

BRIDGING BOARD GAPS

*Report of the Study Group
on Corporate Boards*

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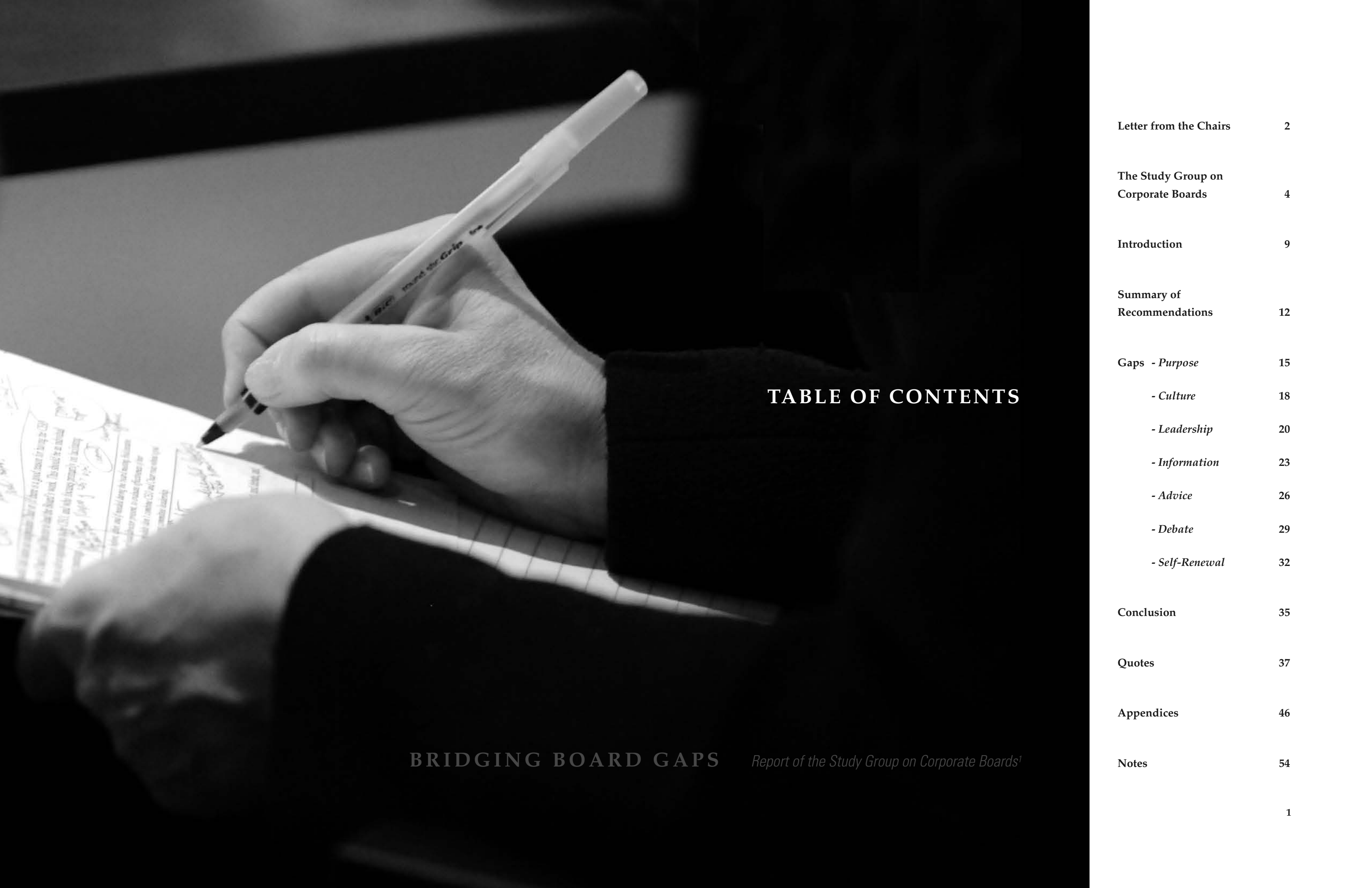


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LETTER FROM THE CHAIRS

“There is too great a gap between the popular notion of what boards do and the reality of what they are capable of doing. Furthermore, the existing system limits the depth of board oversight. We must either change the system or change expectations.” Frank Zarb

Recent institutional failures, surrounded by general economic turmoil, once again sparked the familiar question: *Where were the boards?*² Although the root causes of the financial crisis went well beyond governance, boards have been a focus of many reforms. The Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act), a 2,319-page law, required federal agencies to conduct 81 studies, submit 93 reports, and pass more than 500 rules – including rules directly impacting the boards of all public companies.³ But the new rules for public company boards are focused on board *process*. In addition, boards need a renewed focus on their aspirational *purpose* and guidance for achieving it. They need to recognize the gaps between governance ideals and governance realities – recognizing which gaps can be closed and which may continue, given the process and structure fundamental to our market’s operation.

To identify and address the most critical board gaps, we assembled a group of significant participants in the current governance system, including leaders from academia and the accounting and legal professions, as well as individuals who have led major corporations and boards. Our group also includes a former U.S. Secretary of the Treasury, a former Chair of the Securities and Exchange Commission (SEC) and of the Council of Economic Advisers, and the former general counsel of the SEC (serving *ex officio*). As a diverse group of leaders and experts, we sought to contribute to what we see as a continuing process of improvement in board practices and standards and director attitudes, while acknowledging that board work is an art as well as a science. Our Report aims to show how boards can fulfill their potential in various critical areas. After discussing dozens of general governance topics, we identified seven core problems. Then we drew solutions from the laboratory of real life, based on our own experience.

Our solutions are intended to be practical – new routines boards can adopt (and adapt) to improve the way they operate. We want to give boards a fighting chance to succeed. We hope to contribute to what we see as the gradual but positive improvement of board practices and standards and director attitudes. We hope that this Report will be a guide to boards, stakeholders, and policy makers in order to set rigorous yet realistic expectations for boards and for those who depend on them to deliver. We are grateful to the Rockefeller Foundation for financial support for the Study Group.

