



# NOMINATING/ GOVERNANCE COMMITTEE FUNDAMENTALS GUIDE

The Nominating/Governance Committee Fundamentals Guide was created for Corporate Board Member's Board Leadership Program with content provided by Spencer Stuart.



# Table of Contents

## 03 About This Guide

### SECTION 1

#### Committee Responsibilities

- 06 Listing Requirements
- 08 Key Responsibilities
- 10 Disclosure Requirements
- 12 Disclosure Trends

### SECTION 2

#### Committee Operations

- 16 Composition & Onboarding
- 18 Role of the Chair
- 20 Meetings & Agendas
- 22 Increasing Effectiveness

### SECTION 3

#### Oversight of Board & Committee Composition

- 28 Recruitment & Nomination
- 30 Requirements & Considerations
- 32 Diversity
- 34 Onboarding New Directors
- 36 Board Leadership
- 38 Spotlight on Board Composition

### SECTION 4

#### Oversight of Board Function & Evaluations

- 42 Corporate Governance Principles
- 44 Continuing Education
- 46 Evaluations: Board
- 48 Evaluations: Individual Directors
- 50 Evaluations: Disclosure and Engagement

### SECTION 5

#### Succession Planning

- 54 CEO Succession
- 56 CEO Succession: Best Practices
- 60 Board Succession

#### 62 Conclusion

#### 65 For More Information



# About This Guide

## Nominating/Governance Committee Fundamentals Guide

The Nominating/Governance Committee Fundamentals Guide was created for Corporate Board Member's Board Leadership Program with content provided by Spencer Stuart's North American Board Practice. The material in this guide is drawn from Spencer Stuart research, the *Spencer Stuart U.S. Board Index* and other Spencer Stuart board governance publications.

In addition to extensive work with clients on director recruitment, board succession and board assessments, Spencer Stuart has long played an active role in corporate governance by exploring—both on its own and with other prestigious institutions—key concerns of boards and innovative solutions to the challenges they face. In addition, Spencer Stuart sponsors and participates in several acclaimed director education programs, including programs for first-time and next-generation directors.

### Director Fundamentals Knowledge Center

The Nominating/Governance Committee Fundamentals Guide is part of Corporate Board Member's Director Fundamentals Knowledge Center, an innovative resource for public company boards that provides directors with a multi-faceted learning experience through concise guidebooks and interactive training courses. The goal of the knowledge center is to arm new directors with the fundamental training needed to be an effective director from day one.

The Director Fundamentals Knowledge Center consists of the following suite of resources:

- **Director Fundamentals Guide & Training Course**
- **Audit Committee Fundamentals Guide & Training Course**  
*Content provided to you with support from PwC*
- **Compensation Committee Fundamentals Guide & Training Course**  
*Content provided to you in partnership with FW Cook*
- **Nominating/Governance Committee Fundamentals Guide & Training Course**  
*Content provided to you in partnership with Spencer Stuart*

# SECTION 1:

## COMMITTEE RESPONSIBILITIES

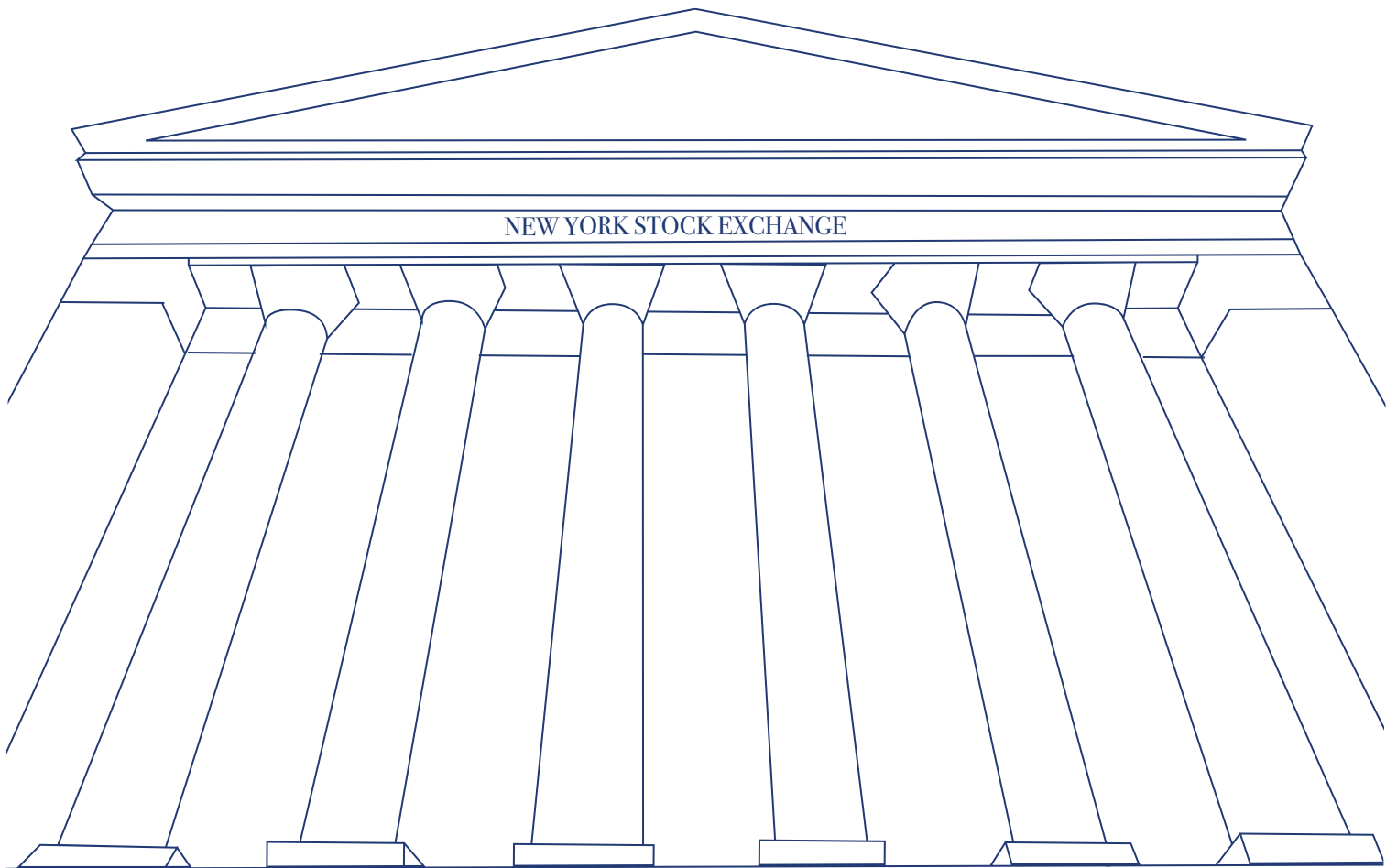
Expectations of the nominating/governance committee have grown, as investors step up demands for greater transparency into boards' approaches to optimizing their composition. This section looks at listing and disclosure requirements related to the nominating/governance committee, the committee's key responsibilities and the trends we're seeing in disclosure.





# Listing Requirements

With institutional and activist investors increasingly scrutinizing the composition, diversity and quality of boardrooms, the spotlight is on the directors responsible for nominating individuals to serve on the board. Today, investors want to understand why directors are the best fit for a company's current and forward-looking risks and strategies, and they want evidence that the board has robust processes and strategies for optimizing the board composition. The result: expectations of nominating/governance committees are on the rise.





U.S. publicly traded companies, with limited exceptions, are generally required to have some form of independent oversight of director nominations. However, the requirements for the underlying structure for director nominations vary by exchange.

## LISTING REQUIREMENTS

### New York Stock Exchange

Listed companies must have a nominating/governance committee composed entirely of independent directors.

Exception: NYSE-listed controlled companies are exempt from certain corporate governance listing standards, including rules requiring that nominating/governance committees consist of independent directors.

### NASDAQ Stock Market

Director nominees must be selected or recommended for the board's selection, either by:

- (A) independent directors constituting a majority of the board's independent directors in a vote in which only independent directors participate, or
- (B) a nominations committee comprised solely of independent directors.

Exception: if the nominations committee is comprised of at least three members, one director, who does not qualify as an independent director and is not currently an executive officer or employee or a family member of an executive officer, may be appointed to the nominations committee if the board, under exceptional and limited circumstances, determines that such individual's membership on the committee is required by the best interests of the company and its shareholders. A company that relies on this exception must disclose, either on or through the company's website or in the proxy statement for the next annual meeting subsequent to such determination (or, if the company does not file a proxy, in its Form 10-K or 20-F), the nature of the relationship and the reasons for the determination. In addition, the company must provide any disclosure required by Instruction 1 to Item 407(a) of Regulation S-K regarding its reliance on this exception. A member appointed under this exception may not serve longer than two years.

# Key Responsibilities



New York Stock Exchange requirements set a baseline for the roles and responsibilities of nominating/governance committees of its listed companies. It requires nominating/governance committees to have a written charter (posted on the company's website) detailing roles and responsibilities, which at minimum must address:

- Identifying individuals qualified to become board members, consistent with criteria approved by the board;
- Selecting, or recommending that the board select, the director nominees for the next annual meeting of shareholders;
- Developing and recommending to the board a set of corporate governance guidelines applicable to the corporation;
- Overseeing the evaluation of the board and management; and
- Overseeing an annual performance evaluation of the committee.

The NYSE suggests that nominating/governance charters also address the qualifications, appointment and removal of committee members, committee structure and operations, and committee reports to the board.

The NASDAQ Stock Exchange requires its listed companies to certify that they have adopted a formal written charter or board resolution, as applicable, addressing the nominations process and any related matters required under federal securities laws.

## TODAY, THE ROLES AND RESPONSIBILITIES OF NOMINATING/GOVERNANCE COMMITTEES FREQUENTLY ENCOMPASS THE FOLLOWING AREAS:

- **Board composition:** Evaluate the expertise, qualifications, skills, attributes, diversity, contributions and independence of incumbent directors and director candidates; oversee ongoing director succession planning; develop and recommend criteria for board composition and director candidates; lead searches for new director candidates; recommend individuals for election or re-election to the board.
- **Committee structure and composition:** Review and recommend the structure, composition and leadership of standing or ad hoc board committees.
- **Corporate governance:** Develop and recommend corporate governance guidelines; oversee and recommend changes to the corporate governance framework (including board procedures and practices, bylaws, certificate of incorporation and corporate governance guidelines).
- **Evaluations:** Develop, recommend and oversee the evaluation processes of the board, board committees and individual directors.

## OTHER RESPONSIBILITIES THAT MAY BE HANDLED BY THE NOMINATING/GOVERNANCE COMMITTEE INCLUDE:

- **Business conduct and ethics:** Develop, oversee and recommend changes to the code of ethics for executives and directors; review and recommend waivers from the code of conduct for executives and directors.
- **CEO succession planning:** Oversee CEO and senior management development and succession planning.
- **Director compensation:** Review and recommend changes to director compensation.
- **Corporate social responsibility:** Oversee strategy and risks related to company sustainability and environmental/social/governance (ESG) issues, including political and campaign contributions.

# Disclosure Requirements

Disclosures related to the nominating/governance committee, its roles and responsibilities and individual directors are set by stock exchange requirements and rules promulgated by the U.S. Securities and Exchange Commission (SEC). Companies should engage qualified legal counsel to navigate the rules and ensure compliance with the requirements.

The intent of the SEC disclosure rules is to provide shareholders sufficient information to evaluate the board and individual directors and make informed voting decisions. The rules do not mandate the format of the disclosures. As a result, companies have the flexibility to use a variety of presentations to provide the information to investors.

As a start, all U.S. public companies must disclose if they have a standing nominating/governance committee (or a committee serving a similar function), and, if so, they must list the names of committee members, detail the number of meetings held during the last fiscal year and provide a brief description of the committee's functions. Companies without a standing nominating/governance committee must disclose the board's rationale for not having such a committee and identify the directors participating in the consideration of director nominations.

## SEC RULES ALSO MANDATE A VARIETY OF DISCLOSURES ABOUT THE PROCESS FOR NOMINATING DIRECTORS, INCLUDING:

- **Does the nominating/governance committee have a charter?**

**IF YES:** Disclose whether the charter is available on the company website (and include the website address) or is disclosed as an appendix to the proxy statement at least once every three years (with year of disclosure provided) or after any material amendment.

- **Does the nominating/governance committee have a policy regarding the consideration of director candidates recommended by shareholders?**

**IF YES:** Describe the material elements of the policy, including whether the committee will consider candidates recommended by shareholders. If the committee will consider shareholder-recommended candidates, describe the procedures to be followed by shareholders submitting recommendations.

**IF NO:** State that fact and disclose the board's basis for not having such a policy.

- **What, if any, are the specific minimum qualifications that must be met by committee-recommended director nominee(s) and the specific qualities/skills necessary for one or more directors?**

- **What is the process for identifying and evaluating director nominees, including shareholder-recommended nominees, and are there any differences in how the nominating/governance committee evaluates shareholder-nominated candidates?**

- **Is diversity considered in identifying nominees or directors?**

**IF YES:** Describe how diversity is considered. If there is a policy regarding the consideration of diversity, disclose how the policy is implemented and how its effectiveness is assessed.

