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Given that shareholders of some large companies have voted to split the chairman and CEO roles, do you see that as a sign that more companies will follow suit?

Gwin: There is no right answer that fits all companies—it is really situational. If a company does choose to go that route, role definition is critical. The CEO and chairman need to have an excellent working relationship and clear 'line of sight' as to how they divide responsibilities.

How does this flow into board evaluations and recruiting?

Gwin: There's a continued focus on ensuring that recruiting is a highly independent process—underscore the word process—that delves into the strategic needs of the company, naturally dovetails with what shareholders want, and informs how boards think about the right talent around the table. What we're seeing now will continue to highlight the need for an independent and expertise-driven process.

Risk is multi-disciplined and that's one emerging area that boards are feeling most concerned about. How do you suggest they deal with risk exposure?

Meyer: That has been a fundamental governance gap that has been exposed in the last 18 months, especially within financial-services boards. And it has been an issue for management teams. What's been proven is that external risk factors can easily overwhelm established policy firewalls that often provide insufficient protection for the institution—reputational risks can morph in the modern viral world. Merely understanding the technical risk resident within the company's operations is not sufficient for boards. Many boards still think it's a function of the audit committee, which is typically a rear-view-mirror conversation. More boards may need to build ad hoc committees of existing directors to unlock the best thinking. Over time, I think many boards will decide to build a standalone enterprise risk-management (ERM) committee that serves the entire board and is answerable to shareholders on the subject of risk.

Gwin: This is a huge issue that boards are grappling with. As a result, boards are looking for directors with lots of experience and sitting CEOs will be at even more of a premium. They have been through big up cycles and big down cycles and I think there's going to be continued demand for that kind of experience.

Last question: Boards need to be better listeners and yet lead directors and others could drive themselves crazy listening to a very vocal minority. What's your advice?

Meyer: There should be a concern that you're not just allowing anecdotes to drive decisions and conversations in the boardroom. I think it's different if you have a constant flow of external information into the boardroom that generates proactive discussion, instead of reacting to a random set of impressions. One area we will focus on is separating the critical shareholder issues from those that are casual, trendy, or merely gripes.

In all cases, we will be helping boards to listen to the pulse of the shareholder base, and then carefully evaluate which issues deserve serious attention and which need further development and analysis. ◼

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In Practice

Who is in the Boardroom?

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

By Richard Leblanc

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 sustainability, 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?

> **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.**

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 Item 7 of its directors and corporate governance committee charter, only that it will "formally review each director's continuation on the board every five years." Exxon Mobil'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 surveys 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."
- "Is management overly optimistic?"
- "What's the link between behavior, results, and action?"
- "For behavioral issues, are we comfortable as a board versus holding back?"
- "How do we evaluate personalities?"
- "It's mind boggling. We are not even at zero. We're probably at minus 40."
- "No comprehensive understanding at the board level."
- "We should admit that the training is inadequate. We don't know what we don't know."
- "I have more work to do [in order] to feel more competent."
- "For risk, we can't blame management."
- "Risk management in the company is pretty poor."
- "We should have had a peer appraisal."
- "We're not changing with the times [or] concentrating on the right issues."

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. Requiring American directors to be recruited and assessed on the basis of the competencies and skills each individual director is expected to bring to the board is probably the single greatest governance reform that Schapiro could make.

Overcoming the Obstacles

The belief that it is problematic, from a collegiality point of view, to assess individual directors is flawed, given the number of significant professions that have managed member assessments effectively, including the unpleasant task of counseling out non-performing members. The notion that assessing directors, from a legal point of view, should not happen (for example, concerns that results may be used as evidence in litigation by the plaintiff bar), is not a reason, in itself, to avoid conducting director assessments. Otherwise, fields would never evolve because of litigation fear. That said, regulators should consider a safe harbor or zone of privilege to promote meaningful director review without directors looking over their shoulders, and require disclosure of the evaluation process only, not the results.