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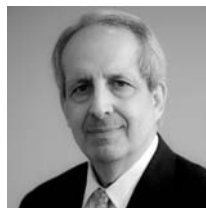
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The Study Group gratefully acknowledges administrative support from **Alba Bates**, Weinberg Center of Corporate Governance, University of Delaware, and **Wilhelmina Sanford**, Columbia Business School.

INTRODUCTION

How can boards improve? Corporate governance is not subject to easy generalizations. Every company has unique circumstances, and no two directors are alike. Furthermore, corporate problems can arise that do not stem from inadequate governance.⁶ This Report attempts to bring out the best in our basic model of governance for public companies – an independent board overseeing and advising full-time managers on behalf of the corporation and its shareholders.

This model poses an intrinsic dilemma. The roles and responsibilities of directors are designed to provide direction, oversight, and advice on a part-time basis for a limited duration to the professional executives who manage the day-to-day affairs of the corporation.⁷ Over the years, directors have been devoting more time to their roles, but there is a natural limit to this time.⁸ Directors were not elected to run the daily affairs of the corporation – that is management’s role. Taken to an extreme, full-time, long-tenured members of a board could themselves become “insiders” in need of the monitoring and perspective an independent board can bring.⁹

The Study Group believes that improvements can be made within the existing model by changing the manner in which directors do their jobs. This change does not merely entail putting in more hours (although the Study Group recognizes board service is a significant responsibility entitled to as much effort as required) but instead may involve working more effectively. But how?

The aim of this Report is to encourage meaningful improvement in the effectiveness of public company directors. As an initial matter, directors must accept that boards work part time (typically meeting six times a year for two days per meeting¹⁰) and generally receive the bulk of their information from management. Directors are not a full-time board of managers, nor does the Study Group suggest they should be. Yet directors must be on the front lines for the constructive oversight of public companies; regulators alone cannot do this job.¹¹ To this end, it is worth considering how to empower part-time boards to a greater extent.

The Study Group is aware of the many governance solutions already reached – or now under way – including the following noteworthy initiatives:

- From directors themselves, who have been working for decades to set voluntary standards, we have a score of Blue Ribbon Commission reports from the National Association of Corporate Directors (NACD). NACD has also published a set of “Key Agreed Principles” expressing points of agreement among the NACD reports and reports from the two other primary corporate constituencies – CEOs (represented by the Business Roundtable) and investors (represented by the Council of Institutional Investors and the International Corporate Governance Network).¹² The Corporate Laws Committee of the Section of Business Law of the American Bar Association publishes *The Corporate Director’s Guidebook*, now in its fifth edition. The Committee is revising that edition and is expected to publish a sixth in the spring of 2011.

- Shareholders have provided numerous resolutions aimed at changing practices for director nominations and elections, board leadership, CEO compensation, and myriad other topics voted on during every proxy season. Some are advisory or precatory resolutions that leave boards discretion – the power to make choices. Others change board processes in more definitive ways.
- Courts have also offered useful principles for the board’s work. Case by case, the courts have carefully identified the fact patterns behind corporate problems, and, based on the merits of each case, have judged directors on the processes they used and on the care, loyalty, and good faith with which they created and followed these processes. Taken together, cases involving boards provide a treasure trove of guidance for boards.
- Congress, regulatory agencies, and the stock exchanges have put forth a number of “bright-line” standards for boards in the aftermath of the Public Company Accounting Reform and Investor Protection Act of 2002 (Sarbanes-Oxley) and the Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank).¹³ Along these same lines, the New York Stock Exchange recently issued a set of principles to guide the interaction of corporations, investors, and regulators.¹⁴

All these efforts (detailed in Appendices A through C) are commendable, but in our view, *gaps remain* between what boards can do and what they actually do. To close those gaps, we make recommendations in the following areas:

- Purpose
- Culture
- Leadership
- Information
- Advice
- Debate
- Self-Renewal

The recommendations, summarized and explained in the following pages, would apply to all public companies, but directors must evaluate them in light of their company’s specific needs. Boards must understand the purpose, plans, and strategies as well as the strengths and weaknesses of the organizations they serve. They must appreciate the instrumental steps required for the board to make its best contribution to the organization, within the full scope of its monitoring and advisory role. Each recommendation will require adaptation and fine-tuning based on the circumstances at hand.

Our goal is to move in the direction of progress by suggesting actions boards can take to bridge the most critical chasms between what they are today and what they can become tomorrow.

SUMMARY OF RECOMMENDATIONS

Purpose

Boards must understand their purpose: to ensure that the corporations they serve create sustainable long-term value for shareholders.

- *As individual directors and as a board, strengthen awareness of long-term shareholder value and foster it in others.*
- *Ask with every discussion: How will this decision affect long-term shareholder value?*
- *Review and refresh governance documents to focus on this purpose.*

Culture

As part of a “tone at the top,” boards must practice appropriate rules of engagement between management and the board – engagement that serves the long-term interests of the company and its shareholders.

- *When evaluating the CEO, ask: Does this person understand, respect, and foster the role of directors as guardians of long-term shareholder value?*
- *Ask with every discussion: How will this decision impact our company’s values?*
- *Consider creating a Values Statement for internal board use and sharing this statement with management, shareholders, and the public.*

Leadership

The default for board structure should be the independent Chair.¹⁵ However, there are circumstances when a board may legitimately choose to join the roles of CEO and Chair. In such circumstances, we recommend a lead director empowered to call meetings and generally act as a first among equals.