- **What are the source(s)—shareholder, non-management director, CEO or other executive officer, third-party search firm or other—of each first-time nominated, non-executive nominee approved by the nominating/governance committee for inclusion on the proxy card?**

- **What function(s) are performed by any third party paid to identify or evaluate nominees (or assist with the identification or evaluation of nominees)?**

- **What are the names of any nominees submitted for consideration by a shareholder or group owning at least 5 percent of the stock for at least one year and the identity of the 5 percent shareholder or group—provided both give their consent—and did the nominating/governance committee choose to nominate any of the potential candidates?**



**IN ADDITION TO INFORMATION ABOUT THE NOMINATING PROCESS, U.S. PUBLIC COMPANIES MUST ALSO PROVIDE DETAILS ABOUT INDIVIDUAL DIRECTORS, INCLUDING:**

- Names and ages of all current and nominated directors;
- All positions and offices within the company held by each director/nominee, the term of office and the periods served in each position;
- Any arrangements or understandings between any director/nominee and any other person under which the director/nominee was or is to be selected to serve on the board;
- Any family relationships between any directors/nominees and executive officers;
- Brief description of the past five years of business experience of each director/nominee, including occupations and employment;
- Other public company directorships held by each director/nominee during the past five years;
- Description of certain legal or regulatory proceedings during the past 10 years involving any director/nominee; and
- Specific experience, qualifications, attributes or skills supporting the conclusion that the director/nominee should serve on the board.

# Disclosure Trends

The heightened interest of investors and other stakeholders in board composition and the skills and backgrounds of individual directors has led many companies to rethink their communications on these and other governance issues. Today, instead of viewing proxy materials as required compliance documents, companies increasingly are transforming proxy materials into visually compelling communications tools spotlighting company best practices, showcasing the quality of the board and individual directors and focusing on key governance practices.

Companies are changing the way they present required disclosures to enhance their readability and to highlight the board's leading practices. Disclosures regarding individual director skills and qualifications are becoming less boilerplate and more bespoke, tailored to individual company needs and strategies. Companies are also expanding disclosures beyond the mandated SEC and stock exchange requirements in an effort to address top-of-mind issues for stakeholders.

### ENHANCED DISCLOSURE APPROACHES:

- Table of contents and section headers, with hyperlinks, to highlight information and enhance a reader's ability to find information of interest;
- Executive summary spotlighting significant governance issues and best practices;
- Letters from the independent board chair or lead director discussing governance issues;
- Checklist of governance "dos" and "don'ts";
- Infographics summarizing board composition issues such as:
  - > **Independence**
  - > **Tenure**
  - > **Age**
  - > **Gender diversity**
  - > **Racial/ethnicity diversity**
- Matrix highlighting individual director skills and qualifications; and
- Committee-specific disclosures regarding member skills and qualifications of importance to the committee.

In addition, companies are expanding their websites to enhance disclosures about the board and individual directors. Some companies are posting videos (with hyperlinks included in proxy materials) of board and committee leaders discussing their roles and key focus areas.

Investor interest in disclosures about directors and board composition is expected to intensify. In late 2017, New York City Comptroller Scott Stringer called on the boards of 151 companies to publicly disclose a matrix of the skills, race and gender of each director. His letter noted that "...shareowners need to know the race and gender of a company's directors, information that is—by and large—unreported today. In addition, shareowners need to see how each director's skills and experience fit into the company's overall strategy, where there are gaps and understand how boards are refreshed." A sample of the NYC Comptroller's suggested matrix follows.

## [Insert Your Organization Name]

### Board Matrix

This sample matrix can help boards and investors assess the level of experience each company director/nominee has in various areas, as well as in the areas of gender, sexual orientation and racial/ethnic diversity, age and tenure.

	Board of Directors							
	Name 1	Name 2	Name 3	Name 4	Name 5	Name 6	Name 7	Name 8
<b>Skills &amp; Experience</b>								
Board of Directors Experience	X			X				
[Specific Industry Experience]		X					X	
CEO/Business Head	X			X				
International	X					X	X	
Human Capital Management/Compensation			X				X	
Finance/Capital Allocation		X			X		X	
Financial Literacy/Accounting (Audit Committee Financial Expert or "ACFE")			X			X		
Government/Public Policy	X			X				
Marketing/Sales			X		X			
Environmental Science/Policy/Regulation						X		
Academia/Education								
Risk Management				X				
Corporate Governance		X						X
Technology/Systems					X			X
Business Ethics			X			X		X
Real Estate		X			X			X
[Custom 1]								
<b>Demographic Background</b>								
<b>Board Tenure</b>								
Years	15	15	10	8	7	7	4	1
<b>Sexual Orientation (voluntary)</b>								
LGBTQ	X							
<b>Gender</b>								
Male		X	X	X	X	X		X
Female	X						X	
Non-Binary								
<b>Age</b>								
Years old	60	63	65	62	60	67	55	47
<b>Race/Ethnicity</b>								
African American/Black	X							
Asian, Hawaiian or Pacific Islander								
White/Caucasian		X	X	X		X	X	X
Hispanic/Latino					X			
Native American								
Other								

# SECTION 2:

## COMMITTEE OPERATIONS

Nominating/governance committees perform the functions detailed in their charters. In this section, you will learn about the role of the nominating/governance committee chair, committee meeting agendas, committee assessments and committee onboarding.







# Composition & Onboarding



**The nominating/governance committee plays a key role in the operation of the board, including overseeing composition, onboarding and director onboarding.**

## COMPOSITION

Nominating/governance committee charters often define a minimum number of committee members, guidelines for meeting independence requirements, the process for appointing members and, occasionally, the specific people who should serve on the committee. For example, one charter we reviewed stated that the chairs of the audit and the compensation committees should be members of the nominating/governance committee.

On some boards, nominating/governance committee members are elected annually to one-year terms by a majority vote of the board. Other boards do not define specific terms but leave it to the board to appoint members, address vacancies and remove members (which may require a majority vote by independent directors).

Nominating/governance committees may be authorized to establish subcommittees, which may or may not be composed of members of the nominating/governance committee, to which the committee can delegate responsibilities.

## NOMINATING/GOVERNANCE COMMITTEE SNAPSHOT

	S&P 500*	RUSSELL 3000*
Companies with a Committee	99.6**	96%
Size (average number of members)	4.6	3.6
Meetings (average number)	4.7	3.8

Source: \*2018 U.S. Spencer Stuart Board Index; \*\*EY 2017 proxy statements: An overview of the requirements and observations about current practice.

\*\*Includes one board with a standing corporate governance committee in addition to the nominating committee. Controlled companies are not required to have nominating committees.

## ONBOARDING

A robust onboarding process for new nominating/governance committee members is essential to enable committee members to most efficiently and effectively contribute to the committee's work. The onboarding process should be formalized, structured and include a conversation with the committee chair. New committee members also share in the responsibility for successful onboarding. They should request any specific information needed to fully understand the history and functioning of the committee. In addition, the company's corporate secretary or general counsel should play a key role in onboarding new members of the nominating/governance committee. (See more about onboarding in Section 3.)

## SAMPLE NOMINATING/GOVERNANCE COMMITTEE ONBOARDING MATERIALS

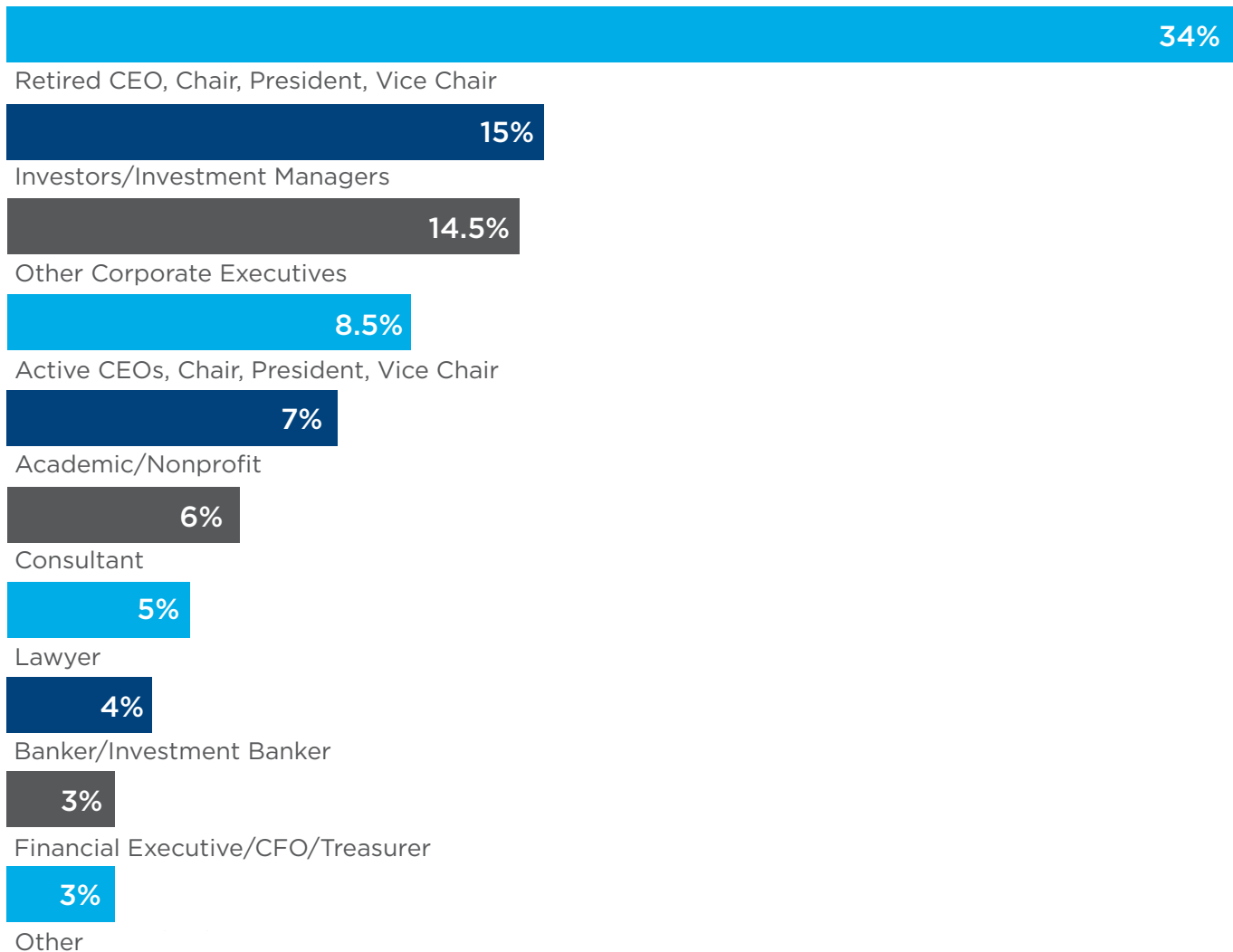
TOPIC	MATERIALS FOR REVIEW/DISCUSSION
Legal Requirements	NYSE or NASDAQ Listing Requirements SEC Disclosure Rules
Corporate Governance Framework	Company Certificate of Incorporation Company Bylaws Corporate Governance Guidelines Governance Benchmarking
Committee Processes	Committee Charter Meeting Agendas Meeting Minutes
Board Composition and Succession	Director Skills Matrix Board Succession Plan Committee Self-Assessment
Environmental Scan	Investor Considerations/Feedback Regulatory Environment/Issues

# Role of the Chair

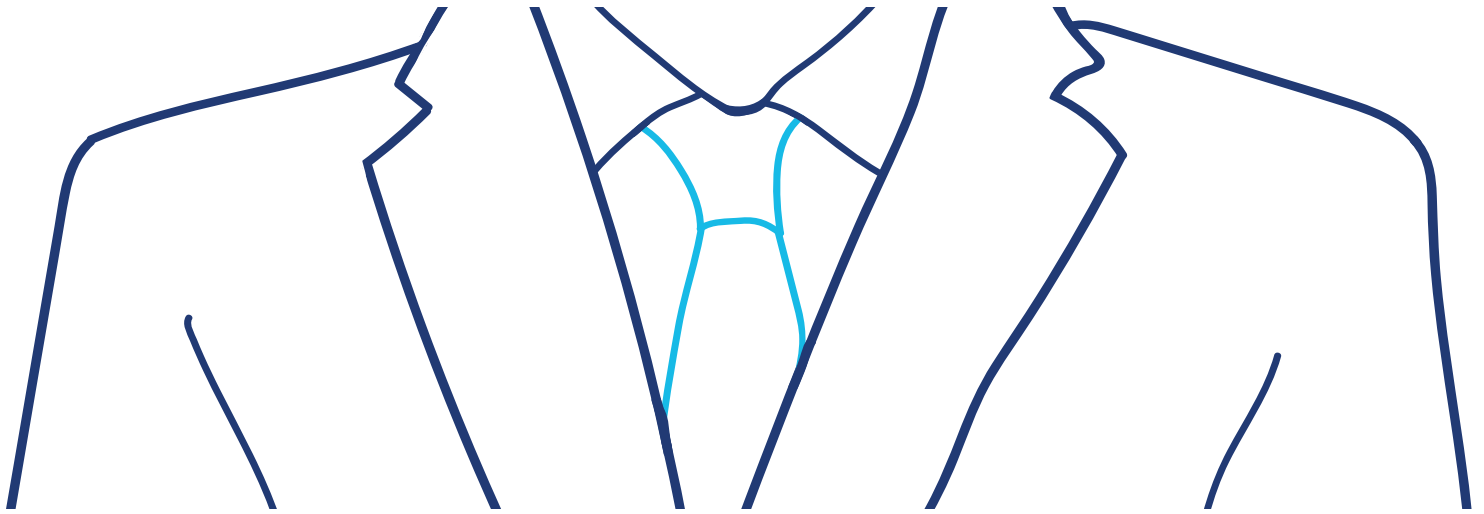
The nominating/governance committee chair is an independent director, typically selected by the board as a whole, the independent directors on the board or by the majority of the nominating/governance committee members. The independent chair of the board or lead director often chairs the nominating/governance committee. Spencer Stuart found that 21% of S&P 500 independent chairs or lead directors also chaired the nominating/governance committee.

