Public Company Series

Board Structure and Composition

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PUBLIC COMPANY SERIES

Board Structure and Composition

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Public Company Series: Board Structure and Composition

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Introduction

New York Stock Exchange

Chris Taylor, *Chief Development Officer, NYSE*

In today's dynamic corporate environment, the role of the boardroom has never been more vital. As businesses navigate a rapidly shifting landscape—driven by technological advancements, evolving stakeholder expectations, and heightened regulatory scrutiny—directors and officers are tasked with ensuring their organizations remain agile, resilient, and forward-thinking.

At the New York Stock Exchange (NYSE), we witness firsthand how the strength of board leadership directly affects the performance and longevity of public companies. The Public Company Series: Board Structure and Composition offers an invaluable resource for directors, C-suite executives, and governance professionals seeking to deepen their understanding of how to design and sustain high-performing boards.

This guide brings together the collective wisdom of some of the world's most esteemed experts in corporate governance. From evaluating the optimal structure and composition of a board to refining committee functions and enhancing shareholder engagement, this book addresses critical dimensions that define effective board leadership. As public companies confront increasing complexity, the insights presented here will equip directors with the tools they need to drive sustained success.

Elevating governance to new heights

A company's ability to adapt, innovate, and manage risk hinges on the strength of its governance framework. As highlighted throughout this guide, building an effective board requires a thoughtful approach to board composition, committee structures, and succession planning. It demands a commitment to diversity of thought, experiences, and backgrounds—ensuring that boards reflect the dynamic environments in which their companies operate.

Moreover, the evolving regulatory landscape demands that boards remain vigilant in their oversight of compliance, risk management, and shareholder engagement. Directors must not only meet the requirements set forth by the Securities and Exchange Commission and stock exchanges but also anticipate emerging trends in corporate governance. This guide explores best practices that align governance practices with shareholder expectations, enhancing trust and transparency.

Preparing boards for the future

As the business environment continues to evolve, boards are increasingly called upon to address complex issues, from cybersecurity threats and environmental, social, and governance imperatives to chief executive officer succession planning and shareholder activism. In this era of heightened accountability, directors must balance short-term performance with long-term strategy. This book provides a roadmap for navigating these challenges, offering practical insights and actionable strategies that empower boards to lead with confidence.

Additionally, the Public Company Series underscores the importance of continuous learning and development for board members. Effective governance is not static—it evolves alongside the market, regulatory frameworks, and societal expectations. This guide reinforces directors' understanding of their evolving responsibilities and encourages a forward-looking, adaptive approach to governance.

Looking ahead, the Public Company Series will continue to explore the issues that matter most to today's boards—especially those navigating fast-changing regulatory demands and growing investor scrutiny. Future guides will cover timely and essential topics such as artificial intelligence in the boardroom, shareholder engagement, mergers and acquisitions, cross-border governance, shareholder activism, and other emerging or unforeseen issues that are shaping the responsibilities of public company leadership. These resources are designed to help directors stay informed and prepared, offering practical insights that support effective oversight, strong governance, and alignment with evolving expectations in the public markets.

Strengthening the public company ecosystem

The NYSE has long been committed to advancing corporate governance and supporting the success of public companies. By providing this essential resource, we reinforce our dedication to equipping board members and executives with the knowledge, insights, and strategies needed to meet the demands of today's business landscape.

As you engage with the expert perspectives presented in this guide, I encourage you to embrace the opportunity to strengthen your board's effectiveness and to cultivate a governance culture that fosters resilience, innovation, and sustainable growth.

On behalf of the NYSE, I am honored to introduce this indispensable resource and I am confident that it will serve as a valuable tool for those tasked with shaping the future of corporate governance.

Introduction

J.P. Morgan
Anu Aiyengar, *Global Head of Advisory & M&A*

Board directors today are at the forefront of crucial decisions that shape business, markets, and society. Your role extends beyond fiduciary duties—it encompasses strategic, cultural, and personal dimensions. In an era characterized by stakeholder scrutiny, rapid technological change, regulatory challenges, and global complexity, the demands on today's directors are increasing. However, this also presents an opportunity to lead with clarity, purpose, and innovation.

This guide—The Public Company Series: Book I—Board Structure and Composition—has been designed as a practical and strategic companion for directors navigating this evolving landscape. Developed in collaboration with the **New York Stock Exchange** and leading governance experts, legal professionals, and institutional advisors, the volume serves as both a resource and a catalyst for thought. Each section explores the fundamental architecture of board leadership: from designing effective committees and meeting regulatory criteria, to refreshing director pipelines, managing risk, and sustaining a high-performing board culture.

The structure of this guide reflects the life cycle of board service. We start with the foundation—how boards are built, composed, and governed. From there, we examine the nuanced work of board committees, the strategic oversight directors provide during times of change, and the tools needed to anticipate and manage risk in real time. You will also find essential insights on succession planning, onboarding, and continuous education—areas where the best boards excel through discipline and intention. Finally, we address the evolving demands of talent, disclosure, and shareholder engagement, offering directors a perspective on where governance is heading, not just where it has been.

The insights provided speak directly to your day-to-day responsibilities as stewards of shareholder capital, company values, and long-term strategy. They reflect the complexity you encounter in the boardroom and the high standards expected of you outside of it. Whether you are reevaluating your board's structure, responding to shareholder activism, enhancing committee effectiveness, or preparing the next generation of leadership, this guide was crafted with your needs in mind.

On behalf of J.P. Morgan and our collaborators, thank you for your leadership. We hope this volume serves as a valuable resource throughout the year and as an impetus for meaningful conversations in the boardroom. We welcome your feedback and look forward to engaging with you further.

Public Company Series

Board Structure and Composition

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Board Structure and Composition

Section 1: Building the board

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Global board governance practices and trends

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With the rising influence of institutional investors and growing expectations from various forms of stakeholders (including private equity investors, families, and founders), corporate governance has become more professionalized in recent years.

That is not to say more professional governance is a new development. Corporate governance structures, laws, and expectations of how directors should conduct themselves are well established around the world. However, given increased performance expectations, increased business risks—and a rise in shareholder activism—checking the box with superficial oversight and governance will be insufficient to win over investors, employees, and other stakeholders who see transparent and rigorous governance as illustrative of strong business management.

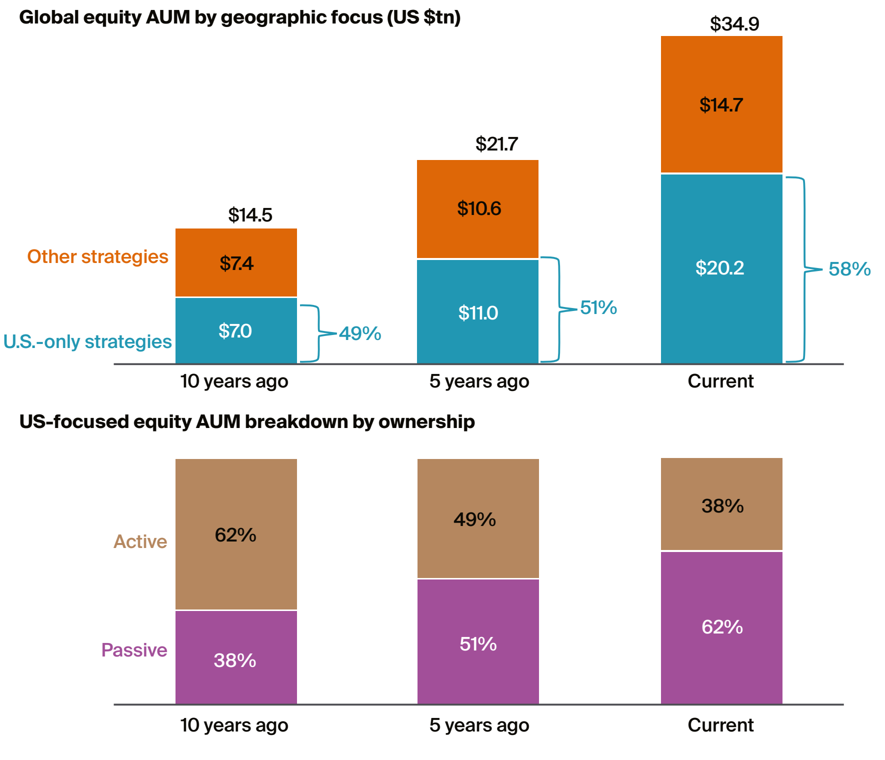
Looking to the US

Professional board governance is equally a focus outside of the US. Most jurisdictions worldwide have established corporate governance codes, operating on a comply or explain basis, or laws that dictate the structure and function of the board of directors. The importance of corporate governance is also an increasing focus in markets where it has been less emphasized historically.

A recent trend of non-US domiciled companies listing on US exchanges has also driven the "Americanization" of board culture. The past decade or so has seen an increased concentration of global equity assets under management ("AUM") in the US, as well as a rise in passive asset managers (whose decision-making framework makes them likely to engage in corporate governance issues) for US equity AUM (*see Exhibit 1*).[1] As a result, in the past few years several European companies have also announced their intent for the US to be their main listing location, with a handful executing on this in 2024. This shift in geographic focus requires a rapid adaptation to and understanding of US regulatory requirements and prompts these companies to carefully consider board director appointments that align with their new operating environment. The search for board members has thus evolved to prioritize individuals with cross-border experience and expertise, making them credible to US investors.

The trend toward US listings also raises interesting questions about whether board governance for overseas companies will increasingly reflect US practices or if there will be a convergence of US and international governance laws, regulations, and shareholder expectations. For instance, the UK Corporate Governance Code stipulates that a director of a UK public company is no longer deemed

Exhibit 1. Global AUM and US-focused AUM breakdown



independent after three terms of 3 years, totaling 9 years. The UK Institute of Directors further notes that while there is no recommended tenure for non-executive directors, the 9-year mark often serves as a “de facto” ceiling on tenure.

Boosting value

This desire to create boards that allow better engagement with shareholders and investors around the world is driving change not only in companies in English-speaking jurisdictions. For example, in the belief that the right governance model can unlock more value, companies in Japan, South Korea, Latin America, and Australia are eager to recruit directors, such as more women and overseas representatives, that are compelling to global shareholders. These businesses recognize the need for more rigor, accountability, and transparency. Where companies have a large number of US investors, they also want to formalize board structures and practices, such as committees and minutes, that are familiar to this base.

According to the “*A New Board Agenda for Japan*” report from Bain & Company and Board Advisors Japan in November 2023:

…relative to other countries, Japan has by far the highest percentage of CEOs who also serve as chair, at 71%. At the same time, the percentage of independent directors is the lowest, at 35%. The ratios of women and foreign nationals, albeit climbing, are also lower than those of other countries, at 14% and 6%, respectively. Even within the Asia-Pacific region, Japan is nearly the lowest in every dimension of age, gender balance, and percentage of international directors.

Concepts such as independent directors are well established around the world. The latest edition of the “*Boards Around the World*” (Boards Around the World: Navigating Stormy Seas) publication from consultant Spencer Stuart found that

Figure 1. Regionally, Japan’s boards have the highest average age and the fewest international members, while ranking next to last in the number of women

	AUS	SIN	IND	JPN	IDN	SK
Average board size	9.2	10.4	11.0	10.8	16.3	8.6
Share of women on boards	34%	18%	17%	14%	12%	6%
Average age of directors	61	62	62	64	57	60
Share of international directors	31%	20%	8%	6%	16%	7%
Share of independent directors	77%	46%	48%	35%	38%	37%

Source: The CS Gender 3000 in 2022 for ‘Share of women on boards’; Nikkei (2022) for ‘independent directors’ for Japan; Egon Zehnder (2022) for the remaining data points, OECD survey, OECD factbook: A. Stotz Investment Research (2017) for ‘independent directors’—South Korea, India, Singapore, Indonesia, Malaysia, Thailand

Brazil, Chile, Spain, and Turkey were the only countries surveyed where fewer than half of directors fit the local criteria for independence.

However, in some countries, the ambition to professionalize board governance is hindered by structural impediments. As an example, jurisdictions without a civil law system lack the frameworks in which to embed board governance rules or company law.

In some Middle East jurisdictions, where the absence of established Civil law codes creates corporate governance challenges, rules exist requiring local citizens to comprise high percentages of the board, particularly for local listings, narrowing the pool of candidates from which a company can select.

Due to their colonial history, the more significant sub-Saharan African markets have adopted UK-based corporate governance structures, rules, and legislation. The governance challenge they face centres around aligning those structural and legal frameworks with skills development, while balancing political objectives with sound governance practices with a focus on appointing qualified individuals rather than those with political connections.

In summary, every region faces its own inherent challenges in achieving robust corporate governance, shaped by unique legal, cultural, and economic contexts. Despite these obstacles, the critical takeaway is the consistent trend towards enhancing governance practices. This ongoing commitment to improvement reflects a global recognition of the value that strong governance brings to organizational resilience, transparency, and stakeholder trust. By continually striving to refine governance frameworks and practices, regions are laying the groundwork for long-term success.

The complexity of defining the board role

One obstacle to detecting any trends and new practices in board governance are the contrasting views that boards in different jurisdictions, particularly in the US and Europe, hold about what their role should be.

In the US, a board's primary concern tends to be litigation risk, whether that is coming from regulatory authorities or from external parties, and the strategic direction of the company. In dealing with these, better functioning boards will work closely with management.

In contrast, an entity from Europe may be incorporated in one jurisdiction, with the founders in another one and its listing in another one again, so the landscape for investors is not as unitary as in the US.

Added to that, US public company boards historically have had one focus, that is, the shareholder. Europe's two-tier structure—management and supervisory boards—means it has many others, and it is often a challenge for the board to balance those objectives.

Traditionally, Europe's supervisory boards, which include employee representatives, have seen themselves as having a monitoring role over the management board's activities, particularly in relation to topics such as internal control, risk management, and compliance. Now, they are adding more responsibility for strategic direction. That does not mean the company's day to day management necessarily, instead, it is more concerned with information and oversight.

Increasingly such boards are also adding more responsibility for the direction of the company, but frequently without the appropriate information flows.

Many recent corporate scandals have arisen because the board did not receive sufficient information, or where management has actively limited the flow of information to the board.

An honest discussion about the true purpose and role of the board across jurisdictions (and how best to effect that) is urgently required.

A retirement job?

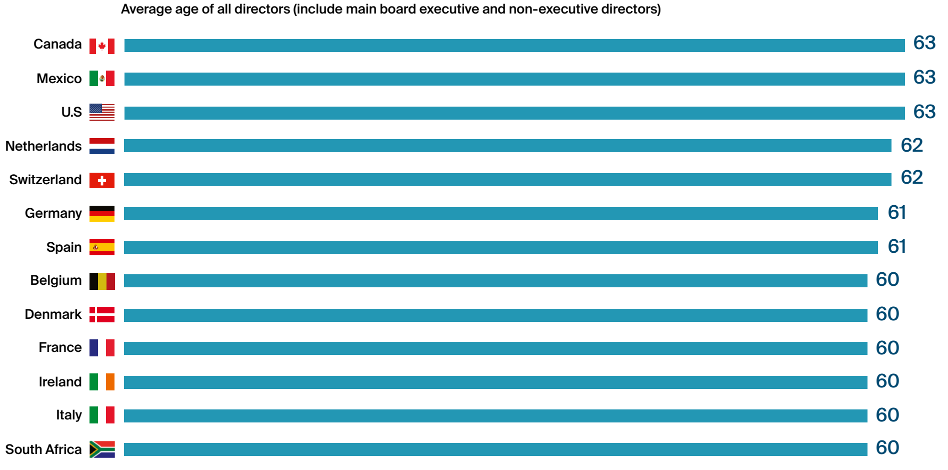
A board should have a mix of seasoned directors and active executives as post-retirement board members are often less integrated into the market information flow. In contrast, a C-suite executive, though they may have less time, often will have information pertinent to decision-making at the board level. A board needs a combination of lived experience, as well as individuals who are dealing with current topical issues on a daily basis.

This challenge is particularly noteworthy in the technology and high-growth sectors. Younger founders are often focused on appointing board members who have a similar professional experience and consequently want younger board members, often with less public company experience. They may however be less focused on traditional governance criteria and face a challenge in delivering on market and investor expectations. Aligning these incentives can be a painful adjustment process for some new economy companies.

The diversification of boards

One area where European boards are typically more diverse than their US counterparts is on international experience and nationality. US companies often do not include foreigners without significant US market experience in their boardrooms, given the size and focus of the domestic

Figure 2. Age of directors



The composition of boards in the United States and Europe can differ significantly. Traditionally, serving on a public company board in Europe was often seen as a post-retirement role. However, this is changing, with the average age of directors in the US now slightly higher than in many European jurisdictions. Source: https://www.spencerstuart.com/research-and-insight/boards-around-the-world?category=all-board-composition&topic=director-age&currency=all.

market. In Europe, with more cross-border operations, many companies appoint directors located in other jurisdictions, with an increasing focus on US expansion. That said, European board positions typically are less well-remunerated than in the United States, meaning that it is often harder for European companies to recruit top board talent.

Creating a multi-cultural board can be challenging for cultural reasons as well. For the director, understanding home-office culture and the expectations of the board role in that country, is critical.

In contrast, European companies tend to underperform on gender diversity metrics despite the existence of board quotas in many European countries. For example, European boards have surprisingly few female chairs.[2] Though almost 35% of board members in the EU member states were women in 2024, according to the gender statistics database[3] only 8.8% of board chairs were female. Even jurisdictions, which have relatively high female participation in the workforce and in senior government roles, have relatively few females in key board posts.

Research from consulting firm Spencer Stuart of "larger listed companies" found that S&P 500 independent directors in the US received an average of $327,096 in 2024, including stock and retainer fees.[4] Of the countries surveyed, Switzerland came second with $244,059. Germany is the EU member state that pays its independent directors the most at $138,483. Mexico brings up the rear with its public companies paying independent directors $21,051.

Public company board chairs in Switzerland were paid the best in 2024: $2,045,835. In fact, the US only came sixth ($500,375) in this list, behind France, the UK, Italy, and South Africa.

Private equity influence

Private equity firms are playing a pivotal role in shaping investor perceptions of corporate governance, including significantly influencing the growing emphasis investors place on good governance.

As a result, more companies, even in their early stages, are prioritizing governance. Practices such as establishing independent boards or appointing external chief executive officers (CEOs) are increasingly common in companies with private equity investment. The relationship between private equity and the emphasis on board governance is driving substantial impact and stands out as one of the most notable trends, alongside diversity, equity, and inclusion and environmental, social, and governance (ESG) considerations.

Call for specialists

A core responsibility of any public company board is to select and nominate new board members who will contribute vital skills and expertise, given the unique challenges the company faces at a point in time. Depending on the industry the company operates in or the product or service it provides, specialized knowledge can be critical to the proper functioning of the board.

Consider a biotechnology company: in its early stages, it is crucial for board members to possess a solid understanding of the science involved. This knowledge will enable them to adequately evaluate the potential of new products by effectively assessing the outcomes of trials and testing. Similarly, at a later stage, directors who can assess not just the financial viability but also the scientific compatibility of potential transactions will be invaluable. However, identifying such individuals can be difficult, as academics in the field may be reluctant to join a board due to potential conflicts of interest arising from their ongoing research.

Defining what "specialized expertise" means can be as challenging as finding the candidates who possess it. This complexity is evident in areas like ESG. The rise of ESG as a focal point prompted boards to actively pursue ESG-specialist appointments, yet the criteria for expertise is often unclear. While some candidates might hold ESG-related certifications, a company in a high-impact energy sector may require someone with a deep understanding of science and supply chain emissions. Similarly, when boards seek cybersecurity experts, the definition of expertise can vary, ranging from experience in intelligence services to a strong grasp of technology. Ultimately, the skills and expertise required are highly dependent on the company's industry and unique needs, underscoring the importance of clearly defining specialized expertise in the board selection process.

Global upheaval

In the era of globalization, geopolitical risk has emerged as a critical concern for company boards. Companies will look for steady hands, prioritizing the appointment of experienced leaders who have navigated similar challenges in the past. Consequently, there may be a decline in the appointment of first-time directors, with boards favoring external CEOs or individuals with substantial senior-level experience.

Directors with specialized expertise might also be at a disadvantage, as boards increasingly value candidates with breadth of experience. The current complexity of economic and political affairs requires directors who can provide comprehensive insights across multiple disciplines, such as supply chains, artificial intelligence (AI), cybersecurity, and international operations, rather than those limited to a single area of expertise.

Moreover, the talent pool may not yet be sufficiently broad to allow boards to select new directors from emerging sectors like AI. While individuals from these backgrounds can guide companies on the strategic role of AI, they may lack the breadth to advise on matters such as CEO succession planning or financial partnerships. Reflecting on the past, when the internet was a nascent industry, boards often sought directors from this emerging field without a clear strategy for leveraging their expertise. To avoid repeating this oversight, it is imperative for boards to plan strategically and ensure they maximize the potential of their director selections.

Best practices

Regardless of the jurisdiction, the role of a board director is no longer merely a reward for long service or loyalty. It is a critical position filled based on the specific needs of the company and requiring a careful balance of technical expertise, business acumen, and interpersonal dynamics. Effective board chemistry and robust communication among members are essential prerequisites for success.

Companies should adopt a holistic approach to board composition by identifying current and anticipated skill gaps and building a talent pipeline to proactively bridge these gaps at both the board and committee levels. The focus should be on ensuring that boards are greater than the sum of their parts, leveraging diverse skills and perspectives to drive comprehensive, globally-focused decision-making, and strategic oversight.

A board's role as a supporter and a guide remains vital in safeguarding the

company and enhancing management's execution of their strategic vision.
As companies navigate increasingly complex global challenges, the emphasis on professional board governance will continue to grow, ensuring that boards are well-equipped to provide effective oversight and drive long-term value creation for shareholders.

Chapter notes

1 As of 31 December 2024 ("Current" refers to November 2024) per ISS Simfund, LSEG Eikon, Morningstar; geographic focus as defined by LSEG Eikon; "Other strategies" includes global-focused strategy and other country/regional strategies.
2 https://www.consilium.europa.eu/en/policies/gender-balance-corporate-boards/.
3 https://eige.europa.eu/gender-statistics/dgs/indicator/wmidm_bus_bus__wmid_comp_compbm/datatable?sex=W&UNIT=PC&POSITION=MEMB_BRD&NACE=TOT&col=time&row=geo.
4 https://www.spencerstuart.com/research-and-insight/boards-around-the-world?category=all-compensation&topic=all-topics&currency=all.

2

Board structure and composition considerations

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No topic is more foundational to effective governance than the structure and composition of boards of directors. Boards with the right membership and effective leadership produce better governance, which in turn can provide meaningful benefits to companies and their shareholders. The challenge, of course, is that governance should not be "one size fits all." The right board leadership structure and composition for a tightly held technology company with a founder CEO would not be appropriate for a widely held energy company with professional management. Companies have a number of options to choose from at each of the many decision points they face when determining the ideal governance structure for a company's particular circumstances.

In this chapter, we provide an overview of key board structure and composition considerations, including board leadership structure, board size, director tenure and board refreshment, director skills and experience, and director independence.

Board leadership structure

One of the most important decisions a company and its shareholders can make is whether to combine or separate the roles of CEO and chair. Although it is more common for large-cap companies to separate the roles of CEO and chair (as evidenced by the fact that as of January 2025, approximately 61.5% of S&P 500 companies and 69.8% of Russell 3000 companies separated CEO and chair roles), many companies with good governance practices nonetheless combine the CEO and chair roles.

Combining the CEO and chair roles

Support for combining the roles of CEO and chair is rooted in "stewardship theory," which is based on the idea that members of the board and management are stewards of the company, motivated by fiduciary duties and a desire to achieve long-term success by running the company well for the company's shareholders. Governance trends and market perspectives also encourage a nuanced consideration, rather than outright disavowal, of having a combined CEO and chair role.

Some considerations in favor of having a combined CEO and chair role include:

- **Streamlining the chain of command, leadership, and strategy, and reducing additional administrative burdens.** One of the central arguments for combining CEO and chair roles is that it can streamline and clarify a company's strategy, leadership, and chain of command, which may make decision-making more efficient and interactions with external parties—such as shareholders, customers, and suppliers—more effective. Having a singular vision for a company's strategy can also foster better long-term decision-making.
- **Channeling board expertise to the CEO, and CEO knowledge to the board.** Because the CEO is most intimately acquainted with the company and its business, a CEO that serves as chair may be better suited to integrate both board and personal expertise, and impart it to the rest of the board through the chair function by crafting thoughtful board agendas and schedules. Through such guidance, the board as a whole may become better informed and able to formulate board actions that would allow the CEO to execute on the company's strategies more effectively.
- **Facilitating succession planning.** Separating the roles of CEO and chair can detract from operational and strategic success, not only by dismantling the unified leadership that a CEO/chair can contribute to a company but also by complicating succession planning. This can be especially true if the separation occurs due to pressure from stakeholders, and not as a result of board initiative. For example, succession planning can become complicated if a retiring CEO remains the chair and only gives up the role of chair after the new CEO passes a certain transition period. The new CEO could find it harder to lead the company when the company's prior CEO is still involved as the chair.

In cases where the CEO and chair roles are combined, the appointment of a lead independent director may help assuage concerns of certain stakeholders, such as proxy advisory firms and investors, about the potential downside effects of a combined CEO/chair. For example, when considering a shareholder proposal for the board chair position to be filled by an independent director, Institutional Shareholder Services (ISS) cites a weak or poorly defined lead independent director role that fails to serve as an appropriate counterbalance to a combined CEO/chair role as one of several factors that will increase the likelihood of ISS recommending that shareholders vote "for" that proposal. In addition, where the company has neither an independent chair nor a lead independent director, Glass Lewis will generally recommend voting against the chair of the governance committee.

Separating the CEO and chair roles

Support for separating the roles of CEO and chair and for having an independent chair is based on "agency theory," which is rooted in the view that differences in the time horizons and risk appetites of shareholders and management create conflict that threatens corporate performance. Boards can mediate this conflict by monitoring management, starting with the CEO, and ensuring that there is an independent person tasked with that key function.

Some considerations in favor of separating the roles of CEO and chair include:

- **Ensuring sufficient board oversight of management.** The primary argument against combining the CEO and chair roles is the perception that a CEO/chair limits the board's independent oversight of management.
- **Controlling information flows.** Another reason for separating the roles of CEO and chair stems from concerns about the chair's control of information flows to and from the board. For example, a CEO might have specific strategic preferences that could influence information flows to and from the board: a CEO may elect not to share certain information with the board if he or she is concerned that the board may react in a way that conflicts with the CEO's strategic vision.
- **Streamlining the CEO's responsibilities.** Another consideration for separating the roles of CEO and chair is whether the responsibilities associated with being chair could overburden and distract the CEO, and make it more difficult for the CEO to execute business strategies and absorb information flows from the board. Under this line of reasoning, the CEO should focus on operational goals and executing the business, and relinquish oversight for certain longer-term strategic goals to the chair.

Although corporate stakeholders such as proxy advisory firms and major institutional shareholders generally look favorably upon a separation of the two leadership roles, they are likely to defer to a board's judgment on whether to combine or separate the two roles, and examine a company's overall governance structure and performance when assessing shareholder proposals calling for independent chairs.

Board size

A company's board size can also have a significant effect on its governance outcomes, and should be determined based on the company's specific needs and circumstances. Generally, companies with larger revenues or market capitalization tend to have larger boards. Average board size across multiple indices are shown below:

Fortune 100	S&P 500	S&P Mid-cap 400	S&P Small-cap 600	S&P 1500	Russell 3000
11.9	11.0	9.8	9.0	9.9	9.8

Source: Russell 3000 data from The Conference Board, *Board Composition: Diversity, Experience and Effectiveness* (2022). All other data from EY Center for Board Matters, *Corporate Governance by the Numbers* (March 2023).

Factors to consider when determining the size of a public company board include:

- **Strategic needs.** The strategic needs of a company are a significant consideration in determining board size. Companies that operate in diverse sectors or geographies may require a larger board to ensure the board has sufficiently diverse expertise. Additionally, the growth stage of the company can play an important role. For example, smaller, growing companies where boards are called on to be more active may prefer smaller boards in order to maintain agility and streamline decision-making, whereas larger companies where the board is primarily concerned with long-term strategy may benefit from a larger board that can provide broader representation and build consensus around strategic decisions. The need for industry-specific expertise—such as regulatory, technological, or scientific insights—can also shape board size.
- **Regulatory and listing requirements.** Public companies are generally required to have a majority of independent directors, as well as standing board committees that are made up of independent directors. A board's size must be sufficient to meet these requirements while ensuring that the committees include members who have the appropriate skills and qualifications.
- **Peer and industry trends.** Peer benchmarking can help a company measure its competitiveness, given that investors and other stakeholders may compare a company's governance practices, including board size, with those of its peers. Within the S&P 500 index, companies in the financial sector have an average board size of 11.7, companies in the healthcare sector have an average board size of 10.4, and companies in the real estate sector have an average board size of 10.1. (Source: 2024 Spencer Stuart Board Index.)
- **Stakeholder expectations and rights.** Stakeholder expectations, particularly those of institutional investors and proxy advisory firms like ISS and Glass Lewis, are also important to consider when determining board size. For example, for US public companies, Glass Lewis believes boards should have at least five directors "to ensure sufficient diversity in decision-making and to enable the formation of key board committees with independent directors." Conversely, Glass Lewis believes that "boards with more than 20 members will typically suffer under the weight of 'too many cooks in the kitchen' and have difficulty reaching consensus and making timely decisions."

Director tenure and board refreshment

Having the right board composition is crucial to establishing good corporate governance, and board refreshment is a key component of ensuring the composition of directors meets a company's evolving needs. A board must determine its own perspective on striking the proper balance between maintaining a board with the appropriate experience and knowledge of the company's business that comes from serving over time, with the potential benefits of adding new viewpoints to the board. Companies can promote board turnover by focusing on average tenure and imposing term limits and mandatory retirement ages.

- **Average tenure.** According to the "*2024 U.S. Spencer Stuart Board Index*," the average tenure of directors on S&P 500 boards is 7.8 years. US public companies tend to focus on average tenure across all of the directors serving on their boards, rather than individual director tenure, to ensure a balance of retaining experienced directors, with bringing in new nominees for fresh perspectives.

- **Term limits.** Even as companies face pressure on board turnover, term limits remain unpopular, though there is evidence that this view may be slowly changing. According to the "*2024 U.S. Spencer Stuart Board Index*," only 43 S&P 500 boards (9%) report having term limits for non-executive directors, compared with 16 boards (3%) in 2014. Where they are used, term limits average 14.7 years and range from 10 to 20 years, with 31 boards (72% of boards with term limits) setting them at 15 years or more. However, some companies that have not adopted strict tenure policies in the form of term limits make clear that director tenure is an important consideration during director evaluation and re-nomination processes. In addition, hybrid tenure policies are emerging. A hybrid tenure policy requires either re-examining a director's nomination after a set period, or seeking an average tenure on the board as a whole or among independent directors.
- **Mandatory retirement age.** According to the "*2024 U.S. Spencer Stuart Board Index*," 67% of S&P 500 companies have a mandatory retirement policy, with an average mandatory retirement age of 74. Mandatory retirement policies remain a predominant factor driving director turnover, as they tend to offer more predictability and allow for advance planning. In addition, recognizing the importance of board stability and flexibility, many boards and corporate governance committees retain the authority to grant a waiver exempting the directors from the mandatory retirement age, and it is not unusual for a board to do so.

Director skills and experience

When evaluating its composition and considering new director candidates, a board should focus on whether the board has the appropriate set of skills, qualifications, experience, and expertise represented, and whether it has a succession plan in place in order to address retirement or unplanned departures from the board, and to facilitate the representation of diverse skills on the board.

Some (though by no means all) companies have adopted a "skills matrix" approach in which the board or a board committee pre-determines a set of skills that it desires to be represented on the board. These companies then either measure current directors against the identified skills or assess whether the board possesses such skills as a whole. When the board is considering new director candidates to fill a vacancy, it can revisit these assessments to determine what skill sets should be prioritized in selecting each particular candidate, and can focus its director search on identifying and interviewing candidates that possess the desired skill sets.

Director independence

The New York Stock Exchange (NYSE) requires a listed company's board of directors to consist of a majority of independent directors (subject to certain exemptions available to foreign private issuers, controlled companies, limited partnerships, and certain management investment companies). The NYSE establishes a definition of "independent director" and requires boards to make affirmative determinations of director independence. Even though a director may otherwise meet the NYSE's and the Securities and Exchange Commission's heightened independence requirements for audit committee and compensation committee membership purposes, the director still may not be deemed independent under ISS's and Glass Lewis's separate director independence standards.

ISS and Glass Lewis maintain their own standards of independence, which are found in their annual proxy voting guidelines, and may recommend voting against, or recommend withholding a vote for, the election of a director who does not meet their standards in certain circumstances (for example, if a non-independent director serves on the audit, compensation, or nominating committee). The independence classifications currently maintained by ISS and Glass Lewis differ from stock exchange rules in several key ways. For example, both firms provide longer look-back periods for former employees that render a director not independent, and neither firm considers directors to be independent if they exceed certain share ownership thresholds.

In addition, both ISS and Glass Lewis apply dollar amount thresholds that are significantly lower for professional services that render a director not independent. Whereas the NYSE applies a $120,000 threshold for direct compensation received by a director or an immediate family member from the company (other than director and committee and committee fees and pension or other forms of deferred compensation for prior service), ISS applies a threshold of $10,000 for professional services provided by the director or an immediate family member to the company. For Glass Lewis, the relevant materiality threshold is $50,000 for directors who are paid for a service they have agreed to perform for the company, including professional or other services.

While proxy advisory firms' standards are not bars to a finding of independence, they sometimes inform a company's view on who to put on which committee as well as overall board composition.

3

Critical choices in designing a board: an overview

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Building an effective board of directors is an ongoing task that takes time and careful planning. We have yet to find a single template or set of best practices that work for all boards at all times. Instead, we have found that boards are likely to be more effective if they are designed to fit the company's specific needs and circumstances. In practice, that means giving thoughtful consideration to each element of board design and making critical choices tailored to the particular situation.

Drawing from research, case studies we have written, and engagement with scores of directors who participate in our executive programs at Harvard Business School, we review six critical choices that can have a profound effect on board functioning: how the board's purpose is defined, who serves as directors, how the board is structured, how roles within the board are defined, what processes are implemented, and what norms are adopted. Each choice involves important trade-offs that must be carefully considered.

Understanding these fundamental choices and their implications cannot guarantee an effective board, but it can help a board provide both robust oversight and strategic value.

1. How the board's purpose is defined

Clarity about the board's purpose is fundamental to board effectiveness. Differing assumptions about such basic issues as the board's governing objective, whose interests it should prioritize, how involved directors should be in the company's business, and what tasks belong to the board versus management can give rise to divisions among directors, especially in times of crisis or distress when a decisive board is most needed.

Consider an unsolicited bid for the company. Other things being equal, directors who see their role as protecting the corporate interest may be more inclined to resist the bid and try to maintain the company's independence. Those who see their role as serving shareholders may be more responsive to what the dominant shareholders want. Differing assumptions about whether the board should prioritize shareholders, a broader set of stakeholders, or the institution's long-term survival can also manifest themselves in areas such as resource allocation, performance measurement, and executive pay design.

Similarly, different views about the appropriate level of involvement in the company's activities can lead to tensions among directors. Those who see the board's role as principally that of a monitor may be more inclined to adopt a "noses in, fingers out" approach compared to those who see the board as a pilot setting strategic direction or a partner with management. Directors' failure to align on the appropriate level of involvement in the business can also fuel dysfunctional relationships with management. Directors who are more involved may think they are just doing their job, while managers see them as overstepping their authority. By the same token, managers may regard less-involved directors as too passive or not pulling their weight.

To help reconcile potential differences in core principles among directors and the chief executive officer (CEO), former Merck CEO Ray Gilmartin has called for boards to develop an explicit agreement or "pact" with management on the fundamental beliefs by which the firm will be run, starting with whether the primary focus will be on shareholders, stakeholders, or society at large.[1]

Beyond these core beliefs, the board also needs a shared understanding of its proper scope and functions. To be sure, this understanding will shift as the company evolves. In early-stage companies, boards typically focus more on strategy, fundraising, and providing operational guidance; in growth-stage companies, they emphasize scaling challenges and organizational development; in mature companies, they concentrate more on capital allocation and efficiency; and in companies requiring transformation, they become more deeply involved in strategic repositioning and leadership succession.

Moreover, boards face an ever-expanding set of expectations to oversee everything from cybersecurity and artificial intelligence ethics to corporate culture and climate risk, while simultaneously being held accountable for company performance and shareholder returns. Boards must clarify to themselves how they will prioritize their responsibilities and allocate limited time and attention across competing demands. The challenge is particularly relevant during crises or transformational periods, when boards must decide whether to become involved in operational decisions while maintaining their oversight role.

2. Who serves on the board

The importance of board composition is widely recognized, but identifying the right people to serve as directors is not easy. The difficulty stems in part from the board's

[1]Raymond V. Gilmartin, "CEOs and Boards Need a Pact on How the Firm Will be Run," *Harvard Business Review Online*, 28 October 2011, https://hbr.org/2011/10/ceos-and-boards-need-a-pact-on.

dual nature as both a collection of unique individuals, and as a governing body that must make decisions and act as a group.

As a group, boards need directors with the particular skills and capabilities required to understand and oversee the company's business. Most boards have developed a "skills matrix" showing the proficiencies needed by the group, but creating a matrix can be challenging. Boards must balance the traditional need for directors to have a strong understanding of competitive dynamics and operational issues with the need for new competencies in areas like digital transformation, artificial intelligence, cybersecurity, and ESG. Boards must also decide whether to seek directors with broad generalist skills versus specialists in critical areas. Given the smaller board size needed for efficient decision-making, "T-shaped directors"—those with deep expertise in some critical area as well as broad generalist skills—are especially desirable.

Diversity of experience and perspective are also valuable attributes of the group. Directors who have operated in different business contexts—from startups to mature multinationals, from highly regulated industries to dynamic technology sectors—bring different skills and insights. Similarly, individuals with public company board experience bring governance knowledge, while those from entrepreneurial backgrounds may challenge traditional approaches and push for greater agility. Many directors say that gender and racial diversity are important for achieving diversity of thought. And research suggests that diverse thinking styles help boards identify risks and opportunities, challenge conventional wisdom, and develop innovative solutions.

At the same time, diversity can also create tensions among directors and complicate the board's ability to make timely decisions. To help navigate between maintaining sufficient common ground for collaboration and ensuring enough diversity to prevent groupthink, boards should actively seek out directors who can bridge different perspectives.

As individuals, all directors should have the ability to exercise independent judgment unbiased by personal loyalties. They must be able to assess competing interests and priorities and make decisions that withstand scrutiny from multiple stakeholders. Board members must also be able to articulate their views effectively, challenge constructively, and build on others' ideas. This requires a healthy tension between directors who take thoughtful but strong positions on critical issues and those who excel at fostering collaborative discussion and consensus-building.

The growing complexity of board responsibilities has intensified the focus on director commitment. Beyond meeting attendance and preparation, boards today need directors with the bandwidth to engage between meetings, leverage their networks for company benefit, and contribute to company strategy and culture. The desire for fully committed directors has to be tempered by the reality that some attractive prospects have demanding primary roles—as sitting CEOs or C-suite executives—that compromise their ability to fully engage at times.

3. How the board is structured

Board structure can have a profound effect on board functioning. Take board size, for example. A board that is too large can slow down decision making, diminish individual directors' sense of accountability, and make candid conversation difficult. A smaller board can lack the skills and expertise needed to make critical decisions or even to perform basic board functions.

Research on publicly traded companies suggests that a board size around 10 is optimal on average.

Board leadership structure remains one of the most contentious areas of governance design. The central debate is whether the roles of board chair and CEO, which by tradition in the US have often been combined, should be separated. Proponents of separation argue that it provides clearer CEO accountability and stronger oversight, while defenders of the combined roles emphasize unified leadership and streamlined decision-making. The concept of a lead independent director is an attempt to balance these competing considerations, but this solution continues to be debated. Whatever leadership structure is adopted, the focus should be on defining clear responsibilities for each role.

The board's committee structure—including what committees to set up beyond the traditional audit, compensation, and nominating committees—can also shape the board's functioning. The decision to establish a sustainability or technology committee, for instance, can deepen the board's expertise and strengthen its oversight in those areas, but it also runs the risk of creating board silos and reducing the full board's engagement on critical topics. These risks can be mitigated through mechanisms such as rotating committee membership, cross-committee meetings, and ensuring that key topics are addressed both in committee and with the full board.

Terms of office and director election cycles also deserve careful consideration. The directors of most US-listed companies are elected annually for 1-year terms, largely due to shareholder pressures to eliminate "staggered" boards where subgroups of directors are up for election each year and serve for multi-year terms. Critics of staggered boards argue that they promote director complacency, unduly protect management, and deter takeovers that would benefit shareholders. Proponents say they promote institutional continuity, long-term thinking, and orderly director succession. Research on how staggered boards affect firm value is mixed, but recent studies suggest they can be helpful for younger companies that depend more heavily on long-term investment and innovation.

These and other structural arrangements are typically fixed for a period of time but, like other elements of board design, they need to change as circumstances change. The appointment of a new CEO may necessitate a change in board leadership structure; the emergence of new oversight areas may require a revised committee structure; a special situation may call for the creation of an ad hoc committee. Even though certain aspects of board structure are prescribed by law or stock exchange listing standards, boards have considerable discretion to design structures suited to their specific needs.

4. How roles within the board are defined

As discussed, clarity about the purpose and role of the board as a whole is critical to effective board functioning. Equally important is clarity about roles within the board. Failure to agree on the roles of board chair and CEO when those roles are separated can be particularly problematic. Tensions can arise over a range of issues: the scope of the chair's authority, control of the board's agenda, and the chair's engagement with employees, to name a few. In practice, the relationship between the chair and CEO matters more than their formal roles, but a healthy relationship can be facilitated (or undermined) by how their roles and responsibilities are defined.

The chair is considered the leader of the board—in theory, first among equals—with responsibility for setting the tone and style of the board, managing board dynamics, ensuring effective oversight of management, and fostering productive relationships with the CEO and executive team. The chair sets the board's agenda, typically in collaboration with the CEO and with input from other directors, and presides at board meetings. The chair also convenes "executive sessions" of the independent directors—sessions without the CEO or other management present—and presides at meetings of the shareholders. The chair may also be responsible for overseeing the CEO's performance evaluation and, in some situations, may represent the company to external stakeholders.

By comparison with a board chair, a lead director's responsibilities are much more limited. Like a chair, the lead director serves as a liaison between the board and management, and convenes "executive sessions" of the independent directors, but the lead director typically does not have primary responsibility for the board's agenda, preside at board meetings, or preside at shareholder meetings. Lead directors customarily deal with matters internal to the board though the role may take on an external dimension in times of crisis, especially if the crisis involves the chair/CEO. Despite lead directors' more limited authority, they serve as an important safety valve for governance concerns. And, like other roles, this one can be defined broadly or narrowly depending on the needs of the company and the board.

Clarity about the CEO's role is also essential. Standard definitions say the CEO manages the day-to-day operations of the business, but what that entails in practice varies widely. While CEOs need sufficient freedom to execute strategy and manage operations, they must also maintain transparent communication with the board and respond to increasing oversight needs. This balance becomes particularly important in areas like strategy development, where the line between management's role and the board's role can become blurred. Explicit discussion of the board's and CEO's respective roles can help mitigate the potential for friction. The board should also be clear on what matters require its approval and what information it expects from the CEO.

Many boards could benefit from greater clarity about the roles of committees, which have become more complex as they have taken on more responsibility for specialized oversight. While the roles of traditional committees (audit, compensation, and nominating) are well-established, those of newer committees in areas like technology or sustainability are sometimes vague, and their work often overlaps with that of existing committees. At the same time, certain issues such as cyber risk or climate change should be viewed through multiple committee lenses. Some boards assign different aspects of these issues to the relevant committee—for example, climate disclosures to audit, and climate strategy and metrics to a sustainability committee.

5. What processes are put in place

Board processes are another critical element of board design. Failure to put in place a process for ensuring CEO succession, for example, can make it difficult for a board to respond effectively when faced with a sudden CEO departure or crisis that requires removing the CEO. More routinely, a poor process for planning board meetings wastes the scarce time that directors have together.

Deciding what processes to put in place can be challenging, however. Boards arguably need processes to carry out a wide range of tasks—setting agendas, conducting meetings, staying informed about the company, keeping in touch with management, making decisions, tracking the company's performance, overseeing risk management, scanning the competitive landscape, staying abreast of investor and other stakeholder concerns, monitoring the legal and regulatory environment, getting educated about new topics, unearthing and addressing conflicts of interest, refreshing the board, and anticipating the future, among others.

At the same time creating too many processes or overly rigid ones runs the risk of stifling director engagement or crowding out time to address unforeseen issues. Structured annual agendas for board meetings, for example, ensure systematic coverage of key responsibilities, but they can also lull directors into complacency and prevent them from digging deeply into critical strategic matters that may require more time. Structured annual agendas also presume a regularity and predictability of events that is increasingly at odds with reality. These difficulties can be mitigated by building flexible time into the structure, but they cannot be eliminated entirely.

Striking the right balance between efficiency and comprehensiveness is a recurring tension in process design. It is exacerbated by the limited amount of time that directors typically devote to their board work. The tension is evident, for example, in time allotted to routine reviews of financial and operating performance versus strategic and exploratory discussions. The tension is particularly acute in designing processes for key decisions such as CEO succession. An ideal process would be comprehensive—unfolding over a period of years and including a broad pool of candidates from inside and outside the company. However, time and circumstances do not always allow for such an approach.

In designing processes—whether for decision making, monitoring, advising, or learning—directors should also consider the balance between management and board involvement. Boards are necessarily reliant on management for much of the analysis and information required to make sound decisions, but they should also consider other perspectives and information sources. Too much management control over the information and analyses provided can skew the board's perspective. Engaging with outside advisors can help mitigate this problem, keeping in mind that the board must own its decisions.

6. What norms are adopted

Unwritten rules and norms of behavior can be as powerful as defined structures and processes in shaping board effectiveness. Where directors sit, who chats with whom, and how directors participate in discussion—these behaviors can affect whether the board functions as a cohesive group or devolves into factions or subgroups. How directors behave outside the boardroom—who is in touch with whom, which directors meet socially, and who has the ear of management—matters as well. While informal interactions and pre-existing relationships can facilitate board functioning, they can also lead to a "board-within-the-board" dynamic that disenfranchises some directors.

In designing a board, directors should consider what norms of behavior they want to foster. The aim is not to codify all desired behaviors but to develop a shared understanding of what behaviors enhance the board's functioning—and what behaviors should be avoided.

Many boards could benefit, for example, by clarifying norms around informal exchanges with management. New directors, in particular, often wonder whether it is appropriate to reach out directly to senior management. While some boards encourage open lines of communication between directors and senior management, others worry that this can undermine the CEO's role as primary management liaison or be a distraction for executives. These issues become especially sensitive when informal communications touch on strategic issues or potential problems that have not been formally presented to the full board. Open discussion of these tradeoffs can sensitize directors to these concerns and help boards develop helpful norms of informal exchange. A norm of simply informing the CEO—either before or after the outreach—may be a solution in some cases.

Another challenging area is discussion norms, especially when board members have different cultural or professional backgrounds. A range of behaviors can hamper fruitful discussion: making speeches (instead of engaging in discussion), making comments that are too long (or too short), and unknowingly repeating comments made by others (aka "not listening"). At the same time, boards have different cultures and may differ in what they consider appropriate participation—the frequency of comments, the depth of questioning, and how disagreement is expressed.

The norms of board discussion are shaped by each and every director, but they are heavily influenced by the board chair. The chair must create an environment that encourages challenging questions and substantive debate while maintaining collegial relationships and moving discussions toward conclusion. This last consideration is especially relevant in time-sensitive decisions, where the pressure for quick resolution must be balanced against the need for thorough consideration. The chair also plays a key role in managing participation equity and ensuring that the loudest voices do not crowd out quieter ones.

Changing the norms and unwritten rules of board behavior—especially for boards with long-tenured directors—can be more challenging than changing other aspects of board design. A first step is identifying the issue and raising it with other directors. In some situations, formalizing the desired behavior in a code of conduct, set of governance guidelines, or structured process can be useful. For instance, changing the norms of director tenure on a board that lacks term or age limits may require the adoption of explicit policies and the creation of a defined process for board renewal. In all cases, however, it is imperative that the chair and other directors lead by example through their own behavior.

Conclusion

Building an effective board is not a once-and-done task. It is an ongoing endeavor that requires attention to all elements of board design—from the board's purpose, membership, and structure to its internal roles, processes, and behavioral norms. We have discussed these elements sequentially, but in practice they are highly interdependent and must work together as a system. As a company and its circumstances change, the board should regularly assess its own effectiveness and be prepared to make the design changes needed to provide the level and type of governance expected of good boards today.

4

The shareholder composition of US public corporations: how it impacts corporate governance

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Introduction

By law, the business and affairs of the corporation are managed by, or under the direction of, its board of directors. Thus, legally, the board holds the power. Viewed more realistically, however, that may be an oversimplification. For much of the 20th century, the board's power came less from the law and more from economic reality. Shareholder ownership in public corporations in the US was long characterized by great dispersion and very small ownership stakes. Retail shareholders were sufficiently fragmented and owned such small amounts that it was simply too costly for them to seek to challenge management. In a famous book, Adolf Berle and Gardiner Means argued that this dispersion of ownership implied a "separation of ownership and control."[1] As a result, professional managers in effect controlled the typical public corporation, because they could anticipate that shareholders would have no choice but to remain passive.

True as this once may have been, the structure of share ownership has changed dramatically over the last 40 odd years. Not only has the percentage of stock owned by institutional investors soared, but the even more important change may be the recent and extraordinary concentration of share ownership in the hands of a limited number of owners. Today, a recent study finds that institutional investors own 73.7% of the value-weighted average US corporation, while insiders and their affiliates

[1] A. A. Berle and G. Means (1932), The Modern Corporation and Private Property.

only 5.2%.[2] In terms of shareholder concentration, the value-weighted average US firm has (i) 2.8 institutional investors with a stake greater than 5% who collectively own 20.1% of its shares and (ii) 49.8% of its shares owned by its top 25 institutional shareholders.[3] With less than 3 institutional shareholders owning 20% and another 25 such shareholders owning nearly 50%, collective action, long unlikely for dispersed retail shareholders, has become much more feasible for these larger shareholders, who are almost certain to know each other and probably to have collaborated in the past. Today, the larger the corporation, the greater the degree of ownership concentration—and arguably the greater the accountability to shareholders.

Two other important developments have also encouraged collective action by institutional investors. First, proxy advisory firms (most notably Institutional Shareholder Services, Inc. and Glass Lewis & Co.) have arisen to offer relevant information at low cost to investors on voting matters. Second, the SEC has deregulated in a manner that encourages institutional activism by liberalizing the ability of shareholders to communicate freely on voting matters, and has also mandated the "universal proxy card," which appears to enhance the ability of insurgents to elect their own candidates to the board.[4]

In this light, some analysts discount the danger that insiders and managers can exploit public shareholders, seeing it as a remote possibility now that institutional investors can closely monitor and replace management. So viewed, the separation of ownership and control has ended.

Still, while true in part, such a conclusion may overlook important facts. Above all, institutional shareholders are not homogenous and may have very different attitudes toward participation in corporate governance; some are active, but others are passive. In addition, as share ownership becomes concentrated, the same shareholders may come to control all the firms in an industry. This is often referred to as the "Common Ownership" problem, and it may imply that, once a small group of shareholders comes to dominate all the major firms in an industry, they will have little interest in encouraging hyper-active (but costly) competition among the firms they own.[5] Competition among their portfolio firms may result in a zero sum outcome with the gains and losses to these firms largely offsetting each other. Instead, investors with common ownership might prefer quiet collusion among these companies (leading to higher prices to consumers). This suggests that there may be risks to the public from the concentration of share ownership.

[2] J. Lewellen and K. Lewellen, The Ownership Structure of U.S. Corporations (available at https// ssrn/abstract=4173466) (posted 1 June 2022) at p. 1.

[3] Id. at p. 1. Although it is possible that individuals and non-institutional shareholders rank among the corporation's top 25 shareholders, this is not typically the case.

[4] This Rule (SEC Rule 14a-19(e) under the Securities Exchange Act of 1934) requires that in any contested election of directors the names of all nominees must appear on the ballot. This eliminates any need for investors to execute multiple proxy cards in cases where the insurgents are submitting only a "short slate" of a few directors or in cases where investors wished to vote for names from both slates.

[5] For a full statement of this thesis and the conclusion that such behavior violates current antitrust law, see E. Elhauge (2016), Horizontal Shareholding, 129 Harv. L. Rev. 1267, 1316–17. Some empirical work has been done supporting this thesis, but the debate continues and there is no consensus at this point. See M. Patel (2018), Common Ownership, Institutional Investors and Antitrust, 82 Antitrust L.J. 279 (finding the issues in common ownership to be very fact-specific).

1. The heterogeneity of institutional investors

Unlike business corporations, financial institutions seldom acquire the corporations in which they invest. Rather, they invest and typically hold for the long-run. But they differ markedly in their level of activism (namely, their willingness to become involved in matters of business strategy and internal corporate governance).

a. Activist investors. Some institutions (most typically, hedge funds) seek out companies that they believe are sub-optimally managed and invest in them before beginning a campaign to change those sub-optimal practices and/or the incumbent management. To the extent they succeed, these activists both secure board representation with which to make their desired changes and make themselves more credible contestants in future proxy fights.

A well-known and successful activist may develop a reputation that leads others to invest in a target company that it identifies. Typically, such an activist buys just over 5% of the common stock of the target public company, at which point the federal securities laws require it to file a disclosure statement with the SEC (known as a "Schedule 13D"), which statement, among other things, must disclose the 5% beneficial holder's plans for the target company. In response, the activist's disclosures will set forth its agenda for reform, and the market reaction is generally positive (on average, a 7%–8% rise, net of market movement, in the target's stock price in response to this filing with the SEC).[6] This, in turn, may cause a loosely-knit collection of other institutions to invest in the target just after the disclosure document is filed (or even before that point if they have been tipped). This collection of investors—known in the M&A parlance as a "wolf pack"—may hold as much as 15% or more of the target company's stock and so, with the activist investor, they can typically outvote the insiders and management.[7] Once the activist gains board representation, board dynamics change, and the CEO, having been rebuffed by his own shareholders, may lose some influence and power and often departs within a year or two.

Still, proxy fights are costly and uncertain, and, in part for this reason, activist proxy campaigns generally do not result in an actual proxy fight. Instead, the vast majority are settled, with the activist typically receiving some board representation (but less than a majority of the seats). This outcome saves money for the activist and spares target management any risk of ouster.

Activists' campaigns are increasing. In 2023, 962 companies were subject to activist campaigns globally, and, also in that year, the number of US companies so challenged rose by 7.8%.[8] The issues sparking such campaigns vary from time to time, as profit-motivated activists seek out new issues to use to convince shareholders that their managements have poorly served them. Obviously, activism is controversial within the business community. Corporate executives view activists as focused on the short-term and likely to interfere with sound long-term planning. In 2023, 23.4% of Russell 3000 companies responded to an SEC

[6] See A. Brav, W. Jiang, F. Partnoy and R. Thomas (2008), Hedge Fund Activism, Corporate Governance & Firm Performance, 63 J. Fin. 1729, 1730.

[7] See J. C. Coffee, Jr. and D. Palia (2016), The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance, Ann. Corp. Gov. 542.

[8] See R. Sharratt, Shareholder Activism Annual Review 2024, Harvard Law School Forum on Corporate Governance (March 12, 2024) at p. 1.

disclosure requirement and identified shareholder activism as one of the key risks to their business.[9] Of course, the counter-perspective is that these activists benefit shareholders by framing issues and aggregating the preferences of shareholders who, by themselves, could not have easily influenced management. Whichever perspective one takes, the phenomenon of shareholder activism by hedge funds (and others) appears to be increasing—in large part—because it pays.

b. Indexed investors. Significant as the impact of activist investors may be, the assets that they manage are small in relation to those held by a much larger class of institutional investors: broadly diversified index funds.[10] This latter category has grown at an extraordinary rate from roughly 1% of the US stock market in 2000 to an estimated 33.5% today.[11] Moreover, the most distinctive characteristic of these indexed investors is that they remain largely passive owners, who do not become involved in most internal corporate governance matters. This term "passivity" needs some qualification, as some indexed investors (most notably BlackRock, the largest) do regularly communicate with portfolio firms, offering advice and sometimes prodding them to follow their recommendations, but they do not generally support activist proxy proposals.

Why are indexed investors "passive" to this extent? First, their goal is not to beat the market but only to mimic it—a much easier task. This can be done at relatively low cost, and many investors are satisfied with such a return. The three largest investors in the US—BlackRock, Vanguard and State Street (collectively known as the "Big Three")—are essentially asset managers who oversee and maintain market-matching portfolios for their clients.[12] Because this objective requires them to own a very large number of stocks, they do not consider it feasible to become involved in internal governance matters at each of these companies. Hence, they are said to be "passive", and generally they do not support the governance campaigns of activist hedge funds. This is not an iron rule, however, and the activist investor who can attract the support of indexed investors has a virtually assured victory.

A second explanation for passivity is that indexed investors are largely immune from firm-specific risk, but remain subject to systemic risk (namely, those risks that diversification does not eliminate). Hence, an indexed investor is much more interested in systemic risk issues (such as climate change) as diversification does not fully protect it from these. The fact that the Big Three tend to support certain social goals (such as climate change proposals) can be interpreted as their responding

[9] Id. This was up from 21.4% a year earlier.

[10] There is no official definition either of activist or of the share of the market that they own. But those studying activists estimate that "almost all" public firms have an activist shareholder, who owns between "1% and 10% of its equity". See A. Amed-Zaleh, F. Kasperk and M. Schmalz (2022), Mavericks, Universal and Common Owners: The Largest Shareholders of U.S. Public Firms, (available at http://ssrn.com/abstract_id=4059513).

[11] See A. Chinco and M. Sammon (2024), The Passive Ownership Share is Double What You Think It Is, 157 J. Fin. Econ. 103860.

[12] In 2020, the Big Three held between 15% and 25% of the equity of all S&P 500 firms. See A. Amed-Zaleh, F. Kasperk and M. Schmalz, supra note 10, at p. 12. This percentage has likely increased since 2020. In addition, most institutional investors are required to report their holdings to the SEC under Section 13(f) of the Securities Exchange Act of 1934, and these reports show that their holdings constitute between 60% and 80% of most S&P firms. Id. Thus, at the top of the corporate ladder, large firms are owned by large institutions, with only occasional exceptions for firms with controlling shareholders.

to systemic risk issues.[13] Of course, corporate managements have a different reason for accepting these proposals from large diversified institutions (which they might have resisted if proposed by other shareholders). Their willingness to support proposals from the Big Three and others may reflect both the indexed investor's status as a permanent shareholder and its potential role as holding the balance of power in the event of a proxy campaign by an activist hedge fund.

2. Common ownership

The extraordinary increase in shareholder concentration implies not only that a relatively small group of large institutional investors hold potential control over even the largest public companies, but also that these same institutions similarly hold control over all the major firms in some concentrated industries. From an economic perspective, such investors would not want their controlled companies to engage in expensive, dog-eat-dog competition with each other, unless they profited from it. In theory, intense inter-firm competition within an industry can result in zero sum outcomes in which the gains at the successful firms is matched (or exceeded) by losses at the losing firms, and thus such competition would not benefit a portfolio that held all these stocks. Hence, a "common owner" might prefer that these companies avoid costly competition and even collude on prices (and other matters) so that all companies in its portfolio prosper. Known as the "Common Ownership" problem, this topic has been the subject of much academic debate and increasingly some regulatory attention.[14] At least in industries with only a few large firms (such as the domestic airlines industry), this logic could explain a pattern in which those firms do not compete very aggressively.

Conclusions

Beyond any serious debate, the board of directors' discretion has been constrained by the rise of institutional investors and the increase in shareholder concentration. This hardly means that the board lacks discretion, but it does imply limits on that discretion. Even if a particular board has clearly independent directors, it may need to negotiate with activists and indexed investors over its strategic policies and governance (particularly if it has recently lagged the market).

Nonetheless, it cannot be assumed that institutional investors wish to exercise control, even when a limited number of institutional investors own a near majority of the corporation's stock. Here, we must return to the heterogeneity of institutional investors. Although retail investors tend to side with management in proxy contests, activist investors focus on the stock market price and show less loyalty for past performance. Also, indexed investors are wary of reforms that may pass *de facto* control of the firm to any group of activists, at least without assuring the indexed investors that they will share in any control premium. Still, there are occasions in which corporate management loses its credibility or in which the market's preference is clear. In such cases, indexed shareholders may vote against the incumbent management.

[13] For a more detailed explanation of this point, see J. C. Coffee, Jr. (2021), The Future of Disclosure: ESG, Common Ownership and Systemic Risk, 2021 Colum. Bus. L. Rev. 602. For a good example of indexed investors focusing on such social issues, see T. A. Gormley, V. K. Gupta, D. A. Matsa, S. C. Mortal and L. Yang (2023), The Big Three and The Effectiveness of Shareholder Voice (available at https://ssrn.com/abstract=3724653; estimating that the Big Three led or supported campaigns that caused American corporations to add at least 2.5 times as many female directors in 2019 as these corporations had in 2016).

[14] See sources cited at supra note 5.

Because activist investors cannot normally be certain of winning a proxy contest, they typically compromise and settle with management. This may produce a smaller gain for activist investors, but it is also a more certain gain over a relatively short period. Managements have probably even more reason to fear a proxy contest, because if they lose, they have been rejected by their own shareholders. The result is an overall pattern of compromise that generally precludes a proxy vote on the key contested issue, but may be followed by board conflict and eventual managerial departures.

Less consensus exists on the issue of common ownership. Little, if any, evidence suggests that institutional investors have intervened to pressure for less competition among their portfolio companies, but they could tolerate a managerial preference not to engage in costly competition with their industry rivals. Finally, their desire to minimize their exposure to systemic risk may lead them to support climate change and similar measures that could reduce current earnings—a tradeoff that is economically rational for them.

Both activist investors and indexed investors presumably want to maximize their portfolio's value. Nonetheless, they regularly disagree on strategy and tactics. Why? One reason may be that indexed investors are "permanent" shareholders who are unlikely to buy or sell on any sudden movement in the stock's price. Thus, even if the announcement by an activist shareholder of a proxy campaign will lead to an immediate stock price increase, this may not benefit a permanent shareholder who has no interest in selling. Alternatively, the indexed shareholder may want to maintain amicable relationships with the corporate managements in its portfolio so that they listen to its private advice and defer to its public positions (such as on board diversity or climate change). In short, indexed investors do not want to disrupt this relationship by siding with activist investors, except in extreme circumstances. Finally, institutional investors are more focused on systemic risk, and climate change is probably the leading current example of such a risk that cannot be avoided simply through diversification.

As a result, regardless of how independent and wise the current board may be, the composition of the corporation's shareholders and the presence of a professional activist among them implies that the board's discretion may be constrained. Interestingly, this impact is greatest in the case of the largest corporations where institutional ownership is highest. Smaller corporations may be less subject to such pressure because indexed institutional investors prefer to invest only in companies that offer high liquidity. Thus, the impact of institutional ownership is greatest at the largest firms, which may be where greater accountability is most important.

The past two decades have seen a significant movement in the direction of greater shareholder democracy. But this shift is not toward a romantic vision of democracy as typified by a New England town meeting. Instead, we are moving toward a non-transparent continuing negotiation between sophisticated parties—activists, indexed investors, boards and managements—each with their own self-interests, which negotiations on some occasions (but few) will burst into a full scale proxy battle. The board retains a critical role, but it is often compelled to act more as a mediator than as an all-powerful decision-maker, given the influence of those with voting power. The future may be one of constant quiet negotiations among the principal players. All that is certain is that, in the field of corporate governance, little remains static for more than a decade.

5

Meeting SEC and stock exchange criteria for boards and committees

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Introduction

Stockholders own corporate entities but elect a board of directors to govern the company. The board is responsible for overseeing the general management of the company's business (for the benefit of the stockholders) and—except for certain matters reserved for stockholders—has decision-making authority over the company's affairs. Directors, in turn, delegate much of the day-to-day operational matters of running the business to officers of the company, who hire employees and engage other third-party consultants and advisors. Boards must approve most major corporate actions that involve significant financial, legal, or tax consequences, including—for example—distributions, hiring and firing of senior officers, operating budgets, amending the company's organizational documents, borrowing or lending money, changes to employee benefit plans, and any major sale or merger transaction.

Committees are critical in helping a board of directors meet the many obligations that come with overseeing a public company. Federal law and stock exchange rules set standards and qualifications with which public company board committees must comply. The following is a summary of those requirements.

Overview of stock exchange corporate governance and board composition requirements

The stock exchanges impose corporate governance and board composition requirements as part of their respective listing standards. Foreign private issuers and controlled companies are exempt from some of these standards. A "controlled company" is one in which more than 50% of the voting power for the election of directors is held by an individual, a group, or another company.

Below is a summary highlighting the stock exchange board composition requirements.

Stock exchange corporate governance requirements

In addition to the quantitative and maintenance listing standards of the stock exchanges, a company must meet certain

Exchange requirement	Foreign private issuers	Controlled companies	Emerging Growth Companies (EGCs) and Non-EGCs
• Majority of independent directors	May follow home-country practice	Not required	Yes, within 12 months of listing
• Fully independent nominating/corporate governance committee	Same as above	Same as above	Yes[1]
• Fully independent compensation committee	Same as above	Same as above	Yes[1]
• Fully independent audit committee			
• Must meet requirements of Rule 10A-3[2]	Yes	Yes	Yes
• Must have at least three members	May follow home-country practice	Yes	Yes

[1] The requirements for these committees are:

- one independent director on each committee at the time of listing;
- a majority of independent directors within 90 days thereafter; and
- fully independent committees within one year.

[2] The following transition periods apply to all initial public offering (IPO) companies:

- *for the first 90 days* after an IPO, all but one member of the audit committee are exempt from Rules 10A-3's independence requirement; and
- *for the first year* after an IPO, a minority of the members of the audit committee are exempt from Rule 10A-3's independence requirements. (Since most audit committees have three members, this means that only two need to be independent for the days 91 through 365 following the IPO.)

corporate governance standards for an initial listing, with two key exceptions:

- **Foreign private issuers**. Foreign private issuers are permitted to follow home-country practice in lieu of the stock exchanges' corporate governance standards. Whether a listed foreign private issuer follows the stock exchanges' corporate governance standards or its home-country practice, it must disclose any ways in which its corporate governance practices differ from those followed by domestic US companies.
- **Controlled companies**. As mentioned above, a controlled company is a company in which more than 50% of the voting power for the election of directors is held by an individual, a group, or another company. Master limited partnerships often qualify as controlled companies. A controlled company is not required to comply with the stock exchanges' requirements to have a majority of independent directors, a nominating/corporate governance committee, or a compensation committee. If a controlled company chooses to have a nominating/corporate governance committee or a compensation committee, the committees do not need to consist of independent directors.

Majority of independent directors

A majority of a company's board of directors must consist of independent directors. A director will qualify as independent only if the board affirmatively determines that the director does not have any material relationships with the company (either directly or as a partner, shareholder, or officer of an organization that has a relationship with the company). In making its determination, the board of directors must consider a candidate's commercial, industrial, banking, consulting, legal, accounting, charitable, and familial relationships, among others. A director's stock ownership, even if significant, should not in and of itself negate a determination of independence.

A director would not be independent if:

- currently or during the previous three years, either the director was an employee of the company or an immediate family member of the director was an executive officer of the company;
- during any 12-month period within the last three years, the director (or any of the director's immediate family members) has received more than $120,000 in direct compensation from the company (other than in the form of director and committee fees, pension, or other forms of deferred compensation for prior service, provided such compensation is not contingent in any way on continued service);
- (i) the director is a current partner or employee of a firm that is the company's internal or external auditor; (ii) the director has an immediate family member who is a current partner of such a firm; (iii) the director has an immediate family member who is a current employee of such a firm and personally works on the company's audit; or (iv) the director or an immediate family member was, within the last three years, a partner or employee of such a firm and personally worked on the company's audit within that time;
- the director or an immediate family member is, or has been within the last three years, employed as an executive officer of another company where any of the listed company's present executive officers at the same time serves or served on that company's compensation committee; or

- the director is a current employee, or an immediate family member is a current executive officer, of a company that has made payments to, or received payments from, the listed company for property or services in an amount which, in any of the last 3 fiscal years, exceeds the greater of $1 million, or 2% of such other company's consolidated gross revenues.

An "immediate family member" is defined broadly to include a person's spouse, parents, children, and siblings, as well as mothers- and fathers-in-law, sons- and daughters-in-law, brothers- and sisters-in-law, and anyone who shares that person's home (other than a domestic employee). "Listed company" or "company," for the purpose of determining independence, includes any parent or subsidiary in a consolidated group with the company.

With respect to service on the compensation committee, the board of directors must affirmatively conclude that the director can be independent from management after considering all relevant factors, including:

- the director's compensation, including any consulting, advisory, or other compensatory fees paid by the listed company; and
- any affiliation between such director and the listed company, any of its subsidiaries, or any affiliates of its subsidiaries.

Executive sessions

The listed company must hold regularly scheduled meetings of non-management directors without management present. A listed company that chooses to include all non-management directors at such meetings should also hold an executive session solely for independent directors at least once a year.

Nominating/corporate governance committee

The listed company must have a fully independent nominating/corporate governance committee, which is governed by a written charter that:

- addresses the committee's purpose and responsibilities, which must include: identifying and selecting, or recommending director nominees; developing and recommending corporate governance principles; and overseeing the evaluation of the board and management; and
- provides for an annual performance evaluation of the committee.

The nominating/corporate governance committee charter should also address how the committee:

- qualifies its members;
- appoints and removes its members;
- is structured and operates (including the authority to delegate to subcommittees); and
- reports to the board.

Finally, the committee charter should also specify that the committee has the sole authority over the retention and termination of any company engaged to identify director candidates, including the terms and fees relating to such search.

Compensation committee

Companies must have a fully independent compensation committee, which is governed by a written charter that:

- addresses its purpose and responsibilities, including, at a minimum, direct responsibility for:
  - setting corporate goals and objectives relevant to chief executive

officer (CEO) compensation, evaluating CEO performance, and determining and approving CEO compensation levels in light of such evaluation;

  - recommending compensation, incentive-compensation plans, and equity-based plans for non-CEO executives that are subject to approval of the board; and
  - producing a report on executive compensation as required by the Securities and Exchange Commission (SEC) to be included in the company's annual proxy statement or annual report filed with the SEC;
- provides for an annual performance evaluation of the compensation committee; and
- sets forth the following rights and responsibilities with respect to the use of compensation consultants, legal counsel, or other advisers by the compensation committee:
- the ability, in its sole discretion, to retain or obtain the advice of a compensation consultant, independent legal counsel, or other adviser upon considering all of the factors relevant to that person's independence from management, including:
  - any other services to be provided to the company by the employer of the compensation consultant, legal counsel, or other adviser;
  - any fees to be received from the company by the employer of the compensation consultant, legal counsel, or other adviser taken as a percentage of the total revenue of such employer;
  - the policies and procedures of the employer of the compensation consultant, legal counsel, or other adviser that are designed to prevent conflicts of interest;
  - any business or personal relationships between any member of the compensation committee and the proposed compensation consultant, legal counsel, or other adviser;
  - whether such compensation consultant, legal counsel, or other adviser owns any stock of the listed company;
  - any business or personal relationship of the compensation consultant, legal counsel, other adviser, or the person employing the adviser with an executive officer of the listed company; and
  - responsibility for the appointment, compensation, and oversight of the work of any such compensation consultant, independent legal counsel, or other adviser. The listed company must provide for appropriate funding, as determined by the compensation committee, for payment of reasonable compensation to such compensation consultant, independent legal counsel, or other adviser.

The compensation committee charter should also address committee member qualifications, committee member appointment and removal, committee structure and operations (including authority to delegate to subcommittees), and committee reporting to the board.

Audit committee

Composition

Companies must have an audit committee composed of at least three members that meet all of the stock exchange independence requirements as well as the independence and other requirements of Exchange Act Rule 10A-3 (implementing Section 301 of Sarbanes–Oxley).

The audit committee members must be "financially literate," and at least one member must have accounting or financial management expertise, as determined by the company's board based on its business judgment. For any audit committee member that serves on the audit committees of more than three public companies at the same time, the board must determine that such service would not affect such member's ability to serve effectively on its audit committee, and it must disclose its determination on or through the company's website or in the company's annual proxy statement or, if the company does not file an annual proxy statement, in its annual report filed with the SEC.

Charter

The audit committee must have a written charter that addresses:

- the committee's purpose, which at a minimum must be to:
  - assist the board with oversight of (i) the integrity of the company's financial statements; (ii) the company's compliance with legal and regulatory requirements; (iii) the independent auditor's qualifications and independence; and (iv) the performance of the company's internal audit function and independent auditors; and
  - prepare an audit committee statement as required by the SEC to be included in the company's annual proxy statement or annual report filed with the SEC;
- an annual performance evaluation of the audit committee; and
- the duties and responsibilities of the audit committee, which at a minimum must include those set out in Exchange Act Rule 10A-3(b)(2), (3), (4), and (5) (concerning responsibilities relating to: (i) registered public accounting firms; (ii) complaints relating to accounting, internal accounting controls, or auditing matters; (iii) authority to engage advisers; and (iv) funding as determined by the audit committee), as well as to:
  - at least annually, obtain and review a report by the independent auditor describing: (i) the firm's internal quality-control procedures; (ii) any material issues raised by the most recent internal quality-control review, or peer review, of the firm, or by any inquiry or investigation by government or professional bodies, within the preceding five years respecting one or more independent audits carried out by the firm, and any steps taken to deal with any such issues; and (iii) all relationships between the independent auditor and the company (to assess the auditor's independence);
  - meet to review and discuss the company's annual audited financial statements; quarterly unaudited financial statements with management and the independent auditor, including the company's management, discussion, and analysis disclosures; earnings press releases; financial information and earnings guidance provided to analysts and rating agencies; and policies with respect to risk assessment and risk management;
  - meet separately, periodically, with management, with internal auditors and with independent auditors;
  - review with the independent auditors any audit problems or difficulties and management's response;

- set clear hiring policies for employees or former employees of the independent auditors; and
- report regularly to the board.

Listed company audit committees—Rule 10A-3

Exchange Act Rule 10A-3 (which implements Section 301 of Sarbanes–Oxley) requires that each audit committee member has to be a member of the board of directors and meet certain independence requirements. To be "independent," an audit committee member is barred from accepting any compensatory fees from the company or any subsidiary, other than in their capacity as a member of the board, and may not be an "affiliated person" of the company. The definition of affiliated person includes a person who, directly (or indirectly through one or more intermediaries) controls, or is controlled by, or is under common control with the specified person. However, a safe harbor exists for certain non-executive officers and other persons who hold shares of 10% or less of the company.

Rule 10A-3 also requires that:

- the audit committee must be "directly responsible" for the appointment, compensation, oversight, and retention of the external auditors, who must report directly to the audit committee;
- the audit committee must establish procedures for the receipt, retention, and treatment of complaints regarding accounting, internal controls, or auditing matters, and the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters;
- the audit committee must have the authority to engage independent counsel and other advisers as it deems necessary to carry out its duties; and
- the company must provide the audit committee with appropriate funding for payment of external auditors, advisers employed by the audit committee, and ordinary administrative expenses of the audit committee.

Under the stock exchange rules, IPO companies are entitled to certain exemptions during a transitional period following their public offering:

- **For the first 90 days** from the date of listing, all but one of the members of the audit committee may be exempt from the independence requirements.
- **For the first year** after the date of listing, a minority of the members of the audit committee are exempt from the independence requirement (e.g. only two out of three members need to be independent for days 91 through 365).

These transitional rules effectively apply in the same manner to EGCs, controlled companies, and all other IPO companies.

An IPO company will have to disclose in any proxy or information statement filed with the SEC and in its annual report that it has relied on one of these exemptions and the company's assessment of whether and, if so, how, such reliance on an exemption would materially adversely affect the ability of the audit committee to act independently.

Audit committee financial expert

Sarbanes–Oxley requires that at least one member of a public company's audit committee has accounting or financial management expertise that would qualify that person as an audit committee financial expert. The SEC defines an audit committee financial expert as someone who has: (i) education and experience as a public accountant, auditor, principal financial officer, principal accounting officer, or controller, or experience in one or more positions that involve performance of similar functions; (ii) experience actively supervising persons in the positions above; (iii) experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing, or evaluation of financial statements; or (iv) other relevant experience, and who has:

- an understanding of GAAP and financial statements;
- the ability to assess the general application of such principles in connection with the accounting for estimates, accruals, and reserves;
- experience preparing, auditing, analyzing, or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the company's financial statements, or experience actively supervising one or more persons engaged in such activities;
- an understanding of internal controls and procedures for financial reporting; and
- an understanding of audit committee functions.

A public company must disclose in its Form 10-K the name of at least one audit committee financial expert on the company's audit committee or, if no audit committee financial expert sits on the audit committee, an explanation of why the committee does not include a financial expert.

Corporate governance requirements for foreign private issuers

As noted above, foreign private issuers are permitted to follow home-country practice in lieu of the stock exchanges' corporate governance standards, other than the requirements that they must: (i) have an audit committee that meets the requirements of Exchange Act Rule 10A-3; and (ii) provide prompt notification from its CEO of non-compliance with the applicable provisions of the governance rules.