- *Periodically ask: Does our leadership of the board and committees – in both the structure we use and the people we choose – give the board ownership of its agendas and meetings? If not, make appropriate changes.*
- *Run executive sessions routinely before and/or after – and, if needed, during – the board meeting.*
- *Hold these sessions occasionally without the independent Chair/lead director present in order to evaluate the effectiveness of his/her leadership.*

Information

Directors should periodically review the company’s information-reporting format and content to ensure that they adequately inform the board and its committees on all topics relevant to corporate growth and well-being. Directors should also regularly receive a concise and comprehensible report in plain English on risks facing the company, in order of importance. Any additional information can be provided in appendices.

- *Encourage direct dialogue with the entire organization by having routine contact with employees beyond the senior management team.*
- *Organize periodic meetings with major shareholders, having counsel present to ensure compliance with company policies as well as with rules and regulations, including Regulation FD.*
- *Make full use of available technology to improve understanding of the perspectives and sentiments of all shareholders.*

Advice

Directors should not hesitate to use third-party experts to advise the board or a board committee in important matters where they believe that outside advisors would improve the quality of the board's decision.

- Use advisors whenever needed, including for a regular review of critical risk areas.
- Set a budget for all board expenses, including expenses for the retention of advisors.
- When engaging advisors, do not limit your choices to the ones already retained (such as external auditors), but consider a wider range of experts as needed.

Debate

Chairs should foster an environment of discussion and debate, recognizing the benefits of disagreement and dissent, when necessary, in achieving better decisions.

- As a Chair, encourage constructive skepticism, debate, disagreement, and, when necessary, dissent.
- As a director, speak your mind and ask questions.
- As a board, build a culture of candor and trust.

Self-Renewal

Boards should institute a regular, formal process for board and director evaluation. This process should be legally encouraged and protected – and balanced with term limits based on company needs. Additionally, board members should receive continuing education on topics related to their board service.

- Engage in frank and meaningful discussion about the suitability of the current board composition for advancing the company's long-term value, seeking the views of shareholders as part of this effort.
- Set a process for rotation of board and committee leaders.
- Develop policies and practices to ensure ongoing evaluation and education of current directors, using the services of an independent third-party facilitator when needed, and considering education both on and off site.

The views expressed here represent those of individual Study Group members and do not necessarily represent the views of their organizations. Furthermore, this Report is a collective document. Although not every member agreed with every conclusion, this Report represents a consensus of the views held by the Study Group as a whole.

“Maybe we should rename directors ‘shareholder representatives’ – then they would pull up to the table in the right mind-set.” Ralph Whitworth

“More often than not, long-term shareholders and stakeholders share common interests – and it is the role of thoughtful directors to work with management to set the corporation on that course toward long-term value creation.” Damon Silvers

PURPOSE

“Corporations are managed under the direction of a board of directors for the purpose of protecting and enhancing the corporation's long-term value to stockholders. The directors' fiduciary duties of care and loyalty, carried out in good faith, are the indispensable means to that end.” E. Norman Veasey

Every institution of integrity wants to excel at what it does. *So what do boards do?* In the view of this Study Group, corporate boards serve a distinct economic purpose – monitoring and advising a corporation for the purpose of creating sustainable long-term value for shareholders. While shareholder value is the ultimate goal, boards must, as a consequence, be concerned with other constituencies whose effort is required to produce value. We believe that these two considerations converge in the attainment of long-term value.

Generally speaking, in addition to making the fundamental corporate decisions that they are required to make by law,¹⁶ board responsibilities include:

- Approving corporate goals, strategy, and planning
- Monitoring and advising business performance
- Controlling CEO and senior management compensation
- Participating in and approving succession planning (including hiring, evaluating, and, when necessary, firing the CEO)
- Taking reasonable steps to ensure appropriate financial disclosure
- Taking reasonable steps to ensure that an appropriate risk management system is in place (and monitoring that system once it is in place)
- Taking reasonable steps to ensure an appropriate ethical tone at the top
- Participating actively in authorization of fundamental transactions
- Self-consciously considering board governance¹⁷

All of these responsibilities can be boiled down into one simple goal: *the creation of sustainable long-term value for shareholders*. In their role as guardians of value, however, directors are forced to pay attention to process – sometimes to an extreme degree.

Stock exchanges have set forth listing rules on the structure and composition of boards, and the Securities and Exchange Commission (SEC) has issued a number of proxy disclosure rules in this regard. Boards must devote time to develop and maintain compliance with these requirements.

Furthermore, every proxy season, scores of governance proposals appear on company proxies at shareholder request, attracting additional board attention to these issues. And looming over all of this activity is the sure knowledge that, if and when the matter comes to judgment, the court will focus on proper process above all.

Given these considerable pressures, it is tempting to let management run strategy and let long-term shareholder value take care of itself. Yet boards should never mistake *process* for *purpose*.

What matters most is how the board uses its processes – such as the formation of independent committees, holding of executive sessions, and so forth – to further its purpose.

For example, when it comes to strategy and risk oversight, directors can meet periodically in a retreat setting to give these areas additional focus and clarity in light of long-term value.

Regarding business performance and executive compensation, boards can make sure that the metrics used to measure and reward performance include long-term indicators and that the structure of compensation has a long-term focus. And with respect to succession planning, boards can do more to attract, develop, and retain value-building human capital – especially in key positions, where unplanned turnover can be detrimental.¹⁸

Other areas of board oversight can also benefit from a long-term value focus. The importance of risk management, ethics, due diligence, and governance best practices need no elaboration here, but disclosure may be an area for improvement. As directors review annual reports for the companies they serve, they can ask: Does this tell me the long-term story? If not, they can urge management to make this clearer.

Potential: The ideal board focuses on the creation and protection of sustainable long-term wealth for shareholders.

Reality: Many boards lack a sense of their own purpose and focus instead on their process, resulting in an overemphasis on compliance at the expense of strategic input.

Recommendation: Boards must understand their purpose – to ensure that the corporations they serve create sustainable long-term value for shareholders.