Retired CEOs, chairs, presidents and vice chairs are most likely to serve in the role of nominating/governance committee chair, Spencer Stuart research has found.

## NOMINATING/GOVERNANCE COMMITTEE CHAIR BACKGROUNDS



Source: 2018 U.S. Spencer Stuart Board Index



In 2018, women chaired 24 percent of S&P 500 nominating/governance committees, compared with 22 percent in 2017. The responsibilities of the nominating/governance committee chair, which may be delineated in the committee charter, generally include:



Establishing rules of conduct for the committee



Setting the frequency and length of committee meetings



Making sure the list of items to be addressed by the committee during the coming year is circulated to each committee member as well as other board directors prior to the committee's first meeting of the year



Establishing the agenda for committee meetings



Ensuring that the agenda and supporting materials for each upcoming meeting are circulated to other committee members in advance



Presiding at each committee meeting



Amending the agenda to respond to matters that warrant attention, with approval of the majority of committee members

# Meetings & Agendas

Nominating/governance committee charters may spell out the minimum number of annual committee meetings to be held and provide for additional meetings or for actions to be taken by written consent, when deemed necessary or requested by the committee or the chair. On some boards, any committee member can call a meeting of the committee. Charters may explicitly provide for the committee to meet in executive session without company management present.

Charters may also address how and when the committee will report on its activities to the board. They typically require the committee to regularly report committee actions and recommendations to the board after every meeting.

## SAMPLE CALENDAR FOR NOMINATING/GOVERNANCE COMMITTEE MEETINGS

J  
A  
N  
U  
A  
R  
Y

Review and approve minutes of prior meeting

Assess expertise, qualifications, skills, attributes, contributions and independence of incumbent directors and other director candidates in light of the company's strategy and needs and recommend to the full board candidates for elections or re-election to the board

Review draft of governance-related disclosures for proxy statement, including disclosure related to (1) the experience, qualifications, skills and attributes that led to the conclusion that the nominees/directors should serve/continue serving as directors of the company; (2) the consideration of diversity in the process by which directors and candidates are identified; and (3) the board's administration of its risk oversight function (S-K Items 401(e), 407(c)(2)(vi) and 407(h))

Review board leadership structure and draft proxy statement disclosure regarding why such structure is appropriate, including the reasons why the company has the same or different persons serving as chair of the board and CEO and the role of the lead independent director, if any (S-K Item 407(h))

Review D&O insurance coverage, indemnification provisions and policies relating to advancement of expenses; also review developments in law regarding D&O insurance, exculpatory charter provisions and indemnification/advancement of expenses; and make recommendations to the full board

Review form of questionnaire to be used in board and committee self-evaluations

Review updates to proxy advisory firm voting policies

J  
U  
L  
Y

Review and approve minutes of prior meeting

Consider shareholder proposals and voting results from prior proxy season and anticipate any shareholder engagement needed on governance matters (e.g., proxy access)

Review completed questionnaires relating to board and committee self-evaluations; discuss potential areas for improvement and consider impact on board succession planning

Review the following and recommend any proposed changes to the full board:

- Standing resolutions on delegation of authority and information flow
- Charter/bylaws (including in light of any recent corporate law developments, e.g., increasing prevalence of exclusive forum provisions)
- Corporate governance guidelines (NYSE § 303A.09)
- Policies and procedures for approval of related person transactions (S-K Item 404(b))

Review form and amount of board and committee compensation and recommend any proposed changes to the board

Review nominating and corporate governance committee charter, recommend any proposed changes to the full board

Annual committee self-evaluation (NYSE § 303A.04(b)(ii))

Review and approve minutes of prior meeting

Review form of D&O questionnaires

Review criteria and qualifications for board membership, including diversity tenure and standards for assessing independence, and recommend any changes to the full board

Review policy (if any) regarding diversity in the identification of nominees for directors and assess the effectiveness of such policy

Review policies and procedures for receipt of shareholder recommendations of candidates for nomination by the board

Develop an orientation program for new directors and a continuing education program for all directors (NYSE § 303A.09)

Approval of board and committee calendar for the coming year for recommendation to the full board

Initial review of board size and composition and any expected director departures and consideration of appropriate slate of nominees for next year's annual shareholders meeting; determine whether any rotation in board leadership roles is advisable

**POSSIBLE ADDITIONAL ITEMS (FOR REGULAR MEETINGS OR BASES FOR CALLING SPECIAL MEETINGS OR TAKING ACTION BY UNANIMOUS WRITTEN CONSENT)**

- Any change in independence status of any individual director
- Any performance concerns regarding a director
- Letter of resignation submitted by any director, including by any director nominee who does not receive a "majority of votes cast" at the annual meeting
- Review shareholder proposals, nominations and/or recommendations
- Request for waiver of the *Code of Business Conduct and Ethics*
- Negative vote recommendation from proxy advisory firm
- Review board refreshment mechanisms (e.g., whether to modify approach to conducting board and committee self-evaluations or analyzing the results; whether to institute or modify mandatory retirement age or term limits)
- Review any new SEC disclosure rules relating to corporate governance
- Review emerging trends and shareholder input relating to corporate governance (e.g., proxy access)
- Review any new influential governance recommendations (e.g., the *Commonsense Principles of Corporate Governance* published in July 2016, *Business Roundtable's Principles of Corporate Governance* revised in August 2016)

Source: The Sidley Austin Best Practices Calendar for Corporate Boards and Committees 2018

# Increasing Effectiveness

The full board, along with the audit, compensation and nominating/governance committees of NYSE-listed companies are required to annually assess their performance. Today, board and committee evaluations are considered best practice for all companies, and nearly all (87 percent) of S&P 500 boards report annual assessments of the performance of board committees. Some also specifically call for the committee chair and individual members to be evaluated.

From a process standpoint, committee evaluations are most effective if they are completed by each committee member, with the entire committee discussing results, focusing on areas for improvement or with great variation in answers, identifying a plan and a timeline for follow-up and monitoring progress.

## SAMPLE QUESTIONS: NOMINATING/GOVERNANCE COMMITTEE SELF-ASSESSMENT FORM

GENERAL		Rating 1 = Poor, 5 = Excellent					Comments
Annually reviews charter and recommends any necessary changes to the board.		1	2	3	4	5	
Has adequate access to the services of staff.		1	2	3	4	5	
Provides new committee members with an effective onboarding program.		1	2	3	4	5	
MEETINGS		Rating 1 = Poor, 5 = Excellent					Comments
Circulates meeting agendas and related background information in a timely fashion to ensure that full and proper consideration is given to the issues.		1	2	3	4	5	
Meets regularly and an appropriate number of times.		1	2	3	4	5	
Periodically provides meaningful and focused updates to the board.		1	2	3	4	5	
COMMITTEE SPECIFICS		Rating 1 = Poor, 5 = Excellent					Comments
Committee members have experience needed to serve effectively.		1	2	3	4	5	
Members regularly prepare for and attend committee meetings.		1	2	3	4	5	
Committee leadership is strong and effective.		1	2	3	4	5	
Has a viable succession plan for committee membership and leadership.		1	2	3	4	5	
BOARD COMPOSITION		Rating 1 = Poor, 5 = Excellent					Comments
At an appropriate time prior to each annual stockholder meeting, directors are to be elected or reelected. The Committee recommends, based on exercise of its judgment, well-qualified, willing and able candidates to the Board for nomination.		1	2	3	4	5	



BOARD COMPOSITION	Rating 1 = Poor, 5 = Excellent					Comments
At an appropriate time after a vacancy arises on the Board or a director advises the Board of his or her intention to resign, the Committee recommends to the Board for appointment such prospective member to fill such vacancy based on exercise of its judgment, has found to be well qualified and willing and available to serve.	1	2	3	4	5	
Has a viable board succession plan to ensure board candidates are identified in a timely manner.	1	2	3	4	5	
EVALUATIONS	Rating 1 = Poor, 5 = Excellent					Comments
Annually assesses the committee's performance, takes any necessary corrective action and reports the results to the board.	1	2	3	4	5	
Oversees the board in the board's annual review of its performance (including its composition and organization) and the performance of management and makes appropriate recommendations to improve performance.	1	2	3	4	5	
Annually reviews the performance of each current director and considers the results of such evaluation when determining whether or not to recommend the nomination of such director for an additional term.	1	2	3	4	5	
GOVERNANCE	Rating 1 = Poor, 5 = Excellent					Comments
Makes recommendations to the board regarding governance matters, including, but not limited to, the company's certificate of incorporation, bylaws, the committee charter and the charters of the company's other committees.	1	2	3	4	5	
Develops and recommends to the board the Corporate Governance Guidelines.	1	2	3	4	5	
Develops and recommends to the board a policy regarding the consideration of director candidates recommended by the company's security holders and procedures for submission by security holders of director nominee recommendations.	1	2	3	4	5	

Please comment on the board's practices regarding delegation to this committee.

Please describe your personal level of satisfaction with the work of this committee.

How can the committee improve its performance?

How can I improve my performance?

Name: \_\_\_\_\_

Signed: \_\_\_\_\_

Date: \_\_\_\_\_

## SECTION 3: OVERSIGHT OF BOARD AND COMMITTEE COMPOSITION

A key responsibility of the nominating/governance committee is to continuously evaluate the composition of the board and its committees to increase board effectiveness. This section covers board composition strategy, key requirements, diversity and onboarding.





# Recruitment & Nomination

**A core responsibility of the nominating/governance committee is the oversight of the composition of the board and its committees. Board and committee composition lie at the heart of board effectiveness. The ideal board comprises a diverse group of directors from widely varying backgrounds offering complementary expertise who work well as a team and who possess the skills necessary for board and committee work. The ability to recruit the right directors and integrate them successfully is one of the clearest indicators of a high-functioning board.**

## BOARD COMPOSITION: A STRATEGIC ASSET

Boards ideally view their composition as a strategic asset, annually reviewing their makeup in light of company strategies and competencies that would be valuable to have in future boardrooms. Nominating/governance committees generally consider a variety of variables when recruiting new directors and determining whether to recommend the nomination of sitting directors.

Some nominating/governance committees use a board skills matrix to examine the demographics and professional backgrounds of current board members and evaluate the board's composition. Some boards are disclosing a skills matrix in publicly available materials such as the proxy statement. See Section 1 for a sample skills matrix recommended by the New York City comptroller and the New York City pension funds.

## DEVELOPING A SKILLS MATRIX



Identify the key skills, backgrounds and experience necessary to oversee forward-looking strategies and risks, while satisfying legal requirements and committee needs.



Inventory the skills, contributions and diversity of current board members.



Identify gaps in skills, backgrounds and experiences to shape searches and influence decisions to renominate directors.

## S&P 500 NEW DIRECTOR BACKGROUNDS

**50%**



of new directors are women or minorities

**428**



new independent directors

**33%**



of new directors are serving on their first public board

**34%**



of new independent directors have backgrounds in the technology or telecommunications industry

Source: 2018 U.S. Spencer Stuart Board Index

## BUSINESS STRATEGY

Strategy is the starting point for every review of board composition. The sheer pace of change means that companies—and boards—are having to respond to market, competitive, technology, political, regulatory and customer changes that are coming at them faster than ever.

The nominating/governance committee is the front line for ensuring that the board is composed of directors with the right skills and qualifications to oversee forward-looking strategies and emerging threats and opportunities. Each year, the nominating/governance committee should consider the company's strategy for the next several years, assess whether the current board composition aligns with company strategies and plan to address any gaps.

A balanced board will be comprised of directors who bring specific experiences, skills and perspectives and yet who are also capable of contributing to board decisions on topics that may fall outside their sphere of expertise. In other words, they need to have sufficient financial and business acumen that they will not be left behind in any aspect of board debate.

Boards look to the nominating/governance committee to determine the specific backgrounds, expertise and experience that are relevant for the board as a whole and its individual members relative to company strategies. Based on strategic considerations, some boards are identifying new boardroom needs and prioritizing new areas of expertise. They are tapping "nontraditional" candidates, especially younger, active executives, to bolster their knowledge in disciplines such as digital or social media, e-commerce, certain areas of finance and emerging markets or global business. Nominating/governance committees are also considering directors without previous board experience.

# Requirements & Considerations

## INDEPENDENCE REQUIREMENTS

The nominating/governance committee is responsible for reviewing the independence of directors and board committees to ensure compliance with stock exchange requirements.

### LISTING REQUIREMENTS

#### New York Stock Exchange

Independent directors must comprise a majority of the board.

Boards must have all-independent audit, compensation and nominating/governance committees (with limited exceptions).

#### NASDAQ Stock Market

Independent director must comprise a majority of the board.

Boards must have all-independent audit and compensation committees.

Boards must have an all-independent nominating/governance committee or nominees must be selected by independent directors constituting a majority of the board's independent directors (with limited exceptions, including: under certain limited circumstances and with additional disclosures, one non-independent director may serve on the audit, compensation or nominating/governance committee for no longer than two years).

Both exchanges have specific minimum definitions for determining director independence and also require boards to affirmatively determine that directors who are classified as independent have no material relationship with the company, either directly or as a partner, shareholder or officer of an organization that has a relationship with the company.

For more details on independence: [NASDAQ definition](#) [NYSE, 303A.01 and 303A.02](#)

Institutional investor proxy voting guidelines may incorporate more stringent standards for director independence. As a result, nominating/governance committees should consider whether directors satisfying exchange independence standards run afoul of investor standards for independence.