Whether a listed foreign private issuer follows the corporate governance standards or its home-country practice, it must disclose any ways in which its corporate governance practices differ from those followed by domestic US companies. A brief, general summary of differences is enough. A foreign private issuer that is required to file an annual report on Form 20-F with the SEC must include the statement of significant differences in that annual report. All other foreign private issuers may either (i) include the statement of significant differences in an annual report filed with the SEC, or (ii) make the statement of significant differences available on or through the listed company's website. If the statement of significant differences is made available on or through the listed company's website, the listed company must disclose that fact in its annual report filed with the SEC and provide the website address.

6

Unlock your board's full potential: why culture is the key to a high-performing board

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Diagnosing and treating board culture issues

"We put 12 highly successful people together, call them a board, put them in a room together four times a year and expect them to know how to be a board."

This sentiment, shared by a participant at a recent board retreat, highlights a common reality: while individual directors' experiences and contributions matter, it is the collective board culture that truly determines a board's effectiveness. This essential factor is too often ignored or taken for granted. Just as organizational culture shapes the day-to-day environment for employees, board culture profoundly influences how directors interact and make decisions, ultimately impacting how the organization performs.

Boards that cultivate a strong culture typically engage in more thorough discussions, exhibit higher levels of trust among board members and with the executive team, and demonstrate improved conflict resolution and governance practices. Conversely, a dysfunctional culture can be a major liability for boards, leading to poor decision-making and less effective governance overall. It is up to board leaders to set the tone for building and maintaining a strong, functioning culture.

Establishing a robust board culture takes time, effort, and intentional oversight. After conducting hundreds of Board Effectiveness Reviews (BERs) over the last several years, we have observed three critical factors that contribute to a poor board culture, all of which greatly affect the necessary board dynamics and the board's overall ability to sustain a fully functioning feedback culture:

- ineffective leadership of the chair or lead director;
- minimal investment in building the board's ability to operate as a group instead of a collection of individuals; and

- poor onboarding and integration of new board members.

In this chapter, we will explore strategies to diagnose and address these issues to ultimately guide the board toward fostering a stronger culture.

Culture issue #1: ineffective leadership of the chair or lead director

The board chair or lead director plays a pivotal role in shaping and maintaining the board culture. An environment where every director feels safe to communicate openly and the collective is able to make balanced decisions is a strong hallmark of an effective chair. Boards with ineffective leadership, however, often exhibit uncertainty about direction, lack of open feedback exchange, and even poor decision-making.

To avoid this, chairs must set the cultural tone from the top by championing the organization's purpose and mission. This means consistently communicating the board's values and strategic priorities, ensuring that every decision and discussion aligns with the overarching goals of the organization. By embodying the core principles and demonstrating unwavering commitment to the organization's purpose, the chair inspires directors to uphold these standards as well.

Beyond establishing these overarching objectives, effective chairs can nurture and maintain the board culture by requesting and being open to critical feedback and engaging in reflection after every meeting, considering points such as:

- Did I connect sufficiently with each board member in advance of the meeting to ensure they were ready and prepared to discuss the issues at hand?
- How do directors feel about this board? How regularly am I assessing their energy and contribution levels?
- Was the agenda structured to ensure breadth of leadership and balance of voice?
- How did we broaden perspectives and understanding?
- Did everyone have an opportunity to speak?
- Did any one person dominate a discussion?
- Did we get to consensus too quickly, or have we thoroughly considered different perspectives?
- Are we missing any critical perspectives as a group?
- Have we kept debate on the issue and not the person?

The increased diversified representation of boards has made creating an inclusive culture more imperative. Cultivating inclusivity requires intention and practice. It is evident in the way chairs prepare for and run meetings, how dissent is handled, as well as in overall new director onboarding, sitting director reorientation, and candid conversations about director succession planning.

When a board chair is dialed into the dynamics at play in the boardroom, the likelihood of a more connected and inclusive culture is much higher. It creates a blueprint for how other board leaders should run their committees and ensures that the desired culture permeates these subgroups of the full board.

However, in some instances, it may be revealed in a BER or through another mechanism that a board chair is not open to receiving feedback and falling short of being an effective culture champion. These chairs do not make the necessary adaptations to be the cultural leaders their board needs. In these cases, the nominating and governance chair plays an important role in what happens next—it could be naming a new board chair sooner than expected or altering the chair's role description for the future, with an emphasis on culture-building capabilities.

Culture issue #2: the board operates as a collection of individuals, not as a group

Boards often fail to invest adequately in building their ability to function as a cohesive unit rather than a group of individuals. Viewing the board as a constellation, where the board is an independent yet interconnected collection of members that together form a cohesive and balanced whole, can improve overall dynamics. This approach, rooted in the Internal Family Systems (https://ifs-institute.com/) model of Dick Schwartz, focuses on patterns, dynamics, habits, and processes within the board.

As shown in the graphic below, examining the board as a constellation enables

Our Constellation Model looks at board culture through four lenses:

Purpose

This is the essence of the organization, guiding decision-making and providing a clear picture of the desired state. Board members must be well aware of the organization's overriding purpose and keep it at the forefront of their agenda and decision-making. When this is not the case, the board culture tends to value process over insight, leading to decisions made outside of their broader impact and often key opportunities are missed.

Signs your board isn't aligned on purpose: Directors are too focused on minor details, they exhibit a lack of clarity on goals, have low levels of motivation, and little appetite for innovation.

Order

The board must follow an agreed-unon order. The responsibilities of individual board members and committees need to be clearly delineated and adhered to. When this is out of sync, progress is noticeably affected and hard to regain. It can be difficult to initiate even small changes in processes and board members may be overly concerned with boundaries and overstepping them.

Signs your board is out of order: There is no formal board leadership succession plan, egos dominate discussion, and there is a sense of powerlessness among board members.

Connection and Inclusion

This principle focuses on the relational dynamics of a board, balancing independence, and cohesion. A healthy board culture is inclusive, ensuring new perspectives are heard and innovation thrives. Without an inclusive feedback culture, new board members may feel isolated, leading to stifled debate and limited decision options. The ideal state is a board culture that fosters universal participation, deep listening, and careful dissension and debate.

Signs your board is exclusive instead of inclusive: There is a lack of robust onboarding plans for new board members and few to no board buddy systems or mentorships. In discussions, the same perspectives dominate, and side conversations become the norm instead of respectful debate within the board meeting. There may also be extreme levels of loyalty or "groupthink."

Exchange

This is the give-and-take that balances time horizons (that of company strategy and individual board member tenure), transparency, and mutual respect. When out of sync, board members can become defensive and untrusting. Effective exchange involves clear communication and a balance between internal (management) and external (board members) perspectives.

Signs your board has an exchange issue: Management presents ideas and strategies and the board simply critiques—there is no co-creation, and directors become defensive at the first sign of dissent or an inquisitive comment. There may also be "inner circles" and "outer circles" on the board, which can hamper healthy exchanges within the board and with management.

leaders to identify areas where the culture is thriving and pinpoint where it is out of sync, hindering team interaction and cohesion.

By aligning the board's culture with these principles, boards can ensure they operate as a unified body, effectively navigating the complexities of governance and fostering a thriving, inclusive environment for all members.

Culture issue #3: poor onboarding and integration of new board members

Signs of poor onboarding and integration include new board members feeling isolated, struggling to understand the organization's goals and processes, and hesitating to contribute in meetings. Additionally, a lack of clear guidance and mentorship can lead to new members feeling overwhelmed and disengaged, ultimately affecting their performance and the overall board dynamics.

Effective onboarding is crucial for integrating new board members and ensuring they contribute meaningfully from the start. In best-in-class boards, onboarding begins during board recruitment. How board members are selected, the transparency of the process, and who is included in the process are all parts of "pre-onboarding" new members and initially exposing them to the board culture. Overall, an official onboarding process should cover four main areas:

- company familiarization (including values, corporate culture, history, and offerings);
- educational sessions with the executive team and board leaders;
- corporate governance; and
- intangibles.

The first three elements are effective methods for helping new board members gain a better sense of the business and its priorities. This could include getting to know the company's management as individuals and understanding their roles as well as touring plants and operating facilities. Another good tool is a training guide for new directors that outlines all of the key processes of the board.

Less standard in the onboarding process is addressing the intangibles, like understanding the board's culture and dynamics. Chairs can enhance onboarding by pairing new members with seasoned directors for mentorship, providing training guides, and fostering an environment where new members feel comfortable speaking up and engaging in discussions.

To support this adaptation period, the board chair and nominating and governance committee chair should team up to pair new members with a more tenured director to accelerate integration. This mentor would provide additional cultural or business context, observe and provide real-time feedback, gather feedback on new members' initial meetings, and enable a safe space for those who may not feel comfortable asking questions in front of the full room. In addition, new board members should be provided with more extensive feedback during their first 2 years of board service. This can include pre- and post-board meetings to share their reactions and help them to decode some of their observations of the board dynamics at play.

Practical examples of how chairs have improved board culture

When chairs or lead directors have observed that elements of their board culture are out of sync, if they have not already been indicated through a BER, that is the best place to start. BERs reveal areas where boards tend to get stuck and offer the opportunity to step back and reflect on the board's culture and how board members are experiencing it. They can also inspire thinking about how the board can improve as a collective and as individuals, leading to a greater impact.

In several examples, we have seen boards leverage the learnings from BERs over the course of many years. When individual feedback is received and incorporated by directors and the board chair considers what the company needs for the future of the company, there is a visible improvement in participation, performance, and culture.

We have also seen board chairs make shifts to improve their board culture by enhancing the strength of the connections between board members. One such example is when an incoming chair attended a leadership retreat and subsequently asked us to facilitate a board workshop. During the workshop, the board members engaged in activities designed to help them understand each other better. They discovered that most members identified themselves as having a largely results-driven mindset, while fewer saw themselves as more creative, visionary thinkers. This insight led the board chair to incorporate time for more big-picture thinking, to better address the question, "What are we missing?"

Another example is when a major dairy company held a board retreat where, instead of the usual plant tour, board members participated in cheese-making. This hands-on activity fostered camaraderie and deeper understanding among members. Such workshops and activities, where board members get to know each other as individuals and as a collective (all while learning more about the business), can significantly enhance board culture.

What directors learn in these workshops can also translate into how they engage in board meetings. The former board chair of a multinational oil and gas company shared that one of his hallmarks for maintaining his board's strong culture is emphasizing their responsibility in ensuring that the company maintains the highest ethical standards. "We agreed that the board needed to set the pace for the whole company in setting and achieving these standards," he said. "So, we started every meeting with a board member or a member of management sharing an ethical dilemma they dealt with in their careers and how they handled it." Those personal stories made each board member feel more connected and more committed to the goal of developing the highest ethical standards in the industry. Clear priorities like this one often offer a great opportunity for boards to deepen their connectivity and motivation.

Fostering a high-performance board culture

A board's culture is a vital enabler of its performance, just as it is for the entire organization. It acts as a guide, leading the board toward practices that boost inclusivity, collaboration, and strategic thinking. By fostering an open, creative, and respectful culture, boards achieve higher performance levels, ensuring their decisions are responsive and inclusive. Additionally, better aligning board culture with organizational culture empowers the board to move away from practices that no longer serve them and adopt innovative approaches, leading to sustainable value creation and better governance. A robust board culture is not simply a "nice to have" element of board functioning. The highly complex environments in which boards are now working and making decisions demand more attention to cultural health and alignment.

Improving board performance starts with recognizing the crucial role culture plays in shaping effective leadership and decision-making and noticing where it is falling short. Picture a boardroom where diverse perspectives are not just heard but actively sought out, where bold ideas are nurtured, and where high levels of engagement from all directors transcend hierarchies. By rooting their culture in these values, boards can transform into agile, forward-thinking entities capable of navigating the complexities of modern governance. This transformation is not about abandoning established practices but about evolving them to meet the new challenges and opportunities that lie ahead.

7

The personal roadmap: attributes of outstanding board members

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The personal roadmap: attributes of outstanding board members

Becoming a leading-edge board steward is a journey that requires time, dedication, and a commitment to developing the skills required to be an exceptional contributor in a board setting. While you may have mastered the responsibilities of being a directive leader as a chief executive officer (CEO) or C-suite executive, as well as the skills needed to secure a board seat, excelling as a director demands a distinct set of competencies.

A board is a team of peers. It is a team composed of talented and diverse individuals who must learn to collaborate effectively with one another and the management team to ensure the long-term health of the organization. Contributing effectively in a board setting—saying what needs to be said at the right time and in the right way—requires a different set of "muscles" that directive leaders, even at the peak of their careers, may find are a bit rusty or in need of refinement.

Additionally, each board is different, made up of a different team seeking to add value in a different setting. The journey toward collective excellence is unique to each board dynamic. Building influence in the boardroom requires a clear vision and demands introspection, reflection, and continuous learning.

We created a first-of-its-kind personal benchmarking tool to rate your personal effectiveness in the boardroom along key dimensions of excellence. This roadmap provides a structured framework for assessing your skills and guiding your journey toward achieving boardroom excellence.

Why is this tool relevant?

It is more difficult than ever to be a corporate board member. Today's boards and board members face an unprecedented landscape of complex challenges and heightened expectations. Additionally, board members are expected to address a wide variety of topics with increasing pressure to respond quickly.

Why did we build this tool?

Our mission is to improve the performance of corporate boards, and we created this tool as a way to democratize key lessons we have learned in our experience working in highly effective board rooms.

The benchmarking tool

Our personal roadmap tool focuses on the interpersonal dynamics of boards and how individual board members gain influence.

The first three skills—*individual purpose, learning mindset, and skillful means*—are competencies that can be developed individually.

1. **Purpose and motivation**—understanding personal motivation and purpose and how it aligns with the organizational purpose.
2. **Learning mindset**—cultivating curiosity and open-mindedness to learn that creates informed perspectives on the path to long-term sustainable value.
3. **Skillful means**—refers to the art of tailoring one's actions to a situation or audience and employing specific approaches.

The next four skills—*trusted relationships, team play, engagement with the management team, and candid conversations*—build upon the first three and can be honed only through interactions and engagement with others.

4. **Trusted relationships**—building and maintaining strong relationships with other board members and stakeholders inside and outside the board room.
5. **Team play**—working collaboratively as part of a team grounded in purpose with a commitment to long-term value creation.
6. **Engagement with management team**—effectively interacting and

Benchmarking Tool

	Early	Evolving	Aspirational
Individual Purpose			
Learning Mindset			
Skillful Means			
Trusted Relationships			
Team Play			
Engaging with Management Team			
Candid Conversations			

balancing support with challenge for the management team.

7. **Candid conversations**—conducting thoughtful and transparent discussions, especially when times are tough.

The benchmarking tool offers a comprehensive analysis and explanation of each skill, enriched with thought-provoking insights. It illustrates the three stages of mastery—**early, evolving, and aspirational**—showing the progression and growth of individual board directors as they mature in their roles.

Here, we provide a lead-in for the personal roadmap[1] and an introduction to the seven attributes and what an aspirational director looks like.

The seven attributes

Skillsets to cultivate individually

Individual purpose

Leading edge stewards know why they are involved with the organizations they serve. Understanding one's own purpose requires self-knowledge which tends to deepen as a board member wrestles with their own values, behaviors, and competencies as well as the organization's.

Aspiration: at the aspirational level, the objective is to contribute to the organization's excellence in every way. This commitment is integrated into a broader individual purpose to positively contribute to individuals, groups, organizations, industries, and society. Satisfaction comes from seeing the organization thrive—ensuring the well-being of its leaders, mainstream talent, customers, and stakeholders.

Learning mindset

Curiosity about the world, their organizations, and how to improve their own behavior characterizes leading edge stewards. When they hear something that does not align with their expectations, they ask genuine questions to develop a better understanding and have the emotional maturity to listen first.

Aspiration: a proactive, continuous learner dedicated to understanding all facets of the organization and its ecosystem, this leader actively seeks to upskill in areas like technology, governance, and social trends. By using language that fosters collective learning with both the board and management, they view strategy as a dynamic, adaptable process, and champion collaborative testing of various approaches. They promote a board culture grounded in open dialogue, constructive debate, and data-driven decision-making while valuing before-and-after action reviews as essential learning tools for both board and management.

Skillful means

Skillful means refers to the art of tailoring one's actions to a situation or audience. We apply the concept broadly to six approaches that effective directors employ. The best directors are highly aware of their own "inner climate", how they feel, whether they are experiencing discomfort, and what impact that might be having on themselves or others.

Aspiration: this leader exemplifies a balanced approach, showing patience, intensity, and courage with the right audience at the right time. Skilled at making unseen issues clear, they use high-impact questions to challenge assumptions and drive meaningful discussions. With infallible timing, they sense the group's mood and strategically contribute to fostering consensus. Thinking in terms of emerging risks and opportunities, they lead fluidly from any position—always with a focus on creating value in board service.

Skillsets to hone through interaction and engagement with others

Trusted relationships

Trusted relationships require thoughtful engagement with fellow board members inside and outside of the board room to avoid personal and interpersonal breakdowns when times inevitably become tough.

Aspiration: as a key leader of the board, this leader tries to support all other board members and has a strong relationship with the chair. They can be trusted to bring an independent perspective.

Team play

Leading edge stewards see themselves as part of a team, and are committed to the board culture and their contribution to it, not just themselves. A new board member's first order of business is to understand existing team roles and how their experiences or expertise can fit in to provide helpful insights before exerting influence.

Aspiration: being part of a team requires a culture built on individual skills and encouragement of all to develop skills and spend time between meetings to strengthen collective muscle in coordination with one another as a shared effort.

Engagement with the management team

A unique challenge that board members face is working with another high-performing team, the management team. The best boards, CEOs, and management teams draw the best from each other. Board members do not overstep their role, but step in at the right time in the right way when necessary.

Aspiration: this leader expertly balances support and challenge, earning trust as an advisor to the CEO and management team while cultivating relationships beyond senior leaders through the CEO. As a board or committee chair, they maintain a strong, collaborative relationship with their executive counterpart, are always focused on shareholder value, and are prepared to make tough decisions, including disciplining or transitioning management when necessary.

Candid conversations

Leading edge stewards understand the value of candid conversations and approach challenging discussions with honesty, empathy, and tact. They prioritize transparency and open communication, believing it strengthens relationships and drives effective governance.

Aspiration: this leader creates a culture where both board members and management can openly discuss challenges and opportunities and provide constructive feedback. They encourage authentic, good-faith dialogue, recognizing that a strong process and trust often reduce the need for bold interventions. They view breakdowns as opportunities for breakthroughs, fostering a board environment where even the most challenging conversations drive collective resilience.

How to use the benchmarking tool

The **personal roadmap benchmarking tool** is designed to help individuals assess their readiness and fit for board service, identify areas for growth, and track progress over time. The tool is structured as a matrix for users to evaluate their own competencies required for effective board service. Each row focuses on a specific area, such as individual purpose. For each area, the individual rates themselves across three stages of development:

- **Early days:** the minimum standard of behavior; board members typically are only invited to serve on a board if they have already demonstrated these competencies.
- **Evolving:** once the "early days" skills are achieved, a board member may progress to the right as he or she exhibits growing expertise or contributions.
- **Aspirational:** the most advanced stage is the (seldom reached) target. Only the highest-performing board members exhibit this level of maturation reflecting years of experience, self-awareness, and practice.

By completing the tool, individuals gain clarity on their current strengths, areas needing attention, and actionable steps to move toward their aspirational goals. Here is an example of Individual Purpose and Motivation:

1. Purpose and Motivation

Leading edge stewards know why they are involved with the organizations they serve.

Understanding their own personal purpose enhances their effectiveness and authenticity with their fellow directors and the management team, and gives the board member clarity regarding competencies, values, and behaviors that an organization needs to achieve its own mission and purpose.

	Early Days	Evolving	Aspirational
Purpose and Motivation	Motivated by financial reward, desire for flexible time, stature, attraction of rubbing shoulders with board members and organizational leaders. Purpose is to be a fiduciary and contribute ideas that add to commercial success.	Service is a key motivator and leads to an explicit sense of responsibility to stakeholders and business purpose. Good alignment between mainstream life, career, and board priorities. Engagement with the organization, its people, customers, and fellow board members is rewarding and fun. Strong desire not to disappoint.	Objective is to help the organization be outstanding in every way. Part of an overall individual purpose based on desire to contribute to individuals, groups, organizations, industry, society. Satisfaction driven by health and value of organization, its leaders, mainstream talent, customers, stakeholders. Leadership of board and/or committees is attractive means of achieving purpose.
Key Take Away: Moving from personal gain to service to others			

You can find the full tool, workbook, and supporting context, which covers each of the seven attributes with detail comparable to the above table, in the personal roadmap tool.[2]

Actionable Insights

The implicit assumption in this work is that each individual owns his or her behavior and that effectiveness begins with leadership of self and expands to interactions with others. This tool provides even the most experienced and high-performing directors a structured framework for self-assessment, promoting a mindset that continuous growth and improvement are always possible. Truly self-aware and curious directors will recognize that achieving excellence is an ongoing journey; few, if any, will consistently rate themselves at the "aspirational" level across all competencies, as there is always room to deepen their impact and influence.

How board members seeking excellence can use this tool to improve effectiveness:

1. Self-assessment for directors looking to challenge themselves.
2. Organizational assessment tool to assess the strength of the board as a whole.
3. Workbook to promote reflection, possibly with a trusted "buddy" with board experience.

Conclusion

Above all, it is essential to pause and reflect on your impact as a board member. Your work on any board is always in motion and evolving. By regularly pausing to reflect on your personal purpose, learning mindset, and the quality of your interactions, you strengthen both your own impact and the board's collective performance.

There are many resources available to learn about the fiduciary nature of the role. This personal roadmap addresses individual behaviors to be more effective, both in the boardroom and out in the broader world.

Ultimately, every organization deserves a resilient, high-performing board. By continuously challenging themselves to grow—both individually and as a team—directors can build a board culture that drives meaningful impact, adapts to challenges, and upholds the organization's mission with integrity and purpose.

Chapter notes

1 (https://stanfordwomenonboards.stanford.edu/learn/leading-edge-stewardship).
2 https://stanfordwomenonboards.stanford.edu/.

Section 2: Board committees and special roles

Subsection: Committee structures and functions

Subsection: Audit and financial oversight

Subsection: Compensation governance

Subsection: Governance oversight

Subsection: Leadership structures

Subsection: Special situations

8

Board committees: serious business

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In this rapidly changing, complex business environment, the focus on effective corporate governance continues to be heightened. And with this, there is an increased number of topics and responsibilities of boards and their committees. For boards of directors, committees are serious business; they are said, with justification, to perform "the real work of the board." And state corporate laws generally provide that directors, individually and collectively, "shall be fully protected in relying in good faith upon . . . opinions, reports or statements presented . . . by any committees of the board of directors."[1]

This article discusses some critical aspects of the board committees that do much of the "heavy lifting" of the board, including the types of committees that companies are required to have; other committees that some companies have, even though not required; committee composition and refreshment; and how committee roles and even names are evolving as committees help boards to address the many challenges and opportunities that companies face in the current environment.

Required committees

Subject to some limited exceptions, US public companies are required to have audit, compensation, and nominating/governance committees. The composition, roles, and responsibilities of these committees for New York Stock Exchange (NYSE) listed companies are set forth in the NYSE Listed Company Manual as follows:

- audit committees;[2]
- compensation committees; and[3]
- nominating/governance committees.[4]

The stock exchange listing standards requiring these committees permit companies to combine committees, as long as (i) the members of the combined committee meet the independence standards and other criteria applicable to both committees (*see "Committee composition" in another section in this article*) and (ii) the combined committee is responsible for all the matters normally handled by each of the component committees. Because the independence standards and other criteria applicable to, and the responsibilities of, the audit committee are generally more significant than those of the other two committees, the audit committee is rarely combined with other committees.

Under exchange listing standards, certain matters for which a committee is generally responsible can be handled by another committee. For example, director compensation can be addressed by the compensation committee or the nominating/governance committee, which is generally more familiar with directors' roles and responsibilities and may therefore be in a better position to evaluate the appropriate level of director compensation.

Under the Dodd-Frank Act,[5] publicly traded bank holding companies with more than $10 billion in assets are required to have risk committees. However, due to industry standards, most banks have a risk committee even when not required by legislation.[6]

Role of the standing committees

This section provides a brief overview of each of the three standing committees of a public company:

- The audit committee is responsible for overseeing the company's financial reporting processes, internal controls, and compliance with legal and regulatory requirements. It oversees the external audit process, including the selection, compensation, and independence of the external auditors, as well as reviewing audit plans and results. The committee also monitors the effectiveness of the internal audit function and the company's risk management policies. Additionally, it ensures compliance with laws and ethical standards, manages whistleblower mechanisms, and regularly reports its findings to the board of directors. Through these responsibilities, the audit committee plays a crucial role in maintaining investor confidence and upholding the company's financial integrity.
- The compensation committee is tasked with overseeing and guiding the company's executive compensation policies and practices to ensure they align with the company's strategic objectives and shareholder interests. Key responsibilities include setting the compensation for the chief executive officer (CEO) and other senior executives, which encompasses salaries, bonuses, stock options, and other incentive plans. The committee also reviews and approves the company's overall compensation philosophy and ensures that executive compensation is competitive and aligned with performance. Additionally, the committee is responsible for evaluating and recommending the adoption of new compensation plans or amendments to existing ones, ensuring compliance with regulatory requirements, and providing transparent disclosures in the company's proxy statements. By fulfilling these duties, the compensation committee helps to attract, retain, and motivate top executive talent while aligning their interests with those of the shareholders.

- The nominating/governance committee is tasked with ensuring effective corporate governance and overseeing the composition and functioning of the board of directors. This committee is responsible for identifying and recommending qualified candidates for board and committee positions. It regularly reviews and updates the company's corporate governance guidelines and practices to align with regulatory requirements and leading practices. The committee also oversees the evaluation of the board's performance, including individual directors and committees, to ensure they effectively fulfill their duties. Additionally, it is responsible for succession planning for board and senior executive positions, and for facilitating director education and orientation programs. By fulfilling these responsibilities, the nominating/governance committee helps to ensure that the board operates efficiently and in the best interests of shareholders, maintaining high standards of corporate governance.

Other committees

Some companies have standing committees in addition to those required by law. The 2024 U.S. Spencer Stuart Board Index (the "Index") reports that the S&P 500® companies have the following standing committees, among others: finance (26%), executive (25%), science/technology (17%), and environmental/health/safety (13%). The types of additional committees a company has may be driven by several factors, most notably the industry sector. For example, 67% of S&P 500® utility companies have finance committees, and 45% of S&P 500® energy companies have environmental/health/safety committees.

Notably, unlike audit, compensation, and nominating/governance committees, which must be comprised entirely of independent directors (with independence standards that vary among those committees, as discussed within the "Committee composition" section), these other standing committees may include directors who are not independent. This can provide needed industry or other expertise that may be beneficial to the company.

While there are no legal limits on the number of standing committees a company's board may have, having too many committees may be impractical. This is due to the limited number of directors and the time they can devote to committee service. Additionally, each committee generates a certain degree of bureaucracy related to scheduling meetings, distributing materials, and requiring personnel to support the committee's needs. Due to these and other factors, the Index reports that 68% of the S&P 500® companies have four or fewer committees, that only 2% of those companies have seven or more committees (a decrease from 4% in 2014), and that the average number of committees across all the S&P 500® companies is 4.2.

However, from time to time, companies also create special committees to address certain matters. For example, companies may form ad hoc committees to address specific opportunities or challenges that may require a "deep dive", as has been the case with technology issues such as cybersecurity and artificial intelligence. In many cases, these committees are dissolved when their remit is addressed, although they can remain in existence as standing committees. In other cases, companies form committees of independent—or even "super-independent" directors (*see the "Committee composition" section*)—to evaluate significant transactions in cases where some members of the board may have conflicts of interest, or to evaluate whether the company should pursue derivative litigation brought against directors and/or others on behalf of the company. These limited-purpose committees are generally temporary in nature and are dissolved once the matter in question is resolved.

Committee composition

Audit committee

While the three required committees must be comprised solely of independent directors, some independent directors are more independent than others; specifically, under the Sarbanes–Oxley Act,[7] the independence requirements of audit committee members are the most stringent and include a prohibition against the receipt of any compensation from the company (other than director compensation). In addition, companies are required to disclose whether at least one member of the audit committee is an "audit committee financial expert"[8] or, if not, why not. Given the awkwardness involved in having to explain the lack of an audit committee financial expert, very few (if any) companies choose to go that route.

In addition, NYSE listing standards require all audit committee members to be "financially literate", as determined by the board of directors, and require board approval for any audit committee member to serve on more than three public companies, reflecting the workload of the audit committee. If the board approves such service, its determination must be disclosed on the company's website or in its proxy statement or 10-K. While this requirement is unique to NYSE-listed companies, many companies include it in their audit committee charters or corporate governance guidelines.

Compensation committee

Per the Dodd–Frank Act, compensation committee members are subject to enhanced independence standards, although these standards are less stringent than those applicable to audit committee members. The standards for compensation committee members include consideration of (i) the sources of a member's compensation and (ii) any affiliations that would place the member under control of the company or its senior management, as well as (iii) whether any such compensation or affiliation would impair the member's ability to make independent judgments about the company's executive compensation.

Unlike the audit committee standards noted earlier, however, compensation committee members are not required to possess any particular knowledge of compensation matters.

Nominating/governance committee

Members of this committee do not have to meet any enhanced independence standards, nor are they required to possess any particular knowledge of governance matters.

Special committees

Given the factors necessitating the formation of special committees, it is not surprising that they have to be comprised of independent directors. In fact, the level of independence for these committees' members is often greater than for any other committee. Thus, the courts have sometimes rejected as committee members individuals who are otherwise qualified as independent for all other purposes due to their personal relationships with other directors, officers, or others. Among the most notable examples of a "super-independence" standard is a 2003 case in which the Delaware Chancery Court rejected the recommendations of a special committee because two of its members were affiliated with a university to which the company's CEO was considering making substantial donations.[9]

Committee member succession planning and refreshment

While director succession planning and refreshment have generated a great deal of attention and commentary,[10] succession planning and refreshment at the committee level do not seem to be addressed very much, if at all. This may be explained by the fact that, with the possible exception of the need to have an audit committee financial expert, committee qualifications may not be the driving force behind the selection of directors generally.

However, one related topic that occasionally generates discussion is the desirability of rotating committee members and/or chairs among members of the board. According to the Index, only eight of the S&P 500® companies have a formal chair rotation policy. It is not clear whether or to what extent companies have committee member rotation policies. However, there seems to be little incentive to change committee members, at least in cases where the committee is functioning properly.

Committee practices

With some exceptions, committees generally do not take action on their own. Rather, they recommend action to the board. The exceptions include grants of equity awards to certain executives, which must be made by an independent committee for purposes of certain US Securities and Exchange Commission (SEC) rules,[11] and the appointment of a company's independent auditor, which is within the sole authority of the audit committee.

Committees are generally required to report their activities to the board. These reports are made by committee chairs at regular board meetings and include the recommendations on which the board can take formal action. Historically, these reports were often made close to the end of the board meeting, which led to criticism that the reports in question tend to be perfunctory. As a result, some companies have revised their board meeting agendas to include committee reports at the beginning of the meeting rather than the end.[12]

Another practice that has evolved over the years relates to the distribution of committee materials to, and attendance at committee meetings by, directors who are not members of a committee.[13] In recent years, some companies have opted to send materials to all directors (which has been facilitated by the distribution of materials electronically) and to invite or even encourage directors not serving on a committee to attend its meetings. While these practices facilitate greater knowledge of committee activities, they pose some risks. Committee meetings can be difficult to manage when attended by all directors, particularly in cases where non-members actively participate in the meeting (versus simply observing it). In addition, it is unclear whether a non-member director who receives committee materials and/or attends a committee meeting can be held liable for failing to focus on potential problems discussed in the materials or raised during a meeting.

The evolving roles—and names—of committees

It is axiomatic that the responsibilities of boards and committees have grown significantly in recent years. Committees have taken on—perhaps not by choice—oversight responsibility for matters well outside their traditional purviews. For example, many audit committees now oversee cybersecurity in addition to their traditional roles around financial risk, financial reporting, internal controls, and enterprise risk. Compensation committees no longer focus solely on oversight of executive compensation; rather, they now routinely address matters well beyond the C-suite that impact the workforce in general, such as talent and development opportunities, job satisfaction, and oversight of employee compensation and benefits generally. And nominating/governance committees have taken on areas such as their companies' responses to climate change and their roles in the community and society at large.

These and other examples of expanding committee responsibilities have led to a focus on the names of committees. If a committee's remit now includes oversight of employee satisfaction generally, does it make sense to continue to call it the "compensation committee"? Does that risk alienating the members of the workforce who look to that committee for support and diminishing the role of the committee? Whether for these or other reasons, committees' names have been changing to reflect their evolving responsibilities.

During the period from 2012 to 2022, committees formerly known as compensation committees changed their names to include terms (sometimes in combination) such as human capital, human resources, talent, leadership, management development, executive development, people development, culture, personnel, and succession. Similarly, nominating/governance committee name changes included terms such as corporate responsibility, sustainability, environmental, social, and public policy.

Given the extent to which audit committee responsibilities have grown, it is perhaps ironic that naming variety is less pronounced with audit committees. Data shows that audit committees have changed their names, but in many cases the new names merely were "audit and finance" and "audit and risk" (or a similar variation, such as "audit and risk oversight").

Conclusion

Board committees play a pivotal role in corporate governance, handling critical responsibilities that ensure effective oversight and strategic alignment. As the business environment evolves, so do the roles and structures of these committees, adapting to new challenges and opportunities to maintain robust governance standards and shareholder confidence.

Chapter notes

1. Delaware General Corporation Law, Section 172.
2. https://nyseguide.srorules.com/listed-company-manual/09013e2c85c0074a.
3. https://nyseguide.srorules.com/listed-company-manual/09013e2c85c00749.
4. https://nyseguide.srorules.com/listed-company-manual/09013e2c85c00748.
5. The Dodd–Frank Wall Street Reform and Consumer Protection Act: Background and Summary | Congress.gov | Library of Congress.
6. The 2024 U.S. Spencer Stuart Board Index (the "Index") reports that 62% of S&P 500® financial companies maintain standing risk committees and that 12% of all S&P 500® companies maintain risk committees, unchanged since 2019.
7. SEC.gov | Standards Relating to Listed Company Audit Committees.
8. As defined in SEC rules, an audit committee financial expert is a person determined by the board to have several key attributes, including an understanding

of generally acceptable accounting principles and financial statements; the ability to assess such principles in connection with accounting for estimates, accruals, and reserves; and experience preparing, auditing, analyzing, or evaluating financial statements that present a breadth and level of complexity of accounting issues reasonably expected to be raised by the company's financial statements. See Item 407(d)(5) of SEC Regulation S-K.

9 See *In re Oracle Corp. Derivative Litigation*, 824 A.2d 917.

10 See Deloitte's *Board composition and effectiveness: A strategic approach* in this guide.

11 Rule 16b-3 under the Securities Exchange Act of 1934 exempts certain grants of equity awards, such as stock options, from the short-swing profit recapture provisions of Section 16(b) of the Act, but only if certain conditions are met. One such condition is that the grant must be made by an independent committee of the board.

12 According to Deloitte's and the Center for Audit Quality's *2025 Audit Committee Practices Report* (https://www2.deloitte.com/us/en/pages/center-for-board-effectiveness/articles/audit-committee-report.html), 48% of audit committees indicate that committee reports occur near the start of board meetings.

13 See Deloitte's and the Center for Audit Quality's *2025 Audit Committee Practices Report* (https://www2.deloitte.com/us/en/pages/center-for-board-effectiveness/articles/audit-committee-report.html), for related practices impacting audit committees.

9

Balancing workload and responsibilities of the board and its committees

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Introduction

It may be time for US public company boards to take a fresh, disciplined, and in-depth look at their committee structure. This would involve more than the standard annual review of committee charters in light of evolving regulatory requirements, investor expectations, and proxy advisory firm policies. Instead, it would be a thorough and company-specific evaluation of how committees can best support the board in fulfilling its *multiple* roles in guiding the corporation.

Since November 2004, the major US stock exchanges have required listed companies to have three standing committees composed exclusively of independent directors: audit, compensation, and nominating.[1] That requirement continues to have a profound impact on the committee structure at US public companies. Twenty years later, nearly 100% of S&P 500 companies have audit, compensation, and nominating committees.[2]

Yet, most major public companies are evidently finding these three committees alone inadequate for their needs. As of mid-2023, 74% of the S&P 500 had more than three board committees: 36% had four, 21% had five, and 13% had six.[3] Along with executive, finance, and risk committees (also required by regulation for certain large financial institutions),[4] boards have established committees focused on public policy, science and technology, and sustainability, among other areas.[5]

In addition to establishing new committees, boards are expanding the remit of the three core committees. For example, nearly half of S&P 500 companies have expanded the role of their compensation committees to cover topics relating to human capital management,[6] a comparable percentage has assigned general oversight of environmental, social, and governance (ESG)/sustainability to their nominating committee,[7] and companies have long been adding responsibility for areas such as cybersecurity to the laundry list of audit committee duties.

Something is going on here. It is, I would suggest, more than just boards' desire to respond to the governance topic *du jour*. Rather, it reflects a widening gap between today's imperative that the board and its committees serve as *strategic thought partners* with management in guiding the direction of the corporation, and the more limited role of the board and committees codified in the stock exchange listing standards adopted over 2 decades ago, which focused on the board's responsibility for *independent oversight of management*. If this hypothesis is correct, then boards should do more than make *ad hoc* adjustments to their committee structure and should instead undertake a more comprehensive review.

This article explores why it is worth revisiting the traditional committee structure and provides a roadmap for companies to conduct a thorough review of their committee structure, taking into account how board committees can add value in helping the board fulfill its potential.

Such company-specific board committee reviews may not—indeed, probably *will not*—result in a wholesale revision of a board's committee structure. After all, boards will still need to comply with laws, regulations, and listing standards that focus on three or four committees. And there are only so many committees a board can reasonably populate and a management team can responsibly support. But a comprehensive review *can* give boards a clearer understanding on how their committee and board structures can (and should) evolve in tandem over time to serve the corporation's best interest.

A (mis)match made in crisis

From the very outset, there has been a mismatch between many of the rules governing board and committees, on the one hand, and their actual roles and responsibilities, on the other.

Professors Jay Lorsch and Colin Carter neatly outlined the three core responsibilities of boards in the classic governance text from 2003, "*Back to the Drawing Board: Designing Corporate Boards for a Complex World*: Boards *decide*, *oversee, and advise*." Today, board members also frequently *engage* directly with investors and sometimes other stakeholders.[8]

Even as *Back to the Drawing Board* was hitting the shelves, the US stock exchanges, under the auspices of the Securities and Exchange Commission (SEC), were developing corporate governance listing standards, approved by the SEC in November 2004, that focused very heavily on just *one* of those areas of board responsibility: independent oversight of management. Even then, the listing standards did not focus on oversight in general, but rather on specific areas, particularly relating to financial reporting, disclosure, and risk management.[9]

The listing standards' limited focus is understandable

The standards were, of course, adopted in the wake of the collapse of Enron and WorldCom. As policymakers reviewed the boards' roles in those catastrophic corporate failures, they repeatedly focused on the board's lack of independent oversight of management in a few key areas. For example, the key Senate Subcommittee report on The Role of the Board of Directors in Enron's Collapse made recommendations that fell under just two headings: “strengthening oversight” and “strengthening independence.”[10]

And it was undoubtedly easier (and wiser) for policymakers to focus attention on a board’s oversight role in areas such as finance and risk, rather than on the board’s role in making decisions on the company’s business, which is inherently more dependent on a company’s individual circumstances. Indeed, while policymakers also cited Enron’s “asset light” *strategy* as contributing to its bankruptcy, they did not attempt to dictate what the board’s role should have been with respect to setting strategy.[11]

Yet, this emphasis on independent oversight in a few (albeit important) areas left some big gaps. For example, while the NYSE listing standards require companies to have corporate governance guidelines that address the full board, they do *not* require those guidelines to define the collective role or responsibilities of the board; rather, they focus on the qualifications, responsibilities, and access to information to enable *individual* directors to perform their role.[12] Nowhere do the listing standards address the board’s or committees’ roles—in either a decision-making *or* oversight role—in strategy, operating or capital plans, budget,[13] capital allocation, or in key areas such as the company’s technology, workforce, facilities, public policy, and so on.

Over time, some companies have tacked these missing areas onto existing committees—even when they may not particularly fit or when it may result in overburdening the committee. For example, many boards have given responsibility for substantively overseeing the company’s sustainability (ESG) efforts to the nominating committee, even when those committees may not have the background to oversee the development and integration of environmental and social responsibility in the company’s business.[14] And audit committees have been described as becoming the “kitchen sink” of the board, where areas that do not squarely fit within the scope of the audit committee, but which have some link to financials, risk, and disclosure (does not everything?) find their home.[15]

Even with this accretion, gaps remain

And these gaps can have serious negative consequences. A series of Delaware court decisions have faulted boards for failing to have committees responsible for overseeing “mission critical” areas of the company’s business, whether aircraft safety at Boeing[16] or food safety at Blue Bell Creameries.

Beyond the harms that can come with a committee structure that does not align with the company’s business needs, there can also be lost opportunities. What acquisitions may not have been pursued, products not developed, efficiencies achieved, talent developed, or public policy goals advanced because of a lack of committee engagement? One might argue that the decision-making responsibility for most if not all of these business areas falls more properly under management rather than the board or a board committee. Fair enough. But as former Harvard Law School Dean Robert Clark observed 2 decades ago, boards and committees nonetheless play an invaluable if subtle role:

The mere fact that the top executives know they have to make formal presentations about key issues on a regular basis to an audience that may probe and criticize, and that has formal power to remove them, elicits a great deal of valuable behavior.

Facts are gathered more carefully and completely, ideas and judgments are made more explicit, competing considerations are anticipated and dealt with, and modes of articulation that can withstand scrutiny outside the inner circle are found. The consequence of all these efforts to better "explain and sell" the executive viewpoint may well be to clarify strategic thinking and improve decision making.[17]

So, for all these reasons—the fundamental mismatch between the roles of the board and the required committee structure, the resulting gaps that can cause losses (and lost opportunities), and the sub-optimal attempts to fill those gaps—it is at least arguably worth boards taking a fresh and comprehensive look at their committee structures.

The real-world benefits and costs of board committees

The following is a suggested five-step process that companies can undertake to conduct a thorough review of the board's committee structure.

As a threshold matter, the process is probably best led by the corporate secretary or general counsel, enlisting the input from other key executives, including the chief executive officer (CEO) and others with responsibility for areas that are reported to (or should be reported to) the board and its committees. The project should be conducted under the auspices, and with the active engagement, of the nominating committee. While a lot of the groundwork in assessing committee structure can be done by management, there should be no doubt that the nominating committee is in charge of this project, answerable only to the board. As a legal matter, it is up to the board to decide its committee structure. And as a practical matter, management alone may be hesitant to recommend additional responsibilities for board committees (or even the creation of new committees) that could mean more scrutiny and work for management. Having the nominating committee, especially its chair, play an active role in this process can help to ensure that management thinks more broadly about how committees can provide incremental value.

Step one: conduct an inventory of existing board and committee responsibilities

The first step is to develop an inventory of the current responsibilities of the board *and* its committees, whether those are formally reflected in the by-laws, governance policy, and committee charters, or are simply a matter of practice. While the focus is on *committee* responsibilities, it is important not to look at them in isolation, but instead understand how committee responsibilities lead up to the full board and, conversely, how the full board's responsibilities are informed by the committees.

As you create the inventory, it can be helpful to note what type of role the board and committees are playing (decision-making, oversight, advisory); whether the role is clearly defined (for example, the term "review" can be an ambiguous and suggest either approval *or* oversight); and whether the item reflects a regulatory requirement.

Step two: consider how board and its committees add value

Now, set aside the wonderful inventory you have created and take a moment to think bigger. Consider how the board and committees can add value in light of your company's particular circumstances.

To frame this discussion, it may be helpful to being by thinking about the company's strategy. After all, strategy is where boards want to, and often can, add the most value. Consider how the company's business strategy is carried out in three broad arenas: (i) the marketplace (i.e. the products and services the firm sells, and those it buys); (ii) the workspace (i.e. its operations and workforce); and (iii) the public space (e.g. its disclosures and other communications, governmental affairs, corporate social responsibility).

Then consider how board and its *committees* could contribute in those three strategic arenas. In concept, there are at least four ways committees can deliver value:

- **Pre-board review:** first, committees can improve the effectiveness and efficiency of the full board by providing an opportunity for a subset of directors to delve more deeply into a topic before it is presented to the full board for consideration. This is a function served today by audit committees, which review financial statements before they are presented to the full board, as well as by nominating committees that typically review governance documents before board approval. But there are other areas where boards are finding it helpful to have a committee—either on a permanent or temporary basis—review matters first, such as in the areas of strategy, finance, sustainability, and technology. By contrast, an executive committee that simply serves as dress rehearsals for board meetings may not add that much value.
- **Heightened oversight:** a second and related way committees can add value is by providing a heightened degree of oversight of management in certain areas. This is a common function of audit and risk committees. However, it may also be appropriate in other areas where the company's management is facing particular challenges (e.g. product or employee safety) or future opportunities (e.g. post-merger integration), and where a greater degree of board-level attention can be beneficial.
- **Independent decision-making**: a third useful function of committees is to provide a forum for making decisions that are not only independent of management, *but also (at least to some extent) from the full board*. For example, this is a common function of compensation committees, which (rather than the full board) approve executive compensation. And, of course, it is true of special litigation committees and similar committees that are established to review legal claims implicating fellow board members.
- **Forging a consensus:** there are also situations where committees do more than just provide a conventional pre-review of items that go to the board. Here, the role of committees is even more meaningful than improving the efficiency of board meetings; it is to drive consensus. This can occur when there is disagreement on the board, the need to handle a particularly sensitive topic, or a desire for greater coordination among board committees. These functions can be served by an executive committee that brings together committee chairs and other board leaders. Or they can be served often by temporary committees, for example, to build consensus on company strategy, to oversee CEO succession, or to determine how to allocate responsibility that may fall under multiple committees.

To visualize this analysis, you can think of filling in the following chart:

Area of business activity/role of committee	Marketplace	Workplace	Public space
Pre-board review			
Heightened oversight			
Independent decision-making			
Forging consensus			

So, under the heading of the company's marketplace activities, would it help to have a committee review the company's product strategy before it goes to the board? Could a committee usefully provide heightened oversight over product innovation or the supply chain resilience?

Under the heading of the workplace, would it make sense to have a committee to provide heightened oversight of operations in general, or some subset such as technology?

When it comes to the company's activities in the public space, would it be helpful to have a board committee take play an independent decision-making role in deciding whether to weigh in on social issues (thereby helping to protect management from constant pressure)?

Or, looking a look at a topic that cuts across a company's activities in the marketplace, workplace, and public space, would it help to have a committee forge a consensus, provide heightened oversight, and offer pre-board review of the company's sustainability strategy?

This process should result in a list of strategically important responsibilities that could be assigned to committees. This exercise can also be extended beyond core business strategy to other support areas such as finance, technology, and human capital.

Step three: conduct a gap analysis

The next step is to conduct a "gap analysis" comparing the current responsibilities (step one) with the list of potential committee responsibilities (step two).

As a result of this review, you might conclude that there are some new responsibilities that could be assigned to committees, or existing committee responsibilities that can be removed. Perhaps most importantly, however, you may identify additional ways in which the *full board*, and not just committees, can add value.

This process should result in a comprehensive list of desired committee responsibilities.

Step four: defining a desired committee structure

The next step is to figure out how to allocate current and new responsibilities among committees.

Clarity: as a threshold matter, it will be important to be very clear about the responsibilities themselves. Is it the committee's role to decide, review, oversee, or advise with respect to each responsibility?

Cohesion: next, ensure that each committee has a cohesive set of responsibilities, which is usually based on subject matter, but also could consider the stakeholders they focus on (e.g. employees, investors, regulators).

Number: consider how many committees you can responsibly populate. This will depend on the size of the board (including the number of eligible directors) and the size of committees. For example, a 10-member board could theoretically populate four committees with five people each, if each person served on two committees.

Timeframe: consider whether you need to have a standing committee, or if this should be a temporary committee that has a defined goal, or if it is something in between. There is no shame (or harm) in having a dynamic set of committees that evolve in response to a board's changing circumstances.

Composition: evaluate whether you have the right set of directors to populate committees. There may be no need to seek "expertise" on most committees, other than on the audit committee; fluency and the willingness to learn may be enough, as long as the committee can draw on expertise from inside and outside sources. Similarly, unless required by regulation, you may also want to consider whether you want only independent directors on a particular committee.

Workload: assess whether the workloads are appropriately balanced among the committees and among individual directors. While it is important to consider workload, it should probably take a backseat to cohesion and capabilities. For example, nominating committees have often given responsibility for ESG, in part because they already have responsibility for "G" in their remit and because they may be perceived as having more time than the compensation or audit committees. But does the nominating committee actually have the composition to add value in overseeing the company's environmental strategy as carried out in the marketplace, workplace, and public space?

Resources: do you have the sufficient internal and external resources to support the committees?

Stakeholder perspectives: finally, it can be helpful to consider how your new committee structure would not only satisfy any regulatory requirements, but also be viewed by your major institutional investors, proxy advisor firms, and other influential stakeholders.

Step five: defining and implementing plan to get there

The foregoing analysis should give you a schematic with the number, name, responsibilities, and desired composition for each committee.

It may not be possible to get to a desired committee structure off the bat. You may need more directors—or different directors—which may require time as vacancies occur on your board and committees. You may need additional internal or external resources to support the new committee structure. And the board may have an appetite only for incremental change.

But once the board endorses an approach, management should develop a plan to achieve it and to track progress over time. It also can be helpful to communicate your plan within the management team (even beyond the executives involved in the project) and, at the appropriate time, with your investors, who may be keenly interested in (and delighted by) your careful analysis of how your committees can best add value in advancing the company's strategy.

Conclusion

Taking a fresh and rigorous look at a company's committee structure can do much more than simply result in the renaming of committees or reorganizing responsibilities. It can lead to a deeper understanding and consensus regarding the roles of the board, committees, and management—and the relationship among the three. It can help to identify gaps in board and committee oversight; in board, committee, and management capabilities; and even in the company's underlying strategy. So even if the exercise results in few, if any, changes in the committee roster or committee charters, it can have significant salutary benefits.

Chapter notes

1 Securities and Exchange Commission, NASD and NYSE Rulemaking: Relating to Governance, Release 34-48745 (November 4, 2003) https://www.sec.gov/files/rules/sro/34-48745.htm. While regulations and listing standards refer to nominating/ corporate governance committees, this article refers to them by shorthand as "nominating" committees. Boards may allocate the responsibilities of the nominating and compensation committees to other committees, as long as those committees are composed exclusively of independent directors; they may not do so with audit committees. Compare, for example, commentary to NYSE Listing Standard 303A.04–05 ((nominating and compensation committees) with 303A.07 (audit committees).

2 Board Practices and Composition 2024 Edition, A. Jones, M. Spierings, and P. Hodgson, The Conference Board (2024).

3 Board Leadership and Structure: Spotlight on Flexibility and Transparency, M. Spierings, The Conference Board (2023).

4 12 USC Section 5365 (2023); 12 CFR Section 252.22. (2019).

5 Id.

6 The Compensation Committee's Evolving Role in Human Capital Management, B. Jones, J. Teefey, Rachel Kai, Harvard Law School Forum on Corporate Governance (2023) (Link: https://corpgov.law.harvard.edu/2023/10/31/the-compensation-committees-evolving-role-in-human-capital-management/).

7 Board Leadership and Structure: Spotlight on Flexibility and Transparency, The Conference Board M. Spierings, (2023).

8 ESG Is Changing Boards. Investors Should Look Closely, P. Washington, Barron's (2023) (noting over half of S&P firms report that their board members directly engage with shareholders).

9 See, generally, NYSE, Section 303A.07 (2013) (describing the role of the audit committee). (Link: https://nyseguide.srorules.com/listed-company-manual/09013e2c85c0074b).

10 The Role of the Board of Directors in Enron's Collapse, Committee on Governmental Affairs Permanent Subcommittee on Investigations (2002) (Link: https://www.hsgac.senate.gov/wp-content/uploads/imo/media/doc/REPORT%20-%20Role%20of%20Board%20of%20Directors%20In%20Enron's%20Collapse%20(July%202002).pdf.

11 Id.

12 NYSE, 303A.09.

13 Other than the internal audit function budget under NYSE Section 303A.07 (2013).

14 Board Leadership and Structure: Spotlight on Flexibility and Transparency, M. Spierings, The Conference Board (2023).

15 The Audit Committee: The Kitchen Sink of the Board, L. Cunningham et al., Center for Audit Quality (2022) (Link: https://thecaqprod.wpengine.com/

wp-content/uploads/2022/11/caq_ac-kitchen-sink-of-the-board_2022-11.pdf).

16 In Re The Boeing Company Derivative Litigation, Del. Ch. (2021) (Link: https://courts.delaware.gov/Opinions/Download.aspx?id=324120).

17 Corporate Governance Changes in the Wak of the Sarbanes-Oxley Act: A Morality Tale for Policymakers Too, R. Clark (2005) (Link: http://www.law.harvard.edu/programs/olin_center/papers/pdf/Clark_525.pdf).

Subsection: Audit and financial oversight

10

Audit committee fundamentals

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Audit committees play a vital role in maintaining the integrity of a company's financial reporting and ensuring compliance with regulatory standards. To help in achieving effective governance, it is important to understand and adhere to the various requirements and listing standards related to audit committees. These requirements form the foundation for the committee's operations and oversight responsibilities. This article highlights several key categories fundamental to audit committee governance, including requirements and considerations related to committee composition and the development and maintenance of a comprehensive charter. Additionally, it explores the significance of ongoing education and periodic reviews to confirm that committee members possess the requisite expertise and remain compliant with evolving standards. Through outlining both requirements and common practices, this discussion aims to equip companies with the knowledge needed to help build and potentially sustain an effective audit committee, which can ultimately enhance their governance practices and financial oversight.

Composition

To effectively meet the company's evolving demands and fulfill their responsibilities, audit committees should regularly evaluate their composition to ensure the necessary skills and experience are present.

Under New York Stock Exchange (NYSE) requirements, the audit committee should consist of three or more independent directors as determined by the board. All members must comply with the independence and financial literacy requirements of the Securities and Exchange Commission (SEC) and NYSE. Audit committees are not required to include an audit committee financial expert as defined by the SEC, but if they do not, they must disclose why, which encourages the inclusion of at least one financial expert. Audit committees should periodically review their composition to ensure members have the necessary knowledge and experience.

Under NYSE standards, if an audit committee member serves on more than three public company audit committees, the board must determine that such simultaneous service would not impair the member's ability to effectively serve and disclose this in the proxy statement.

Independence and qualifications

Audit committee members must be independent directors and meet stricter independence standards than those required for other board members. Therefore, the independence of audit committee members should be consistently maintained, monitored, and reviewed at least annually. Listed companies should implement policies to promptly identify any changes in relationships or circumstances that could affect the independence of audit committee members.

Generally, companies require directors to complete independence questionnaires upon joining the board and annually thereafter, as well as to report any changes that might affect their independence. For audit committee members, these questionnaires should be customized to address the additional independence criteria specific to them. The board should examine any relationships or circumstances disclosed in audit committee members' responses to these questionnaires to determine if they compromise or could be perceived as compromising their independence. Companies may consider involving legal counsel in evaluating the independence of audit committee members and other directors.

SEC requirements

Section 10A of the Securities Exchange Act of 1934 outlines general criteria for audit committee independence. According to these criteria, an audit committee member is allowed to receive compensation such as director fees, retainers, and meeting fees for serving on the board, the audit committee, or another committee. However, they may not accept any other consulting, advisory, or compensatory fees from the company or any subsidiary, nor be affiliated with the company or any subsidiary. Prohibited compensation includes fees for services rendered by a law firm, accounting firm, consulting firm, investment bank, or similar entity where the audit committee member is a partner, executive officer, or holds similar positions. This also extends to payments to spouses, minor children or stepchildren, and adult children or stepchildren who share a home with the audit committee member.

Section 10A also bars individuals affiliated with the company or a subsidiary from serving on its audit committee. Under SEC rules, a person is affiliated if they are an executive officer, a director and employee, a general partner, or a managing member of another entity that controls, is controlled by, or is under common control with the company. Control is defined as "the power to direct or cause the direction of management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." According to SEC rules, a director is considered independent to serve on an audit committee if they are neither an executive officer nor a holder of 10% or more of the entity's shares. The rule provides limited exceptions.

NYSE requirements

The NYSE listing standards incorporate the SEC's independence requirements but add further criteria. An audit committee member is not independent if:

- The member is an employee, or an immediate family member is or was an executive officer of the company in the past 3 years. Immediate family members include a spouse, parents, children, siblings, in-laws, and anyone (other than domestic employees) sharing the person's home.

- The member or an immediate family member received over $120,000 in direct compensation from the company in any 12-month period during the past 3 years, except for director fees, committee fees, pension, deferred compensation for prior service where such compensation is not contingent on continued service, and other permitted payments.
- The member or an immediate family member is a current partner of the company's internal or independent auditor; the member is a current employee of such a firm; the member has an immediate family member who is a current employee of such a firm and works on the company's audit; or the member or an immediate family member was a partner or employee of such a firm and worked on the company's audit in the past 3 years.
- The member is an employee, or an immediate family member is an executive officer, of another company that made or received payments from the listed company for property or services exceeding the greater of $1 million or 2% of the other company's consolidated gross revenues in any of the past 3 fiscal years.

Financial literacy

Audit committee members must possess financial literacy to fulfill their oversight responsibilities effectively. SEC rules and exchange listing requirements define these criteria differently.

SEC requirements

The SEC mandates that issuers disclose whether at least one "audit committee financial expert" is on the audit committee, including the expert's name and independence status. The SEC defines an audit committee financial expert as someone with:

- an understanding of financial statements and generally accepted accounting principles (GAAP);
- the ability to assess the application of GAAP for estimates, accruals, and reserves;
- experience in preparing, auditing, analyzing, or evaluating financial statements of generally comparable complexity to the company's financial statements, or supervising those who do;
- an understanding of internal control over financial reporting; and
- an understanding of the audit committee's functions.

The rule states that the attributes can be acquired through:

- education and experience as a principal financial officer, principal accounting officer, controller, public accountant, auditor, or similar roles;
- experience supervising a principal financial officer, principal accounting officer, controller, public accountant, auditor, or similar roles;
- experience overseeing or evaluating the performance of companies or public accountants in preparing, auditing, or evaluating financial statements; or
- other relevant experience.

Companies must disclose in their annual report or proxy statement if at least one audit committee member is an audit committee financial expert. If the company does not have at least one audit committee financial expert, the company must explain why it does not. The disclosure must include at least the financial expert's name and independence status. The company may choose to disclose whether more than one audit committee member is an audit committee financial expert, but the names of any experts need not be disclosed.

NYSE requirements

The NYSE requires all audit committee members to be "financially literate", as determined by the company's board, or to become financially literate within a reasonable period after their appointment. At least one member must have "accounting or related financial management expertise" as interpreted by the board. While NYSE listing standards do not mandate that the audit committee include a person who meets the SEC's definition of a financial expert, someone who meets the SEC's definition will also fulfill the NYSE requirements.

Common practices and considerations related to committee composition

In designating an audit committee financial expert, the board should consider consulting legal counsel due to the complexity involved in complying with SEC rules and listing requirements. Often, audit committees designate more than one financial expert, given the breadth of issues addressed, such as risk, cyber, and sustainability matters. They can utilize a skills matrix to outline necessary skills and experiences and use questionnaires to assess whether individuals meet these criteria.

Committee members should stay updated on financial reporting and auditing standards, as well as company-specific issues, to determine if the committee's composition needs updates. When skill gaps are identified, the audit committee chair should engage with the governance committee involved in board succession planning. Boards sometimes reaffirm the financial literacy of committee members and periodically revisit the expert designation. The SEC requires proxy disclosures about directors' qualifications and the nomination process, detailing the experience, qualifications, and attributes considered. While individual committee qualifications disclosures are not mandatory, companies may include them in overall board qualifications disclosures to enhance transparency and provide a comprehensive view of the board's expertise. This practice can help stakeholders better understand the board's composition and its alignment with the company's strategic needs.

Charter

The audit committee charter delineates the purpose, authority, and responsibilities of the audit committee within an organization. It serves as a foundational guide, ensuring that the committee operates effectively and independently in overseeing the company's financial reporting processes, internal controls, and compliance with legal and regulatory requirements. The charter typically includes the committee's mission, scope of work, access to necessary resources, and reporting lines. Its value lies in providing clarity and structure, fostering accountability, and promoting transparency in the committee's activities. By defining the committee's role in risk management and compliance, the charter can enhance the organization's ability to identify and mitigate risks. Additionally, it can ensure adherence to regulatory standards set by bodies such as the SEC and NYSE. A well-defined audit committee charter strengthens governance practices, improves oversight, and builds stakeholder confidence in the organization's integrity and performance.

The SEC and NYSE set minimum requirements for the content of the audit committee charter.

SEC requirements

Companies must disclose in proxy statements if the board has an audit committee charter and if it is available on the company's website, and if so, the website address should be provided.

NYSE requirements

The NYSE requires the audit committee charter to highlight the oversight of several key areas, including:

- the integrity of the company's financial statements;
- the company's compliance with legal and regulatory requirements;
- the independent auditor's qualifications and independence; and
- the performance of the company's independent auditor and internal audit functions.

Charters of NYSE-listed companies must also set forth the audit committee's responsibility to: discuss policies with respect to risk assessment and management; discuss the company's earnings releases and information provided to analysts and ratings agencies; meet in executive sessions with management, internal audit, and the independent auditor; assess the audit committee's performance annually; prepare the audit committee report required by the SEC; comply with Section 10A of the Securities Exchange Act of 1934; and perform various other responsibilities specified by NYSE standards.

Right to engage independent counsel

The SEC and NYSE authorize the audit committee to hire and compensate independent counsel and advisers under the Sarbanes–Oxley Act. Separate counsel may be needed for legal proceedings, governance issues, whistleblower inquiries, fraud, SEC matters, and process improvements.

Common practices and considerations for the charter

An annual review of the charter is recommended for all audit committees. Factors that may call for updates include:

- changes in regulatory or legal requirements, including new disclosure requirements;
- the board's delegation of new or reassigned responsibilities;
- changes in the company's bylaws affecting committee composition or member appointments; or
- formalizing practices the audit committee wants to include among its responsibilities.

The charter should outline the audit committee's recurring responsibilities and its oversight of areas beyond those required by the SEC and listing standards. It should also allow for the committee to meet outside the official calendar when necessary. During the charter review, the committee should examine its meeting schedule to make sure it has sufficient time to fulfill its responsibilities.

To aid in planning, audit committees can use their charter to create a calendar outlining topics for each meeting throughout the year, though charters and calendars may not align precisely. Consulting with legal counsel, management, internal auditors, and the independent auditor can be helpful when updating the charter and calendar. Any recommended changes to the audit committee charter should be presented to the board for approval.

Evaluation and self-assessment

The NYSE listing standards require audit committees to conduct an annual performance evaluation, which must be included in the committee's charter. While SEC standards do not mandate performance assessments, all audit committees should consider how such evaluations could improve their performance and processes.

Building a framework for evaluating the audit committee's performance can involve collaboration among directors, legal counsel, independent auditors, and third-party facilitators. Key factors include the committee's composition and members' independence, qualifications, knowledge, skills, experience, and understanding of business risks. Assessing the committee's adherence to its charter and oversight of financial reporting, internal controls, audit functions, ethics, and compliance is also crucial.

Conducting the assessment

Conducting the assessment involves selecting a coordinator and establishing a timeline. The process can be led by internal leaders or an objective third party, using evaluation forms, interviews, and both qualitative and quantitative feedback. The assessment can be led by various parties, including the committee chair, the board chair, the nominating/governance committee chair, or the general counsel. Some audit committees find it useful to engage an objective third party periodically.

The format may consist of evaluation forms, interviews, or a combination. The party leading the evaluation may solicit information from individuals who interact significantly with the audit committee, including management. Regardless of who leads the evaluation, committees should seek qualitative feedback in addition to quantitative ratings. Committees should consult with counsel about the level of documentation to be provided and retained. Audit committees can also consider extending the process to enable committee members to evaluate each other's performance. Using a questionnaire that benchmarks against leading practices can assist in self-assessment.

Addressing the results

The results of the assessment should be discussed privately among committee members to develop an improvement plan. Qualitative comments often provide better insights than numerical scores. The assessment may highlight issues such as committee composition, qualifications, understanding of accounting issues, and meeting agendas. Results can also support the committee's oversight of financial reporting. If the self-assessment included an assessment of individual directors, the party leading it should consider how best to share individual director feedback.

A well-crafted assessment helps prioritize agendas, focus on critical issues, and identify future topics and education sessions, and may improve the quality of materials from management. It also addresses the committee's composition relative to current and future needs, potentially prompting committee refreshment if necessary.

Conclusion

The preceding overview of requirements for audit committee governance across areas such as composition, independence, qualifications, and the committee's charter is not comprehensive, but rather a starting point for understanding the essentials of effective governance. The ongoing education and periodic reviews highlighted in the article may be vital for sustaining effective audit committees and maintaining compliance with requirements. By focusing on foundational elements, companies can build and potentially sustain effective audit committees, thereby providing for robust governance practices and financial oversight.

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Overview of the audit committee's responsibilities

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Audit committee members play an essential role in overseeing a company's activities and performance, particularly in financial reporting, internal controls, risk management, the work of independent and internal auditors, and ethics and compliance. Their responsibilities are primarily defined by rules from the US Securities and Exchange Commission (SEC) and the exchange on which the company's shares are listed (e.g. New York Stock Exchange (NYSE)). Additionally, certain responsibilities may fall to the audit committee resulting from requirements for independent auditors imposed by the Public Company Accounting Oversight Board (PCAOB).

In addition to these core responsibilities, audit committees are increasingly being tasked with overseeing areas such as cyber risk and sustainability reporting. The following offers an overview of the most prominent areas of audit committee oversight responsibility.

Financial reporting

The audit committee, management, and the independent auditor play distinct roles in financial reporting. Management is tasked with preparing the financial statements, establishing and maintaining internal control over financial reporting (ICFR) and disclosure controls and procedures, and evaluating the effectiveness of ICFR. The independent auditor expresses an opinion on whether the financial statements fairly present, in all material respects, the financial position, results of operations, and cash flows in conformity with generally accepted accounting principles (GAAP) and, when applicable, evaluates the effectiveness of ICFR. Internal auditors, where present, provide objective assurance and act as advisers to management.

The audit committee oversees the financial reporting process, confirming that management's processes and controls are effectively designed and operating. To provide appropriate oversight, the committee relies on management, the independent auditor, internal audit, and any advisers it engages. Important areas for the committee to focus on include complex accounting areas; significant accounting policies, judgments, and estimates; prior internal control issues; antifraud and anticorruption compliance programs; tax strategy and risk management; uncertain tax positions; and pending financial reporting and regulatory standards and developments.

NYSE requirements

The NYSE listing standards require the audit committee to review major issues related to accounting principles and financial statement presentation, including changes in the selection or application of accounting principles, adequacy of internal controls, and special audit steps for addressing material control deficiencies. These discussions often occur during quarterly review meetings with management. The committee must also assess management's analyses of significant financial reporting issues and judgments, including effects of alternative GAAP methods. Additionally, the audit committee should evaluate the impact of regulatory and accounting initiatives and off-balance-sheet transactions on financial statements, discussing pending technical and regulatory matters and management's plans for implementing new guidelines.

Review of filings and earnings releases

The audit committee generally reviews earnings releases, SEC filings containing financial information, and other financial information provided to analysts and rating agencies. NYSE listing standards require the committee to discuss the company's annual audited financial statements and quarterly financial statements with management and the independent auditor. The committee should also address its responsibility to discuss earnings press releases and financial guidance, focusing on the types of information disclosed, especially pro forma or adjusted non-GAAP financial information.

SEC rules require that any non-GAAP financial measures disclosed must include the most directly comparable GAAP financial measures, with GAAP measures given equal or greater prominence, and that GAAP and non-GAAP measures must be reconciled. The SEC scrutinizes non-GAAP measures, so companies and audit committees should ensure their appropriate use and control. See Deloitte's publication, "*Non-GAAP financial measures and metrics*,"[1] for additional information.

The audit committee should also confirm a legal review of disclosures was performed for reasonableness and to ensure compliance with policies on forward-looking statements. Finally, the committee should understand SEC comment letters received and management's responses, as well as comment letters received by others in the industry.

ICFR

ICFR is intended to provide reasonable assurance that policies, processes, and procedures governing financial reporting produce effective reporting and promote compliance with relevant reporting obligations. Management is responsible for designing, implementing, operating, and maintaining ICFR, while the audit committee oversees the system of internal controls, confirming it is adequate and well-functioning. The audit committee also should promote a culture that supports reliable and timely reporting. The committee should regularly interact with management, the internal auditor, and the independent auditor to receive timely information regarding the functioning of internal controls. These reports should address the design and operating effectiveness of controls; ongoing monitoring activities; and failures or weaknesses in controls, including root causes and actions to remedy them. Additionally, the committee should understand the role of outside service providers in the company's ICFR.

The Committee of Sponsoring Organizations' (COSO) "*2013 Internal Control—Integrated Framework*"[2] provides a structure for designing and evaluating internal controls, which the SEC recognizes as a suitable framework for management reporting on ICFR. The framework emphasizes the board's—and by extension, the audit committee's—role in overseeing internal control as a key aspect of governance. It highlights the board's responsibilities in setting expectations for integrity and ethics, assessing risks of management overriding controls, and maintaining open communication lines, including whistleblower hotlines.

Related-party transactions

NYSE listing standards mandate that an independent body of the board review and oversee related-party transactions, and this task is sometimes assigned to the audit committee. These transactions can include dealings between the company and businesses affiliated with directors or their immediate families, as well as trusts for employees managed by the entity's management. While these transactions often occur in the normal course of business, they may carry risks of financial misstatement or fraud, necessitating close scrutiny by auditors and the audit committee.

Proxy disclosures

SEC rules and exchange listing requirements mandate the disclosure of certain audit- and audit committee-related information in proxy statements, and, on company websites, SEC rules require the names of audit committee members and an audit committee report to be included in the proxy. This report must state whether the audit committee has reviewed the audited financial statements with management, discussed required matters with the independent auditor, received required independence disclosures from the independent auditor, and recommended to the board the inclusion of the audited financial statements in the annual report.

Issuers must also disclose whether they have a standing audit committee, the number of meetings held, the functions performed, and whether the board has adopted a written charter for the audit committee, among other requirements. In recent years, investors and regulators have shown interest in getting more detailed disclosures about audit committee activities, prompting committees to consider enhancing their proxy statement disclosures.

Fee disclosures

SEC rules require companies to disclose fees paid to the independent auditor for the current and prior years, including descriptions of services in all categories except audit fees. The audit committee's preapproval policies and procedures must also be described. These disclosures are required in the issuer's Form 10-K and proxy statement, with companies allowed to incorporate the information from the proxy statement into the Form 10-K.

Institutional investors and proxy advisers have guidelines for proxy vote recommendations related to audit fees, prompting many companies to disclose the nature and amounts of specific services within each fee category. Issuers should consult legal counsel to determine the content of fee disclosures. The SEC's four fee categories and select services are:

Audit fees: fees for services related to statutory and regulatory filings, including the audit of ICFR, comfort letters, statutory audits, attest services, and consents. Also included are services from specialists who assist in the audit, such as tax and valuation specialists, and other services that only the independent auditor can reasonably provide.

Audit-related fees: fees for assurance and related services performed by the independent auditor, such as employee benefit plan audits, merger and acquisition due diligence, and financial accounting consultations.

Tax fees: fees for tax services in areas such as tax compliance, planning, and advice, excluding audit-related services.

All other fees: fees for services other than audit, audit-related, or tax services.

Risk

The SEC considers risk oversight a major board responsibility and requires disclosure of the board's role, including whether the entire board or individual committees oversee risk and if risk management employees report directly to the board. The board should clearly define how risk is governed by the board and its committee and ensure all key risks are appropriately covered.

NYSE listing standards indicate the audit committee must discuss guidelines and policies to govern the process by which management assesses and manages the company's risk exposure, including discussion of major financial exposures and how management is monitoring and controlling such exposures. Many companies use COSO's enterprise risk management (ERM) framework, which promotes a principles-based approach to ERM using a common language.

The audit committee's primary risk oversight responsibilities are focused on financial risks, ERM, and ethics and compliance risks. In companies with risk committees, the audit committee's risk oversight responsibilities may vary.

The full board typically oversees strategic risks that could significantly affect the company's strategy, while the audit committee reviews the guidelines, processes, and policies management has in place to assess and manage risk as a whole. For any specific risks overseen by the audit committee, business leaders and other relevant parties should periodically provide updates to help the audit committee effectively carry out its oversight role.

Additional risks the audit committee often oversees are discussed in the following sections.

Fraud risk

The audit committee should ensure the company has programs and policies to deter and detect fraud, working with management to establish antifraud controls and take action when fraud is detected.

The audit committee can help oversee the prevention and detection of financial statement fraud by monitoring management's assessment of ICFR. The committee should:

- be aware of the main areas of fraud risk;
- understand the company's obligations under anticorruption laws;
- ensure appropriate oversight and resources for the anticorruption compliance program;

- understand policies and procedures in place to identify and mitigate corruption-related risks;
- discuss identified corruption-related risks and management's response; and
- monitor any violations and management's response.

Cyber risk

Rapid advancements in digital technology have escalated cyber risk, making it a high priority for management and boards. The pervasiveness of cyber risk significantly increases concerns about financial information, internal controls, and reputational risks.

According to Deloitte's "*2025 Audit Committee Practices Report*,"[3] oversight of cyber risk most often falls to the audit committee, though it may rest with the full board or risk committee. Regular dialogue with information technology and cyber leaders is crucial, with most audit committees discussing cyber risk quarterly. While primary oversight may be delegated, the full board should also discuss the threat landscape and evaluate the cyber program's performance at least annually.

Audit committees should understand their specific oversight areas, which may include monitoring management's cyber threat responses, regulatory developments, and threats to the company. Additionally the committee should understand enhanced disclosure requirements[4] regarding cyber risk management, strategy, governance, and incident reporting issued by the SEC in July 2023.

Artificial intelligence

Artificial intelligence (AI), including generative AI, is advancing rapidly, and governance processes are evolving as discussed in Deloitte's "*Strategic governance of AI: A roadmap for the future*."[5] Companies are increasingly investing in AI initiatives and scaling AI use cases. Effective oversight is important to potentially realize value, drive outcomes, and address business risks and ethical concerns like bias and transparency.

According to Deloitte's "*2025 Audit Committee Practices Report*,"[3] primary oversight of AI typically does not fall to the audit committee. However, the audit committee should understand AI's use within the company, especially in finance and internal audit. AI applications range from automating tasks to using predictive analytics for decision-making and creating new content. The audit committee should also understand how AI-related risks are identified and addressed and who oversees these risks. Additionally, the audit committee should be aware of AI disclosures in financial statements.

Governments and regulators are considering various AI regulations and policies. Staying informed about this evolving environment is important for companies and audit committees. The various facets of AI will likely involve the full board and other committees.

Mergers and acquisitions

While due diligence is primarily management's responsibility, the audit committee oversees risk analysis, internal controls, and financial information on which the terms are based. The audit committee should satisfy itself that the due diligence process is thorough and that the board is fully informed of risks before the transaction is approved. The committee should also review SEC reporting and the accounting for acquisitions in financial statements.

Post-merger, SEC rules require integrating disclosure controls and controls over financial reporting, which audit committees should oversee. They can play a critical role ensuring internal control systems and processes are stable upon integration or soon after. They oversee talent integration in financial areas and monitor technology platforms for compatibility. Additionally, they can perform post-acquisition reviews to evaluate initial assumptions and adjust future acquisitions if necessary.

Sustainability

The focus on climate change and shareholder activism has increased attention on sustainability issues in some corporate boardrooms. Regulations on climate-related disclosures and corporate sustainability reporting are continually evolving across jurisdictions. Audit committees are increasingly involved in the sustainability agenda due to investor's likely reliance on sustainability disclosures. When applicable, they should ensure appropriate internal controls and disclosure procedures for sustainability information, review disclosures, consider sustainability strategies' financial impact, and seek assurance on reporting, as applicable. Audit committees may also oversee sustainability-related activities and metrics, helping to ensure that the company's sustainability disclosures are accurate and reliable. Additionally, staying apprised of how the regulatory agenda changes in this area will be important for audit committees in the future.

Independent auditor

Audit committees of listed companies are responsible for the appointment, compensation, and oversight of the independent auditor. They should maintain a relationship with the auditor, including the lead audit partner, focusing on qualifications, performance, independence, and compensation. Regular meetings, including quarterly discussions, are essential to cover financial reporting, internal controls, and the audit process and results. These discussions should periodically include specialists in areas such as tax and information technology.

Additionally, NYSE rules require the audit committee to participate in periodic private sessions with management, independent auditors, and internal audit. These discussions facilitate open communication and help identify concerns.

SEC and PCAOB rules govern auditor independence, and the audit committee has a role in monitoring that independence. The independence rules include:

- financial relationships;
- employment relationships;
- business relationships;
- non-audit services;
- contingent fees;
- partner rotation; and
- audit committee pre-approval.