- + As individual directors and as a board, strengthen awareness of long-term shareholder value and foster it in others.
- + Ask with every discussion: How will this decision affect long-term shareholder value?
- + Review and refresh governance documents to focus on this purpose.

CULTURE

"It all boils down to integrity. Do you believe your management team has integrity? If not, it's time to change." Jon F. Hanson

"Many governance problems can be traced to a lack of ethical values at some level of the organization. Boards can change corporate culture through example and action." Paul O'Neill

"Good governance is an essential part of a fair and transparent business environment." Arthur Levitt

Definitions of culture vary, but perhaps the simplest is that culture is the "ideas and the standards" people have in common; culture creates a "consistent pattern of thought and action."¹⁹

Culture need not have a flashing light that says "Culture." It is conveyed through example, often anonymously. Indeed, culture can be invisible until it starts to change. This is certainly the case with board culture.

Directors cannot anticipate every problem or create or outsource every solution. So what can boards provide? Certainly, every effective director must bring probity, diligence, courage, intelligence, commitment, and often specialized substantive information or experience. But perhaps the single most important trait that every director must bring to a board is uncompromising integrity.

Over time, boards have a profound effect on the culture of the organizations they head. This effect is rightly called "tone at the top," yet its impact extends throughout an organization.

The most immediate expression of a board's "tone" may be its choice of a CEO and the ways in which directors work with this leader to maximize and protect long-term shareholder value while holding him or her accountable for results. How the board and management work together to allocate responsibilities and power is a critical aspect of board and company culture.

A good board and corporate culture will provide the setting for effective use of business judgment at every level in the pursuit of long-term shareholder value, from rules of engagement between management and the board to policies that show respect for all constituencies.

Potential: The ideal board works with management to exemplify, prioritize, and promote proactively the highest possible norm for ethical values on behalf of the corporation and its shareholders.

Reality: Many boards focus appropriately on selecting CEOs and directors of good character but fail to place attention on how the board engages with the CEO, management, and the entire organization to serve long-term shareholder value.

Recommendation: As part of a "tone at the top," boards must practice appropriate rules of engagement between management and the board – engagement that serves the long-term interests of the company and its shareholders.

- + When evaluating the CEO, ask: Does this person understand, respect, and foster the role of directors as guardians of long-term shareholder value?
- + Ask with every discussion: How will this decision impact our company's values?
- + Consider creating a Values Statement for internal board use and sharing this statement with management, shareholders, and the public.

LEADERSHIP

*“Yes, CEOs and cultures are crucial.
But people are flawed, and
systems are fragile. This is why
we need governance.”* William T. Allen

*“Shareholders have the power
to hold boards accountable
for everything, but boards can’t
and shouldn’t do everything.”* Paul Washington

*“Boards only know what the CEO
and CFO tell them. Nothing more.
This is a significant problem.”* Richard Beattie

Board independence, required by rules and encouraged by best practices, is essential to good governance. The value of independence reveals itself in the dynamics of board meetings. Given the limited amount of time directors have to do their work, they must be highly efficient. The leader of the board must make sure agendas cover key issues and that meetings follow those agendas, but the leader should also encourage free-ranging discussions of fundamental issues, such as strategy and risk. An effective board leader will also ensure good time management for the precious few hours of board meeting “prime time.”²⁰

There are two basic models now in use in the United States for board leadership: an independent Chair who is not the CEO,²¹ and combined roles with (or without) the use of an independent lead director.²²

The Study Group recommends that the default for board structure should be the independent Chair.* However, recognizing that one approach does not fit all situations, we acknowledge that there are circumstances when a board may legitimately choose to join the roles of CEO and Chair. For example, a combined Chair and CEO may be an appropriate leadership response to a catastrophic corporate event. Alternatively, combining the positions of CEO and Chair may be appropriate for a company founder who retains substantial equity ownership. In such circumstances, we recommend a lead director empowered to call meetings and generally act as a first among equals.

*The question of the extent to which companies should be encouraged to have an independent Chair of the board is one that continues to generate divergent views. Some members of the Study Group believe that it is inappropriate to have a “default” position favoring an independent Chair; rather, they believe that this matter should be determined without presumptions by each board on a case-by-case basis and then regularly revisited by the board. They note that, while an independent Chair may facilitate independent oversight of management, there are other ways to accomplish that objective, and that selecting an independent Chair presents an array of issues relating to the proper division of responsibilities between the Chair and CEO. These issues include perceptions of authority both inside and outside of a company; appropriate processes for making decisions; accountability for those decisions; and the compensation, rotation, performance goals, evaluation, and continuing independence of the Chair.

Whatever model is used, the independent Chair or independent lead director serving with a CEO-Chair should be an individual who has no aspirations to be CEO of the company and who focuses primarily on facilitating effective board meetings.

Executive sessions are also valuable, both before the meeting, to check the agenda and significant issues to be discussed, and after the meeting, to go over action items.

The following questions may be helpful to boards in checking for effective board leadership:

- Are the roles of CEO and Chair clearly defined?
- When the CEO and Chair roles are combined, is there a lead director who plays a significant leadership role and galvanizes the work of the independent directors?

- Does the person chairing the meeting ensure effective board discussions? Does this meeting leader work from an agenda approved by the independent directors in consultation with management?
- Does the board devote the necessary time to consideration of long-term strategy and related risks?
- Does the board fulfill its important role of CEO evaluation and succession?

Potential: On the ideal board, the Chair ensures robust discussion and well-reasoned decisions on fundamental issues, such as strategy and risk. Executive sessions are held regularly to ensure independent consideration of these and other key issues.

Reality: The board Chair, whether as a current or aspiring CEO, may focus too much on running the company instead of running the board. Board meetings can lack substantive agendas and dynamic discussions of key topics. This puts an undue burden on executive sessions, which can be brief and perfunctory.