Some investors have questioned whether directors with "excessive" tenure should still be considered independent, and a few consider tenure when assessing director independence. While tenure is a director independence consideration in some markets outside of the U.S., there are currently no specific regulations or listing standards in the U.S. that link director independence to tenure.

## COMMITTEE NEEDS

Nominating/governance committees must also consider committee needs, including regulatory requirements, legal considerations and policies—such as rotation—related to board committee leadership and membership. Knowledgeable, independent directors are needed to lead and serve as members of the audit, compensation, governance and other committees. The chair, especially, must be current on the relevant governance issues and trends related to each committee.

The majority of boards maintain between three and four standing committees.

## PREVALENCE AND INDEPENDENCE OF STANDING COMMITTEES AMONG S&P 500 COMPANIES

	% with this committee		% composed entirely of independent directors	
	2018	2013	2018	2013
Audit	100%	100%	100%	100%
Compensation	99.8%	100%	99.6%	99.6%
Nominating/Governance	99.4%	99.4%	99.6%	100%
Executive	30%	36%	2%	2%
Finance**	31%	31%	76%	78%
Risk	12%	8%	77%	72%
Science & Technology	9%	10.5%	93%	88.5%
Public Policy/Social & Corporate Responsibility	9%	8%	87%	74%
Environment, Health & Safety	9%	8%	84%	90%
Legal/Compliance	4.5%	5.5%	86%	90%
Strategy & Planning	2%	4%	50%	72%
Investment/Pension	3%	3%	59%	77%

\*12 boards have a combined compensation and nominating committee. They are counted as separate committees for the purpose of this analysis.

\*\*Includes two boards with a standing corporate governance committee in addition to the nominating committee. Controlled companies are not required to have nominating committees.

\*\*\*13 boards have a combined finance and risk management committee. They are counted as separate committees for the purpose of this analysis.

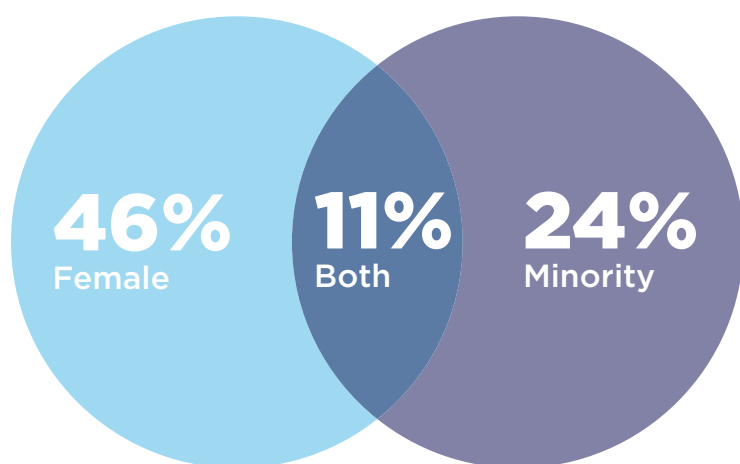
Source: 2018 U.S. Spencer Stuart Board Index

# Diversity

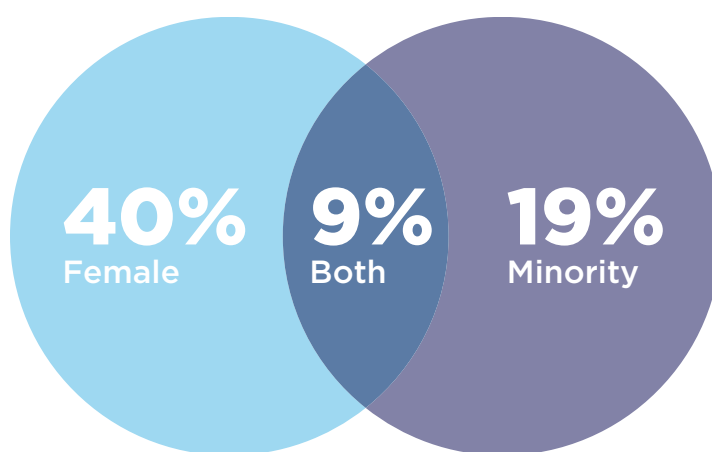
Boards increasingly appreciate the value of having diverse perspectives—in the areas of age, gender, race and ethnicity and, in some cases, geographic knowledge—to foster better debate and decision-making and less groupthink. Diversity takes many forms, and the relevant mix of perspectives sought by a board will vary depending on factors such as the scale of the business and demographic considerations such as customer base and geographic footprint.

## BOARDS ARE TAKING STEPS TO ENHANCE BOARDROOM DIVERSITY

First-Time Directors (% S&P 500)



All New Directors (% S&P 500)



Source: 2018 U.S. Spencer Stuart Board Index

## GENDER DIVERSITY

In recent years, female representation on boards in particular has been a growing area of focus, with a variety of stakeholders criticizing the slow pace of progress. Boards face more pressure on gender diversity from institutional investors, who point to research showing that companies with more diverse boards—and, especially, more women—perform better.

## RACIAL AND ETHNIC DIVERSITY

Increasing ethnic and racial diversity is another priority for many boards. According to Spencer Stuart's 2018 survey of nominating/governance committee members, 43 percent indicated that recruiting minority directors was a priority.



## INTERNATIONAL DIRECTORS

Another consideration is whether to add an international perspective to the board. For example, it may be valuable to have one or more directors from strategic markets or with working experience in those markets if the company is expanding its global footprint, building manufacturing or distribution capabilities overseas or moving into a complex or particularly competitive market. A number of dimensions should be considered when thinking about adding international representation to the board, including differing time zones, languages, customs and cultural nuances. International directors remain a small minority on U.S. boards, accounting for just 8.2 percent of directors in the top 200 S&P 500 companies. By comparison, boards in eight European countries average more than 30 percent foreign directors, with foreign directors representing 58 percent of directors of Swiss boards.

Boards do not have to sacrifice critical skills or expertise to increase diversity, but they may have to broaden their approach to director recruitment and their perceptions about the ideal director. For example, boards often define the ideal board member as a current or former CEO or CFO, and women and minorities are still underrepresented in these ranks.



# Onboarding New Directors

Onboarding programs are designed to familiarize new directors with the company's businesses, strategies and policies and to assist new directors in developing the skills and knowledge required for board service. While many boards do not explicitly place responsibility for new director onboarding with the nominating/governance committee, on many boards the committee plays a supporting role with the corporate secretary and board chair.

A thorough, tailored program should bring the director up to speed on key topics, ranging from the board's structure, governance and responsibilities to the company's strategic objectives, financial reporting and relationships with investors and management.

If a new board member has prior director experience, the onboarding program can focus on the company, its products, services and key players; the wider business context; and the culture of the board and how it operates. A first-time director without previous board experience will also benefit from general training on the role of the board and individual directors, important governance regulations and listing requirements and the governance issues affecting boardrooms today. And in all cases, new directors should also own the onboarding experience by taking responsibility for ensuring they are getting the training and insights needed to quickly get up to speed in the boardroom.



## DIRECTOR ONBOARDING BEST PRACTICE PROCESS



Meetings with key business executives and functional leaders, including finance, marketing, IT, HR, legal, internal audit

- Presentations on the business model, key performance indicators (KPIs), profitability and performance
- Explanation of regulatory and governance issues
- Overview of the operations, operational challenges and underlying infrastructure
- Overview of the company's risk profile, including how the board views sector and company risk and how management assesses, presents and articulates risk
- Overview of board calendar activities—not just what the next board meeting is about but the key processes of the board over the course of 12 months of board meetings
- Discussion of director roles and responsibilities (key for first-time directors)



Meet one-on-one with as many directors as possible to provide a sense of the priorities of the board and the dynamics among directors and between management and the board



Review prior 12 months' board materials and minutes to provide context on the current issues



Visit operations to get a better sense of how the business works and an opportunity to meet people on the ground



Meet with external advisers such as accountants, bankers, brokers and others



Attend investor day



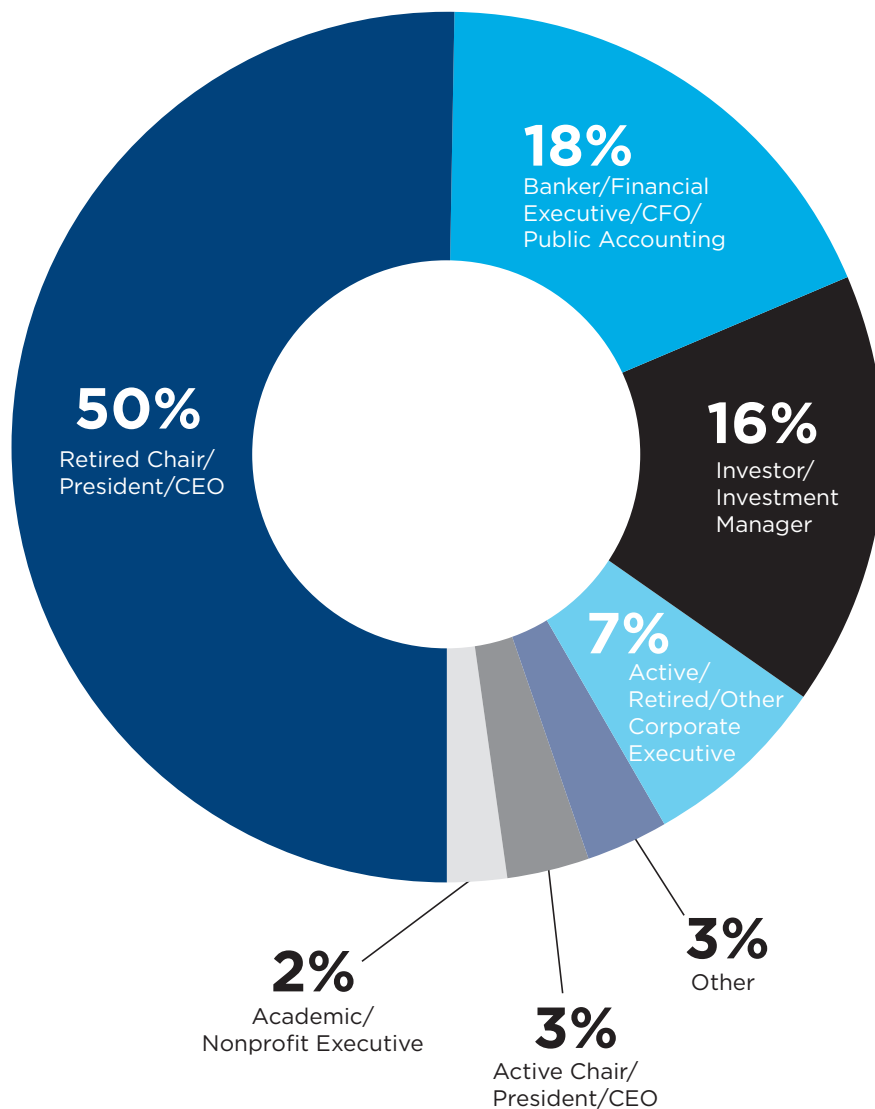
Assign a mentor (*Note: First-time directors especially tell us they appreciate having a mentor during the first six to 12 months on the board. An informal mentor program pairs a new director with a more experienced director who can provide perspective on boardroom activities and dynamics or help with meeting preparation, explain aspects of board papers and debrief and act as a sounding board between meetings.*)

# Board Leadership

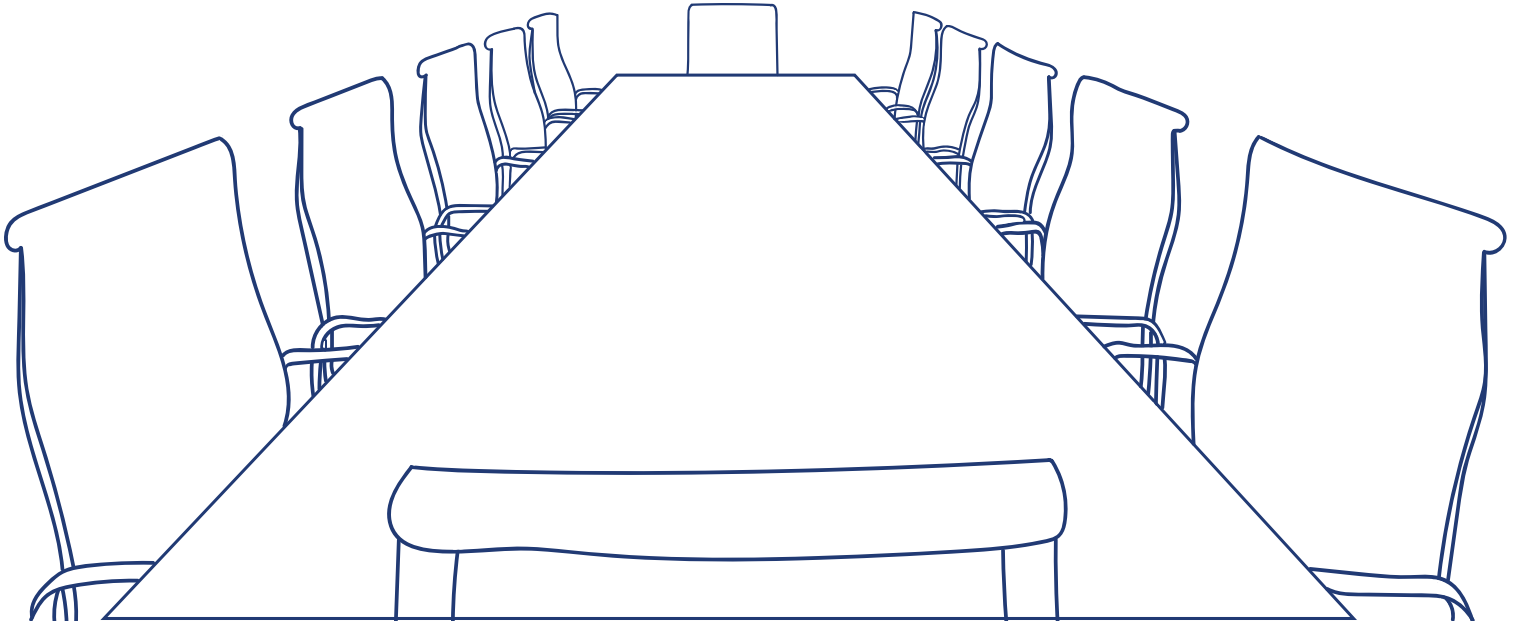
Nominating/governance committees generally are responsible for recommending the board's leadership structure. Investors expect boards to have robust independent board leadership, and some advocate independent chairs as the best structure. Today, S&P 500 boards are more likely than in the past to split the chair and CEO roles between two people. However, independent chairs—a director who meets the applicable NYSE or NASDAQ rules for independence—are less common; only 30.5% of S&P 500 boards, versus 28% in 2017 and 16% in 2008, have an independent chair. Among the 92 boards where the chair is separate but not independent, nearly all (93.5%) have identified a lead or presiding independent director.