Auditor communications

The NYSE and PCAOB outline required communications between the audit committee and the independent auditor, many of which focus on the audit committee's responsibility to oversee the independent auditor. Note that these are not a comprehensive set of requirements.

NYSE requirements

The audit committee must communicate with the independent auditor in several ways:

- Review at least annually a report by the independent auditor on independence, internal quality control procedures, and material issues raised by recent internal quality control review, peer review, or by governmental or professional authorities.

- Meet with the independent auditor to discuss annual and quarterly financial statements, including unaudited disclosures.
- Periodically meet separately with the independent auditor, management, and the chief audit executive (CAE).
- Review with the independent auditor audit problems or difficulties and management's response.
- Set hiring policies for employees or former employees of the independent auditor.
- Assist in board oversight of the auditor's qualifications and independence, as well as the performance of internal audit and the independent auditor.

PCAOB requirements

The PCAOB requires the independent auditor to communicate certain items to the audit committee as described in SEC Regulation S-X. These communications, driven by auditing standards, must be timely and often occur before the issuance of the auditor's report. Key communications include:

- **AS 1301: communications with audit committees**: addresses communications relevant to various aspects of the audit, from engagement through report issuance, including difficulties encountered in performing the audit and disagreements with management.
- **Critical audit matters**: requires the auditor to disclose to the audit committee and in its audit report, matters communicated or required to be communicated to the audit committee that relate to material accounts or disclosures that involve especially challenging, subjective, or complex auditor judgment.

Evaluation of the independent auditor

After reviewing the independent auditor's report(s) described in the first bullet in NYSE requirements within the Independent auditor section, the audit committee is expected to be in a position to evaluate the auditor's qualifications, performance, and independence, including a review of the lead audit partner. This evaluation should consider the opinions of management and internal audit, and the conclusions should be presented to the full board.

Evaluation practices vary from formal processes to informal assessments but should consider factors such as frequency and timing, who will participate, and the format and content of the assessment.

Internal auditors

NYSE listing standards require companies to have an internal audit function to provide management and the audit committee with ongoing assessments of the company's risk management processes and system of internal control. A company may choose to outsource that function to a third party other than its independent auditor.

An effective relationship between the audit committee and internal auditors is fundamental. Internal audit should have direct access to the audit committee, with the CAE reporting directly to the committee and administratively to senior management. This structure supports independence and objectivity.

The audit committee should:

- ensure internal auditors have appropriate independence and recognition from senior management;
- support the CAE, especially when reporting potential management lapses;

- maintain regular, direct, and open communication with the CAE;
- set high expectations for the internal audit department and hold it accountable;
- hold regular executive sessions with the CAE, as required by NYSE listing standards; and
- participate in discussions on internal audit strategy and goals, and evaluate the performance of the function and the CAE.

It is also important for the audit committee to assess whether internal audit's priorities are aligned with those of the audit committee and help determine the balance between compliance and operational audits, as appropriate. Additionally, the committee should review the internal audit plan for alignment with the company's strategic objectives and understand if the CAE has sufficient budget and resources (talent and technology) to execute.

For internal audit functions following the Global Internal Audit Standards™,[6] the audit committee should be familiar with the Essential Conditions defined within, which outline activities of the audit committee identified as "essential" to the internal audit function's ability to fulfill its intended purpose. These conditions can support dialogue between the CAE, the audit committee, and senior management.

Ethics and compliance

The audit committee can promote a strong tone at the top, positive culture, and adherence to the company's code of ethics. They should meet periodically with those overseeing ethics and compliance and ensure the code of ethics complies with requirements and is accessible. Communication and training are critical to fostering an ethical culture.

As part of its oversight, the committee should monitor the risk of management override of controls and risk mitigation mechanisms. It can also initiate investigations on relevant matters.

The NYSE listing standards require a code of conduct that covers all employees, and it must be disclosed on the company's website. The code must address conflicts of interest; corporate opportunities; confidentiality; fair dealing; protection and proper use of listed company assets; compliance with laws, rules, and regulations; and encouraging the reporting of any illegal or unethical behavior, providing for consistent enforcement, whistleblower protection, clear compliance standards, and a fair process for addressing violations. NYSE standards allow multiple codes as long as all directors, officers, and employees are covered.

Hotlines

Management and the audit committee should establish an independent process for investigating ethics and compliance complaints. SEC regulations and NYSE listing standards require the audit committee to establish procedures for:

- receiving, retaining, and addressing complaints regarding accounting, internal controls, or auditing matters from internal or external sources who wish to remain anonymous, as well as reporting a range of compliance matters; and
- the confidential, anonymous submission of employee concerns regarding questionable accounting or auditing matters.

The most common method for receiving tips is through a telephone and web-based hotline monitored by an internal department or third party with anonymous reporting options. Employees (and third parties) should be informed of reporting channels through various communications, including the code of ethics, employee handbook, training, and communications. The audit committee should confirm management is aware of complaints and establish expectations for reporting to the audit committee, including what complaints warrant immediate communication to the committee. Companies with international operations must comply with local laws, which may differ from US requirements.

Conclusion

The audit committee plays an essential role in overseeing a company’s financial reporting, internal controls, and compliance with legal and regulatory requirements. Effective communication and staying informed about the latest regulatory developments are essential for the committee to fulfill its oversight responsibilities. By fostering a culture of transparency and accountability, the audit committee can protect the organization from financial misstatements and unethical practices and may also enhance its ability to navigate the complexities of the modern business environment. As their responsibilities expand to include emerging risks such as cyber and AI, audit committees must remain vigilant and proactive. By working closely with the rest of the board, this may allow a unified approach to governance, enabling the organization to effectively address both traditional and evolving challenges.

Chapter notes

1 https://www2.deloitte.com/us/en/pages/audit/articles/a-roadmap-to-non-gaap-financial-measures.html.
2 https://www.coso.org/_files/ugd/3059fc_1df7d5dd38074006bce8fdf621a942cf.pdf.
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Leading practices for audit committee effectiveness

Deloitte & Touche LLP
Krista Parsons, *Audit & Assurance Managing Director*

Given the audit committee's broad and evolving scope of responsibilities across a range of financial reporting, compliance, risk management, and technology matters, its agenda can easily become overloaded. To provide effective oversight, it is important to prioritize and plan thoughtfully.

Beyond establishing processes to fulfill mandated responsibilities based on regulatory requirements, there are a variety of leading practices audit committees can consider adopting that may enhance their efficiency. This publication highlights some of those key practices. It is important to recognize that these recommendations are not comprehensive, and certain tasks may be managed by the full board or other committees. More general information on the audit committee's responsibilities and required activities can be found in Deloitte's chapters within this publication titled *"Audit committee fundamentals"* and *"Overview of the audit committee's responsibilities."*

Audit committee meetings

Efficient use of meeting time is vital to maintaining effective oversight. Committees can implement several practices to enhance preparation and increase the effectiveness of their meetings.

Evaluate meeting frequency and timing

Audit committee meetings should occur at least quarterly, with additional meetings scheduled as needed to address emerging issues and important ongoing matters. The committee should consider whether a quarterly schedule is adequate or if more frequent meetings are necessary. Maintaining a calendar of required activities and reviewing it annually can help confirm that the charter's mandates are addressed at the appropriate time. Consulting with management, the independent auditors, and internal auditors during the calendar update process can surface areas of focus and their timing.

Additionally, committees may benefit from having legal counsel review both the charter and the calendar to confirm that all requirements are adequately covered.

Assess meeting format and length

The committee should regularly review the format and duration of its meetings to verify alignment with the company's needs. Given the increasing prevalence of virtual and hybrid meetings, it is essential to evaluate how technology is affecting dialogue and participation among members. The committee also can suggest rotating the locations of board and committee meetings to inspire fresh ideas and discussions. This strategy provides an opportunity for committee members to visit different company sites, interact with management teams, and observe operations directly, which is important for comprehending and overseeing the company's culture.

Focus the agenda on priority areas

A well-organized and effectively managed agenda is essential for keeping the committee focused. Typically, a member of management is tasked with developing the agenda and should collaborate with the audit committee chair, independent auditors, internal auditors, and other management members on topics. The agenda should align with the responsibilities outlined in the charter and calendar, and the audit committee chair should approve its content. Although it is beneficial to have a management member oversee agenda development, the agenda should reflect the committee's evolving priorities. Reusing previous agendas without further discussion should be avoided.

As a leading practice, high-priority items should be placed at the beginning of the agenda; the order of topics may shift from one meeting to the next. Using a consent agenda, which consolidates routine items into a single action, can help manage common topics that do not require extensive discussion. Members should still have the opportunity to raise questions about any individual items as desired. Each agenda item should have a predetermined time allocation to maintain focused discussion, and the chair should enforce these time limits as needed to make sure all topics are covered.

Meeting agendas should remain flexible to address issues that arise between meetings and to allow for thorough discussion by committee members. Additionally, time should be set aside on the annual agenda for educational topics or in-depth reviews to keep committee members informed about emerging and evolving risks. These sessions can be led by management or involve external specialists as appropriate.

Prepare materials that will foster productive discussion

Meeting materials should offer timely, relevant information to facilitate discussion and effective decision-making. These materials should align with priority areas, featuring executive summaries that highlight critical issues, key metrics, and required decisions. It should be clear whether the information is for informational purposes or requires a decision, and any expected actions should be specified.

Pre-reads should be thorough yet concise, avoiding excessive operational details. Limiting the number of slides or pages during meetings can help the committee focus on key messages and takeaways and allows more time for discussion.

Presenters of financial information should focus on key changes from the prior period and balances involving judgment, directing the discussion to areas needing the audit committee's attention, including those with close calls or subjectivity. Materials should include insights on both past performance and likely future issues of importance.

It is recommended to assign a single point of contact for committee members' questions during pre-read reviews. Publishing pre-read materials on a portal is a leading practice, and all materials should be provided to the committee well in advance of the meeting to allow for sufficient review time.

Connect with stakeholders in advance of the meeting

To provide for a smooth audit committee meeting, the chair should engage with key stakeholders beforehand to understand the main issues and topics that will be discussed. This allows the chair to inform stakeholders about potential questions or challenges that may arise from the committee. These pre-meetings typically involve one-on-one discussions with essential participants such as the chief financial officer (CFO), controller, independent auditor, chief audit executive, and chief legal officer.

Pre-meetings are valuable and may enhance meeting efficiency and reduce unexpected issues. They also provide an opportunity for the chair to review and suggest updates to the pre-read materials. Based on the pre-meeting review, the chair could consider sharing a summary of the discussions with other committee members, possibly via email, before the meeting.

Do your homework

Audit committee members should read all pre-meeting materials to be well informed and ready to engage in discussions. They should stay updated on emerging risks, regulatory changes, and industry events that could affect the company. Continuous engagement not just before meetings, but throughout the year, is crucial as companies face complex reporting requirements and a rapidly changing external environment.

Make sure the right people are in the room and participating

Audit committees should be deliberate about who attends meetings and encourage their active contribution to the dialogue. The committee should have the authority to invite individuals deemed relevant to provide updates and address specific concerns. Periodically inviting specialists such as cyber experts, business unit leaders, and actuaries can enhance the committee's understanding of specific issues and offer valuable insights into identifying and addressing risks. External specialists can also provide fresh perspectives that benefit both management and the committee. Pairing these specialists with management counterparts for presentations can be particularly effective. To facilitate succession planning for finance and internal audit, potential successors should be invited to present during meetings, allowing the committee to have a firsthand view of their capabilities.

Promote open dialogue

Candid discussions are essential for audit committees to function effectively. All attendees should feel comfortable posing questions and openly expressing their views. Audit committee members should focus on constructive challenges, asking management and auditors questions such as: Where were the hard calls? What were the gray areas? What keeps you up at night? It is important to follow up if answers are not satisfactory.

To promote dialogue, presenters should assume that everyone has read the pre-read materials and should try to avoid reviewing each slide during the meeting. Instead, presentations should be limited to around one-third of the allotted time, leaving two-thirds for discussion.

Conduct executive sessions in association with each meeting

Executive sessions provide audit committees with an opportunity for unfiltered communication with key stakeholders, including management, internal audit, and the independent auditor. These periodic sessions, required under New York Stock Exchange (NYSE) corporate governance rules, can be scheduled in association with each audit committee meeting. While the listing standards do not specify a particular frequency, holding executive sessions at every meeting helps promote consistency and encourages thoughtful, candid discussion from all stakeholders. To encourage full candor, minutes are typically not recorded.

Executive sessions often are held immediately after meetings to discuss sensitive items not appropriate for the general meeting. Separate sessions are typically held with management (usually the CFO and chief audit executive), independent auditors, and other regular presenters such as the chief information officer and the owner of cyber risk. They provide real-time feedback and discussion on the effectiveness of meetings, future agenda items, and any areas for follow-up. Executive sessions also allow audit committees to discuss the results of the committee's annual self-assessment and succession plans for the finance organization and internal audit.

Brief committee-only executive sessions (approximately 5 to 15 minutes) before and after meetings can promote alignment on the agenda, confirm priorities, and identify concerns. These sessions help in surfacing issues without management's influence, identifying topics for follow-up, and beginning to build the agenda for the next quarter. They also provide an opportunity to assess the meeting in real-time and make necessary adjustments for future meetings.

Interactions with finance

Given that the audit committee both oversees and relies significantly on the finance function, continuous and open communication is crucial. The audit committee should confirm that the finance team has adequate resources to maintain high-quality financial reporting and robust controls. This involves understanding the finance organization's structure, budget, and key personnel, particularly at the CFO level and one level below. It is important to have regular discussions with the chief executive officer (CEO), CFO, and other finance executives about succession plans for critical roles. Additionally, audit committees can provide valuable input on performance evaluations, compensation, and goal-setting processes for finance professionals.

Coordination with the board and other committees

Regular reporting to the board on the audit committee's responsibilities, activities, issues encountered, and recommendations is required under NYSE standards and is a leading practice for all companies. The audit committee should have a clear understanding of the risk areas and responsibilities overseen by the board and other committees. For areas where responsibilities overlap, engaging with other committee chairs or holding combined meetings can provide for comprehensive oversight and avoid gaps. For instance, while the compensation committee oversees compensation plans, the audit committee should understand their financial implications, including risks related to employee retention and potential fraud. Having a director serve on both committees can enhance coordination and confirm that all relevant issues are addressed.

Succession planning and onboarding

Actively monitor succession planning needs and processes

The audit committee chair should regularly assess whether the skills and experience of committee members, including the chair, meet the committee's evolving requirements and areas of focus. As needs change and transitions are anticipated, the chair should coordinate with the nominating/governance committee on succession planning. This process should focus on members' independence, financial expertise, and relevant industry, risk management, business, and leadership experience. The audit committee chair should communicate the skills and experiences needed to effectively carry out the audit committee's responsibilities to the nominating/governance committee chair.

Support new committee members through a thoughtful onboarding process

A robust onboarding process can help audit committee members quickly get up to speed and become effective contributors. In collaboration with management, the audit committee should develop comprehensive onboarding materials and conduct tailored onboarding sessions. These sessions should cover:

- an overview of the company, including its history and operations;
- company policies and the code of ethics;
- major business and financial risks;
- corporate governance requirements and practices;
- audit committee responsibilities, including oversight of accounting policies and practices;
- external and internal audit activities; and
- industry trends.

Onboarding sessions can involve a variety of stakeholders, including key members of management, other audit committee or board members, the CEO, the finance team, internal audit, counsel, and the independent auditor. While the audit committees of public companies have certain core responsibilities, specific responsibilities in overseeing risk and other areas may vary significantly among different committees. The onboarding process should clearly lay out, for new members, the scope of the audit committee's role in overseeing risk and other areas.

Education and assessment

Engage in continuing education

Continuing education is essential for audit committees to stay informed on emerging issues and leading practices and to address knowledge gaps. NYSE listing standards require board education to be addressed in the company's corporate governance guidelines. Audit committees should embrace a continuing education program tailored to their needs.

Educational topics can be included on the agenda during regularly scheduled audit committee meetings or in special sessions throughout the year. These sessions should cover:

- audit committee roles and responsibilities, including internal control over financial reporting and risk oversight;
- complex accounting issues and critical accounting policies;

- industry trends and developments; and
- regulatory updates.

Topics should be tailored to the company's specific needs and may include sessions with business unit leaders discussing their areas and related risks, refreshers on significant accounting estimates or policies, or deep dives into emerging and evolving risks. The most effective approach for delivering the program may involve a mix of internal experts and external specialists. Independent auditors or outside consultants can assist in identifying appropriate topics and speakers.

Participation in external programs focused on board or audit committee–related topics is another effective way for committee members to remain informed. These programs, offered by professional services firms, universities, and not-for-profit organizations, provide opportunities to meet with peers, share experiences, and gain insights from specialists on trends in corporate governance. However, boards should be cautious not to rely solely on public programs designed for a broad audience, as they may not address the specific dynamics of the company and its industry.

Assess the audit committee's performance

Audit committee assessment is a critical element in maintaining the effectiveness and efficiency of the audit committee as it fulfills its oversight responsibilities. A well-crafted assessment can highlight areas for improvement across topics such as qualifications, understanding of complex accounting issues, and meeting agendas. Additionally, the assessment can bring focus to the committee's composition relative to its current and future needs and challenges, potentially leading to committee refreshment if warranted.

A coordinator should be selected to lead the process. This could be the committee chair, board chair, lead independent director, nominating/governance committee chair, general counsel, or corporate secretary. Engaging an objective third party to assist with the evaluation process can also provide a fresh perspective and should be considered every 2 or 3 years, with internal facilitation in other years. Establishing a timeline for the assessment promotes a systematic and efficient process.

Using tools such as questionnaires that benchmark performance against leading practices can be valuable in self-assessing performance and highlighting strengths and areas for enhancement. Self-assessment tools should be tailored to the specific needs of the audit committee and the issues it oversees.

Obtaining qualitative feedback in addition to quantitative ratings is essential, and feedback should be solicited from individuals who have significant interaction with the audit committee, including certain members of management. The results of the assessment can be discussed in a private session limited to audit committee members, and an actionable plan should be developed based on identified opportunities and areas of concern. Sharing the results of the evaluation with the board and providing feedback to individual committee members as appropriate confirms transparency and accountability.

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The value of the internal audit function and the risk of not engaging

The Institute of Internal Auditors
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Audit committees champion a culture of accountability and compliance, recognizing that their judgments and decisions influence stakeholder views, including those of shareholders, regulators, and employees. By upholding these principles, boards and audit committees collectively contribute to creating and protecting investor value, fostering trust in capital markets, and promoting the long-term sustainability of their organizations. Internal auditors support this culture by assessing and providing insight into the sufficiency of an organization's control and risk management environment, instilling greater trust and confidence in an organization's operations and enhancing its ability to serve the public interest.

To achieve that trust, however, all stakeholders—especially the board and audit committee—must have a common understanding of what internal auditing is, the scope of its activities, and how it is distinct from other professions. The Institute of Internal Auditors' (IIA's)[1] Global Internal Audit Standards™[2] defines internal auditing as:

"An independent, objective assurance and advisory service designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management, and control processes."

Because audit committees play a critical role as liaisons between the leader of the internal audit function—often referred to as the chief audit executive (CAE)—and the board, all members of the committee should understand the standards internal auditors must follow and how the function can best serve the organization.

What internal audit functions do

An internal audit function's responsibilities extend beyond compliance with internal controls over financial reporting to address an organization's broader risk landscape. An internal audit plan focuses on assessing the key internal controls designed to mitigate the top risks of the organization. Depending on the organization and industry, an internal audit plan could include audits (also called assurance engagements) of cybersecurity, information technology (IT), human resources/culture, data privacy and protection, artificial intelligence (AI), fraud, business continuity, market risk, regulatory risk, etc. The plan should be risk-based and dynamic, adjusting to reflect organizational changes and goals. Because internal audits provide coverage of all risks, the plan is usually executed on a cyclical, rotating basis. In addition to assurance, internal auditors may also provide advisory services to further assist their organization.

The internal audit function, mandated by the board through a charter, serves as a key mechanism to assess how well key organizational risks are mitigated, thereby enhancing governance and protecting shareholder value. This function brings a systematic and disciplined approach to identifying risks, evaluating governance frameworks, assessing key processes and controls, and recommending improvements. Internal audit teams provide boards, audit committees, and management with important data around how well the organization's key risks are being mitigated. This work contributes to safeguarding and sustaining organizational value through the internal audit function's independent, objective assurance and advisory services. Internal audit's work aligns governance, risk management, and control activities with key risks and stakeholder priorities, reinforcing trust and confidence in corporate operations.

Where the internal audit function is organizationally positioned

Internal audit functions may be located within the organization,[3] co-sourced (where a portion of internal audit services are outsourced), or fully outsourced (where the entire function is contracted out).

No matter the model, internal audit must report *directly* to the board for the function to be truly independent and effective. The board facilitates this independence through the tone it sets and the approval of the internal audit charter. When this reporting structure is not independent of management, issues may arise, including potential scope limitations or pressure on the internal auditors. The CAE should have an administrative reporting line to the chief executive officer, or equivalent, to support daily activities and ensure the work of the internal audit function is given due consideration.

Essential risk oversight responsibilities of board and audit committees

Audit committees are vital to risk oversight and ensuring the effectiveness of the internal audit function. For audit committees to fulfill their responsibilities, they must ensure the internal audit function is independent, well-resourced, and empowered to operate at the highest levels of the organization. According to The IIA's Standards, the purpose of internal auditing is to:

"[S]trengthen the organization's ability to create, protect, and sustain value by providing the board and management with independent, risk-based, and objective assurance, advice, insight, and foresight."

For this to occur, audit committees must recognize the unique contributions of internal auditors and actively support their mandate. In addition to their traditional financial reporting responsibilities, boards and audit committees are being asked to focus more on cybersecurity, business resilience, enterprise risk management, and AI. Internal audit functions are already working in these areas—or at least they should be. Audit committees should clearly communicate their expectations of internal audit and use its work to gather valuable insight and lessen the committee's workload. Corporate governance policies must preserve the scope, independence, and objectivity of internal auditors to allow them to deliver maximum value.

What boards should look for

1. **Oversight and independence**:
   - Boards should approve the internal audit charter, which includes the internal audit mandate and the scope and types of internal audit services as stated in Domain III: Governing the Internal Audit Function of The IIA's Standards. This domain presents the responsibilities of the CAE as well as the support of board and senior management needed for internal auditing to be most effective. The board—not management—also approves the internal audit budget, whether the function is in-house or outsourced.
   - The internal audit function should operate under a board-approved charter that defines its authority, role, and responsibilities. When defining the internal audit function's responsibilities, conversations should occur among the CAE, senior management, and the board. These conversations create awareness and build trust, which is critical to the three-way partnership. As required in The IIA's Standards, the CAE must provide the board and senior management with the information necessary to establish the internal audit mandate.
   - The audit committee should ensure management implements recommendations from the internal audit function.
   - The IIA includes a visual of organizational and governance reporting lines in its Three Lines Model.[4] Figure 1 outlines a well-positioned and effective governance and reporting structure and explains how each role and responsibility contributes to an organization's success. The internal audit function's independent assurance role is unique within an organization, which positions it to play a vital role in organizational value creation and protection.

2. **Standards and quality**:
   - To be successful, internal audit functions should adhere to The IIA's Standards, which are globally recognized.
   - In addition to having a written charter and following the Standards, internal audit functions should:
     1. **Be independent from management.** Internal auditors should be directly accountable to the audit committee or the governing body.
     2. **Have qualified staff.** This can be demonstrated through such means as holding appropriate certifications or other credentials, such as the Certified Internal Auditor® (CIA®) and specialty credentials related to expertise in areas or topics subject to an internal audit.
     3. **Be objective.** Internal auditors should perform activities in an objective and unbiased manner.

Figure 1. Governance reporting lines

4. **Have an external quality assessment** (i.e. an audit of the internal audit function). Examples include The IIA's External Quality Assessment, a self-assessment with independent validation, or any alternative, high-quality private sector equivalent. Assessments should be conducted at least once every five years.

3. **Broad risk coverage**:

- Internal auditors assess risks across the organization beyond financial controls. These can include, but are not limited to cybersecurity, sustainability reporting, use of AI, data privacy and protection, and supply chain integrity.
- This comprehensive risk focus ensures the organization is well-prepared to address emerging threats and opportunities.

Enhancing the value of internal audit

Audit committees sometimes underestimate the value of internal audit functions. As noted in The IIA's Global Public Policy Position Paper (*see source from Figure 2*):

"While external financial audits are an important public protection, they do not cover the breadth of assurance provided by internal audit functions. Internal auditors look holistically at an organization, providing independent objective assurance over not just financial internal controls, but also over internal controls related to cybersecurity, data privacy and protection, supply chain risks, ESG/ climate and sustainability reporting, human capital, artificial intelligence, corporate governance, and a whole host of other areas vital to the operational success of the organization."

Figure 2. The internal audit function

Source: A Legal, Regulatory, and Policy Framework for the Internal Audit Profession,[5] an IIA Global Public Policy Position Paper (GP4)

To address this issue, boards need to:

- Understand the strategic role of internal auditing in risk management and governance.
- Ensure the CAE has direct access to the audit committee to provide unfiltered insights.
- Support the internal audit function in building expertise in critical areas like fraud prevention, ethics, and organizational culture, as well as in emerging areas like cybersecurity risk and AI.

By actively engaging with the internal audit function, audit committees can ensure their organizations are equipped to navigate complex risk environments, thereby protecting stakeholders and fostering long-term success.

A vision of the future

The Internal Audit Foundation's[6] Vision 2035 reports, released in July 2024, outlines the internal audit profession's challenges and opportunities as it adapts to an evolving risk landscape and technological advancements. Key insights were gathered from more than 7000 stakeholders from around the world. According to the report, "there is both a strong desire and, more importantly, a need for internal auditors to confront the challenges of today and the future to achieve the profession's vision and fulfill its purpose."

Key findings

1. **The evolving role of the internal auditor**:
   - Internal auditors must expand from providing traditional assurance services to becoming strategic advisors, leveraging insights and foresight to help boards and management achieve objectives. Vision 2035 states:

     "Today, internal auditors primarily provide objective, independent assurance to executive management and governing bodies. They confirm the comprehensiveness and reliability of the organization's governance processes, assess the adequacy of internal controls in mitigating risks, and ensure that the business operates as intended to achieve its objectives, protect

stakeholders, and serve the public interest. In addition, as part of these assurance services, internal audit makes recommendations to strengthen internal controls and holds management accountable for implementing actions to improve risk management. Both actions are required by The IIA's Global Internal Audit Standards™."

Based on the research results, the top areas worldwide where internal auditors provide assurance and/or advisory services, either individually or as part of their internal audit function, include:

- operations/processes (75% personally, 87% function);
- compliance (69%, 82%); and
- risk management (63%, 77%).

The areas where internal auditors are less likely to provide services include:

- external financial reporting (18% personally; 29% function); and
- sustainability (21%, 34%).

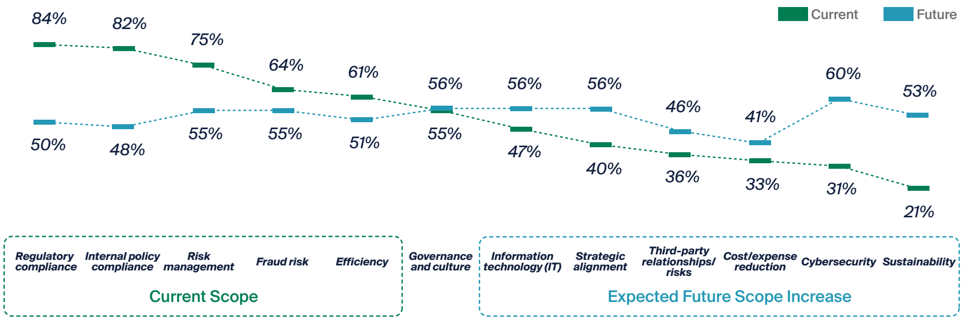
- As risks become more complex, internal audit functions must address broader areas beyond financial reporting, including cybersecurity, sustainability, and AI. Vision 2035 reports an increase in what will be expected of the internal audit scope in the areas of cybersecurity and sustainability (*see Figure 3*).

2. **Stakeholder support and independence**:
   - Audit committees and boards must reinforce internal audit's independence, ensuring the CAE reports directly to them and operates without interference. According to The IIA's Standards, the CAE needs to be positioned at a level within the organization that enables the internal audit function to perform its services and responsibilities without interference.
   - Greater collaboration among boards, senior management, and internal auditors is needed to enhance the profession's value. Vision 2035 research finds 45% of survey respondents indicate a need for more support from leadership and stakeholders.
   - CAEs or leaders of internal audit functions must be strategically positioned within organizations and preferably hold certifications like the CIA® to effectively lead internal audit functions.

3. **Technology's impact:**
   - Advanced technologies are reshaping how internal audits are conducted. Boards must ensure internal audit teams are equipped to use and assess emerging technologies, such as AI, while addressing related risks. These emerging technologies will influence how internal audit functions and teams complete their work while also improving quality and providing new opportunities to add value.
   - Eighty-seven percent of Vision 2035 respondents agree that failing to adopt new technologies would hinder the internal audit's ability to manage risks. Internal auditors will need more support from boards and audit committees to ensure the function has the appropriate technology to fulfill the internal audit charter and to train on the skills necessary to assess the technology.

4. **Upskilling and talent development:**
   - Internal auditors must acquire new skills, either by hiring experts, co-sourcing, or upskilling existing teams. Talent strategies must attract

Figure 3. Current and future audit scopes



Source: Internal Audit: Vision 2035 Survey[7]

diverse professionals with technical and strategic capabilities.

Questions boards should ask internal audit leaders:

To assess the internal audit function's effectiveness, audit committees can ask the CAE several questions.

1. **Independence and governance:**
   - Is the internal audit function positioned independently to provide unbiased assurance and advice?
   - Are there any organizational structures or reporting lines that could compromise the internal audit function's independence?
   - What other areas of the business (e.g., risk or compliance) is the CAE managing?
   - Is the internal audit function following The IIA's Standards?
   - When was the last time an external quality assessment, or the equivalent, was performed?
2. **Collaboration and stakeholder engagement**:
   - How does the internal audit function collaborate with other stakeholders to maximize its value to the organization?
   - Does the board and management provide adequate support to enhance the internal audit function's impact?
3. **Strategic role and advisory services**:
   - How is the internal audit function evolving to address strategic risks such as cybersecurity, sustainability, and emerging technologies?
   - In what ways is the internal audit function contributing beyond assurance to become a strategic advisor?
4. **Technology integration**:
   - What technologies does the internal audit function leverage to enhance efficiency and accuracy?
   - How are emerging technology risks being evaluated and managed?
5. **Talent and expertise**:
   - What strategies are in place to attract and retain talent with the necessary skills for future challenges?
   - Does the organization invest in sufficient training and development to prepare the internal audit function for emerging risks?
   - Does the internal audit function have enough skilled staff to achieve the internal audit strategy and plan?

Conclusion

The internal audit profession's ability to evolve and meet future challenges hinges on the full support of boards and their audit committees. By aligning with organizational strategies and demonstrating measurable value through advisory and assurance engagements, internal audit can surpass outdated perceptions and become a trusted strategic partner.

To increase the support for and value of the internal audit function, board members and senior executives need to communicate the value offered by internal audit throughout the organization. Senior executives should also support the CAE's participation (non-voting) in key management meetings and executive steering committee meetings (i.e. give them a seat at the table).

This is a two-way street. To do their part, the CAE and internal audit leadership must effectively communicate their contributions to the board. Internal audit needs to stay updated on the latest business or operations initiatives and provide real-time advice, insight, and foresight.

By addressing these issues and engaging with CAEs more frequently, boards and their audit committees can ensure that their internal audit functions remain future ready, strategically aligned, and equipped to handle the complexities of tomorrow's risk landscape.

Chapter notes

1 The Institute of Internal Auditors (IIA) is an international professional association that serves more than 255,000 global members and has awarded more than 200,000 CIA® certifications worldwide. Established in 1941, the IIA is recognized throughout the world as the internal audit profession's leader in standards, certifications, education, research, and technical guidance. For more information, visit theiia.org.

2 Global Internal Audit Standards™ https://www.theiia.org/globalassets/site/standards/editable-versions/globalinternalauditstandards_2024january9_editable.pdf.

3 Internal Auditing's Role in Governing Body/Executive Committees https://www.theiia.org/en/content/position-papers/2019/internal-auditings-role-in-governing-bodyexecutive-committees/.

4 The IIA's Three Lines Model https://www.theiia.org/en/content/position-papers/2020/the-iias-three-lines-model-an-update-of-the-three-lines-of-defense/.

5 https://www.theiia.org/globalassets/site/content/position-papers/2024/iia-global-public-policy-position-paper_gp4.pdf.

6 The Internal Audit Foundation is an essential global resource for advancing the internal audit profession. Foundation-funded research provides internal audit practitioners and their stakeholders with insight on emerging topics and promotes and advances the value of the internal audit profession globally. In addition, through its Academic Fund, the Foundation supports the profession's future by providing grants to students, educators, and academic institutions across the globe who participate in The IIA's academic programs. For more information, visit theiia.org/Foundation.

7 Internal Audit: Vision 2035 https://www.theiia.org/globalassets/site/foundation/latest-research-and-products/vision-2035-report.pdf.

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The board's role in conducting an effective assessment of the external auditor from A to S

Center for Audit Quality
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Among other important duties, Section 301 of the Sarbanes-Oxley Act of 2002 (SOX) states "the audit committee of each issuer, in its capacity as a committee of the board of directors, shall be directly responsible for the appointment, compensation, and oversight of the work of any registered public accounting firm employed by that issuer (including resolution of disagreements between management and the auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or related work, and each such registered public accounting firm shall report directly to the audit committee."

Therefore, as part of carrying out this oversight responsibility, audit committees should regularly (at least annually) evaluate the external auditor in order to make an informed recommendation to the board whether to retain the external auditor. Robust dialogue that includes providing constructive feedback to the external auditor may improve audit quality and enhance the relationship between the audit committee and the external auditor.

The term "external auditor" is intended broadly and comprises the lead audit engagement partner, the engagement team, and the audit firm. The lead audit engagement partner—referring to the member of the engagement team with primary responsibility for the audit—is responsible for proper supervision of the work of engagement team members and for compliance with Public Company Accounting Oversight Board (PCAOB) standards, including standards regarding using the work of specialists, other auditors, internal auditors, and others who are involved in testing controls.

An assessment is more meaningful when informed by the risks the company faces and the external auditor's views regarding how management is addressing those risks. It is appropriate for the audit committee to base their assessment upon their own personal dealings with the external auditor—presentations, reports, dialogue during formal meetings, ad hoc meetings, and executive sessions—as well as obtain observations on the external auditor from others within the company, including management and internal audit, accompanied by discussions with other key managers. In evaluating information obtained from management, the audit committee should be sensitive to the need for the external auditor to be objective and skeptical while still maintaining an effective and open relationship with management. Accordingly, audit committees should be alerted to whether management displays a strong preference for or a strong opposition to retaining the external auditor—and follow up as appropriate to understand the reasons.

Audit committee members can assess the external auditor throughout the audit process via both formal and informal assessments. Informal assessments can be made based on private meetings between the audit committee chair and the lead audit engagement partner, which can help build a constructive and mutually respectful working relationship. These contemporaneous assessments provide important input into the annual assessment. Audit committees may wish to consider those contemporaneous observations as part of a more formal assessment process by using a questionnaire or guide.

Other sources of input into the audit committee's assessment of the external auditor may include discussions with the external auditor regarding its firm-level approach to promoting and monitoring audit quality, as well as information published by the firm that addresses audit quality issues (such as firm transparency and audit quality reports), regulator inspection reports, and peer review findings, as applicable.

Finally, the audit committee should consider advising shareholders that it performs an annual evaluation of the external auditor—for example, in its audit committee report included in the proxy statement. The audit committee should also consider explaining its process, scope of the assessment, and factors considered in selecting or recommending the audit firm or assessing its performance.

As part of a formal assessment, four areas the audit committee may want to focus on include:

1. the audit engagement team—quality of services and sufficiency of resources;
2. the audit firm—quality of services and sufficiency of resources;
3. communication and interaction; and
4. auditor independence, objectivity, and professional skepticism.

The Center for Audit Quality's *External Auditor Assessment Tool*[1] includes detailed questions and a sample template that may be useful in conducting a formal assessment. The sample questions highlight some of the more important areas for consideration; they are suggested for consideration and not intended to cover all areas that might be relevant to a particular audit committee's evaluation of its external auditor, nor do they suggest a "one-size-fits-all" approach. Moreover, an assessment is not designed to determine compliance with all legal or regulatory requirements for audit committees or external auditors.

The following is a summary of key points to consider:

[1](https://www.thecaq.org/external-auditor-assessment-tool-a-tool-for-audit-committees)

Part 1—the audit engagement team—quality of services and sufficiency of resources

The audit committee should assess whether the primary members of the engagement team demonstrated the knowledge, skills, and experience necessary to address the company's risks of material misstatement. The engagement team should have provided details regarding its risk assessment during the planning stage of the audit, including an assessment and discussion regarding fraud risks. Planning is critical to audit quality. The discussion of audit risks with the audit committee should not be rushed through with little changes from the prior year strategy. It is important to take the time to understand the planned audit strategy and to refresh the audit strategy as needed throughout the year.

During the audit engagement, the engagement team should have demonstrated a good understanding of the company's business, industry, and the impact of the economic environment on the company. In addition, the engagement team should have identified and responded to any significant auditing and accounting issues that arose from changes in the company or its industry, or changes in applicable accounting and auditing requirements.

The audit committee should consider (not all inclusive):

a. The engagement team skill and responsiveness:
   - Did the lead audit engagement partner and engagement team have the necessary knowledge, skills, and experience (company-specific, industry, accounting, auditing) to perform the audit of the company's financial statements?
   - Were additional and appropriate resources available to complete the audit timely and efficiently?
   - Was the lead audit engagement partner accessible to the audit committee and company management?

b. Engagement team hours and workload:
   - Did the lead audit engagement partner discuss trends in engagement hours and related timing?
   - Did the lead audit engagement partner discuss key engagement team members' workloads and workload information (compared to a standard workload by level as determined by the audit firm)?

c. The audit plan and risks identified:
   - Did the lead audit engagement partner discuss the audit plan, including the use of technology and how it addressed company- and industry-specific areas of accounting and audit risk (including fraud risk and other significant risks) with the audit committee?
   - Did the lead audit engagement partner identify the appropriate risks in planning the audit?
   - Did the external auditor adjust the audit plan to respond to changing risks and circumstances?

d. Audit participants:
   - If other accounting firm(s) participated in the audit, did the lead audit engagement partner provide information about the technical skills, experience, and professional objectivity of those external auditors?
   - Did the lead audit engagement partner and/or engagement team provide information on significant interactions with other audit participants?

e. Engagement team succession planning:
   - If applicable, has the audit firm sufficiently explained how key changes or rotations of the lead audit engagement partner or senior engagement team personnel will be managed?

f. Complex accounting and auditing matters, including consultations:
   - Did the lead audit engagement partner discuss with the audit committee the results of any consultations with the audit firm's national professional practice office or other technical resources on accounting or auditing matters in a timely and transparent manner?

g. Audit scope and cost considerations:
   - Were the scope, hours, and cost of the audit reasonable and sufficient for the size, complexity, and risks of the company?
   - Were the reasons for any changes to scope, hours, and cost communicated to the audit committee?

Part 2—the audit firm—quality of services and sufficiency of resources

Beyond the audit engagement team, the right audit firm is important to evaluate in relation to the company's needs. Important considerations for an audit committee include whether the audit firm has the relevant industry expertise, geographical reach, sufficient resources, appropriate specialists and/or national office resources necessary to continue to serve the company. The audit committee should also understand if the audit firm's system of quality control is designed to deliver timely, efficient, and effective audits in accordance with applicable professional standards.

The audit committee should consider (not all inclusive):

h. Leadership, culture and firm governance:
   - Does the audit firm's leadership, culture, and firm governance promote audit quality?
   - Do the firm's core values, principles, and code of conduct emphasize audit quality?

i. Firm specialized knowledge and geographic reach:
   - Is the audit firm the right size for the company?
     - Is the audit firm too small and unable to provide sufficient resources to properly conduct the audit?
     - If the company is growing and expanding, has the company outgrown a local audit firm?
     - If the company is considering going public, is the audit firm registered with the PCAOB?
     - Is the audit firm too big and unable to provide sufficient attention and service to the company?
   - Does the audit firm have the necessary industry and specialized accounting and reporting expertise relevant to the company's primary operations?
   - Does the audit firm have the resources and geographical reach required to continue to serve the company?

j. Firm policies and procedures and system of quality control:
   - Do audit firm policies reinforce planning and performing the audit to avoid surprises, promote early detection of issues, and achieve the timely completion of the audit?

k. Inspection results:

- If the audit was subject to inspection by the PCAOB or other regulators—or other internal quality review—did the external auditor advise the audit committee in a timely manner of the selection of the audit findings, and the impact, if any, on the audit results?
- Did the lead audit engagement partner communicate relevant results of the firm's inspection or internal quality review that may be pertinent to the company, such as themes and types of findings regarding companies in similar industries with similar accounting or audit issues?
- Did the lead audit engagement partner explain the audit firm's root-cause analysis, if applicable, and remediation processes and how, as a result, the audit firm planned to respond to the inspection findings and to internal findings regarding its quality control program?

Part 3—communication and interaction

Frequent and open communication between the audit committee and the external auditor is essential for the audit committee to obtain the information it needs to fulfill its responsibilities to oversee the company's financial reporting process. The quality of communications also provides opportunities to assess the external auditor's performance.

In addition to communicating with the audit committee as significant issues arise, the external auditor should also meet with the audit committee on a basis frequent enough to ensure the audit committee has a complete understanding of the stages of the audit cycle (e.g. planning, completion of final procedures, and, if applicable, completion of interim procedures). Such communications should focus on the key accounting or auditing issues that, in the external auditor's judgment, give rise to a greater risk of material misstatement of the financial statements, as well as any questions or concerns of the audit committee.

The audit committee should consider (not all inclusive):

l. Openness of communications:

- Did the lead audit engagement partner maintain a professional and open dialogue with the audit committee and audit committee chair?
- Were discussions frank and complete?
- Did the external auditor explain accounting and auditing issues in an understandable manner?

m. Nature of communications:

- Did the external auditor adequately discuss the quality of the company's financial reporting, including the reasonableness of accounting estimates and judgments?
- Did the external auditor discuss with the audit committee current developments in accounting principles and auditing standards relevant to the company's financial statements and the potential impact on the audit?
- Did the lead audit engagement partner explain the external auditor's responsibilities related to other information in documents containing audited financial statements, such as certain financial information that is calculated and presented on the basis of methodologies other than in accordance with generally accepted accounting principles (GAAP),

commonly referred to as non-GAAP financial measures?

- Did the external auditor discuss critical audit matters (CAMs) communicated in the auditor's report and how CAMs were identified?

n. Communication of concerns:

- In executive sessions, did the external auditor discuss sensitive issues candidly and professionally, such as:
  - any concerns about management's reporting processes;
  - the quality of the company's financial management team; or
  - lack of sufficient cooperation from management?

Part 4—auditor independence, objectivity, and professional skepticism

The external auditor must be independent of the issuer and its affiliates. Auditor independence is a shared responsibility among the auditor, the audit committee and management. Audit committees should be familiar with the statutory and regulatory independence requirements for external auditors and evaluate the external auditor in light of those requirements. The external auditor must exercise a high level of objectivity and professional skepticism. The audit committee's interactions with the external auditor during the audit provide opportunities to evaluate whether the external auditor demonstrates integrity, objectivity, and professional skepticism.

The audit committee should consider (not all inclusive):

o. Independence compliance:

- Did the external auditor report to the audit committee all matters that might reasonably be thought to bear on the audit firm's independence, including exceptions to its compliance with independence requirements?
- Did the external auditor discuss processes in place to monitor and remediate independence violations?

p. Disagreements with management:

- Were there any significant differences in views between management and the external auditor and if so, did the external auditor present a clear point of view on accounting issues for which management's initial perspective differed?
- Was the process of reconciling views achieved in a timely and professional manner?

q. Promotion of professional skepticism:

- Did the external auditor promote the application of professional judgment and exercise of professional skepticism in executing the audit?

r. Internal audit reliance:

- If the external auditor placed reliance on internal audit testing, did the audit committee agree with the extent of such reliance?
- Were there any significant differences in views between the internal auditors and the external auditor and if so, were they resolved in a professional manner?

s. Pre-approval of non-audit services:

- As required by Section 202 of SOX, did the audit committee pre-approve all permitted non-audit services (as defined by the Securities and Exchange Commission's Rule 210.2-01(f)(14), the following non-audit services are NOT permitted to be performed by the auditor: (i) bookkeeping or other services related to the accounting records or financial statements of the audit client; (ii) financial information systems design and implementation; (iii) appraisal or valuation services, fairness opinions, or contribution-in-kind reports; (iv) actuarial services; (v) internal audit outsourcing services; (vi) management functions or human resources; (vii) broker or dealer, investment adviser, or investment banking services; (viii) legal services and expert services unrelated to the audit; and (ix) any other service that the PCAOB determines, by regulation, is impermissible)?

- In obtaining such pre-approvals on permitted non-audit services, did the lead audit engagement partner discuss safeguards in place to protect the independence, objectivity, and professional skepticism of the external auditor?
- Did the audit committee discussed with the external auditor and implemented as appropriate a de minimis exception level for pre-approval of non-audit services as permitted by Section 202 of SOX?

Conclusion

An assessment of the external auditor enhances audit quality and allows for a constructive dialogue between the external auditor and the audit committee. The audit committee has the responsibility and the opportunity to ensure the audit process is efficient and effective to support high quality financial reporting and protect investors.

Subsection: Compensation governance

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Compensation committee composition

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Independence requirements

The New York Stock Exchange ("NYSE") mandates that listed companies have a standing compensation committee composed of a majority of independent directors. Rule 10C-1 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), enhances this framework by providing guidance on determining committee member independence and the role of compensation consultants, legal counsel, and other advisors.

Requirements under Rule 10C-1 of the Exchange Act

Rule 10C-1 under the Exchange Act ("Rule 10C-1") directs national securities exchanges, including NYSE, to establish listing standards that require listed companies to have compensation committees. Key provisions include:

1. **Independence requirements:** requires listed companies to ensure that a majority of members of the compensation committee meet heightened independence criteria, including the source of compensation of the director and whether the director is an affiliate of the listed company.
2. **Authority to retain compensation advisors:** compensation committees of listed companies must have the sole authority to hire compensation consultants, independent legal counsel, or other adviser (collectively, "Compensation Advisors" and each a, "Compensation Advisor").
3. **Funding and oversight:** listed companies are required to reasonably fund the committee's Compensation Advisors, as determined by the compensation committee, to ensure that it can carry out its duties effectively.

4. **Advisor independence:** before engaging a Compensation Advisor, the compensation committee must assess the Compensation Advisor's independence using factors such as:
   - Provision of other services to the listed company.
   - Relationships between the advisor and members of management.
   - The advisor's financial ties to the listed company.

These rules provide a consistent framework for ensuring that compensation committees have the tools and independence needed to fulfill their fiduciary duties.

Independence standards

Section 303A.05 of the NYSE Listed Company Manual, together with Rule 10C-1, requires boards to evaluate and determine the independence of each compensation committee member, taking into account:

1. **Material relationships:** relationships with the company that would impair their independence, such as significant business or familial connections. A director would not be independent if the director (or an immediate family member) is currently or formerly employed by the company within the last three years.
2. **Sources of compensation:** a director's source of compensation, such as consulting or advisory fees from the company, that could compromise their ability to act independently. A director would not be independent, if within a 12-month period within the past 3 years, the director (or an immediate family member) has received $120,000 in direct compensation from the company (other than fees for serving as a director).
3. **Affiliation considerations:** affiliations with major shareholders, subsidiaries, or other entities related to the company to ensure objective decision-making; provided that stock ownership, even if significant, would not in and of itself negate a determination of independence.

These criteria are designed to help the board mitigate conflicts of interest and ensure that decisions regarding executive compensation are aligned with shareholder interests. Following review of the criteria, the board must affirmatively conclude that each director is able to be independent from management and can make reasoned independent decisions with respect to the company.

Other composition considerations

Non-employee directors for Section 16 purposes

In addition to independence requirements, an NYSE-listed company should consider the designation of its compensation committee members as "non-employee directors" under Rule 16b-3 under the Exchange Act ("Rule 16b-3"). See *Main responsibilities—Section 16 compensation matters*.

Role of Compensation Advisors

The role of Compensation Advisors is critical to ensuring fair and competitive executive compensation practices. Both Rule 10C-1 and NYSE listing rules emphasize the importance of advisor independence to avoid conflicts of interest.

NYSE rules empower compensation committees to:

- Retain their own Compensation Advisors.

- Require the listed company to provide appropriate funding for such Compensation Advisors' services.
- Assess Compensation Advisor independence using objective criteria.

This oversight ensures that the committee receives unbiased guidance, enabling it to design compensation packages that align with shareholder interests and regulatory requirements.

Main responsibilities

Fundamentals of the compensation committee charter

The compensation committee of an NYSE-listed company must be governed by a written charter that addresses the committee's:

- purpose and responsibilities—the compensation committee must have direct responsibility to: (i) review and approve corporate goals and objectives relevant to chief executive officer (CEO) compensation, evaluate the CEO's performance in light of those goals and objectives, and, either as a committee or together with other independent directors (as directed by the board), determine and approve the CEO's compensation level based on such evaluation, (ii) make recommendations to the board with respect to non-CEO executive compensation, and incentive-compensation and equity-based plans that are subject to board approval, and (iii) prepare the compensation committee report relating to the Compensation Discussion and Analysis ("CD&A") to be included in the company's annual report on Form 10-K, proxy statement on Schedule 14A or information statement on Schedule 14C pursuant to Item 407(e)(5) of Regulation S-K;
- annual evaluation of its performance; and
- rights and responsibilities, including as related to committee advisors.

The charter should also address: member qualifications; member appointment and removal; committee structure and operations (including authority to delegate to subcommittees); and committee reporting to the board.

A listed company must post its compensation committee charter, and the charter of any committee to which compensation committee functions have been delegated, on or through its website. It must also disclose in its annual proxy statement, or if it does not file an annual proxy statement, in its Form 10-K, that the compensation committee's charter is available on or through its website and provide the website address.

Section 16 compensation matters

Pursuant to Section 16(b) of the Exchange Act, any profits resulting from the trading of the company's equity securities within a period of less than 6 months (commonly referred to as short-swing profits) by reporting persons under Section 16 of the Exchange Act are recoverable by the company irrespective of any intention on the part of such Section 16 reporting person (the "Short-Swing Profit Rule").

Rule 16b-3 provides an exemption to the Short-Swing Profit Rule for executive officers and directors of the company. Under Rule 16b-3, a transaction between the company (including an employee benefit plan sponsored by the company) and an executive officer or director of the company that involves equity securities of the company shall be exempt from the Short-Swing Profit Rule if it satisfies certain conditions, including generally, if the transaction was approved in advance by the company's board or a committee thereof that is composed solely of two or more "non-employee directors."

A "non-employee director" is a director who: (i) is not an officer or employee of the company or a parent or subsidiary of the company, (ii) does not receive compensation in excess of $120,000, either directly or indirectly, from the company or a parent or subsidiary of the company, for services rendered as a consultant or in any capacity other than as a director, and (iii) does not possess an interest in any transaction for which disclosure would be required as a "related party transaction" pursuant to Item 404(a) of Regulation S-K. The exemption provided by Rule 16b-3 is commonly used for equity-based awards, but it is also available, subject to the conditions specified in Rule 16b-3, for certain other transactions between the company (including an employee benefit plan sponsored by the company) and an executive officer or director of the company.

To the extent an NYSE-listed company wishes to rely on any corresponding exemption from the Short-Swing Profit Rule under Rule 16b-3, the company should (i) be prepared for its board to make approvals under the exemption, (ii) ensure that its compensation committee consists solely of two or more "non-employee directors" such that the compensation committee may make approvals under the exemption, or (iii) ensure that its board forms a special committee or compensation committee sub-committee that consists solely of two or more "non-employee directors" that may make approvals under the exemption.

Equity plan administration

A common function of the compensation committee is to oversee, or act as the administrator with respect to, a company's equity compensation plan. In this role, the compensation committee often has all powers necessary to implement a company's equity compensation program, including the powers to specify the terms of awards and approve awards, resolve all questions under the plans, and make all necessary determinations under the company's plans.

The implementation of the company's equity compensation program should follow the company's specific business objectives. An evaluation of those objectives will guide the compensation committee's approach to both forms of equity to be issued under a plan as well as the specific vesting criteria. Committees also may evaluate approaches of peer companies, in particular those peer companies that are in competition with the company for talent.

Recognizing that the compensation committee may meet quarterly, and there is a desire to provide equity incentives to new employees in connection with commencement of employment, a committee often will delegate limited powers to one of company's officers to approve new hire equity compensation awards to non-Section 16 officers within tight confines specified by the committee, including a specified vesting schedule and a limit in the size of the award based on the position. As is discussed above, the committee usually retains authority for grants to Section 16 officers so that those grants qualify for an exemption from the Short-Swing Profit Rule.

CD&A proxy disclosure

The CD&A section of a company's annual proxy provides the compensation committee an opportunity to explain the company's compensation philosophy and to specifically comment on how the committee's decisions with respect to named executive officer compensation align with that philosophy. Although there is no prescribed format, Item 402(b) of Regulation S-K sets forth a specific list of items that should be discussed (including objectives, compensation elements, and how amounts of each element are determined) and provides examples of items that may be relevant to include (such as policies for allocation between long-term and currently paid compensation, specific corporate objectives taken into account in setting compensation policies and making compensation decisions, and how specific forms of compensation are structured and implemented to reflect individual performance). However, at a high-level, and as is explained in the instructions to Item 402(b) of Regulation S-K, the "purpose of the CD&A is to provide to investors material information that is necessary to an understanding of the [company's] compensation policies and decisions regarding the named executive officers."

Certain meeting practices

Frequency

The compensation committee should meet regularly to fulfill its duties, with the frequency and intervals depending on the company's business, compensation arrangements and the scope of the compensation committee's responsibilities. Many committees hold regularly scheduled meetings on a quarterly basis and any ad hoc meetings on an as-needed basis. The company must disclose in its annual proxy statement the number of compensation committee meetings held during the prior fiscal year (along with certain enumerated information in Item 407 of Regulation S-K).

Meeting agendas and minutes

The compensation committee should set meeting agendas aligned with key milestones for each fiscal quarter or meeting period, as well as any strategic or business issues raised by the board or management. Agendas and meeting minutes help to ensure and memorialize that the committee remains focused on its responsibilities and strategic objectives.

Typical key agenda items throughout the company's fiscal year include, but are not limited to:

- approving remuneration budgets;
- evaluating executive performance and incentive-based compensation;
- reviewing compensation parameters, policies, benefits, and related plans;
- addressing promotions and new executive employment matters;
- approving the CD&A and proxy disclosures;
- assessing the company's peer group and benchmarking compensation;
- reviewing updates from advisors; and
- evaluating the committee's charter, performance, and advisor effectiveness.

Session participation

The compensation committee may include management in its meetings but should generally meet without management when evaluating executive performance or approving compensation matters.

Delegation of authority

If permitted by its charter and applicable laws and regulations, the compensation committee may delegate responsibilities to a subcommittee thereof, typically consisting of members of the compensation committee, and, in certain instances, to other directors, officers, or employees of the company. Delegated responsibilities should have clearly defined scopes, and the subcommittee, committee, or individuals to whom responsibility is delegated should provide regular and transparent updates to the compensation committee.

As noted above, to maintain the exemption under Rule 16b-3 to the Short-Swing Profit Rule, the compensation committee should not delegate the authority to grant awards, such as equity-based awards, to reporting persons under Section 16, to any person or other than to any committee or subcommittee that is composed solely of two or more "non-employee directors" of the company.

Considerations for foreign private issuers

Foreign private issuers ("FPIs") may choose to voluntarily adopt the same US corporate governance practices applicable to US domestic issuers, as discussed in the sections above. However, FPIs listed in the US benefit from flexibility in complying with such regulations of the Securities and Exchange Commission (the "SEC") and US stock exchange standards allowing them to follow home-country practices in key areas, such as those relating to compensation committee requirements and compensation disclosure. While less stringent in some areas compared to domestic issuers, FPIs must still provide certain threshold information to ensure transparency and enhance investor confidence.

NYSE standards relating to compensation committee requirements for FPIs provide the following relief:

Adherence to home country practices: FPIs may follow home-country corporate governance standards instead of US requirements. However, they must disclose significant differences in governance practices compared to US standards, either in their annual SEC filings (e.g. Form 20-F) or on their website.

Independence: unlike US companies, FPIs are not required to have a majority of independent directors or committees fully composed of independent directors. However, they must disclose which directors are independent and explain deviations from US practices.

In addition, and consistent with the less stringent compensation disclosure framework applicable to FPIs in connection with their ongoing reporting obligations (FPIs are not required to disclose individual compensation of executive officers to the same extent as US companies), the NYSE rules requiring companies to obtain shareholder approval for corporate actions, like equity compensation plans, substantial share issuances, or changes in control, are not applicable to FPIs.

Despite the general exemptions available to FPIs from numerous NYSE compensation committee governance requirements and the SEC's compensation disclosure obligations, recent SEC rules and NYSE standards on "clawbacks" impose a universal mandate. These rules require all issuers, including FPIs, to implement clawback policies, ensuring the recovery of erroneously awarded incentive-based compensation in the event of a financial restatement.

In light of recent regulatory changes, FPIs face heightened compliance challenges, particularly in areas related to compensation governance. To navigate these complexities effectively, FPIs should routinely assess their governance practices, align home-country requirements with US standards, and proactively address any gaps to ensure full compliance with applicable regulations.

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The expanding compensation committee mandate

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Introduction

Compensation committees have come a long way since their origin. Whereas they traditionally, and exclusively, discussed executive pay, many committees today are vital partners on a wide variety of talent, performance management, culture, leadership development, and oversight issues. Broadly, these topics all fall under the umbrella of human capital management (HCM). The natural link between pay and HCM issues, along with a variety of external forces—from the 2010 Dodd-Frank Act to the COVID-19 pandemic—have continued to push compensation committees to evolve. In many instances, this evolution has resulted in ditching the "comp committee" moniker in favor of new names such as "human capital committee" or "compensation, culture, and people committee." Companies are also rewriting their charters and rewiring committee responsibilities to capture this rapid expansion of the compensation committee mandate.

In the face of rapidly developing technological, regulatory, and societal shifts, boards are finding it essential to expand the scope and practice of corporate governance beyond the executive ranks. While this might have been unthinkable a decade ago, changing the compensation committee's mandate to include HCM issues is a natural extension of previous duties. Advising on the performance, compensation, and trajectory of executive teams already granted compensation committees a way to promote diversity of thought, build inclusive cultures, encourage engagement, and foster creativity. Now, those core executive responsibilities are expanding to the larger employee population.

The following chapter explores how and why compensation committees' mandates are evolving, why the shift is so important, and the steps boards can take to make the most of their expanded role. We also offer a roadmap, sample calendars, and tips for building a robust, adaptable, and data-driven "next-generation" compensation committee that can help talent-forward organizations succeed for decades to come.

The evolution of compensation committees

Before and after: the changing mandate

Understood most broadly, the expansion of the compensation committee mandate is driven by investors' desire to invest in long-term successful organizations and the recognition that human capital is a critical underpinning of that sustainability.

Until relatively recently, compensation committees left the majority of HCM activity to the chief executive officer (CEO), human resources (HR), and relevant managers. At most, they provided high-level oversight and review of the broader employee population, focusing primarily on equity plan compliance and benefit offerings. The early expansion of the committee's scope was inspired by succession discussions. External hires are often more expensive, have a higher failure rate, and carry greater risk of internal disruption. As a result, investors began asking boards to take more accountability in developing successors internally, cultivating a bench of future executives to help mitigate surprises, save costs, and ensure long-term stability.

As succession planning got boards more involved in identifying and retaining talent below the executive level, the benefits of deeper collaboration on other HCM issues became apparent. Related discussions about pay equity prompted committees to better understand company-wide compensation practices and use that understanding to foster a more resilient and motivated workforce.

This growing partnership between compensation committees and management coincided with the elevated importance of retaining high-level, nonmanagerial knowledge workers. As the rate of technological and societal change grows faster, boards recognize that top-level employees are scarce assets worthy of increased investment. At the same time, a tightening in the labor market convinced boards to exercise more oversight of corporate talent strategies. Attracting, retaining, and supporting top talent requires a company's entire leadership team to be aligned on and engaged in human capital strategy. As a result, compensation committees are now being encouraged to help senior management further those objectives throughout the entire organization, not just the executive suite.

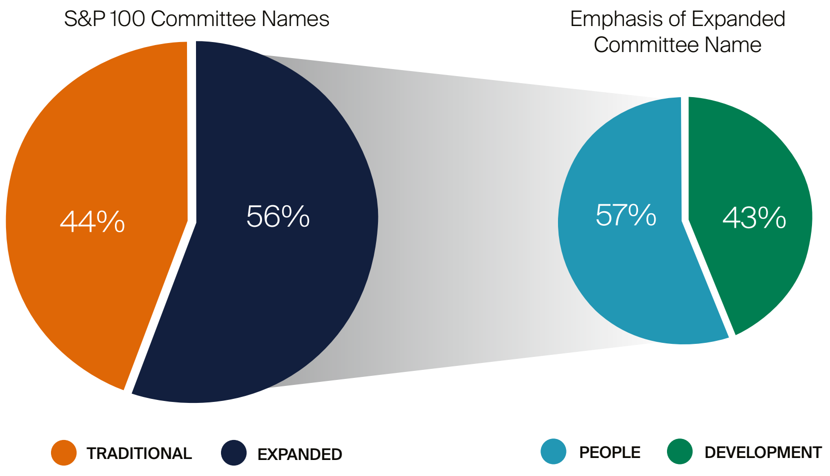
Redefining compensation committees

Renaming compensation committees sends a strong message about evolving priorities. As there is no "standard" title, organizations have redefined compensation committees according to their own needs, as seen in Figure 1 on the next page. Please note that for clarity's sake, however, the remainder of the chapter will still refer to these entities as "compensation committees."

Amending charters clarifies new roles

Amending corporate charters can help align the board in a clear, consistent direction and validate a committee's expanding mandate. It also clearly delineates new responsibilities and creates accountability. Some boards are also beginning to incorporate purpose statements into their charters that explicitly mention the addition of HCM oversight, and

Figure 1. **How Committee Names Reflect Expanded HCM Responsibilities**



Examples:

-Compensation Committee

-Compensation & Benefits Committee

Examples:

-Human Capital Committee

-Compensation & Talent Committee

-People & Compensation Committee

Examples:

-Leadership Development & Compensation Committee

-Management Planning & Development Committee

-Compensation & Organizational Development Committee

we have seen an increase in language that broadly resembles the following:

The purpose of the committee is to oversee the compensation of the members of the Board of Directors, executive officers, and employees; monitor leadership development; and advise on matters relating to human capital management, including workplace environment and safety, pay equity, and corporate culture.

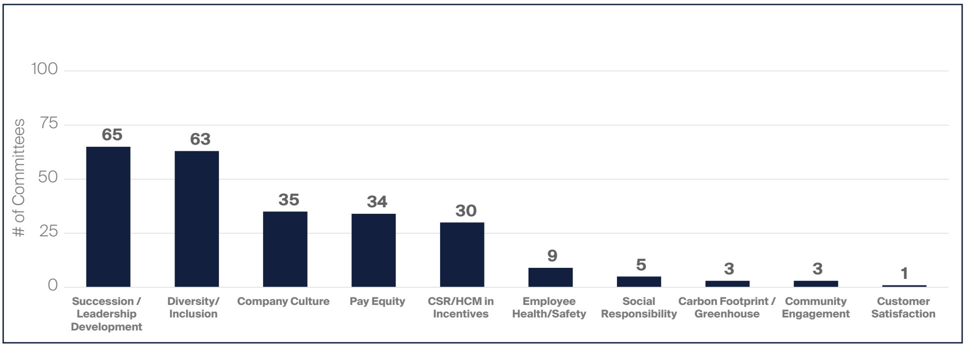
Compensation committees, of course, can add HCM discussions to their agendas without added authority. As seen in the expanded charter responsibilities (taken from the S&P 100) in Figure 2 on the next page, many boards are preferring to codify new responsibilities directly.

New mandates require new skills

The expanded scope of compensation committees will require an expanded skill set to execute, but all organizations have different needs. Early committee discussions might revolve around what specific talent and skills are necessary to reach unique strategic goals, the type of culture that management and the board hope to foster, and any talent issues management or directors perceive. From there, compensation committees can identify areas where developing additional skills or adding experience to the board may be necessary to support long-term goals.

Just as boards look to former chief financial officers when they need finance expertise, many boards are recognizing the value of a

Figure 2. Expanded Responsibilities in Committee Charters



seasoned HCM veteran, such as a former or current chief human resource officer (CHRO), when developing talent strategy. While boards largely functioned without a human capital expert in the past, the changing business and talent landscape suggests that having someone with deep HCM experience, such as a CHRO, is increasingly valuable.

That said, CHROs are not the only ones with knowledge on handling talent. Previous experience working in HR, or time at highly talent-dependent organizations, is also helpful. Some boards also opt to bring in business unit heads to provide insight and context on talent priorities.

Why the changing mandate is vital

Protecting and leveraging your talent is one of the best ways to ensure long-term corporate stability and should thus be a key priority of the board. The expansion of the compensation committee mandate empowers boards to dive deeper into company culture, performance management, succession planning, and pay equity, establishing them as key partners in shaping an organization-wide talent strategy.

Compensation can lead culture

The benefits of a healthy, open-minded company culture are well-documented. Employees often cite a positive culture as the reason that they join or stay at organizations, and a strong culture is one of the best ways to attract and retain talent. A study by BCG and the Technical University of Munich[1] found that organizations with higher levels of diversity of thought, particularly in management, get 45% more revenue from innovation, are more open to new ideas generated by lower-level employees, and receive increasing returns as the company grows in size. Facilitating a multifaceted, inclusive workplace benefits employees, shareholders, and key stakeholders.

More than other areas of HCM, however, culture is subtle and hard to change. Rather than be prescriptive, compensation committees should start from a place of curiosity, asking questions that cut to the heart of the prevailing culture:

- **What are the potential challenges with the current culture?**
  - Does it support the company's broader strategy? Are there places it can be bolstered?

  - How clear are business priorities throughout the organization? Is everyone rowing in the same direction?
- **How does the culture touch employees?**
  - How would employees articulate the prevalent culture? Is it vague and generic or specific to company goals?
  - Who are the culture carriers?
- **What do the employee engagement surveys say?**
  - What other sources might provide insights about the culture or its effectiveness?

It is important to find ways to reward the "culture carriers" that bring a positive company ethos to life. Rather than only rewarding technical skills, boards can focus pay on people who hold up the standard set by the board and CEO. Giving promotions to culture carriers is another way to signal desired behaviors and outcomes throughout the organization while simultaneously putting key employees in a position to lead by example.

Succession planning starts below the C-suite

There are many reasons boards might want to expand their succession plans beyond the C-suite. Sometimes, the board wants a CEO to stay longer than expected, and the first tier of successors age out. The skills required for the job might change so dramatically that current successors are no longer good fits, and sometimes multiple successors leave the company at once and need to be quickly replaced.

Compensation committees now think a layer below executives to ensure there is a robust pipeline of talent to pull from in any situation. Boards will want to think about what skills or experiences future leaders might need to achieve long-term organizational goals and ensure that their "bench" can handle these projected responsibilities. This requires committee oversight of high-potential employees and proactive management of their development plans. Boards can monitor development progress and may contribute directly through mentorship. Finally, boards and management can work together to expand or change an employee's responsibilities in ways that further their growth.

While all companies will delegate differently, it is important to note that C-suite succession will likely remain the provenance of the entire board. Compensation committees, however, can take the board's larger succession goals and help translate them throughout the company.

Performance management flows from the top down

Compensation committees are already in charge of reviewing and approving performance goals for executives in ways that promote company-wide success. Committees can best fulfill this role when they understand how goals cascade through the entire organization, how progress is measured, and how success is communicated internally. While compensation committees may only have direct influence over executive performance, their actions send a powerful message.

There are as many ways to manage performance as there are companies, but all boards can benefit from increased insight into employee performance. For example, when approving CEO goals for the year, some boards ask management to share how these goals are translated throughout the organization and where key accountabilities lie. Others receive an end-of-year report on how all the lines of business and functions did when measured against their goals, as well as the distribution of individual performance ratings across different demographics.

Performance management allows employees to understand how their contributions align with strategic priorities and differentiates high performers. Well-structured performance management systems ensure that pay outcomes are equitable for individuals with comparable skills conducting comparable work. A deeper focus on performance management, therefore, can open fruitful discussions about pay equity, organizational efficiency, and identifying future leaders.

Pay philosophy reinforces talent strategy

Given the global nature of work in many companies, shareholders and stakeholders now see the value of a thoughtful, well-articulated philosophy around pay and talent management. This philosophy needs to be comprehensive and support much more than just annual pay decisions. It must underpin a holistic, long-term strategy for acquiring and nurturing top talent.

Boards should work with HR to develop a deeper understanding of global compensation philosophy. Start by trying to define the organization's employee value proposition and the role of pay relative to other value proposition components, like growth potential or culture. Consider how pay is managed across the organization and, crucially, if pay is accurately rewarding performance. Ensure there are mechanisms that help management ensure equity and fairness. For larger, multinational organizations, compare pay practices across regions and note where they are customized to local regulatory standards and expectations.

Global regulatory and disclosure expectations are constantly evolving. Committees must be aware of the power of public perception and changing societal norms around work and corporate responsibility. Human capital disclosures give investors and current/potential employees valuable insight into company priorities and progress on a variety of issues. Boards need to stay educated on and monitor these disclosures and the data within them to ensure they send messages that help further strategic priorities and attract talent.

Turning words into action

Two of the biggest open questions about the compensation committee's expanding mandate are "Where do we start?" and "Where does it end?" Board meetings are already dense affairs, and adding items threatens to overwhelm full agendas. These changes, however, offer an incredible opportunity for collaboration between the committee and senior leadership and are well worth the time and effort.

The new mandate roadmap

Expanding the responsibilities of the compensation committee is not going to happen overnight. Organizations should take slow, deliberate steps to ensure this transition best supports their unique goals and challenges, starting with the steps below:

1. **Discuss how HCM fits into strategic goals.** Discussion should always stem from well-articulated priorities. Look into the future and discuss the performance metrics, skills, and talent needed to achieve long-term goals.

2. **Clarify the board's new roles and responsibilities.** Committees set their responsibilities across a spectrum, from monitoring progress to approving the key elements of HCM. There is no right answer, but it is essential that everyone clarifies their involvement in advance and prepares to follow through.
3. **Define success and set benchmarks.** What are your top priorities, and how do you know if they have been accomplished? Discuss metrics and goals with management to ensure the entire organization is aligned on any new direction and ensure that there is a way to record and measure success.

It is also important to understand how the committee's responsibilities intersect with other committees and the board as a whole. Boards can use a framework like the one in Figure 3 to ensure that all relevant human capital topics are covered in the right places with the right frequency and cross coordination (*see Suggested HCM oversight responsibility by governing group table below*).

Fitting HCM in the calendar

New responsibilities will add more time to board meetings, but there are natural times when HCM discussions can align with other agenda items. For companies with a calendar fiscal year, summer meetings are an easier time to review HCM issues stemming from company strategy. Future committee meetings can then tackle the items identified as HCM priorities, with conversation topics and agendas flowing from these initial discussions. Another time-saving strategy is to pull standard approval and compliance items into a "consent agenda." Committees can present those materials with good context ahead of the meeting, ask for questions on the materials, and then get a combined approval.

No matter when HCM discussions are scheduled, it is best to provide ample time to review and adjust meeting materials with management, the CEO, and the committee chair in advance of meetings, especially with new topics. Major items are often discussed over two meetings to ensure there is plenty of time to digest, dialogue, and iterate before final approvals. Whenever possible, always leave dedicated time for members to bring up new topics, address ad-hoc items, and evaluate if priorities or goals have shifted (*see Figure 4 for Key HCM discussion topics by quarter table on the next page*).

Figure 3. Suggested HCM oversight responsibility by governing group

	Talent Engagement & Belonging	Company Culture	CSR/ESG Incentives	Compensation/ Pay Equity	Succession/ Talent Planning/ Leadership Development
Board of Directors	Review & Discuss	Review & Discuss			Review & Discuss
Compensation Committee		Monitor	Oversight	Oversight	Oversight
Nominating and Governance Committee			Review & Discuss CSR		

Figure 4. Key HCM discussion topics by quarter

	QI *Reviews / Approvals*	Q2 *Planning*
General Tone	A busy period filled with approvals and decision-making for the year, this is generally less HCM focused.	This is a lighter period often used to cover deep dive topics or facilitate discussion around planning and strategy.
Compensation Decisions	• **Approve** prior year incentive performance and payouts • **Approve** final structure of incentive plans • **Recommend** current year pay changes • **Confirm** compliance with ownership requirements • **Approve** incentive plan agreements • **Review and approve** proxy materials	• **Review** charter and **adapt** as necessary • **Evaluate** Say on Pay outcomes • **Review** executive compensation trends at peers and broader market • **Consider** if changes are needed to executive compensation program design • **Conduct** committee self assessment
HCM Discussions	• **Review or update HCM dashboards**	• **Review of broader HCM strategy and issues** • **Leadership Development Overview** • **Business Unit Leaders discuss talent**
	Q3 *Planning*	Q4 *Planning/Review*
General Tone	Another lighter period focused on pay philosophy and broader planning based on strategy changes and external feedback.	A busy period, where the committee will process and ask questions around pay levels, incentive design, and other major items in the new year.
Compensation Decisions	• **Approve** peer group • **Approve** compensation philosophy • **Evaluate** prerequisites • **Assess** competitiveness of non-employeee director pay • **Develop** program redesign alternatives, as needed	• **Approve** upcoming year calendar and agenda • **Conduct** competitive assessment of executive pay levels
HCM Discussions	• **Succession Planning Below the C-Suite** • **Discuss plans for Top 100 Talent**	• **Discuss engagement survey results, possible issues, and plans to address them** • **Pay equity updates** • **Business Unit Leaders share plans and progress against plans**

Figure 5. **Key questions around HCM data**

Total Compensation Spend	Talent Attraction and Retention	Talent Development
• How competitive are pay opportunities throughout the organization?	• What are turnover rates by sector, role, and voluntary vs involuntary turnover?	• Do we have the right quality and type of talent throughout the organization?
• What are incentive costs as a percentage of earnings? How have they trended over time?	• What is our hiring success rate against critical skill sets?	• How strong are succession plans? Development plans?
• How well is pay correlated with performance in different parts of the organization?	• What is the average tenure of employees in different parts of the organization? Is there appropriate talent replenishment?	• What are employee surveys saying about engagement and well-being?
• Where do the highest labor costs reside?	• Has there been progress on pay equity?	• What is the utilization of well-being offerings?
• What is the company compensation strategy for hourly workers?	• How much differentiation is there in pay and promotion opportunities based on performance?	• What percentage of roles are being filled internally? How competitive is the organization in hiring externally?

For committees without prior HCM experience, we have found that a “crawl, walk, run” orientation helps quickly bring everyone up to speed. Start with report-outs and establish your organization’s baseline on relevant topics (crawl). From there, have HR teams provide regular updates on the progress of HCM initiatives (walk). Finally, consider bringing in business unit leaders to discuss how they are fostering a healthy culture and maximizing talent (run). The committee will then feel empowered to ask challenging, insightful questions about overall HCM strategies at all levels of the organization. Throughout, the hope is to align these discussions about HCM with discussions on broader compensation strategy.

Expanding the HCM data available to the board

Boards can encourage gathering robust, accurate data to help inform their talent strategy. Obviously, directors are not in charge of data collection, but the committee can ask tough questions that spur rigorous efforts to understand the organization’s labor force, which can then be tracked and shared through a comprehensive HCM dashboard. When possible, this data can also be compared against a peer group (*see Figure 5 for Key questions around HCM data table above*).

On the more extreme end of the data-collection spectrum, some boards get feedback directly from management by inviting them into the boardroom. Delta Air Lines, for example, has an employee committee that “relays employee concerns, perspectives and suggestions directly to our executives and Board of Directors.”[2] While this is far from the norm, it illustrates a potential model for further board/management collaboration in the future.

Conclusion

You can have the right strategy, the right market, and the right resources but still fall short of your goals if you lack the right talent. The expanding compensation committee mandate offers greater oversight and coordination with senior leadership for all levels of an organization. As committees become more involved in HCM, managers get more value from their boards, and boards get more value from their managers. This, in turn, helps the entire organization succeed. With a little help from directors, companies can leverage their human capital to thrive in the marketplace, no matter what the external conditions may be.

Best practices in corporate governance must, by design, remain flexible in order to adapt to unexpected challenges and opportunities. The modern expansion of the compensation committee charter is a natural evolution of its long-standing role on the board, and the added scope and flexibility this mandate offers is essential for long-term organizational sustainability. Boards, and especially compensation committees, have always had more influence than they realized over HCM. Accordingly, their mandate has, and will likely continue to, evolve in response.

Chapter notes

1 Lorenzo, Rocío, et al. “How Diverse Leadership Teams Boost Innovation.” BCG Global, 23 Jan. 2018, http://www.bcg.com/publications/2018/how-diverse-leadership-teams-boost-innovation.
2 “Delta 2023 ESG | Employee Engagement.” Delta Air Lines, 2024, http://esghub.delta.com/content/esg/en/2023/employee-engagement.html.