Recommendation: *The default for board structure should be the independent Chair.²³ However, there are circumstances when a board may legitimately choose to join the roles of CEO and Chair. In such circumstances, we recommend a lead director empowered to call meetings and generally act as a first among equals.*

- + Periodically ask: Does our leadership of the board and committees – in both the structure we use and the people we choose – give the board ownership of its agendas and meetings? If not, make appropriate changes.
- + Run executive sessions routinely before and/or after – and, if needed, during – the board meeting.
- + Hold these sessions occasionally without the independent Chair/lead director present in order to evaluate the effectiveness of his/her leadership.

INFORMATION

“It is important to build a relationship with managers beyond the CEO.” Eugene Ludwig

“Most governance problems can be solved through a combination of transparency, alignment, and technology.” Richard Daly

“Information is the lifeblood of effective governance.” Olivia Kirtley

Many governance problems have arisen from poor management decisions, hidden and often compounded through inadequate information disclosure to the board. Boards of directors should be cognizant of, and cautious about, the emphasis they place on internal reports. Of course, it is proper and advisable to rely on the information provided by management, who are the guardians of the financial and business information systems in the company. However, if the board relies solely on management reports, the risk is that information may be incomplete, filtered, or edited, even in good-faith ways. The general name for this problem is “asymmetric information,” and this imbalance can weaken the board’s ability to oversee the corporation properly.²⁴

Certainly, directors can benefit from studying a variety of information sources beyond the reports delivered at board meetings and the financial reports filed with the SEC. As indispensable as these are for understanding a company,²⁵ they need to be supplemented through such sources as analyst reports, transcripts of earnings calls, news in the financial press, and so forth. At the same time, the biases and particular perspectives of these outside commentators must be considered. (For example, sell-side analysts may place undue emphasis on near-term performance.) It’s been said that directors have a duty of curiosity. Rightly interpreted, this unwritten duty does not mean simply that directors need to ask questions. They should also have a general intellectual curiosity about the company’s industry (or industries) and the economic world at large.

Boards need to balance external and internal information, applying their wisdom and experience to recognize problems, develop solutions, and take (or direct) action.

In addition, the right technology can speed and improve the board’s advisory and oversight work. For example, boards can ensure that their companies are using the most appropriate solution – acquired or homegrown – for “enterprise risk management.”²⁶ Directors can ask for regular reports on the “hot zones” of risk affecting their companies, calling upon advisors to help them in this regard. Reports should be brief; certainly a report exceeding 25 single-spaced pages would be too long under most circumstances. Directors can become familiar with these reports as part of their oversight of risk and compliance, and can even use the technology for themselves.²⁷

Directors can also use technology to gain useful information about the views of their shareowners while at the same time proactively seeking opportunities for direct, face-to-face communication. New and pending regulatory requirements, such as “say on pay” (requiring companies to have a shareholder vote on all new compensation plans) and proxy access (requiring companies to place the names of shareholder-nominated director candidates directly on the proxy, in addition to the candidates recommended by the governance and nominating committee²⁸) will require boards to have better and more complete information on the views of their shareholders. When shareholder perspectives vary, boards will need to discern the extent to which certain perspectives are broadly or narrowly held.

In being responsive to the views and perspectives of all shareholders, boards should be mindful of their role as independent fiduciaries for all shareholders of the corporation. They should strive to understand the views of all shareholders, including various types of holders such as hedge funds, public pension funds, investment advisors, and individuals. Technology can help boards achieve such an understanding. For example, sentiment technology and advanced communications networks at brokerage firms can provide greater transparency and enable broader participation in both voting and annual meetings (see Appendix D for a more detailed discussion).

Potential: The ideal board learns from a variety of sources, including both external and internal sources, such as reports from analysts and the company’s managers beyond the senior management team.

Reality: Boards often rely too heavily on information management provides, and they interface with middle managers only when senior managers bring them to meetings or when boards reach out to them under extraordinary circumstances.

Recommendation: Directors should periodically review the company’s information format and content to ensure that they adequately inform the board and its committees on all topics relevant to corporate growth and well-being. Directors should also regularly receive a concise and comprehensive report in plain English on risks facing the company, in order of importance. Any additional information can be provided in appendices.

- + Encourage direct dialogue with the entire organization, having routine contact with employees beyond the senior management team.
- + Organize periodic meetings with major shareholders, having counsel present to ensure compliance with company policies as well as with rules and regulations, including Regulation FD.
- + Make full use of available technology to understand the perspectives and sentiments of all shareholders.

ADVICE

“There are two kinds of gaps that boards must address – gaps in oversight and gaps in expertise.” Glen Hubbard

“Good governance has a human element. More than anything else, boards need practical solutions grounded in expertise.” Peter Langerman

“Playing a meaningful role in properly influencing long-term value is fundamental but challenging. A critical link is advice from trusted sources. Getting out of the boardroom to meet management with different opinions is also very important. And good judgment and common sense are a must.” Deborah Wright

Directors can do more to enhance their role as a source and conduit for expertise through the regular use of independent advisors.²⁹ Clearly, boards have the legal authority to retain independent advisors whenever they need them and to earmark corporate funds to compensate these advisors. The Sarbanes-Oxley Act requires audit committees to be the ones to retain the firm’s external auditor, and rules being promulgated under Dodd-Frank encourage the use of independent compensation consultants. In the case of fairness opinions advising on the price paid in acquisitions, use of advisors has become commonplace and is considered necessary in determinations of fair value. Boards also have full legal protection to rely in good faith on persons they select with reasonable care and reasonably believe to have expert competence concerning the matter in question.³⁰

The Study Group believes that each member of a board should recognize when external advice can be critical to achieve oversight. Collectively and individually, directors should not hesitate to fund the engagement of accounting, legal, or other expert advisors (consultants) as needed. The potential benefit is twofold: greater independence and greater expertise. It bears repeating that the basic reason for a board’s existence is the creation of long-term value. Seeking the perspective of qualified outside advisors can help to achieve this goal.