Half of S&P 500 independent chairs are retired senior executives.

## INDEPENDENT CHAIR BACKGROUNDS AMONG S&P 500 COMPANIES



Source: 2018 U.S. Spencer Stuart Board Index



## QUESTIONS YOU SHOULD ASK: BOARD COMPOSITION

1

Does the board as currently constituted give the company its best shot at success in supporting the strategy?

2

Would additional, and perhaps different, skills significantly enhance the board's ability to do its job?

3

How do stakeholders, including investors, view the diversity of the board and its leadership?

4

Does the nominating/governance committee routinely look ahead to identify boardroom needs and anticipated turnover?

5

What is the refreshment strategy and how is it communicated to stakeholders, including investors?

6

What is the composition of director tenure and how does it benchmark against peers and investor expectations?

7

Is there a mix of tenures in the boardroom?

8

Is our onboarding program robust and tailored to individual needs and backgrounds?

# Spotlight on Board Composition

**Institutional investors increasingly are scrutinizing board composition.**

**“We view the board as one of a company’s most critical strategic assets. When the board contributes the right mix of skill, expertise, thought, tenure and personal characteristics, sustainable economic value becomes much easier to achieve. A thoughtfully composed, diverse board more objectively oversees how management navigates challenges and opportunities critical to shareholders’ interests. And a company’s strategic needs for the future inform effectively planned evolution of the board.”**

*August 31, 2017, An open letter to directors of public companies worldwide, F. William McNabb, III, Chairman and CEO, Vanguard*

**“Our primary concern is that board members are able to contribute effectively as corporate strategy evolves and business conditions change, and that all directors, regardless of tenure, demonstrate appropriate responsiveness to shareholders. We acknowledge that no single person can be expected to bring all relevant skill sets to a board; at the same time, we generally do not believe it is necessary or appropriate to have any particular director on the board solely by virtue of a singular background or specific area of expertise.”**

*2018 Proxy Voting Guidelines for U.S. Securities, BlackRock*

## TURNOVER

Turnover on U.S. boards has largely been driven by director retirements. Other forces—including activist investors, mergers and acquisitions or the emergence of a need for new perspectives and skills on the board (such as financial expertise after the passage of the Sarbanes-Oxley Act of 2002 and, more recently, digital and cybersecurity experience or diversity (also influence board composition).

The vast majority of board departures are known about well in advance, giving the nominating/governance committee time to engage in boardroom succession planning and to carefully consider the desired profile and expertise of successors.

As a starting point, the nominating/governance committee should stay up to date on the timing of anticipated vacancies, including those due to term or age limits and director plans for retirement. Today, most nominating/governance committees start planning for vacancies at least 12 months in advance and, in cases when several retirements are on the horizon, governance committees think holistically about a multiyear process.

U.S. boards today rely overwhelmingly on formal retirement policies to promote turnover. Among S&P 500 companies, for example, 71 percent report having a mandatory retirement age for directors.

## S&P 500 BOARD RETIREMENT AGES

	2018	2013	2008
70 and younger	3%	11%	27%
71	1%	1%	1%
72	43%	55%	55%
73	4%	4%	4%
74	6%	5%	2%
75 and older	43.5%	24%	11%

Source: 2018 U.S. Spencer Stuart Board Index

Mandatory tenure policies are less common. Only 5 percent of S&P 500 companies set explicit term limits, with a majority of the policies set at 15 years or more. Nearly two-thirds (65 percent) of S&P 500 boards explicitly state in their corporate governance guidelines that they do not have term limits.

Increasingly, meaningful assessments are viewed by investors as the preferred tool for evaluating and enhancing board and director performance and promoting boardroom refreshment. They consider peer and/or self-assessments best practices for providing feedback to directors on their performance, identifying gaps in boardroom skills and perspectives, and facilitating boardroom succession. Despite investor support, individual director evaluations are not prevalent. The 2018 U.S. Spencer Stuart Board Index found that only 38% of S&P 500 companies reported some form of individual director assessments in their process—a percentage largely unchanged over the previous five years.

Some boards are emphasizing that directors should not expect to be renominated annually and that the board self-evaluation process is an important determinant for board tenure. Boards taking this approach use annual evaluations to assess the effectiveness of the board overall as well as the contributions of individual directors to identify directors who are underperforming or whose skills no longer represent a good fit with the strategic direction of the business.

## SECTION 4: OVERSIGHT OF BOARD FUNCTION & EVALUATIONS

Given the increased scrutiny on board composition and effectiveness, most boards have adopted corporate governance guidelines to summarize their governance philosophies and practices, many of which fall under the purview of the nominating/governance. In this section, you will learn about corporate governance principles and requirements, continuing education and best practices for board evaluations.







# Corporate Governance Principles

**While director and board effectiveness and performance are ultimately the responsibility of the full board, the nominating/governance committee plays a critical role with its oversight of the board's governance policies and practices, governing documents, committee structures and annual evaluations. The nominating/governance committee is also often responsible for overseeing the required code of ethics and conduct for directors, officers and employees.**

## CORPORATE GOVERNANCE PRINCIPLES

Companies listed on the NYSE are required to adopt and publish corporate governance guidelines summarizing their governance philosophies and practices. NASDAQ-listed companies aren't required to have formal corporate governance guidelines. However, they are generally considered best practice, and today most boards have adopted governance guidelines.

**The following subjects must be addressed in the corporate governance guidelines required by the NYSE:**

1

### Director Qualifications Standards

These standards should, at minimum, reflect the independence requirements set forth in the NYSE Listed Company Manual. Companies may also address other substantive qualification requirements, including policies limiting the number of boards on which a director may sit, director tenure, retirement and succession.

2

### Director Responsibilities

These responsibilities should clearly articulate what is expected from a director, including basic duties and responsibilities with respect to attendance at board meetings and advance review of meeting materials.

3

### Director Access to Management and, as Necessary and Appropriate, Independent Advisers

4

### Director Compensation

Director compensation guidelines should include general principles for determining the form and amount of director compensation (and for reviewing those principles, as appropriate). The board should be aware that questions as to directors' independence may be raised when directors' fees and emoluments exceed what is customary. Similar concerns may be raised when the listed company makes substantial charitable contributions to organizations in which a director is affiliated or enters into consulting contracts with (or provides other indirect forms of compensation to) a director. The board should critically evaluate each of these matters when determining the form and amount of director compensation and the independence of a director.

# 5

## Director Orientation and Continuing Education

# 6

## Management Succession

Succession planning should include policies and principles for CEO selection and performance review, as well as policies regarding succession in the event of an emergency or the retirement of the CEO.

# 7

## Annual Performance Evaluations of the Board

The board should conduct a self-evaluation at least annually to determine whether it and its committees are functioning effectively.

# 8

## Requirements

**Website Posting Requirement:** A listed company must make its corporate governance guidelines available on or through its website.

**Disclosure Requirements:** A listed company must disclose in its annual proxy statement or, if it does not file an annual proxy statement, in its annual report on Form 10-K filed with the SEC that its corporate governance guidelines are available on or through its website and provide the website address.

# Continuing Education

Expectations of corporate boards and directors have never been higher. They are expected to be more engaged, more knowledgeable and more effective than in the past. At the same time, business disruptors and risks are evolving at an unparalleled pace, and the roles and responsibilities of directors are growing increasingly complex. Director education is considered a best practice for establishing a boardroom culture of continuous improvement and for positioning individual directors and boards for success in today's ever-changing business environment.

Directors do not have to be licensed, certified or otherwise satisfy minimum standards to serve on corporate boards, and companies are not required to provide directors with training or continuing education. However, today's companies and investors generally expect that corporate directors will be committed to optimizing their performance by participating in training and continuing education on current and emerging issues and rules and regulations relevant to the boardroom.

Companies may offer a variety of educational programs and opportunities to help directors best perform their duties and stay abreast of emerging issues.

## BOARDROOM APPROACHES TO DIRECTOR CONTINUING EDUCATION

- Hosting regularly scheduled, in-boardroom educational sessions featuring internal and external experts on topics of particular relevance to the company and its business
- Paying reasonable expenses related to third-party educational programming related to director responsibilities
- Providing directors with an educational budget to be used, as they elect, for boardroom related training and education
- Covering membership dues for board-focused organizations
- Encouraging participation in free educational programming available to directors, including webinars and events sponsored by professional firms, such as law and accounting firms



Companies are not required to disclose details about director training and ongoing education. However, NYSE-listed companies must address director education and orientation in their corporate governance guidelines.

To help spread knowledge gained through continuing education, boards may allocate a few minutes of each board meeting for directors to share takeaways from recent educational programming, or they may designate a location (such as the portal for board materials) for directors to share information or summarize learning.

## QUESTIONS YOU SHOULD ASK: COMMITTEE OVERSIGHT FUNCTIONS

1

Are our governance policies and documents (bylaws, charter) current and best structured for the unique considerations of the board and the company?

2

How do our corporate governance policies and key provisions of our governing documents benchmark against peers and investor expectations?

3

What feedback, if any, have we received from investors and other stakeholders about our governance policies and documents?

4

Does the board have a commitment to supporting continuing education for directors?

5

What mechanisms are in place to encourage sharing of learning from director continuing education programs?

# Evaluations: Board

Nominating/governance committees generally take the lead overseeing annual board evaluations, which boards are increasingly using to examine and improve their effectiveness. Annual assessments have become the norm for boards in many countries, with nearly all listed companies in Canada, France, the UK and the U.S. conducting some sort of assessment each year. Annual evaluations are also widespread in Italy and Spain and gaining attention in many Asia Pacific markets, where the issue of board effectiveness is moving up on the corporate governance agenda.

Done effectively, board evaluations provide a forum for directors to review and reinforce appropriate board and management roles, highlight best practices and ensure that problem areas or gaps are identified and addressed promptly.

Since board structures, governance issues and cultural norms differ by company and country, one size does not fit all when it comes to board assessments. To be most effective, a board assessment must be tailored to a company's current business context and unique circumstances.

An independent facilitator may be engaged by the board to assist with the annual evaluation. In some markets, boards are required to engage a third party to facilitate board evaluations. Many boards hire third-party facilitators periodically (such as every third year) or as needed in response to changing board dynamics or emerging challenges.

## IN OUR EXPERIENCE, BOARDS DERIVE THE HIGHEST VALUE FROM A BOARD ASSESSMENT SHAPED BY FIVE KEY PRINCIPLES:



### **The Board Agrees on Clear Objectives for the Assessment**

A shared agreement among directors about the goals for the assessment encourages directors to commit to the process and provide the candid feedback essential to identifying and addressing potential roadblocks to board effectiveness.

For some boards, a “triggering event,” such as the arrival of a new CEO or a change in board leadership or composition, can shape the priorities and objectives of the assessment. For example, an assessment occurring during a CEO transition can help forge an understanding between the CEO and the board about expectations and accountabilities, clarify the respective roles of the board and CEO and ensure that time is spent early in the CEO's tenure to consider whether changes are needed in the way the board is composed, structured or operates.



### **A Board Leader is Responsible for Driving the Process**

Essential to a successful evaluation is having an independent board leader champion the assessment process. The independent board chair, chair of the nominating/governance committee or the lead independent director is in a position to drive the process and involve the right people, ask for directors' time, schedule time on the agenda to discuss the results and ensure that the board follows up on the issues that emerge. While the CEO should be an integral part of the process, he or she should not be leading it.

The board leader driving the assessment process plays a significant role in managing expectations about the process, serves as an independent resource for directors and management to turn to with concerns and may deliver feedback to individual directors, if the board is not working with a third party to facilitate the process.



### **The Process Incorporates Perspectives Beyond those of Directors, Including those from Senior Management and Best Practices from Outside the Company**

One way the board can limit the value of a board assessment is to look only inwardly at its own effectiveness. An emerging best practice among U.S. boards, although still less common in European boards, is to seek input from the key senior management team members who interface with the board. Soliciting input from the executives who participate in most of the board meetings—such as the general counsel, the president, the chief financial officer and head of human resources—can broaden the perspectives on the board’s effectiveness in key areas, including board/management relations. As regular board observers, these executives often have very thoughtful feedback about what the board does well and what it could do better.