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Board pay evolution and aligning design with shareholders

Pay Governance LLC
Steve Pakela, *Managing Partner*
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Over the past 10 years, since our 2014 chapter on nonemployee director compensation, pay practices have evolved and compensation levels have increased reflecting an expanded and more complex remit, increased risk, time demands, and market competitive factors. There have been significant societal, business, and economic changes over the past decade resulting in increased scrutiny by current and potential directors as to their life and work priorities, including the value of their “free time” and tradeoffs of serving on one or more boards, particularly at public companies subject to disclosure requirements and corresponding risks.

The external challenges, and resulting opportunities and need to evolve, have been significant for boards as they help lead companies in navigating their businesses, supporting human capital and talent management needs. Boards have had to help navigate a global pandemic, several large-scale geopolitical events, impairments of supply chains with wild fluctuations in input availability, climate change, a rollercoaster of interest rates and inflation cycles, and re-evaluation of the company’s facility, supply chain and talent strategy, and locations. During this time, boards have needed to be leaders in evaluating and shaping the company’s strategy and role for ESG-related areas (including diversity, equity, and inclusion) while dealing with strong conflicting views among various constituencies. For multi-national companies, there is the added difficulty of adhering to applicable regulations and changing mandates as government leadership turns over and new/contrary views are implemented. The board’s role, importance, and complexity have also expanded due to the next waves of technology—artificial intelligences, cyber security, and digital privacy.

Compensation trends over the past 10 years

- Generally, compensation increases have been nominal (e.g. 2%–3%) on an annualized basis; however, most companies only increase compensation periodically and at a higher level (e.g. 5%–7% every other year).
- A higher weighting on equity compensation is often preferred, particularly at larger companies and in certain industries (e.g. high tech).
- Cash compensation has been simplified with large companies typically delivering cash solely through retainers rather than having a portion provided in meeting fees.

Design principles

In designing and administering director compensation, a common framework followed by companies includes the following:

1. **Pay philosophy**—total pay is targeted to be competitive with the market median, with a modestly higher emphasis on equity compensation and an ongoing stock ownership or holding requirement.
2. **Peer group**—comparisons are made to the company's pay peer group (companies used for chief executive officer (CEO) and executive officer pay benchmarking) and may be supplemented by a larger data set of comparably sized general industry companies reflecting the broad market for director talent.
3. **Pay benchmarking**—review market pay benchmarking at least every 2 years (many companies review annually).
4. **Pay adjustment timing**—the general bias is to not make changes every year (even though pay benchmarking may be conducted annually). In recent years, there have been some companies that have decided that smaller, annual increases are preferable to making less frequent larger increases.

Summary of compensation and changes over time

At S&P 500 companies, from 2015 to 2023, the median total direct compensation for the "typical director" increased by approximately 19% or on an annualized basis of 2% over the 8 years (*See compensation element table on the next page*).

In the below sections, we review the following elements of compensation:

- cash compensation;
- equity and cash compensation mix;
- equity compensation design;
- board leadership compensation;
- committee compensation;
- stock ownership guidelines;
- director pay limits; and
- contemporary best practices.

Cash compensation

At large companies, the typical director compensation program is provided through annual retainers for board participation and for those chairing a standing committee. At nearly 45% of companies, members of standing committees also receive an annual retainer for their committee service. Board meeting fees were provided by only 8% of S&P 500 companies in 2023, down from the 18% prevalence in 2015. We note that some companies may have provisions that trigger meeting fees if the number of annual meetings exceeds a specified threshold.

Compensation Element	2015	2023	Cumulative Percent Change	Annualized Percent Change
Annual Board Cash Retainer	$88,000	$100,000	14%	2%
Other Cash*	$22,000	$15,000	N/A	N/A
Annual Equity Retainer	$150,000	$195,000	30%	3%
Total Direct Compensation for "Typical Director"**	**$260,000**	**$310,000**	**19%**	**2%**
Cash Weighting	41%	37%	N/A	N/A
Equity Weighting	59%	63%	N/A	N/A
<u>Board Leadership Pay</u>				
Lead Director Retainer Additional Pay	$25,000	$40,000	60%	6%
Non-Executive Board Chair Retainer Additional Pay	$130,000	$180,000	38%	4%

<u>Notes</u>:
*Other cash is derived from the difference between total direct compensation and the two retainer amounts (annual board cash retainer and annual equity retainer); it generally represents the minority of companies who provide meeting fees, and the nearly one-half of companies that also pay non-chair committee members an additional retainer.
**Median total direct compensation for "Typical Director" reflects the sum of board cash retainers, committee member retainers, board and committee meeting fees, and annual equity retainers. It excludes incremental fees for board leadership and committee chair leadership roles.

Equity and cash compensation mix

Over time, as director compensation has increased, the trend has been to deliver a greater portion in equity compensation, which provides direct economic alignment to the shareholders whom directors represent. At S&P 500 companies, the typical director pay mix is weighted higher on equity at 63% and cash at 37%. For directors in leadership positions such as non-executive board chair, lead director, or committee chair, the cash/equity mix weighting may be different depending on pay structure of the additional retainers. The emphasis on equity compensation for directors is also directionally consistent with the typical pay mix for senior executives. The pay mix may vary at smaller companies (e.g. closer to an equal mix) or in certain industries or situations (e.g. even higher weighting on equity).

Equity compensation design

Full value shares are the predominant form of awards for providing equity compensation at large companies. Nearly all companies in the S&P 500 grant directors at least one type of full value share. Less than 10% of large companies grant stock options to directors. In the early 2000s, stock options delivered most or all of director equity compensation—similar to the approach applied by many companies for compensating executives. Over time there has been a significant shift to use solely or primarily full value shares for director equity compensation.

Companies vary in the delivery of the full-value shares with one or more of the following common award types:

1. Restricted stock units or restricted stock, which have a restriction period that may range from 6 months to 3 years (with 1 year generally the most common).
2. Deferred stock units, in which actual shares are not delivered or sold until departing the board.
3. Outright grants of common stock, which are immediately vested at grant.

The use of performance-based awards (e.g. performance shares) for directors is nearly non-existent due to the desire to avoid any misperceptions between compensation and their duties and responsibilities which include setting performance goals, then assessing and certifying performance results for executive incentive plans.

Board leadership compensation

The typical board governance model is comprised of nearly all independent directors (except for the CEO) and is led by either a board chair (executive or non-executive) or a lead director (for companies that maintain a combined board chair and CEO role or have an executive board chair). For the added responsibilities, potential specialized skills, time requirements, and heightened risk, the board leadership role typically receives an additional retainer. As shown in the prior table, over time, the additional compensation for the board leadership positions has increased at a higher rate (+4% to +6% at the median) than the regular annual cash and board retainers (+2% or +3% at the median).

At companies that have separated the board chair and CEO roles, an independent non-executive chair is typically appointed to lead the board. The responsibilities of this position vary by company as does the compensation of the position. Typically, the non-executive chair receives an additional retainer delivered in cash, equity, or a combination thereof that is in addition to the typical director's compensation. At the low end of the spectrum, the non-executive chair's additional retainer is typically positioned above the additional retainer provided to the audit committee chair and at the high end of the spectrum, the additional retainer is $250,000 or more. At median, the extra retainer is $180,000.

Some companies have an executive chair, which is typically a transitional role for an outgoing CEO or company founder. This position is typically limited in duration, ranging from 3 months to 2 years and generally receives compensation representing a modest discount to the executive's previous salary and target annual opportunity with no or a modest equity award. This role remains an employee of the Company, unlike independent director roles.

Committee compensation

Nearly all companies pay an additional retainer to the chairs of standing committees—the three most common of which are audit, compensation, and nominating/governance. Audit chair is typically the highest paid; compensation is paid at the same or a lower level compared to audit, depending on the company's view of the comparability of the time requirements, risks, and other factors; and nominating/governance is typically the lowest paid of the three.

At the S&P 500 companies in 2023, the median additional retainers for committee chairs were as follows:

- audit chair $30,000;
- compensation chair $25,000; and
- nominating/governance chair $20,000.

In 2023, audit committee non-chair members were paid an additional retainer at 50% of companies (median of $15,000), whereas for compensation and nominating/governance non-chair members an additional retainer was paid by nearly 40% of companies (median of $10,000 and $12,000, respectively).

Stock ownership guidelines and requirements

There is near universal use of stock ownership guidelines or retention requirements for directors, which is consistent with the prevalence of requirements for senior executives and ensures ongoing alignment of directors' economic interests with the shareholders they represent. Minimum stock ownership guidelines are typically specified as a multiple of the annual cash retainer or equity award value. At larger companies, the minimum stock ownership guideline is typically five times the annual board cash retainer. At smaller companies, the ownership requirement may be lower at 3 to 5 times the annual board cash retainer or applied as a multiple of the equity award value. The common requirement is that the ownership guideline will be achieved within 5 years of joining the board.

Some companies also have stock retention requirements, which may be used in addition to stock ownership guidelines. For example, companies may require directors to retain net (after tax) shares upon lapse of restrictions until the minimum stock ownership guideline is achieved. Other companies may solely use stock retention requirements (such as grant equity compensation as deferred stock units) to ensure directors accumulate and retain meaningful levels of stock ownership through their board tenure.

Due to their duties and fiduciary responsibilities, shareholder optics, and other factors, some directors decide to retain all of the equity compensation provided during their board service. In addition, some directors may decide to make outright stock purchases to accelerate their accumulation of company stock.

Director pay limits

There has been a significant increase in the prevalence of specified annual limits on director compensation driven by lawsuits asserting that directors breached their fiduciary duties and awarded themselves excessive compensation. At S&P 500 companies, nearly 70% of companies have established meaningful director pay limits within their shareholder-approved equity plans. Practices vary in defining the annual pay limits as equity compensation only or having it apply to total compensation; in both cases the median value is $750,000.

Contemporary best practices

Over time, director compensation levels and program designs have evolved to address the changing regulatory environment, increased time requirements, and risks for directors. Director compensation arrangements have settled to a general design adopted by most large companies:

- Articulate the director compensation philosophy with market benchmarking frequency and adjustment strategy (e.g. bias for annual or less frequent increase).

- Annual cash retainer paid quarterly and representing approximately 35%–45% of the total program value.
- Annual equity award delivered through full-value shares that represent approximately 55%–65% of the total program value.
- Additional retainers for board leadership positions.
- Additional retainers for committee chairs and, potentially, other committee members (near 40% prevalence) particularly if director committee assignments are not generally equivalent across the independent directors or if the workload is significantly greater among certain committees (i.e. audit committee members).
- Stock ownership guidelines representing three to five (or more) times the annual board cash or equity retainer.
- Individual annual director pay limit that is part of a shareholder-approved equity plan.

We anticipate that director compensation will continue to increase at levels similar to recent years (e.g. less than 5% annually) and pay delivery structure will generally continue to emphasize equity. For smaller companies, we anticipate companies will evaluate their pay mix and program design and consider implementing some of the changes that S&P 500 companies have made over time.

18

Demonstrating alignment of CEO pay and performance

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Introduction

Realizable Pay (RP) has long been the "gold standard" for demonstrating shareholder aligned pay for performance as it incorporates the impact of stock price performance on equity-based compensation, the largest component of top executive pay. The Securities and Exchange Commission (SEC)'s Pay Versus Performance (PVP) rules, which were mandated under Dodd–Frank, have incorporated many of the concepts of RP and require that companies compare compensation actually paid (CAP) to the chief executive officer (CEO) and the other named executive officers to the company's total shareholder return (TSR) and other financial measures.

In its final rules, the SEC acknowledged the importance RP played in shaping the new PVP disclosure requirement:

"We believe that the adopted approach in the final rules is similar to the concept of realizable pay, recommended by some commenters, as it reflects an attempt to measure the change in value of an executive's pay package after the grant date, as performance outcomes are experienced."[1]

Based on our research, there is a very strong correlation between CAP and TSR across the S&P 500, and much can be learned from this disclosure. We believe that RP provides more accurate insights; however, the CAP amounts reported by the company and its peers in the PVP tables are more readily available.

This chapter discusses how to use RP or CAP to demonstrate shareholder aligned pay, the major differences between CAP and RP, potential causes for a pay for performance disconnect, and possible ways to improve alignment.

Background

The core provisions of the current SEC compensation disclosure rules became effective for companies with fiscal years ending after 15 December 2006. The new rules introduced the Compensation Discussion and Analysis (CD&A) and Summary Compensation Table (SCT), among many other disclosure requirements. The CD&A and various tables provide several insights into a company's executive compensation philosophy, decision process, use of peer groups, rationale for the selection of annual and long-term incentive measures, grant date values for equity awards, and performance used to determine the amount of annual incentives and long-term performance-based awards, and are very effective from a corporate governance perspective.

The impact of the 2006 disclosure changes, however, did little to further shareholders' understanding of how pay outcomes moved with shareholders' results and placed too much emphasis on the grant date value of equity incentives as determined under ASC 718 (previously FASB 123R). It is difficult to overstate the emphasis the SEC—and investors, academics, the media, and proxy advisory firms—placed on the "one number" reported in the SCT for total compensation. For example, the SEC's Director of Corporate Finance, John White, stated at the time the rules were issued:

*"Investors will now be provided with **one number** (our emphasis) for total annual compensation for each named executive officer. The clarity and comparability of this one number will be complemented by the principles-based narrative disclosures in our new Compensation Discussion and Analysis section and by the requirement that these disclosures be made in plain English."*[2]

The lack of performance-adjustments to equity compensation, and emphasis on the one number led to the creation of new but flawed pay for performance models, including those developed by the proxy advisory firms for their highly impactful Say on Pay voting recommendations that rely on the SCT values. These models have incorrectly determined in dozens of instances that compensation was not aligned with performance, whereas RP or CAP would have shown far better alignment. This problem persists today as a high percentage of their Say on Pay against recommendations appear to be heavily influenced by their quantitative tests (Record Low ISS S&P 500 Say on Pay Opposition: The Trends Behind the Decline). This could be changing as the proxy advisory firms have indicated they may consider the PVP disclosure in their qualitative assessment of a company's compensation program.

To combat the overemphasis on the grant date value of long-term incentives, companies, compensation consultants (including Pay Governance), and some institutional investors, such as Vanguard,[3] developed their own pay for performance models that relied on outcome-based pay models concepts such as RP. Some companies included these analyses in the CD&A to demonstrate shareholder-aligned compensation.

The following sections discuss RP and PVP, providing a detailed comparison of these two approaches and the implications of these analyses.

RP

RP includes the sum of actual cash compensation earned, the aggregate value of in-the-money stock options, the current value of restricted shares, actual payouts from performance-share or

-cash plans, plus the estimated value of outstanding performance-share or -cash plans granted during the performance period being examined (typically 3–5 years). It is also assumed that all shares earned during the performance period are held until the end of the applicable performance period.

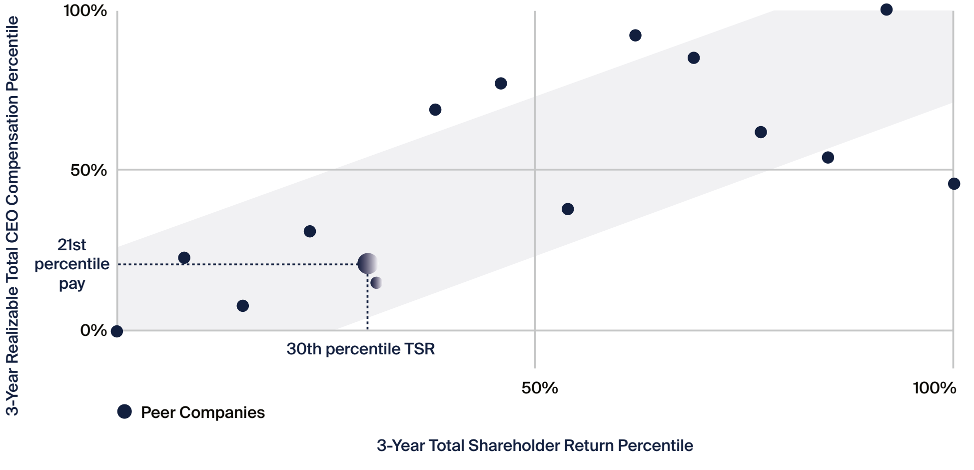
When performing a RP analysis, the CEO's RP is compared to that of the RP of the peer companies' CEOs to determine the subject company's compensation percentile rank. The company's TSR (or any other appropriate financial measure) is also compared to the TSR of its peers to determine the company's performance percentile rank. The resulting RP and performance percentiles are then compared to determine if there is an alignment of pay and performance. For example, 50th percentile RP and TSR would indicate a perfect match of pay outcomes and performance. In practice, however, perfect alignment rarely occurs, but pay outcomes within certain ranges (for example, between the 40th and 60th percentile) would likely demonstrate sufficient alignment to the board and shareholders.

Below is a sample disclosure of RP included in a recent proxy (company name omitted in accordance with our editorial policies). It illustrates strong alignment between CEO RP (at the 21st percentile) and relative TSR (at the 30th percentile) (*see diagram below*):

The SEC was concerned that RP and its disclosure, as described above, were not calculated consistently across companies and worked diligently to develop a standard methodology.

PVP

As noted, the PVP rules were mandated under the Dodd-Frank legislation to address the flaws in focusing solely on SCT compensation. The most revolutionary aspect of the PVP rules was the definition of CAP, which provides for updates to the grant date values of equity incentives included in the SCT for actual stock price and the performance factor of performance-based equity awards. The PVP disclosure of CAP and the related performance data were intended to approximate an RP analysis



but do not provide comparisons of *both* pay and performance *on a relative basis.* The relative comparison of pay and performance provides investors with meaningful insights about the pay for performance relationship.

Understandably, the SEC could not require the inclusion of peer CAP comparisons alongside the peers' TSR data, as such compensation data is not available until all the peers file their respective proxies. Once filed, however, this data can be used in a similar fashion as RP to determine if pay outcomes are aligned with performance.

Pay Governance conducted an analysis of the most recent PVP disclosures covering the 2020–2023 performance period and found a statistically significant correlation between cumulative 4-year CAP and TSR. In addition, several companies studied also had shareholder-friendly pay outcomes (we generally define a shareholder-friendly outcome when TSR rank exceeds the CAP rank by more than 25 percentile points). Key findings shown below:

- Correlation between TSR rank and CAP rank was 0.56.
- The percentage of companies that falls within ±25 percentile points (the green zone) was 64%.
- The percentage of companies that falls within the yellow zone (shareholder-friendly outcomes) was 18% (*see Figure 1 below*).

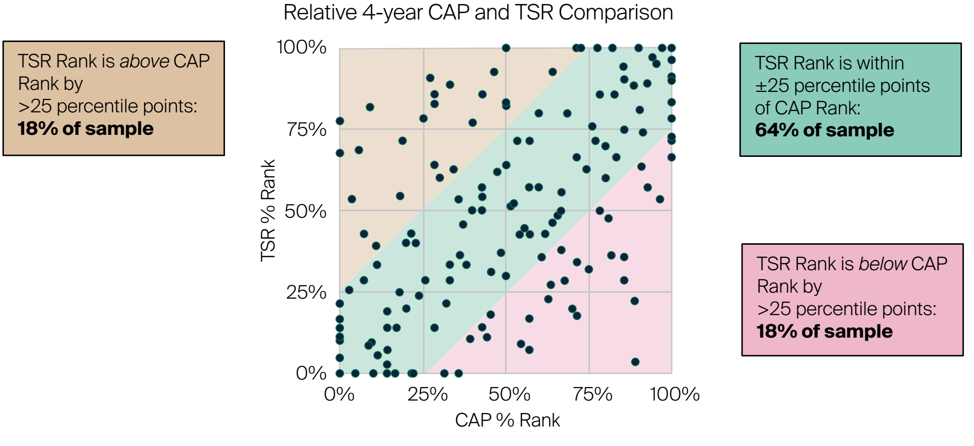
Comparing CAP and RP by element

The following compares key elements of RP and CAP and is intended to provide the relative pros and cons of using these measures to assess shareholder-aligned CEO pay and performance.

Salary, discretionary bonuses, and annual incentives

Salary, bonuses, and annual incentives are the least contentious components of compensation in terms of how they should be measured. However, CAP does not annualize or make any adjustments for newly hired executives, which can result in distortions of annual cash compensation.

Figure 1. Relative 4-year cumulative CAP versus 4-year cumulative TSR (N=159 S&P 500 companies)



With RP, it is best to investigate each incumbent to present the truest picture of annual cash compensation. This often involves reading CD&A's and 8-Ks to find salary rates or annualizing amounts based on hire dates (*see Time-based restricted stock/unit awards table below*).

CAP can overstate or understate compensation for a given year by *including the change in value of grants made in years prior to the PVP performance measurement period*. These prior year awards may include tranches of equity awarded 3 and 4 years *prior* to the commencement of the PVP measurement period. It is essential, that when using this type of analysis, to try to match the performance and pay (mostly stock grants) periods as much as possible. Indeed, based on Pay Governance's analysis of 160 S&P 500 companies, the change in CAP was significantly affected by the change in value of the prior year awards (74% of the change in CAP from 2021 to 2022 and 58% of the change in CAP from 2020 to 2021; What Shareholders Can Learn from the SEC's New Pay Versus Performance Disclosure). The significant proportion attributable to prior year awards is due to the cumulative effect of the number of unvested shares remaining from grants made during these prior periods.

Another difference occurs as CAP stops tracking changes in the value of equity awards once they vest. This SEC requirement essentially assumes the executive sells all the shares immediately upon vesting, which is often not the case. The SEC notes that once vesting occurs, the executive's decision to retain or sell the shares is an investment decision, and any change in stock price thereafter is unrelated to compensation. In high volatility markets, this valuation approach could differ significantly from other methods, such as valuing at the end of the performance period as does RP.

In contrast, RP assumes that all the shares granted and vested during the 3- or 5-year measurement period are retained until the end of the period to measure the impact of the change in stock price on awards granted during the measurement period. While this assumption ignores that some shares may have been sold or withheld to cover taxes and exercise price, the impact is normalized on a relative basis, as RP makes the same

Time-based restricted stock/unit awards

	CAP	RP

Time-based restricted stock/ units (RSAs/RSUs)	• Considers all equity granted during the 5-year period plus unvested equity granted prior to the 5-year period
	• Valued using stock price at time of vesting or at each fiscal year end if unvested during the covered period, taking differences vs. prior fiscal year end as applicable
		• Considers all equity granted during the 3- or 5-year period
		• Valued using stock price at end of 3- or 5-year period
		  ◦ Awards vested during the year are valued at the end of the 3- or 5-year measurement period
		  ◦ This ensures compensation earned is valued based on the stock price at the end of the performance measurement period

assumption for all companies in the peer group *(see Timebased stock options/stock appreciation rights table below*).

The same points discussed above for time-based RSAs/RSUs regarding an overstatement of compensation due to including equity grants made outside the measurement period and disconnect of valuing awards at vest are also true for time-based stock options and SARs.

In addition, there is typically a large variance observed between CAP and RP due to CAP's use of expected valuation models, (e.g. Black-Scholes) versus RP's use of intrinsic value *(see Performance based RSAs/RSUs table on page 143)*.

CAP's requirement that in-flight performance cycles be valued based on expected performance is one of the largest differentiators to RP. Expected performance estimates are often based on confidential information and are rarely disclosed in the PVP table footnotes or the broader CD&A. CAP values for in-flight performance share units (PSUs) that are based on a market condition (i.e. stock price hurdles, relative TSR, or absolute TSR) are based on a Monte Carlo simulation of future performance. RP is based on the estimated payout of performance-based awards for the subject company and the corresponding peer data relies on the footnotes to the Outstanding Equity Awards Table, which typically discloses actual performance for the most recently completed performance cycle and either threshold, target, or maximum payout levels for the remaining in-flight PSU awards. In cases where companies electively disclose estimated payout levels for in-flight awards within the CD&A, RP will reflect those values *(see Long-term cash incentives table on page 143*).

CAP ignores the value of in-flight performance cycles for cash-based long-term incentives, which is at odds with the mark-to-market valuation requirement for equity awards. Thus, CAP ignores what could be a material portion of an executive's long-term incentive in determining PVP until the final year of the performance period. RP, on the other hand, considers the awards made during the performance period, including payouts of relevant completed cycles and estimated levels of achievement for in-flight awards.

Time-based stock options/stock appreciation rights

	CAP	RP

Time-based stock options/stock appreciation rights (SARs)	• Considers all equity granted during the 5-year measurement period plus unvested equity granted prior to the 5-year period
	• Valued using valuation model (e.g. Black-Scholes or binomial) at time of vesting or at each fiscal year end if unvested during the covered period, taking differences vs. prior fiscal year end as applicable
		• Only considers equity granted during the 3- or 5-year measurement period
		• Valued using intrinsic value (stock price - exercise price) at end of 3- or 5-year period
		  ◦ Awards vested during the year are valued at the end of the 3- or 5-year measurement period
		  ◦ This ensures compensation earned is valued at the based on the stock price at end of the performance measurement period

Performance-based RSAs/RSUs

	CAP	RP
Performance-based RSAs/RSUs	• Considers all equity granted during the 5-year period plus unvested equity granted prior to the 5-year measurement period • Awards with performance conditions (non-market conditions) are valued using stock price and management estimates of expected achievement while unvested, and stock price and actual achievement upon vesting, taking differences vs. prior fiscal year end as applicable • Awards with market conditions are valued using a Monte Carlo simulation while unvested, and stock price and actual achievement upon vesting, taking differences vs. prior fiscal year end as applicable	• Only considers all equity granted during the performance period • Completed cycles valued using actual achievement • In-flight cycles valued using estimated achievement levels as disclosed in the Outstanding Equity Awards Table or as described in the CD&A, if available • All awards (both vested and in-flight) are valued at the end of the measurement period

Long-term cash incentives

	CAP	RP
Long-term Cash Incentives	• Included in CAP when reported in the SCT based on when the award is earned • To illustrate, cash long-term incentive plans earned based on performance during 2022-2024 and paid in 2025 is reported as 2024 SCT and CAP	• Considers all awards granted during the 3- or 5-year measurement period • Completed cycles valued using actual achievement • In-flight cycles valued using estimated achievement levels as disclosed in the CD&A, if available; if not disclosed, typically assumed at target

Relative PVP implications and considerations

Compensation Committees and management may find that using a relative analysis of cumulative CAP and TSR against a company's peer group or industry sector can provide a meaningful evaluation of pay and performance, the results of which may help improve compensation programs.

Companies in the green zone, where relative CAP rank is commensurate with TSR rank, indicate that compensation outcomes are consistent with the shareholder experience, and diligent monitoring remains essential to ensure continued alignment. For companies in the yellow or red zones, there may be several program design features that might be worth examining to improve alignment, including:

CAP vs. TSR outcomes and possible symptoms/ explanations	If TSR rank materially exceeds CAP rank (yellow zone)	If CAP rank materially exceeds TSR rank (red zone)
Pay opportunities/targets may be:	Low relative to peers	High relative to peers
Pay mix may be:	Lighter on equity	Heavier on equity
Performance targets may be:	More difficult than peers	Less rigorous than peers
Incentive plans may be:	Less leveraged than peers	More leveraged than peers
Achievement of financial metrics may be:	Translating to increased share price performance—strong correlation of TSR and changes in the financial metric used	Not translating to share price performance—weaker correlation

Conclusion

Both RP and PVP have revolutionized the assessment of executive pay for performance that can be used to demonstrate alignment of pay and performance both internally and externally, rather than relying on a static assessment of pay for performance based on SCT grant values of equity incentives. Indeed, recent academic research suggests that the PVP data is already influencing investors' voting preferences.[4]

Chapter notes

1 US Securities and Exchange Commission, Pay Versus Performance Final Rule, Federal Register, 8 September 2022; https://www.federalregister.gov/documents/2022/09/08/2022-18771/pay-versus-performance.

2 US Securities and Exchange Commission, SEC Votes to Adopt Changes to Disclosure Requirements Concerning Executive Compensation and Related Matters., 26 July 2006; https://sec.gov/news/press/2006/2006-123.htm.

3 https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/policies-and-reports/us_proxy_voting_policy_2024.pdf.

4 Aiyesha Dey, Pay Versus Performance and Investor Voting Decisions, Harvard Law School Forum on Corporate Governance, 26 December 2024; https://corpgov.law.harvard.edu/2024/12/26/pay-versus-performance-and-investor-voting-decisions/.

Public Company Series

Board Structure and Composition

Subsection: Governance oversight

19

An overview of the nominating and corporate governance committee

Cleary Gottlieb Steen & Hamilton
David Lopez, *Partner*
Francesca Odell, *Partner*
Lillian Tsu, *Partner*
Natalia Rezai, *Associate*

In many ways, the nominating and corporate governance committee is the backbone of a public company's board of directors. The committee frames the very functioning of the board—by designing its structure, recruiting its members, ensuring that directors have the necessary tools and are poised to succeed, evaluating their performance, and shaping corporate governance norms.

Overview of New York Stock Exchange requirements

The New York Stock Exchange ("NYSE") requires companies listed on the exchange, other than "controlled" companies, to have a nominating/corporate governance committee (the "NCGC"). The NCGC must be composed entirely of "independent" directors, operating under a written charter framing the committee's purpose and responsibilities, including an annual performance evaluation of the committee. At a minimum, the purpose of the committee is to (i) identify individuals qualified to become board members consistent with board-approved criteria, (ii) select, or to recommend that the board select, the director nominees for the company's next annual meeting of shareholders, (iii) develop and recommend to the board a set of corporate governance guidelines, and (iv) oversee the evaluation of the board and management.[1]

The responsibilities of most NCGCs, however, extend beyond the above core requirements to address other legal and practical issues, of which one of the most important and common is an extensive role in corporate governance that goes beyond developing guidelines. This expanded role is a response to increased pressure from institutional investors and proxy advisory firms. The voting recommendations of the two largest proxy advisory firms, Institutional Shareholder Services ("ISS") and Glass Lewis ("GL"), play a significant role in the proxy voting process and often influence the outcome of shareholder votes. For example, a recent study in the Journal of Financial Economics finds that ISS and GL control over 90% of the proxy advisory market, and when a proxy advisory firm issues a recommendation opposing management, their customers are 20% more likely to also oppose management compared to other investors.[2] In addition, large institutional investors have become more active in recent years in promoting their corporate governance agendas by developing their own policies and engaging companies with respect to perceived deficiencies.

These proxy advisory firms and institutional investors all have their own unique and slightly different approaches to governance matters. For instance, ISS will generally recommend voting against or withholding the vote from the chair of the NCGC (or other directors on a case-by-case basis) at companies where there are no women on the company's board and, in the case of companies in the Russell 3000 or S&P 500, where the board has no apparent racially or ethnically diverse members.[3] Blackrock, on the other hand, has a policy that it may vote against members of the NCGC to the extent that, based on its assessment of corporate disclosures, a company has not adequately explained their approach to diversity on their board composition. Helping companies navigate this sometimes conflicting sea of policies, overseeing shareholder engagement and responses to shareholder proposals and considering environmental, social and governance (ESG) matters generally are additional key responsibilities of the NCGC.

Key roles and responsibilities

Building an effective and balanced board

A basic tenet of corporate governance is that board composition drives board effectiveness, and therefore one of the NCGC's core roles is to analyze the mix of board member's individual skills and experiences with the strategic priorities of the company and the needs of its various stakeholders. Underscoring the importance of this role, the "Big Three" institutional investors (BlackRock, Vanguard, and State Street Global Advisors, who collectively represented a 24.9% portion of votes cast at annual meetings for S&P 500 companies in 2021)[4] all have policies regarding board composition. For instance, absent a compelling reason, Vanguard will generally vote *against* the NCGC chair, or another relevant board member, if the NCGC chair is not up for re-election, "if a company's board is not taking action to achieve board composition that is appropriately representative, relative to their markets and the needs of their long term strategies."[5] In addition, institutional investors and proxy advisory firms keep a close eye on average board tenure and board refreshment policies to ensure companies actually have the ability to onboard new directors in a thoughtful manner.

In thinking about the right mix of individuals, the NCGC must be mindful of all applicable regulatory requirements. There are two important rules of the Securities and Exchange Commission ("SEC") that come to bear here: the first is the requirement to disclose any specific minimum qualifications that the NCGC believes must be met by a nominee and any specific qualities or skills that the NCGC believes are necessary for one or more of the company's directors to possess.[6] The second is the requirement to disclose the specific experience, qualifications, attributes, or skills that led to the conclusion that the nominee should serve as a director in light of the company's business and structure.[7] In addition, the NYSE requires listed companies to have a majority of independent directors, on the premise that boards of directors are more likely to be effective and engage in high quality oversight when they are able to exercise independent judgment and are less likely to have potential conflicts of interest.[8]

Simultaneously complying with these requirements can be challenging. However, there are various tools the NCGC can use to ensure a balanced board. One such tool is a skills matrix. By distilling the qualifications of each board member into a visual reference tool, a skills matrix can help the NCGC holistically evaluate the board's collective experience and skills. From there, the NCGC can use the skills matrix to pinpoint gaps in the board's skills or expertise, select candidates that fill those gaps, or augment the board's makeup based on the company's strategic objectives and future goals and develop targeted succession plans.

Designing director orientation and continuing education programs

As discussed above, companies will often onboard new members to expand the board's collective knowledge and secure fresh and diverse perspectives. According to Spencer Stuart, 34% of directors appointed at S&P 500 companies in 2024 are first-time directors.[9] The transition to a first time public company director is not a straightforward or easy one. The NCGC plays a central role helping shepherd directors through this process, coordinating with management, and, ultimately, helping ensure their successful integration into the board.

The NCGCs role in director orientation can vary. In total, 63.1% of Russell 3000 companies perform director orientation in-house, with 22.6% performing director orientation with both in-house and outside resources.[10]

The concerns and practices of public companies evolve continuously, driven in part by changing expectations on the part of institutional investors and other stakeholders, in part by cultural and political changes, and in part by changing economic conditions. Each year, boards face a host of new and developing business issues and a large array of regulatory developments, from new and growing risks and opportunities from the adoption of artificial intelligence, to ever-changing ESG issues and backlash, as well as enhanced focus on government enforcement and review. Another important role of the NCGC is giving directors the tools to keep up with these developments by designing continuing education programs for directors. Again, this can take many different forms depending on the particular needs of the board or an individual director. At times, re-boarding sessions may be appropriate; other times, inviting external experts may be the best way to identify company blind spots or biases and provide insights into best practices from other companies and industries. In particular, board tabletop exercises that simulate real-word scenarios are becoming an increasingly common method of training and allow boards to practice how to respond in critical situations.

Evaluating the board and its committees

The NYSE requires all boards and their audit, compensation, and nominating committees to perform self-evaluations of the board itself and each committee, and the NCGC is specifically tasked with overseeing evaluations of the board and management.[11] In addition, shareholders are increasingly demanding with respect to board performance management. For instance, State Street believes that boards should "have a regular evaluation process in place to assess the effectiveness of the board and the skills of board members to address issues, such as emerging risks, changes to corporate strategy, and diversification of operations and geographic footprint."[12] Certain large institutional investors are also pushing for greater transparency with respect to these processes. Blackrock, for example, encourages boards to "disclose their approach to evaluations, including objectives of the evaluation; if an external party conducts the evaluation; the frequency of the evaluations; and, whether that evaluation occurs on an individual director basis." Some believe that evaluation practices should be linked with board refreshment.[13]

The purpose of the evaluation will vary depending on the audience. For purposes of the board, evaluations should aim to assess the company's performance, the board's structure, policies and procedures, including its corporate governance guidelines, and the board's role in effectively overseeing corporate culture and strategy and any crisis or significant events that occurred that year. Committee evaluations, on the other hand, should aim to assess whether they have an adequate structure and procedures and sufficient access to the full board and to management, whether the committee is sufficiently integrated into the board and well-positioned to contribute and whether the committee's charter is designed to facilitate all these purposes.

How these evaluations are carried out in practice is left to the discretion of boards and NCGCs. In this camp, there is no one-size-fits-all solution, and various practices have developed. Standard written board evaluations may be an efficient way to comply with annual obligations to self-assess, but they may not elicit enough information to provide meaningful insights into board effectiveness or provide a path forward to increased efficacy. For example, 37.8% of Russell 3000 companies evaluated the full board, committees and individual directors in 2024 (up from 17.6% in 2018), with 17.0% of Russell 3000 companies hiring an independent facilitator to conduct the assessments.[14] It is also possible that an approach that worked one year might not be appropriate the following year. In light of this, NCGCs have the difficult task of creating processes that are meaningful yet manageable and that "fit" the company's particular needs as those needs evolve over time. In designing the right processes, NCGCs should consider several factors, including the board's culture and personalities, whether the board is dominated by one or two influential directors, industry practices, a company's status (e.g. stable or going through an important transition) and similarly that of the board, as well as management's ability to provide support.

Designing an optimal corporate governance structure

Last but certainly not the least, the reference to "corporate governance" in the title of the committee is a nod to the increasing number of responsibilities assumed by the committee relating to corporate governance matters. In fact, the NYSE originally designated this committee as a "nominating committee"; however, along with the increased focus on governance, the name formally changed to the "nominating/*corporate governance* committee." Corporate governance has many meanings ascribed to it, but generally it is understood to be the discipline of establishing procedures and norms that, together, establish the rights, powers, and obligations of a company's various stakeholders and that facilitate well-considered and well-informed decision making in a manner that minimizes or eliminates conflicts of interest. There is no one-size-fits-all approach; instead, boards must tailor their corporate governance structure to the specific company, bearing in mind factors unique to the company such as its business, long term goals and strategy, culture, and dynamics among principal stakeholders. Boards must also take into account the laws of a company's jurisdiction of incorporation, which can play a role in defining the parameters of a company's corporate governance framework. For example, Delaware, the state of incorporation for 68.5% of US companies in the Russell 3000, has state laws impacting the input shareholders have with respect to certain corporate governance matters such as the right to nominate directors for election.

Typical corporate governance responsibilities of the NCGC include the development and implementation of corporate governance guidelines, engagement with shareholders, consideration of shareholder proposals, and oversight of ESG matters.

Some of the attributes of a company's corporate governance structure are expressed by the board in its corporate governance guidelines. Companies listed on the NYSE are required to adopt and disclose corporate governance guidelines, and the NCGC is specifically required to develop and recommend these guidelines to the board. In accordance with NYSE guidance, no single set of guidelines would be appropriate for every listed company, but areas of universal importance include director qualifications and responsibilities, responsibilities of key board committees, and director compensation.[15] As such, the role of the NCGC committee is to review, assess, and consider evolving "best practices" alongside the interests of the company and its various stakeholders, and recommend a set of guidelines applicable to the company based on its own assessment as to the company's optimal corporate governance structure. In a similar fashion, the NCGC periodically reviews the company's charter and bylaws and policies relating to transactions among related parties and insider trading.

Members of the NCGC are uniquely positioned to participate in shareholder engagement given their deep understanding of a company's corporate governance structure. Shareholder engagement is the process of communication and relationship building between a company's board of directors and its shareholders, which is particularly important because 72% of investors in a recent survey expect that stewardship activities will have an impact on an investment's performance over the next 3–4 years.[16] The process often takes place following a company's annual meeting of shareholders and is a helpful way of understanding shareholder perspectives, engaging proactively in a transparent and communicative way and creating long-term value. Often, management leads a company's shareholder engagement efforts but may find it useful for the chair of the NCGC to participate in select meetings given the chair's specific governance responsibilities and insight into issues at the top of most shareholders' agenda today: board effectiveness and refreshment, director accountability and performance, and—for an increasing number of NCGC—oversight of sustainability.

Relatedly, the NCGC often is tasked with overseeing the handling of shareholder proposals related to governance. This is proving to be an increasingly burdensome task as shareholder proponents continue to submit proposals at a record rate. The 2024 proxy season saw yet another increase in the number of shareholder proposal submissions, surpassing 2023's record number (including a 17% increase in governance-related shareholder proposal submissions).[17] Notably, the continued increase of shareholder proposals has caused some at the SEC to wonder if there is a "shareholder proposal overload."[18] While average investor support for shareholder proposals has declined in recent proxy seasons, 2024 saw a notable increase in average investor support for governance-related proposals. This is indicative of the recent focus on governance as a foundation for a company's success. For companies that have seen a proliferation of shareholder proposals in recent years, the high volume and specificity of governance proposals can place significant demands on NCGCs evaluating the company's response to the proposal. When assessing shareholder proposals related to governance matters, the NCGC must consider the fiduciary duties of the board, the accountability to shareholders, the materiality of the issue at hand, whether the proposal proposes good governance practice, if it advances long-term shareholder interests, and the constantly evolving thinking on corporate governance matters. Therefore, the proposed response to a governance proposal must be reviewed by the NCGC on a case-by-case basis and with great care in order to deliver a recommendation to the board.

Finally, ESG topics, particularly climate, sustainability, labor relations and diversity, equity and inclusion matters, have in recent years been at the forefront of investor and stakeholder engagement with public companies, together with the controversy surrounding it. Increasingly, the NCGC is tasked by the board with oversight of ESG matters. In practice, this means members of the NCGC must be prepared to monitor and proactively assess a company's ESG profile, shareholder engagement strategies, and take defensive preparedness measures in light of those developments.

Conclusion

While the NCGC may have had sleepy beginnings, it has very much evolved to perform some of the key functions of a public company's board. It helps build an effective and balance board by carefully selecting and recruiting its members; it helps ensure directors remain engaged and informed through well-designed orientation and continuing education programs; it helps identify areas that need improvement and gauge the board's preparedness for the future through evaluations of the board and its committees; it serves as a critical link between the board and the company's shareholders; and it strives to promote responsible and effective governance practices that are purposefully designed to contribute to the company's overall success.

Chapter notes

1 See NYSE 303A.04 (https://nyseguide.srorules.com/listed-company-manual/09013e2c85c00748).
2 C. Shu, "The Proxy Advisory Industry: Influencing and Being Influenced" (May 2024), available at https://corpgov.law.harvard.edu/2024/05/02/the-proxy-advisory-industry-influencing-and-being-influenced/.
3 ISS "United States Proxy Voting Guidelines" (effective February 2024), available at https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf?v=1.
4 L.A. Bebchuk and S. Hirst, "Big Three Power, and Why it Matters" (December 2022), available at https://corpgov.law.harvard.edu/2022/12/13/big-three-power-and-why-it-matters/.
5 Vanguard "Proxy Voting Policy for U.S. Portfolio Companies" (February 2024), available at https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/policies-

and-reports/us_proxy_voting_policy_2024.pdf.

6 See Item 407(c)(2)(v) of Regulation S-K (https://www.ecfr.gov/current/title-17/chapter-II/part-229/subpart-229.400/section-229.407).

7 See Item 401(e)(1) of Regulation S-K (https://www.ecfr.gov/current/title-17/chapter-II/part-229/subpart-229.400/section-229.401).

8 See NYSE 303A.01 (https://nyseguide.srorules.com/listed-company-manual/09013e2c85c00744).

9 Spencer Stuart, "2024 U.S. Spencer Stuart Board Index" (as of 30 April 2024), available at https://www.spencerstuart.com/-/media/2024/09/ssbi2024/2024_us_spencer_stuart_board_index.pdf.

10 Data from ESGauge as of 13 November 2024.

11 The requirements are found in NYSE 303A.09 (https://nyseguide.srorules.com/listed-company-manual/09013e2c85c0074d; board), 303A.07 (https://nyseguide.srorules.com/listed-company-manual/09013e2c85c0074b; audit committee), 303A.05 (https://nyseguide.srorules.com/listed-company-manual/09013e2c85c00749; compensation committee), and 303A.04 (https://nyseguide.srorules.com/listed-company-manual/09013e2c85c00748; nominating committee).

12 State Street Global Advisors "Global Proxy Voting and Engagement Policy" (effective 25 March 2024), available at https://www.ssga.com/library-content/assets/pdf/global/asset-stewardship/proxy-voting-and-engagement-policy.pdf.

13 Russell Reynolds, "Is Your Board Effective?" (5 October 2022), available at https://www.russellreynolds.com/en/insights/articles/is-your-board-effective.

14 Data from ESGauge as of 13 November 2024.

15 See NYSE 303A.09 (https://nyseguide.srorules.com/listed-company-manual/09013e2c85c0074d).

16 PwC, "PwC's 2024 Stewardship Investor Survey" (2024), available at https://www.pwc.com/us/en/services/governance-insights-center/library/inaugural-stewardship-investor-survey.html.

17 The Conference Board, "2024 Proxy Season Review: Corporate Resilience in a Polarized Landscape" (12 October 2024), available at https://corpgov.law.harvard.edu/2024/10/12/2024-proxy-season-review-corporate-resilience-in-a-polarized-landscape/.

18 Commissioner Mark Uyeda, "Remarks at the Society for Corporate Governance 2023 National Conference" (21 June 2023), available at https://www.sec.gov/newsroom/speeches-statements/uyeda-remarks-society-corporate-governance-conference-062123.

Public Company Series

Board Structure and Composition

Subsection: Leadership structures

20

Independent board chair—trends and issues

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Board effectiveness is one of today's hot corporate governance topics, and the appropriate board leadership structure is a key part of this discussion. In this chapter, we explore the more recent trends and considerations relating to the topic of board leadership structure. While there has been a clear shift toward independent board leadership, views on whether that independent leader should be a true independent chair separate from the chief executive officer (CEO) or a lead independent director (LID) serving alongside a combined CEO/chair vary among companies, investors, and other stakeholders.

Fundamentals of board leadership structure

A company may mandate a specific board leadership structure in its bylaws and/or corporate governance guidelines by requiring an independent chair separate from the CEO or, alternatively, that a LID serve alongside a combined CEO/chair; however, companies often do not prescribe a specific structure in order to preserve flexibility to determine which leadership structure is most effective for the company based on its circumstances at any given time.

The duties of a board chair typically include presiding over board and shareholder meetings, calling board meetings and setting their agendas, serving as the liaison between management and the independent directors, serving as the main contact person for other board members, and acting as spokesperson for the board to stakeholders.

A LID is an independent non-employee director appointed to represent the independent directors and perform certain leadership duties in the absence of an independent chair. Common baseline responsibilities often partially overlap with the traditional chair role and include the authority to call board meetings and set or collaborate with chairs on meeting agendas, to call and preside at meetings of independent directors, and participate in stakeholder engagement. In practice, however, LIDs often exercise less authority than a typical board chair. LID best practices include LID participation in CEO succession planning and acting as an advisor to committee chairs. The scope of the LID role varies among companies; however, due to a number of factors—such as board and CEO preferences, power dynamics, company circumstances, and investor pressure—there has been a trend in recent years toward expansion of the role, driven primarily by investor and proxy advisory firm expectations. While institutional investors and proxy advisors vary in the degree of specificity of their expectations for LIDs, a common theme is the importance of sufficient responsibilities to be able to ensure independent oversight or, as Vanguard puts it, "sufficiently robust authority and responsibilities [to] provide a strong counterweight."

Securities and Exchange Commission disclosure obligations

The Securities and Exchange Commission (SEC) requires companies to disclose their board leadership structure in proxy and information statements. Specifically, Item 407(h) of Regulation S-K requires companies to disclose, "whether the same person serves as both principal executive officer and chairman of the board, or whether two individuals serve in those positions." Further, "[i]f one person serves as both principal executive officer and chairman of the board", companies must disclose whether they have "a lead independent director and what specific role the lead independent director plays in the leadership of the board. This disclosure should also indicate why the [company] has determined that its leadership structure is appropriate given the specific characteristics or circumstances of the [company]."

This SEC disclosure requirement, as well as proxy advisory firm and institutional investor policies discussed further below, requires companies to give thoughtful consideration to their board structure and the scope of any LID role.

So, why have an independent chair or a LID?

Why combine roles

Advocates of combining the CEO/chair roles posit that it creates synergies that allow management to respond more efficiently to board feedback, in addition to creating clear accountability. Such advocates state that separating the roles creates an artificial divide with little practical benefits and duplicates leadership, thereby leading to less efficient decision-making and internal confusion. In addition, CEOs may have more in-depth knowledge of a company's business and industry or greater strategic vision and, for industries where technical, regulatory, or competitive knowledge is most acutely important, having the same deeply informed person in both roles can ensure that a company's strategy is shaped by an appropriate understanding of the core business. Further, in industries where the pace of innovation and competition is most intense, not having to coordinate with a separate chair may allow for greater real-time integration of strategic direction and technical execution, particularly as the CEO is often perceived as the best position to understand the challenges and opportunities in a particular fast-evolving sector. More prosaically, advocates of combined roles also note that requiring the roles to be separate can make recruitment of a new CEO more difficult, as the expectation of some CEO candidates is to lead both the board and management.

Why LIDs are seen as indispensable to boards with a combined CEO/chair

When a company combines the CEO/chair roles, a LID can serve as a counterweight, allowing the board to exercise effective independent oversight and decision-making without undue influence from the CEO. A LID can also facilitate open and candid discussions, particularly when it comes to evaluating CEO performance, and assist in driving the board's agenda.

Why independent chairs are sometimes preferred to LIDs

Proponents of separating the CEO/chair roles rebut the arguments above, stating that the role of the CEO and management is to run the company, while the role of the board is to provide independent oversight over and management of the CEO. They posit that the role enhances the board's independence and leads to better monitoring and oversight. These proponents believe that having an independent chair allows for a clear distinction between the roles of the board and management; eliminates potential conflicts of interest in the areas of management performance evaluations, executive compensation, succession planning, and the recruitment of new directors; gives one director clear authority to speak on behalf of the board; allows the CEO to focus completely on strategic, operational, and organizational matters; and fosters a thoughtful and dynamic board that is not dominated by the views of senior management.

While a LID can provide an independent counterweight to a combined CEO/chair, the LID shares authority with the chair, which can blunt the impact of the role. In addition, a LID is only effective to the extent the particular individual in the role is able to work cohesively with the CEO/chair while maintaining independence.

Impact of board structure on company performance

Academic research has indicated that having an effective board structure is more about having the right individuals in leadership roles—individuals who are competent and set the right tone and culture—than whether a company has an independent chair versus a combined chair and CEO. For example, in a 2015 paper, "*Seven Myths of Boards of Directors*" (Rock Center for Corporate Governance, Stanford Closer Look Series—CGRP51, 30 September 2015), and subsequent 2019 article, "*Loosey-Goosey Governance: Four Misunderstood Terms in Corporate Governance*" (Rock Center for Corporate Governance, Stanford Closer Look Series—CGRP79, 7 October 2019), David F. Larcker and Brian Tayan of Stanford University point out that research shows no consistent benefit from requiring an independent chair, citing multiple studies, including:

- one meta-analysis across 31 studies that found no correlation between chair status and performance;
- one study examining the impact of a change in independence status that found no impact on performance;
- one study that found that forced separation leads to worse performance; and
- one review of 48 studies that found that independence status has no impact on performance, managerial entrenchment, organization risk taking, or executive pay practices.

As discussed above, even a LID with well-defined responsibilities may lack the authority and level of involvement of an independent chair as a practical matter because the LID shares responsibilities with the CEO/chair. Moreover, it is important to choose an individual who can work productively with and is respected by the CEO/chair if the LID is to be effective.

The statistics: what can they tell us?

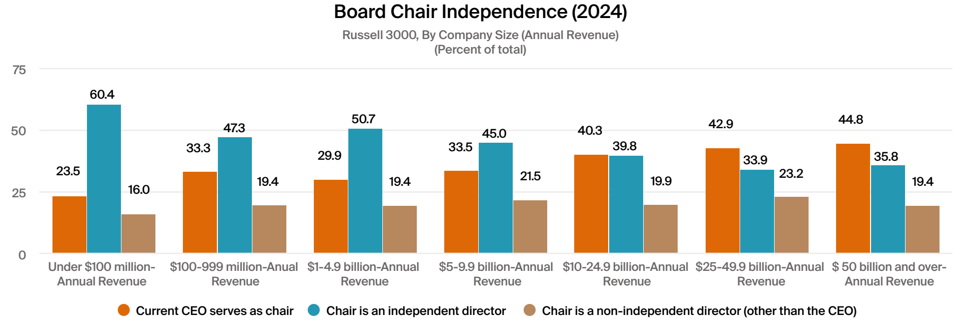
According to survey data from The Conference Board and environmental, social and governance (ESG) data analytics firm ESGAUGE in 2024, 41.2% of S&P 500 boards had the current CEO serving as chair in a combined role, 39.8% had an independent chair, and 18.9% had a non-independent chair other than the CEO. Based on the data, the percentage of S&P 500 companies combining the CEO and chair roles decreased from 48.7% in 2018 to 41.9% in 2022 but has since plateaued. In a survey released in 2024 that reviewed proxy data from 1 May 2023 through 30 April 2024, Spencer Stuart reported that among 104 S&P 500 boards with executive or non-independent chairs, 101 had identified a LID (Spencer Stuart, "*2024 U.S. Spencer Stuart Board Index*"). Four boards did not report having any form of independent leadership, either as a chair or as a LID.

In a report published by The Conference Board and ESGAUGE in June 2022, (Merel Spierings, "*Board Leadership, Meetings, and Committees*"), the author concluded that the growing percentage of independent chairs from 2018 to 2022 was "likely driven by CEO succession events, as well as the growing workloads of board and management, rather than shareholder proposals calling for CEO/board chair separation." The report noted that shareholder support for such proposals had remained in the 30% range, while boards and management faced increased workloads as they grappled with "a multitude of crises, fundamental transitions in business models, and growing demands for companies to address ESG issues and the needs of stakeholders." The report further noted that, of the 27 CEO succession announcements at S&P 500 companies through June 2022, only one company chose to replace a departing CEO/chair with someone who would assume both positions.

When looking beyond the S&P 500, data from The Conference Board and ESGAUGE as of December 2024 suggest a strong correlation between company size and board leadership model, with a majority of the largest companies (those with annual revenues of $50 billion and over) having a combined CEO/board chair or otherwise non-independent chair and a majority of the smallest companies (those with annual revenues of under $100 million) having an independent board chair.

As shown in the figure in the next page, nearly 45% of companies with annual revenues of $50 billion and over had a combined CEO/chair compared to just 23.5% of companies with annual revenues under $100 million. Meanwhile, over 60% of companies with annual revenues under $100 million had an independent chair compared to 36% of companies with annual revenues of $50 billion and over.

Based on data from 50 initial public offerings that took place in 2021, 65% of companies that completed an initial public offering in 2021 had a combined CEO/chair at the time of the initial public offering. However, the correlation between company size and board leadership role held even among these companies, with only 44% of companies with annual revenues under $100 million at the time of the initial public offering having combined roles, compared



Source: ESGAUGE, 2024.

to 65% to 70% of companies with higher annual revenues.

It is likely that smaller companies with more limited resources seek to benefit from having an independent chair who can focus on managing board affairs and leading the board, freeing the CEO up to focus on managing the company, while larger companies seek to benefit from the synergies achieved by having the same individual in both roles.

Data from the same 50 initial public offerings also showed variation in board leadership structure by type of pre-initial public offering investor, with approximately 70% of venture capital-backed companies having combined roles (75% for founder-led companies) at the time of the initial public offering compared to just 50% of private equity-backed companies. This difference between venture-backed companies and private equity-backed companies is not surprising given that private equity-backed companies are often still controlled by the private equity sponsor following the initial public offering and accordingly more likely to have a separate chair appointed by the private equity sponsor to counterbalance the CEO.

With respect to policies on board leadership, the trend since 2018 has been a shift toward greater flexibility, with the percentage of companies with a flexible leadership structure policy increasing at both S&P 500 companies (from 72% in 2018 to 76% as of December 2024) and Russell 3000 companies (from 63% in 2018 to 70% as of December 2024), according to data from The Conference Board and ESGAUGE.

Independent chair proposals: persistent, but not driving adoption

Since the mid-2000s, shareholder proposals calling for an independent chair have been one of the most common types of governance proposals. Following a spike in 2023, in which 84 shareholder proposals (approximately half of which came from a single proponent) calling for an independent chair went to a vote, independent chair proposals fell back to a more historically typical 42 in 2024. The increase in such proposals in 2023 was not accompanied by a significant increase in average shareholder support levels, however, which have remained between 28% and 35% from 2013 through 2024. The last time an independent chair proposal passed was in 2021, garnering only 52% support.

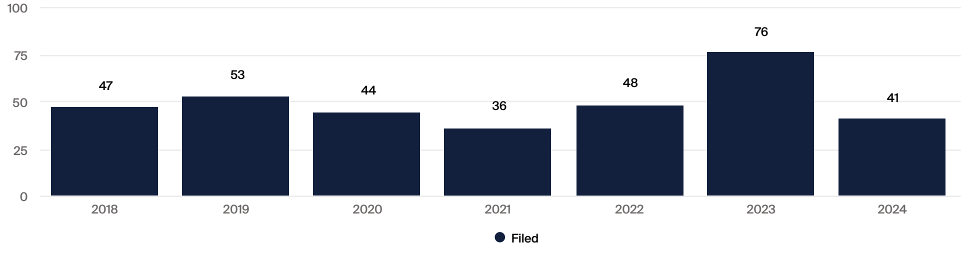
Shareholders appear to be persuaded by company arguments that mandating a separation of the chair role is not in shareholders' best interests. These arguments include: (i) that mandated separation impedes the board's ability to use its experience, judgment, and insight, as well as shareholder feedback, to determine the best board leadership structure based on a company's then-existing facts and circumstances; (ii) that an independent LID with robust responsibilities provides a strong independent counterbalance to the CEO/chair; and (iii) that the company's performance is better evidence that its approach to board leadership is effective.

Although, as noted above, it has likely been factors other than independent chair proposals that have driven trends toward the separation of the CEO and chair roles, data from ISS Corporate Solutions (ISS) indicates that larger companies with a combined CEO/chair should continue to be prepared to receive independent chair proposals (see "*Investors Press U.S. Boards to Separate Chair, CEO Roles*," posted by Subodh Mishra, Institutional Shareholder Services on the Harvard Law School Forum on Corporate Governance on 12 October 2023).

As the data show, a significant percentage of companies in the S&P 500 without independent chairs continue to receive independent chair proposals, with nearly one in four such companies, for example, receiving a proposal in 2023. By contrast, only a very small percentage of Russell 3000 companies that are not in the S&P 500 continue to receive such proposals.

Independent Board Chair—Shareholder Proposals

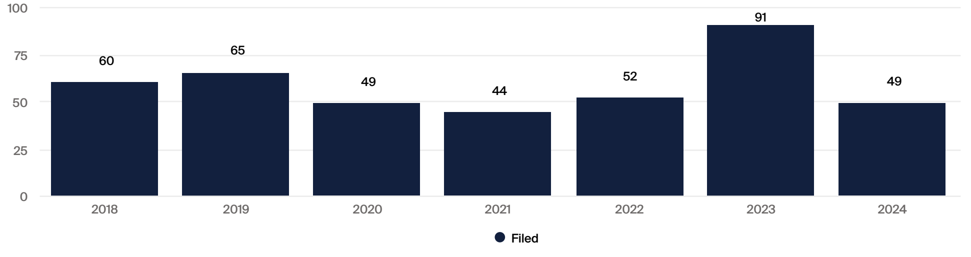
S&P 500
(Number of proposals)



* Findings for the current year may not yet be statistically meaningful.
Source: ESGAUGE, 2025.

Independent Board Chair—Shareholder Proposals

Russell 3000
(Number of proposals)



* Findings for the current year may not yet be statistically meaningful.
Source: ESGAUGE, 2025.

Proxy advisory firm and institutional investor voting policies

The policies of proxy advisory firms and institutional investors favor strong independent board leadership either through an independent chair or presence of a LID.

ISS voting policies state that ISS will generally support independent chair shareholder proposals. However, during the period from 2022 through September 2024, ISS only supported 58% of such proposals.

Factors that ISS will take into account in making its recommendation with respect to an independent chair proposal include: the scope and rationale of the proposal; the company's current board leadership structure; the company's governance structure and practices; and company performance. ISS states that it will consider how the board's current leadership structure benefits shareholders and/or specific factors that may preclude the company from appointing an independent chair, if such disclosure is provided by the company, and that boilerplate rationales will be viewed less favorably. For example, ISS took a mixed view on independent chair shareholder proposals received by major financial institutions during the 2024 proxy season, recommending for such proposals at institutions with ostensibly robust LIDs where recent developments, such as leadership transitions or controversies, raised questions regarding the ability of LIDs to provide sufficient independent oversight.

A weak or poorly-defined LID role that fails to serve as an appropriate counterbalance to a combined CEO/chair role is more likely to result in a "for recommendation" from ISS on an independent chair proposal. ISS considers a robust LID role to be one where the LID is elected by and from the independent members of the board and has clearly delineated and comprehensive duties.

Glass Lewis (GL), on the other hand, states that it does not believe that having an independent lead or presiding director who performs many of the same functions as an independent chair (e.g. setting the board meeting agenda) provides as robust protection for shareholders as an independent chair and that it typically recommends that its clients support separating the roles of chair and CEO whenever that question is posed in a proxy statement. However, unlike ISS, GL may recommend against the chair of a company's governance committee if the company has neither an independent chair nor a LID.

Meanwhile, the largest institutional investors, such as Blackrock, Vanguard, and State Street, will generally defer to companies on leadership structures if the LID role is robust. Such investors generally look for disclosure regarding the scope of the LID role.

Conclusion

Advocates for an independent chair emphasize that separating the positions enhances corporate governance by reducing the potential for conflicts of interest and providing more effective oversight over CEO performance. Proponents of a combined CEO/chair role argue that it provides greater efficiency and unified leadership, especially in fast-moving industries where strong, decisive direction is critical, and that a robust LID role can serve as a check and balance on a CEO/chair. As discussed above, there is no one-size-fits-all approach, and companies will need to continue to determine which leadership structure is most effective for the company based on its circumstances at any given time.

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The independent board chair: succession, responsibilities, and skills of effective chairs

Korn Ferry
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Board leadership is critical in today's corporate boardrooms, especially as organizations face increased scrutiny and rapid changes in the business landscape. The evolving expectations of shareholders, regulatory bodies, and other stakeholders require boards to remain adaptable and proactive in their governance practices.

Indeed, the role of the chief executive officer (CEO) has become so vast and demanding that many question whether one person can truly manage it all. This has elevated the importance of chairs and lead independent directors (LID). They now play a crucial role in steering the company toward sustainability and growth, particularly during times of uncertainty.

In the past, the selection of the chair or LID often lacked a clear process. Some organizations simply let seniority take precedence over a thoughtful evaluation of competencies and experience. Today, however, it is more important than ever for the chairman and CEO to form a complementary partnership, working together closely to guide the company through challenging times.

To select the right chair or LID, a disciplined approach is needed to ensure the right leader is chosen—one who possesses the requisite skills, experience, competencies, and vision to effectively guide the board. The ideal chair or LID should be a proven leader who can provide strong oversight, courage, and mentorship to the CEO. This requires both a deep understanding of the industry and the organization's strategic priorities, as well as also having the emotional intelligence to guide discussions and mediate differing perspectives among board members. A well-planned succession for committee leadership should align closely with the succession of the lead director, ensuring a seamless and positive transition when leadership changes occur.

This is not to say that a board should wait around for a vacancy before getting to work. Boards should also focus on chair progression. Chair progression is more than choosing the right person for the role, it is about preparing the board well in advance. Through the development of the board's capabilities ahead of time, organizations can ensure that, when a transition is necessary, the board is already primed for success.

By thoughtfully preparing for these transitions before a change is imminent, boards can maintain continuity in governance and uphold their commitment to strategic oversight, thereby positioning the organization for sustained success in a complex and ever-evolving marketplace.

Defining the roles of the executive chair, and lead independent director or non-executive chair

The executive chair typically holds a significant operational role within the company, as a complement to and working closely with the CEO to oversee the company's long-term outlook and performance. Both roles are more effective when the executive chair and CEO have clearly defined responsibilities and complementary capabilities.

In contrast, the non-executive chair or LID focuses on ensuring effective governance from an independent standpoint. This role is crucial for fostering a balanced relationship between the executive team and the board, promoting accountability and objectivity. The non-executive chair or LID acts as a liaison between the board and the CEO, facilitating communication while ensuring that the interests of shareholders are represented.

In scenarios where a transitioning CEO serves as the chairman of the board, complexities arise. Here, the outgoing CEO may continue to hold the title of executive chair, which can lead to an overlap in authority as the new CEO steps into their role. This situation requires careful management to avoid potential conflicts and to ensure that governance remains effective.

During the transition, the incoming CEO, while taking on their new responsibilities, might need to navigate a delicate balance of authority with the executive chair's continuing influence. In this case, the role of LID is crucial. The LID can help delineate roles and responsibilities, ensuring the new CEO is empowered to lead while also maintaining a collaborative relationship with the outgoing CEO, who is now the executive chair. The LID can act as a mediator, facilitating discussions and helping to clarify governance dynamics to support a smooth transition.

Defining these roles clearly is vital, particularly during leadership changes, to ensure that the board operates effectively and that both the new CEO and the executive chair/former CEO can work collaboratively for the organization's benefit. This clarity fosters a governance atmosphere that supports strategic objectives while maintaining independence and accountability. To illustrate these roles with clarity, a matrix of roles and responsibilities are shared below:

Figure 1. Executive chairman, CEO, LID (or non-executive chair): decision rights framework.

RESPONSIBILITIES	LEAD INDEPENDENT DIRECTOR	EXECUTIVE CHAIRMAN	CEO
BOARD AND SHAREHOLDER MEETINGS			
Preside over Board and shareholder meetings		X	
Preside at meetings of the Board at which the Chairman is not present	X		
Set/Approve meeting agendas for the Board	X (Approves agenda)	X (in collaboration with CEO)	X (Sets agenda)
Ensure that meeting schedules permit sufficient time for discussion of all agenda items		X	
Authority to call special meetings of the directors or shareholders	X	X	X (in conjunction with Chair)
Act as intermediary, provide guidance, and refer issues to executive session	X		
EXECUTIVE SESSIONS			
Authority to call meetings of the independent directors	X	X	
Set agenda and lead executive sessions of independent directors	X	X	
Brief the CEO on issues that arise in executive sessions	X	X	
Receive feedback from executive sessions			X
BOARD COMMUNICATIONS			
Facilitate discussion among directors on key issues and concerns outside of Board meetings	X		
Serve as conduit to CEO of views, concerns, and issues of the directors	X		
Communicate as needed with directors on key issues and concerns outside of Board meetings	X	X	X
Keep Chairman and Lead Independent Director aware of key input and collaboration	X		X
ADVICE AND CONSULTATION			
Serve as liaison between Chairman and the independent directors, including reporting to the Chairman on all relevant matters arising from executive sessions of the independent directors	X		
Advise the Chairman/CEO regarding the sufficiency, quality, quantity and timeliness of information provided to the Board	X		
Recommend to the Board the retention of advisors and consultants who report directly to the Board	X	X	X
Available for consultation and direct communication with major shareholders, if requested	X		X
EXTERNAL STAKEHOLDERS			
Represent the organization to and interacts with external stakeholders and employees		X	X
Participate in meetings with key external stakeholders at the discretion of the Board	X	X	X
COMPANY OPERATIONS			
Global accountability for all company operations			X
Financial management			X
Large-scale transformation and organizational structure			X
Strategy development		X (key advisor)	X
Digital transformation and technology-driven outcomes			X
Culture, talent, and diversity			X
Brand representation and market leadership			X

Evolving role and responsibilities of the chair

The role of the chair has evolved in response to increased complexity in corporate governance. Today's chair must help the board and CEO navigate an environment shaped by technological disruption, stakeholder activism, and shifting geopolitical societal expectations. As Korn Ferry's just released 2025 global study[1] shows, 76% of chairs report heightened demands from stakeholders, marking a shift from periodic updates to continuous engagement across various constituencies.

As one chair noted, "the chair has a more pronounced obligation to speak to shareholders. This was not the case five years ago. Speaking with large institutional investors is important because they want to discuss governance, long-term strategy, sustainability, and IT developments, which will continue to increase in the future."

The modern chair must balance multiple critical responsibilities, including:

- **Strategic partnership with CEO**: a critical responsibility of the chair is to create a strong strategic partnership with the CEO. This partnership should be grounded in mutual trust, enabling candid conversations and collaboration on the company's leadership agenda. While collegial, the relationship must remain objective, with both the CEO and the chair providing complementary oversight over the board agenda and shareholder concerns.
- **Stakeholder management**: chairs are tasked with managing relationships with a wide range of stakeholders, including activist investors and institutional shareholders. The ability to maintain a productive dialogue while protecting long-term corporate interests is a key skill in today's governance environment.
- **Strategic and governance balance**: the role of the chair is as much about strategic guidance as it is about corporate governance. A successful chair needs to bring relevant strategic experience to the table to help guide the company in the right direction.
- **Technological acumen**: with technology rapidly transforming industries, chairs must demonstrate a deeper awareness of technological transformation, notably artificial intelligence, in the current landscape. Approximately 62% of chairs emphasize the need for technology literacy to oversee technological changes effectively.[1]
- **Emotional intelligence**: a successful chair must possess high emotional intelligence to manage board dynamics, foster inclusive decision-making, and establish strong, trust-based relationships with the CEO and fellow board members.
- **Mentorship for newly appointed CEOs**: newly appointed CEOs need a strong mentor in the chair role more than ever. The chair serves as an advisor, providing valuable insights and leadership during the CEO's initial years. Mentorship ensures that the CEO's strategic vision aligns with the long-term objectives of the company.
- **Courage to challenge**: the chair must possess the courage to challenge both management and the board when necessary. By encouraging other directors to voice dissenting opinions and engage in constructive challenges, the chair fosters a culture of accountability and thoughtful decision-making.

[1] Korn Ferry Global Board Chair Study, 2025. This work serves as a key reference throughout this chapter.

- **Trust and integrity**: to be effective in today's evolving corporate and geopolitical landscape, a chair must demonstrate the ability to foster mutual trust between the CEO and the board. The chair should embody strong yet collaborative leadership, ensuring alignment across the board while providing objective perspectives.

Board leadership succession planning process

Succession planning for board leadership has become more sophisticated in modern corporate governance. With 78% of chairs emphasizing the importance of a structured succession development process[1]. The planning process should address both immediate leadership needs and the long-term resilience of the organization. Ongoing leadership development and planning is crucial for boards to ensure a pool of qualified candidates ready for future leadership roles. This development should be a continuous process that involves regular assessments of board members' strengths and their preparedness for committee leadership responsibilities and potential for becoming a board chair.

One effective strategy is to conduct periodic peer reviews as part of the board evaluation process.

Additionally, implementing a policy on board leadership rotation practices allow directors to chair various committees, such as audit, compensation, or governance, thereby developing essential board leadership attributes such as agility, adaptability, strategic decision-making, and followership/credibility.

Engaging board members in scenario planning and crisis simulations prepares them for critical situations, ensuring the board remains resilient in the face of challenges. Aligning these efforts with the succession of the chair supports seamless transitions in leadership.

Selection criteria and succession timeline

An ideal candidate is one that has understanding and mastery of the critical capabilities needed in the position and a proven ability to motivate others. But to find the right fit, boards must know *what* they are looking for and *how* to get them. The following suggestions will make for an effective selection process:

- **Selection process and board input:** leading organizations employ a structured 12–24-month planning process for chair succession, typically led by the nominating committee. The selection process balances the merits of internal candidates against external candidates (e.g. those who offer institutional knowledge and stability versus those who bring fresh perspectives but require longer integration periods). Successful boards engage all directors through individual interviews and structured evaluation frameworks to ensure alignment and buy-in for the final selection. Some boards plan for the next chair to move into a vice-chair capacity for 6–12 months before the transition occurs to ensure a smooth transition.
- **Establishing a chair or LID success profile:** developing a success profile serves as the foundation for identifying and evaluating potential candidates, ensuring alignment with the organization's strategic goals and values with key competencies, mindsets, and experiences required for the role.
- **Internal candidate scanning:** conducting a thorough internal scan

for potential candidates identifies individuals who not only possess institutional knowledge but also demonstrate the competencies outlined in the success profile.

- **Candidate interviews:** engaging in structured interviews with potential candidates allows the board to assess their qualifications in depth. This process offers insights into their leadership style, problem-solving abilities, and fit with the organizational culture.
- **Ethical leadership and corporate responsibility**: about 70% of chairs emphasize the increasing importance of ethical leadership and corporate responsibility.[1] As one chair notes, "Transparency and ethical behavior are no longer optional—they're demanded by stakeholders." Ethical leadership is non-negotiable in today's governance environment, as companies face growing scrutiny from investors, regulators, and the public.
- **Innovation and change management**: the ability to manage change and innovation is essential for board leaders. Approximately 72% of chairs emphasize the importance of adaptability in leading organizations through periods of transformation.[1]
- **Strategic experience**: strong candidates for board leadership roles must possess significant strategic experience. This includes the ability to think long-term, anticipate challenges, and guide the company in the right direction during periods of uncertainty.
- **Emotional intelligence and collaboration**: as governance structures become more complex and diverse, emotional intelligence has become more important to assess as a key factor in selecting board leadership. Effective board leaders need to manage relationships with a wide variety of stakeholders and encourage productive collaboration.

Transition period management

Transition management fundamentally impacts organizational stability. Effective transitions not only maintain governance continuity and ensure that the company preserves its strategic objectives during periods of change. A well-planned transition helps mitigate risks associated with other planned leadership changes, fostering confidence among stakeholders and minimizing disruption to operations.

Key considerations include:

- **Best practices for transition timeframe:** it is ideal to begin the selection for the incoming chair or LID up to 24 months in advance of the transition. This allows for a meaningful overlap between the incoming and outgoing leaders, which fosters effective knowledge transfer and operational continuity. This overlap also minimizes the potential for disruption and supports a smooth leadership transition.
- **CEO partnership**: a strong partnership between the incoming LID or chair and the CEO should start early to align both leaders on the company's vision and strategic goals. Regular communication fosters trust and ensures that the new LID can effectively grasp the organization's challenges, which can enhance board effectiveness during the transition.
- **Stakeholder communication**: transparent communication with all stakeholders (i.e. shareholders, employees, customers, and partners) is critical during leadership transitions.

Providing timely updates about the process and the new leadership helps alleviate concerns about stability. Utilizing various communication channels—such as meetings, press releases, and newsletters—ensures stakeholders feel informed and engaged, reinforcing their confidence in the company's direction.

Conclusion

The role of the chair has grown with the complexities of modern governance. But selecting the right chair takes succession planning. Boards must take a more active role to find out what type of chair will be best for the organization's future challenges and opportunities. Succession planning provides real potential for building further strategic partnership between board leadership and management. Through this process, organizations can capitalize on opportunities in an increasingly complex business environment.

By following the suggestions outlined above, boards can ensure that the selected chair has the right competencies, experience, and personal traits to complement the CEO's leadership. Further, boards can set the chair up for success by streamlining a transition process that ensures the chair hits the ground running.

Boards will also be primmed for chair progression. Leadership transitions within a board should be seen not just as a change in personnel, but as an anticipated opportunity that strengthens the organization. This approach not only guarantees a smooth transition but also positions the organization for sustained growth, with a leadership team ready to tackle future challenges effectively.

Corporate governance today is a team effort. In this context, boards that prioritize thoughtful succession planning, chair progression, and a collaborative approach will select a chair who can guide the organization and drive effective leadership.

Subsection: Special situations

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Special committee overview

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1. Introduction

Special committees are an important tool for public company boards. In appropriate circumstances, they can be used to facilitate expedient decision-making, or they may serve strategic purposes to reduce litigation risk and potentially insulate conflict transactions from judicial review. Common situations where special committees are employed include mergers and acquisitions transactions (particularly going private transactions with a controlling stockholder), restructuring or bankruptcy, internal investigations, financing transactions, and other transactions involving conflicts of interest. Forming a properly constituted and empowered special committee is fundamental to its effectiveness. This article focuses on Delaware law as the most developed US state law governing corporations and a jurisdiction that many other states look to for guidance; however, it is important to consult with legal counsel whenever a board considers forming a special committee.

2. Judicial review of corporate transactions

To understand the role a special committee can play in a corporate transaction, it is first necessary to understand how courts review corporate transactions when they are challenged by stockholders. "There are three standards of review for corporate transactions under Delaware law: business judgment, enhanced scrutiny, and entire fairness."[1]

Under most circumstances, decisions made by informed, disinterested, and independent directors are protected by the "business judgment rule", which is "[a] presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company."[2] "If the business judgment standard of review applies, a court will not second guess the decisions of disinterested and independent directors. The reviewing court will only interfere if the board's decision lacks any rationally conceivable basis, thereby resulting in waste or a lack of good faith."[3]

"If the plaintiff rebuts the business judgment rule" (e.g. because a majority of directors lacks disinterestedness or independence, or acted in bad faith), "the court will review the challenged act by applying the entire fairness standard of review."[4] "Entire fairness" is also the "presumptive" standard of review where the controlling stockholder "transacts with the controlled corporation and receives a non-ratable benefit."[5] Additionally, "[t]ransactions where the controller is on only one side of the transaction" but "stands to earn 'different consideration or some unique benefit'" also are subject to entire fairness review.[6]

3. Benefits and protections provided by special committees

In circumstances where the business judgment rule applies, a special committee can be employed for convenience and to promote efficiency by empowering a subset of the board with the authority to consider, recommend, and/or approve a particular transaction (subject to applicable statutory limitations). A smaller, more flexible group may be better suited to take on matters that will involve a significant amount of work or particularly sensitive or time-intensive matters. See "Other common uses of special committees" below.