This Study Group does not envision a board meeting in which each director has his or her own legal counsel or expert advisor. Nor do we advocate checking every statement made by the CEO and his or her team. Such developments could erode valuable board-management trust. However, we do believe that boards should make a reasonable effort to seek a second opinion on particularly complex and critical matters. Although there may be resistance to this apparent invasion of management turf, the competent CEO will welcome such support if the board selects the right areas for its use.

Compensation presents an important case in point. If a board overpays, it wastes corporate assets; if it underpays, it may lose the best human capital. To pay the right amount in the right way, boards must either possess compensation expertise or retain it.³¹

One of the unexplored frontiers in governance is the amount of funds that boards have to spend on experts (or even on their own compensation and operating expenses, for that matter). While there are backward-looking data on how much boards have spent to compensate board members and advisors in the past,³² boards do not tend to construct budgets for how much they anticipate spending in the future. The amounts allocated for non-routine advisors range from zero at some boards to very large and uncontrolled sums at others. Boards can do better than this ad hoc approach.

Risk is a particularly important area (see Appendix E). Without the constraint of a board looking out for the long term, management can take too many risks. The board can act as a valuable counterweight to excessive risk-taking by management. As mentioned earlier, directors can ask for regular reports on the risk affecting their companies, calling upon advisors to help them in this regard. Managers may perceive such requests as intrusive or untrusting, but this perception is wrong. Wise managers will understand that when it comes to the oversight of risk management, boards need all the help they can get, both internally and externally. The use of external advisors to review critical risk areas can and should be routine.

Potential: The ideal board seeks the perspective of outside advisors on a regular basis, with the full support of management.

Reality: Boards are reluctant – and management resistant – to spend company funds on outside independent advisors to review or supplement the judgments of managers and their advisors. Boards often assume that managers and their advisors already have expertise in all needed areas, and managers may not be keen to prove otherwise.

Recommendation: Directors should not hesitate to use third-party experts to advise the board or a board committee in important matters where they believe that outside advisors would improve the quality of the board's decision.

- + Use advisors whenever needed, including for a regular review of critical risk areas.
- + Set a budget for all board expenses, including expenses for the retention of advisors.
- + When engaging advisors, do not limit your choices to the ones already retained (such as external auditors), but consider a wider range of experts as needed.

DEBATE

“The key to a board's informed decision making is that the directors should probe until they fully understand the issues, information, and advice presented, to the point where they can explain it to others.” E. Norman Veasey

“Boards need to empower individual directors. Too often, a director will raise a concern about a motion on the table, and the response is, ‘Thank you for sharing. Do we have a second for the motion? All in favor? Next.’” Reuben Mark

“Dissent in the boardroom, expressed respectfully in the company's best interests, is a healthy thing for effective board oversight. Diversity of viewpoints leads to more effective decision making.” Charles Elson

Boards of directors, like other groups of individuals, are subject to the interpersonal dynamics of the individuals who form the group. In a board setting, however, the person chairing the meeting needs to be mindful of the primary purpose of the board – to enhance shareholder value – and must be cognizant of using the board’s time and resources in furtherance of this goal.

The effective board meeting Chair should make sure that every viewpoint gets a full and fair hearing consistent with orderly decorum, within the constraints that are imposed by time or other considerations. This may mean tabling discussions, ending filibusters, or drawing out more reticent members. Whatever actions are needed, the Chair must perform them, or the board can designate another individual to assume the role of Chair.

The burden of ensuring effective meetings does not fall on the Chair alone, but extends to every director. The Study Group believes that a good board will be constructive, respectful, and professional, with directors making a proactive effort to understand one another. But this does not mean “going along to get along.” Achieving consensus is important, but many boards put forth too great an effort to achieve it. While strict parliamentary procedure is usually not necessary in small groups, boards should still respect due process in the airing and discussion of ideas.³³

Every director must be capable of exercising healthy skepticism and constructive challenge to avoid the syndrome of groupthink.³⁴ Each individual director who realizes something is wrong has an obligation to say so, and boards as a group need to encourage debate, not only in executive sessions but also at board meetings. On a board that fosters debate, CEOs and directors will not feel pressured to make decisions that contradict their judgment or betray their values.

No board wants individuals or factions who are unmoved by fact or reason or who are disruptive or rude. When managers focus on having to make a presentation to a smart, inquisitive board, they are inspired to perform at their best. When they have to prepare for perpetually dissenting directors who pick fights (often the wrong ones), their efforts are geared towards appeasement – hardly an optimal result. Board meetings should be structured to permit directors to share their candid views with the CEO without creating circumstances that diminish the authority of the CEO in front of subordinates, clearly a counterproductive outcome. This consequence does not mean, however, that dissent should be discouraged. Indeed, effective dissent is healthy for optimal board performance.

The Study Group believes more can be done to encourage meaningful dialogue, pointed argumentation, and, when necessary, dissent. Consensus has great value when it is achieved through a full vetting of ideas wisely shepherded by a judicious discussion leader. However, in some cases, consensus is simply not possible. In the end, following a thorough discussion, some opposing views may remain. In these cases, a split vote should be recorded with unapologetic confidence. Meeting minutes can routinely indicate that measures passed by a “majority vote following robust discussion.”³⁵

Lack of unanimity should neither increase nor decrease the liability of directors voting either way.³⁶ On the contrary, it can and should be construed as a sign of governance strength. Directors should not be afraid to register dissent, when necessary, in debates or in board or committee votes.

Potential: The ideal board values and leverages debate, disagreement, and, when necessary, dissent.

Reality: Many boards discourage dissent by emphasizing collegiality of discussions and unanimity of votes.

Recommendation: Chairs should foster an environment of discussion and debate, recognizing the benefits of disagreement and dissent, when necessary, in achieving better decisions.