Some of the companies that do conduct board evaluations (New York Stock Exchange companies are required to conduct them each year, according to its listing standards) either do a poor job on the individual evaluations or they conduct a blanket evaluation, without assessing the abilities of individual directors. "Some of the board evaluations I've seen don't even rise to the level of awful," says Kenneth Daly, CEO of the National Association of Corporate Directors. "Essentially, they don't evaluate how board members are adding value. Because of collegiality, they don't want to go to somebody and say, 'Look, you're no longer productive. You're a dud.' So what happens is they evaluate the overall board and not whether they have the right composition for the company's strategic needs. I don't know what good that does for figuring out problems with individuals and director criteria."

Many corporations, including Pfizer, GM, JPMorgan Chase, DuPont, Exxon Mobil, Home Depot, and Disney, don't evaluate individual directors, according to published reports in the business media.

Evaluation Improvement

A robust evaluation compels a board to look inward and address issues related to leadership, management relationships, reporting, and oversight. The more an evaluation focuses on non-structural factors (for example, competencies, behaviors, and processes of the board; in short, how it acts or fails to act), the better. To make director assessments more effective, consider the following:

1. Robust criteria

The chairman of the board or lead director and the chair of each principal committee should be assessed against key criteria, such as a publicly disclosed position description. Individual directors should be assessed against the competencies and skills each director is expected to bring to the board.

2. Effective leadership

The chair of the nominating and governance committee, in collaboration with the board chair or lead director, should lead or oversee the director-assessment process in a manner acceptable to the board. This could start with some form of shared expectations and an annual one-on-one discussion with the board chair for the purpose of a self and peer review. Competencies, skills, contribution to teamwork, and developmental needs of the individual members should be addressed. The board chair or lead director should also be assessed on key criteria, including leadership and the ability to hold members accountable.

3. Effective follow-through

Boards should be committed to act on the results. An individual director's peer results should not be shared with other directors, other than the chair or lead director for development and feedback purposes.

The chair of the board should discuss with each director their appraisal and what actions, if any, should be taken. The chair should report back to the board on the process and outcomes. The board and each committee should have a similar discussion on each of their assessments and fashion action plans to address shortcomings, if any, for the following year. Nominating and governance committees should consider linking director evaluation with continued director tenure and hold individual chairs responsible for implementing reforms from the previous year.

4. Effective disclosure

Lastly, reporting on director evaluation to shareholders should be disclosed in a meaningful and reasonably detailed manner to demonstrate that a strong and viable assessment program is in place and the board holds itself, its committees, its chairs, and other individual directors accountable for performance. Best practices include a disclosure of a comprehensive narrative on the process, dimensions of assessment, general outputs, action taken, and what governance improvements, if any, were made over the preceding year. Companies are even beginning to disclose some of the assessment results, scores received, and the number of directors who possess skilled and expert application in the competencies the board deems necessary to oversee the company.

A number of innovative boards have risen to the challenge and have renewed and fundamentally transformed their governance practices. The key for these boards is leadership, transparency, accountability, a commitment to have the best directors possible, and a sincere desire to be proud of their governance and to say to all of their shareholders: "Welcome—this is who we are." More boards in the United States need to take up this challenge. Great boards don't just happen. They are designed by great directors. ■

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, inspires, 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 HAS A CONSTRUCTIVE WORKING RELATIONSHIP WITH THE COMPANY'S CEO** Is supportive and collaborative, yet is independent
- ☐ **THE BOARD CHAIR CONDUCTS AN EFFECTIVE DECISION-MAKING PROCESS** Ensures that, for crucial decisions, alternatives are generated, a thorough discussion and analysis ensues, relevant perspectives are brought to bear, the best decision is made, and the decision is supported
- ☐ **THE BOARD CHAIR BUILDS 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 member 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

Source: Board, committee, and director evaluation research and assessment conducted by Richard Leblanc in 2009.

Richard Leblanc, a professor of corporate governance at York University, can be reached at rleblanc@yorku.ca. He is the author of the chapter, "Getting the Right Directors on Your Board," from *Boardroom Realities: Building Leaders Across Your Board* (Jossey-Bass, 2009).

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