In circumstances involving conflicts of interest or controlling stockholders where entire fairness is likely to apply, a special committee can be deployed strategically to take advantage of recently enacted statutory safe harbors for conflict transactions under Section 144 of the Delaware General Corporation Law (the "DGCL").[7] Where the safe harbors apply, a conflict transaction "may not be the subject of equitable relief, or give rise to an award of damages" against a director, officer, and/or controlling stockholder.

- **Director and Officer Conflict Transactions**: Amended Section 144(a) of the DGCL provides a safe harbor for director and officer conflict transactions if: (i) the material facts as to the director's or officer's relationship or interest as to the transaction, including any involvement in the initiation, negotiation, or approval of the transaction, are disclosed or known to all members of the board of directors or a committee of the board, and the board or committee in good faith and without gross negligence authorizes the transaction by the affirmative vote of a majority of "disinterested directors" (as defined in the statute and discussed below) then serving on the board or such committee (if a majority of the directors are not disinterested directors, then the transaction must be approved (or recommended for approval) by a committee that consists of two or more directors, each of whom the board has determined to be a disinterested director with respect to the transaction); or (ii) the transaction is approved or ratified by an informed, uncoerced, affirmative vote of a majority of the votes cast by the disinterested stockholders.

- **Controlling Stockholder Going Private Transactions**: New Section 144(b) of the DGCL provides a safe harbor for controlling stockholder going private transactions if: (i) the material facts as to such controlling stockholder transaction are disclosed or known to all members of a committee of the board of directors to which the board has expressly delegated the authority to negotiate (or oversee the negotiation of) and to reject such controlling stockholder transaction and such controlling stockholder transaction is approved (or recommended for approval) in good faith and without gross negligence by a majority of the disinterested directors then serving on the committee; *and* (ii) such controlling stockholder transaction is conditioned, by its terms, as in effect at the time it is submitted to stockholders for their approval or ratification, on the approval of or ratification by disinterested stockholders, and such controlling stockholder transaction is approved or ratified by an informed, uncoerced, affirmative vote of a majority of the votes cast by the disinterested stockholders.
- **Other Transactions Involving Controlling Stockholders**: For transactions involving controlling stockholders other than going private transactions, new Section 144(c) of the DGCL provides a safe harbor if such transactions are approved by either (i) a disinterested director committee *or* (ii) a disinterested stockholder vote, as described more fully above.

4. Considerations for forming a special committee: composition and mandate

Among the key considerations for special committee formation are the composition of the committee and the scope of its mandate and authority. As a baseline, special committee members must have the ability, competency, and time to dedicate to special committee work, which is often time consuming and arduous. Committee size should also be taken into consideration in light of the potentially significant number of meetings that special committees typically undertake to have, frequently on short notice and under intense time pressure.

A. Committee composition

A well-constituted special committee generally is comprised entirely of disinterested and independent directors. Importantly, under the business judgment rule, directors are presumed to be disinterested, independent, and to act on an informed basis, in good faith, and in a manner the director believed to be in the best interests of the corporation.[8] To overcome the powerful presumption of the business judgment rule, the burden is on a stockholder plaintiff challenging the transaction to plead facts showing, among other things, that directors lacked disinterestedness or independence in making the challenged business decision.

Similarly, to take advantage of the Delaware safe harbors, a majority of "disinterested directors" (as defined in the statute) must approve the transaction whether as a full board or a committee. Amended Section 144 of the DGCL defines a "disinterested director" as one who is (i) not a party to the transaction, and (ii) lacking both a material interest in a transaction or a material relationship with a person who has a material interest in the transaction.[9] A director of a corporation whose stock is traded on a national stock exchange is presumed to be a disinterested director if the board has determined that the director satisfies the relevant stock exchange listing criteria for independence vis-à-vis the company and the controller or control group. This presumption "shall be heightened" and may only be rebutted by "substantial and particularized facts" that the director has a material interest (as defined by the statute) in the challenged act or transaction or has a material relationship with a person with a material interest in such act or transaction. Nonetheless, because the presumption under the safe harbor is rebuttable and will be subject to judicial construction as transactions utilizing the safe harbors are litigated, it would be best practice to consider the disinterestedness and independence of committee members with an eye towards Delaware case law on those issues, even if the director otherwise would be deemed independent under the applicable stock exchange rules.

Disinterestedness

"Disinterestedness" "means that directors can neither appear on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally."[10] To state the obvious, a direct financial interest in a decision that comes before the board would mean that the director is not disinterested with respect to that decision. However, a lack of disinterestedness also can arise from indirect financial interests, such as benefits derived through equity ownership of a counterparty or a creditor relationship with the corporation, benefits that devolve on immediate family members, etc. It is, thus, important for directors to be vigilant in considering any potential interests they may have in decisions that may come before the board and to be transparent with their fellow directors about any such potential conflicts. This allows the board to take appropriate steps to prudently manage potential conflicts, including by forming a special committee where appropriate.

Independence

"Independence means that a director's decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences."[11] Although directors are presumed to be independent, even when appointed by a controlling shareholder,[12] director independence can be subjective and, therefore, challenging to identify. While stock exchange listing requirements prescribe certain bright-line criteria for a director to be considered "independent", it is important to bear in mind that state law assessments of a director's independence, particularly under Delaware law, can be far more searching and subjective. In Delaware, courts have considered a wide array of potential sources of influence or control that could taint a director's independence, such as: (i) employment, personal, family, business, philanthropic, or political relationships; (ii) a "sense of owingness" to another for career success, appointments to other corporate directorships, personal wealth, etc.; and (iii) joint ownership in unique assets or participation in unique investment opportunities. Practically speaking, however, public company directors often have some connection to each other, whether from a past business or personal relationships that predate their service together on the board, or through their service together on the board over a number of years. Delaware courts have taken a pragmatic approach and recognize that not all ties are disqualifying. Ultimately, the specific details and circumstances matter (e.g. independence from whom and for what purpose), and it is prudent for boards to consult with legal counsel in assessing director independence, particularly when forming a special committee. Boards should require directors to disclose compensatory, financial, and business relationships, as well as personal or social ties that could impair their ability to discharge their duties so that the board has appropriate information to evaluate and determine director independence and disinterestedness.

Even if a director does not have an interest in a particular matter under review, the director may be disqualified if he or she lacks independence from the controlling stockholder or another person or entity that is interested in the matter. Thus, it is important for directors and their legal advisors, particularly in conflicted transactions, to think comprehensively about potential independence issues.

B. Committee mandate and authority

In all circumstances, it is important for a properly constituted special committee to have formal resolutions setting forth the committee's mandate and authority. A key question to ask at the outset is whether the committee is being empowered to serve a convenience function, in which case its mandate perhaps can (and should) be more narrowly tailored (e.g. to review and make a recommendation to the board as to whether a transaction should be approved), or whether it is being formed to manage a conflict. As discussed above, in conflict situations, a robust mandate with full authority to approve the transaction, including the ability to "say no" (and mean it) is critical to accessing the statutory safe harbors.[13] Special committees also should be empowered to retain independent advisors to assist the committee in fulfilling its mandate,[14] and directors serving on such committees should be active and engaged in discharging the committee's role and responsibilities.

5. Key takeaways: avoiding traps for the unwary

- **Identify conflicts early and remain vigilant.** There is no bright-line test. Directors should be vigilant in identifying their own potential conflicts, and the company's internal and/or external counsel should be consulted for guidance as needed.
- **Weigh pros and cons of forming a special committee.** While special committees can provide a number of benefits, there are also downsides that should be considered, including precedent setting, potential delays in formation, issues regarding compensation, considerations regarding engagement of yet additional advisors to the committee, strategic litigation considerations, and the alienation of the remainder of the board.
- **Carefully vet special committee members.** Legal advisors should assess the independence and disinterestedness of proposed committee members before the committee is formed.
- **Establish clear mandates and scopes of authority.** Resolutions forming the special committee and establishing its duties and responsibilities should be clear and specific. Special committees generally should have a narrow mandate, but with broad authority to act with respect to such mandate. The committee's mandate and authority should be vetted with counsel to ensure the committee will be able to serve its intended purpose.
- **Consider engaging separate advisors.** Special committee advisors should be independent and free from conflicts, which means that they should, in most circumstances, be different from the company's advisors. In certain circumstances, however, advisors with knowledge of the company can be a benefit and other steps can be taken to mitigate conflicts.
- **Establish special committee guidelines: maintain confidentiality and speak with one voice**. Sharing any information outside of the committee and its advisors can jeopardize the

process. At the outset, guidelines should be developed and adhered to by the special committee members and advisors (or potential advisors), the board, management, and the conflicted or controlling persons to ensure the sanctity of the committee process. All communications regarding the committee's work should come from the special committee (not one individual director), which should speak with "one voice" on the matter. It is also important to consider potential privilege issues to the extent the committee and its counsel will report to the board or otherwise as circumstances warrant.

- **Focus on what is best for the company**. Special committees must seek the right balance when considering what is best for the company and its stockholders. This means considering a range of alternatives and reviewing the risks and benefits in consultation with advisors.
- **Compensation**. The board will want to consider the structure (e.g. fixed fee vs. per meeting fees, or a combination) and reasonableness of any additional compensation paid to special committee directors and ensure that it is commensurate with comparable compensation in similar circumstances.
- **Process documentation: minutes.** Special committee meeting minutes should take care to accurately and appropriately record the committee's considerations, deliberations, and determinations throughout the process. The record should reflect an independent, careful, and informed process.

Chapter notes

1 *Maffei v. Palkon*, 2025 WL 384054, at *16 (Del. 4 February 2025). This article does not discuss circumstances triggering "enhanced scrutiny" review under Delaware law.

2 *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), quoted in *In re Match Grp., Inc. Derivative Litig.*, 315 A.3d 446, 459 (Del. 2024).

3 *Match Grp.*, 315 A.3d at 459.

4 Id.

5 Id.

6 *Maffei*, 2025 WL 384054, at *18.

7 The amendments to Section 144 of the DGCL were enacted on March 25, 2025 and supplanted existing Delaware case law established in *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014) [hereinafter "MFW"], *Match Grp.*, 315 A.3d at 446, and their progeny, which established strict procedures to shift the standard of review in conflicted controller transactions from entire fairness to business judgment. To the extent states outside of Delaware have adopted or would otherwise follow Delaware law on these issues, it is important to consult with legal counsel to appropriately plan for a transaction before substantive economic discussions begin.

8 *Aronson*, 473 A.2d at 812.

9 Sections 144(e)(7) and (8) of the DGCL define "material interest" and "material relationship," respectively:

"'Material interest' means an actual or potential benefit, including the avoidance of a detriment, other than one which would devolve on the corporation or the stockholders generally, that (i) in the case of a director, would reasonably be expected to impair the objectivity of the director's judgment when participating in the negotiation, authorization, or approval of the act or transaction at issue and (ii) in the case of a stockholder or any other person (other than a director), would be material to such stockholder or such other person."

"'Material relationship' means a familial, financial, professional, employment, or other relationship that (i) in the case of a director, would reasonably be expected to impair the objectivity of the director's judgment when participating in the negotiation, authorization, or approval of the act or transaction at issue and (ii) in the case of a stockholder, would be material to such stockholder."

10 *Aronson*, 473 A.2d at 812.

11 *Id.* at 816.

12 *Id.*

13 *In re S. Peru Copper Corp. S'holder Derivative Litig.*, 52 A.3d 761, 798 (Del. Ch. 2011) (The special committee "fell victim to a controlled mindset and allowed [the controlling stockholder] to dictate the terms and structure of the Merger.").

14 See e.g. *Gesoff v. IIC Indus., Inc.*, 902 A.2d 1130, 1147 (Del. Ch. 2006) ("As has been repeatedly held, special committee members should have access to knowledgeable and independent advisors, including legal and financial advisors.").

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The board observer: considerations and limitations

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Overview

Appointing a board observer has long been a tool in an investor's arsenal. Board observers can represent the interests of the appointing investor by monitoring and participating in the activities and decisions of the company's board of directors. They can observe meetings of the board, ask questions of the other directors and weigh in on key deliberations. By observing the inner workings of a company's board of directors and indirectly influencing board decisions, a board observer can help to monitor—and protect the value of—the appointing entity's investment.

Board observers are distinguishable from board directors in terms of voting power, fiduciary liability, and the source of their rights and obligations. While board observers can indirectly influence a board's decisions by asking pointed questions and providing constructive feedback at board meetings, only members of a company's board of directors have the right to formally vote on matters submitted for approval by the company's board of directors. While members of a board of directors generally have fiduciary duties to the corporation on whose board they serve (including, in the case of corporations organized in Delaware, the fiduciary duties of care and loyalty, including the subsidiary duties of good faith, oversight, and disclosure), board observers do not owe fiduciary duties to the corporations whose boards they observe or to other stakeholders in such corporations. Rather, the rights and duties of board observers are defined by contract between the corporation and the appointing investor.

Board observers have long been pervasive in private companies. According to a January 2024 survey conducted by the National Venture Capital Association, 82% of the surveyed venture capital funds reported utilizing board observers within their governance frameworks, with 21% of such firms planning to increase the number of board observers in the near future. The increased reliance on board observers as a source of governance rights in private companies may be attributed to the increased leverage held by founders (who are increasingly reluctant to cede control in the form of board seats) and the increased size of financing rounds. While the lead investor in a private company financing round may receive the right to designate a member of the company's board of directors, other investors are generally limited to a board observer or the right to receive quarterly updates from management. The prevalence of board observers in the private company context stands in stark contrast to public companies, where board observers are not necessary to ensure a steady flow of information about the company (in light of the company's periodic reporting obligations) or provide a means to influence corporate decision-making (in light of the other methods for exerting influence, such as shareholder activism), are therefore exceedingly rare.

The presence of board observers may benefit both corporations and the investors that appoint them. From a corporation's perspective, the inclusion of board observers in certain meetings may expose the board and management teams to knowledge and experience that is otherwise lacking among the members of the board. From an investor's perspective, this informal position allows the appointing investor to both monitor its investment and influence corporate decision-making, steering the corporation in the direction favored by the appointing investor, without incurring the fiduciary liability of a director for the decision.

Board observer positions may make particular sense in certain contexts or industries. For example, board observer positions may be critical for lenders to distressed companies, which typically do not have representation on the board of directors but require more frequent information updates than the quarterly or monthly reporting of financial performance that lenders typically receive. Board observers appointed by lenders can also bring to the boardroom critical experience in overseeing the implementation of a restructuring plan, which is experience that those elected to the board based on industry experience may be lacking. Additionally, as discussed below, board observer positions may be necessary in consolidated industries as the only means by which a corporate investor can provide insight to, and attend meetings of, the board of directors of a potential or actual competitor, given the Clayton Act's prohibition on interlocking directors.

Access to information

Delaware courts have held that directors of a Delaware corporation generally have unfettered access to corporate information as a matter of law. Board observers, on the other hand, have no rights to corporate information unless set forth in a contractual agreement with the corporation. Such contractual agreements typically grant board observers the right to attend all meetings of the corporation's board of directors and any committees thereof, and to receive all materials provided to the corporation's board of directors and any committees thereof. However, these contractual agreements also frequently contain limitations. The most frequent limit on a board observer's right to access information relates to privileged legal advice. Directors of a Delaware corporation are treated as joint clients with the corporation, and therefore share the attorney–client privilege with the corporation. However, board observers are not formal members of the board, and do not share the attorney–client privilege. In most circumstances, therefore, the sharing of information with board observers would destroy any claim of attorney–client privilege. Accordingly, contracts establishing the information rights of board observers frequently caveat that observers have no right to receive board materials containing privileged information and no right to attend any board meetings at which such information will be discussed. Such contracts also frequently exclude board observers from accessing board materials containing trade secrets or other sensitive information, particularly where the board observer or appointing investor is a potential competitor. Indeed, one of the main competition concerns regarding board interlocks is that the flow of competitively sensitive information from one company to another through a board relationship could inhibit competition or lead to unlawful coordination between competitors.

While the Delaware General Corporation Law ("DGCL") does not set forth a duty of confidentiality, directors of a Delaware corporation are subject to the fiduciary duty of loyalty, which generally requires them to maintain the confidentiality of information obtained through their service on the board. Board observers, who do not have fiduciary duties to the corporation, are not subject to any such confidentiality obligations as a matter of law. Just as the primary source of a board observer's right to access information is the privately negotiated contract, the primary source of a board observer's obligation to keep that information confidential would be that same contract. And while the National Venture Capital Association's model provision for the establishment of board observer rights previously included language requiring board observers to act in a "fiduciary manner" with respect to the information disclosed to them, this language was removed in 2020. Instead, the confidentiality obligations of a board observer will often be negotiated using the company's standard form of nondisclosure agreement.

Liability of board observers

Fiduciary duty liability

Members of a board of directors generally have fiduciary duties to the corporation on whose board they serve, and claims may be brought in the name of such corporation against any director who breaches such fiduciary duties. However, as noted above, board observers in a Delaware corporation do not owe fiduciary duties to the corporation and, therefore, do not face exposure under this theory of liability.

Securities law liability

This distinction between board observers and members of the corporation's board directors also minimizes their liability with respect to securities law. In 2019, the US Court of Appeals for the Third Circuit, in *Obasi Investment Ltd. v. Tibet Pharmaceuticals, Inc.*, found that board observers could not be held liable under Section 11 of the Securities Act of 1933 for misrepresentations regarding the financial condition of Tibet Pharmaceuticals, Inc. in connection with the company's initial public offering. Section 11 of the Securities Act of 1933 imposes liability on anyone who, with his or her consent, is named in a registration statement as, among other things, a person performing similar functions as a director. The court held that the company's board observers could not be held liable under Section 11 as the role and legal liabilities of Tibet's board observers were dissimilar to those of directors, noting that the board observers did not have the right to vote, did not have a fiduciary duty to shareholders and could not be voted out by shareholders.

While *Obasi* may give board observers some comfort, the Securities and

Exchange Commission ("SEC") has suggested that any individual may be considered a director for purposes of Section 16 of the Securities Exchange Act of 1934 if the individual "functions as a director." In a 2002 amicus curiae brief to the US Court of Appeals for the Second Circuit, the SEC noted that a "person's title is not determinative" of whether he or she is a director. However, where an individual does not have the title of a director, merely having access to nonpublic information about the corporation and assisting the board in formulating policy is not enough for the SEC to label that individual as a director.

Insider trading liability

Board observers and the entities that appoint them should also be mindful of compliance with Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934, which prohibit fraud in connection with the purchase and sale of securities. Entities with a right to appoint a board observer to attend meetings of a corporation's board of directors frequently hold significant economic interests in such corporations. Whether these economic interests are in the form of equity securities or debt securities, the appointing investor's ultimate goal is to enhance the value of that economic interest and ultimately sell it for a favorable return. By attending board meetings, board observers will frequently become privy to material nonpublic information ("MNPI"). If a board observer or appointing investor proceeds to trade securities of the corporation while in possession of MNPI about that corporation without disclosing such MNPI to the purchaser of the securities, it could constitute fraud in connection with the sale of securities and expose the board observer or appointing investor to liability under the federal securities laws or equivalent state laws regarding insider trading. While board observers are generally not covered by trading "blackout" periods under a corporation's insider trading policy, as a matter of law, the observer and appointing investor will not be able to trade in the corporation's securities while in possession of MNPI. Accordingly, if an appointing investor desires flexibility to trade in the securities of the corporation, it would be prudent for the appointing investor's board observer to stop attending board meetings or terminate their board observer position.

Indemnification

While the range of potential sources of liability is more limited for a board observer than for members of a company's board directors, the absence of fiduciary duties does not prevent an observer from being named as a defendant in litigation. For example, a board observer who misuses confidential information could be held liable for basic negligence. And while Delaware courts will generally defer to a director's business judgment (as long as the director was acting in good faith, exercising reasonable care, with the reasonable belief that the director was acting in the best interests of the company), no such deference would be afforded to actions by a board observer. Additionally, while the DGCL provides that a director shall be fully protected in relying in good faith on company records, no such protection would be available as a statutory matter to a board observer.

Importantly, board observers do not benefit from the indemnification and expense advancement afforded to members of a company's board of directors by statute and the company's organizational documents. While the DGCL provides that a company's certificate of incorporation may eliminate the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, such a provision would not typically impact the personal liability of a board observer who is not a director. The cost of defending oneself against even the most frivolous lawsuits can be significant, and it is therefore wise for board observers to secure some form of insulation against this expense.

Insurance

In certain cases, the contractual arrangement with a corporation that allows an investor to designate a board observer may require the corporation to add the board observer to its director and officer insurance policy. However, this approach is uncommon—particularly in the case of private companies—where insurance policies typically contain an "insured versus insured exclusion" of coverage for matters where certain parties covered by the policy (which would include any board observer covered by such insurance) are suing each other.

The most likely source of insulation against the cost of defending claims against a board observer would be an insurance policy purchased by the investor appointing the board observer. If the appointing investor is a private equity or venture capital firm and the firm has purchased general partner liability insurance, the board observer will generally be covered under this policy. The appointing investor may also offer to provide the board observer with indemnification and expense advancement similar to the indemnification and expense advancement afforded by the company to members of its board of directors.

Increased regulatory focus

Section 8 of the Clayton Act prohibits a person from serving on the board of directors of two competing business entities. It has been interpreted broadly to prohibit different individuals from sitting on the board of directors of two competing business entities as representatives of the same corporate investor. However, Section 5 of the Federal Trade Commission Act (which prohibits "unfair methods of competition") may prohibit arrangements involving interlocking directorates that violate the "spirit" of the competition laws, even where not expressly prohibited by the Clayton Act. To avoid running afoul of the ban on interlocking directorates, many corporate investors that wish to invest in a potential or actual competitor will request the right to have an individual representative attend and observe meetings of the board of directors of the company, rather than the right to elect an individual to serve on the company's board of directors. However, this practice is increasingly being scrutinized by regulators.

In December 2023, the Federal Trade Commission ("FTC") and the Antitrust Division of the Department of Justice ("DOJ") jointly released guidelines ("2023 Merger Guidelines") describing the factors and frameworks the agencies often utilize when reviewing mergers and acquisitions. Guideline 11 specifically addresses the anticompetitive risks that stem from partial or minority acquisitions that provide an investor with rights in the target, including the right to appoint a board observer to the target company's board of directors. The FTC and Antitrust Division of the DOJ warned that such acquisitions can present significant competitive concerns by giving the appointing investor an ability to influence the target company's competitive conduct, giving the appointing investor access to nonpublic, competitively sensitive information and reducing the incentive of the appointing investor to compete. Notwithstanding speculation that the new Trump administration would rescind the 2023 Merger Guidelines, new leadership at both the FTC and DOJ has indicated that these guidelines will remain in place.

Further, in a January 2025 statement of interest, these same agencies argued that board observers should be subject to the same prohibitions that would apply if they were serving as directors. While that statement of interest was filed in the final days of the Biden administration, the two Republican commissioners (including the new Chairman) concurred in the statement, signaling that this position may persist under the new administration.

The Committee on Foreign Investment in the United States ("CFIUS"), an interagency committee that investigates the national security implications of certain transactions involving foreign investments in the US, has also recently increased oversight regarding the use of board observers. While CFIUS regulations previously required filings only for transactions that could result in *control* of a US business by a foreign person, the Foreign Investment Risk Review Modernization Act of 2017 broadened the scope of transactions subject to CFIUS review to include *noncontrolling* investments by foreign investors in US companies whose business involves critical technologies, critical infrastructure or sensitive personal data. This includes transactions that afford the foreign investor with the right to appoint an observer to the company's board of directors or access to any material nonpublic technical information in the possession of the company.

Conclusion

Before accepting a board observer seat, companies and individuals should consider the implications. While the liability profile for a board observer is more benign than the potential liability for a director, the access to and possession of material nonpublic information may limit flexibility to transact in the company's securities and expose the board observer to claims under multiple theories of liability, without affording the board observer certain protections that are available to directors as a matter of common law or statute. The potential for the board observer or appointing investor to influence the target or access certain information may also result in scrutiny from regulators.

The opinions expressed in this article are those of the author(s) and do not necessarily reflect the views of Skadden or its clients.

Section 3: Strategic oversight and governance in a changing environment

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Governance for strategic M&A: navigating spins and more

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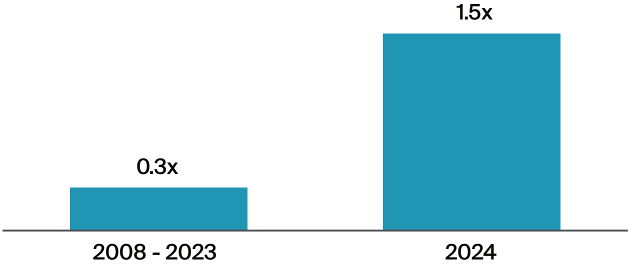
Public companies effect corporate separations, or spin-offs,[1] for a number of reasons including unlocking a sum-of-the-parts discount, optimizing capital allocation and management focus, improving efficiency, or responding to regulatory scrutiny from antitrust or competition authorities. Shareholder activism can also be a catalyst; historically, approximately 30% of large-cap spin-offs have had activist involvement.[2]

Corporate separations occur as a result of internal and external discussions that lead management teams and boards to determine that a subsidiary or business unit(s) which had previously operated as a part of the parent company would prosper more as a standalone company.

Corporate structure is critical to the long-term success of a company. It is why corporate clarity, which refers to a clear internal understanding and external articulation of a company's role in the economic sector in which it operates and allows for streamlined decision-making and stakeholder engagement, remains near the top of the list of topics managements and board discussions regularly. Data shows that companies with a narrower focus and fewer reporting segments are typically valued more highly than companies with more reporting segments (*see Exhibit 1 on the next page*).[3] When a company's strategic focus becomes unclear or shifts in response to events, the question of the suitability of a division within a large group should be considered.

Exhibit 1. Difference in valuation for companies with 1-2 reporting segments vs. 3+ reporting segments



While corporate clarity is an important issue for boards and management, data also suggests that bigger companies enjoy premium valuations across different sectors. The best explanation of these two seemingly contradictory things is that markets like scaled players with a clear area of focus. A simple narrative on business purpose and objectives allows the market to better evaluate a company's prospects and provide a premium valuation. Conversely, markets are less inclined to reward companies that operate disparate businesses with no or limited synergies.

Role of the parent board

Public company boards should regularly ask their management teams about mechanisms to enhance shareholder value. This may include raising the issue of transformative actions such as separating divisions that may prosper as standalone public companies.

In some regards, the questions boards should be asking may be the same as those from activist investors, for example:

- stock price performance;
- capital allocation and balance sheet strategy;
- synergies between different business units; and
- differentiated value-enhancing strategies.

Increasingly, given global trade and geopolitical tensions, geographic issues may also become a compelling reason to look at the portfolio of assets under one umbrella. Markets do not always value similar assets in different jurisdictions in a similar manner and this disparity has been growing in recent times.

In the event there is a compelling case for a business separation to enhance value, the board must take on the role of encouraging and guiding the management team through the process.

Planning and execution

When a company decides on a separation, the outcome is an independent public company created from scratch. While the degree to which operational interdependencies between the remaining company and the separated business may vary, the new company has not existed as a standalone public entity before.

Navigating a spin-off to create a new public company out of an existing business division requires meticulous planning, decision-making, and execution to give the venture the best possible start. Whether corporate strategy, shareholder activism or another factor is behind the action, success depends on getting many issues correct, including leadership team, board structure and composition, and executive compensation.

As with all transformative corporate actions, the potential exists for a sub-optimal execution or an unfavorable market environment following spin completion. Risks that companies should be aware of include dis-synergies being higher than anticipated, companies being unprepared to fulfill public market expectations of performance, and activist involvement derailing management's long-term planning.

The list of issues the transaction team and their advisors must work through is lengthy. They need to make decisions on what businesses, assets, and liabilities will form part of the new company, as well as deal with tax and accounting, securities law, and financing issues.

Constructing and operating a newly formed board in this situation presents unique challenges. For example, the management team of the newly separated entity may not have had experience interfacing with investors and stakeholders as a public company. It is common for the chief executive officers (CEOs) and chief financial officers of the spun off company to be hired internally (*see Exhibit 2 below*).[4] Running a division within a bigger group is not always sufficient preparation for handling earnings calls, proxy issues, credit rating agencies, regulators, etc. The newly formed board often must take on an important coaching role in this situation. Additionally, the board must navigate its fiduciary responsibilities carefully through the transaction.

Advisors to the parent company helping on the separation transaction also have a key role to play in positioning the new company and its management team in the best possible light for the public markets. Given the complexity of these transactions and the unique role advisors may need to play, picking the right team with appropriate breadth of experience becomes critical.

A spun-off entity's board will need to be built out. The more materially different the line of business of the separated entity is, the more important it becomes to find the appropriate expertise and experience that is relevant to the separated entity. Further, the formation of the new board is also an opportunity to incorporate directors with experience in new trends (e.g., artificial intelligence (AI)) that are likely to impact any business.

Some overlap between the parent company board and the separated entity's board may exist, but a prolonged overlap may lead to market scrutiny, as stakeholders will be eager to observe how the new organization performs independently. Approximately half of large-cap spin-offs have at least one overlapping SpinCo director that continues on as a director at the parent company.[5] An overlap

Exhibit 2. **Breakdown of c-suite hires for newly spun off companies**

of directors may present other problems in the form of conflict of interest and duty of loyalty. Additionally, compliance with the director independence rules that emanate from stock exchange requirements, regulation, and legislation such as the Sarbanes-Oxley and Dodd-Frank Acts in the US are all crucial factors to keep in mind. Both the directors of the parent company board, and the new management team of the separated entity will want to be involved in putting together the most impactful new board.

An individual cannot be on the boards of two US public companies that compete against each other, as this would breach the Clayton Antitrust Act. However, as a separation usually involves splitting off businesses that are not in the same industry or that do not compete against the parent directly, this law may not be relevant in most situations.

The requirement for financial expertise on the separated entity's board is increased given its balance sheet has been created from scratch and may not always be optimized for the business from day one. Several issues may need to be resolved over time, including amount of leverage, ownership of real estate, transferred pension, other retirement-related liabilities, etc. A board that has relevant experience navigating these issues becomes invaluable to the management team.

Shareholder action

Newly public companies may face additional challenges, and the board should be ready to justify why it is a viable entity in the public market. During the early stages as a public company, there may be increased vulnerability to unwanted attention from activists. The lack of a track record, likely smaller size, and potential lack of an experienced management team may all become potential issues that the board will need to defend against. Establishing a classified board, where a company's board of directors serve different term lengths, can be one tool to help defend against activist action as well as promote effective corporate governance.

Clearly articulating the reason for the separation and having a compelling value creation plan for the new company as well as a robust shareholder engagement plan can all help make sure that the original thesis supporting the separation is realized over time.

Incentive structure

Executive compensation is another important issue for a new public company. The new public company CEO and other executives may have received parent company stock as part of their previous package. Going forward, designing an appropriate compensation package to attract and retain talent, and to align incentives is a crucial exercise where board oversight becomes critical. The parent company's board also plays a role in adjusting compensation packages of employees who are moving over to the new company from the parent company.

Designing appropriate incentives to ensure the entire management team is aligned to the success of the newly formed company is one of the most important roles of the new board. Getting this right will often be the most important factor in the success of the new company.

Incorporation

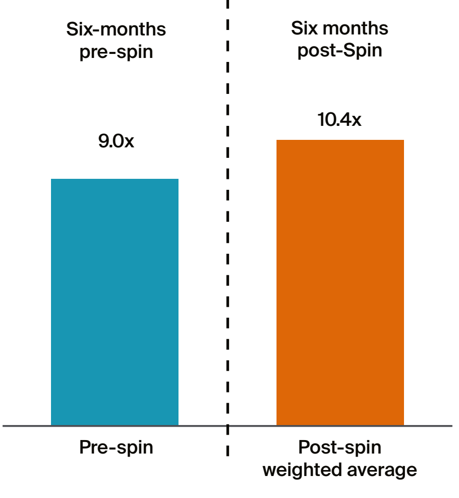
Choice of where to incorporate a new company has also become an important consideration recently. This decision must factor in valuation differences across international markets as well as state-level considerations in the US. Historically, a majority of US public companies were Delaware incorporated, as almost a default choice, due to the sophistication of Delaware's corporation statutes as well as the specialization of its courts. Using another state to incorporate was often down to an accident of history and was rarely a conscious choice.

This is now shifting, albeit slowly, with locations like Nevada, Maryland, and Wyoming gaining popularity. Incorporation is therefore another question for spin-off transaction teams to consider. The answer may not be as automatic as it used to be, although at this moment in time the volume of re-incorporations from Delaware is still minimal.

Delivering success

Successful spin-offs deliver value creation for the parent company as well as the spun off entity, and past large-cap spin-offs have delivered multiple expansions within 6 months of completion (*see Exhibit 3 below*).[6] Navigating the successful spin-off of a new public company requires substantial planning and precise execution. A company usually undertakes this step only after thorough discussion and investigation to determine if it is the appropriate course of action. Corporate governance planning, including board composition, may be only one of the issues transaction teams have to consider and implement, but it is an extremely important one. Having a board with the right skills and experience in place from the start gives the new public company every chance of success. Additionally, there are many emerging considerations that a board needs to grapple with—including emergence of transformative technologies like AI, as well as increased geopolitical and global trade related issues. Having a board that can navigate these complex times and help the management team deliver value is critical to fulfilling the promise that corporate clarity transactions offer.

Exhibit 3. Valuation multiples pre- and post-spin



Chapter notes

1 Note that while there are transaction types other than spin-offs that can be used to effect a corporate separation, the term spin-off is used for simplicity.
2 As of 31 December 2024; based on announced spin-offs by S&P 500 companies since 2010; activism involvement tracked by Deal Point Data.
3 As of 31 December 2024; Based on difference between median NTM P/E valuation of S&P 500 companies with 1–2 reporting segments vs. median NTM P/E valuation of S&P 500 companies with 3+ reporting segments per FactSet data; 2008–2023 value shows median from that time period; 2024 value shows 31 December 2024 value.
4 As of 31 December 2024; based on completed spin-offs by S&P 500 companies announced since 2010 per company filings.
5 As of 31 December 2024; based on completed spin-offs by S&P 500

companies announced since 2010 per company filings.

6 As of 31 December 2024; based on completed spin-offs by S&P 500 companies announced since 2010 per company filings; valuation based on EV/NTM EBITDA per FactSet data; post-spin weighted average refers to parent company and spun off company, based on EBITDA weightings 6-months post-completion of spin-off.

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The board as a corporate shield—how effective board design and CEO succession planning can deter shareholder activism

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With good reason, corporate boards and management teams view shareholder activism as a significant area of concern, with 71% of corporate directors surveyed by PricewaterhouseCoopers saying that their boards have "taken action related to actual or potential shareholder activism in the past year", up from 65% in 2019. Data compiled by Diligent Market Intelligence (DMI) shows that shareholder activism in the US reach a new record in 2024, and globally the total number of companies publicly targeted by activist investors surpassed 1000 for the second consecutive year.

Given these factors, we advise companies to regularly evaluate their preparedness to face activism. A key element of this preparation is for companies to "think like an activist", identifying and addressing vulnerabilities proactively. In defense against shareholder activists and proxy contests, mistakes that are determinative are usually made before the contest even begins. A board often has choices that can prevent an activist approach in the first place or create an off-ramp to reach a constructive agreement. Put simply, peace time matters—a strategically designed board and a well-thought out succession plan serve as a foundation for a company's defense. Chief executive officer (CEO) and board succession planning should be high priorities in any self-examination.

A board that fails to plan for succession—or that cannot demonstrate convincingly to shareholders its genuine commitment to succession planning—can draw the attention of activists and will be less able to defend itself when targeted. Looked at more positively, credibly communicating or demonstrating a focus on succession planning can help a company shield itself from activist scrutiny, and strengthen the company's ability to defend itself when necessary.

Asking hard questions about succession

Broadly speaking, corporate boards have a duty to maximize value for shareholders. The strategy they develop to create that value is executed by a management team, which in practice means that the board's primary responsibility is to oversee management. A board that is seen to be failing in this task—or that an activist can credibly *depict* as failing—is a vulnerable board, guiding a vulnerable company.

To preempt being perceived as lacking in oversight ability, and therefore vulnerable, boards should ask themselves questions like these while "thinking like an activist":

- Do we disproportionately defer to a long-time CEO or founder or permit them to act unchecked? Even if we believe we do not, could an outside observer—one not privy to the details of our board meetings—reasonably conclude otherwise?
- Have some of our members served with the same CEO long enough that they might not be seen as truly independent? Do they appear to act as a bloc, impairing the ability of newer directors to effect change?
- Beyond the formal standards for board independence set by stock exchanges, do we demonstrate independence in how we conduct ourselves in relation to the CEO? Can we make that independence visible to shareholders when called upon to do so?
- Do we have the right leader for the current moment, and for the future we see ahead for the company? If not, can we either help the CEO change their direction, or replace them now with someone more suitable for the purpose?
- Do we have a substantial succession plan? Could we accelerate that plan to get the right person in place now to deliver on our strategic plan?

A good plan is more than just a name

As part of its role overseeing management, every board should have a succession plan in place for the CEO and other key senior leaders. Most boards do. The mere existence of a plan, however, is not enough. An effective succession plan should include more than just the name of a suitable candidate, it should also:

- Address how that candidate would be brought onboard, consider how the transition would be communicated, and anticipate potential challenges the candidate may face when they are appointed.
- Contemplate a short list of secondary candidates in the event the primary candidate should be unavailable.
- Be regularly reviewed, renewed, and made relevant to the moment.
- Consider what public actions the board and company can take to show their advance preparation and thoughtfulness for when the time of succession arrives.

Importantly, the board should also be prepared to alter its plan when the assumptions behind that plan are undermined by unexpected events, and, as appropriate, explain to its stakeholder constituents what the plan was and why it was changed.

CEO replacement is an increasingly likely outcome of shareholder activism

The flipside of a well planned and executed succession is the sudden ouster of a CEO under pressure by activists. One of the most striking changes in shareholder activism over the past 10 years has been the increased likelihood that activists will directly seek to remove or replace a company's CEO. In past eras of activism, CEO replacement was often a subtext and a second order problem: *the company is being mismanaged, because the board is not adequately overseeing management—the solution, therefore, is change in the boardroom*. The implicit next step would often be a change of CEO, but shareholders were not being asked explicitly to vote on that action.

The high profile 2016/17 campaign of Mantle Ridge LP against CSX Corporation, in which Mantle Ridge openly, and successfully, called for the replacement of the company's CEO with its own hand-picked choice, signaled a new era in activism. Activists are increasingly likely to target CEOs, as whatever taboo might once have existed around directly seeking the replacement of a CEO is gone. In 2024 alone, companies like Starbucks and CVS Health replaced their CEOs under fire from activists, while activist funds demanded the departure of the CEOs of companies including Southwest Airlines, BP, and Pfizer. According to DMI, 64 US-based companies were publicly subjected to activist demands to remove personnel in 2024, a 20% increase from the prior year. This shift, combined with more direct criticism of CEO performance, is increasingly likely to win the support of passive investors and influential proxy advisors Institutional Shareholder Services and Glass Lewis.

CEO replacement campaigns remain a relative rarity, but data suggests that activist campaigns—even those that do not go to a vote or publicly target the CEO—are likely to accelerate the replacement of the CEO. Sometimes a CEO will appear to survive a public fight but will depart the company not long after the settlement agreement ink is dry. Looking again at data from DMI, the number of CEOs who left US-based companies after a public activist campaign nearly tripled in 2024, and 67 of the 846 CEOs who departed a US company last year did so within 12 months of a public demand by an activist investor, roughly 8%, and a significant increase from 3% in 2023 (24 of 916 CEOs who departed).

CEO tenure overall has decreased sharply in recent years, escalating the importance of succession planning. According to research from Equilar, the average CEO tenure has decreased by 34% since 2017. In fact, there has been a sharp 30% increase in the number of CEOs with tenure less than 1 year and an equally sharp 30% decrease in the share of CEOs with a tenure in the 10–20-year range. The continued decrease in the length of CEO tenure and the increased number of CEOs being targeted (successfully or not) indicate both that activist pressure behind the scenes is intense, and that succession planning is failing. Boards that do not get the right person in the CEO's office are ceding succession planning to activists.

Balancing continuity and change

Succession planning should balance continuity and change. A board that feels the company is headed in the right direction would understandably not want to change what is not broken or create a needlessly jarring transition for employees, customers, and other stakeholders. Boards also want to incentivize internal leaders with the prospect of promotion to the top spot. These factors lead many boards to focus on internal candidates for succession. While this might be the right decision in the abstract, if the company is seen as heading in the wrong direction—even if that perception is not accurate—shareholders may perceive insider successors as simply more of the same.

In political elections around the world in 2024, incumbent party successors were unable to escape the perception that they would be a continuation of an administration that was (fairly or unfairly) viewed as unpopular. A similar dynamic can apply when the appointment of an internal CEO successor is viewed as a merely cosmetic change, or as the action of a board unwilling to change its direction. While boards can say in a transition announcement that they "considered both internal and external candidates", investors may discount this claim when the actual successor named is an internal one.

- In part, a board can help ease the transition for potential internal successors by providing them with a role on the quarterly earnings call, at investor conferences, and/or opportunities to communicate publicly to customers, employees, business partners, media and others. The company's communications team can also help a designated successor develop messages that subtly demonstrate openness to change, an independent attitude, or a different approach.

To combat the perception that it is not serious about external candidates, a board engaged in succession planning could instead commit not to merely "consider" external as well as internal candidates, but actually designate one of each in its succession plan. While under most circumstances the identities of the candidates would not be information the company discloses publicly, a clear public commitment to this approach would help demonstrate to shareholders and proxy advisory services the board's openness to change. Should it become necessary to put the succession plan into effect, having both types of candidates identified in advance will also speed the implementation and ease the difficulty of a transition.

Another way to demonstrate such openness could be to actively invite the participation of shareholders—activist and otherwise—into the succession planning process, democratizing what is typically a closely held internal board matter. A radical step, perhaps, and not without its risks, but engaging with shareholders on the topic of succession can, in some cases, be a means to avoid a costly and destructive public battle over leadership succession.

The opposite part of the balancing act in succession planning is the need to avoid installing a new CEO whose appointment will destabilize the company and create a vulnerability (even a short-lived one) to activism. An outside successor may lack familiarity with the business, may be an uncomfortable unknown to employees and other executives, or may have no relationship with the board and major shareholders. All of these are problems regularly remedied over time—but activists no longer give honeymoons to new CEOs. More than one CEO has justly complained that no one warned them during recruitment that the biggest challenge of their first year on the job would be a long running, behind-the-scenes activist campaign.

In a September 2024 report, Accenture cites Harvard Law School research showing that newer CEOs are disproportionately likely to be targeted by activists: while the median tenure of S&P 500 CEOs was 4.8 years in 2022, 64% of campaigns target CEOs with tenures below this median, much higher than the expected 50%. Accenture notes further that "nearly 18% of the campaigns in our dataset focused on CEOs with less than one year of tenure, even though they make up just 13% of the CEO pool", concluding that "activists may view them or the companies they lead as more vulnerable."

Any effective board would thoughtfully vet its CEO candidates, whether internal or external, but few boards put advance consideration into the potential vulnerabilities a candidate might create in a proxy contest. A board may not feel particular concern over a new CEO candidate who, for example, lacks experience in the company's industry, sat on the board of a company that sought bankruptcy protection, or has close, long-term ties to multiple members of the board that selected him. These are, however, exactly the sort of issues that can provide grist for the activist mill. Boards should not avoid candidates like this—no candidate's record is so spotless someone cannot find fault—but they should prepare for them:

- They should perform their own opposition research to identify anything that might raise questions or be presented in a negative light.
- The company's communications team should build a robust plan to tell the new CEO's positive story starting from day 1.
- Communications should also build out responses and rebuttals to any issues identified, so that they can respond readily and not allow unwarranted criticisms to take root early in the new CEO's tenure.

Building a sustainable board

Succession planning for the CEO (and other key management roles) is necessary, but in the current environment it is not sufficient. Directors should devote at least as much consideration to succession *within* the board itself. Here again, reliance on the corporate commonplace of a "commitment to board refreshment" often proves insufficient against a determined activist. Indeed, numerous campaigns have succeeded in recent years against boards that have already added or recently replaced multiple directors.

To combat this risk, boards that have not already done so should professionalize their own succession planning. Relying on the personal and business networks of the individual directors risks creating the perception of a self-perpetuating club, and can be a red flag to activists and proxy voters.

Skill matrices must keep evolving as the strategy of the company and the demands of both the marketplace and governance landscape change. Boards should consider periodically dismantling their existing matrices and criteria, and building them back up from scratch to suit the current reality. This helps ensure not only that the company has the right board for the moment, but also that it is prepared at all times to articulate why this board is thoughtfully and appropriately constructed.

Under ordinary circumstances non-management directors are inherently less visible to shareholders and the public than the CEO and other corporate executives. One result of this is that their qualifications and contributions—which may be considerable—are not self-evident. Activists often have free rein to create misleading negative narratives around incumbent or management-appointed directors, and the efforts of a communications team to do damage control after the fact may be too little, too late. Instead, companies should—on an ongoing basis—do everything possible to highlight the specific attributes each director brings to the board. The advent of the universal proxy card has increased the ability of activists to target specific directors for replacement and heightened the importance of articulating the contributions and qualifications of *each* director. Techniques we recommend to our clients include:

- Refresh how the board is presented, both as a group and individually in places like the annual report and the corporate website. Consider the use of videos, question and answer, and/or blog posts to humanize the directors and also demonstrate their expertise and engagement with the company's business areas.

- Update director bios in the proxy statement (even in the absence of a proxy contest) to ensure all content is current, clear, and relevant and provides specific support for attributed skills. Make sure the director bios on the corporate website do not differ materially from the proxy bios, which might create confusion or muddle messages.
- Enhance disclosure in the proxy around board refreshment and succession planning so that it is clear what the board is doing in these areas and why.
- Adopt modern design elements in the investor website, proxy statement, and other shareholder materials to show that the company is keeping current in its approach to corporate governance and investor relations.

Just as with a new CEO, boards should also perform opposition research on their own current and prospective members, identifying and inoculating against anything that could provide a wedge for an activist. Adding new members provides the board with a natural opportunity to communicate about those joining and clarify how each serving director contributes to the whole.

Board succession plans should be in place for whenever a director unexpectedly leaves, so that an opening is not created for an activist either in the literal sense of an unoccupied seat or the figurative sense of creating a new weakness to attack. As noted above for new CEOs, new directors should be fully vetted and well prepared for the risks of activism. Specific plans should also be in place for replacing the chair should that director be forced to step down, as well as for the heads of key committees. Committee chairs are often held accountable by activists and proxy advisors for perceived missteps under their jurisdiction; key committee seats are also often a matter of contention in settlement discussions. For these reasons, considering which director(s) holds these seats is a serious matter.

For corporate boards a great deal is at stake in succession planning

Simply because activists are more likely to call for CEO replacement does not mean that activists will let directors off the hook. Indeed, the opposite is true: activists who believe that a board has allowed the CEO to take the company in a direction that does not generate value, or has failed to bring onboard the right new CEO, could accuse the board not only of shirking its responsibility for oversight but also failing in its primary duty to create value.

Ultimately, the question of whether a board successfully planned for succession is one that can only be answered in hindsight—did the new CEO succeed? Nonetheless, boards that plan proactively for succession and communicate effectively about it can lay the groundwork for success (and ensure they receive due credit for the thoughtful work they have done).

In activist defense and proxy contests, a board that addresses the vulnerabilities outlined above well in advance—and which continues to do so on a regular basis—is better prepared to win a fight against an activist, or better yet avert it altogether.

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Essential strategies for positioning directors in today's environment

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The role of a public company's board of directors is straightforward in premise: to make informed and prudent decisions on behalf of shareholders. In practice, executing this duty is extremely complex, requiring directors to constantly balance risk and reward while navigating the fine line between supporting the management team and overseeing its actions. In today's era of universal proxy, where directors are voted on by shareholders individually rather than as a single group, the challenge has only intensified.

Public company directors are now effectively treated as political candidates running for office, and shareholders want to know why they should support them. Each director today will face heightened scrutiny of their skills, experience, and ongoing performance every year, even if they are "running" unopposed. Especially in a proxy fight, where incumbents go head-to-head against individual activist nominees, each candidate's value to the board comes under the microscope. If that value has not been clearly demonstrated, the director becomes vulnerable to replacement and reputational damage, which could contribute to the loss of the overall proxy fight.

Compounding this pressure on board members to regularly demonstrate their value is rising demand from institutional investors, proxy advisors, and index funds for direct engagement with board members. With an increasing focus on governance issues, such as board refreshment, tenure limits, and compensation, as well as overall culture issues including broader environmental and social risks, these institutions expect individual board members not only to respond to their concerns, but also to shape their practices in these areas around investor needs.

As a result, the role of the modern board has fundamentally transformed. In addition to the primary goal of building value for shareholders, directors must now be prepared to articulate the rationale behind their decisions and the merit each fellow board member brought to the deliberations. Moreover, they must create a two-way flow of information with shareholders, and build more transparent, strategic, and careful communication into every aspect of their governance.

The importance of this new responsibility cannot be overstated: if a board fails to consistently demonstrate that they actively monitor management, accept and react to feedback from shareholders, and thoughtfully make changes to increase value, they will be replaced.

Board building and refreshment

Critical to success in the current landscape is the idea of board refreshment as an ongoing process. Where refreshment used to be a one-time endeavor to replace a retiring member, shareholders now see refreshment as a necessary way to adapt to the changing needs of the company. Boards must therefore adopt the same perspective, evaluating potential directors not just on leadership or industry experience, but on their ability to develop the right strategy and effectively oversee management's execution.

Traditional considerations remain relevant. Each potential director needs strong leadership skills, financial acumen, and strategic vision. Directors should also be practically fit for the role, with a willingness to collaborate with other members, a passion for the company's mission, and the ability to devote their time and effort. However, these skills *alone* are no longer enough. Specific skills that bring clear and direct value to board discussions are what now set a candidate apart. An effective refreshment process must involve assessing what questions the board does not have answers to, or what questions they are not asking, and looking for candidates with relevant experience and expertise to fill those gaps.

For example, a candidate who led a company through a merger or acquisition will have a clear understanding of how to drive organizational change, optimize operations, and quickly pivot business strategy. Thus, they would be an especially valuable addition to the board of an organization preparing for a merger or facing financial pressure. Similarly, an executive from a sector such as healthcare will be familiar with complex regulatory environments and the necessary compliance and risk management measures required in these spaces, making them a qualified seat on any board concerned with regulatory impacts. A public affairs background, international experience, marketing, or a specific technical background are further examples. Ultimately, while any candidate worth their salt will possess standard leadership skills, it is their unique know-how that can deliver demonstrable value to the company, and that should take precedence in the decision-making process.

Equally important is overall board composition. Beyond selecting individuals with a range of competencies, directors need to think about how these individuals will come together in service of the larger needs of the board and company and, by extension, its shareholders. The ideal board will contain diversity across:

- **Experience levels**—it is always helpful to pair experienced board members who have learned from prior leadership with first-time directors who can offer fresh perspectives.
- **Backgrounds**—blending individual directors from the same industry as the current company with those who have a history in other fields helps to balance a specific focus with a bigger picture lens.

- **Roles**—not all directors need to be former chief executive officers. Other C-suite executives, such as chief financial officers or heads of marketing, provide valuable insights that are useful for ensuring the board is prepared for a range of situations.
- **Skillsets**—in addition to relevant experience, every board should also have a few directors with specialty skills in areas like artificial intelligence, cybersecurity, human resources, and so on. These skillsets help directors better anticipate different risks, challenges, and outcomes.
- **Thought**—diversity of thought is perhaps the most important factor in composing a strong board. Including a director who approaches the industry differently, thinks about things from a unique angle, or knows how to ask questions others may not think of brings a necessary point of view that ensures the board is being as detailed and thoughtful as possible.

As representatives of *all* shareholders, boards need to accurately understand and consider the wide range of wants and needs different shareholders will have, while prioritizing their obligation to mitigate risk and increase value overall. A well-constructed board helps ensure that each member's knowledge is put to good use and strengthens the company's ability to articulate its value proposition to shareholders.

Announcing these new board members also comes with its own challenges. In the past, issuing a press release with a quick look at a member's background and a nice quote was all that was necessary. Now, it is not just the result of board refreshment that shareholders want to see, but an inside look at the process. Boards should be careful to demonstrate at least two essential steps in refreshment communications:

1. Identification of a clear board need: refreshment should come from consistent examining and re-examining of board needs over time. If the need that ultimately prompted refreshment directly relates to an element of the company's strategy, or a change in the company's strategy, explain this to shareholders. The more they can connect the dots between refreshment and the value it will deliver to them, the better.
2. Retaining a third-party firm: enlisting support to help source and vet candidates helps to show that the new director is independent. By disclosing a thoughtful process, the board gives themselves and the new candidate increased credibility, allowing them to better serve the company's shareholders.

Committees and their evolving role

The shift in board expectations also extends to committee building. Boards today must actively leverage director skills within their committees to advance the company's objectives. First, though, they need to evaluate what committees are necessary.

Nearly every company will require some combination of the classic committees: Compensation, Nominating and Governance, and Audit/Risk Management. Yet, as with director skills, modern committees benefit from greater specificity. Boards should identify subject areas they need more information on to make prudent decisions, or what issues they anticipate will need further attention from the organization, and craft committees accordingly. Such committees might be human capital–focused, like a People and Safety Committee; industry-specific, like a Technology or Science Committee; or they may concern specific business risk areas such as Regulatory Affairs, Cybersecurity, or Digital Transformation Committees.

Regardless of its focus, all of these committees should follow the same composition principles as the overall board in terms of diversity of experience and rationale for membership. It is essential that no single director becomes the head of every committee. Instead, each committee should be staffed with a blend of experienced committee members and novices, directors with concentrated expertise and general skillsets, and individuals with distinct points of view or ways of thinking. Above all, every committee member selected must have or learn the specific skill of shareholder engagement.

Committees as communicators

Committees have become the primary avenue through which shareholders wish to engage. Specifically, as index funds and the like have gone from holding a small percentage of public company stock to often being the top 3 shareholders over the past 2 decades, they have required members of Compensation, Nominating and Governance and even Audit Committees to engage with them both during and outside of contentious proxy fights. In fact, continued engagement with board members is seen as central to their role as responsible passive fund managers.

The same is true of proxy advisory firms, whose voting recommendations have been followed by an increasing number of institutions in recent years, and whose role and relationship to boards is therefore only growing. While executive management does regularly engage with active shareholders, directors—particularly chairs of the Compensation or Governance committees—have become the primary conduits for conversation.

In this way, committee members have essentially become the direct ambassadors to at least 20%–40% of the shareholder vote annually. Therefore, to be successful in their role as committee chair or member, a director must be able to distill and convey key discussions, decision-making processes, and strategic visions to shareholders. They will also need to ask investors questions, be open-minded to their feedback, and incorporate it clearly into future plans.

Their ability to do so has *significant* tangible impacts, as investors tend to use these meetings to gain perspective into how well the board is functioning. If management dominates the conversation or the board's answers seem perfunctory or scripted, investors will speculate as to whether the board is performing its oversight duty. Further, a board that communicates poorly can be perceived as lacking empathy, honesty, or competence, which can have dire consequences for shareholder relations.

On the contrary, when these meetings go well, directors gain credibility with shareholders, helping them garner support that could prove critical in the future. Take for example a scenario where a company's strategy is to improve financials, but an activist targets the company after stock performance has lagged. The credibility built up through careful committee engagements and thoughtful investor materials could be the deciding factor in the vote. With this in mind, every public company should consider investing in training their board members in areas such as public speaking, crisis management, and media relations to maintain a favorable relationship with shareholders. It may also be worth investing in ongoing education and training programs for board members to help them stay ahead of technology and other evolving trends that will affect their ability to make informed decisions on a wide range of potential issues the company and the public may take an interest in.

Board advocacy and the power of transparency

Thoughtful board refreshment and committee-building strategies offer clear benefits to any company. Yet, their greatest potential lies in how they could affect the shareholder–board relationship, which means they must be showcased publicly. When shareholders can clearly see a fit-for-purpose board—a panel of experts whose experiences are directly related to the company's strategy—they are more likely to trust the board's ability to guide the company in the right direction. Further, they will better recognize individual board members and connect their unique expertise to the issues they care about, ensuring they know who to support and engage in critical moments.

Board advocacy is key to achieving these goals. Just as a political candidate needs the strength of a party behind them, a board needs support from the company. It is the company's responsibility to ensure shareholders are made aware of director value explicitly and regularly, beginning by shifting all board communications away from the "who" and toward the "why." Instead of merely presenting a board member alongside a bio that summarizes their curriculum vitae, companies need to outline what each director offers to the board and *why* they are an asset to the organization. A clear connection between relevant resume points and the company's industry or strategy should be drawn, and details on the member's contributions to board efforts, such as their role in steering critical initiatives or tackling challenges, must be highlighted.

Critically, this cannot be a one-time effort and should instead be visible to all stakeholders, from shareholders to customers and employees, everywhere they may encounter the brand. Examples might include:

- annual general meetings;
- proxy statements and annual reports;
- investor relations meetings;
- press releases and public relations;
- company website;
- industry events;
- social media;
- internal and employee communications; and/or
- partnership announcements.

While advocacy may seem a lower priority relative to all other board duties, the importance of a consistent board advocacy message platform has only grown in the context of universal proxy. It is simply easier than ever to challenge boards, and the challenge will now be aimed at specific board members. Highlighting the contributions of individual board members is difficult due to the non-public nature of much of their activity, making it necessary to use the communications platforms available to connect the company's progress on its strategy to the backgrounds and experience of their board. This is foundational to building and maintaining confidence in the board's ability to meet changing and increasingly complex shareholder expectations. It also facilitates the building of critical relationships with proxy advisors and institutional investors. Simply put, it enhances the board's reputation—through good times and bad times—and positions each member for long-term success.

Advocacy is particularly crucial in times of crisis and shareholder activism. Strong advocacy will reduce the likelihood of activism by consistently demonstrating to investors that the board has the right skills and processes in place to monitor management and make informed and sound decisions. Still, when activist situations do arise, advocacy helps to ensure shareholders are well aware of the value current directors bring to the table and bolsters their support. Members themselves benefit too, as advocacy prepares them to showcase their skill, relate to shareholders, and articulate the board's work effectively.

Similarly, there are several other stakeholders whose perceptions of the board and company at large can be shaped through advocacy. Employees, customers, and the community should see regular communications around board activities that help them understand how the company is reacting to social and political changes and acting responsibly and inclusively. In this way, the board can help secure a more favorable position for the company in the public consciousness that can affect the company's success and longevity.

Essentially, boards must understand that every aspect of what it means to build and operate a board has been reshaped. In the era of universal proxy and ever-greater interconnectivity, transparency and adaptability are not just buzzwords; they are the pillars that enhance board effectiveness and fortify shareholder confidence. Much like politicians who must continuously engage with their constituents, board members must actively communicate with their stakeholders, demonstrating their value and responsiveness to concerns.

As board members adapt to these principles becoming the norm, and the shape of their role continues to evolve, one thing is certain: building out communications skills, and integrating communication considerations into every decision-making process, is not a negotiable aspect of governance but a vital component of a successful and resilient public company.

By preparing for and embracing these changes, boards can not only meet the demands of today's shareholders but also anticipate and adapt to the future challenges of the stakeholder economy.

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The modern board: addressing activism, talent, risk

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Modern public company boards face a string of challenges and opportunities, from geopolitical and environmental threats, and shareholder activism, to demographic and technological risk and regulation. The pressure is on boards to nominate and elect the best candidates as directors to help them formulate, execute, and provide oversight over strategies to address these challenges and opportunities.

Artificial intelligence (AI) ranks high on the list of risks and opportunities for any company, no matter what the sector. It is impossible to imagine it not having an impact on employment, though opinion is divided about how much. How can a company transition to adapt to this new future? Boards play a crucial role in addressing these societal and policy challenges.

Add electoral uncertainty around the world to any risks and threats: in the 10 months between late April 2024 and late February 2025, France, Germany, India, Japan, South Africa, the UK, and the US were only some of the countries to hold either parliamentary or presidential elections. In many of those jurisdictions, the government either continues to have a shaky hand on power because of public dissatisfaction or a new administration is not yet in place.

Political, economic, and health risks, including pandemics, are not the only challenges that board directors have been confronted with in recent years.

Technological risk, in particular the rapid advent of AI, has forced them to think hard about the decisions they need to make to prepare their organizations for the impending transformation.

Financial shareholder activism

One of the biggest parts of any modern board's risk profile is shareholder activism, which has grown rapidly into a global phenomenon. These activists are focused on financial themes to drive share price and valuation, even though they spend considerable time focusing on governance aspects in order to achieve their financial objectives. Public companies of all sizes are potential targets now. Activists are not industry specific, and, increasingly, not country specific, provided that there are minority shareholder rights that can be enforced. A company could even have been an outperformer, and be an outperformer now, but if its outperformance has deteriorated over time in relation to peers, that can still make it a target.

The 243 public activist campaigns that took place around the world in 2024, according to data from the Harvard Law School Forum on Corporate Governance, marked[1] the highest number since the 249 campaigns in 2018. This included a record 66 in the Asia Pacific (APAC) region. In fact, APAC saw more total activity than Europe for the first time. Less than half the campaigns took place in the US, a fall from 2015 when they totaled 69%. Moreover, these figures do not capture the full extent of activist efforts which is substantially behind the scenes, especially in Europe and APAC.

Shareholder activism is now a fundamental component of capital markets. It is no longer a phenomenon exclusive to English-speaking countries such as the US or the UK. Activism is now extensive, both publicly and privately, across Western Europe and Japan. Once relatively immune to shareholder activism, these regions are now among the most promising markets for activists globally. South Korea has also seen an increase in shareholder activism (predominately led by home grown activists) despite many leading companies having a Chaebol structure.[2]

Activists, typically with limited share ownership positions, are fundamentally seeking good companies, with strong cash generation, where there is a valuation issue and total shareholder return issue versus *global* peers. Activists seek to catalyze a rerating in the stock price and valuation through the sale of companies, break up of companies, monetization of non-core assets more broadly, relisting of companies, and frequently an alteration of the capital allocation of these companies to favor shareholder distributions (primarily through share buybacks) rather than investment. Activists over recent years have been more genuinely focused on operational improvements at large cap US companies, but otherwise, activists have not been fundamentally focused on this despite spending not considerable time attacking operational performance.[3]

A rapidly changing environment for activists

What makes activism grow globally? The material difference in capital markets versus even 5 years ago is the receptivity of global and domestic institutional shareholders to the activist thesis. Activists have difficultly prosecuting their companies without the support of other shareholders. With the support of even a limited number of institutional shareholders, activists can apply significant pressure on boards, including at annual general meetings. In fact, over the last 6 months, the front-footedness of institutional investors to demand change has increased dramatically. Active managers are under significant pressure from passive money outlets and tools, which have been outperforming active managers. Managers are then turning to activists to help drive returns, or even adopting activist tools themselves to drive change directly.

As a result, the risk to companies' medium- and long-term strategies is material.

Critical to know the risk and get ahead of it

For companies, addressing the risk from activism means getting ahead of it and understanding the activist's thesis—as an activist would present it. Activists are fundamentally crafting a narrative that the current state of affairs is inadequate and that change is necessary and asserting that they possess the plan to address and improve the situation. Consequently, boards must understand the potential narrative, assess how it might resonate with their shareholders, and proactively address it. To be successful, extensive preparation is required before an activist's arrival, rather than merely reacting to it.

A critical component is board composition. Board members must ask whether they have properly explained to their shareholders that they have the right skills and expertise to address the challenges that a company is facing. If not, there is an increasing risk, not just in the US, but globally, that an activist will have an alternative version of the board to present to shareholders.

As a sub-component of this, appropriate board refreshment and succession planning are critical to countering potential activist approaches.

Board directors should discuss risk openly, such as what is in the news cycle and how it impacts the business. More transparent discussion at every board meeting will lead to a culture where people can raise those sorts of concerns freely and regularly.

Future of boards

A company lacking a continuous board succession strategy—one that involves engaging with potential candidates and initiating the process of refreshing its board—risks being side-lined in the pursuit of top talent.

Many management teams feel they do not have the best board. However, once a director is elected by the shareholders, the chief executive officer (CEO) does not have a whole lot of control.

According to PwC and The Conference Board's "*Board effectiveness: A survey of the C-suite*,"[4] which collected the views of 600 C-suite executives at US public companies, only 30% of executives rate their boards' overall performance as excellent or good and 92% say one or more directors on their boards should be replaced.

"While there is recognition of the board's proficiency in traditional oversight areas and confidence in the board's resolve, there is a clear call for additional education in emerging areas", the survey reports.

The more companies invest in this sort of research, the more the truth comes out, and they can receive more actionable feedback to remove underperformers. It may be natural for directors to say that their board has a good culture, is transparent and communicates well, that issues surface and real debate is possible. Ideally, the chair and independent directors set the culture, which allows for more accountability and more effective feedback to allow for the replacement of underperformers, more successful board effectiveness and a more effective board dynamic.

It works both ways. A new director joining a public company's board also needs to do his or her research. That includes looking for answers to questions such as how decisions are made and what the relationship is between management and the board. These are basic questions for any board interview, but the new director also needs to become a student of the business, for example, by visiting stores if it is a retail business, speaking to the associates, finding out what it is like underneath the shiny surface that only the board is likely to see.

In his or her first couple of meetings, a new director is going to see the story the board wants to tell, but it is important they dig under the surface and find out what the operational opportunities and challenges are, read the analyst reports, and ask questions of departing management team members or directors.

Directors on modern boards must have integrity. It is not enough to have been successful as an owner or to know the CEO or chief financial officer. They must be engaged and be a team player, with strong communication and influencing skills, and a small enough ego that they can get comfortable with the decision that is being made. Whether they agree with it or not, they are going to link arms with their fellow directors and support the decision.

These are fundamental traits for directors. If they are disruptive thinkers who can challenge the status quo, rather than merely check the box for being a financial expert who came out of a relevant industry, that director will be set up for success.

Societal and policy changes have brought about substantial turmoil and upheaval in recent years. Modern boards have not been immune from the impact of these trends. The risks to companies may be easy to spot, but taking action to get ahead of them is not straightforward.

Chapter notes

1 https://corpgov.law.harvard.edu/2025/01/21/2024-review-of-shareholder-activism/).
2 "Chaebol structure"—A type of large, family-controlled business conglomerate common in South Korea.
3 The JP Morgan *2025 M&A Outlook: Opportunities Are on the Horizon* (https://www.jpmorgan.com/content/dam/jpm/cib/documents/2025_M_A_Market_Outlook.pdf) reported.
4 https://www.pwc.com/us/en/services/governance-insights-center/library/board-effectiveness-and-performance-improvement.html.

Section 4: Boardroom risk, compliance, and crisis management

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Risks in the boardroom: strategies for personal protection, including directors and officers insurance

Woodruff Sawyer A Gallagher Company
Priya Cherian Huskins, *Senior Vice President and Partner*

Managing risk has always been part of a director's job. But the stakes have changed as the risks tied to corporate governance have grown more complex and more personal.

Modern directors must navigate a minefield of global uncertainty, regulatory crackdowns, technological disruptions, and heightened investor scrutiny. In this environment, even the most experienced leaders can face personal exposure through lawsuits or regulatory actions.

The good news, however, is that directors can still protect themselves. The key is to understand the biggest risks directors are facing as well as strategies for personal asset protection, so that directors can lead with confidence.

The modern boardroom and its evolving risks

The modern director faces complex risks that require agility and proactive oversight. These risks include everything from securities class actions to technological disruption and shifting regulations.

Securities class actions

Securities class actions continue to be one of the most frequent and costly forms of litigation faced by public companies, their directors, and officers.

According to D&O Databox, the proprietary litigation database maintained by Woodruff Sawyer (the insurance brokerage I work for), SCA filings are on the rise. In 2024, there were 206 filings—a 9% increase from 2023.

2024 total settlement $
Highest $ settled per year in history of Securities Class Actions (SCAs)

	10 Years (2015 to 2024)	2024	2023	2022
Settlement $	$27B	$4.1B	$3.4B	$2.4B
Average	$37M	$52M	$37M	$26M
Median	$13M	$16M	$13M	$12M
75th %	$26M	$43M	$37M	$24M

Unfortunately, there has also been a rising number of large-dollar settlements, with 2024 seeing settlements totaling $4.1 billion.

These suits follow a familiar pattern: when a company's stock drops due to an unfortunate announcement (for instance, missed earnings or other unexpected events), shareholder plaintiffs allege that directors and officers misled investors. In many cases, directors are personally named.

Derivative suits

Derivative suits are another source of risk for directors. Derivative suits target directors (and sometimes officers, too) for alleged breaches of fiduciary duty. Many of these suits claim that the board breached its duty through failure to oversee key risks.

Large-dollar derivative settlements are becoming increasingly common, with several recent cases surpassing tens of millions—and a few reaching into the hundreds of millions.

Top 10 derivative suit settlements (2015 to 2024)

Entity	Cash Settlement Amount	Settlement Year
Renren	$300,000,000	2021
American Realty (n/k/a VEREIT)	$286,500,000	2020
Wells Fargo	$240,000,000	2019
Boeing	$237,500,000	2021
FirstEnergy	$180,000,000	2022
Insys Therapeutics	$175,000,000	2023
McKesson	$175,000,000	2020
Paramount Global	$167,500,000	2023
Freeport-McMoRan	$147,500,000	2015
Cardinal Health	$124,000,000	2022

Will every derivative suit amount to these catastrophic numbers? No. However, here are five common types of derivative suits that have historically resulted in larger payouts:

1. **Board-level conflicts of interest**: these suits arise when directors allegedly have conflicts that compromise their decision-making.
2. **Merger and acquisition (M&A) failures**: claims in this category involve allegations that poor due diligence during M&A activities led to diminished company value.
3. **Egregious behavior directed at consumers or employees**: these suits involve allegations of severe misconduct affecting individuals.
4. **Health and human safety oversights**: suits in this category allege that directors neglected their duty to oversee matters affecting public health or safety.
5. **Massive fraud**: These suits involve allegations of large-scale fraud orchestrated or overlooked by company leadership.

Derivative suits may not dominate headlines like securities class actions, but their financial and reputational impact can be just as significant. Remember, too, that unlike settlements for securities class action suits, companies are often prohibited by corporate law from indemnifying directors for derivative suits settlements.

Economic/geopolitical turbulence

Recent years have felt like a rollercoaster of global risk, and we are still buckled in. In any given year, geopolitical tensions are among the top risks boards are monitoring. Global tensions can strain supply chains, increase costs, and add new layers of regulatory complexity.

Economic pressures can also trigger a rise in litigation. When market volatility leads to missed earnings or business disruptions, lawsuits follow. Even the best boards can be named in litigation simply for being caught up in an economic or geopolitical crisis.

Technology and cybersecurity

Technology oversight has been on the boardroom agenda for a while now. Boards must grapple with the Securities and Exchange Commission (SEC)'s updated rules on cyber disclosure. What is more, as companies embrace new technologies like artificial intelligence (AI) to stay competitive, directors must monitor the risks they bring.

The plaintiffs' bar is already watching for companies that overpromise on AI capabilities (also known as "AI washing"), or that have misused AI in some way,[1] and the SEC has signaled its intent to monitor AI issues closely.[2]

See the chapter titled "*High-Impact Cyber Events: How Insurance Can Play a Major Role in Mitigating Damage to a Company and its Ds and Os*" for more on this important topic.

ESG and reputational risks

In the current polarized sociopolitical climate, ESG is a balancing act for boards. On one hand, some investors and regulators are pushing for more transparency and greater ESG commitments. On the other hand, some investors and governmental entities are pushing for exactly the opposite.

ESG from a board risk perspective is about navigating both reputational risk and regulatory risk. Take the SEC's proposed climate disclosures, currently stayed in court,[3] or state-level requirements such as California's Climate Corporate Data Accountability Act (SB 253) and the Climate-Related Financial Risk Act (SB 261).

In a world where even the best-intentioned directors can end up in the crosshairs, good corporate governance is the best defense against shareholder lawsuits, regulatory enforcement, and reputational damage.

Corporate governance: the fire sprinklers of D&O risk

For directors, risks are often unavoidable—but they are also manageable. Corporate governance is the board's "fire sprinklers"—the system to detect early risks and address them before they ignite into full-blown crises. At the core is effective oversight, a fiduciary duty that safeguards both the company and its directors from liability.

Oversight is a two-part approach

A director's duty of oversight often comes under the microscope in litigation. *Caremark* claims alleging a failure of director oversight may be among the hardest for plaintiffs to win, but defending against them can be costly and damaging for directors.

In practical terms, effective oversight is about executing two key responsibilities: (i) making sure risks are brought to the board's attention promptly and (ii) taking action to address those risks once they are identified.

Risk identification systems

Boards need to put in place systems designed to bring risks to the board's attention. This includes formal reporting to ensure the board hears about red flags before it is too late. The Delaware Supreme Court's landmark decision in *Marchand v. Barnhill, et al.*[4] reinforced this point, making it clear that boards can be liable for failing to monitor key risks.

Responsive action plans

When risks are flagged, it is not enough to simply acknowledge them—the board must act. This involves meetings, developing strategies to address issues, and overseeing implementation. Ignoring red flags or delaying action is a breach of a board's fiduciary duty and can expose directors to significant personal liability.

The importance of documentation

Good governance does not end with oversight—it must be documented. Thorough, accurate board meeting minutes can show that the board was informed and proactive in addressing risks.

Best practices for meeting minutes include:

- Capturing key discussions and decisions without unnecessary detail.
- Avoiding subjective commentary that could be misinterpreted in litigation.
- Reviewing and approving minutes promptly to ensure accuracy.

The bottom line is that good meeting minutes show that the board took its oversight duties seriously and acted in good faith. This can be a critical defense in any fiduciary duty litigation.

Caremark claims: "trying" counts

A recent case involving Walgreens[5] provides a real-world example of how oversight and documentation can play out in court.

The events leading to the derivative suit against Walgreens involved allegations of overbilling, including the government, for insulin. While the situation was serious, the case ultimately demonstrated how boards can successfully defend against a *Caremark* claim by showing their governance processes were both active and well-documented.

While the court acknowledged that the approach taken by the Walgreens board was not perfect, the court emphasized that perfection is not expected.

What matters is a demonstrated, good-faith effort to oversee compliance risks and respond appropriately. In Walgreens' case, the court's decision was influenced by the board's meeting minutes, which clearly outlined their ongoing oversight efforts.

The key takeaway? Trying counts. This case serves as a reminder that good governance is not about preventing every problem; it is about demonstrating diligence.

However, even the most diligent boards cannot eliminate all risks—and directors know they can be personally named in lawsuits despite their best efforts. That is why it is essential to pair robust governance with protections designed to shield directors from personal liability.

Indemnification agreements: a first line of defense

Indemnification agreements are contracts between a company and its directors, ensuring that if they are faced with litigation, the company will advance legal fees to directors and cover settlements where the law allows.

Having said that, indemnification agreements are not without their limitations. For example, indemnification for settlements in derivative suits is typically off the table. That is because in most jurisdictions (including Delaware), companies can not indemnify directors for settlements for derivative suits. Similarly, indemnifications have little value in the event of corporate bankruptcy—exactly when directors may need protection the most.

There are a couple of best practices to keep in mind for ensuring indemnification agreements are as robust as possible:

- **Review the agreement regularly**: laws and risks evolve. Directors should ensure their agreement is up to date with current indemnification statutes and case law.
- **Clarify advancement of legal fees**: make sure the agreement explicitly requires the company to advance legal costs promptly, rather than reimbursing them after the fact.

At the end of the day, indemnification agreements are a critical piece of personal risk management for directors. However, they are only as strong as the company's ability to honor them.

That is why a well-structured D&O insurance program remains the gold standard for protecting personal assets when serving on a board. Importantly, indemnification agreements and D&O insurance should be viewed as complementary tools—not interchangeable ones.

D&O insurance: the gold standard and how it works

While indemnification agreements are a strong first line of defense, D&O insurance provides both a backstop and a safety net. In the next section, we will explore how these policies work, and why a strong D&O program is indispensable in protecting directors.

The ABCs of D&O insurance: Side A, Side B, and Side C coverage

Large D&O insurance programs are comprised of D&O insurance policies offered by different carriers. A classic D&O insurance policy has three insuring agreements, traditionally referred to as Side A, Side B, and Side C.

Side A coverage: personal protection for directors

Side A is the "personal protection" part of a D&O insurance policy. Side A responds when a matter is insurable but company indemnification is not available.

If the company is bankrupt or otherwise legally unable to provide indemnification (as is often the case for derivative suits), Side A coverage ensures that directors are not left footing the bill for defense costs or settlements.

When properly structured, Side A covers losses on a first-dollar basis without requiring directors to pay the self-insured retention (like a deductible).

Side B and Side C coverage: balance sheet protection for the company

While Side A coverage is all about personal protection, Sides B and C protect the *company's* balance sheet.

- **Side B** reimburses the company for indemnification payments it makes to individual insureds, for instance, directors and officers. For example, if the company advances legal fees to a director, Side B coverage allows the company to recover those costs from its insurer.
- **Side C**, also known as "entity coverage", responds on behalf of the company itself. For public companies, this is typically limited to securities claims.

Why Side A-only/difference-in-condition policies matter

Given the critical role of Side A coverage in protecting directors, many companies first purchase ABC D&O insurance policies and then purchase additional Side A-only/difference-in-condition (DIC) policies as an extra layer of protection. DIC policies are a specialized type of Side A-only policy.