- + As a Chair, encourage constructive skepticism, debate, disagreement, and, when necessary, dissent.
- + As a director, speak your mind, ask questions, and disagree or even register dissent if needed.
- + As a board, build a culture of candor and trust.

SELF-RENEWAL

“Volatility and complexity are not going away. Boards need to constantly challenge their processes and ensure they have the right competencies around the table.” Ken Daly

“To function effectively as a monitor to protect corporate value, boards must refresh their membership on a periodic basis.” Charles Elson

“Balance here, as in other areas of life, is critical. The board should have sufficient knowledge of the company’s business – including technical details – to ask smart questions. But the board also needs generalists who have diverse knowledge and/or experience in other fields.” Ken Bertsch

Board composition must continue to evolve to suit a company’s strategy. The average tenure of directors is now about seven years,³⁷ but some of the turnover is due to mergers rather than to actual rotation of directors. Furthermore, the presence of managers other than the CEO on some boards presents another opportunity for positive change. If managers will be providing their views to the board anyway in their management roles, why should they occupy a voting board seat? The board can thus expand its pool of expertise by increasing the percentage of nonmanagement directors.

Boards today tend to be small, and rightly so: Deliberative groups much larger than a dozen members tend to become unwieldy. Given a limited number of seats, and given the great range of expertise and experience needed by every board, each board seat counts, making board composition a vital concern for every board.

Boards can engage in affirmative succession planning for their ranks. Every board should have a self-renewal plan. If boards could calibrate director tenure to maximize director usefulness, they could keep their boards vital. Furthermore, there could be a positive chain reaction. With more board seats opening up, individuals who have a chance to serve as directors on other boards would be less inclined to cling to their current board seats and more able to move on when the time seems right. Such “enabled directors,” if supported by the other practices and resources recommended in this Report, could have a greater positive impact on the corporations they serve.

To select the most useful directors, boards need to pay as much attention to the person as to the résumé, striving for diversity in both dimensions. An effective group will be diverse in many ways, including, as appropriate, not only professional experience, educational background, and industry background, but also temperament, worldview, stakeholder knowledge, age, and general personal background. And even within industry experience, diversity is important.³⁸

Although it is necessary and valuable for corporate directors to spend significant time getting to know a company before making an informed contribution, they also need to move on when the time for departure has come. After 15 years, assuming changes in the company, the marketplace, and the director, chances are that someone else may be more qualified to fill the seat held by that director. Directors and nominating committees need to seek the perspective gained by asking: *How do I add value?* and *Can someone else add more?*

Director evaluation is a complex and important topic worthy of its own report.³⁹ For our purposes, suffice it to say that board and director evaluation must be regular, robust, and linked to the company’s strategy and attendant risks, and results must be treated anonymously, confidentially, and objectively. Third parties can help facilitate this process.⁴⁰

To encourage renewal among existing board members, many boards rotate committee leadership every three years and membership every five years or so.⁴¹ Also, to encourage board renewal, a growing number of nominating committees are using executive recruiting firms to locate candidates.⁴² Some committees tap directly into databases of available candidates.⁴³

Boards may wish to consider the value of term limits. It is generally agreed that director perspectives on a particular company can become stale and even compromised after many years of continuous service.

It may be difficult to remain objective about a company one has served for a long time. In the United Kingdom, after nine years on a board, a director is no longer considered independent. Boards can consider imposing term limits of this nature, or at least informal guidelines for a duration that makes sense for their industry. Periodic retreats to build board awareness of business and broader trends can keep directors current during their periods of service.

Potential: The ideal board is composed of individuals who complement management's knowledge and skills in support of the organization's strategy. Directors receive regular education, and board and committee membership rotates at reasonable periods to bring in new perspectives while maintaining some continuity.

Reality: Without the benefit of regular, rigorous evaluation and development, too many directors become complacent educationally and stay on boards past the point of maximum effectiveness.

Recommendation: Boards should institute a regular, formal process for board and director evaluation. This process should be legally encouraged and protected – and balanced with term limits based on company needs. Additionally, boards should receive continuing education on topics related to their board service.

- + Engage in frank and meaningful discussion about the suitability of the current board composition for advancing the company's long-term value, seeking the views of shareholders.
- + Set a process for rotation of board and committee leaders.
- + Develop policies and practices to ensure ongoing evaluation and education of current directors, using the services of an independent third-party facilitator when needed for evaluation, and considering education both on and off site.

CONCLUSION

“Many solutions to governance problems lie within the board's power and outside the scope of government control.” David Becker

“Many directors I talk to about board service today believe that expectations of board members are increasingly inconsistent with a model based on part-time service. At some point, the gap must be examined and addressed.” Deborah Wright

“Board behavior varies. It falls along a normal curve. Our goal is to move the curve in the direction of progress.” Reuben Mark

In this Report, we have tried to identify gaps in board excellence and suggest ways to close them. To increase investor confidence, corporate boards can ask themselves the following questions:

