF COMMITMENT BY DIRECTORS IS PROMPTLY ADDRESSED BY THE BOARD CHAIR**
  Takes appropriate action, including developmental suggestions, peer remediation, member rotation or retirement, and other timely, corrective action as required.

- **RIGOROUS SUCCESSION PLANNING OCCURS FOR ALL MEMBERS OF THE COMMITTEE**
  Includes, with due consideration by the nominations committee, a formal and transparent process, identifying gaps between current members' competencies and skills and committee requirements, a pool of directors possessing desirable qualifications, to serve on and chair the committee, and, where appropriate, retaining a search firm to identify such a director.