Side A DIC policies offer the following advantages:

- **They ensure directors have dedicated protection in bankruptcy**: when a company files for bankruptcy, there is a concern that the traditional D&O policy (which includes Side B and Side C) could be viewed as part of the bankruptcy estate. In these cases, directors might find themselves competing with creditors to access those funds. The Side A-only policy avoids this issue entirely.
- **They provide fewer exclusions and more reliable coverage.** Side A DIC policies often include fewer exclusions than standard D&O policies, which makes them more likely to pay out in complex claims.
- **They can drop-down and pay a self-insured retention if needed.** Solvent companies must pay the self-insured retention before a policy advances legal fees—but what if the company refuses? Side A DIC policies can "drop down" to pay the SIR in this situation.
- **They can drop-down and pay a non-indemnifiable loss if an underlying carrier is insolvent.** Imagine the terrible scenario of experiencing a non-indemnifiable loss at the same time as one of the carriers in your insurance program goes insolvent. Side A DIC policies can drop down and replace the insolvent insurance layer.

- **They offer first-dollar protection.** Unlike Side B and Side C coverage, which typically require the company to pay a deductible or self-insured retention, Side A policies kick in immediately. This is a big relief when directors face legal action and need funds to cover defense costs right away.

In some cases, companies may elect to purchase *only* Side A coverage to save money on the overall cost of the insurance program by forgoing any balance sheet protection. This is typically only done by very large companies or by companies that cannot afford to purchase balance sheet protection.

Practical guidance for securing the best D&O coverage

Securing the right D&O coverage is a complex process. The nuances of who is covered, how the insurance program is structured, and how it will respond to claims can make a significant difference in protecting directors from unexpected risks. In this section, we will explore practical guidance when obtaining D&O coverage.

D&O insurance is a claims-made policy

D&O policies are claims-made policies, meaning the policy in place at the time the claim is made (not when the alleged wrongdoing occurred) will respond.

However, these policies can include “past acts” dates, which exclude coverage for incidents that occurred before the specified date. To ensure robust protection, directors should negotiate for the elimination of past acts dates or push them as far back as possible.

Watch policy definitions

Policy definitions can impact how and when coverage will apply—and they are very tricky. For example, the definition of “claim” can determine whether informal regulatory inquiries or investigations trigger coverage.

Your best bet is to work with an experienced broker or coverage attorney and ask questions about whether there is coverage for a variety of litigation and regulatory enforcement scenarios.

Understand policy exclusions

All insurance policies come with exclusions. In D&O policies, the scope and timing of exclusions can be profound. One common exclusion relates to fraudulent or dishonest conduct. While this exclusion is standard, how it is applied can be negotiated.

For example, a “final adjudication” clause ensures that exclusions only apply after a court has issued a final ruling on the matter. This protects directors from having coverage pulled prematurely.

Other typical exclusions may relate to Employee Retirement Income Security Act claims or employment practices claims, which are typically covered by other types of insurance. Understanding these exclusions ensures there are no surprises when a claim arises.

Be aware of rescindability and severability

One major risk for directors is that an insurer could rescind the policy if it believes the company misrepresented information during the underwriting process.

To protect directors from this risk:

- **Non-rescindable Side A coverage is key**: it ensures that even if the policy is voided for the company, individual directors and officers will still be protected.
- **Severability provisions can prevent bad actors from tainting coverage for other directors**: this means that if one insured person is found guilty of wrongdoing, innocent directors can still access the policy.

Directors should not have to worry about losing coverage because of another individual's misconduct or a company's missteps; this makes strong severability provisions and non-rescindable Side A coverage indispensable.

Limit the insureds under a policy as needed

Most directors are content with a D&O insurance program that protects all the directors and officers as a group. However, another way to maximize the protection available for directors is to limit who shares the policy.

Some policies, like independent director liability or "IDL" policies, restrict coverage to non-officer, independent directors. This ensures that high-value claims do not erode coverage available to independent directors.

For directors who sit on multiple boards, personal director liability or "PDL" policies offer even more protection, covering a director across multiple companies. While these policies are less common, they can be valuable for directors who want to ensure they have dedicated, personal coverage without competing for shared policy limits.

Select the right broker

Purchasing insurance from a reputable *carrier* is important. Remember, however, that the pricing, terms, and conditions of a D&O insurance policy are almost entirely driven by a skilled *broker*. So choosing the right broker is one of the most important decisions a company can make in securing D&O coverage.

A skilled broker will:

- Tailor the policy to the company's specific risk profile.
- Negotiate key terms and definitions to ensure directors are covered in a wide range of scenarios.
- Provide insight on policy limits, based on historical claims data and not just industry averages.
- Consult on risk management policies and loss control.
- Advocate on behalf of directors and officers if a claim arises.

In short, the right broker is not just one that secures a policy; it is the one that serves as a trusted advisor and claims advocate, ensuring directors and officers are protected when it matters most.

In conclusion

The risks directors face today are complex, but the solutions to manage those risks are well within reach. Good governance remains the cornerstone of risk management; however, even the best practices cannot eliminate all threats, which is why robust personal protection—like indemnification agreements and comprehensive D&O insurance—is essential to attracting and retaining high-quality directors.

Chapter notes

1 See Cigna's class action [https://www.documentcloud.org/documents/23885679-cigna-complaint/?responsive=1&title=1] regarding denied claims.
2 Gensler, 2024; https://www.sec.gov/newsroom/speeches-statements/sec-chair-gary-gensler-ai-washing.
3 Cleveland-Peck, 2024; https://www.wsj.com/articles/u-s-appeals-court-temporarily-halts-sec-climate-disclosure-rules-456f2f4c.
4 2019; https://law.justia.com/cases/delaware/supreme-court/2019/533-2018.html.
5 2023; https://courts.delaware.gov/Opinions/Download.aspx?id=360250.

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High-impact cyber events: how insurance can play a major role in mitigating damage to a company and its directors and officers

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What is a "High-Impact Cyber Event"? This question can be answered in a number of ways. A business may suffer financial harm because it paid a ransom in a cyber-attack. That same company may experience business income loss and extra expense if its systems are shut down and can not operate. Once the cyber event is disclosed, client distrust and reputational harm could result. Upon disclosure, the company's stock may drop, and shareholder concerns could give rise to securities and derivative claims against the company and its directors and officers. The Securities and Exchange Commission (SEC)'s cyber disclosure rule also requires public companies to timely disclose material cyber incidents. The SEC may open an investigation into the company's cybersecurity efforts and disclosures if the SEC is suspicious of the company's actions.

These are not only challenges that the company must address; directors and officers are exposed to high-impact cyber events. Additionally, if a company suffers losses as a result of a high-impact cyber event, and the proper mechanisms are not in place to minimize those losses, exposure to directors and officers could increase significantly. That is why risk transfer via insurance is critical to prepare for these events. There are two key insurance products that can respond to protect companies and their directors and officers in high-impact cyber events: cyber insurance and Directors and Officers Liability (D&O) insurance.

To illustrate these risks and solutions, let us walk through several high-impact cyber event exposures and how cyber and D&O insurance can respond to and protect both the company and its directors and officers.

First party losses and insurance coverages

Cyber events involve two types of losses: first and third party losses. First party losses are directly suffered by the company. Third party losses are suffered as a result of third party claims against the company and its directors and officers (and other individuals).

The most prevalent example of a first party cyber loss is a ransomware attack. Ransomware attacks have been an ongoing plague for years, and bad actors are indiscriminatory. Attacks happen to small and large companies across all industry segments. As companies evolve to avoid the risk of attacks so do threat actors who are constantly changing their methods through phishing campaigns, malicious emails, and other means.

Of course, the goal of a threat actor in a ransomware attack is to demand and receive payment. In exchange, threat actors promise to release a decryption key and/or proof that any data exfiltrated was destroyed. Whether a company chooses to pay a ransom is a business decision and dependent on many factors unique to that company's exposure. For example, companies in the retail industry with supply chain issues could suffer significant setbacks. Companies that hold personally identifiable information may have to navigate an extortion demand on the threat of exfiltrated data being released on the dark web.

Complicating matters further, regulatory oversight of a ransom payment is a forefront issue with the Office of Federal Assets Control (OFAC). OFAC is an agency of the US Treasury Department that enforces trade sanctions against threats to the US economy, among other things. OFAC has warned companies that payments made to threat actor groups on the OFAC sanctions list, even when payment is made under duress of a ransomware attack, is a violation of federal sanctions regulations. If the regulations are violated, OFAC may impose civil penalties.

The presence of cyber insurance can become critical for a company facing the need to make a ransom payment. Many cyber insurance policies will provide extortion coverage, which includes the ransom payment itself (with the insurer's consent). Importantly, however, an insurer will not agree to cover any ransom payment made to a threat actor on the OFAC sanctions list.

Apart from the decision to make a ransom payment, companies are met with the expense of retaining vendors to respond to the breach. Breach counsel is engaged to assess the impact of the breach and the extent to which the company must comply with breach notice laws. Forensics is retained to evaluate the existence, cause and scope of the breach. A ransom negotiator provides the company with data and insight into the strategy around communications with the threat actor (and review for OFAC clearance as discussed earlier). If the event could be leaked, a public relations firm may be retained to assist with consistent messaging to employees, customers, and shareholders regarding the event.

While these vendor services may be necessary for a company's protection throughout the duration of a ransomware attack, expenses can add up quickly. Cyber policies typically provide expense reimbursement to the company for legal, forensics, public relations, notifications, call centers, credit monitoring, and other necessary fees.

Irrespective of whether a ransom is paid, there is a likelihood of interruption to a company's business during a cyber-attack. Business interruption costs can be significant if a company is unable to operate for a period of time. Cyber insurance policies generally include business interruption loss and extra expense as a component to coverage if the loss is caused by a breach. Business interruption losses are generally identified as the company's net profit before taxes that would have been earned but for the interruption to the network. Extra expense is categorized as those reasonable and necessary expenses incurred to minimize or avoid income loss (i.e. to mitigate business interruption).

Using an earlier example, what if a company is part of a supply chain and is impacted by a breach at another company with which it contracts to do business? Cyber policies also offer dependent business interruption coverage that covers both lost income and extra expense that the company sustains as a result of another's breach.

Third party losses and insurance coverages

In addition to first party losses directly suffered by companies, there are outside exposures that could lead to third party losses from high-impact cyber events. Examples include claims (i.e. demands, lawsuits, etc.) by shareholders or regulators that allege the company and its directors' and officers' failure to properly secure information negatively impacted shareholders, and those shareholders suffered resulting damages.

For public companies, the threat of securities and derivative litigation exists over the alleged failure to take reasonable cybersecurity measures. This has become a category of "event-driven" securities litigation. Event-driven securities litigation can surface when there are categorical allegations that investors were misled by a company's misstatements (and/or omissions) that oftentimes impact societal issues in violation of the Securities Exchange Act of 1934 (the "1934 Act"). Similarly filed derivative actions against individual decision-makers allege breach of directors' and officers' fiduciary duties.

Plaintiffs' attorneys focused on filing event-driven securities and derivative litigation pay close attention to cyber events and target any industry class if a stock price decline is remotely related to adverse news of those events. Most cases have a common fact pattern involving the alleged failure to disclose data breaches or material information relating to how customer data was secured.

Cyber insurance policies provide third party liability coverage for claims arising from a data or security breach. For example, coverage may apply for a consumer class action alleging the failure to properly protect information. However, cyber policies generally do not cover securities or derivative claims. Most cyber policies will have an express exclusion for claims or loss arising out of violations of securities laws or regulations, the ownership, or the sale or purchase (or offer to sell or purchase) securities.

The D&O policy will be the primary insurance to respond to securities and derivative litigation. As discussed in Chapter 28, *Risks in the boardroom: strategies for personal protection, including directors and officers insurance*, company coverage is provided for securities and derivative claims under Side C of the policy. Coverage under the D&O policy is also available to the company for its indemnification of directors and officers named in a securities claim under Side B coverage. If the company is not indemnifying the directors and officers in the securities class action, coverage is available to the individuals under Side A. For derivative claims made against the board of directors, both Side A and Side B of the D&O policy may be implicated.

But what if a lawsuit has not been filed, and shareholders have simply made a demand for books and records, or a sent a shareholder derivative demand investigation related to a breach? The D&O policy can be a risk transfer mechanism for costs incurred in responding to both. D&O policies can be enhanced to include coverage for both securityholder derivative demand investigation costs and the costs incurred to respond to a books and records demand. These enhancements are usually limited to a portion of the D&O policy's limit of liability (a sublimit), but additional sub-limits can be purchased on excess layers of insurance that will drop down over the primary sublimit.

As a way to prioritize cybersecurity accountability, regulators have created new requirements for entities and holding directors and officers accountable for ensuring the safety of the data held. For public companies, the SEC has gone a step further. In September 2023, the SEC's Cyber Security Risk Management Strategy, Governance, and Incident Disclosure Rule took effect. The intent of the Rule is to hold public companies accountable to investors by requiring timely and informative disclosures of cyber incidents.

The Rule mandates disclosure of "material cyber incidents" within 4 business days of the company's materiality determination. According to the SEC, information is "material" if:

1. there is a substantial likelihood that a reasonable shareholder would consider it important in making an investment decision; or
2. disclosure of the information would have been viewed by the reasonable investor as having significantly altered the total mix of information made available.

(See SEC Final Rule Release No. 33-11216, *Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure* quoting *TSC Indus. v. Northway*, 426 U.S. 438, 449 (1976)). Despite the SEC's intent to clarify materiality, companies continue to struggle with its scope and meaning.

The role of the Chief Information Security Officer (CISO) has also been impacted by the Rule, with the CISO primarily in charge of responding to high-impact cyber events and determining disclosure to the SEC under the Rule. Not only is the CISO affected by the Rule, cybersecurity may now be a compulsory agenda item for every boardroom meeting.

Cyber policies often provide coverage for regulatory claims. This coverage includes defense of regulatory actions, including investigative subpoenas and enforcement actions, and coverage for fines or penalties (to the extent insurable by law). As discussed, however, most cyber policies have exclusions for claims arising from a violation of securities laws. If an exclusion exists, companies should look to the D&O policy for this coverage.

Under the D&O policy, regulatory investigation coverage will depend on the type of policy purchased. Most D&O policies provide coverage for regulatory investigations against directors and officers as long as they are the target of the investigation. D&O policies can also provide company investigation coverage, but it is not generally included in the D&O policy. This coverage can be offered to the company under a variety of scenarios: (i) where there is also a parallel securities claim pending; (ii) while there is an ongoing investigation of an insured person who is identified as a target of the investigation;

or (iii) if the company is the target of the investigation.

Once a regulatory investigation becomes a proceeding, coverage is oftentimes triggered for both the company and directors and officers under the D&O policy. Typically, a proceeding would be commenced by service of a complaint, or a similar pleading.

High-impact cyber case study: SolarWinds

In 2020, SolarWinds Corp., a publicly traded company providing information technology software to private and government actors, suffered a cybersecurity breach. Specifically, the Russian Foreign Intelligence Service injected a malicious code into SolarWinds' Orion software which, when downloaded by a customer, could be used to compromise their server.

After the breach, SolarWinds' shareholders filed a securities class action lawsuit against the company, its former CEO, Kevin Thompson, and its CISO, Tim Brown, alleging violations of the 1934 Act. *In re SolarWinds*, No. 1:21-cv-00138-RP (W.D.Tex., 1 June 2021). The plaintiffs alleged that they learned of the breach through media reports revealing that cybercriminals had inserted malware into updates for SolarWinds software. According to the complaint, a US government official identified the SolarWinds breach as the "worst hacking case in the history of America." The plaintiffs alleged that SolarWinds did not disclose the breach and the company's infected software updates were downloaded for over six months and by thousands of SolarWinds customers. Multiple other reports alleged deficient practices and vulnerabilities leading SolarWinds to be an "easy target" for a breach. On this news, SolarWinds suffered multiple stock drops.

According to the plaintiffs, CISO Brown identified himself as being responsible for the security of SolarWinds products, was intimately involved in the company's cybersecurity, and therefore knew of the company's actual cybersecurity practices and absence of policies. Plaintiffs claim CEO Kevin Thompson made an unorthodox sale of over one million shares of his personal SolarWinds stock worth over $20 million before the stock dropped.

The defendants moved to dismiss the case, but the court sustained nearly all of the claims. SolarWinds subsequently settled with the shareholder class for $26 million.

A derivative lawsuit was also filed against SolarWinds' then-current and former board of directors. *Construction Industry Laborers Pension Fund, et al. v. Mike Bingle, et al.*, Case No. 2021-0940-SG (Del Ch., 4 November 2021). Among other things, the plaintiffs alleged that the twelve directors were obligated to:

1. implement protocols requiring management to keep the board apprised of cybersecurity compliance practices, risks, and reports on an ongoing basis;
2. nominate and appoint directors with appropriate expertise in cybersecurity and technology and regularly educate board members on these matters;
3. discuss on a regular basis key cybersecurity issues; and
4. take remedial action when apprised of cybersecurity deficiencies.

The plaintiffs alleged the directors breached their fiduciary duties of loyalty and care through bad faith failure to oversee SolarWinds' cybersecurity. The plaintiffs did not make a pre-suit demand on the board, arguing demand futility.

A motion to dismiss was filed. There, the court dismissed the derivative action against the SolarWinds board of directors, emphasizing that oversight liability claims established by the *Caremark* decision (discussed in Chapter 28, *Risks in the boardroom: strategies for personal protection, including directors and officers insurance*) are one of the most difficult claims to prove. The court found no reason why the plaintiffs were excused from making a demand on the board before filing suit, as plaintiffs did not properly plead a sufficient connection between the corporate trauma and the actions of the board.

Although the court dismissed the derivative action, the allegations in the complaint revealed what may be alleged by shareholders and demonstrates how plaintiffs' firms (and shareholders) view directors' and officers' obligations with respect to the cybersecurity of a company.

Following its own investigation into the SolarWinds breach, the SEC filed a landmark cyber enforcement action against SolarWinds and CISO Brown, individually, claiming that they made materially false and misleading statements in the Security Statement, company podcasts, blog posts, and press releases. *SEC v. SolarWinds Corp. and T. Brown*, No. 23-cv-9518 (S.D.N.Y., 30 October 2023). Interestingly, much of the SEC's claims were dismissed by the court relating to disclosures, holding that innocent errors are an inadequate basis to plead deficient disclosure controls. The surviving claims included the allegation the Security Statement posted on SolarWinds' website by the company and Brown in 2017 may have been false or misleading. Importantly, the court did not dismiss Brown from the case.

Additional fallout occurred from this high-impact cyber event and spread to other companies. After the SEC filed suit against SolarWinds and CISO Brown, the SEC charged four current and former public companies with making materially misleading disclosures regarding cybersecurity risks and intrusions. The charges against the companies resulted from an investigation involving public companies potentially impacted by the compromise of SolarWinds' Orion software and other related activity. The companies agreed to pay civil penalties ranging from $990,000 to $4 million. The downplay of the severity of the SolarWinds breach was a significant aspect of the SEC's findings, as were the allegations in the securities and derivative actions.

The SolarWinds Case Study is an example of how the target of a high-impact cyber event, its directors and officers, and other businesses can be exposed. Directors and officers must therefore remain hyper vigilant on cybersecurity within their companies.

Insurance policy limits adequacy for high-impact cyber events

Now that we've walked through high-impact cyber events and their varying exposures, what are the right insurance limits to protect a company and its directors and officers? Knowing the right limits for a high-impact cyber event is important for transferring risk in both first and third party losses, but limit adequacy analysis can be a moving target. There are several ways in which businesses might determine limit adequacy for both cyber and D&O insurance. For cyber insurance, considering daily financial loss caused by a significant business interruption due to a cyber event or system outage is useful. As brokers, we also utilize risk quantification tools that use historical loss data and an individual company's exposures to create potential loss scenarios as a way to evaluate limit adequacy for cyber policy limits.

There are also various ways to determine limit adequacy for D&O insurance. Most public companies purchase D&O coverage but are unsure of how much coverage they need and what program structure is necessary. Different tools help address limit adequacy, such as peer-to-peer benchmarking and stochastic modeling simulations. As brokers, we rely heavily on our D&O analytics to guide these recommendations. There is no "one size fits all" approach to the appropriate level of risk transfer through D&O insurance. We must utilize our experience, particularly when it comes to how much personal asset protection for high-impact cyber event exposures is sufficient for directors and officers on a company-by-company basis.

Section 5: Board refreshment and succession planning

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Succession planning for the board: the blueprint and the talent

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Chief executive officers (CEOs) today are leading through a period of rapid disruption that brings complex challenges, unclear solutions, and an overwhelming number of choices. CEOs must drive transformation while making sure day-to-day operations continue to run smoothly. This pressure to balance change with performance has been building for years, but it has been greatly intensified by today's business environment. Traditional business practices just do not work anymore. Innovation or stability? Ambitious growth or core focus? The expectation to "change the tires while the car is moving" is greater than ever, demanding strategic foresight and agile governance.

The real challenge lies in balancing competing priorities to ensure immediate success and long-term viability. **CEOs cannot do this alone.** Board members are critical in promoting operational stability and innovation. A board is even more important than ever in helping to guide the CEO to success while ensuring they are forward-looking in order to position the company for what is next.

Boards that adopt an agile and adaptive approach to governance stay effective in this fast-moving landscape. This encourages curiosity and ensures board members stay attuned to market shifts, new technologies, and geopolitical swings. Boards need to embrace a continuous learning mindset—whether through attending industry events, networking with peers, or engaging with thought leaders. Staying informed enables boards to offer timely advice, helping their organizations steer through change with confidence.

One critical—yet often overlooked—element of adaptive governance is succession planning. Boards are famously slow to change, but for boards to remain "fit for purpose" a proactive succession plan is a must, ensuring board renewal in a way that brings fresh perspectives into the boardroom. Importantly, renewal creates a culture where directors evolve alongside the company, and bring new capabilities that align with those required at the leadership level. Term limits, staggered appointments, and regular evaluations help keep boards dynamic, guaranteeing they remain responsive to both current and future challenges. To stay aligned with evolving strategies, **boards must embrace change**.

To make an effective change requires succession planning. Boards and CEOs must embed ongoing succession planning and talent relationship development into governance. In addition, boards should not only assess their composition, but they should also identify the key mindsets required to address the complex challenges of today. These efforts cannot be one-time events—they are a continuous process. Succession planning not only gives insight into the board itself but also keeps an eye out for undiscovered talent. Successful boards are those that prioritize succession planning to create a culture of collaboration, adaptability, and integrity.

From stagnation to innovation: the case for board progression

Stagnation is widespread. According to PriceWaterhouseCooper and The Conference Board's report, "*Board Effectiveness: A Survey of the C-Suite*," out of 600 C-suite executives surveyed in 2024, 92% said one or more directors on their boards should be replaced. According to S&P 500 proxy data from ESGAUGE, there was only a 6% increase in the number of board members that did not stand for re-election in 2024 (450) vs. 2023 (423), while only 3% went to first time directors. Progression in the boardroom continues to be slow.

At the same time, boards cannot throw the baby out with the bathwater by undervaluing experience. Seasoned directors provide invaluable stability with their deep historical knowledge. This experience should be used alongside current perspectives that reflect the fast-paced changes in the business environment. For instance, while an existing director with a background in traditional consumer marketing brings essential insight, new expertise in areas like digital and social transformation can help address emerging complexities. To stay relevant and forward-looking, boards must focus on integrating experience with innovation.

Regular rotation and strategic refreshments can keep the board dynamic and adaptable to drive sustained success. This process should be a shared responsibility. Every board member should assess their contributions to ensure they are still relevant to the organization. Boards can be highly effective, responsive, and future-ready when they engage in open communication, hold every director accountable, and consistently prepare to meet evolving business demands through regular updates to their succession plan.

Going beyond the matrix: creating a proactive succession blueprint

Effective succession planning relies on a comprehensive, future-focused succession blueprint that goes beyond the director skills matrix. In fact, according to ESGAUGE, the number of S&P 500 companies that disclosed the use of such matrices has nearly doubled in just 5 years, rising from 42% to 79%. But to what result? Traditional board composition matrices identify technical skills, which, although useful, often miss the strategic power of cultural alignment, diversity, and judgment. A matrix does not capture intrinsic capabilities such as whether a director is an agile thinker, whereas the succession blueprint defines the holistic qualities required for board members to be successful, strategic assets for the company.

The succession blueprint is more than a checklist of technical skills. It starts with an assessment and benchmark of the organization's strategic priorities against market and global trends. It then assesses the board's composition and capabilities against those elements. In this way, the succession blueprint is bespoke and provides a nuanced view of the capabilities required to navigate your specific company's environment.

The succession blueprint must be flexible and forward-looking. To build an effective succession blueprint, boards should consider the following components:

- What are the core capabilities of a successful director, beyond just skills and experience?
- How can the board ensure diverse perspectives in decision-making?
- Does the board composition support the company's long-term strategic goals? If not, does the board need to shift its focus and/or structure to adapt?
- How will directors be evaluated and when will these evaluations take place?
- How will the board address rotation and refreshment?
- How will future directors be courted and selected?

This assessment of a board's capabilities calls for a culture of accountability. A culture where the performance of individual directors, and the board as a whole, is assessed with candor, transparency, and rigor. These evaluations should be thorough and honest, empowering boards to refine their strategies and strengthen their composition.

To make the succession blueprint more effective, Korn Ferry generates a "Board Success Profile." A Board Success Profile defines key leadership capabilities including experiences, behaviors, and mindsets required of future directors. More importantly, the profile caters to a specific organization, rather than a one-size-fits-all approach. Korn Ferry's Board Success Profile defines the **experiences** that should be represented around the table and the **leadership behaviors** of each director that will make them a success on a high-performing public company board.

Experiences

When represented through multiple directors, diverse experiences enable a board to guide management on the organization's strategic priorities. For example, a director with audit-focused experience may have a different approach to a problem than a director with experience in digital, generative artificial intelligence, or sustainability. But, when both perspectives are represented on the board, it is better equipped to anticipate and navigate challenges that a more single-minded board would not notice.

Leadership behaviors

Characteristics that define leadership behaviors support an effective board culture. When boards know a director's leadership style, they can better assess how well a potential director will fit within the board's culture. This way, boards can maintain momentum without stalling on account of unknown leadership behaviors that hurt, rather than help.

Key Elements of the Board Success Profile

Integration of Insights

The Board Success Profile integrates insights on the organization's culture, ecosystem, and transfomation agenda, as well as the external market landscape

Proprietary Data and Research

It leverages Korn Ferry's proprietary data and research to define what makes a successful board member in a specific business context

Customization

The profiles are tailored to fit the unique needs and strategic goals of each organization, ensuring that board members are aligned with the company's vision and objectives

In addition to finding the right talent, boards must be ready when experienced board members leave. A seasoned director is a treasure trove of institutional knowledge that cannot be ignored. Korn Ferry utilizes a "gap analysis" to account for required capabilities that will be lost, such as qualified financial expertise. The gap analysis is critical to succession planning because it helps prioritize the future board director specifications.

In the end, a succession blueprint should leave the board with four things: (i) a clear review of the company's strategic and future objectives; (ii) a competitive review and benchmark of market trends; (iii) an understanding of individual directors' capabilities and retirement timelines; (iv) and more importantly provide a roadmap on how to engage with highly sought after directors as part of an ongoing, proactive talent scan against recruitment priorities.

Key Elements of the Board Succession Blueprint

1. **Strategy & Benchmarks** - Benchmark company strategy against peers in the market
2. **Board Composition Analysis** - Analyze director competencies, capabilities, and experiences against an agreed upon Board Success Profile
3. **Gap Analysis** - Prioritize short-, medium-, and long-term specification criteria
4. **Rotation Considerations** - Plan ahead to fill board and committee leadership roles
5. **Execution Timeline** - Map goals and milestones to ensure a clear path forward

Activating a proactive succession blueprint: getting the candidate you want

Succession planning should be an ongoing process rather than a last-minute scramble. Board succession planning is not just about replacing directors. It is about creating a roadmap for all the contingencies that might disrupt the business. Effective boards prepare for risks that have not yet materialized like a sudden geopolitical crisis, or an unexpected director departure. Just as in business, stability in governance means anticipating and preparing for potential challenges before they arise, not waiting for a crisis to strike.

Proactive recruitment helps boards select the best candidates and build a talent pipeline well before vacancies arise. This approach equips the board with the capabilities needed to propel the organization forward, while broadening the search to include long-term, desirable candidates well before they are in the market. Moreover, a proactive approach reveals talent that boards could otherwise overlook. If boards have the time to explore potential talent, in advance, they have more flexibility to go beyond the usual suspects. Proactive recruitment allows for strategic foresight and long-term planning—boards can court and build relationships with candidates to further discern their cultural and strategic fit.

Proactive recruitment offers several benefits:

- It prepares boards to fill vacancies with the best candidates.
- It creates a more diverse board with varied perspectives.
- It finds candidates who match the organization's vision and culture.
- It minimizes disruptions and maintains effectiveness.
- It equips the board to drive innovation and address challenges.

Seamless transitions: effective onboarding and offboarding practices

Anticipating turnover helps maintain a strong governance structure. When directors retire or step down, boards need to assess how this departure affects their composition and the organization's strategic direction.

Onboarding should start before a newly appointed director's official start date, with a structured plan integrating them into board activities, committees, and culture. Think of this as laying the foundation for a building, providing stability and strength from the outset. Thoughtful succession planning acts like a well-oiled machine, maintaining a seamless transition when directors step down and preserving the board's strategic focus and momentum.

A well-designed onboarding process provides new directors with a deep dive into the inner workings of the business. This proactive approach accelerates their contributions, improves decision-making, and quickly integrates new members into the board. A strong mentorship or "board buddy" program also plays a critical role in successful integration, acting as a compass that helps new directors build relationships and become influential contributors.

Offboarding, too, must be handled with care and respect. Boards should start by recognizing the contributions of outgoing directors. Think of this as a graceful exit from the stage—not a hook. Outgoing directors' performance should be celebrated in a way that acknowledges their legacy.

Five Key Actions For Effective Onboarding	
1. Develop a 6- to 12-month onboarding plan, including one-on-one meetings with committee chairs.	✓
2. Create a customized board education program tailored to each new director's needs.	✓
3. Pair new directors with experienced mentors for up to 12 months, ensuring regular feedback.	✓
4. Provide additional support and guidance to directors without prior board experience.	✓
5. Encourage early contributions from new directors to facilitate their integration.	✓

Key elements of an effective offboarding process include:

- facilitating knowledge transfer;
- implementing mentorship programs to guide new directors; and
- conducting exit interviews to gather valuable feedback.

This offboarding approach smooths the transition of board members. It allows for the preservation of valuable institutional knowledge and strong relationships between the current board and the former director. In many ways, a formal offboarding process acts like a bridge, maintaining continuity and promoting best practices in governance.

Building a resilient board

A resilient board is one that has the tools to diagnose what it needs to be successful. The need for board rotation can only be satisfied when it is accompanied by a well-informed succession blueprint. Rather than rely on a standard checklist, boards that use a succession blueprint have the strategic foresight to ensure that the board remains "fit for purpose."

Once boards are armed with a succession blueprint, they can put it into action. Proactive succession planning identifies and cultivates potential board members well in advance. The time saved in recruitment is not only valuable, in itself, but also allows boards the opportunity to implement seamless onboarding and respectful offboarding.

Board progression is like charting a course for a ship. By staying vigilant, planning proactively, and holding themselves accountable, boards can navigate the rough seas of complex challenges and emerge stronger, ready to steer their organizations toward sustained success.

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Episodic to continuous: transitioning the board recruitment process for today's nominating committee

BoardProspects, Inc.
Mark Rogers, *Founder and Chief Executive Officer*

Introduction

Today's corporate boards wield tremendous influence, providing strategic oversight and guiding organizations through complex challenges. The nominating committee is the architect of the boardroom, responsible for building and sustaining a corporate board that is equipped to meet the organization's strategic objectives by identifying, evaluating, and recommending candidates for board service.

This responsibility extends beyond simply filling empty seats; nominating committees must ensure the board remains dynamic, forward-looking, and aligned with the company's values and needs. Composition plays a critical role in a board's effectiveness. Unfortunately, most nominating committees still approach recruitment with a one-off task mindset, waiting until a vacancy arises before beginning the board recruitment process.

In addition to exploring the external forces re-shaping board composition, in this chapter, I set forth a five-point plan to help nominating committees transition their board recruitment process from episodic to continuous. Only by adapting this proactive approach can the nominating committee ensure it balances continuity with innovation while addressing gaps in skills, perspectives, and experiences.

The outdated episodic model

Over the years, the nominating committee's responsibilities have broadened beyond the occasional recommendation of an individual to fill an open board seat, to one in which they must ensure the board's adherence to appropriate standards of good governance. Indeed, in an effort to reflect this expanded role, many corporations have changed the committee's formal name to the "Nominating & Corporate Governance Committee" to reflect this expanded role. At its core, however, the primary responsibility of the committee remains the recruitment of new board members. As the committee's role has evolved, so too must its approach to how it participates in board succession.

The outdated episodic model of board recruitment is event-driven. Specifically, it is most often characterized by the retirement, illness, or other unexpected departure of a sitting board member which subsequently causes the nominating committee to begin the search process for a replacement. In some instances, the committee will engage the services of an executive recruitment firm to identify and assess potential board candidates. Either way, the result is usually a short list of candidates from which the nominating committee makes a recommendation to the full board. It is a rather archaic process which is not designed to find the right candidate(s) who can best help the organization confront the challenges and opportunities it will continue to face in the years ahead. As Susan Angele, Senior Advisor, KPMG Board Leadership Center, recently told me, "We urge the nom/gov committee to hit the reset button on what directorship and director tenure should look like."

External forces

Historically, the nominating committee has operated in a bit of a vacuum in terms of the board recruitment process. Today, however, there are external forces at play which are slowly pulling back the seal on that vacuum. The continued expansion of shareholder engagement, along with the growing influence of proxy advisory firms and astounding advancements in technology, are disrupting the traditional episodic model.

Shareholder activism

While there have always been activist investors—shareholders advocating for change(s) at a company—the modern-day activist investor (ex. Carl Icahn, Nelson Peltz, Bill Ackman, Dan Loeb, etc.) has increasingly turned to criticism of board composition in their campaign against a company. Buoyed by the adoption of the universal proxy card, which allows them to propose their own slate of board candidates, activists have increasingly chosen to employ this tactic of singling out members of an organization's board for not having what they believe to be the appropriate credentials. The company is then forced into the uncomfortable position of having to publicly defend the qualifications of its board members. As the number of activist campaigns continue to increase, more and more companies are likely to be placed in this position in the years ahead.

Growing influence of proxy advisory firms

While certainly not as overt as the efforts of activist investors, proxy advisory firms exert substantial influence over the composition of today's boardrooms. Institutional Shareholder Services (ISS) and Glass Lewis have created a duopoly of selling their recommendations to institutional investors (i.e. CalPERS, BlackRock, Vanguard, State Street, etc.) on how to vote on thousands of proxy proposals each year, including board candidates. Although approval of a board's slate of candidates has traditionally been a pro-forma exercise, activist campaigns have caused ISS and Glass Lewis to be much more vocal in terms of whether or not they support board candidates.

Advancements in technology

It is impossible to deny that we are in an era of breakneck developments in technology, particularly with the widespread adoption of artificial intelligence (AI). At a recent conference I had the good fortune to hear a talk from Amy Wilkinson, a highly regarded technology expert and member of the faculty at Stanford University Graduate School of Business. Wilkinson placed the impact of AI in context when she emphasized that “AI is bigger than the creation of the printing press.” The reality is that every single industry will be disrupted by AI in the years to come, and to compete in such an environment, boards are going to need individuals who, at the very least, understand the opportunities and risks associated with this technology.

These external forces have two significant implications for the nominating committee. First, they are placing the work of the committee under increasing scrutiny. And second, they are amplifying the competition to recruit highly qualified talent for the boardroom. This is why it is necessary to adopt a forward-looking approach to board recruitment which will help the board remain agile and well-equipped to navigate a rapidly changing business landscape and ensure that it is always prepared to address the board’s current and future needs.

A 5-point plan for a continuous approach to board recruitment

Now that we know why today’s nominating committee must transition from the episodic to the continuous board recruitment model, how does a nominating committee pursue that objective? The following 5-point plan is designed to help nominating committees adopt the continuous model of board recruitment.

1. Maintain a dynamic board skills matrix

A board skills matrix has unfortunately become a pro-forma inclusion in the company’s annual proxy statement instead of a living document regularly updated to reflect evolving needs. When used effectively, the matrix serves as both a diagnostic tool and a roadmap for recruitment by helping the nominating committee identify gaps in the board’s composition, prioritize key attributes for future candidates, and align recruitment efforts with the organization’s strategic objectives.

As a starting point, it is imperative that the nominating committee use external evaluations to gain objective insight into where the board can improve its composition and update its matrix accordingly. Frank Kurre, a Managing Director at Protiviti, believes effective board evaluations are “essential for spotlighting gaps in skills, knowledge and perspectives in the boardroom and assessing board performance and composition. They identify opportunities to improve boardroom culture and dynamics and ensure the board’s composition aligns with the company’s strategic needs, thereby enhancing the board’s functioning over time. They also support the nominating committee in sustaining a high-performing board that is best positioned to help the CEO formulate and execute winning strategies.” Other considerations for maintaining a dynamic board skills matrix, include:

- **Frequent reviews:** update the matrix at least quarterly to capture changes in the organization’s strategy, industry trends, and director expertise; communicate findings to stakeholders to enhance transparency and accountability.
- **Comprehensive metrics:** go beyond technical skills to include leadership qualities, industry insights, cultural fluency, and geographic representation.

Best of Breed Illustrative Matrix

SUMMARY OF QUALIFICATIONS AND EXPERIENCE	DIRECTOR NAMES									
	A	B	C	D	E	F	G	H	I	J
STRATEGIC SKILLS										
• Business and Digital Transformation										
• Business Model / Ecosystem										
• Human Capital										
• Innovative / Disruptive Technologies										
• Global Business / International Affairs										
• Marketing / Brand Management										
• M&A Expertise										
• Operational Execution and Efficiency										
• Supply Chain Excellence										
KEY COMPETENCIES										
• Senior Leadership Experience										
• Corporate Governance										
• Cybersecurity Expertise										
• Environmental / Sustainability										
• Finance / Capital Allocation										
• Financial Expertise										
• Industry Knowledge										
• Legal / Regulatory / Public Policy										
• Risk Management										
ATTRIBUTES										
• Age										
• Gender Diversity										
• Independent										
• Industry Diversity										
• Racial / Ethnic Diversity										
• Tenure (Years)										

Matrix developed and provided by Protiviti Managing Directors Jim DeLoach and Frank Kurre.

- **Active application:** use the matrix to guide all discussions regarding recruitment efforts, inform succession planning, and communicate priorities to stakeholders.

The board skills matrix should be comprehensive, cataloging all directors based on:

- **Core competencies:** technical skills, industry expertise, and leadership experience.
- **Emerging priorities:** incorporate attributes related to emerging challenges, such as digital transformation, ESG (environmental, social, and governance) issues, and cybersecurity.
- **Diversity metrics:** demographic, experiential, and cognitive diversity dimensions.
- **Strategic alignment:** skills that reflect the company's growth plans and risk profile.
- **Tenure:** how long each director has served on the board as well as any relevant term limits or retirement age.

One critical mistake in putting together a dynamic board skills matrix is to only consider the current needs of the boardroom. As Justin Nowell, partner at Sidley Austin LLP, recently told me, "To build a high-functioning board, nominating committees need to start planning now for the candidates they're going to need five years from now."

2. Understand the board composition landscape

Does your nominating committee understand today's trends in board recruitment—both within your industry and generally? More importantly, does your nominating committee even know who is on the board of its competitors? These are critical pieces of information which should provide valuable insight and inform recruitment strategies and succession planning. By benchmarking how your board compares to that of your competitors, the nominating committee can ensure that the board remains competitive and forward-looking. Here are a few key metrics for benchmarking:

- **Skills and expertise:** identify areas of focus, such as digital transformation, human capital, or global market expertise.
- **Diversity representation:** assess how competitors are addressing age, gender, ethnic, and cognitive diversity.
- **Director tenure:** evaluate average tenure and refreshment rates and compare against industry norms to identify opportunities for improvement.

The monthly e-publication, *Board Recruitment*, is one way in which your nominating committee can stay up-to-date on the latest board appointments and departures among publicly traded corporations, as well as general trends in board recruitment and composition.

3. Consider internal impediments to board refreshment

Board refreshment is essential for maintaining a dynamic and effective boardroom that can address evolving challenges and seize new opportunities. Cultural resistance in the boardroom often hinders efforts to introduce new members or adopt modern governance practices. Long-serving directors and entrenched traditions can create an environment resistant to refreshment. This attitude has consequences, including groupthink, limiting the board's ability to consider diverse viewpoints. A reluctance to refresh the board can prevent the inclusion of directors with skills aligned to emerging challenges, and investors and other stakeholders may perceive resistance to refreshment as a sign of poor governance.

Below are a few of the most common internal impediments to board refreshment along with action steps to counteract each.

Lack of term limits

Many boards lack policies that enforce term limits for directors. Without these guidelines, directors can remain on the board indefinitely, leading to stagnation and reducing opportunities to introduce fresh perspectives. A lack of term limits for directors can lead to:

- **Limited innovation:** long-serving directors may become resistant to change, hindering the board's ability to adapt to emerging challenges.
- **Reduced accountability:** directors with indefinite tenure may become complacent, undermining the board's effectiveness.
- **Missed opportunities:** the absence of turnover prevents the inclusion of directors with skills in emerging areas, such as technology.
- **Independence:** directors who stay too long get to know management and directors too well personally and can lose objectivity.

Strategies for successfully introducing term limits include: (i) implement term limits of 9 to 12 years to create predictable opportunities for turnover while balancing continuity; (ii) use staggered terms to ensure that not all directors are replaced at once, preserving institutional knowledge (staggered terms—or "classified boards"—are not without pitfalls, and should be thoughtfully considered before implementation, as they can also serve as a way to entrench underperforming directors for years, possibly causing more harm than they prevent); and (iii) communicate the value of term limits to stakeholders as a governance best practice.

Lack of retirement policies

Boards that do not enforce mandatory retirement ages often struggle to plan for succession, as directors may remain in their roles indefinitely. A board that lacks retirement policies may experience:

- **Unclear succession planning:** the lack of defined retirement policies makes it difficult to anticipate vacancies and plan for smooth transitions.
- **Perceived resistance to change:** stakeholders may view the absence of retirement policies as an unwillingness to embrace refreshment.
- **Missed diversity goals:** delayed retirements can prevent the board from achieving its objectives related to demographic or cognitive diversity.

Strategies for creating expectations around retirement age include: (i) establish a mandatory retirement age (e.g. 72–75) while allowing for exceptions based on the board's discretion; (ii) pair retirement policies with skills assessments to evaluate directors' contributions irrespective of age; and (iii) engage directors in early discussions about retirement to ensure alignment and avoid last-minute transitions.

Lack of board service restrictions

Overboarding occurs when directors serve on too many boards simultaneously, limiting their ability to dedicate adequate time and attention to any single role. If directors are stretched thin by their commitments to other boards, this can result in:

- **Reduced effectiveness:** overcommitted directors may struggle to stay informed about the company's operations, challenges, and opportunities.
- **Increased risk:** directors with divided attention may be unable to provide effective oversight, leading to governance gaps.
- **Negative perception:** stakeholders may view overboarded directors as insufficiently committed, potentially harming the board's reputation.

Strategies for combating director overboarding include: (i) implement policies limiting the number of boards on which a director can serve (e.g. one public board for sitting executives and four for nonexecutives); (ii) regularly review directors' external commitments as part of the annual evaluation process; and (iii) encourage directors to prioritize quality of service over quantity of commitments, emphasizing the importance of active engagement.

Addressing these barriers requires a proactive approach from the nominating committee, along with a commitment to continuous improvement in governance practices. By implementing policies that promote turnover, embracing diverse recruitment strategies, and fostering a culture of adaptability, boards can ensure their composition remains dynamic, relevant, and aligned with the organization's strategic priorities.

4. Develop a board candidate pipeline

Boards that rely solely on traditional recruitment methods—such as personal networks or referrals—often limit the diversity and quality of their candidate pools. This approach perpetuates homogeneity and overlooks highly qualified individuals outside of existing networks; it may also draw criticism from stakeholders, including investors and regulators, who rightly view the board recruitment process as a significant opportunity to build value.

I recommend a three-prong approach to building a talent pipeline, including identifying board talent within the personal networks of sitting board members, leveraging modern board recruitment platforms, and engaging external recruitment firms.

Professional networks: the "who do you know?" conversation

Boards must move beyond the "who do you know?" conversation as the sole method to recruiting new talent to the board; however, we would be remiss to write off the inherent value of identifying promising board talent from within existing directors' personal networks. Truthfully, this type of networking is still how the vast majority of board seats are filled.

Board recruitment platforms

Modern board recruitment platforms, like BoardProspects, offer a cost effective, convenient, technology-driven way for nominating committees to identify, assess, and recruit potential board members from a large pool of talent. BoardProspects is an innovative platform designed to fully engage the nominating committee in the continuous board recruitment model. In addition to providing access to a searchable and trackable community of more than 12,000 highly qualified board candidates, the features of the platform allow collaboration among the members of the nominating committee as to the candidates which best fit the needs of the organization.

Executive recruitment firms

Most large executive recruitment firms have a dedicated board practice designed to help organizations identify potential board candidates. These firms typically have a substantial database of potential candidates from which they can identify board candidates based on the criteria provided to them by the client.

5. Full-board engagement

An effective nominating committee engages with the full board to identify emerging needs and encourages all directors to contribute to the identification and evaluation of potential candidates. At a minimum, the board candidate pipeline should be a standing agenda item for both nominating committee and full board meetings.

Conclusion

In an era of increasing complexity, continuous recruitment is the key to creating resilient, future-ready boards. The continuous model of board recruitment is not just a best practice—it is a governance imperative. The nominating committee is at the heart of board recruitment and can best ensure that the board remains aligned with the organization's strategy, responsive to emerging challenges, and representative of diverse perspectives.

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Board refreshment strategies I: setting tenure limits and retirement ages

Spencer Stuart
George Anderson, *Partner, Board Effectiveness Leader*
Jason Baumgarten, *Global Board and CEO Practice Leader*
Julie Daum, *North American Board and CEO Practice Co-Leader*

In a rapidly evolving business landscape, public companies must prioritize dynamic governance to thrive and navigate new risks. Regular turnover helps ensure that the board has the right mix of capabilities, expertise, perspectives, and styles to effectively support the chief executive officer (CEO) and leadership team and advocate for shareholders.

Top-performing boards anticipate and proactively address planned and unplanned vacancies in the boardroom. They are strategic and deliberate about the process, with the goal of building a multi-year succession plan for the board's makeup. This allows them to bring exceptional talent in not only when they have a reactive refreshment but also in advance to take advantage of a wider time period for relationship development and recruitment.

Boards can apply a wide range of tools and mechanisms to facilitate turnover, such as tenure limits, age caps, voluntary retirement or resignation, requested retirement or resignation, and others. In this chapter, we will focus on two: tenure limits and retirement ages.

- **Tenure limit:** the maximum years of board service.
- **Retirement age:** a maximum age at which directors must step down from the board.

Both tenure limits and retirement ages are typically stipulated in corporate governance guidelines or the charter of the board committee responsible for board composition and director recruitment. While they can be useful tools and help boards evolve, they should *not* be the sole mechanisms for board refreshment.

Board refreshment trends

In our data, board turnover at US companies is consistently low—and may be too low for today's business environment. Consider the following:

Leaders are concerned about the pace of change

In Spencer Stuart's 2024 report, *Measure of Leadership: CEOs and Directors on Navigating Change*, three-fourths of CEOs and board directors report high levels of business uncertainty, and most see the risks accelerating. Approximately one-fourth worry that their organization is "sluggish" in responding to new challenges.

Boards believe in their CEO more than CEOs believe in their board

When it comes to dealing with a changing business environment, the *Measure of Leadership* research also found that 87% of board directors have faith in the readiness of their CEO to respond to these challenges. But the share of CEOs expressing high confidence in directors' ability to help guide them through the issues confronting their organizations is far lower—only 32%.

Board turnover is persistently low

Spencer Stuart's *2024 US Board Index* finds that board turnover has shown little variation over the past 25 years, with rates consistently around 7% or 8% a year. Only 58% of S&P 500 boards appointed a new director in the 2024 proxy year, translating to an overall turnover of less than one (0.83) new director per board.

Many boards say they have directors who should be replaced

In a 2024 Spencer Stuart survey of S&P 500 and S&P MidCap 400 nominating/governance committee chairs, more than one-fourth of respondents (26%) said they have one or more directors who they believe should be replaced. The top reasons for change: a director's skills or expertise is no longer current (62%) or no longer relevant to the board (23%), or the director is underperforming (21%).

Executives are even more likely to want some board directors replaced

A 2023 survey on board effectiveness by PwC and The Conference Board found that only 29% of executives rate their board's performance as excellent. Two-thirds point to long-tenured directors' reluctance to retire as the top reason for lack of board diversity, and 89% said that one or more directors on their board should be replaced.

Stakeholder expectations regarding board director tenure and retirement have evolved significantly

Over the past decade, investor expectations regarding director tenure and retirement have evolved significantly, emphasizing accountability, diversity, and adaptability in corporate governance.

- Institutional investors increasingly advocate for regular board refreshment as essential for fostering agility and innovation. Investors now prioritize director performance over mere tenure, expecting comprehensive evaluations to ensure each member contributes meaningfully to governance and strategy. Transparency and communication have become critical, with investors seeking greater insight into boards' composition strategies and the rationale behind tenure and retirement decisions. They also look for clear succession planning processes to ensure responsiveness to evolving challenges.

- CEOs and executive teams view board refreshment as crucial for maintaining the right mix of expertise to respond to rapid market changes.
- Governance experts like Institutional Shareholder Services (ISS) and Glass Lewis emphasize the importance of having formal policies, such as tenure limits and retirement ages, as well as robust evaluation processes to assess director performance on an ongoing basis. They advocate for a balanced approach that combines these policies with ongoing skills assessments to ensure that the board remains aligned with the organization's strategic goals.

These shifts underscore the importance of proactive turnover and the value of formal mechanisms as supplementary tools to help boards continually refresh with new directors, ensuring that governance aligns with a fast-changing business environment and effectively supports the leadership team and organization.

The benefits of tenure limits and retirement ages

Two mechanisms to facilitate turnover are tenure limits and retirement ages, which can set outer boundaries of board service and help refresh the board, providing several governance benefits.

- They give boards greater visibility about the outer limits for each director's service so boards can be proactive about succession planning.
- They reduce boardroom stagnation by providing mechanisms for rotating directors off the board and creating openings to add new directors with a diverse range of backgrounds and perspectives. This turnover can help ensure that the board has directors with the necessary skills and experience, particularly in rapidly evolving areas like digital technology, artificial intelligence, cybersecurity, regulatory/government, and global experience.
- They reinforce the message that board service is not a lifetime appointment.
- They can provide boards with a means for gracefully exiting ineffective or underperforming board members.

Challenges with tenure limits and mandatory retirement ages

At the same time, both measures have some potential drawbacks.

- Mandatory departures when a director reaches a tenure limit or retirement age can lead to the loss of seasoned board members who may be top contributors with deep institutional knowledge and valuable experience.
- That effect can be compounded if several valuable board members roll off at the same time, or if turnover happens during a period of crisis for the company.
- High board turnover may impact board culture, cohesion, and effectiveness, requiring more energy and deliberate effort to onboard a new group of incoming directors and build up the board's culture.
- Both mechanisms—tenure limits and mandatory retirement ages—can be crutches for boards to avoid more difficult conversations about a problematic, ineffective or less relevant board member. Rather than addressing these issues head on, some boards may opt to simply let a director stay on until forced off by a policy.

Tenure limits among US boards

Overall, the number of US boards adopting tenure limits, while slowly increasing, is low. Among companies on the S&P 500, the number has grown from 3% in 2014 to 9%—only 43 companies—in 2024. And most set high tenure limits: 72% of boards that restrict tenure set limits at 15 years or more. The average tenure for directors on S&P 500 boards is 7.8 years, one of the longest averages among the countries that Spencer Stuart tracks; directors leave S&P 500 boards with an average of 12.2 years of board service.

Hybrid tenure policies are emerging; for example, Microsoft's tenure policy targets an average tenure of 10 years or less for the board's independent directors and Best Buy's corporate governance policy states that non-executive directors should resign 5 years after they stop pursuing their primary career when they were first appointed to the board, effectively acting as a de facto tenure policy.

In countries where tenure limits for public company directors are more common (and often required by securities regulators), they tend to kick in earlier—often 9 to 12 years.

A survey of tenure limits and policies in other markets

Regulators in other countries have a range of policies regarding board tenure and independence.

Belgium: no limit.

Denmark: no limit, but directors lose independence after 12 years.

France: no limit, but directors lose independence after 12 years.

Germany: code recommends setting a maximum tenure, but in practice, no limit.

Hong Kong: no limit, but directors lose independence after 9 years.

Italy: no limit, but directors lose independence after 9 years.

Netherlands: officially 12 years, but in practice, 8 years is becoming the norm.

Norway: no limit.

Singapore: code encourages companies to limit tenure to 9 years, but directors can exceed this, subject to rigorous review.

Spain: no limit, but directors lose independence after 12 years.

Sweden: no limit.

Switzerland: no limit.

UK: directors lose independence after 9 years.

The current state of retirement ages among US boards

According to the "*US Spencer Stuart Board Index*," the number of S&P 500 boards disclosing a mandatory retirement age for directors has declined in the past decade, from 73% in 2014 to 67% in 2024. At the same time, the retirement age of boards with these policies continues to rise.

- The average retirement age is 74, unchanged for the past 4 years, but up from 73, 10 years ago.
- Among boards with age limits, nearly two-thirds (60%) have a mandatory age of 75 or older, compared with 30% in 2014 (*see diagram below*).

One reason for the reduction in mandatory retirement policies could be that boards are instead relying on other mechanisms to encourage turnover, such as director evaluations, skills assessments via board matrices, and voluntary retirements. Another reason could be that boards are eliminating the policies as directors approach the age cap.

Implementing tenure limits and retirement ages

Boards considering adopting tenure limits and/or retirement ages should keep several principles in mind—all commonly used by high-performing boards.

Determine the right benchmarks for your board

All organizations have their own unique needs and circumstances. The board—typically through the nominating/governance committee—should give careful thought to what the right metrics should be regarding tenure limits and/or retirement ages.

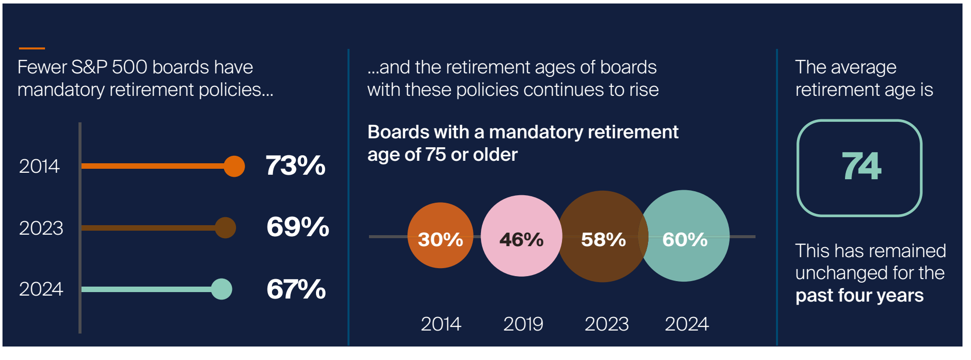
Boards should think creatively about tenure limits. Tenure policies relating to director independence could be considered. Another approach is to require directors to submit their resignation from the board once they have been retired from their primary corporate job for a certain period of time (such as the Best Buy example above).

Look ahead to proactively map turnover

When implementing tenure limits, boards should understand the impact of the new policies and plan accordingly to think ahead on boardroom succession planning.

Adopt a no-exceptions policy

Formal turnover policies should not be waived. Waivers can set expectations in the boardroom that the policy will routinely be waived for all directors, making it difficult going forward to roll off directors and



refresh the board. Investors may view a waiver of the retirement age as a signal that the board is reluctant to refresh or weak at its own succession planning.

Some investors have policies opposing waivers of retirement policies. For example, Glass Lewis's 2024 proxy voting guidelines state:

If a board adopts term/age limits, it should follow through and not waive such limits. In cases where the board waives its term/age limits for two or more consecutive years, Glass Lewis will generally recommend that shareholders vote against the nominating and/or governance committee chair, unless a compelling rationale is provided for why the board is proposing to waive this rule, such as consummation of a corporate transaction.

Engage relevant parties early and regularly

Involve current directors, executives, and major shareholders in discussions about the rationale for tenure limits and retirement ages. Solicit their input and feedback to address concerns and build consensus. Keep relevant parties informed about the implementation process, outcomes, and any adjustments to the policies over time.

Clearly communicate rationale and benefits

Communicate the reasoning behind these policies clearly and transparently. Emphasize the benefits, such as enhancing diversity, bringing in fresh perspectives, increasing accountability, and aligning governance with the evolving business environment.

Document policies

Develop clear, written policies regarding tenure limits and retirement ages. Include these in corporate governance guidelines and ensure that they are easily accessible to all relevant parties, including shareholders, regulators, auditors, etc. Having documented policies can prevent misunderstandings and set clear expectations.

Ensure that formal turnover policies are a supplement to ongoing board refreshment work

Most importantly, boards implementing tenure limits and/or mandatory retirement ages should not think that their work is done. They need to establish a culture and mindset of continuous improvement and refreshment. This entails cultivating a dynamic board culture in which all directors understand that their service is contingent on boardroom needs and is not a guaranteed position. Boards also need to proactively identify and address skills gaps among directors, conduct objective evaluations, and be willing to make difficult decisions such as asking underperforming directors to step down if necessary.

Conclusion

Effective board oversight requires continuously refreshing the board's composition. Tenure limits and mandatory retirement ages can be useful in ensuring board turnover and adding new voices and fresh perspectives, particularly as the pace of change in business continues to accelerate. Critically, these formal tools should be part of a broader set of practices that the board uses to foster turnover, including objective and robust director evaluations, skills matrices, and ongoing discussions with the executive team. We will discuss board evaluations in the next chapter.

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Board refreshment strategies II: board, committee, and director assessments

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Effective governance involves a range of considerations, including strong leadership, effective collaboration and communication with the chief executive officer (CEO) and executive team, and the right mix of expertise and perspective. These attributes must also be appropriate to the context of the current strategic landscape, operating reality, and future outlook. However, boards cannot know how well they embody these attributes without a structured mechanism for measuring performance—both collectively and for individual directors.

For that reason, high-performing boards take a thoughtful approach to the board evaluation process, establishing mechanisms to identify strengths, weaknesses, and areas of potential growth not abstractly, but specifically to support and govern the organization's evolving needs. Those mechanisms change over time, but the core objective remains: to provide a clear assessment of performance, underscore areas for improvement, and foster a culture of continuous development that supports overall board refreshment to meet the evolving needs of the organization and its stakeholders.

Types of board assessments

To effectively evaluate board performance, three assessment types are essential:

- Overall or full board evaluation
- Committee evaluation
- Individual director evaluation

Overall/full board evaluation

This type of assessment offers a comprehensive overview of the board's performance. It focuses on governance processes, decision making, board dynamics, and alignment with the organization's long-term strategy and operational reality.

The nominating/governance committee generally takes the lead in shaping and overseeing the full board evaluation process. Key areas of the full board evaluation include:

Governance and strategic oversight

- Is the board aligned with management on the organization's mission, vision, and strategy?
- Is the board adequately addressing key risks, opportunities, and compliance requirements?
- Does the board oversee the development and execution of strategies of the business, rather than simply looking at governance or regulatory matters?
- Is the board ensuring that the company creates sustainable value and maintains or increases competitiveness over time?

Board composition and structure

- Does the board have the right mix of skills, expertise, styles, and diversity?
- Are committees functioning effectively with up-to-date charters and responsibilities?

Leadership and meeting effectiveness

- Are the independent board leaders and committee chairs demonstrating effective leadership?
- Are meetings well-structured, efficient, and focused on strategic priorities?
- Are the requirements of the board taking an appropriate amount of CEO and management time to prepare and respond to?

Board dynamics and relationships

- Is there a boardroom culture of trust, collaboration, and constructive challenge?
- Are relationships between directors and management productive, constructive, and transparent?

Accountability with relevant parties

- Does the board effectively communicate with and gather insight from shareholders, employees, creditors, vendors, auditors, regulators, customers, communities, and government agencies?

Continuous learning and development

- Are directors staying current on industry trends, governance best practices, and emerging risks?
- Do directors have a clear and unbiased fact base around not only company performance but the actions that are leading to that performance?

The overall assessment provides a holistic view of board performance, identifying collective strengths and weaknesses, and enhancing overall governance practices. However, depending on who conducts the evaluation, it may yield overly general results. It also does not include an assessment of the performance of individual committees or directors.

Committee assessments

Committee assessments are a key component of board evaluations, particularly for boards listed on the New York Stock Exchange (NYSE), which also requires boards to assess the effectiveness of their committees.

These evaluations focus on the performance of specific board committees (e.g. audit, compensation, governance). They typically involve evaluating effectiveness in fulfilling committee mandates, assessing committee member participation and engagement, and evaluating the quality of discussions and decision making. Committee evaluations are typically conducted annually by the committee chair, nominating/governance committee, or an external consultant in conjunction with the overall board assessment. Ideally discussions should include the view of the committee effectiveness by those impacted by the committee but not sitting on the committee. Key areas of committee evaluation include:

Committee structure and composition

- Are committee members appropriately qualified?
- Is there appropriate understanding of committee succession risks?
- Is the size of the committee optimal for effective discussion?
- Are new members oriented properly about their roles and responsibilities?

Mandate and responsibilities

- Are the committee's roles and responsibilities clearly defined?
- How well does the committee fulfill its mandate?

Meeting effectiveness

- Is the committee focused on the most critical issues facing the organization?
- Is the committee spending too much time on non-essential matters?

Feedback and collaboration

- Does the committee communicate effectively with the full board?
- Is the committee collaborating effectively with other committees and the full board? Management?

Benefits of conducting committee evaluations include providing targeted insights into specific committee performance, identifying opportunities for improvements in governance practices, and encouraging accountability within committees. However, boards should be aware of the potential for bias if assessments are conducted solely by committee members and avoid evaluations narrowly focused on formalities rather than on fostering genuine improvements.

Individual director assessments

Individual assessments provide feedback to each director, focusing on their strengths, relevant skill sets, and opportunities for improvement. These assessments are typically conducted by the independent board leader (chair or lead director), nominating/governance committee chair, or an external party. Many boards adopt a staggered schedule (e.g. every two or three years) for individual evaluations. Key areas of individual director evaluations include:

- Significant contributions
  - What are the director's most impactful contributions to the board's overall effectiveness?
- Enhancing effectiveness
  - What could the director do to be more effective in the boardroom?
- Additional insights
  - What further feedback or suggestions can be offered for this director?

Individual director assessments have many potential benefits, including promoting individual accountability, identifying personal development needs, and enhancing overall board effectiveness through individual contributions. Neither major US stock exchange mandates individual assessments.

Boards are more likely to assess individual director contributions than in the past; 47% of S&P 500 boards disclosed that they have some form of individual director evaluations in 2024, an increase from 34% a decade ago. However, this figure likely underrepresents the true number of boards engaging in individual assessments. Our own research suggests they are more broadly practiced:

- Sixty-two percent of respondents to a 2024 Spencer Stuart director survey said their board conducts individual assessments; of that subset, 83% do so yearly.
- More than half of boards conducting individual assessments (54%) use both peer feedback and self-evaluations. Thirty percent use peer feedback only.
- Seventy-one percent said that individual director assessments improve overall board effectiveness.
- Sixty-three percent said that these assessments help directors grow and perform better.

In addition to individual director evaluations led by board leaders or an external party, boards can apply two other measures to evaluate directors.

Self-evaluations. Self-evaluations allow board members to reflect on their performance and contributions autonomously. Directors self-identify their strengths and areas for improvement.

Self-evaluations can help increase director self-awareness, spur personal growth, and identify individual goals related to board service. At the same time, when directors have limited self-awareness of how their contributions are viewed by others, it may lead to inflated perceptions or inability to identify weaknesses.

Peer evaluations. In peer evaluations, board members assess one another's performance. These can be conducted separately or combined with self-evaluations, depending on board preferences. Peer evaluations are typically conducted periodically led by the independent board leader (chair or lead director), nominating/governance chair, or independent third party. They should be conducted separately from renomination decisions to minimize potential stress about peer reviews.

Peer evaluations encourage open dialogue and collaboration among directors, and they can highlight interpersonal dynamics within the board. Potential downsides include a risk of bias or favoritism, and the possibility of conflicts or discomfort if feedback is too critical.

The three assessment types—overall board, committee, and individual evaluations—complement one another to provide a comprehensive view of board performance.

Obstacles to a meaningful board assessment

The 2024 US *Spencer Stuart Board Index* found that 99% of boards conduct some sort of performance evaluation. While companies listed on the NYSE are required to perform an annual evaluation of the performance of their board and its committees, companies listed on other US exchanges are not required to do so; nonetheless, annual board evaluations have become widely recognized as best practice.

However, some evaluation processes are more comprehensive and effective than others. Less effective processes often exhibit the following shortcomings:

- Rote, check-the-box exercises that fail to lead to real scrutiny or insight.
- Over-confident boards who grade themselves too highly.
- Resistant directors who dismiss the value of evaluations.
- Reluctant directors hesitant to provide candid feedback about the performance of individual directors, or of the board as a whole.

In those situations, boards can have an incorrect—potentially inflated—sense of their performance and ability. They may also have critical blind spots in important aspects of governance, and they also may not know where to prioritize improvements.

In our experience, more effective processes include peer evaluations, regularly updated skills matrices, and periodic use of third parties.

Methods for conducting assessments

While the purpose of each evaluation type differs, the methods used to conduct them often overlap. Typically, boards will use one or all three of the following:

Method		Pros	Cons
Surveys or questionnaires	• Anonymous feedback is collected from all directors • Includes quantitative ratings and open-ended questions for qualitative input	Cost-effective and less time intensive	• Limited ability to probe deeper insights • Often result in a collection of high scores with little explanation or rationale for them
Interviews	• Facilitated by the board chair, lead director, or an external consultant • Can provide nuanced feedback	Allows for deeper insights and exploration of sensitive issues	• Time-consuming and requires skilled facilitation • Yields unstructured, qualitative data that requires thoughtful synthesis

Who conducts assessments

The choice of who conducts evaluations plays a critical role in shaping the evaluation's effectiveness, the quality of feedback, and the overall governance culture. Boards must carefully consider the qualifications, perspectives, and potential biases of those involved in the process to ensure that all evaluations lead to meaningful insights and improvements. Typically, board evaluations are conducted by the following roles:

General counsel/corporate secretary

The general counsel or corporate secretary plays a pivotal role in guiding the board evaluation process, leveraging their expertise in legal and regulatory matters. Their familiarity with governance requirements and best practices ensures that evaluations comply with legal standards, and their objective perspective can lead to unbiased assessments. However, there are potential conflicts of interest to consider, given their role in management. Additionally, they may lack the comprehensive skills needed for nuanced evaluations. Therefore, it is essential for the board to ensure that the general counsel or corporate secretary has the necessary resources and skills to conduct thorough assessments.

Board chair/lead director

The board chair typically possesses a deep understanding of board dynamics and a perspective on individual and collective performance. Their insider perspective can be valuable to facilitating open discussions around performance. Nevertheless, there is a risk of perceived bias if the chair is responsible for evaluating peers, which can affect the candor of feedback. To address this risk, the board should implement clear protocols that foster transparency and fairness during evaluations led by the chair.

Nominating/governance committee chair

Their expertise in governance matters allows for structured evaluation processes, which can yield meaningful insights. However, this role may lack insight into all aspects of board performance, potentially limiting the comprehensiveness of the assessment. It is crucial for the nominating/governance committee chair to receive support from the board in facilitating effective evaluations.

Third-party adviser

Engaging a third-party consultant can introduce specialized expertise and a comparative perspective to the evaluation. External consultants typically provide objective assessments based on industry standards and best practices while offering benchmarking insights. Despite these advantages, the costs associated with hiring a consultant can be prohibitive, particularly for smaller organizations. Additionally, directors may not be comfortable revealing sensitive concerns to an outsider. For this reason, selecting a consultant with a proven track record and capabilities tailored to the organization's specific context is of utmost importance.

Best practices for board assessments—before, during, and after the process

To ensure that the assessment process leads to meaningful outcomes, boards should follow established best practices before, during, and after the evaluation.

Before the assessment begins

Assign clear accountability

The board evaluation process is typically handled by the nominating/governance committee, with the committee chair overseeing all phases of the process, or by the independent board leader. Regardless of who leads the effort, that person should have clear accountability for overseeing the design and execution of the evaluation, including sharing results with the board, overseeing development of a plan to address areas for improvement, and monitoring progress on the action plan.

Align on process and goals

Before the evaluation process begins, directors should have the opportunity to discuss the approach, so they can provide input, voice concerns, and work toward setting clear parameters about the assessment's scope and objectives, how it will be conducted and reported back, and the need to openly share and receive feedback. The goal is to build consensus on the process and ensure directors understand its value and fully commit to supporting it.

Leverage technology

Boards can leverage various technological tools and platforms to streamline the evaluation process, improving efficiency, data collection, and overall assessment quality. Survey applications can facilitate the design and distribution of questionnaires, while data analytics software can help analyze responses effectively. Platforms that enable anonymous feedback can enhance the candidness of evaluations.

Consider periodically using a third-party facilitator

Board, committee, and peer evaluations require directors to be open about their views of their own abilities and those of their peers. The process can make some board members uneasy. A skilled outside facilitator can manage this process, offer a "safe", confidential place for directors to provide candid feedback, and ensure that feedback gets delivered in a way that is productive. They can observe live meetings to get a firsthand view of how well directors communicate and collaborate.

Perhaps most important, outside facilitators can manage sensitivities and remove some of the emotion from the process, helping the board stay focused on the big-picture objective of strengthening individual and board performance.

During the assessment process

Interview directors individually

Many board evaluations are limited to director questionnaires, which can be useful, but results can be difficult to interpret. Even those that ask for qualitative input—like an open form for additional comments—may not generate deep insights.

Instead, the board evaluation process should include interviews with each director. In this process, board members are interviewed individually on a confidential basis and asked for their assessment of key topics that contribute to board, committee, and individual director effectiveness. Questions should be provided in advance so directors can reflect before the interview and interviews should include time for open-ended discussion. They should be conducted by a person with direct, deep experience with boardroom issues and CEO/board dynamics.

Gather input from the CEO and other senior members of the executive team

CEOs and members of the senior management team who regularly interface with the board, such as the general counsel, president, chief financial officer, and chief human resources officer, often have thoughtful feedback about the board's strengths and potential areas of growth. This information can be sensitive, so it should be limited to the person directly responsible for overseeing the evaluation.

Set a tone of constructive, forthright discussion

The board chair (and, when applicable, the person overseeing the evaluation process) should set a tone for the overall process that values candid, forthright feedback. The process works best when there is a collegial board culture, grounded in professionalism, and encouraging openness to giving—and receiving—regular feedback. Board leadership is key to creating and maintaining this culture.

After the assessment is complete

Follow up on the findings

The insights gained from a board evaluation are only valuable if the board actively addresses them. The results should be synthesized to key findings, presented to the board through an open discussion, and turned into an action plan with a set of clear priorities to address any issues. To ensure that these findings are not tabled or forgotten, boards should regularly evaluate progress toward the key takeaways.

Communicate results with relevant parties

Boards should develop a thoughtful approach to communicating evaluation results, insights, and action plans with shareholders and management. This communication should include a robust disclosure in the proxy statement outlining the evaluation process and high-level takeaways. To foster engagement and trust, it is beneficial for boards to provide clarity on the evaluation mechanics and their commitments to improvement. Some boards may choose to disclose whether they engaged an external adviser to conduct the evaluation and briefly outline the adviser's role. This transparency helps shareholders, regulators, customers, etc., understand the evaluation process without delving into the specifics of the findings.

Provide ongoing feedback

Individual directors should get feedback on their performance. The goal should not be to grade directors, but to provide constructive input as required.

In extreme cases—such as a director who is clearly underperforming—the independent board leader should be prepared to have difficult conversations, either to reinforce standards and expectations for improvement, or to suggest that the person step down from the board (enforced through a vote if necessary).

Provide ongoing support

A board is a complex team and like all teams sometimes further performance support is helpful or necessary. Because most boards operate as a group of peers versus a traditional hierarchy, sometimes clear interventions to improve performance are critical. While some boards tackle these tasks themselves, others turn to external experts to help facilitate and provoke a higher level of trust, candid problem solving, and conflict resolution.

Review and adapt evaluation processes over time

Just as board evaluations should happen annually, the nominating/governance committee should review the evaluation process itself each year. Leading practices evolve, and boards—and board dynamics—change. As a result, boards should review the evaluation process annually to modify and adjust to best suit the board needs.

Boards should review the assessment structure, questions, and overall effectiveness each year, adapting the approach as needed to ensure continuous relevancy and alignment with governance goals. This involves reflecting on whether assessments yield actionable insights and facilitate meaningful changes in governance practices. Boards can also take a fresh look at their assessment approach and evolve the format or ask different questions to drive a better outcome. They may even find it valuable to dive deeper into a few particular areas where they believe there is potential for improvement.

Conclusion

Strengthening the board is essential for companies to support business strategy and navigate the challenges of an uncertain and fast-changing world. Regular and thorough assessments of the overall board, committees, and individual directors help boards enhance their existing strengths, remove obstacles to progress, and stay ahead of evolving standards of corporate governance. The process requires careful planning and a willingness to ask tough questions and deliver candid feedback. But when implemented correctly, it can yield invaluable dividends in helping boards improve their performance.

Section 6: Assessing and developing the board

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Board composition and effectiveness: a strategic approach

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In recent years, the number and complexity of challenges confronting boards have significantly heightened and are poised to continue escalating. These challenges often extend beyond the board's direct influence, encompassing global phenomena such as pandemics, geopolitical instability, and rapid technological advancements. Nonetheless, boards can proactively shape their strategic paths through various methods, foremost of which is a robust board composition process. By assembling a board comprised of appropriately skilled members and implementing continuous and strategic succession planning, a company may be poised to effectively navigate challenges that might otherwise appear beyond its control.

Board composition and succession planning

As indicated above, a robust board composition process is comprised of complementary components: considering and selecting directors and longer-range board succession planning. The effective operation of both components does not guarantee that a board will be highly effective and remain so for the foreseeable future; however, it should greatly increase the chances of achieving those goals.

Of course, neither component is easy. Some have compared considering and selecting directors to a multi-dimensional chess game; there are so many factors and goals at play that some can conflict with others. Consider, for example, a board that has concluded, following a thoughtful succession planning process, that it not only needs to find a director with deep experience in marketing but also needs to achieve a greater level of diversity. Even the long-range succession planning process can be fraught;

imagine a situation where a shift in the corporation's strategy means that a highly respected and engaged board member needs to step down (or be told to do so) because their skills and attributes no longer satisfy the company's needs.

In addition, in considering board composition, companies need to be mindful of various legal and regulatory requirements. For example, boards of most companies listed on the New York Stock Exchange (NYSE) must consist of a majority of independent directors, and most publicly traded companies need to disclose whether at least one audit committee member is an audit committee financial expert or, if not, to explain why not.

The guiding principle

Given the complexities described in the previous section, the alignment of the directors with the company's strategy is the guiding principle of board composition. It may seem obvious, but a board comprised of individuals whose skills are not aligned with the company's strategy may not be able to help the company execute that strategy. For example, if a significant component of a company's strategy is to expand internationally, a board whose members have no experience in international growth may not be able to provide the oversight and guidance that the company and its management need to achieve that objective.

Beyond strategy—nuts and bolts

Strategic alignment may be the guiding principle, but seeking director candidates requires a more granular focus—identifying the specific skills and attributes needed to achieve the company's strategic goals. Thus, a company whose strategy includes international expansion should think about what type(s) of international experience a candidate might need: non-US residency or citizenship? Experience running significant operations overseas? Experience in one country or region, or more of a multinational or global perspective? Similarly, rather than seeking a director with experience in technology, consideration needs to be given to identifying which type(s) of technology skills and attributes are needed (e.g. cybersecurity, artificial intelligence, software development).

In addition, given that strategies often have multiple components and that boards must deal with a wide variety of challenges, many of which may not relate to or even conflict with strategic goals, companies need to assess a wide variety of director skills and attributes in considering and selecting director candidates as well as in longer-term succession planning. Consequently, it is important to identify a broad range of desired skills and attributes.

The skills matrix—a valuable tool

Many companies use a skills matrix to determine the skills and attributes that need to be considered in board composition and longer-term board succession planning. Increasingly, companies are including a skills matrix or something similar in their annual proxy statements to demonstrate the strengths of their boards and their board succession planning processes.

At the outset, it is important to note that while a skills matrix can be very helpful, it is only a tool; the hard work is developing and implementing a process to identify the desired skills and attributes, finding the candidates, interviewing and vetting those candidates, and determining whether a candidate is a fit for the company at that time.

The skills matrix consists of two axes: one with the desired skills and attributes, and the other with the names of current board members.