Board assessments also can be more valuable when boards benchmark themselves against other high-performing boards in the same industry segment or against best practices in specific areas. For example, boards often want to know how they compare to peers in areas such as committee structure, compensation and mandatory retirement age. A third-party facilitator with significant experience in the boardroom and knowledge of governance guidelines and regulations can provide perspectives on how the board compares to its peers or measures up to the evolving standards of corporate governance by providing an up-to-date perspective on best practices.



### **The Assessment Process Goes Beyond Compliance Issues to Examine Board Effectiveness**

Done well, the assessment process can reveal a variety of issues and obstacles to high-performing boardrooms. These range from easily addressed operational complaints about meeting length or the composition of the agenda, to larger, thornier issues concerning the board’s role in strategic decision making, gaps in knowledge and competencies on the board, and executive and director succession planning. Corrective actions range as well—from improving the timeliness of board materials and winnowing overly long agendas to making changes in the composition and, occasionally, the leadership of the board.

While many of the concerns that surface through evaluations focus on board procedures, they sometimes go to the important relationship between the board and management, which can vary depending on the size and development stage of the company, the international makeup of the board and the current state of the business. In Europe, many boards also are re-examining the board’s involvement in areas such as succession planning and strategy planning, considering whether the board should be more involved earlier in the process, for example, to review the competitive assumptions shaping management’s strategic plan.



### **Directors Commit to Reviewing the Results of the Assessment and Preparing an Action Plan for Addressing Issues that Emerged**

Assessments can fall short when boards do not commit the time to review the results and address the issues that are raised. Some boards, for compliance reasons, begin an assessment process, but then spend little or no time discussing the findings. In addition to leaving issues unresolved, this lack of follow-up can generate cynicism about the process and the board leadership’s commitment to improving effectiveness in the future.

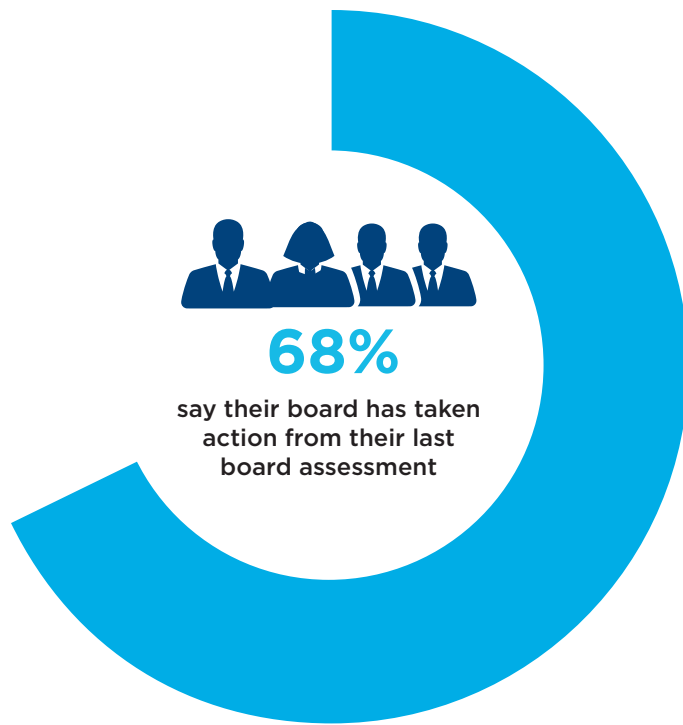
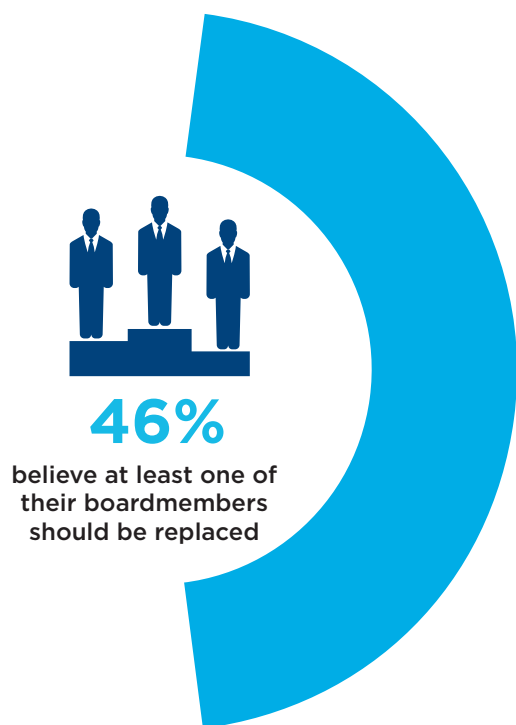
Boards have to be open to the results of the assessment and committed to dealing with the findings. This involves having an open discussion among the board members about performance issues that were raised and prioritizing items that should be addressed in the coming year. Follow-up is typically delegated to the nominating/governance committee, which develops an action plan based on the board’s recommendations. The board reviews its progress as part of the following year’s assessment.

# Evaluations: Individual Director

Annual board evaluations are increasingly standard practice in boardrooms around the globe. And increasingly boards are retaining independent experts to assist with evaluations.

Individual director assessments—whether self or peer—appear to be less common. The 2017 Spencer Stuart U.S. Board Index found that just over one-third (37%) of S&P 500 companies disclose some form of individual director assessments in their process—a percentage largely unchanged from five years ago.

Despite the challenges, consensus is growing in support of conducting individual director assessments as part of the board effectiveness assessment—not to grade directors but to provide constructive feedback that can improve performance. High-performing boards expect directors to stay engaged and to contribute fully and are willing to address underperformance. They also create an environment that encourages individual directors to think critically about their contributions and the relevance of their skills to the company strategy.



Source: PwC, 2017 Annual Corporate Directors Survey





The need for mechanisms, such as assessments, for providing feedback to directors is evident. PwC surveys have consistently found that significant percentages of directors believe one or more colleagues on the board should be replaced, citing reasons such as directors overstepping the boundaries of their oversight role, failing to challenge management or interacting in ways that negatively affects board dynamics. Advanced age and diminished performance are also cited.

The collegial nature of the boardroom, so vital to board effectiveness, can make peer assessments uncomfortable for directors. Because it can be difficult to share negative feedback about a fellow director, peer assessments may be avoided or can become compliance exercises that fail to address any elephants in the room.

Some boards use a formal individual director assessment or a peer assessment process. Others may implement a mentoring program for directors. Another approach is have each director meet periodically with the chairman/lead director or nominating/governance committee chair.

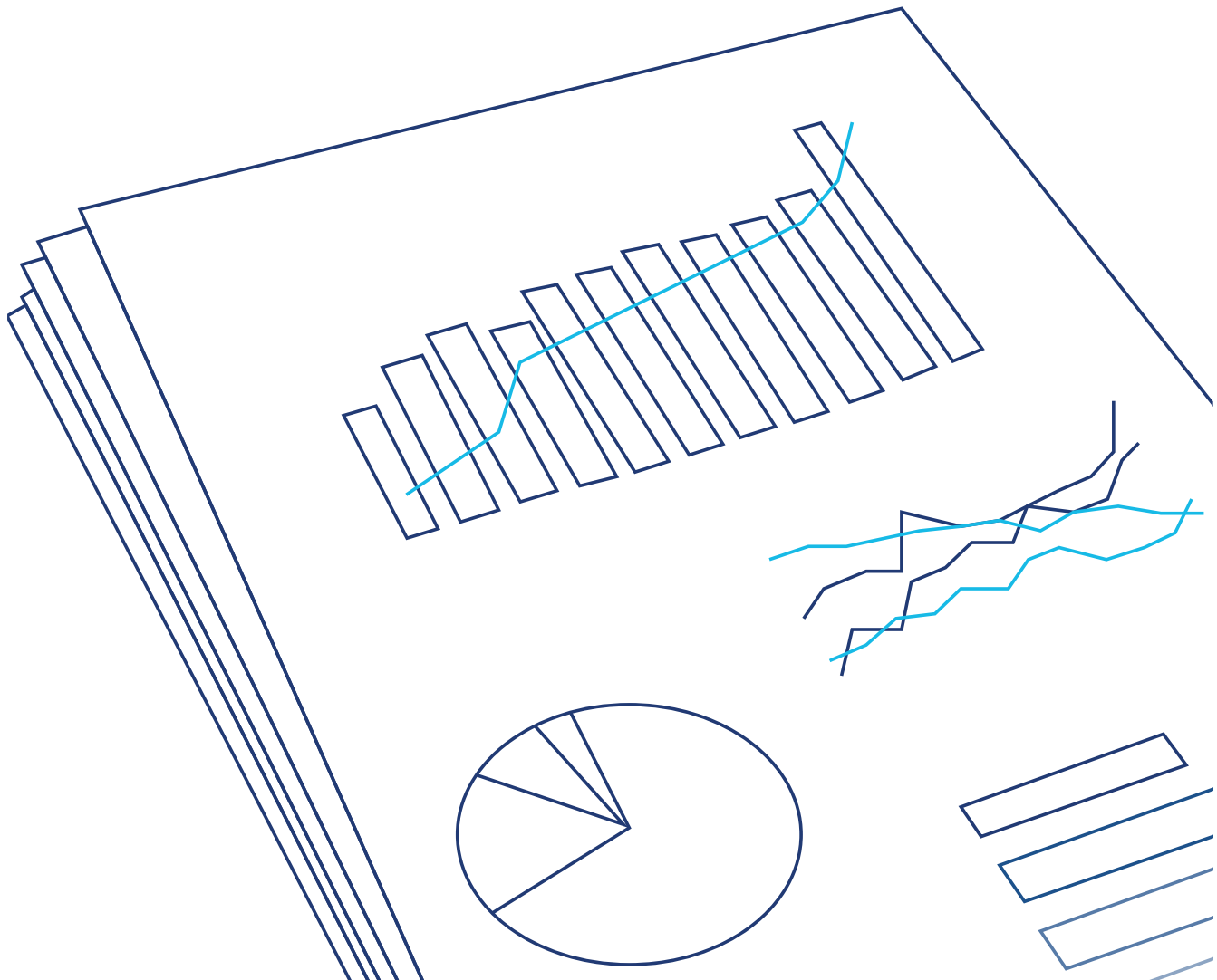
Board leadership plays a critical role in ensuring directors receive important feedback, since they frequently receive feedback on individual directors or observe behavior in meetings that can be improved. High-performing board chairs and lead directors will embrace this role.

# Evaluations: Disclosure & Engagement

Shareholders are seeking more information about how boards address their own performance, including whether they are using assessments as a catalyst for refreshing the board. Disclosures are currently fairly limited in this area. Beyond reporting that boards conduct an annual assessment, most S&P 500 boards disclose few details about their assessment process. However, companies are starting to offer more detailed disclosures, including descriptions of the areas that the board assessment covers, the process and the actions the board has agreed to take following the assessment.

Today, large institutional investors such as BlackRock, State Street and Vanguard are calling for greater transparency about how candidly boards are addressing their own performance and the suitability of individual directors. The Council of Institutional Investors (CII) suggests that enhanced disclosure “is an indication that a board is willing to think critically about its own performance on a regular basis and tackle any weaknesses.”

CII highlights two best-practice models for disclosure. One focuses on the mechanics of the assessment process, illustrating the process the board uses to identify and address gaps in its skills and performance. The other focuses on the most recent assessment, recapping the key takeaways and plans for improvement.



## QUESTIONS YOU SHOULD ASK: BOARD EVALUATIONS

### 1

What is the scope of the assessment?

- Board
  - Board committees
  - Individual directors
- Board leaders (independent chair, lead director, presiding director, committee chairs)

### 2

What is the most appropriate assessment approach for the board?

- Director questionnaire
- Director interviews

### 3

Who should lead the assessment?

- Third-party facilitator
- Independent chair, lead director and/or nominating/governance committee chair

### 4

What gaps exist in the current assessment process?

### 5

What will be publicly disclosed about the board evaluation?

### 6

What is the process for discussing the results of the evaluation and developing an action plan to address key areas?

### 7

Who is responsible for ensuring follow-up on evaluation takeaways?

### 8

What areas does the board want to delve into more deeply?

- Board processes
- Agendas and materials
- Board behaviors and dynamics
- Communication issues
- Effectiveness of executive sessions
- Role of the lead independent director
- Board relationship with the CEO and management
  - Board composition
- Committee organization and processes
- The role of the board and board leaders
  - Board culture and dynamics
- Potential board development needs
  - Overall board effectiveness
  - Individual effectiveness

*Note: in countries where annual assessments are required, some boards find the process more valuable when they choose a specific topic each year—such as the board's committee structure or its role in the strategic planning process—to examine more closely.*

# SECTION 5:

## SUCCESSION PLANNING

Having an effective succession plan is of vital importance to the success of a company, and the nominating/governance committee plays a key role in developing board and CEO succession plans. This section provides best practices for succession planning.