Sample board skills matrix

Qualification	Example	CEO	Director 1	Director 2	Director 3	Director 4	Director 5	Director 6	Director 7	Director 8	Identified Gaps
Professional Competencies and Expertise											
Digital, new technology, IT											
Finance, accounting, financial reporting	●										
Leadership, senior leadership, management	●										
International business experience	○										
Legal, regulatory, public policy, government											
Sales, marketing, PR, branding											
Risk management	●										
Industry experience	●										
Manufacturing, supply chain, operations											
Initial public offering experience	○										
Sustainability											X
Governance / corporate governance											
Public company BOD experience											
Human capital management, human resources											
Cybersecurity and privacy											
Global and capital markets											
Mergers & acquisitions	○										
Strategic planning and development	●										
Ethics, integrity, value and compliance											
Personal											
Tenure on board (years)	4										
# of other current boards	1										
Independent	YES										
Retired	NO										
Board Committees											
Audit	CH										
Compensation	M										
Nominating / governance											

This sample matrix shows common professional competencies; however, it is important to tailor the matrix to provide for skills in line with your company's unique strategic objectives.

Mark an X for skills that no (or few) current board members have. Use the identified gaps column to determine the skills that you want to prioritize during board refreshment, as you recruit new board members, or to build skills in existing board members.

Use the key to populate ● Considerable expertise ○ Some expertise X Identified gap CH Chair M Member

There are several key points to keep in mind when preparing a skills matrix.

- **Focus on the skills, not the people**. Some companies start by concentrating on the skills and attributes of the current directors. That is an important part of the exercise, but focusing on the existing directors can result in a misalignment of board composition with strategy. Consequently, it is advisable to focus on the skills and attributes that support and align with the strategy as well as other desired skills and attributes. Once the skills and attributes are set forth, the focus can shift to the existing directors to determine whether and to what extent they match the company's needs.
- **Go beyond the bios**. When the focus shifts from the desired skills and attributes to those of the current directors, go beyond the usually general wording of the directors' bios and "skill set" disclosures in the proxy statement. Rather, as an institutional investor has stated, consider why having that person on the board adds more value than an empty seat in the boardroom. One possible approach is to ask the directors how they think they add value.
- **Look at peer company board members**. It can be very helpful to consider the skills and attributes of peer companies' directors, particularly peer companies that have been successful. This can bring attention to skills and attributes that existing directors may lack.
- **Consider likely retirement dates**. It can be helpful to understand the anticipated retirement dates of current directors; even for companies that have neither director term limits nor mandatory retirement ages for board members, it is usually possible to estimate when existing directors are likely to leave the board. This can greatly facilitate director succession planning. For example, if a current director has expertise in a critical area, considering when they are likely to retire may indicate when you should start looking for a successor to effect a seamless transition.

The "soft" factors

The skills and attributes referred to in the previous section are important, but no more so than several "soft" factors that are prerequisites to having an effective board. A director who is an expert in a field that may be critical to the company may not be an ideal director—or even a good one—if they are unable to listen to others' views or cannot "disagree without being disagreeable." Similarly, given the many challenges that boards face, resilience and flexibility is another desirable trait. While it may not be possible to measure these attributes, they are nonetheless important components of the board composition and succession planning process and need to be considered.

Other considerations

There are several additional considerations that impact board composition, including the following:

- **Skills and experiences**: companies should recruit and retain board members with a wide range of skills and experiences to ensure diverse perspectives during boardroom discussions. While diversity in skills and experiences was once considered optional, many boards now recognize it as essential. Companies aiming for well-rounded boards should be mindful of the types and levels of the skills and experiences their directors possess.
- **Expertise**: it may seem desirable to recruit directors who are experts in their fields; after all, a company is likely to benefit from having a director who is an expert in its industry or a key component of its strategy. And yet, companies and

others have resisted adding experts to boards. For example, when the US Securities and Exchange Commission proposed to require public companies to disclose whether their boards included a cybersecurity expert or, if not, to explain why not, public comments generally opposed the proposal. Among the reasons for opposition was that boards "require 'broad-based skills in risk and management oversight, rather than subject matter expertise in one particular type of risk.'"[1] Others have noted that non-expert directors might defer to the expert, placing undue reliance on their views, and that it is impossible to have an expert for every issue that boards need to address.

- **Independence**: director independence is generally regarded as an important or even critical element of board composition. In fact, aside from some exemptions based upon specific company circumstances, the exchanges require most listed companies' boards to have a majority of independent directors. However, some have expressed concern that independence concerns prohibit or discourage individuals with industry-specific expertise from serving on boards of companies within that industry. As a result, independent board members may lack sufficient familiarity with that industry, making it difficult for them to pose challenging questions to management. Finally, the listing exchange's specific definition of independence should be considered to confirm compliance in this area.

Board refreshment

As discussed in the previous section, board composition and board succession planning are complementary components of the same process. Board succession planning and board refreshment are also closely related. However, while succession planning focuses on the skills and attributes desirable for future board members, board refreshment also contemplates replacing existing directors with new ones. Replacement can result from routine attrition—e.g. when a director retires voluntarily or is required to do so in compliance with term or age limits—but it can also result from processes designed to effect the replacement of directors who are not adding sufficient value to the board. Sometimes replacement is called for when a long-serving director ceases to be engaged, fails to read board pre-reads or other materials, or for one reason or another no longer fits. However, replacement may also be called for when a change in corporate strategy or other external circumstances call for skills or attributes that existing directors do not possess. In other words, the fact that it may be time for a director to step down may not be due to any failing or deficiency and may actually reflect how much that director has contributed to the enterprise. For example, a director with expertise in capital-raising activities may have helped the company to finance growth to a point where it no longer needs constant capital infusions. Companies may be able to use director education to convey that board refreshment is a healthy practice and that directors are not appointed for life.

Board self-assessments

One of the tools that boards employ to determine director effectiveness—and in some cases to provide an indication that a director may need to step down—is the board self-assessment. Companies listed on the NYSE are required to conduct annual board and committee self-assessments, but boards of many companies listed on other exchanges and even private companies conduct self-assessments as a matter of good governance practice. In fact, the 2024 U.S. Spencer Stuart Board Index reports that 99% of the companies surveyed conduct some sort of annual performance evaluation.[2] Moreover, even though only 47% of those companies report some form of individual director evaluation, self-assessments almost always shed light on the performance of individual directors.

Although a detailed discussion of board assessments is beyond the scope of this article, the following sets out some key aspects of a healthy board self-assessment process:

- **Who should perform the assessment**: there are various approaches to board self-assessments. Some companies follow a do-it-yourself model, overseen by the board or its nominating/governance committee and conducted by in-house counsel or the corporate secretary and relying upon a standard questionnaire. At the other end of the spectrum, some companies use a facilitated model in which an independent third party conducts the process, using a customized survey, including open-ended questions, as well as personal interviews with each director that can yield valuable information about the directors' views on a wide range of topics—often including other directors' performance and effectiveness. In some cases, the process includes distributing a separate questionnaire to management—or at least those members of management who regularly interact with the board—as well as interviews with management to evaluate how management perceives the effectiveness of the board.

  Some companies follow a "hybrid" approach in which a third-party facilitator is engaged periodically—maybe every 2 to 3 years—to conduct a very thorough process. One possible benefit of this approach is that it reduces the risk that using a do-it-yourself approach every year becomes a perfunctory or check-the-box process that does not yield constructive insights.
- **Limiting the blame game**: self-evaluations should not be used to find fault or to assign responsibility or blame. Doing so could harm the company in litigation or otherwise. Rather, they should be used to determine how the board and its members can do their respective jobs better, regardless of whether they are high-functioning boards or those that may not be functioning optimally.
- **What happens next**: perhaps the most important aspect of the self-assessment process is how the board addresses the feedback. There is no one-size-fits-all approach, but in many cases the board chair or lead director, often in conjunction with the nominating/governance committee and/or its chair, shares responsibility for addressing any recommendations that come to light in the self-assessment process. This can include speaking to directors whose effectiveness has been questioned to find out the possible reasons. Has there been an illness in the director's family? Have they been distracted by problems at another company on whose board they serve? Are these reasons likely to diminish such that the director believes they can return to their former levels of effectiveness and, if so, over what period? Does the director feel that their skills are no longer needed on the board?

Tough conversations

The conversations described above can be difficult; a director who is told that other directors question their performance may be surprised, and even when there are legitimate reasons for diminished performance, they may prefer not to discuss them. On the other hand, given the potential liability and other risks to which the company and other directors may be subject, these conversations need to take place.

Moreover, tough conversations need not and should not occur only when a board self-assessment yields expressions of concern from other directors. Rather, they should take place on an ongoing basis whenever it becomes apparent that a director is not performing up to expectations. Board chairs (or lead directors) as well as committee chairs should be sufficiently cognizant of their fellow board or committee members' performance and should take the initiative to discuss shortcomings as they occur. In fact, to the extent that board and committee self-assessments ask about the effectiveness of the chair (or, in the case of the board, the lead director), that individual may receive negative comments if they are unwilling to have those conversations about other directors.

Conclusion

Companies of varying sizes and across industries need effective boards to guide them, support management, ask tough questions, challenge assumptions, and offer valuable suggestions. Comprehensive board composition, succession planning, and refreshment processes can help boards perform at their best, thereby enabling their companies to excel.

Chapter notes

1 See https://www.sec.gov/files/rules/final/2023/33-11216.pdf.
2 See https://www.spencerstuart.com/-/media/2024/09/ssbi2024/2024_us_spencer_stuart_board_index.pdf.

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Board assessments that deliver

Stuart Levine & Associates LLC
Stuart R. Levine, *Chairman and CEO*

Board evaluations play a crucial role in enhancing board performance, particularly in succession planning and board revitalization. They provide an important opportunity to engage all directors to understand their perspectives on issues they deem worthy of focus. They represent a delicate balance of art and science, as they have the potential to make people uncomfortable; however, they should be seen as an ongoing process for improvement that offers the benefit of constructive feedback.

On the science side of things, per the NYSE's regulation 303A.09 regarding the annual performance evaluation of the board, "The board should conduct a self-evaluation at least annually to determine whether it and its committees are functioning effectively." The NYSE expects its listed companies to annually evaluate both the full board and each of the key board committees—audit, compensation, and nominating/governance (NYSE Regulation—Section 303A).

On the art side of things, the cliché to avoid the "check-box-design" is applicable yet woefully superficial. The best and most valuable board assessments utilize straightforward questions and interview techniques, but they are led by an individual or an individual in concert with an independent expert with board and/or chief executive experience, governance expertise and extraordinary interpretive powers to guide boards into the future.

According to Korn Ferry's "*2024 Annual State of Board Evaluations in the U.S.*," three noteworthy board assessment trends have emerged. First, 50% of disclosing companies in 2024 noted evaluating individual directors vs. 48% in 2023. Second, there was a slight increase in boards engaging with a third party to assist in board evaluations from 32% to 35%. This increase may be because boards vary how they conduct the evaluation process from year to year, or it may illustrate a growing trend to involve third parties at least periodically. Their analysis found that companies use third parties in various ways, from minimally involved (e.g. reviewing the board's evaluation process) to highly engaged (e.g. conducting interviews and facilitating director feedback sessions). Third, in 2024, 51% of disclosing companies used interviews in the evaluation process vs. 49% in 2023 and 35% of the disclosing boards used a questionnaire/survey and interviews in their board evaluations (Korn Ferry's Annual State of Board Evaluations in the U.S. 2024).

In brief, key points for self-evaluations include the following:

- It is important to select a facilitator/leader who can provide an objective understanding of the board's performance in areas such as oversight, strategic planning, and decision-making. This may involve the corporate secretary, general counsel, governance expert, or another senior manager. In all cases, the company's general counsel should be involved in the entire process, including handling comments, ensuring confidentiality, reporting results, and determining the recipients of the report.
- The framework design includes chief executive officer (CEO) and director pre-assessment conversations to gain insight into incorporating questions on roles, responsibilities, and performance expectations. This encompasses company performance, CEO performance, and board performance.

  The major components that our firm includes, but is not limited to, are **board culture** (e.g. does the culture promote the timely resolution of issues and conflicts?), **board management** (e.g. do current practices enhance efficiency and performance?), **board composition and leadership** (e.g. are the board and board committee leadership effective?) and **board governance**—structures and practices—full board and committee focus (e.g. is there agreement on the most pressing issues?). Our proprietary framework and scale utilize a numerical 0–10 scale. The scale is used in conjunction with the verbal answers to distinct qualitative questions, which are catalysts for actionable suggestions. To reiterate, the framework design should provide quantitative and qualitative results collected through a survey and confidential interviews that yield strategic themes and insights (Stuart Levine & Associates Research).
- At a minimum, the crux of evaluations/assessments should involve information flow; culture; succession planning; the board's handling of crises; skills; operational resiliency; innovation; financial oversight; and effectiveness in dealing with risk. Again, done correctly, it will constructively determine if the board and each director have demonstrated integrity, accountability, and solid judgment.

As to the importance of culture in these conversations, a paraphrased version of Norm Augustine's view is one to consider—"If the objective is not to change the organization's culture, then the question becomes how does the current board member fit into the existing culture? Culture can be a powerful lever for good or, sadly, harm."

Further, individual directors' understanding of the company's strategy, drivers of profit, competitive risk, corporate sustainability, human capital management, risk control systems, legal and governance standards, duty of care, duty of loyalty, acting in good faith, and dedication to continuous learning must be part of the assessment process.

The board report details the strengths, weaknesses and opportunities for the full board and its committees. More specifically, it should underscore requisite board action as the self-evaluation or independent board assessment may pinpoint that additional expertise to the board is needed, a change in the composition of board committees is warranted, board diversification is required, counsel to a board member should be implemented, a director should not be re-nominated, and a compliance issue(s) requires fixing (Corporate Director's Guidebook, 7th Edition).

To provide a corollary to avoid the "check-the-box-design," go beyond the survey scores and demand a substantive and unfettered analysis of the quantitative and qualitative findings that have a one to two-hour discussion session reserved at the next in-person full board meeting.

Once again, the goal of the board assessment findings is to foster constructive discussion, optimize board effectiveness, and enhance it, rather than impose punishment.

Directors dedicate over a month each year to board-related activities. High-functioning boards dare to reflect honestly on their performance, recognizing both their strengths and areas for improvement. Hiring a qualified independent third party to go to the next level and assist in this process fosters transparency and provides an unbiased perspective. This initiative engages the board in identifying and maintaining its strengths while also highlighting opportunities to enhance the board's culture. Additionally, it serves as a foundation for making informed decisions about the re-nomination of director candidates.

By utilizing an independent, confidential and professional process that encourages self-reflection, third parties can create an environment conducive to learning and growth. Data collected from all board members regarding the board's overall performance significantly contributes to optimization efforts.

The assessment provides overall score averages based on 20–30 carefully crafted questions. It captures diverse opinions from board members and offers valuable suggestions for improvement in key areas, including committee chair communications, board succession, and the relationship between the board's oversight role and management's role.

Gathering feedback on board management, composition, governance, and culture helps pinpoint key issues and provides a pathway for enhancing both board performance and culture. Engaging with the CEO and selected senior officers can offer valuable insights that contribute to improved board effectiveness.

Incorporating the executive team into this assessment allows the board to gain insights into how management believes the board can better serve the organization and what the ideal board-management interface should be. This input is essential for board members striving to enhance the quality of board service.

A well-designed board assessment process can address the following questions:

- **Board culture**: is your board culture collegial and capable of sustaining honest and challenging conversations? Do the board and senior management maintain strong internal communication? Are the right issues being discussed?
- **Director performance**: are board members well-prepared, and is "airtime" effectively distributed? Is there an adequate onboarding process for new directors?
- **Strategic planning and risk management**: is the board actively engaged in strategic discussions and appropriately evaluating risks?
- **Succession planning**: is there a succession plan for the board and C-suite executives? Is the board

comfortable discussing succession planning with the CEO?

- **Logistics**: are board materials and minutes provided promptly, allowing sufficient preparation time before meetings and prompt distribution of minutes afterward?
- **Committees**: are the appropriate committees in place, and how well are they functioning?
- **Board composition**: does the board possess the right talent to address current and future strategic needs?
- **Continuous learning**: are board members staying informed and continuing to add value?

Encouraging board members to share candid feedback in a trusted environment fosters improved board dynamics, more focused agendas and streamlined processes, better meeting materials, and more suitable board and committee compositions that clearly define responsibilities.

Identifying board strengths and areas for improvement can lead to enhanced learning programs, individualized director coaching and succession planning that ensures the board possesses the necessary skills aligned with regulatory trends and evolving strategies. Board assessments often reveal shortcomings in the focus and structure of board agendas, including the excessive use of complicated PowerPoint presentations that lack concise executive summaries. They can also highlight whether sufficient time is allocated for discussions on critical strategic issues.

Moreover, board assessments can help determine whether an appropriate CEO dashboard exists to evaluate the CEO's performance and ensure alignment with the organization's goals. The most successful CEOs learn to communicate effectively with their boards, and developing a framework for the CEO dashboard can facilitate this process.

Below is a snapshot of a well-designed strategic CEO dashboard:

Strategic CEO Dashboard

Strategic Performance Category	Weight
Financial Performance	30%
Customer Satisfaction	25%
Culture and Employee Turnover	20%
Technology/AI and Cybersecurity	25%

Culture must become a part of the CEO's dashboard, with a defined measurement. Data must be collected on an ongoing basis to measure cultural alignment with the organization's core values, and then there needs to be a robust strategic communication plan that drives it. Reviewing and affirming the vision, mission and core values of the organization creates a common understanding and common language.

The key factors contributing to an optimized board also relate to having a strong board culture, a focus on ensuring effective company strategies and succession planning and having engaged directors who are prepared for all meetings. Unfortunately, these factors are not easily achieved and require strong leadership from the CEO and dedication from all directors.

The culture of an organization starts at the top, directly reflecting the actions and values of the board. These intangible assets make up a significant part of a company's market value. You cannot have a strong culture without an embraced vision, mission, and core values within the company. Core values become the "guard rails" that help employees make the right decisions. Unfortunately, statistics show that employees do not believe in their company's values, and managers are disengaged, creating disengaged workers. These cultural deficiencies impact valuations, margins, talent recruitment, and productivity.

Helping boards and CEOs embrace culture should be part of managing risk, improving valuation, and achieving strategic success. These intangible assets can now be measured across an organization. As the CEO's primary duties are to drive performance and mitigate risk to improve valuation, it only makes sense that culture, a critical performance driver should be measured on both the CEO and board's dashboard.

Just as individuals should go for an annual physical, businesses should be reviewing their culture in the same way. Collecting the data on the health of your organization's culture can help to identify barriers and make corrections to ensure the effective execution of strategies and satisfying the expectations of your customers and shareholders. Having the courage and will to learn as fast as you can in this rapidly changing and complex world is the only way to ensure value creation.

Very often, an important component of this process becomes coaching and mentoring the CEO. The creation of a CEO dashboard that identifies priorities will be accretive to the future growth of the organization. This mentoring focuses on enhancing the ability for effective strategic communication with the board of directors as well as with the executive team. Prioritizing the utilization of CEO energy additionally creates the desired momentum for the recruitment of the next generation of C-suite officers.

Additionally, board members who should sharpen certain board skills can be coached, to increase that individual's productivity. A lack of improvement, however, should result in the director not getting re-nominated. Re-nomination should not be a given.

Change is hard. However, self-reflection will stimulate discussion in a highly constructive manner and provide recommendations for board optimization and effectiveness. Highly functioning, engaged boards do all they can to up their game. Board assessments, run most confidentially and engagingly, are a crucial tool that will provide value to the board and increase shareholder value.

In turn, a brief case study of a successful board assessment, referred to as unblocking the arteries, follows:

The client: a global, diversified materials distribution company with over 2,000 employees. It is listed on the NYSE and has a history of challenges from activist groups.

The board chair was the first to emphasize the importance of independent data and research regarding the board and the dynamics between the board chair and CEO. The board chair aimed to foster true excellence within the board. We recognized the need to systematize several governance and leadership processes and saw an opportunity to enhance value through improved strategic communications and leadership development.

Challenge:

- Determine the true state of board management and board governance skills of the full board, individual directors, and committee chairs.
- Elevate the communications between the board chair and the CEO.
- Deepen the CEO's perspectives on global revenue growth, shareholder value, and employee relations.

Solution:

- Derive analytical insights from a board assessment with prioritized customized questions about board member collaboration that reflected the highest standards of accountability, strategic thinking, a commitment to creating a culture of trust, board/management dynamics, and a dedication to continuous learning.
- Strategic communications to the board were prepared as needed on behalf of the chair.
- New and improved alignment with current regulatory oversight standards and institutional investor expectations.
- Refinement of key elements in the Nom/Gov and Audit committee charters.
- Faster turnaround time for the review of board minutes.
- An innovative annual board education curriculum.
- A regularly scheduled and agenda-driven board chair/CEO conversation.
- CEO mentoring every week in one-hour sessions.

Results:

- In one year, the board experienced the requisite refreshment, and a new Nom/Gov chair was named.
- A strengthened board culture created a more robust energy in the boardroom and positive results company-wide.
- Continuous learning became part of the board's DNA.

In summation, boards, as well as organizations, are most successful when firmly rooted in mission-driven core values and creating long-term sustainable value for customers and shareholders. Boards must stay engaged and create and maintain a culture of constructive challenge and competence. An effective board is especially critical in today's challenging regulatory environment, particularly in the realms of strategy and succession planning.

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How to educate and upskill directors and boards on critical issues

National Association of Corporate Directors
Friso van der Oord, *Senior Vice President, Content*

From NACD's founding nearly a half century ago, to developing Director Professionalism®, to the New York Stock Exchange (NYSE)'s bold educational recommendations at the turn of this century, to current innovations in board learning channels, director education continues to be an indispensable and ever-improving pathway to enterprise success.

Nearly a quarter century ago, the NYSE raised the stakes on director education with an important new listing rule. On 4 November 2003, the exchange became the first US authority to require formal assurance of ongoing director education. Specifically, as part of the new Section 303A on Corporate Governance in its listing manual, NYSE-listed company boards were required to develop and disclose governance guidelines that included a description of the company's "continuing education and orientation of directors."

The NYSE-National Association of Corporate Directors connection

The National Association of Corporate Directors (NACD), founded in 1977 to help directors become successful stewards of long-term corporate value through education and peer-to-peer networking, was immediately supportive of this recommendation. The group of prominent corporate board members and advisors behind the new NYSE listing rule—namely, the NYSE Corporate Accountability and Listing Standards Committee—cited NACD and several universities as authorities in director education at the time they convened, in advance of the listing rule.[1] In the June 2002 report that led to the new listing rule, the Committee urged the NYSE to host educational programs for directors, collaborating with others such as NACD. The landmark NYSE report quoted NACD in stating that, "Boards should provide new directors with a director orientation program to familiarize them with their companies' business, industry trends, and recommended governance practices," adding "Boards should also ensure that directors are continually updated on these matters."[2]

At that turning point in history, NACD also suggested that the NYSE and other exchanges consider making director orientation and continuing education *mandatory.* "Mandating director education would not be difficult, and the benefits would be great. Many organizations offer industry education, and a small but growing number of organizations, including several leading universities and the NACD, provide education in governance," we noted, concluding that "This type of education seems particularly critical today, when there is a heightened need for directors to maintain a current knowledge of governance issues and practices."[3] These same words could well apply in 2025 and beyond, as critical economic and regulatory changes are increasing demands on boards.

The role of crisis in raising educational expectations

Indeed, crisis is what prompted the NYSE to require director education at the turn of the current century and what catapulted the NACD into the field a generation before. A major impetus for the founding of NACD was the series of scandals involving foreign payments that led to the Foreign Corrupt Practices Act of 1977, which gave boards new responsibilities for overseeing corporate accounting. Similarly, the new NYSE requirements to make disclosures about director education emerged in the wake of the Enron and WorldCom scandals and passage of the Sarbanes-Oxley Act in 2002. At both historic moments, there was a realization that suddenly directors needed to become more accountable and increase their performance, strengthening their

NACD's Education Track Record

NACD was founded in 1977 to educate directors—a cause we have championed since then. Ever since that time we have hosted thousands of educational programs. NACD has convened its annual Directors Summit™ since our earliest years, as have our yearly programs to honor directors of public, private and nonprofit enterprises. Since 1992, we have published annual surveys tracking boardroom trends, and since 1993, we have published Blue Ribbon Commission reports on more than two dozen topics, and for every single topic we have recommended ongoing director education in that particular field.

In addition, some of our past reports have provided extensive guidance on general education of directors. These educationally focused reports include Blue Ribbon Commission reports on *Director Professionalism* (1996) and the *Governance Committee* (2007), *Key Agreed Principles for Corporate Governance in U.S. Publicly Held Companies* (2008) and the following notable reports on board agility: *The Strategic Asset Board* (2016), *Fit for the Future* (2019), *Future of the American Board* (2022) and *Oversight of Technology* (2024). The recommendations in this article include insights from these seven reports as well as other NACD publications.

NACD's certification program offers a recognized form of accreditation for corporate directors, the NACD.DC® designation. NACD develops an annual exam for the directors who wish to obtain certification. We provide an *Exam Syllabus and Resources* document that explains the knowledge domains on the exam and the topics and tasks covered under each domain. Tasks are items directors would normally be expected to perform competently to fulfill their roles as board members. We provide links to suggested resources for each domain, and a general effectiveness in a short period of time—not only as individuals but also as boards.

Responding to permacrisis

Today, we do not need a crisis to remind us of the importance of educating and upskilling directors. We are living in what has been called permacrisis. Directors are not merely facing a single event, such as a major piece of legislation. Rather, they experience disruptive events regularly, prompting new learning needs.

The results of NACD's most recent Trends and Priorities Survey, published in our *2025 Governance Outlook* publication, revealed that nearly half of all respondents (48%) believe that crisis-like disruptions are happening more frequently now compared to 5 years ago. Nearly three quarters of respondents (73%) agreed that the sheer number of issues an individual director must monitor has increased over the past 5 years, and a similar percentage (74%) have noticed an expansion of board agendas. Not surprisingly, 43% of respondents said that, for them, director education is important to some degree. Only 5% said that improvements were "not important."

One example of a continually disruptive issue is the emergence and disruptive force of artificial intelligence and other new technologies, which was the topic of NACD's 2024 Blue Ribbon Commission report. Multiple forces are driving the urgency of technology education for boards—from the compression of strategy timelines to the speed of new innovations outpacing director experience. Even the job of being a director is affected by new applications of emerging tech.

Trends like these suggest a need for continuous learning. As mentioned earlier, NYSE listing guidelines require a proxy

... continued

list of suggested resources at the end of the syllabus.

Hundreds of directors from across the US have been involved in developing the exam questions and case studies, which change periodically. While our director community has agreed on a basic exam blueprint, NACD continuously scans the governance landscape to ensure that our curriculum meets the demands of directorship today and in the future. Since the NACD.DC program was launched in 2020, nearly 2000 directors have earned the certification and the number continues to grow as the demands for director education and upskilling evolve.

statement disclosure on director education, and based on recent disclosures it is clear that boards are rising to the challenge. And although director education is still not mandated by the government or the stock exchanges, both the major stock exchanges offer educational programs and have expressed support for NACD's programs and for various university programs that exist to this day.

As for NACD, there has always been heavy uptake on our educational offerings—from in-person programs, which we have been offering for nearly half a century, to online programs and our more recent work over the past decade in director certification (*see sidebar: NACD's Education Track Record*).

Principles of director education

Over the years, NACD has provided guidance on how boards and directors can approach continuous learning, based on the timeless recommendations from the NACD community. Educational approaches must be adapted to the directors and boards served, depending on company type, maturity, size and industry. A curriculum for a cooperative will vary greatly from one for a mutual fund; a local start-up will not have the same demands as a global multinational, and a bank board will need a learning track different from that of a chip manufacturer. This said, there are a few general principles that boards can consider.

Application to director development and evaluation

Education of directors—whether provided internally or externally—should be customized to the needs of individual directors and to the board. If a director or board is not performing as well as expected due to some deficiency of expertise, the director or group of directors should be given the opportunity to receive education in the area.

Attention to process

Director learning involves more than content: the what and why of the subjects to be explored. It also involves attention to process: the who, when and how of the learning program. Who will be responsible for ensuring an effective approach? Typically, this will be the chair of the governance committee, supported by the corporate secretary, but each board can make its own determination. As far as the "when" of timing goes, director education should be planned in advance from on boarding to offboarding, making adjustments as circumstances require. And as for the "how" of education goes, variety is the key (*see Multi-modality*).

Commitment to continuing education

Although board education starts at orientation, it should be thought of along a continuum from the start of a director's term to its end. Furthermore, boards can benefit by paying attention to both the educational track of individual directors and for the entire board as a group. The call to director learning is a collective mandate for the whole board to stay constantly curious. Board members must make a commitment to learn together, whether through briefings facilitated by outsiders or dynamic war-gaming with management. In their ongoing discussions they can also learn from each other and use learning together to surface critical board issues or help inform decisions.

Knowledge refresh

Longer-serving directors will benefit from periodically refreshing their knowledge of the basics, for example by joining new director orientations or scheduled management trainings on critical issues, such as compliance, security and cultural matters.

Learning from lived experience

The experience of other boards—whether reported in the news or recalled from the director's personal board service—can provide important insights on the failure vs. success of oversight, and can spark discussions and understanding of any vulnerabilities that exist on the current board.

Linkage to enterprise business and strategy

Directors have an obligation to acquire extensive, current knowledge of the organizations they serve, including products and services, relevant technology, markets and economics, and the strategic position of the enterprise (strengths, weaknesses, opportunities and threats). The learning plan for boards and their members should be based on an analysis of what learning must occur for the advancement of the enterprise's strategy. For example, the board of a wholesaler that plans to diversify into retail should have firm knowledge of the strategic landscape for retail in the company's field. This level of education helps to make a board a "strategic asset."

This approach can be supported through experiential learning, where the board visits company stores and production sites and meets local staff.

Maintenance of relevant expertise

Directors should maintain leadership in the field of endeavor that led the board to recruit them. If the board recruited a candidate because the director had financial expertise, that director should be sure to keep up with financial trends. Similarly, if the board has recruited a recently retired CEO because of the candidate's experience in senior management, that director should stay current with the world of business and the latest management thought and practice.

Multi-modality

Director education need not be confined to one modality. From small group sessions to major conferences, education covers a wide terrain. Many boards encourage their directors to visit enterprise locations, such as branches, stores or factories. Attendance at trade shows can also be instructive. Meetings with suppliers, key customers and investors can be additional ways to educate board members. Any educational program created by boards can consider a mix of online and in-person meetings, including strategic retreats and attendance at educational events. Permian Resources, an NYSE-listed company, notes as follows in its 2024 proxy statement: "When a new director joins our Board, we provide a director orientation. Directors are also encouraged to attend continuing education programs designed to enhance the performance and competencies of individual directors and our Board, including through participation in National Association of Corporate Directors events."[4]

Oversight at board level

The board should take accountability for developing an educational program for individual directors and for the board as a collective. The responsible party may be the chair, the lead director, the chair of the nominating and governance committee or the corporate secretary.

Personal accountability for learning

The competent director takes responsibility for developing a personal educational program that fills any gaps left by the board's program. For example, if everyone else on the board has financial expertise but the director does not, then the director should seek learning on that topic, informing the board of this training (*see Tracking*).

Range of topics—including fundamentals

All directors, whether new or seasoned, can benefit from a blend of basic and emerging topics. Competent directorship requires an understanding of core topics such as corporate directors' responsibilities and the general legal principles that guide director conduct. Other core issues include how to work with management, managing crisis, financial reporting and CEO succession. This material is not one and done; it can change over time. So the board's educational curriculum should also include emerging issues in financial markets, technology, climate change, cybersecurity and other headline issues.

Robust planning

Developing a learning plan for a board and its members requires the same level of attention and discipline that any training program demands. Boards should be able to describe their educational programs in a way that gives stakeholders assurance that the leadership at board level has the requisite knowledge and skills to guide the enterprise into the future. An effective learning plan will draw from a variety of resources, including ad hoc use of an outside consultant and/or an advisory board that supplements the expertise of the board (e.g. a cybersecurity expert or a technology advisory board), presentations by management, self-directed research, and accredited outside events and conferences that meet the standards set by the program.

Timing synced to the board calendar

Board educational programs will be most effective if they are coordinated with the board's calendar of work. For example, any education in compensation should be timed prior to the time the compensation committee and the board vote on the senior executive incentive plan.

Tracking the education journey

Boards, through the nominating and governance committee (or similar committee), should track what education directors have upon beginning service and what they acquire during service. The corporate secretary or other appropriate person should keep a record of the education journey for both board members and the board as a whole.

Upskilling

Director education should focus on skills—what directors can *do*—as well as knowledge—what they *know*. Examples include financial acumen, critical thinking for decision-making, team dynamics, and communication (speaking and listening). The full educational plan might include facilitated learning sessions focusing specifically on such skills.

Conclusion

It has been a quarter century since the NACD recommended mandating director education for all public companies, and since the NYSE required such education as part of governance guidelines. Since that time, an entire cottage industry has arisen for director education—always a healthy phenomenon. NACD is proud to be a part of this broad movement to help directors and boards be the best they can be.

Chapter notes

1 *Report of the NYSE Corporate Accountability and Listing Standards Committee*, 6 June 2002, p. A-92 (https://www.iasplus.com/en/binary/resource/nysegovf.pdf).
2 Ibid.
3 Ibid.
4 Please see Permian Resources 2024 Proxy Statement, p. 25 (https://s3.amazonaws.com/sec.irpass.cc/2754/0001308179-24-000490.pdf).

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Giving voice to values in the boardroom: navigating common board challenges for optimal board dynamics

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Introduction

The boards of directors—who have likely never been more vital to the inner workings of a firm—routinely face values conflicts. As boards are pressured to contemplate new regulations about transparency and accountability, ongoing environmental and social concerns, executive pay and performance challenges, and the rights of shareholders and other stakeholders, it is clear that board work is values-driven. Boards must focus both on the moral element as well as the legal aspects of their role.

In this role, directors are increasingly faced with how to give voice to their values, especially when presented with certain ethical challenges, exacerbating the need for this type of board-level competence. While there may be numerous challenges unique to a single board, this chapter focuses on two key challenges that are fundamental to achieving better board dynamics. To help readers of the NYSE Public Company Series develop this skill, this chapter outlines the values conflicts that may arise in two main areas: (i) strategic planning and monitoring and (ii) director independence and nomination.

Values conflicts

All board members face ethical challenges. These dilemmas are most often about conflicts with moral values. By values, we do not mean qualities like "creativity" or even "innovation"—which are important no doubt—but rather moral values that are widely shared across time and culture. Moral values are personal and deeply held beliefs about good and bad behavior, desirable and undesirable actions, and right versus wrong. These values often conflict with some other compelling option (e.g. profit, market share, promotion) or a fear, such as being fired, marginalized, or otherwise retaliated against. Board directors face these types of values conflicts when they are tempted by these other attractive options. Yet, all of us can understand—and even normalize—temptations in the business world without accepting them as being appropriate.

Strategic planning and monitoring

One of the first value conflicts directors are likely to face is balancing the need to monitor management with the ability to offer strategic advice. Many boards struggle with the dual nature of the board's tasks; on the one hand, a board must monitor senior management, on the other, it must provide strategic support for them.

To many, the primary role of a board lies in its ability to protect shareholder interests by hiring the right top management team while monitoring and compensating them properly. In fact, most academic research, media accounts and government regulation all echo the deeply held belief that boards should be able to actively monitor management.

In order to effectively monitor, boards of directors typically adopt one of two philosophies. The first rests on the idea that independent directors can effectively monitor executives. This focus has largely proliferated because of regulation. Boards of firms listed on a US exchange are required to have independent directors on the audit and nominating committee and among a majority of the overall board. The 2002 Sarbanes Oxley Act also increased the monitoring role of boards. This type of regulation spread; by 2016 most member states of the European Union and virtually all major Asian jurisdictions had rules for appointing at least some independent directors to their companies' boards.

The second perspective views effective governance as a function of hiring board members with the right qualifications—those who bring human and social capital—because they provide these much-needed resources and thus they will use them to monitor management. In this way, the board serves as a provider of resources (e.g. expertise, status, advice and counsel), which are then used to evaluate management.

Both approaches rest on bringing an independent director to the board and thus it presents the board with one of its most common value challenges—who can best serve as an independent voice. According to the Securities and Exchange Commission, in assessing a director's independence, the nominating and corporate governance committee needs to take into account certain facts and circumstances:

1) First, it must determine if a director is indeed independent. A director is considered independent when he or she is free from any "material" relationships with either the listed company or with senior management (e.g. commercial, industrial, banking, consulting, legal, accounting, charitable and familial relationships) during the past 3 years.
2) Second, even if a director satisfies each listed requirement, the board still needs to determine whether the director *could* exercise independent judgment given the director's specific situation. The NYSE requires the board of any listed company to make an affirmative determination of each director's independence; this determination must be disclosed publicly.

Ownership of a significant amount of stock or affiliation with a major shareholder, in and of itself, does not necessarily preclude a board from determining that an individual is independent. But, even if a director satisfies each listed requirement, the board must still decide whether the director's independence has been compromised in some way. A recent case is illustrative. On 30 September 2024, the Securities and Exchange Commission (SEC) announced it settled charges against a public company director for violating proxy disclosure rules by standing for election as an independent director without informing the board of his close personal friendship with a high-ranking executive at the company. The director did not disclose this relationship when he completed his Directors' & Officers' questionnaires in which he stated that he did not have a material relationship with the company, including "any other relationship" with the company or its management. This resulted in materially misleading statements in the company's proxy that inaccurately identified the director as "independent" under both stock exchange listing standards and the company's governance guidelines. It also resulted in a compromised chief executive officer (CEO) selection because the director participated in the process of evaluating internal CEO candidates, including the executive he was friends with, without disclosing their relationship.

Another problem area is what to do with "gray" directors. Gray directors are those who lack perceived independence for one or more reasons but are nonetheless independent for regulatory purposes. Some of these reasons include a director who: serves on a second or third board with another director or the CEO, is a former employee or consultant, receives above market director fees, has social relationships with management or other directors, has an office at the headquarters and uses its administrative staff, or has excessive tenure on one board. Over time even those who were once independent directors can become gray by exhibiting the tendency to rely heavily on management briefings to tell them what is going on inside the firm or by lacking "*independence of mind*" by not speaking up or questioning the CEO. Sometimes directors' reason that being in the CEOs' good graces might enable the continuation of what has become a highly lucrative position.

Three additional factors may contribute to a director being perceived as gray. First, a director's independence may have come at the expense of outdated expertise. Second, some directors have been chosen due to their predisposition toward the policies of management. And third, the board itself may not be privy to key management information necessary to do their job effectively.

On the first point, while specialized experience has long been valued in board candidates, two somewhat new skills are increasingly in demand. A 2024 Spencer Stuart Pulse Survey highlights that directors with experience in cybersecurity (92%) and digital/technology (92%) are seen as having the most positive impact on board oversight. However, with limited spots opening up each year, there is now a preference for "generalists" who can effectively manage the wide range of governance responsibilities. According to many respondents to the survey, the most effective boards are well-rounded in terms of experience and expertise and therefore able to contribute to the board's dialog in multiple areas. Board evaluations are a good way to reassess director expertise.

Second, even when a director has a predisposition toward management, the obligation to monitor is intended to be a countervailing force. Activist investors campaigning for board seats often argue that long-serving directors have grown too cozy with management. Academic research has suggested that more social ties among directors and the CEO, the longer the CEO's tenure. Because a director's independent status can change, boards may be well-served by conducting an annual review of the independence of non-executive directors. As new board skills and members are integrated into the boardroom, a culture of monitoring should be continually emphasized.

Directors often lack independence because they suffer from "information capture" when they are too dependent on the content and presentation of information management chooses to provide or conceal. This presents a conundrum; because even when a director is truly independent, they may have few other sources of information internal to the company other than the CEO or the other board members. But in order to monitor management, a director must have information about the inner workings of the company. Certain barriers can exist that ultimately inhibit directors from providing effective oversight on an ongoing basis which lay the groundwork for additional values conflicts. Chief among these barriers is the board member's ability to obtain, process and act on information from management on a timely basis. At the same time, boards have a duty to "ask the right questions" of management and may not escape liability even if management does not inform the board. Thus, even if it can be risky to ask questions, it can be equally risky to not ask them.

Director nomination and selection

A second topic presenting values conflicts, and one related to director independence, is the director selection process. Director selection is the formal or informal process by which individuals are identified and screened for a position on a corporate board. Typically, this task resides with the nominating committee whose main role is to independently evaluate and nominate prospective candidates for the board of directors. Ideally, and as intended by various oversight bodies, the nominating committee seeks out potential candidates for board seats independently from the CEO. The very existence of a nominating committee aims to reduce the influence of the CEO on new director selections. In effect, the members of the nominating committee should have access to more potential candidates from different profiles than the CEO's network. And it allows the separation between management of the firm and control of the firm.

The SEC requires disclosure about the existence and process of this committee and its composition (e.g. level of independence, skills required, and source of nomination). The nominating committee is one of three customary standing committees required by the NYSE to be composed entirely of independent directors. Many countries have similar nomination committee requirements. However, the current structure of board selection—in many countries around the globe—consists of a stand-alone nominating committee wherein the CEO has a great deal of influence.

The board's process for director selection is a vital part of crafting the board's composition and establishes the dynamics and the characteristics of the board and helps determine the overall culture of the board. The quality of the director appointments is, in part, what determines the board's ability to effectively monitor management and offer strategic advice. Furthermore, many boards view their composition as a strategic asset and review it often as the company's own strategy inevitably changes.

It is common to have large institutional investors, proxy advisory firms and regulators attempting to weigh in on the board's nomination committee policies and practices. For example, State Street Global Advisors, Blackrock and Vanguard—the "Big Three" institutional investors—have all published voting policies on board diversity. All are prepared to vote against nominating committee chairs of boards that fall below the market norm, typically 30%. In recent years, they have voiced their concerns directly to management through private engagements about appointments to the board and are increasingly focusing on the diversity of perspectives as well.

Proxy advisors are also exerting their considerable influence. While their policies are primarily governance-focused—historically written to set clear voting expectations for asset managers in areas like board composition, independence and effectiveness—they increasingly focus on diversity and equity among the top management team and the board. Glass Lewis and Institutional Shareholder Services (ISS), the two largest proxy advisors, have targeted nomination committee chairs with "against/withhold" votes if boards do not include a female director, or provide a cogent explanation. Glass Lewis and ISS have diverged in 2025 when it comes to issuing recommendations on directors. Glass Lewis will now provide a "For Your Attention" flag on any proxy report with a negative diversity-related director recommendation. ISS announced that it will no longer consider board gender, racial or ethnic diversity when making its vote recommendations. It's worth noting that in 2024 average support for director elections was 95%, according to The Conference Board.

The values conflict in director selection is present in two ways: (i) the choice of who sits on the nomination committee and how it operates and (ii) the CEO's level of involvement. To some, it represents the biggest threat to true board refreshment, but to others the CEO's recommendation is important because they typically have an extensive network, and they ultimately need to work well with whoever is selected.

The CEO's network has been the search method of choice for directorships since the early 1980s. And while today the CEO continues to be a source of referral, they are often given latitude to influence director selection, despite the nominating committee mandates, due to director selection processes that endorse this behavior. Typically, there are two broad perspectives by which boards have approached the director selection process. The economic perspective is one where the board focuses solely on meeting the monitoring and resource provisioning needs of the firm. The socialized perspective suggests that social factors influence the selection process and reflect not so much of the board's desire to find directors to meet the needs of the firm and its shareholders, but rather the preferences and biases of those who are charged with new director selection. Here, the director selection process is influenced by the social status and prestige of the candidate.

The CEO is more likely to be involved in the selection process if he or she is long-tenured at the firm, has a high amount of stock ownership or is a member in the founding family. Additionally, the background of the chair of the nomination committee is most often likely to be a former/current CEO or the lead independent director. When the lead director and the nominating committee chair are the same person, the level of independence is likely to be compromised. Also potentially contributing to the values conflict is CEO duality. While there has been a continued decline in the number of publicly traded companies who continue to have a dual CEO/Chairman of the board, Spencer Stuart's 2024 Board Index cites 40% of Standard & Poor's list of the largest 500 companies still have chief executives who also serve as chair, increasing the CEO's power and influence within the firm, including the nomination process.

Other factors in the director selection process have crept up in recent years. For example, boards have become increasingly involved in changing the company bylaws so that it can reject a shareholder's nomination. Typically, it does so by requiring shareholders to make a specific set of disclosures to the board in order to submit a valid nomination. And although director re-election tends to be high, shareholders opt to vote against director re-elections to flag their dissatisfaction with governance issues, environmental, social and governance (ESG) shortcomings and the broader strategic direction of a company.

Such tensions, as described here, make the values conflict apparent in the director selection process. Simply put, when directors are hired for their similarities to management, diversity of thought and identity take a back seat which, in turn, can relegate decision-making and oversight to homophilic bias.

Conclusion

Board members need to build moral muscle memory so they develop the competence and confidence to recognize and navigate the values conflicts outlined in this chapter—even, and especially, when forces compel them to act otherwise. Boards of directors are in a unique position to affect change in the business world. In most situations, directors are at the forefront of corporate accountability and judgment. This position, literally, gives board members an opportunity to shape others' actions—especially those of management and other key stakeholders.

Recognizing values conflicts is the first step in giving voice to values as a director. Giving voice to values is about implementation—or the action one takes knowing what their values are. Such an approach is not only a skill that can be developed but a series of tactics to be deployed (e.g. reframing, data gathering, ally and relationship building, sequencing conversations and actions). These skill building exercises as well as additional board challenges are included in "*Giving Voice to Values in the Boardroom*," a book dedicated to helping boards figure out the optimal director behaviors, tasks and roles while learning how to improve board dynamics.

Section 7: The evolving boardroom—talent, governance, and engagement

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Building a balanced board: expanding the reach and pipeline for talent

Leadership Elevated
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Introduction

Corporate governance has undergone a significant transformation over the past decade. Boards face twin challenges of an increasingly complex operating environment and heightened scrutiny from a host of stakeholders, which are forcing an evolution in what it means to faithfully execute fiduciary duties. As directors sharpen their focus on strategy oversight and contend with a shifting risk landscape, they must also rethink their approach to board refreshment. Companies across the globe are recognizing that board diversity is a critical driver of innovation, better decision-making and long-term business success. A 2014 study from the Credit Suisse Institute found that companies with more women on the board tend to have higher returns on equity, better stock performance and higher dividend payouts. Invest Ahead, an investor-led effort to ensure greater board diversity, has created a database of the past 5 years of peer-reviewed, academic research, many of which draw a connection between board diversity and positive impact on the company. Perhaps the most compelling case for creating a more diverse board comes from the investors themselves. Large institutional shareholders including BlackRock, State Street Global Advisors and the California Public Employees Retirement System who represent a combined total of $14 trillion of assets under management, have all made public statements voicing their belief that diverse boards are more effective boards. Many other institutional investors, such as pension funds and endowments, are now actively advocating for board diversity and are using their influence to pressure companies to increase diversity on their boards. Answering this call requires a focused and deliberate approach to expanding the reach and pipeline for talent.

A shift in board oversight

Historically, the board's role was heavily focused on compliance and financial oversight. However, the advent of disruptive technologies, geopolitical shifts and evolving consumer expectations has compelled boards to adopt a more expanded approach to include a stronger focus on strategy and widening the lens on the kinds of risks that could harm the company. In addition, there is increasing recognition that centering people and culture is not just a "nice to have," but critical to protecting and building business value. In Alan Murray's 2023 book, "*Tomorrow's Capitalist: My Search for the Soul of Capitalism*," he surfaces a statistic that underpins this shift: a look at the balance sheet of Fortune 500 companies 50 years ago would reveal that over 80% of the value came from physical entities like oil in the ground and inventory on the shelves. Today more than 85% is tied to intangible assets like intellectual property, software, company reputation and brand equity. This shift demands that boards can assess both strategic opportunities and potential risks through the lens of talent, organizational culture and innovation.

Building an effective board requires a balanced approach:

- Expanding the lens of the idea of who makes a good member.
- Determining which skills, backgrounds, experience and perspectives are important for a given industry, business model, risk profile, stage of growth and strategy.
- Sourcing talent that fits that profile.

The first two are critical in order to do the third. We will examine each in more detail, as well as discuss how and why companies should play an active role in helping to deepen the pipeline for board talent by starting with their own ranks.

Expanding the lens on the ideal board member

One of the key roles of the board is to provide an outsider, higher-level perspective of the company, industry, operating environment and market conditions. As both advisors and fiduciaries, they play a crucial role in pushing the leadership team to consider a wider perspective of issues when making decisions. When boards are homogeneous, it can create blind spots, making this harder to do effectively. Lack of diversity can lead to groupthink, where decision-making becomes skewed, and both risks and opportunities for innovation are missed. A balanced board consists of individuals from diverse backgrounds, including gender, race, ethnicity, professional experience, lived experience and cognitive diversity. This, in turn, brings a mix of perspectives, enhancing the board's ability to understand and respond to different challenges, opportunities and market conditions. A company's employees, customer base and other key stakeholder groups are likely diverse. The more the board can reflect and represent this, the better able they will be to identify both issues and opportunities early on, ask questions of the leadership team to help surface key considerations and bring them into the discussion.

When considering board diversity, there are several key factors to consider. Generally speaking, board diversity centers around several key areas:

- **Gender:** ensuring gender parity on boards.
- **Ethnicity:** including individuals from diverse ethnic backgrounds.
- **Age:** balancing experienced directors with fresh perspectives.
- **Geography:** representing different regions and cultures.

- **Functional expertise:** incorporating a mix of industry, domain, and technical expertise.

Identifying and sourcing the right candidates for a given board starts with re-examining old—and possibly outdated—assumptions about who makes a "good" board member.

Many board positions have traditionally been filled by individuals with decades of experience in executive leadership roles, especially those who are sitting or former chief executive officers (CEOs). While experience in the top job can be a plus, there is growing recognition that a board made up of mostly former CEOs does not provide adequate diversity of perspective especially when it comes to things like digital transformation, voice of the customer and geopolitical considerations. A non-traditional candidates who may not have held a CEO position but has deep expertise in areas such as technology, sustainability, strategy, operations, marketing or finance can bring valuable insights to the boardroom.

For example, someone with expertise in data analytics or artificial intelligence could offer a fresh perspective on the strategic direction of a company in the tech-driven age. Alternatively, individuals with backgrounds in social responsibility and environmental sustainability could guide companies in aligning with broader societal goals. Those with backgrounds in people and culture can raise important questions about how the people strategy aligns with the broader business strategy, a critical factor when we consider the aforementioned statistic on the shift in corporate value from tangible to intangible assets.

Here are several factors to consider that can broaden the pool for qualified board talent:

- **Look beyond the C-suite, focus on impact:** individuals from lower levels of the organizational hierarchy who have demonstrated leadership and experience that mirror the challenges the board must grapple with. Prospective candidates who have led and managed through unique challenges like mergers and acquisitions, a financial turnaround, supply chain issues, or reputational crisis have likely developed the kind of business acumen muscles needed to succeed in the boardroom. Consider individuals with a strong track record in driving operational excellence and cost efficiency, or those who demonstrate leadership through high employee engagement or culture scores.
- **Digital natives:** those with a deep understanding of emerging technologies and their potential impact on business models. According to the "*2024 U.S. Spencer Stuart Board Index*," which analyzes the board composition and governance practices of S&P 500 companies, 29% of next-gen directors appointed in the past year have a technology background, an increase from just 14% the prior year.
- **Younger and first-time directors:** younger leaders bring fresh thinking that can be unfettered by bias toward the status quo. The same Spencer Stuart study found that 14% of the incoming class of 2024 directors are aged 50 or under, up from 11% in 2023, although still down from a peak of 18% in 2022. And while it makes sense that most boards desire someone who has prior experience, it can be a barrier to finding the right skill sets and identifying fresh talent. Do not overlook the value of non-profit and advisory board service. While not the same as corporate board work, they can provide valuable experience to help prepare prospective corporate directors for the job.

- **Global citizens:** globalization has made it possible for companies to tap into talent from across the world. As more businesses enter or engage with new markets, understanding cultural nuances and international business dynamics is increasingly important. Companies should look beyond their domestic borders when identifying talent for their boards. By actively recruiting individuals from different countries and regions, organizations can gain valuable insights into emerging trends, cultural fluency, geopolitical issues and new consumer behaviors.
- **The importance of EQ, decision-making, and asking the right questions:** beyond technical skills, effective board members possess strong emotional intelligence, critical thinking abilities and the capacity to ask insightful questions. They should be able to navigate complex issues, build consensus and challenge the status quo—all things critical in the boardroom where building trust is paramount. Boards also should look for those who bring a learner's mindset to their work, balancing their expertise and knowledge with the curiosity that is vital to innovation and growth. Prioritizing this mindset when sourcing and evaluating candidates can give emerging talent a leg up.

Mapping board composition to strategy

From taxis and hotels to movie studios and large retailers, there is no shortage of cautionary tales featuring companies that did not anticipate the way that technology and changing consumer behavior would transform entire industries, creating new competitors and rendering certain business models obsolete. To effectively navigate the complexities of the modern business environment, boards must align their composition with the organization's strategic objectives. The board must consider not only the way the company makes money today, but also where the market is going and how that might impact the business model 2, 5 or 10 years into the future. This involves identifying the specific skills, experiences and perspectives needed to provide guidance and oversight of both current and future challenges.

The board should conduct a thorough assessment of its current composition and identify skills gaps and areas where additional experience or expertise are needed. The more thought and intention that go into developing a candidate profile, the better the odds that the board will source diverse talent and find the best candidate for the job. When sourcing prospective board members, it is important to look for T-shaped leaders. While subject matter and industry expertise are important, they must be grounded in a more holistic understanding of business strategy and operations. Think of a letter "T"—if the vertical line represents deep, focused expertise, the horizontal line across the top represents the ability to look across the business and understand how various drivers of strategy and risk in one business affect the others. In other words: business acumen.

At the same time, it is important to avoid loading up on requirements such that you create unrealistic expectations that filter out valuable talent. Overly narrow profiles, such as requiring candidates to have a specific combination of executive roles, industry experience, educational background or geographic ties, can unintentionally exclude highly capable individuals who could bring new skills, fresh perspectives and innovative approaches to the boardroom. Striking a balance between defining necessary qualifications and maintaining an open mind allows boards to consider a broader, more diverse candidate pool that brings a powerful new perspective. Ultimately, a focus on essential qualities sourced with intention—such as strategic thinking, demonstrated leadership impact and alignment with the company's mission—can build a board that is both effective and inclusive.

Expanding the reach: sourcing the right talent

To build a balanced board, it is essential to expand the reach for talent beyond the traditional sources. Historically, many boards have been composed of individuals from similar educational backgrounds, industries and networks. Broadening the pool from which board members are selected is key to increasing diversity and ensuring that different perspectives are brought to the table. To identify and attract top-tier board talent, organizations must adopt a proactive and strategic approach. There are several strategies that can help to broaden and deepen a slate of qualified board members:

- **Proactively seek a diverse talent pool:** one of the first steps in expanding the reach for talent is intentionally seeking candidates who bring different demographics to the board. This can include women, people of color, members of the LGBTQ+ community, individuals with disabilities and professionals with diverse international backgrounds. Companies can leverage partnerships with diversity-focused organizations, such as women's leadership groups or minority business associations, to identify potential candidates. Networking within these communities, as well as using specialized executive search firms that focus on diversity, can spotlight talent that might otherwise remain overlooked. Furthermore, creating a formal program to mentor and develop diverse leaders within the organization can serve as a valuable pipeline for future board positions.
- **Leverage networks**: to identify potential board candidates, tap into professional organizations, executive search firms, and alumni networks. LinkedIn is another powerful tool for discovering new talent. Using keyword searches, you can efficiently identify emerging or lesser-known professionals who align with your candidate profile. The platform also provides insights into how board members may be connected with potential candidates, making it easier to both source and vet prospective board members.
- **Expanding the search:** cast a wider net to include individuals from a wider range of backgrounds, including those outside traditional executive roles. There are several wonderful groups in the US that not only train and support highly qualified, diverse board talent and help them to board opportunities. Consider tapping these or similar organizations to create a ready-made slate of diverse candidates with skills that fit their desired profile.
- **Working with search firms:** there are dozens of reputable search firms from multinational to smaller boutique shops, that are highly effective and specialize in placing board talent. Enlisting the support of these professionals can greatly enhance efforts to diversify a board by providing access to broad networks and specialized expertise in diversity recruitment. These firms tap into databases and relationships that reach underrepresented groups, while offering tailored strategies aligned with an organization's talent strategy. Their external perspective helps overcome

unconscious biases and ensures candidates' skills match the board's needs. Additionally, search firms streamline the process by pre-vetting candidates and offering curated options, saving time and effort. Their credibility can also attract high-caliber talent, making them valuable partners in building a diverse and effective board.

- **Support new board members in the role:** there has been a lot of focus on finding and recruiting new board members, but getting the benefits of a diverse board does not work if those new directors are not set up for success. Every board is different with its own culture, personalities, policies, procedures and norms. Boards can get the most out of new talent by ensuring they have robust onboarding processes in place. It can also be helpful to pair new directors with board buddies or mentors who can help guide new directors through the spoken and unspoken rules of the road, especially during their first year of service. Finally, boards should invest in board education and development that can help directors fill gaps in their knowledge and stay current on key issues impacting the company.

Building a pipeline for talent

While expanding the reach for talent is critical, it is equally important to build a pipeline of diverse individuals who are prepared for board roles. This requires a long-term commitment to cultivating and developing emerging leaders within an organization. This is not only good for the pipeline and for good governance overall, it also serves the organization in key ways: it creates a deeper bench of well-rounded leaders who can help tackle complex business challenges. This not only supports the business, but also fosters a strong succession plan for key leadership roles. And as any executive who has served on an outside board will attest, serving as a director at another firm makes them a better leader. Getting an insider's view on how other organizations approach strategy and risk and learning from board colleagues in other industries provide invaluable perspective executives can take back and put to use in their current roles. There are two key ways that companies can play an active role in helping to increase the pipeline for diverse board talent:

- **Mentorship and sponsorship programs:** mentorship and sponsorship are key components in nurturing talent within an organization. Programs that focus on developing high-potential individuals, particularly from underrepresented groups, can help them gain the skills and experience necessary for board roles. Mentors can provide guidance on the complex business challenges, while sponsors—those in influential positions—can advocate for their protégés when board opportunities arise. Mentorship and sponsorship programs can play a crucial role in developing future board leaders. By providing guidance and support, mentors and sponsors can help individuals build the necessary skills and confidence to excel in board roles.
- **Leadership development programs:** leadership development programs that focus on executive skills and strategic thinking are essential for preparing diverse individuals for board positions. These programs should emphasize not only technical expertise but also soft skills such as communication, negotiation and crisis management, which are crucial for board-level discussions. By equipping diverse talent with the necessary tools to succeed, companies can ensure a steady stream of capable candidates for future board openings.

Conclusion

The future of corporate governance depends on the ability of boards to adapt to the evolving business landscape. By expanding the pool of potential board members, the following organizations play a vital role in identifying and training good board members by providing resources, training and networking opportunities and connecting qualified candidates with board opportunities:

Organizations helping to foster board diversity by identifying and training aspiring board members and connecting qualified candidates with board opportunities

Organization	Primary focus
50/50 Women on Boards	Increasing women's representation on boards
Ascend/Pinnacle	Advancing Asian-Americans in business
Athena Alliance	Leadership development for women across executive ranks and the boardroom
Executive Leadership Council	Increasing Black executive representation in the boardroom and executive ranks
Extraordinary Women on Boards (EWOB)	Network of experienced women corporate directors
Him for Her/Illumyn	Male allyship and gender equity/diversity and inclusion in corporate America
Latino Corporate Directors	Increasing Latino representation on boards; board training and opportunities
LGBTQ Directors Group	Increasing LGBTQ+ representation on boards
National Association of Corporate Directors (NACD)	Director certification and general development
Santa Clara Black Corporate Board Readiness Program	Increasing representation of Black leaders on boards
Women Corporate Directors	Global organization supporting women on boards

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Director skills and experiences: disclosure requirements, practices, and key considerations

Society for Corporate Governance
Randi Morrison, *General Counsel & Chief Knowledge Officer*
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Shareholders' rights to elect and remove corporate directors are among the most fundamental rights and a cornerstone of good corporate governance, enabling them to influence the leadership and strategic direction of the companies in which they invest. To help shareholders make informed voting decisions, public companies are *required* by regulation and stock exchange listing standards to provide certain detail and context in their proxy statement about their directors' qualifications. Along with satisfying regulatory requirements, it is *advisable* for companies to highlight the unique combination of qualifications, skills, experiences, and attributes (as used in this chapter, "director skills and experiences") each director—incumbent or new—brings to the board. Additionally, companies should explain how individual directors, as well as the board as a whole, add value in relation to the company's business and strategy.

This chapter explores the information gathering and disclosure practices of public companies related to director skills and experiences. It starts with a high-level overview of key regulatory requirements and investor expectations, followed by an in-depth analysis of companies' data collection and disclosure practices based on a November 2024 benchmarking survey conducted by the Society for Corporate Governance. Drawing on these findings, the chapter concludes with a discussion of key challenges companies face and practical factors they may wish to consider as they strive to provide appropriate and useful disclosures on their directors' skills and experiences. *(Please note that the topics of director and committee member independence as well as board gender, racial/ethnic, and other demographic diversity are outside the scope of this analysis and are therefore not covered in this chapter).*

Disclosure requirements and expectations

Regulatory requirements

The regulatory requirements for US public companies regarding the disclosure of director skills and experiences, established primarily by the Securities and Exchange Commission (SEC), aim to ensure investors have meaningful information about the qualifications of a company's director nominees so that they can evaluate nominees' contributions to the board individually and collectively to make an informed voting decision. The SEC's requirements are laid out in various regulations, notably Item 401(e)(1) of Regulation S-K,[1] which mandates that companies disclose key information about their directors, including the specific experience, qualifications, attributes, or skills that make the person suitable to serve as a director.

Additionally, Item 407(c)(2)(v) of Regulation S-K[2] requires companies to outline any minimum qualifications that the nominating committee (if present) deems essential for a nominating committee-recommended director nominee, as well as any specific qualities or skills the committee believes are necessary for one or more directors to possess.

Finally, while the SEC does not explicitly mandate that directors possess specific skills or experience, Item 407(d)(5) of Regulation S-K[3] requires companies to disclose whether their audit committee includes at least one financial expert.

Investor expectations

Despite variations in explicit disclosure expectations, major institutional investors generally share a focus on ensuring boards have a suitable mix of skills and qualifications to support effective oversight and alignment with company strategy. For example, BlackRock[4] expects companies to *provide sufficient information* on individual director candidates, enabling shareholders to assess their capabilities, suitability, and fit within the overall board composition; State Street Global Advisors[5] believes the right mix of skills, independence, diversity, and qualifications among directors provides boards with the knowledge and direct experience to manage risks and operating structures that are often complex and industry-specific; and Vanguard[6] seeks, among other things, *disclosure on the range of skills, background, and experience that each board member provides* and their alignment with the company's strategy (typically presented as a skills matrix).

Disclosure practices

The data in this section are derived from a benchmarking survey conducted by the Society for Corporate Governance among its members in November and December 2024. Respondents—96 primarily corporate secretaries, in-house counsel, and other in-house governance professionals—represent a diverse range of public companies across various sizes and industries. The analysis also includes an examination of similarities and differences in practices and approaches used by large- and mega-cap companies (i.e., companies with a market cap of $10 billion and up, referred to herein as "large-caps"; n=48) and small- and mid-cap companies (i.e. companies with a market cap under $10 billion, referred to herein as "small/mid-caps"; n=48).

Information gathering and compilation

Companies rely primarily on questionnaires to gather information on director qualifications for disclosure purposes

Nearly all companies represented by respondents use online or paper questionnaires to collect information on their directors' skills/ experiences. A majority review publicly accessible disclosures from other organizations with shared directorships. Publicly available online information (beyond the aforementioned disclosures from other organizations with shared directorships) also plays a significant role (*see Chart 1 below*).

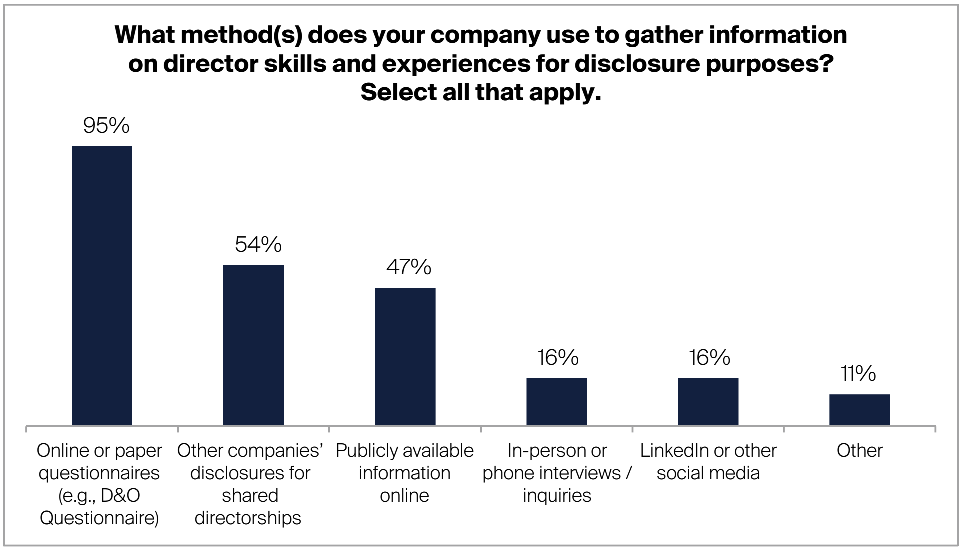
Both large-caps and small/mid-caps predominantly rely on online or paper questionnaires. However, large-caps are more likely to employ additional methods beyond questionnaires: 64% of large-caps assess other companies' publicly accessible disclosures for shared directorships, compared to 44% of small/ mid-caps. Large-caps are also more likely to use publicly available online information beyond the disclosures from other organizations with shared directorships (55% vs.38%). And while both groups are almost equally likely to use LinkedIn or other social media for information gathering, small/mid-caps are more inclined to conduct in-person or phone interviews (20%) than large-caps (13%).

Companies that use online or paper questionnaires to gather information on director skills/experiences employ different methods to compile this data for the proxy statement

The most prevalent approach is to pre-populate a list of each director's skills and experiences based on the prior year's completed questionnaire or proxy statement and ask directors to review and update the information. Another approach is to provide each director with a list of enumerated skills and experiences, asking them to respond in one of several ways: either confirm whether they possess each skill with a simple "Yes" or "No", rank their proficiency on a numeric or qualitative scale, or select from multiple levels of expertise, such as "Expert", "Some experience", or "No experience", to reflect varying degrees of competence *(see Chart 2 on page 306)*.

While companies most commonly pre-populate the list of skills and experiences using the previous year's completed questionnaire or proxy statement and ask

Chart 1

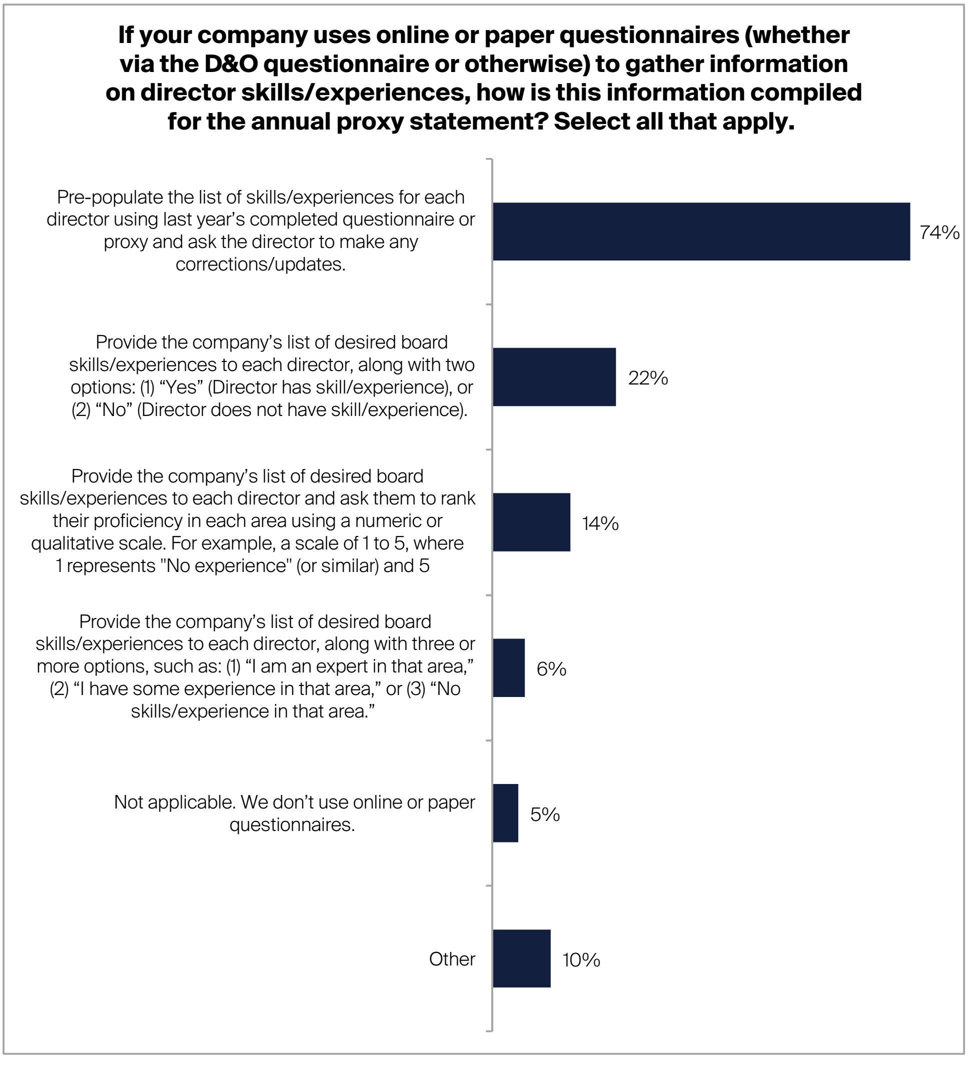


Source: Society for Corporate Governance. N=92.

directors to make updates (71% of large-caps and 78% of small/mid-caps), small/mid-caps are more likely to use additional methods to gather information: 34% of small/mid-caps provide directors with a "Yes" or "No" option to indicate whether they possess a particular attribute from an enumerated list, compared to just 11% of large-caps. Likewise, small/mid-caps are more likely to ask directors to rank their proficiency on a numeric or qualitative scale (17% vs. 11%) or to select from multiple levels of expertise (7% vs. 4%).

When it comes to limiting the number of skills or experiences a director may select or identify, 82% of companies do not impose any restrictions. In contrast, 13%

Chart 2



Source: Society for Corporate Governance. N=86.

of companies limit the number of skills and experiences a director may select or identify.

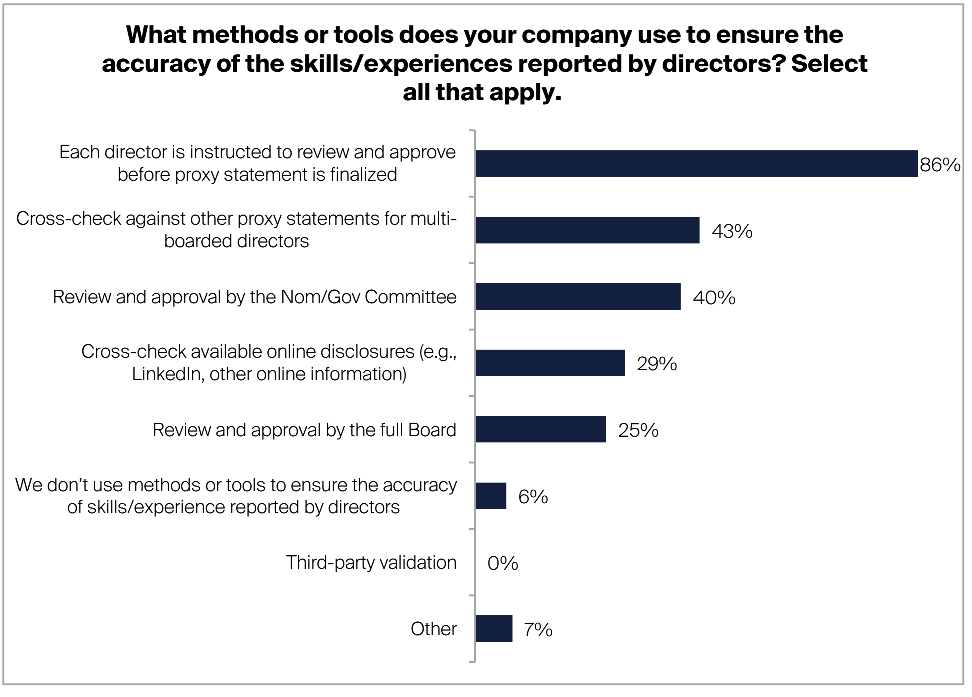
Accuracy and relevance of qualifications

Companies rely largely on internal review processes to ensure the *accuracy* of the qualifications reported by directors

Companies most commonly instruct each director to review and approve their reported skills/experiences intended for inclusion in the proxy statement before the proxy statement is finalized. Additionally, 43% of companies cross-check the reported skills against other proxy statements for directors who serve on multiple boards. A further 40% involve the nominating and governance (nom/gov) committee in reviewing and approving the reported skills. Just under a third of companies cross-check against publicly available online information, while a quarter seek full board review and approval. Notably, 6% of companies do not use any methods to ensure the accuracy of the skills/experiences reported by directors (*see Chart 3 below*).

Both large-caps and small/mid-caps primarily rely on having directors review and approve their reported qualifications before the proxy statement is finalized (84% of large-caps and 87% of small/mid-caps). Large-caps are more likely to cross-check information using other sources, such as proxy statements for multi-boarded directors (57% of large-caps vs. 28% of small/mid-caps) and available online disclosures (39% of large-caps vs. 18% of small/mid-caps). Small/mid-caps are more likely to involve their

Chart 3



Source: Society for Corporate Governance. N=83.

nom/gov committee in the review process (46% of small/mid-caps compared to 34% of large-caps).

The most important criteria in assessing the *relevance* of director qualifications for disclosure purposes are the alignment of director skills/experiences with the company's business, operations, industry, and strategy

The vast majority of companies prioritize the alignment of director skills and experiences with the company's business, followed by a significant number of companies that consider the company's operations. Industry-specific considerations play a significant role as well. Corporate strategy is another consideration for companies, ensuring that directors' skills align with the company's long-term goals.

While less common, more than a third of companies consider both peer practices and disclosures, as well as regulatory requirements, when assessing the relevance of director qualifications for disclosure purposes. Institutional investor input or feedback is taken into account by 30% of companies, while proxy advisor policies and institutional investor policies are taken into account by relatively fewer companies. Only 3% of organizations do not have *any* criteria to assess the relevance of director skills (*see Chart 4 on page 309*).

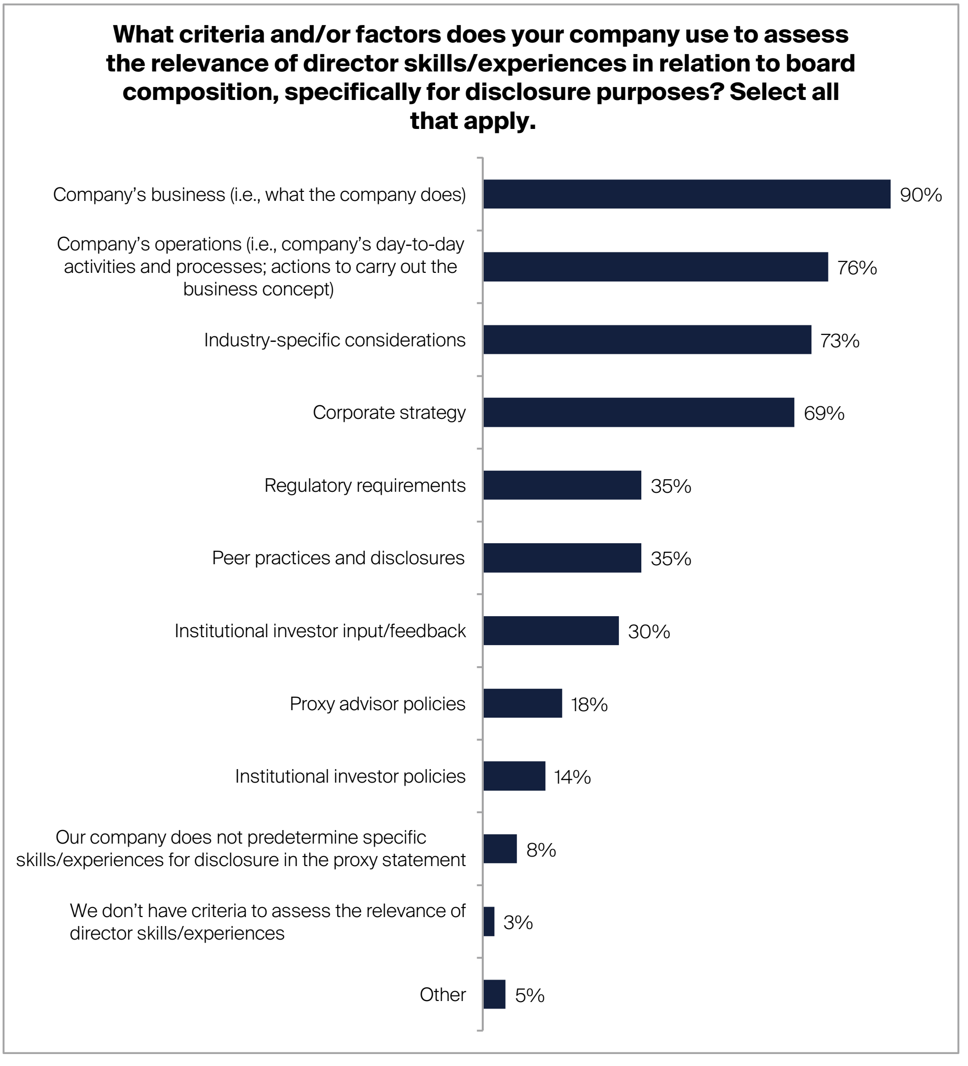
Large-caps generally employ a broader range of criteria compared to small/mid-caps when evaluating the relevance of director skills and experiences for disclosure purposes. For instance, 98% of large-caps consider the company's business, compared to 82% of small/mid-caps, and 79% of large-caps consider the company's operations, compared to 74% of small/mid-caps. Large-caps are also more likely to factor in corporate strategy (81% vs. 55%) and industry-specific considerations (74% vs. 71%). Additionally, large-caps are more inclined to evaluate peer practices (48% of large-caps vs. 21% of small/mid-caps), institutional investor input (45% of large-caps vs. 13% of small/mid-caps), and regulatory requirements (38% of large-caps vs. 32% of small/mid-caps). In contrast, small/mid-caps are more likely to consider proxy advisor policies (26% of small/mid-caps vs. 10% of large-caps). Moreover, small/mid-caps are more likely to forgo predetermining specific director skills and experiences in the proxy statement altogether (13% of small/mid-caps vs. 2% of large-caps).

Companies draw from different aspects of a director's professional background to assess the *depth* of their skills and experiences

For 63% of companies, the roles directors have held, both in the past and present, are a key factor in evaluating the depth of their skills/experiences. Formal qualifications/certifications are considered by 48% of companies. Another important factor is the duration of experience in specific areas. Additionally, a plurality of companies consider other directorships to assess the depth of their directors' qualifications. Notably, over a third of companies do not have any specific criteria to assess the depth of their directors' skills/experiences (*see Chart 5 on page 310*).

Compared to small/mid-caps, large-caps tend to employ a broader range of criteria to assess the depth of director skills and experiences: 67% of large-caps consider the positions held in current/previous roles vs. 58% of small/mid-caps. Large-caps are also more likely to evaluate other directorships (53% vs. 37% of small/mid-caps) and formal qualifications/

Chart 4



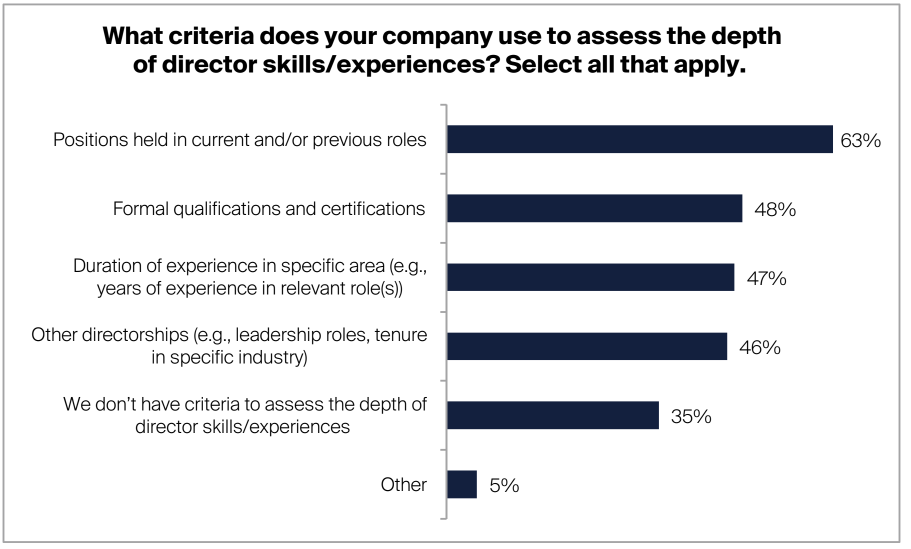
Source: Society for Corporate Governance. N=80.

certifications (51% vs. 45% of small/mid-caps). Small/mid-caps are less likely to use criteria to assess the depth of their directors' skills, with 42% of small/mid-caps reporting no criteria (vs. 28% of large-caps). Despite these differences, nearly half of each group consider the duration of experience in specific areas.

Companies value directors' overall career trajectory, rather than focusing solely on the *recency* of their experience

In fact, 51% of companies do not consider the recency of a director's skills or experience when assessing their qualifications. Meanwhile, 49% of

Chart 5



Source: Society for Corporate Governance. N=81.

companies acknowledge both recent and past qualifications in their assessments. Notably, no companies prioritize recent experience over prior experience.

Disclosure of skills and experiences

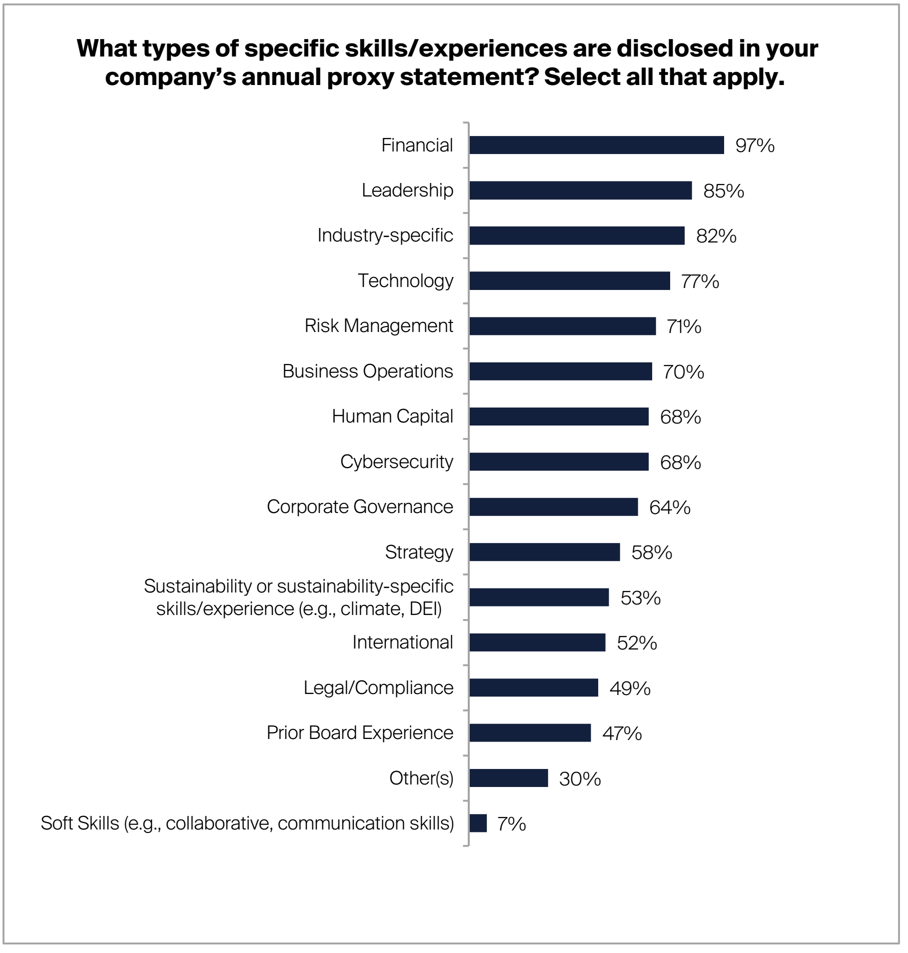
Companies most frequently disclose financial, leadership, and industry-specific qualifications in their proxy statements, highlighting the emphasis on directors' core competencies

Financial experience tops the list of disclosed qualifications, with nearly all companies disclosing in their proxy statements that their boards include directors with financial skills/experiences. Next is leadership experience, while industry-specific knowledge follows closely behind. Other frequently disclosed qualifications include technology, risk management, business operations, cybersecurity, human capital, and corporate governance. More than half of companies disclose qualifications related to strategy, sustainability, and international experience.

Almost half of companies disclose legal/compliance backgrounds and prior board experience, while only 7% disclose soft skills such as collaboration and communication (*see Chart 6 on page 311*).

Both large-caps and small/mid-caps frequently disclose financial (97%), leadership (87% of large-caps and 82% of small/mid-caps), business operations (74% of large-caps and 65% of small/mid-caps), risk management (72% of large-caps and 71% of small/mid-caps), technology (77% of large-caps and 76% of small/mid-caps), and corporate governance (64% of large-caps and 65% of small/mid-caps) skills/experiences in their proxy statement. Large-caps are more likely to emphasize their directors' cybersecurity background (79% of large-caps vs. 56% of small/mid-caps), international experience (69% of large-caps vs. 32% of small/mid-caps), and sustainability qualifications (64% of large-caps vs. 41% of small/mid-caps), whereas small/mid-caps are more likely to highlight

Chart 6



Source: Society for Corporate Governance. N=73.

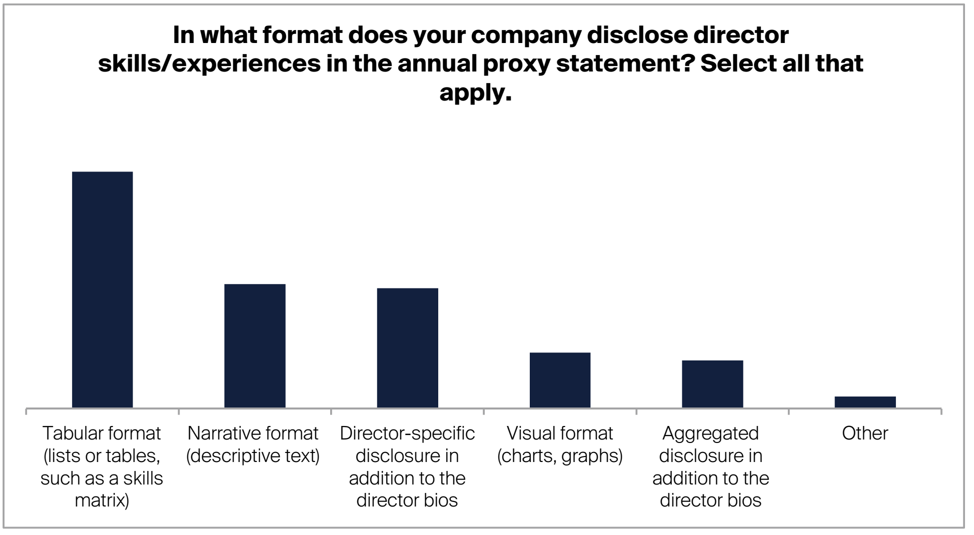
industry-specific (88% of small/mid-caps vs. 77% of large-caps) and strategic experience (68% of small/mid-caps vs. 49% of large-caps).

Most companies use tabular formats to present director qualifications in their proxy statements

A significant number of companies use tabular formats (i.e. a skills matrix) to disclose director skills/experiences in their proxy statements, followed in prevalence by narrative formats (i.e. descriptive text). In addition, 39% of companies include director-specific disclosures, in addition to the director biographies, in their proxy statements (*see Chart 7 on page 312*).

Large-caps tend to employ a broader range of formats for disclosing director skills/experiences in their proxy statements compared to small/mid-caps. While both groups favor tabular

Chart 7



Source: Society for Corporate Governance. N=77.

formats, 90% of large-caps use such formats versus 61% of small/mid-caps. Additionally, 46% of large-caps provide director-specific disclosures in addition to director biographies, while only 31% of small/mid-caps do so. Large-caps are also more inclined to use narrative formats (41% of large-caps vs. 39% of small/mid-caps), visual formats (20% of large-caps vs. 17% of small/mid-caps), and aggregated disclosures in addition to director biographies (20% of large-caps vs. 11% of small/mid-caps).

Evaluation of approach

Benchmarking against peer disclosures is the primary method companies employ to gauge the effectiveness of their director skills/experience disclosures

This approach, in which the effectiveness of director qualification disclosures is assessed by comparing them to peer disclosures, is employed by a majority of companies. Board feedback is the second most common method, followed by periodic reviews of the compilation and reporting process. Additionally, 43% gather feedback from investors, proxy advisors, and other stakeholders to assess the effectiveness of their disclosures. In contrast, relatively few companies report having no process in place to evaluate the effectiveness of their disclosures (*see Chart 8 on page 313*).

Large-caps have generally implemented a more comprehensive evaluation process for assessing the effectiveness of their director skills/experience disclosures. A majority of large-caps (71%) benchmark their disclosures against peers, compared to 42% of small/mid-caps. Additionally, large-caps are more likely to gather feedback from investors, proxy advisors, and other stakeholders (58% of large-caps vs. 28% of small/mid-caps), to seek board feedback (55% of large-caps compared to 44% of small/mid-caps), and to conduct periodic reviews (53% of large-caps compared to 42% of small/mid-caps). In contrast, small/mid-caps are more likely

Chart 8

Source: Society for Corporate Governance. N=74.

to have no formal evaluation process in place, though the difference is relatively minor (16% of large-caps vs. 17% of small/mid-caps).

Disclosure challenges and key considerations

The process of collecting, assessing, and disclosing information on director skills/experiences is complex. While most companies have developed structured methods to gather and report this data, challenges remain. For example, companies primarily use questionnaires to collect self-assessments from directors regarding their qualifications. While this approach is useful for accumulating the information needed for the annual proxy statement, it is subjective. Individual directors may apply different standards and/or definitions when evaluating their own skills/experiences, which can lead to inconsistencies in how their qualifications and expertise are recognized and ranked. Likewise, the criteria employed by companies for determining threshold levels of experience, knowledge, and expertise for disclosure vary across companies such that what may be considered expertise in a particular area at one company may be deemed merely competent or literate at another company. This can make it challenging for investors and other stakeholders to effectively assess directors' competencies and compare them—both within and across organizations. Moreover, it may raise doubts about the substance behind the qualifications disclosed.

Another challenge lies in determining *what* director qualifications to disclose and *how* to present them effectively in the proxy statement. While companies predominantly disclose core qualifications such as financial, leadership, and industry-specific qualifications, only a slim majority highlight other fundamental attributes such as strategic and international experience. While this may stem from the assumption that most directors will possess such qualifications, failing to disclose them may significantly under-represent the board's oversight qualifications and expose boards to shareholder activism.

Additionally, the way skills and experiences are presented in proxy statements can vary greatly from one company to the next. While most companies use skills matrices to summarize qualifications, these often reduce complex skillsets and decades of experiences to oversimplified categories. This not only risks turning the process into a mere compliance exercise, but can also fail to reflect the depth, breadth, and critical nuances of directors' qualifications. On the other hand, formats such as narrative descriptions, while more detailed, can make it more difficult to quickly assess and compare qualifications.

To address the challenges surrounding the data collection, assessment, and disclosure of director skills and experiences, companies can consider taking several actions, including:

- **Provide clear guidelines for self-assessment**. Providing directors with clear guidance on how to self-assess their skills/experiences will lead to more consistent, accurate, and comparable disclosures, and may reduce understating or overstating certain qualifications.
- **Enhance verification processes**. To avoid accusations of greenwashing the board, companies should validate the qualifications self-disclosed by directors to ensure they are supported by relevant data. Implementing more rigorous verification processes can make information disclosed more reliable.
- **Avoid underreporting essential director qualifications**. Key director attributes, such as strategic experience, should not be under-emphasized in the proxy statement in favor of highlighting functional expertise in areas such as cybersecurity or human capital, despite regulatory, or investor pressure to demonstrate fluency (or even expertise) in such areas. While having directors with specialized experience can be valuable, it is essential for boards to demonstrate a broad range of general qualifications needed to effectively oversee key risks and opportunities.
- **Supplement skills matrices with descriptive text**. To offer a more comprehensive view of individual director qualifications, companies should consider supplementing skills matrices with descriptive text and director-specific disclosures. This additional information can provide greater context and depth than a simple tabular format.
- **Evaluate approach to director skills and experiences compilation and disclosure**. Companies should periodically assess the effectiveness of their approach to compiling and disclosing director skills and experiences. By doing so, they can ensure that their disclosures remain accurate, relevant, and aligned with both current market expectations and the evolving needs of the business.

While there is no universal framework for collecting, assessing, and disclosing information on director skills and experiences, aligning data gathering and disclosure practices with best-in-class standards will enhance transparency and credibility, and ultimately increase the likelihood of securing shareholder confidence and support for the (re-)election of directors.

Chapter notes

1 https://www.ecfr.gov/current/title-17/chapter-II/part-229/subpart-229.400/section-229.401.
2 https://www.ecfr.gov/current/title-17/chapter-II/part-229/subpart-229.400/section-229.407.
3 https://www.ecfr.gov/current/title-17/chapter-II/part-229/subpart-229.400/section-229.407.
4 https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-engprinciples-global.pdf.
5 https://www.ssga.com/library-content/assets/pdf/global/asset-stewardship/proxy-voting-and-engagement-policy.pdf.
6 https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/policies-and-reports/us_proxy_voting_policy_2025.pdf.

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Board effectiveness: how can you get to optimal?

Pearl Meyer
Susan Sandlund, *Managing Director, Head of Leadership Consulting*

The best boards are akin to high-performing executive teams. As leadership entities, boards are overseeing organizations that have more challenges than ever. The optimal board can help management teams navigate a changing business landscape and turn obstacles into opportunity. But that optimal board is a rarity, and it does not exist by happenstance. Fostering a nimble, effective, and efficient working group of directors requires several factors: a strong set of leaders; forward-thinking, collaborative, and action-oriented individuals; commitment to near- and long-term improvements; and the proper coaching, resources, and tools.

So how do you get there? It can help to jump-start the process by first looking at what is at stake.

Why it matters

There are the well-known case studies of significant board failure such as Enron or, more recently, Theranos. Others are less egregious, yet still produced significant loss of shareholder value as a result of disengaged or ineffective board oversight in managing succession. Or there are the household names, category-leading companies that failed to address advancing market disruption. We know there are certainly boards in place today—overseeing companies with massive challenges—that will not be able to rise to the occasion and help solve those problems. When this happens, the loss goes beyond shareholders, often affecting a large workforce, customers, or the public at large. And clearly the reputations of the individuals on the management team and on the board are negatively impacted.

The basic requirement: an annual board assessment

For public companies, the Securities and Exchange Commission (SEC) requires an annual board review. It expects comprehensive, transparent board evaluation practices that demonstrate active governance oversight and continuous improvement. While there is no set prescription for what that entails, the basics include:

- disclosure in the annual proxy statement of governance practices and board evaluation processes;
- a detailed reporting on board composition and effectiveness;
- explanation of director nomination and selection criteria; and
- disclosure of board diversity and skill matrices.

The Sarbanes-Oxley Act and subsequent SEC rules further emphasize board accountability and effective self-assessment, making these evaluations a critical governance requirement for public companies.

Without question, all of the points listed above are valid and yet do not go far enough. Even these “acceptable”, traditional assessments have become insufficient in today’s complex organizational landscape. Merely outlining processes and rating a board as “good”, “okay”, or “poor” provides minimal insight into performance and development opportunities.

Simply stated, if the goal is true board effectiveness, meeting the basic requirement will not deliver the goods.

What is standard is not enough: moving to the annual assessment 2.0

Modern board evaluations must be more nuanced and customized, offering a more strategic focus on board performance and value added to the organization. This may involve analysis of governance, strategic capabilities, operational effectiveness, and individual director contributions. Questions that can help uncover a realistic picture and point to possible suggestions for improvement include:

- Does the board fully embrace and understand the business strategy and their role in advising and supporting management in delivering results?
- How is board leadership structured, both formally and informally?
- What processes determine board meeting agendas and topic selection?
- To what extent does the board allocate time for strategic discussions and analysis of external business influences versus over-indexing on details?
- Are directors adequately informed about critical emerging areas such as artificial intelligence and cybersecurity?
- What is the balance between formal reporting and interactive strategic dialog?
- How do directors describe the interpersonal and professional dynamics between board members and management?
- Does the board’s succession planning deliberately consider current needed experience and emerging skillset requirements?
- Is the board able to vary its engagement level based on organizational circumstances, in other words does it have the awareness and discipline to engage more when needed and step back when things are running smoothly?

A comprehensive assessment should provide a detailed roadmap for collective and individual growth, uncovering both potential challenges and opportunities for strategic enhancement. It should be developed with the unique needs of your board in mind, identifying the top two or three priorities that the board should be focusing on in the year to come, and aligned with what the organization and management need most from the board. The design of the assessment process ultimately must align with your board's goals and objectives.

Finally, in addition to the above-noted deeper questions of leadership, engagement styles, and strategic inclination, a revamped and leading-edge evaluation should be anchored by "what, how, and by whom." A comprehensive look at multiple aspects of the board's operation—including assessing the board's basic practices, its leadership, the individual members, and the annual agenda—covers the "what."

But just as important is the "how." Complete and actionable board reviews uncover surface-level information as well as the often more-telling subtext, and they get at this fulsome look by relying on more than just a single avenue of inquiry. Combining the learnings from survey data, interviews, and observation will provide the most accurate picture.

Lastly, "by whom" points to the necessity of an independent third party. Unproductive, difficult, or downright toxic board cultures are unlikely to be remedied by the board itself. While having a non-executive chair or lead director involved can be helpful and the non-director general counsel can also play an important internal role, a professional outside board advisor is the best option for boards that truly want to uncover opportunities for betterment.

Driving improvement: getting positive results from your effort

Assuming that you have recognized a need to look deeper and constructed a more detailed review, you now have a comprehensive picture of the board's performance. But what happens next? This is where the real work takes place. And it is the ideal point at which the required objectivity and coaching acumen of an outside advisor can be augmented by a strong board leader with a growth mindset and the will to enact change.

It is the collaborative follow-through that transforms the assessment from a routine exercise into a strategic development opportunity. Interview and/or survey findings are analyzed and summarized in a comprehensive report along with specific suggestions for enhancing board effectiveness and composition. For peer assessments, key strengths for each director are highlighted to further leverage, and areas of focus to improve individual effectiveness are noted.

The board assessment feedback report is reviewed initially with the board chair and/or nomination/governance chair and chief executive officer (CEO). This is often followed up with a full board discussion, led by the board chair, of findings and conclusions. And the next step is engaging the board in determining how to further its effectiveness and development.

The outcomes from these important discussions should include clear prioritized action plans for the board, follow-up steps, and a timeline for completion. Ongoing development sessions with the board, and potentially individual directors, to accelerate impact and overall performance is ideal.

By treating the assessment as a dynamic tool for governance enhancement—and the first step in ongoing development—boards can systematically address potential gaps and optimize their strategic capabilities.

Over the longer term, discussions among the board and its advisors can also broadly examine board culture and

Management-Led Operating Model	Strategic Operating Model	Agile Operating Model
Agenda set by management	Agenda is jointly set	Agenda is jointly set
In-room discussion is dominated by the management team and presentations	In-room presentation time is limited, with a focus on dialogue	In-room presentation time is limited, with a focus on dialogue
There is limited board/executive interaction	There are multiple and extensive board/executive interactions	There are multiple and extensive board/executive interactions
There are lower demands on directors' time	There are high demands for director engagement and time	**Board engagement varies dynamically based on the needs of the organization**

when needed, develop plans to move from a management-led approach to a more strategic and, ultimately, more agile operation, as outlined above.

Conclusion

Begin with a deep understanding of your board's capabilities and dynamics and what it needs to do in order to better support the organization

It is not all pinpointing weaknesses. Done correctly, an array of customized assessments and in-depth interviews will also help to clarify where your board is strong. It cannot be understated that highlighting and reinforcing what works well can help the board as it begins to focus on areas of development.

Build trust through candid communication

The entire process of building an effective board is based on trust earned through candid, constructive, respectful communication. This is true among the directors as well as in partnership with the board's outside advisors.

Rely on expert external advisors

Having confidence in the neutrality and professional experience of an outside advisor is central to a productive board assessment and, more so, to an ongoing development plan. Going it alone often leads to less effective outcomes and minimal impact on board value-add.

Prepare to succeed with the right development and governance plans

Thoughtful and achievable development plans and education for individual directors and the full board that are created based on each board's unique dynamics and the needs of the organization will lead to higher performance. The right board priorities and governance structure ensure that focus and effort are in the right place.

Boards that embrace this approach are far more likely to be high-performing. Cyclical reevaluation and ongoing feedback will ensure the benefits are not "one and done." The boards that can travel this road together will be in a much better position to remain relevant and effective well into the future, and guide their organizations toward long-term success.

A case in point

A post-initial public offering board took an effectiveness journey and put itself in a stronger position to guide the company through a period of turbulence.

Legacy management serving in a board leadership capacity alongside a first-time lead director had difficulty prioritizing the company's challenges. At the same time, individual directors with the talent and experience to help in several key operational areas were underutilized. To its credit, the board recognized it needed to act.

As the discussions turned to board compensation as a potential "incentive" to get all directors actively involved and working toward the same goals, the company's compensation consultant suggested that a full board assessment might be a better next step, one that could lead to helpful and actionable insights.

The board wanted to begin with a light touch and initially called for a baseline engagement, where an assessment was conducted and verbal feedback—including suggestions for individual directors and the full board—was shared. This was viewed as a beneficial exercise, and the following year the board wanted to go even further with a more in-depth and personal process that included multiple interviews and survey-based assessment tools. The output was a clear and actionable multi-step plan for the board to improve its coordination and decision-making.

The board's assessment and subsequent action plan yielded significant improvements in governance and strategic engagement. By addressing key challenges—some that were well-known and others uncovered by the assessments—the directors enhanced their collective effectiveness and were able to provide more targeted support to the CEO during a critical organizational transition.

Interestingly, rather than a toxic culture, the leadership consultant uncovered that the board's excessive deference to one another was highly collegial but hindering decisive action. Through targeted coaching, the group learned to navigate complex discussions more efficiently while maintaining mutual respect. This approach helped them reach consensus more quickly and constructively.

Additionally, the consultant identified board members with specific expertise relevant to the organization's turnaround strategy and facilitated a strategic alignment between the board and management. Follow-up discussions with the CEO focused on creating mechanisms for board members to provide more meaningful, targeted contributions to the organization's future success.

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Board composition and governance practices in the Russell 3000 and S&P 500: statistics from 2024 disclosures

The Conference Board
Andrew Jones, PhD, *Senior Researcher*

Introduction

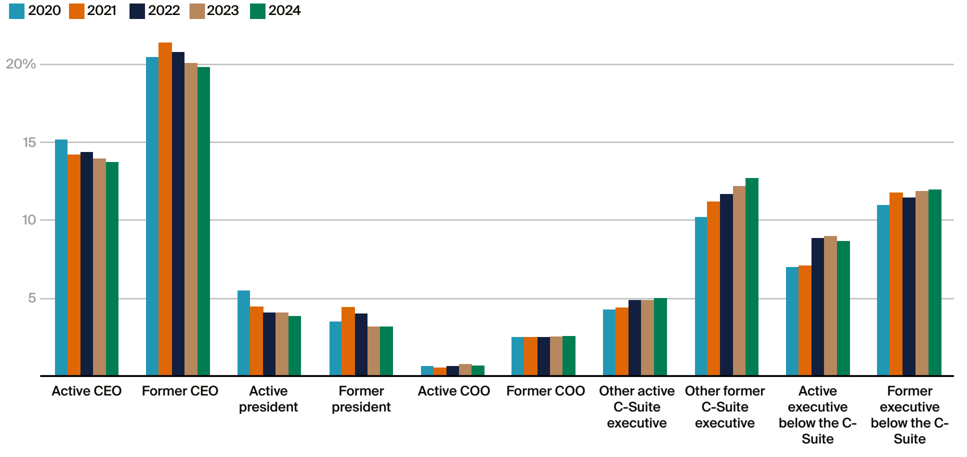
In 2024, corporate boards in the US remain at the forefront of governance evolution, navigating shifting expectations from investors, regulators, and other stakeholders. This chapter examines key trends and insights from Russell 3000 and S&P 500 disclosures, including changes in board composition, skillsets, diversity, and governance practices.[1] Amid a dynamic economic and social environment, companies are balancing heightened demands for expertise in areas like technology, human capital management (HCM) and environmental, social, and governance (ESG) with a broader push for diversity in leadership. The analysis highlights not only progress but also areas where momentum may be slowing, signaling opportunities for boards to reassess recruitment, training, and strategic alignment to meet emerging challenges.

C-Suite diversity on boards

The functional background of board members is gradually evolving in the US, with a growing number of directors bringing C-Suite and near C-Suite experience. This shift enhances diversity of thought and approach in the

[1] The data in this chapter is sourced from TCB Benchmarking platform, developed by The Conference Board and powered by ESGAUGE, which monitors US public company disclosures. Insights are drawn from their live, interactive dashboard on corporate board practices covering trends from 2018 onward, segmented by index, sector, and company size. The research, supported by the KPMG Board Leadership Center, Russell Reynolds Associates, and the John L. Weinberg Center for Corporate Governance at the University of Delaware, includes analysis of SEC filings as of 23 October 2024. For more, visit TCB Benchmarking at: https://www.conference-board.org/topics/tcb-benchmarking.

Figure 1. Independent director functional background, Russell 3000, 2020–2024



boardroom, as these executives offer deep expertise in critical areas and unique insights gained from working across organizations—not just at the top.

In the Russell 3000, the percentage of directors who are active or former C-Suite executives, excluding chief executive officers (CEOs), has steadily increased from 14% in 2020 to 18% in 2024. Directors from levels just below the C-Suite have also become more prominent, rising from 17% to 21% over the same period. By contrast, the percentage of directors who are active or former CEOs has seen a slight decline.

Notably, the representation of former CEOs grows significantly with company size, peaking at 28% for companies with revenues exceeding $50 billion, compared to just 17% for companies with revenues under $100 million. The presence of active CEOs on boards remains relatively stable across all company sizes, ranging between 13% and 17%.

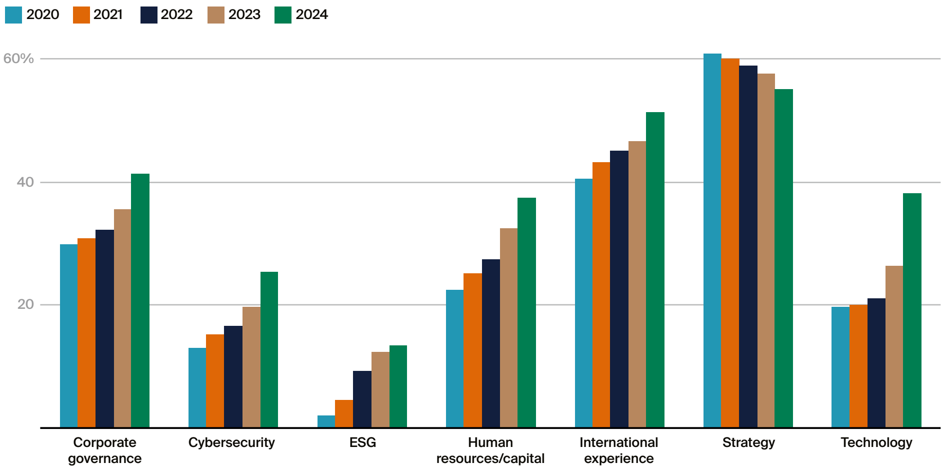
The share of active C-Suite executives—excluding CEOs and chief operating officers—diminishes as company size increases, dropping from 7% in companies under $1 billion in revenue to just 2% in those exceeding $50 billion. In contrast, the representation of former C-Suite executives remains steady, hovering around 13% regardless of company size.

Similarly, active executives below the C-Suite show a sharp decline with increasing company size, falling from 12% in the smallest companies to just 2% in the largest. Meanwhile, former executives below the C-Suite maintain a more consistent presence, ranging from 8% in the smallest firms to 13% in mid-sized companies with revenues between $5 billion and $9.9 billion.

Board expertise trends

As the corporate landscape grows more complex, the expertise of board directors is evolving to meet new challenges and expectations. In addition to overseeing traditional strategic and financial priorities, today's boards must grapple with a dynamic business environment shaped by globalization, digital transformation, regulatory pressures, and workforce shifts. While directors with strategic backgrounds

Figure 2. Independent director qualification and skills, S&P 500, 2020–2024



remain prominent, recent trends point to a diversification of experience that reflects the evolving priorities of companies and their stakeholders:

- **Global experience on the rise**: directors with international expertise have become a priority, increasing to 52% in the S&P 500 (up from 41% in 2020) and 29% in the Russell 3000 (up from 23%). This reflects growing recognition of the need for global perspectives as companies expand operations, navigate geopolitical risks, and engage international markets.
- **Governance takes center stage**: directors with corporate governance expertise saw significant gains, rising to 41% in the S&P 500 (up from 30% in 2020) and 31% in the Russell 3000 (up from 22%). This trend underscores a sharpened focus on governance amid increasing scrutiny from investors and regulators.
- **Technology and cybersecurity expertise surge**: boards are addressing digital transformation and security risks by tapping directors with technology backgrounds, which jumped to 38% in the S&P 500 (up from 20% in 2023) and 26% in the Russell 3000 (up from 15%). Cybersecurity expertise has similarly expanded, reaching 26% in the S&P 500 and 16% in the Russell 3000—doubling in both indexes since 2020.
- **HCM gains ground**: the growing importance of talent strategy and workforce dynamics is reflected in the rise of directors with HR and human capital experience, now 38% in the S&P 500 (up from 23% in 2020) and 26% in the Russell 3000 (up from 14%).
- **ESG expertise is emerging**: although still a smaller segment, the proportion of directors with ESG expertise has increased steadily, rising to 13% in the S&P 500 (up from 2% in 2020) and 9% in the Russell 3000 (up from 1%). This signals a growing need for boards to address environmental and social risks and opportunities with dedicated expertise.

These trends highlight a shift toward a more diverse mix of skills among directors, with a particular emphasis on global perspectives and business acumen, technological expertise, governance, and

HCM. This shift reflects the increasing complexity of the current business environment, where boards must navigate evolving global markets, digital transformation, regulatory scrutiny, and workforce dynamics.

Trends in gender board diversity

Gender diversity in US corporate boards has made notable strides over the past several years, with women occupying more board seats and stepping into key leadership roles. This progress reflects growing efforts to build more representative leadership teams that bring diverse perspectives to governance. However, recent data suggests a potential plateau in new appointments, signaling the need for boards to refine their recruitment strategies to maintain momentum and ensure sustained progress.

The share of women directors has steadily increased, rising from 27% in 2020 to 34% in 2024 in the S&P 500 and from 21% to 29% in the Russell 3000. Gains in leadership positions are also evident: women board chairs grew from 4% to 11% in the S&P 500 and from 5% to 8% in the Russell 3000. Women lead directors saw even more pronounced growth, increasing from 11% to 22% in the S&P 500 and from 9% to 17% in the Russell 3000. This trend reflects the expansion of a qualified talent pool, as women directors gain the tenure, expertise, and relationships necessary for leadership roles.

However, progress among new appointments tells a more nuanced story. Since 2020, the percentage of newly appointed women directors has held steady, fluctuating between 38% and 41% across both indexes. More notably, the share of non-White women among new appointments has declined since peaking in 2022. While this trend may indicate that board diversity is aligning with broader workforce demographics, it also underscores the importance of intentional and targeted recruitment strategies to ensure continued progress in advancing gender diversity.

Trends in racial and ethnic board diversity

Racial and ethnic diversity on US corporate boards continues to improve, but the pace of progress has slowed in recent years. While initial post-2020 gains

Figure 3. Women board directors, lead directors and board chairs, S&P 500, 2020–2024

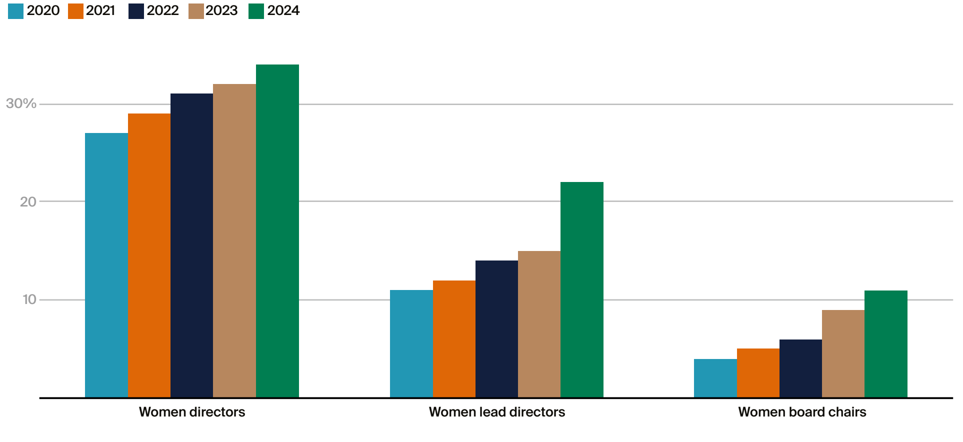
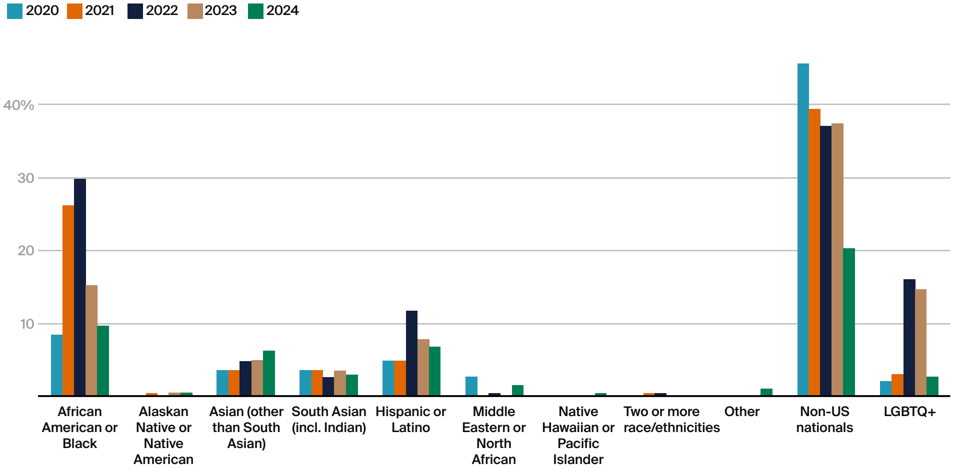


Figure 4. Newly appointed board director demographics, S&P 500, 2020–2024]



reflected significant efforts to prioritize representation, recent data points to a potential stalling of momentum, particularly among new appointments. These trends highlight both progress achieved and areas where renewed focus is needed to ensure boards reflect the broader workforce and society they serve.

The proportion of non-White directors in the S&P 500 grew from 20% in 2020 to 26% in 2024, while the Russell 3000 saw slower progress, rising from 21% to 23% over the same period. Leadership positions have also shown modest improvement: non-White board chairs increased from 8% to 12% in both indexes. However, the percentage of non-White lead directors in the S&P 500 peaked at 15% in 2022 before declining to 13% in 2024, while the Russell 3000 has held steady at 11% since 2022.

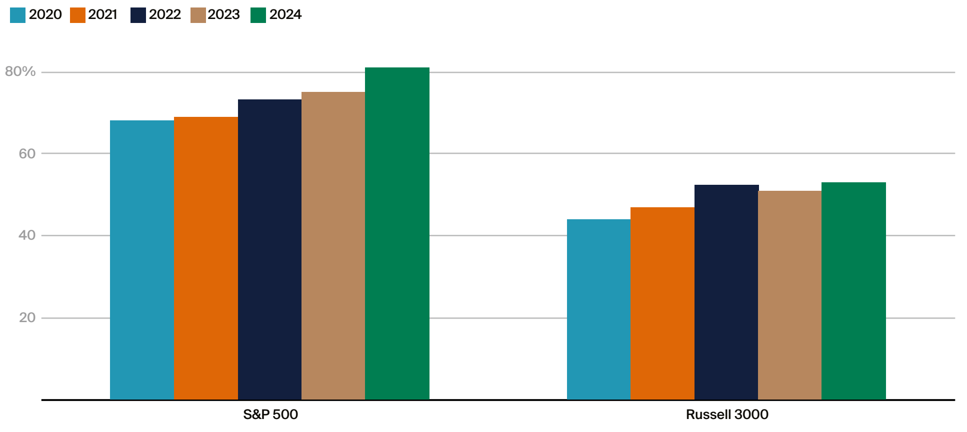
New appointments tell a concerning story. In 2024, 69% of new directors identified as White, marking a significant increase from the historic low of 52% in 2022 for the Russell 3000 and 50% for the S&P 500. This rise has coincided with declines across all non-White racial and ethnic groups, with African American or Black directors experiencing the sharpest drop—from 26% in 2022 to 12% in 2024 for the Russell 3000 and from 26% to 10% in the S&P 500. Self-identified LGBTQ+ directors also fell sharply, from 21% in 2023 to just 3% in 2024 for the Russell 3000 and from 15% to 3% for the S&P 500.

These trends may reflect a natural slowdown as boards approach alignment with workforce demographics, but they also signal challenges to sustaining progress amid increased political and social scrutiny. To maintain momentum, boards should focus on proactive recruitment strategies, including targeted outreach to persistently underrepresented groups and reevaluating how diversity initiatives are implemented and communicated.

Balancing capacity and experience: the rise of overboarding limits

As the responsibilities of public company boards grow more demanding, concerns around director capacity have taken center stage. Overboarding—when a

Figure 5. Share of companies with formal overboarding policy, S&P 500 and Russell 3000, 2020–2024



director serves on an excessive number of boards—has increasingly drawn scrutiny from institutional investors, proxy advisors, and asset managers. The steady rise in overboarding policies reflects an industry-wide focus on ensuring directors can dedicate sufficient time and attention to their oversight roles, balancing effectiveness with experience.

The adoption of overboarding policies has climbed significantly in recent years. In the S&P 500, companies with such policies rose from 68% in 2020 to 81% in 2024. In the Russell 3000, adoption increased more modestly, from 44% to 53%. A key factor behind this increase is the growing emphasis by asset managers on director capacity, with clear expectations that influence their voting decisions during board elections. For example:

- **BlackRock** limits nonexecutive directors to four boards and executives to two.
- **Vanguard** requires companies to adopt and enforce overboarding limits but avoids a uniform cap.
- **Fidelity** votes against directors serving on more than five public boards.
- **State street global advisors** caps nonexecutive chairs and lead directors at three boards and other nonexecutive directors at four.

Current policies reflect this growing emphasis on director focus. In the S&P 500, 65% of companies cap directors at three additional board seats, compared to 52% in the Russell 3000. Conversely, more Russell 3000 companies (37%) permit four seats than in the S&P 500 (29%). Company size also correlates with overboarding patterns, while the financial sector stands out, with 71% of directors holding no other for-profit board memberships.

Evolving board training and assessment practices

As boards navigate increasing complexity in business and governance, director training and performance assessments have become more common tools for enhancing oversight. In 2024, 63% of S&P 500 and Russell 3000 companies rely on in-house programs for director orientation and training. However, a growing number are supplementing these efforts with external resources. In the S&P 500, 36% of companies combine in-house and external programs, up from 23% in the Russell 3000. Fully outsourced programs remain rare across both indexes.

Board assessments are evolving as well. While 55% of S&P 500 firms now incorporate individual director evaluations alongside full board and committee assessments, the Russell 3000 lags behind, with 59% focusing only on full board and committee reviews. However, adoption of individual evaluations is rising in the Russell 3000, increasing from 24% in 2020 to 38% in 2024. Sector variations are also notable: in the Russell 3000, utilities lead in comprehensive evaluations due to regulatory scrutiny, while the energy sector lags at 28%.

Independent facilitators are gaining traction, particularly in the S&P 500, where usage has climbed from 21% in 2020 to 38% in 2024. By comparison, adoption in the Russell 3000 remains lower but is steadily increasing, rising from 10% to 17% during the same period.

Board committee trends: Meeting strategic and emerging challenges

Beyond the core audit, compensation, and nominating/governance committees, boards are increasingly adopting specialized committees to address emerging risks and strategic priorities. This shift reflects the growing need for focused oversight in areas such as risk management, technology, and sustainability. However, adoption varies widely across industries and company size, with larger firms leading the way in committee diversification.

Executive committees remain the most common non-mandatory board committee, present in 32% of S&P 500 companies and 16% of Russell 3000 companies in 2024. Other prominent committees include finance (26% of S&P 500 and 9% of Russell 3000 companies), science and technology (15% and 9%), and risk committees (13% and 12%).

Sustainability and ESG committees remain uncommon, with only 3% of S&P 500 and 4% of Russell 3000 companies establishing dedicated committees. Sectoral trends reveal notable disparities: the energy sector leads with 20% of companies having an ESG or sustainability committee, followed by the materials sector at 9%. By contrast, health care companies lag significantly, with just 0.4% reporting such committees.

Conclusion

The 2024 data on board composition and governance practices in the Russell 3000 and S&P 500 highlights continued progress and evolving priorities. Companies have broadened the range of director skillsets, particularly in governance, technology, and global experience, to meet shifting business demands. While demographic diversity shows steady gains, particularly in leadership roles, ongoing attention will be needed to sustain momentum. By balancing expertise, refining governance practices, and fostering inclusion, boards can enhance their oversight and position themselves to navigate an increasingly complex business environment.

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The future of shareholder engagement

Teneo
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The shareholder engagement strategies developed by companies and boards over the years have historically been very effective. But these shareholder engagement strategies may prove less effective in the current environment where "pro-environmental, social and governance (ESG)" and "anti-ESG" shareholders are pressing companies to move in opposite directions. This tension in the shareholder base creates a whole new dynamic for shareholder engagement, requiring a fresh look at how companies enact their engagement strategies moving forward. For example, are traditional ways of engaging with shareholders still effective? Is meeting with every potential shareholder proponent a prudent strategy? What is a reasonable definition of engagement success? To help companies prepare for the future of shareholder engagement, we provide below (i) a brief history of shareholder engagement in the US; (ii) key considerations for successful shareholder engagement strategies in 2025 and beyond; and (iii) a deep dive on how companies can best manage shareholder engagement related to diversity, equity, and inclusion (DEI).

I. How we got here

Modern shareholder engagement began almost 20 years ago with the arrival of "Say on Pay" in the US With shareholders gaining the ability to vote on a chief executive officer (CEO)'s pay package at annual shareholder meetings, company executives and boards of directors began meeting with their institutional investors to advocate for how their executive compensation plans were aligned with shareholder interests. These shareholder engagements gradually widened in scope to include topics relating to ESG issues. And for much of that time, the general sentiment from both ESG advocacy groups and institutional investors was that companies should increase their focus on ESG initiatives, such as reducing emissions, increasing diversity, and ensuring human rights in the supply chain. In many ways, shareholder engagement became somewhat predictable as there was a perceived consensus among both large and small shareholders that companies and their boards should be proactively managing their ESG risks and opportunities.

But over the past few years, staunch "anti-ESG" advocates have emerged. Unlike the "pro-ESG" advocates and most institutional investors, the "anti-ESG" advocates are pressing companies to completely abandon their ESG (and especially DEI) initiatives. They are using the same tactics as the "pro-ESG" advocates, such as submitting shareholder proposals, launching social media campaigns, and publishing "name and shame" lists. For the first time in the modern shareholder engagement era, companies and their boards now have both "pro-ESG" advocates and "anti-ESG" advocates pushing them strongly in completely opposite directions. Importantly, major institutional investors are stuck in the middle of the ESG debate, making their views more nuanced and less predictable than in years past. As such, company shareholder strategies may not be fully equipped to deal with this new and dynamic landscape. What has worked well in the past may not be suitable for the future of shareholder engagement.

II. The future of shareholder engagement

Engagement is more of a two-way dialogue

Companies have historically engaged with their largest shareholders during both US proxy season (the Spring) and the "off-season" (the Fall). These engagements have been largely focused on companies presenting their ESG strategy and areas of focus to investors. This has worked well in an era when most institutional investors were generally aligned on ESG. While it is still important for companies to present their ESG story, we believe that it is also critical that companies ensure that they understand the current ESG perspectives of their top investors—in large part because the "anti-ESG" movement has not only had an impact on company behavior but also had an impact on many large institutional investors. For example, some asset managers have meaningfully tweaked the language of their proxy voting guidelines relating to ESG. Others have begun to split their votes between European funds and US funds and/or between actively managed funds and passively managed funds. Still, others are also now offering pass-through voting that could impact future vote outcomes. Companies and boards should proactively ensure that any engagement with large investors is a two-way dialogue so that they can better understand how investors are evolving their views on ESG in today's environment.

Note that the recent guidance from the SEC on what constitutes "seeking control" for the purposes of 13D may impact investor willingness to dialogue.

Engagement success is defined more pragmatically

Historically, many companies and their boards went to great lengths to avoid a shareholder proposal appearing on the ballot, including robust engagement with the proponent. And there are still many good reasons to have this as an aspirational goal. But in today's combative ESG environment, companies and boards should expect that receiving a shareholder proposal may be inevitable and that no amount of shareholder engagement will avoid them completely. In addition, the consequences of receiving a shareholder proposal have changed dramatically in the past few years. For example, average support for shareholder proposals relating to environmental and social issues has dropped by about 10% from prior years. In fact, most environmental and social proposals receive far less than majority support and some routinely receive shareholder support in the low single digits. And since most large investors as well as Institutional Shareholder Services (ISS) only expect a response from the company if a shareholder proposal receives majority support, there is less proxy consequence from a shareholder proposal receiving 25% support from shareholders. Nonetheless, companies and their boards should discuss their specific risk tolerance levels for both the receipt of shareholder proposals as well as potential support levels.

"Shareholders" are defined more stringently

When it comes to shareholder engagement, companies have historically defined "shareholder" very broadly. Of course, asset managers and asset owners with holdings in the company have always been considered shareholders. But what about organizations that may not hold any shares, or that hold just enough shares to be eligible to file a shareholder proposal under current Securities and Exchange Commission rules? Historically, it made good sense for companies to consider these organizations like any other shareholder to better understand their perspectives on ESG issues. However, companies may want to reconsider whether continuing to engage with some of these organizations is beneficial given that (i) shareholder proposals related to an environmental or social proposal are far less likely to achieve significant support from shareholders than in years past; and (ii) some organizations have a history of unconstructive engagement and unrealistic expectations of companies on ESG issues (to be fair, some organizations may have the same complaint of some companies). Given the evolving views of large investors on ESG, it may be that some of ESG views of these organizations are grossly misaligned with a vast majority of other shareholders.

"Engagement" is defined more loosely

Engaging with shareholders has taken many different forms over the years. Prior to the Covid-19 pandemic in 2020, it was customary for companies to engage with large shareholders in person. However, virtual engagements are now generally the preferred mode for shareholder engagement as it is far more efficient and can be just as effective as in-person engagements. Regardless of the format, many engagements require intense preparation as the company wants to demonstrate its ESG strategy and thoughtfulness on a specific issue with its major shareholders. There may also be some engagements; however, that do not require intense preparation and can be conducted in "listen-only" mode. Still other engagements may be conducted via email (though it is prudent to be mindful of the many potential pitfalls of written communications). Companies should consider what mode of engagement is fit for purpose and not automatically assume every engagement requires intense preparation. Companies can also rethink which representatives should participate in the shareholder engagement to preserve valuable company resources. For example, director participation is always beneficial but may not always be necessary for certain shareholder engagements.

III. Deep dive: DEI shareholder engagement

DEI has come to mean different things to different people. We will define it here to encompass corporate policies, programs, and partnerships that support the full participation of a diverse workforce. We will also include DEI initiatives aimed at corporate partners such as customers or suppliers and communities where it operates more broadly.

The evolution of investor interest in DEI

Investor interest in DEI was first rooted in risk mitigation following the introduction of equal employment laws and the creation of the Equal Employment Opportunity Commission (EEOC) in the 1960s. Investors wanted to ensure companies were taking steps to protect against pay discrimination or wrongful termination that could lead to costly lawsuits and reputational damage.

Investor interest in DEI shifted again, first gradually in the late 2010s with a growing focus on corporate social responsibility then accelerated around 2015 with the expansion of corporate DEI disclosures and studies linking diversity to positive business outcomes. Beyond mitigating legal risk from discrimination, investors became interested in how companies were expanding talent pools and building diverse teams to boost productivity and innovation and lower turnover costs associated with poor employee engagement. This period also saw a significant increase in shareholder proposals and support for board diversity. Reuters launched its Diversity and Inclusion Index in 2016, noting a "historical shift" with investors approaching diversity as a "performance issue."

Investor interest shifted once again when companies invested heavily in DEI programs in 2020 as social inequality came into focus with the Covid-19 pandemic and death of George Floyd. Investors pressed companies to improve their DEI disclosures. This led to broader adoption of DEI reports that detail corporate programs across the business. Without a commonly accepted standard for DEI data, a growing number of US-based companies began to release their EEO-1 forms. The EEO-1 is an annual report mandated by the EEOC, disclosing workforce demographic data including sex and race or ethnicity across different job categories. When released by the company, this form provides investors with comparable data points to track over time.

DEI as a "risk factor"

Criticism of DEI is not new, but it intensified after the Supreme Court ruling to overturn affirmative action in higher education. Through lawsuits, complaints, and boycott campaigns, critics argued that DEI initiatives are discriminatory and distracting from business objectives. Similarly, anti-DEI shareholder proposals have become more common, although the number is still far fewer than pro-DEI proposals and average below 5% support.

As a result of this polarization, a growing number of companies are listing DEI as a "risk factor" in their securities filings, citing a potential business impact from taking too much or too little action on diversity. Bloomberg (https://news.bloomberglaw.com/daily-labor-report/firms-from-kkr-to-coors-flag-dei-as-a-risk-to-their-bottom-lines) found that the companies that list these initiatives as a risk factor in their 10-Ks also point to DEI in the filings as pivotal to the success of their business.

Corporate response has varied. Some companies dismantled DEI programs and positions, referencing the current political and regulatory climate. Other companies have updated certain DEI programs to mitigate legal risk while reaffirming commitment to these efforts as essential to long-term business success. Still, other companies are staying the course on DEI and making minimal changes to their programs. As of this writing, investors are engaging with public companies to understand if or how their DEI positions have evolved over the past few years.

Managing DEI in shareholder engagement

When it comes to DEI, clear and consistent communication is essential. Disclosures that link the company's DEI position to business objectives and long-term performance are more likely to be successful. Companies should prepare for investors to ask questions about any changes to the corporate strategy, especially where DEI has previously been positioned as an issue with material impact. Proactive engagement in this scenario could help boost understanding and buy in and mitigate potential legal and reputational risks associated with policy changes or public scrutiny.

IV. Conclusion

Over the past 20 years, company strategies on shareholder engagement have evolved along with investor sentiment on ESG. With the recent rise of the "anti-ESG" movement and the continued advocacy of many "pro-ESG" groups, it makes sense for companies to revisit their shareholder engagement strategies to ensure that they (i) have a solid understanding of investor sentiment on ESG; (ii) efficiently use company time and resources; and (iii) set reasonable expectations and definitions of success. Understanding recent voting records and rationales as well as researching the proxy policy changes of investors (which can be very nuanced) can be helpful.

Afterword

New York Stock Exchange

Sharon Bowen, *Chair, NYSE and Board Member, Intercontinental Exchange*

Throughout this series, we have explored the essential ingredients for good board governance, detailing the fundamental elements of board structure and composition, the evolving role of governance, and the best practices that shape successful organizations. The evolution of board governance has been a journey of continuous refinement—moving from traditional, insular boards to dynamic, diverse, and strategically engaged governing bodies. Today, effective boards are no longer oversight entities; they are active, informed stewards who help shape corporate direction, manage risk, and drive long-term value.

Over the past few decades, board governance has undergone significant transformation. What was once a relatively static function—focused on compliance and financial oversight—has evolved into a more proactive and strategic role. Companies now recognize that their boards must be composed of individuals with diverse skills, perspectives, and backgrounds. A well-composed board is not just a regulatory necessity; it is a competitive advantage. Strong governance fosters resilience, innovation, and trust among shareholders, employees, and customers alike.

The pace of change in today's business environment is unrelenting, and boardrooms must be prepared for the unexpected and ready to adapt. Boards are increasingly called upon to navigate complex challenges such as cybersecurity threats, geopolitical tensions, technological innovations, global pandemics, economic downturns, and industry-specific disruptions. Moreover, the expectations placed on boards have expanded significantly—from overseeing sustainability initiatives to addressing the evolving demands of stakeholders and regulatory bodies.

Organizations need governance frameworks that allow them to pivot quickly while maintaining stability. This means having clear risk management protocols, crisis response strategies, and succession plans in place. The best boards do not merely react to crises but rather anticipate them, ensuring that their companies are equipped to navigate uncertainty with confidence.

At the same time, good governance is not about rigidity—it is about evolution. Just as businesses must innovate to stay relevant, so too must their boards. That means continuously assessing board composition, refreshing skill sets, and ensuring that directors are aligned with the company's long-term strategy. It also means fostering a culture of openness, where board members are encouraged to challenge assumptions, ask tough questions, and bring fresh perspectives to the table. The boards that succeed in the future will be those that embrace change, rather than resist it.

At the New York Stock Exchange (NYSE), we recognize the critical role that strong governance plays in corporate success. Our mission has always been to support our listed companies by providing the resources, insights, and networks they need to thrive. As boards face new challenges and opportunities, the NYSE will continue to serve as a trusted partner, helping companies build governance structures that are both resilient and forward-looking. By fostering a culture of excellence in governance, we can ensure that businesses remain strong, adaptable, and well-positioned for the future.

Sharon Y. Bowen

Public Company Series

Board Structure and Composition

Contributor Profiles

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Professor Coffee has been elected a Fellow of the American Academy of Arts and Sciences, and is also a Life Fellow of the European Corporate Governance Institute and the American Bar Foundation. He has also been repeatedly listed by the National Law Journal on its annual list of "The 100 Most Influential Lawyers in America" and LawDragon has elected him to its Hall of Fame for M&A lawyers.

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Anu's leadership extends beyond her professional role; she is actively involved in initiatives to recruit, mentor, and develop women in finance. She serves on the Board of Trustees of Smith College and holds board positions with the American Red Cross, Youth INC, and Dress for Success. Her contributions have earned her recognition as one of Barron's "100 Most Influential Women in U.S. Finance" and American Banker's "Most Powerful Women in Finance."

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Prior to joining Korn Ferry, Tierney spent time at another global executive search firm. Her earlier experience includes account management experience with The Leo Burnett Company, a leading international advertising agency and time with a marketing consulting firm.

She currently serves on the National Make-Wish America Board. Previously, she served on the Leadership Board of the Harvard Kennedy School's Women and Public Policy Program as well as The Chicago Network.

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As a strategic advisor, she founded and leads high impact governance chair networks both prior to and in her current role, where she helps board leaders share and stay ahead of business and governance trends.

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Kim Van Der Zon is Vice Chair and Leader, Board Succession and CEO Practice, based in New York. She has deep experience spearheading large-cap CEO succession planning and searches, as well as board succession, board effectiveness, diversity, and other critical governance matters, such as shaping new boards in preparation for IPOs and spin-outs, and activist defense.

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Previously, Kim was Head of the Global Board Practice at one of the leading executive search and advisory firms. Earlier in her career, she held leadership corporate roles in the financial services and consumer sectors.

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Erin Essenmacher has more than 15 years of experience helping boards and C-suite executives navigate an increasingly complex business environment. She served on the executive leadership team at the National Association of Corporate Directors (NACD), most recently as president and chief strategy officer. In her role at NACD, she worked with thousands of board members to enhance board effectiveness and to elevate the profession of directorship. Erin has helped prepare hundreds of candidates for board service and is a frequent speaker and author on the role of the board and how it is changing. She has served on and chaired numerous non-profit, corporate and advisory boards. Erin currently serves as an advisor to companies across sectors focused on growth strategies and effective governance.

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Colin advises issuers and underwriters on a broad range of U.S. and international capital markets transactions, including registered equity offerings, private placements and convertible bond offerings. He has worked on 30 completed IPOs in the last 10 years. His experience includes playing a leading role in the IPOs of Visa and Saudi Aramco, each the largest IPO globally at the time. Colin also advises public companies at critical times in their life cycles on their obligations and options. His practice includes advice on the full range of U.S. securities laws, including proxy statements, SEC no-action letters, and ongoing reporting requirements.

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Dan Stellenberg is a partner in the Tax practice of Paul Hastings, focusing on executive compensation and employee benefits. Mr. Stellenberg's practice encompasses four broad areas: (i) support of the firm's overall transaction practices, including Private Equity, M&A, Capital Markets, and Corporate Restructurings, (ii) employment restructurings, (iii) outside compensation/benefits counsel, and (iv) representations of individual executives and management teams. More specifically, Mr. Stellenberg's practice focuses on transactional employment matters, including advising on tax, accounting, employment and securities law issues in connection with executive employment and separation agreements, equity compensation arrangements, and bonus plans.

Mr. Stellenberg's experience also encompasses employee integration and retention, due diligence, golden parachute analysis, deferred compensation issues, and public company disclosure guidance. Mr. Stellenberg regularly advises public companies, their boards and their compensation committees, private-equity firms and their portfolio companies, and private companies ranging in size from single-person start-ups to large "unicorn" companies.

Prior to joining Paul Hastings, Mr. Stellenberg practiced at three other Am Law 100 firms. His previous experience also includes working at a compensation consulting firm, where he provided independent advice to technology companies' boards of directors and compensation committees. Before becoming an attorney, Mr. Stellenberg worked as a software engineer at a semiconductor company, and he holds four United States patents relating to software modeling of semiconductor devices.

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Gil provides sophisticated legal counsel to a diverse array of clients, including U.S., European and Israeli issuers and financial institutions, across a wide spectrum of capital-raising activities. His experience spans initial public offerings, equity offerings and public and private placements of investment-grade and convertible debt securities. Beyond transactional work, he serves as a trusted advisor to clients ranging from early-stage startups to well-established, globally recognized companies, offering strategic guidance on corporate governance, SEC reporting, complex transactions and other critical corporate matters. Gil's practice reflects a broad industry focus, encompassing cutting-edge sectors such as deep-tech, cybersecurity, biotechnology, fintech, consumer and retail, and mining.

Clients consistently commend his unparalleled ability to grasp the intricacies of their industries, align with their strategic objectives, and navigate complex legal landscapes. His innovative approach and commitment to delivering efficient, practical and impactful solutions make him a valued partner in advancing their business goals

Prior to joining Paul Hastings, Gil practiced capital markets at Davis Polk & Wardwell.

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President & CEO

Paul Washington is the President and CEO of the Society for Corporate Governance (the "Society"). Founded in 1946, the Society is a not-for-profit organization with over 3,700 members dedicated to enhancing corporate governance through education, collaboration, and advocacy.

Prior to becoming the Society's President in April 2024, Paul led The Conference Board ESG Center, the premier US-based nonprofit think tank addressing corporate governance, sustainability, and citizenship. Before joining the ESG Center, Paul served for two decades as an executive at Time Warner Inc., including as Senior Vice President, Deputy General Counsel, and Corporate Secretary. Prior to Time Warner, Paul practiced law at Sidley & Austin and served as Vice President and Corporate Secretary of The Dime Savings Bank of New York.

Paul also has had a career in public service, including working at the federal, state, and local levels—and in all three branches—of government. Paul has served on over two dozen other boards of cultural, civic, and professional nonprofit organizations. For more than a decade, he was an adjunct Professor at Fordham Law School where he taught corporate governance. Paul graduated *magna cum laude* from both Yale College and Fordham University School of Law.

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John R. Sinkular is a partner at Pay Governance. For over 25 years, he has assisted companies with designing their executive pay programs to achieve talent objectives and drive shareholder value. John consults with publicly-traded, privately-owned, and pre-initial public offering (IPO) companies ranging in size from S&P 500 companies to start-ups that are based in North America and Europe with operations spanning other regions of the globe. His work includes compensation strategy, peer group development, pay benchmarking, annual and long-term incentive plan design, perquisites, pay-performance analyses, board pay, and special situations. John works with companies in a variety of industries, business stages, and situations including helping companies with the pay implications during times of significant change (IPO, transformation, mergers and acquisitions, and change-in-control).

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Mike Kesner is a partner at Pay Governance LLC and is an experienced executive compensation professional with over 30 years of consulting experience. He advises a number of companies' board of directors and senior executives on executive compensation and corporate governance matters. He is a thought leader, a featured speaker, and author on the topic of executive compensation and corporate governance. Mike has served on the advisory board of Compensation Standards and was a member of the Blue Ribbon Commission on Executive Compensation. Mike became a partner at Pay Governance LLC in July 2020 after retiring as a Principal of Deloitte Consulting on 2 June 2018, under the Firm's mandatory retirement provisions. Prior to his retirement, Mike was the partner in charge of Deloitte's US Compensation Consulting practice. He began his career at Arthur Andersen and was the partner in charge of the executive compensation practice until May 2002.

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Blair Jones has 30 years of executive compensation consulting experience. She has deep expertise in advising boards on company transitions, significant investor concerns, and an expanding human capital management mandate. Previously, Blair was the practice leader in Leadership Performance and Rewards at Sibson and an Associate Consultant at Bain & Company. Blair holds the designations of Certified Benefits Professional, Certified Compensation Professional, and Certified Executive Compensation Professional. Since 2013, Blair has consistently been named to the D100, National Association of Corporate Directors Directorship's annual list of the most influential people in the boardroom community, including directors, corporate governance experts, regulators, and advisors. Blair serves on the Mohawk Valley Healthcare System's foundation board and is the Women's Giving Circle leader. She also serves on the advisory board for M3 Placement & Partnership.

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Todd has over 20 years of executive and board compensation consulting experience, joining Semler Brossy in 2002 and named managing director in 2005. Prior to Semler Brossy, he was a senior vice president in Bank of America's Asset Management Group and a trader in listed equity options for O'Connor & Associates.

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Mr. Winter has extensive experience advising innovative and disruptive companies on complex, high-profile transactions. He counsels companies, founders, investors, and investment banks on capital markets matters, including late-stage financings, IPOs, follow-on offerings, exchange offers, and tender offers. Notable representations include WeWork in connection with a $4.4 billion investment from SoftBank, joint ventures, convertible financings, and IPO preparation. He has led growth equity financings for unicorns like Binance.US, Cava, Celonis, Hopper, Nextdoor, Squarespace, and Via. Mr. Winter has also advised Fiverr, NeoGames, Outbrain, and Vroom on IPOs and follow-ons, and represented private companies such as Celonis and WeWork in equity tender offers. His work also spans debt offerings for major companies like Pfizer, DuPont, and General Motors. Beyond transactions, Mr. Winter assists with SEC filings, investor relations, and stock exchange matters. While in law school, he advised startups through Harvard's Innovation Labs and the Harvard Law Entrepreneurship Project.

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Randi Val Morrison is the General Counsel and Chief Knowledge Officer of the Society for Corporate Governance, where she is the lead for content, programming, and day-to-day member engagement, and represents and advises the organization on its legal rights and obligations. With extensive experience in corporate governance, securities law, regulatory compliance, and executive leadership, Randi also develops and supports the organization's policy and advocacy efforts, including regulatory comment letters and strategic initiatives.

Prior to joining the Society in 2013, Randi served for 20 years as General Counsel and Corporate Secretary and in similar in-house roles for publicly traded companies in the homebuilding and construction, big box retail, automotive parts and accessories, and food and beverage industries overseeing the legal, risk management, investor relations, and internal audit functions. Randi has a JD and BA (Political Science) from Washington University in St. Louis.

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Prior to rejoining the Society, Merel was a Senior Researcher at The Conference Board's ESG Center where she wrote publications on corporate governance and related ESG topics, and was featured in major outlets, including Financial Times, Fortune, Forbes, Reuters, Bloomberg, and Politico. She also worked at CamberView Partners, advising public companies on shareholder engagement and activism.

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George has been recognized multiple times as one of NACD's Directorship magazine's 50 Most Influential People in Governance. He has contributed to prominent publications, including Harvard Business Review and The Wall Street Journal, and frequently speaks at events for leading governance organizations

Previously, he was a partner at Tapestry Networks and held roles at Toffler Associates and Accenture. George holds an M.Ed. in human development and psychology from Harvard University and a B.A. in philosophy from Haverford College. He serves on nonprofit boards and is a former trustee of Massachusetts Technology Collaborative (MassTech).

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Specializing in CEO searches, succession, and board development, he has led over 300 CEO and board transitions and has helped many founders with their succession and transition plans. Jason holds an M.B.A. from Stanford University and a B.A. in economics from Vassar College. Jason is frequently cited in top publications including Fortune, Financial Times, Bloomberg, and Harvard Business Review.

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Previously, Julie was the executive director at Catalyst, where she focused on identifying qualified women for corporate boards. She began her career at McKinsey & Company. Julie holds an M.B.A. in corporate finance from the Wharton School at the University of Pennsylvania. She serves on the boards of The Jackson Laboratory, CityMeals, and The Palm Beach Food Bank and is a commissioner for the Women's Refugee Commission.

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Mayree Clark is an experienced independent director who works with both public and private companies.

She spent her career as a leader in the investment banking and investment management industries with Morgan Stanley, AEA/Aetos, and Eachwin Capital.

Today she serves on the board of Ally Financial as a member of the Audit and the compensation, nomination, and governance committees. She is a member of the Supervisory Board of Deutsche Bank, AG, where she chairs the risk committee and is a member of the strategy and nomination committees. She has served as an independent director on the boards of multiple private equity sponsored companies in the enterprise software/data arena.

Mayree is a life member of the Council on Foreign Relations, a director of the Tricycle Foundation and the Wikimedia Endowment, and chair of the Silverleaf Foundation. An alumna of the Stanford Graduate School of Business, Mayree co-founded Stanford Women on Boards in 2009 and currently serves on its Executive Leadership Team.

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Linda serves on the board of two S&P 500 companies, the CSX Corporation and MSCI, Inc., where she chairs the governance committees. She has extensive private equity and nonprofit board experience and continues to serve in various leadership positions and has a passion for high-performing teams. She currently serves on the Executive Leadership Team of Stanford Women on Boards where she has co-authored numerous articles, developed roadmaps, and led forums with her colleague, Mayree Clark, discussing and implementing Leading Edge Stewardship practices.

Linda retired from Morgan Stanley in 2013 after a 25-year career where she served on the management, risk, and operating committees of the firm. She earned her Master of Business Administration from Stanford University and her Bachelor of Arts from Princeton University. She is a former competitive collegiate athlete and an identical twin. Linda lives in Locust Valley, NY, and is married with three daughters.

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Merritt Moran is a recent graduate of Stanford Graduate School of Business where she volunteered as an analyst on the Stanford Women on Boards Leading Edge Stewardship team. She conducted research at Stanford on leadership, corporate responsibility, and diversity in the finance function.

Merritt is a strategic finance leader passionate about driving innovation and delivering measurable impact. With experience in healthcare, insurance, technology, and consumer goods, she specializes in linking financial strategy to operational success. Merritt earned her Bachelor of Science from Georgetown University and is an active community volunteer. She also supports organizations like Girls on the Run Minnesota.

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Mr. Levine has received the "Entrepreneur of the Year" award from Ernst & Young and Inc. Magazine. In 2011 and 2012, the National Association of Corporate Directors named him to the "Directorship 100," recognizing him as one of the most influential directors in the governance community, and appointed him to the NACD Nominating/Governance Advisory Council.

He was the former global CEO of Dale Carnegie & Associates, Inc., which operated in 72 countries, and has served on over 17 boards, including the Nominating & Governance Committee and Audit Committee of Broadridge Financial Solutions.

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Dr. Martha L. Carter is vice chairman and head of Governance Advisory with Teneo. She advises chief executive officers and boards on corporate governance, sustainability, activism defense, executive compensation, shareholder engagement, strategy, and other matters. Martha sits on the advisory council of the Harvard Corporate Governance Forum and previously sat on the markets advisory council at the Council of Institutional Investors. She has certifications in Sustainability Accounting Standards Board and Task Force on Climate-Related Financial Disclosures reporting frameworks.

Previously, Martha was the head of global research at Institutional Shareholder Services (ISS) and chair and founder of the ISS Global Policy Board. At ISS, Martha led Global Research's team of governance analysts in 10 offices worldwide. Martha's team provided institutional investors with research and voting recommendations on more than 38,000 companies in 115 markets.

Martha has been quoted in the media worldwide and has been a speaker at corporate governance events. She has also written articles for a number of publications, including: *NYSE: Corporate Governance Guide*; *International Foundation of Employee Benefit Plans Benefits Magazine*; *ICGN Yearbook*; and *Financial Analysts Journal*. In 2022, she was named one of the Top 25 Women Leaders in Consulting by *The Consulting Report*.

Martha holds a Doctor of Philosophy in finance from George Washington University, and Master of Business Administration in finance from The Wharton School, University of Pennsylvania, and undergraduate degrees in mathematics and French from Purdue University.

Matt Filosa

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Matt Filosa is a recognized leader and trusted advisor on governance and sustainability issues with over 20 years of experience from an investor, public company, and academic perspective. His experience includes serving as senior managing director at Teneo Consulting, vice president and director of corporate governance at MFS Investment Management, and associate director of the Harvard Law School Program on Corporate Governance.

In his current role at Teneo, Matt advises executives and boards of directors on how institutional investors incorporate governance and sustainability issues into their investment and stewardship activities. He also provides companies with strategic insight into sustainability reporting, annual shareholder meetings, ratings and rankings, disclosure frameworks, shareholder engagement, corporate governance, and activism defense.

During his 13-year tenure at MFS Investment Management, Matt built and managed the firm's first global governance and sustainability stewardship program for $500 billion in assets under management. Matt also managed the firm's commitment to the principles for responsible investment and was a founding member of the firm's Responsible Investing Committee and Environmental, Social and Governance Working Group.

During his semester at the Harvard Law School Program on Corporate Governance, Matt managed the Harvard Law School Corporate Governance Forum—a thought leadership blog focused on governance and sustainability issues—and directed the program's events and sponsorship activities. He was also a contributor to the Harvard Law School corporate governance curriculum.

Matt has been a guest lecturer on governance and sustainability at Harvard Law School, Boston University School of Law, and Tufts University. He is a member of the Council of Institutional Investor's Markets Advisory Council and was a founding member of the US Investor Stewardship Group.

Matt contributed the corporate governance chapters of two publications: "The Fund Industry: How Your Money is Managed" (Robert C. Pozen and Theresa Hamacher, 2014), which is considered the main textbook on the mutual fund industry; and "Too Big To Save? How To Fix the US Financial System" (Robert C. Pozen, 2009).

Matt earned a Bachelor of Arts from Tufts University and a Master of Business Administration from Boston University.

Faten Alqaseer

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Faten Alqaseer specializes in global issues management, long-term remediation, and business transformation across a broad range of business, financial, and societal matters. Faten also co-leads Teneo's diversity, equity, and inclusion (DEI) advisory and is a senior member of the firm's environmental, social and governance practice.

Faten provides counsel for Fortune 100 companies as they navigate evolving stakeholder expectations around a range of social issues. Her work encompasses advising on boardroom diversity and public policy to goal setting and corporate disclosure. Faten has extensive experience developing and executing tailored DEI strategies that align with business priorities and enhance company performance.

As a leader in Teneo Ventures, she directs investments in early-stage enterprise solutions that use technology to improve the way companies do business. Faten is responsible for scaling and commercializing portfolio companies in subsectors that include recruiting, employee engagement, and sustainability.

Prior to joining Teneo, Faten co-founded an EdTech start-up in Bahrain to deliver career development services. She started her career at Bank of America Merrill Lynch where she focused on growing the Company's MENA Central Bank and Sovereign Wealth Fund business.

Having worked across the United States, Europe, and the Middle East, Faten is an expert in cultural norms across continents and is fluent in Arabic.

Faten holds a Master of Business Administration in Management, Business Economics, and Public Policy from The Wharton School, where she was director of investments at Wharton Social Venture Fund 2013–2014. She has a Bachelor of Arts in Economics and International Relations from Cornell University.

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Founded in 1931, Weil has provided legal services to the largest public companies, private equity firms and financial institutions for more than 90 years. Widely recognized by those covering the legal profession, Weil's lawyers regularly advise clients globally on their most complex Litigation, Corporate, Restructuring, and Tax, Executive Compensation & Benefits matters. Weil has been a pioneer in establishing a geographic footprint that has allowed the Firm to partner with clients wherever they do business.

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Evert has a robust Delaware law practice, and regularly defends public companies, private equity funds and their portfolio companies, and directors and management in complex litigations in Delaware Chancery Court and Delaware Supreme Court (as well as other important corporate law venues), including breach of fiduciary duty class and derivative litigation, appraisal trials, demands for corporate books and records, and other corporate disputes.

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Kaitlin counsels clients on a breadth of corporate governance and compliance matters in M&A, capital markets and corporate restructuring transactions and regularly advises on SEC regulations and governance issues faced by newly-listed public companies and private companies (and their sponsors) preparing to go public, as well as seasoned public companies engaging in strategic transactions.

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Matthew also counsels clients on a broad range of corporate, securities and business-related matters, including fiduciary duties, corporate governance, disclosure issues and compliance matters, as well as defensive measures, takeover tactics, proxy fights and other contests for corporate control.

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Lyuba advises on a breadth of company governance and compliance issues, including fiduciary duties, director independence, board and committee structure, risk oversight, ESG and sustainability matters, securities law compliance, executive compensation and other employment matters, board leadership structures, shareholder proposals, shareholder engagement and the impact of evolving stakeholder concerns, and corporate governance "best practices."

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Priya serves on two public and two private company boards as well as on the advisory board of the Stanford Rock Center for Corporate Governance. She was named a Directorship 100 honoree by the National Association of Corporate Directors in 2024. Prior to joining Woodruff Sawyer, Priya practiced corporate and securities law at Wilson Sonsini Goodrich & Rosati.