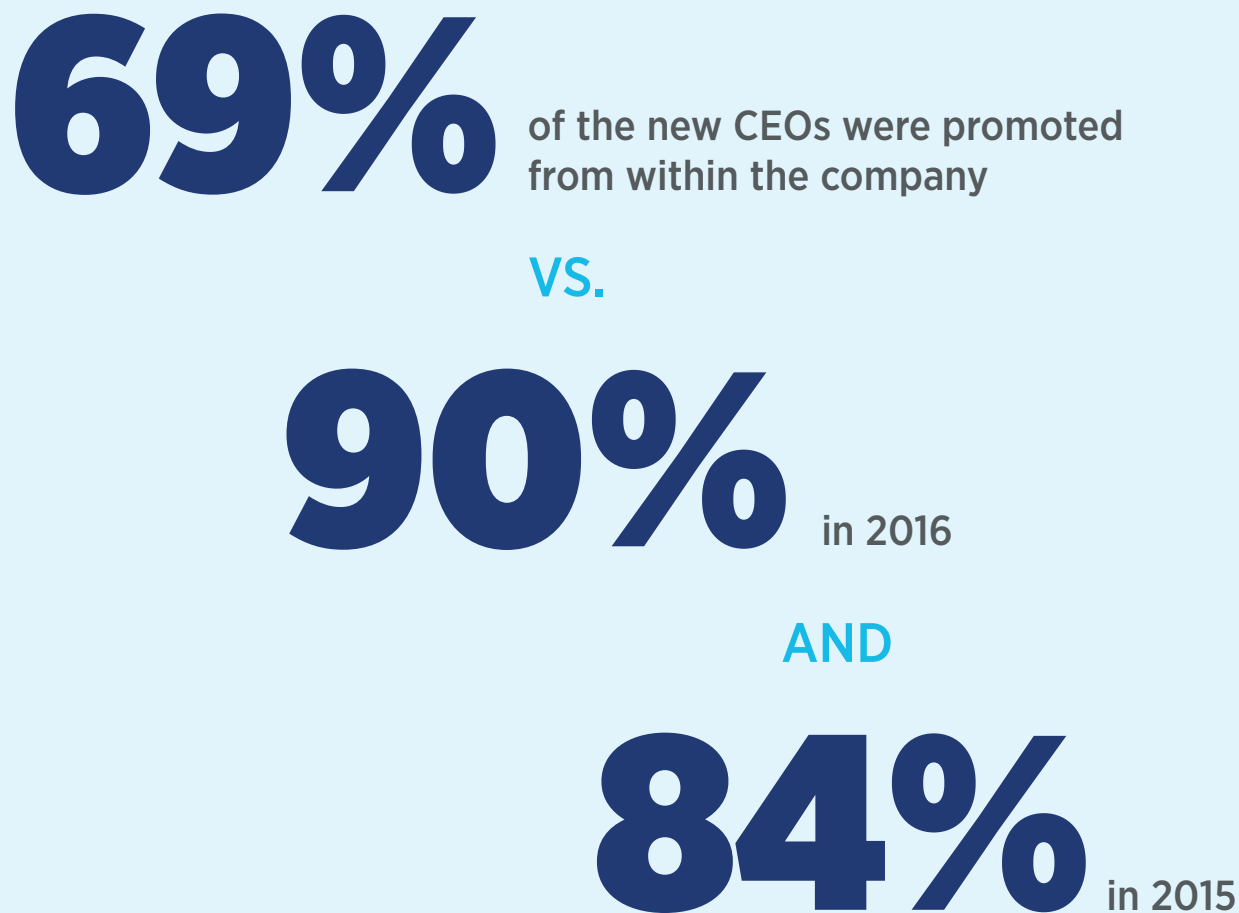


# CEO Succession

The nominating/governance committee generally has responsibility for board succession planning, and it may also lead the board's work overseeing CEO succession planning. Both roles, arguably the most important responsibilities of the board, are of vital importance to a company's success. Effective succession planning enables boards to make the best decision for the company in the event of planned or unplanned transitions.

## CEO SUCCESSION PLANNING

Getting succession planning right is not a hypothetical consideration for most companies. Fifty-nine S&P 500 companies installed a new chief executive in 2017, the highest number of transitions in the last 10 years. Since 2007, when 58 companies named new CEOs, the number of transitions generally declined before hitting a low of 37 in 2012.



Source: Spencer Stuart CEO Transitions 2017

The stakes are high when it comes to CEO succession planning. The impact of the CEO—especially one who fails—is staggering:

- The economic cost of appointing the wrong CEO at global companies is estimated at more than \$100 billion.<sup>1</sup>
- Nearly one-third of investment decisions are related to the reputation of the CEO; 39 percent of investors say they would likely sell a stock based solely on the CEO, while only 15 percent say they are likely to buy a stock based on the CEO's current reputation alone.<sup>2</sup>
- A study conducted by Rakesh Khurana, dean of Harvard College, and Nitin Nohria, dean of Harvard Business School, found that CEOs appointed after 1985 were three times more likely to be fired than CEOs who were appointed before that year.
- According to Harvard Business School, 40 percent of all executives who change jobs or get promoted fail in the first 18 months, a number that has remained steady for the past 15 years.

When it goes well, CEO succession planning produces a strong successor who, in the short term, is well-received by the organization and its stakeholders, including Wall Street, and, in the long run, has the right vision and strategy for the business and drives the company to achieve growth and create value.

Nominating/governance committees should strive to oversee a best-in-class process that maximizes the future readiness of internal talent, coalesces the board directors around a forward-looking CEO profile, aligns directors behind the ultimate selection and identifies the best candidate for the CEO role. However, CEO succession planning can be fraught with hidden risks and challenging dynamics that, if not recognized and managed, can derail the process and destroy value.

---

Source: "2014 study of CEOs, Governance, and Success," Strategy&, April 2015, <http://www.strategyand.pwc.com/global/home/what-we-think-reports-white-papers-article-display/2014-ceo-study>

Source: "CEO Transition Study," FTI Consulting, October 2011, <http://www.prnewswire.com/news-releases/fti-consulting-study-shows-ceo-transitions-are-a-risky-business-when-it-comes-to-shareholder-value-132044798.html>

# CEO Succession: Best Practices

In our experience, nominating/governance committees can best position boards for successful CEO succession planning by ensuring the committee and the board follow these best practices:

## 1

### ADDRESS SUCCESSION PLANNING EARLY AND WITH REGULARITY

Though the board has the ultimate responsibility for CEO succession planning and selecting a CEO successor, it can be difficult to initiate discussions about succession, particularly with a high-performing CEO who doesn't plan on leaving any time soon.

However, by developing a regular cadence around C-Suite succession planning, some of the sensitivities that surround this type of planning can be avoided.

One of the best approaches is to begin CEO succession planning when a new CEO takes the helm and immediately set expectations about the CEO's role in the process. Starting early and making succession planning an ongoing activity can help minimize the emotion that often surrounds succession and enable the board to get to know potential candidates and their performance over time.

Some of the tension surrounding the issue can be eased if the initial conversation with the CEO focuses on the emergency/contingency plan—the “name in the envelope” in case of an unexpected health or family emergency. From there, it can be easier to extend the discussion to the CEO's timeline, making it clear the expectation that the CEO will inform the board of his or her plans two or three years in advance to allow for an orderly succession plan.

## 2

### ENSURE THE STRATEGY AND CRITERIA FOR THE NEXT CEO IS FORWARD-LOOKING

The foundation for CEO succession planning is an agreed-upon strategic direction for the company from which the criteria for the next CEO can be based. The best processes look ahead to where the company needs to be in five to 10 years and avoid articulating strategies too rooted in the present or overly reliant on status quo assumptions. A failure to think about the future may result in criteria for the next CEO that are disconnected from the specific strategic, organizational and operational levers that the next CEO will need to employ and potentially impede the development of internal candidates with these capabilities.

Agreeing on a future-looking strategy that informs the criteria for the next CEO is a critical step that helps make the process go smoothly. It also helps boards avoid the trap of choosing an executive who mimics the incumbent's strengths, instead of selecting the candidate with the qualifications best suited to the company's strategy for the future.



### 3

#### INCLUDE THE CEO AS AN ACTIVE PARTICIPANT IN THE SUCCESSION PLANNING PROCESS

Ideally, the CEO will, early in his or her tenure, emphasize a commitment to management development and provide internal succession options for the board to consider on a long-term basis. The CEO should be a proactive, engaged partner with the board in a regular C-Suite and CEO succession planning process, including planning for emergency succession scenarios.

And as a transition grows nearer and the attention of the organization begins to turn to the next CEO, the board should support the CEO in managing his/her emotions regarding the changes and in stepping back as the process progresses toward the selection of the next CEO.

### 4

#### ASSURE THE DEVELOPMENT OF A ROBUST SUCCESSION PIPELINE

CEO succession planning requires an internal process for developing talent for the top positions in the company, and compensation plans linking CEO and other top executive pay to their success in developing and retaining talent. By taking these actions, boards can more effectively prepare their companies for succession over the short term and help build the bench strength that the company needs for stability and success well into the future.

For the committee responsible for overseeing CEO succession and boards, having confidence in the succession pipeline means ensuring that the CEO is focused on developing a succession-ready team and that directors have the insights about potential CEO contenders in order to oversee the necessary developmental assignments and, ultimately, to choose a successor. This ideally is a broad-based effort that incorporates up-to-date position descriptions for the senior team, regular assessments and benchmarking, and thoughtful developmental assignments.

At least annually, boards should also plan on a deep-dive talent review, which includes having the CEO and CHRO lead a discussion about forward-looking leadership requirements against which talent can be evaluated. By being involved on an ongoing basis, the board can observe patterns of performance and develop a more nuanced point of view on executives' strengths and weaknesses.

#### QUESTIONS YOU SHOULD ASK: CEO SUCCESSION PLANNING

1

Does the board have a CEO succession plan?

2

How often is the plan reviewed and analyzed?

3

What is the CEO's role in the succession planning process?

4

Does the succession plan include emergency succession needs?

5

What executive leadership transitions are anticipated?

6

Should board composition be adjusted to complement the capabilities of the next generation of leadership?

# CEO Succession: Best Practices

## 5

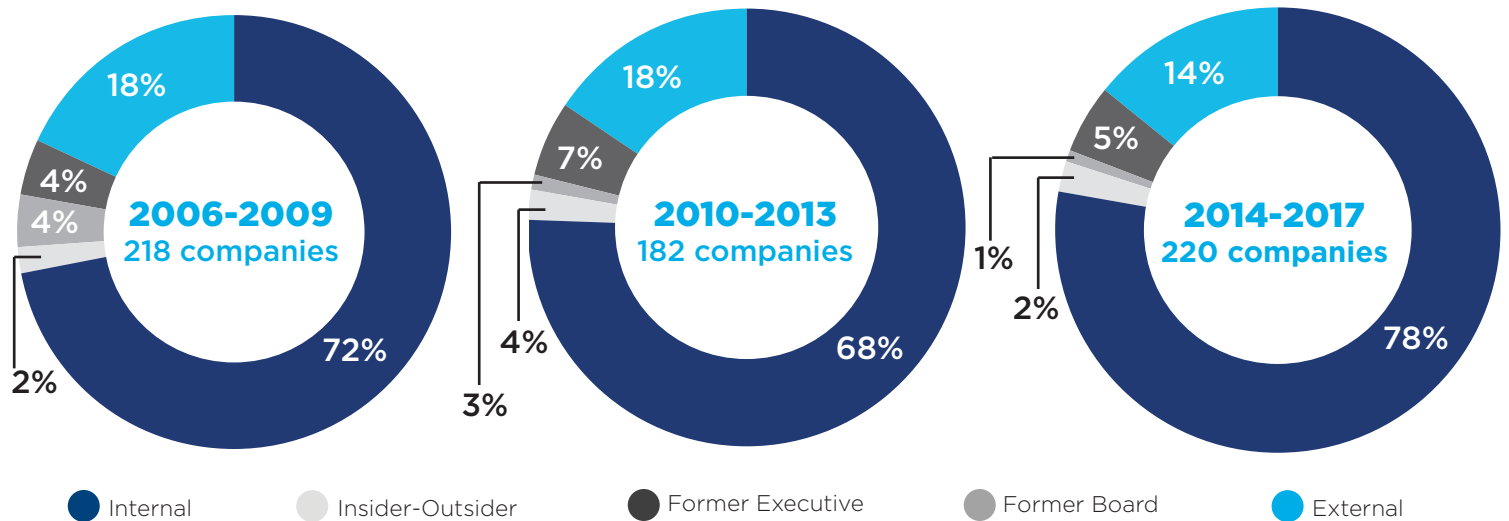
### THOUGHTFULLY AND EFFECTIVELY ASSESS INTERNAL CANDIDATES

Boards tend to see internal candidates through a very narrow window of observation and judge potential based on past performance, which can cause bias (positive and negative) when considering successors. To gain insights needed to understand the capabilities of the company's rising executives and make discerning judgments about their readiness for the top role, the committee responsible for CEO succession planning should ensure that boards get to know the senior leadership through presentations in the boardroom and regular meetings outside of it.

In addition, boards should be willing to cast the net wide enough to consider executives who have greater potential over the long term but require more development time. A longer process provides the time to uncover and develop these "unexpected" candidates, allowing the board to get to know them and become more comfortable with promoting the next-generation leader into the CEO role.

When it comes to internal candidates, boards should embrace an assessment process that is fact-based, rigorous and forward-looking. Objective, third-party assessments can be valuable, particularly if done early enough to provide candidates time to develop and the board time to build a fuller, more nuanced view of internal players. Potential successors are much more likely to be ready if development plans are set early and are based on a clear understanding of individuals' strengths and gaps, and the board has a chance to observe progress against goals. The board should review the plans and candidates' progress at least annually, recognizing that a minimum of one year is required to make meaningful and sustained progress in key developmental areas, and even more time is needed to close gaps in experience.

### NEW CEO BACKGROUNDS



Source: Spencer Stuart CEO Transitions 2017



**144** were promoted from within the company over four years



**91%** were first-time CEOs

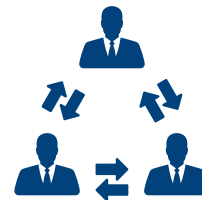
## INTERNAL CEO SUCCESSORS



**24%** were promoted from division CEO



**42%** served on a public company board before becoming CEO



**6%** were promoted from the chief financial officer role



**47%** were promoted from the chief operating officer role

Source: Spencer Stuart study of internal CEO successors in S&P 500 companies from 2012 through 2015.

## 6

### ENGAGE WITH INTERNAL CANDIDATES

Losing a strong internal succession candidate is a greater risk than many boards appreciate. Boards should assume that the strongest internal candidates frequently receive calls about opportunities at other companies. Generally, when internal candidates trust the succession process and timeline, they don't take recruiter calls. However, that can change abruptly. There can be many reasons why a leading internal candidate might begin to mistrust the process, such as a comment (often off-hand) from the CEO suggesting a change in the timeline.

Boards should ensure that potential insider candidates have clarity about the succession process and general timeline and certainty about their value to the organization. One of the most important things the board should do is to establish an open line of communication with potential successors. This begins by creating opportunities for executives to interact with the board directly, with the purpose of ensuring that the board gets to know key leaders and that the leaders get to know the directors. The CEO should encourage these interactions by suggesting recurring check-ins, which should occur more often as a CEO transition approaches, in conjunction with each board meeting, for example.

Because some CEOs can be sensitive to the board wanting to meet directly with potential successors, which can make them feel like a lame duck, it is safest and most natural to focus the conversations on the business or function the executive is leading today, and their individual development plans. For example, it can be effective to have a director spend a day with an executive reviewing the business or addressing the team, which provides a platform for a more natural interaction outside of the formal board meeting environment. This is an opportunity for the board to let an executive know how much the board values him or her.

Board engagement with internal candidates can provide an additional benefit as the succession process nears its conclusion: When the board has been actively engaged with internal candidates and garnered their trust during the process, it will be in a stronger position to approach the runners-up after the selection about their future plans. Every CEO transition carries the risk that executives who are critical to the success of the business will leave the company, especially if they vied unsuccessfully for the CEO role. When the lines of communication have been open, directors can have authentic conversations with runners up about their value to the company, increasing the chance that they may be willing to stay.

# CEO Succession: Best Practices

## QUESTIONS YOU SHOULD ASK: TALENT PIPELINE

1

Does the company have a robust pipeline of executive talent?

2

Does the board have a regular process for evaluating executive talent?

3

Does the board have sufficient opportunities to engage with executive talent?

4

How does the board engage with executive talent?

5

Does the board understand the strengths, weaknesses and development plans for executives and rising talent?

6

Does an independent third party provide assistance with executive evaluations?

7

Has external benchmarking been used recently to assess the company's executive talent strengths and gaps?

7

### INCORPORATE EXTERNAL BENCHMARKING

Companies that are strong producers of internal talent sometimes lose a sense of how their talent compares to the best-in-class talent externally or overlook how the world has shifted around them. Taking a look at external talent—through research, informal or formal introductions or with the support of an executive search firm—can provide additional insight when assessing the readiness of potential successors, evaluating the relative strength of the internal candidates and identifying any experience gaps.

Ideally, external benchmarking should happen in tandem with internal assessments, so that the results of internal assessments and external benchmarking can be compared simultaneously. This process is critical to giving the board a good sense of the relative strength of the internal candidates, as measured against outside talent who have proven themselves as skilled in the operational areas that will be critical for the company's future success and have demonstrated values and behaviors that align with the ideal company culture. The comparison also offers insights into how development plans may need to be shaped or refined to accelerate the readiness of internal candidates so they compare well to best-in-class external options.



## PLAN FOR THE TRANSITION

As a transition nears, the board and CEO should define a more concrete time line for succession. The CEO should be encouraged to shift his or her mindset from “what am I leaving?” to “what am I building?” and think in terms of the legacy left by preparing the next CEO and handing over the reins at the right time, and this includes making room for the development of succession candidates.

Boards should avoid “winging” a transition and instead play a purposeful role in the immediate transition. Beyond the “necessary” activities, such as communicating with stakeholders, negotiating compensation for the new CEO and meeting SEC reporting requirements, boards should be engaged in a rigorous transition process to help advise the outgoing CEO, plan retention strategies for non-selected candidates and other key management players, and coach the incoming CEO through the initial transition period.

The arrival of the new CEO does not mark the end of the CEO succession process. The board may be tempted to move on, but a new phase of the process is just starting. The integration phase is complex and requires active board involvement well beyond the classic first 100 days. The board should stay involved in the CEO transition to ensure the incoming CEO establishes a clear plan for the early days of the transition and that it is executed in a disciplined manner. The board also should make sure that the outgoing CEO provides the necessary support to the new CEO without seeming to interfere.

# Board Succession

Today, in addition to acknowledging the vital importance of long-term CEO succession planning, boards are increasingly embracing the need for board succession planning. Nominating/governance committees are responsible for leading the way and thinking strategically about boardroom composition and director performance.

Boardroom succession planning is becoming a strategic imperative. With the rapid pace of change in business today, companies and boards have to continually evolve, adapt and restructure. Strategic boardroom succession planning provides opportunities to evolve and refresh the board with new and needed skills as the economic and competitive landscape changes—and to increase the diversity of perspectives. When approached thoughtfully, ongoing board renewal can improve board effectiveness.

The nominating/governance committee plays a critical role in analyzing the board's needs over time and planning accordingly. Just as with CEO succession, planning ahead enables boards to widen the net, increase their options and secure the very best talent at the time when it is most needed.

There is growing recognition that boards with a good mix of age, experience and backgrounds tend to foster better debate and decision making and less groupthink. More and more directors say thoughtful succession planning can improve the composition and effectiveness of their boards.



### THREE KEY STEPS FOR BOARD SUCCESSION PLANNING

Analyze	Prioritize	Plan
<ul style="list-style-type: none"> <li>• What is the company’s strategy over the next five years and how does it impact the skills, composition and demographics needed in the boardroom?</li> <li>• What is the expected boardroom turnover over the next five years, and what gaps will these departures create?</li> <li>• Does the board have the right mechanism (e.g., mandatory retirement age, term limits, evaluations of some kind) for triggering departures and board renewal?</li> <li>• How well does the current board composition and culture align with the company’s direction?</li> <li>• How does the board benchmark against key competitors and how should it evolve?</li> </ul>	<ul style="list-style-type: none"> <li>• What is the preferred cadence for change in the boardroom? Is the board comfortable adding more than one director at a time?</li> <li>• How should skills and qualifications of new directors be prioritized?</li> <li>• What combination of desired skills and qualifications are most likely to result in a successful search?</li> <li>• What skills and qualifications are in heavy demand in the boardroom and warrant prioritization?</li> </ul>	<ul style="list-style-type: none"> <li>• What is the optimal timeline for adding new directors?</li> <li>• What is a realistic timeline for recruiting new directors?</li> <li>• How should onboarding be structured to best position new directors for success in the boardroom?</li> </ul>

# Conclusion

The nominating/governance committee is responsible for maintaining board stability and effectiveness by overseeing director nominations, education and independence. Given the enhanced scrutiny on board composition, these efforts are paramount to board health. The committee also helps set governance guidelines regarding board practices and philosophies and the communication of these policies, the latter of which is key to meeting investor demands for increased transparency. Finally, nominating committees help steer the leadership and succession process, both of which are crucial to company success and longevity.

## KEY TAKEAWAYS

### Board Composition, Director Qualifications and Independence

- Board composition lies at the heart of board effectiveness—the ability to recruit the right directors is one of the clearest indicators of a high-functioning board.
- Institutional and activist investors are closely scrutinizing boardroom diversity, expertise and experience and are holding those responsible for director nominations to a much higher standard.
- The nominating/governance committee is the front line for ensuring the board is composed of directors with the right skills and qualifications to oversee forward-looking strategies.
- The committee is responsible for reviewing the independence of directors and board committees to ensure compliance with stock exchange and regulatory requirements.



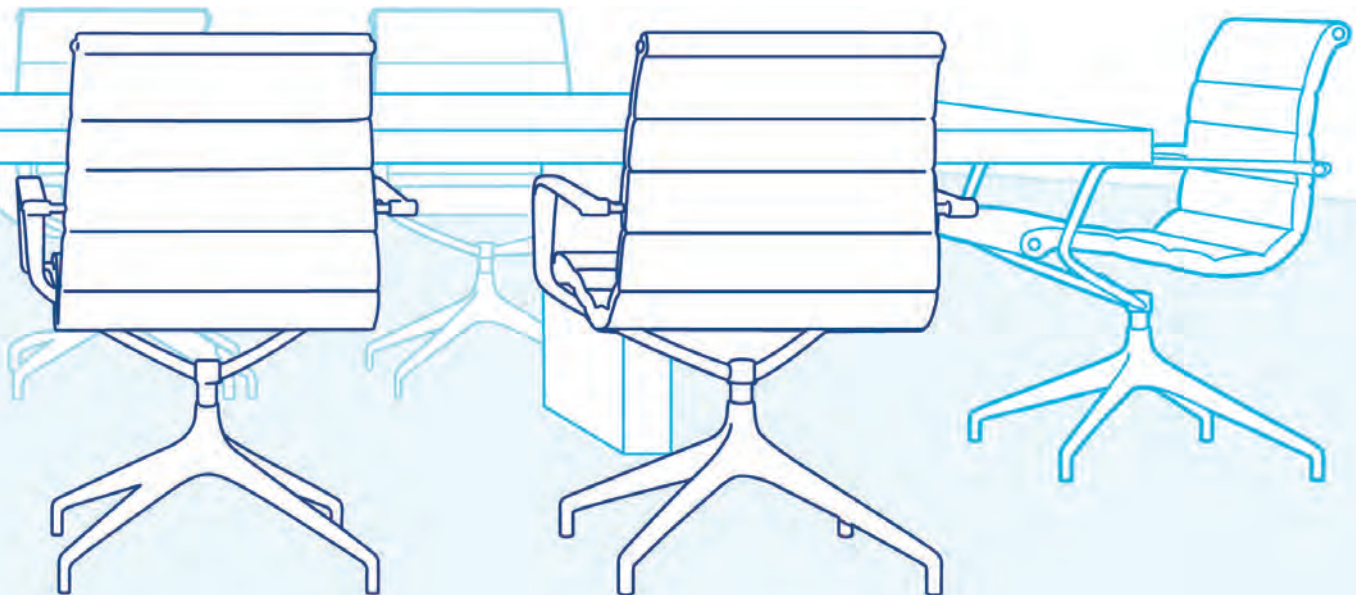


## Board Governance, Communication and Performance

- The nominating/governance committee is often responsible for crafting the corporate governance guidelines that help a board summarize its practices and philosophies regarding board education, evaluation, disclosure and engagement.
- Heightened stakeholder interest means the board should review its communications plan on these and other governance issues, particularly in proxy materials.
- The nominating/governance committee should assess its performance as a committee as well as assisting with board performance reviews annually to ensure directors are following best practices and identifying areas for improvement.

## Board Training, Leadership and Executive Succession

- Onboarding new directors is a key nominating/governance committee responsibility as training and education are crucial to developing the skills and knowledge required for board service.
- The committee is also responsible for recommending the board's structure, keeping in mind that investors expect strong independent board leadership.
- The nominating/governance committee plays a vital role in developing board and CEO succession plans by overseeing the internal candidate pipeline as well as external benchmarking.





# For More Information

The information in this guide is by no means exhaustive. If you wish to dive deeper into the topics in this guide, we encourage you to visit Spencer Stuart's website, where you can find more information and also request a meeting for your board or nominating/governance committee. We also recommend that you discuss questions and issues with your company's general counsel or corporate secretary.

## CONTACT SPENCER STUART



**Julie Daum**

Leader,  
North American Board Practice  
212.336.0263  
jdaum@spencerstuart.com



**Kevin Connelly**

Leader, Board Advisory Services  
312.321.8326  
kconnelly@spencerstuart.com



**George Anderson**

Leader,  
Board Effectiveness Services  
617.531.5748  
ganderson@spencerstuart.com



**Ann Yerger**

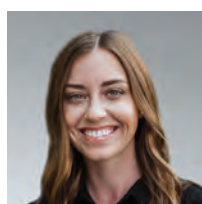
Corporate Governance Expert  
202.741.8359  
ayerger@SpencerStuart.com

## CONTACT CORPORATE BOARD MEMBER



**Scott Budd**

Managing Director  
203.889.4981  
sbudd@chiefexecutive.net



**Leigh Townes**

Program Director  
615.592.1213  
ltownes@chiefexecutive.net

# SpencerStuart

At Spencer Stuart, we know how much leadership matters. We are trusted by organizations around the world to help them make the senior-level leadership decisions that have a lasting impact on their enterprises. Through our executive search, board and leadership advisory services, we help build and enhance high-performing teams for select clients, ranging from major multinationals to emerging companies to nonprofit institutions.

Privately held since 1956, we focus on delivering knowledge, insight and results through the collaborative efforts of a team of experts—now spanning 57 offices, 30 countries and more than 50 practice specialties. Boards and leaders consistently turn to Spencer Stuart to help address their evolving leadership needs in areas such as senior-level executive search, board recruitment, board effectiveness, succession planning, in-depth senior management assessment and many other facets of organizational effectiveness. For more information on Spencer Stuart, please visit [www.spencerstuart.com](http://www.spencerstuart.com).

## CORPORATE BOARD MEMBER®

Corporate Board Member, a division of Chief Executive Group, has been the market leader in board education for 20 years. The quarterly publication provides public company board members, CEOs, general counsel and corporate secretaries decision-making tools to address the wide range of corporate governance, risk oversight and shareholder engagement issues facing their boards. Corporate Board Member further extends its thought leadership through online resources, webinars, timely research, conferences and peer-driven roundtables. The company maintains the most comprehensive database of directors and officers of publicly traded companies listed with NYSE, NYSE Amex and NASDAQ. Learn more at: [www.BoardMember.com](http://www.BoardMember.com)