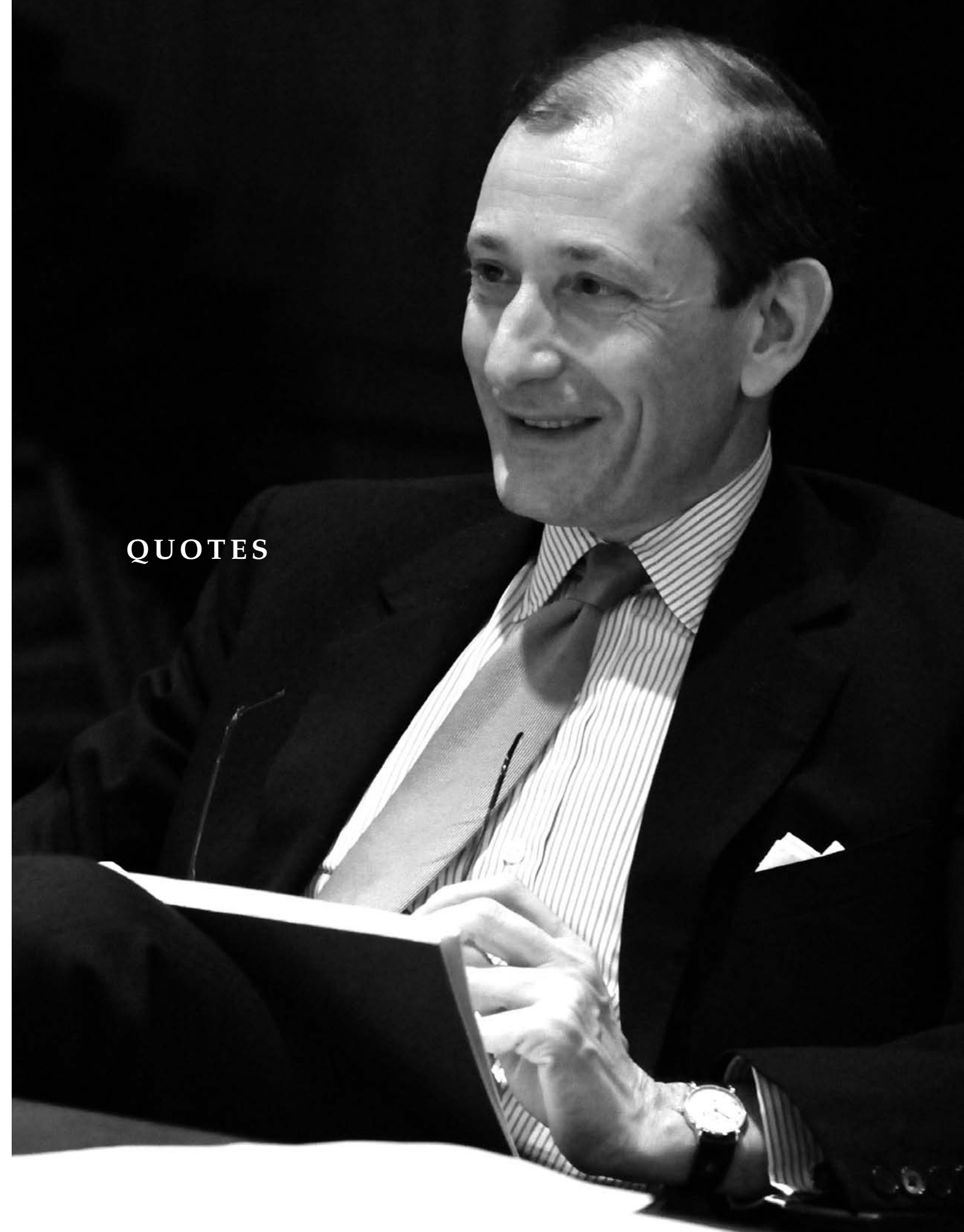
- *Purpose* – Do we focus on long-term value?
- *Culture* – Do we follow appropriate rules of engagement between management and the board in support of long-term shareholder value?
- *Leadership* – Do we have independent board leaders who ensure effective discussions in board and committee meetings and executive sessions?
- *Information* – Do we insist on a variety of information sources, including information derived from advanced technology, rather than relying on traditional sources?
- *Advice* – Do we seek outside perspectives to help the board understand important issues, especially critical areas of risk, and allocate funds to accomplish this goal?
- *Debate* – Do we make a deliberate effort to include a full range of perspectives in the boardroom?
- *Self-Renewal* – Do we keep our directors informed and replenish board membership at regular intervals, as required by our changing environment and strategy?

These changes would all work together to strengthen the board's consideration of its own effectiveness. The full board, under the leadership of its independent Chair or lead director and with the support of the governance committee, can periodically assess all areas covered in this Report in the light of current events and performance. Directors should ask themselves how their boards can "take charge" to improve their functioning. We want to empower boards to do better.

Individually and collectively, directors are not omniscient; they are not more expert than experts, and they cannot always be expected to ask the right question, to find the oyster in the pearl, or to spot the chink in the armor. Yet they can try. Directors can add value through their collective wisdom, supported by independent expertise. As advisors, directors can help CEOs see what they might not otherwise have seen, and as an oversight body, boards can also provide a check against the occasional CEO or management excess.

The voluntary standards we have set forth will always be preferable to universal bright-line standards. One bright-line standard does apply to all boards without exception – the imperative to identify and bridge gaps in their own effectiveness. We offer this Report as a guide to this worthy endeavor.

QUOTES





The following quotes are from Study Group discussions and correspondence.

William T. Allen:

“Yes, CEOs and cultures are crucial. But people are flawed, and systems are fragile. This is why we need governance.”

“There are two ways to see the board’s role. One is increasing long-term wealth. The other is minimizing fraud and abuse. Society loses when boards focus so closely on the second that they neglect the first.”

“Does board independence lead to better financial performance? No one has proved this. Is it designed to assure integrity of decisions even at a cost of performance? Again, it is not clear either that it does achieve this result, or that investors would want such an outcome.”

Richard Beattie:

“Boards only know what the CEO and CFO tell them. Nothing more. This is a significant problem.”

“If one looks at all the failures of the last four years, and it is a long list, the boards were not aware of the risks the companies were taking, because no one was telling them about the risks.”

David Becker:

“Many solutions to governance problems lie within the board’s power and outside the scope of government control.”

“Public rage at what a board should not fail to do is not a proper barometer of what a board can do.”

“The board should not rely too heavily on outside experts. Bear in mind that to a hammer, every problem looks like a nail.”

Ken Bertsch:

“Not all stakeholder conflicts can be resolved through focus on long-term shareholder value, nor does such a focus in any way make a board’s job easy. Still, a singular, self-conscious focus on sustaining long-term shareholder value is the necessary guidepost for boards. This defines the particular role of the board in a wider ecosystem, and without such clear purpose, directors and boards are more likely to lose their way.”

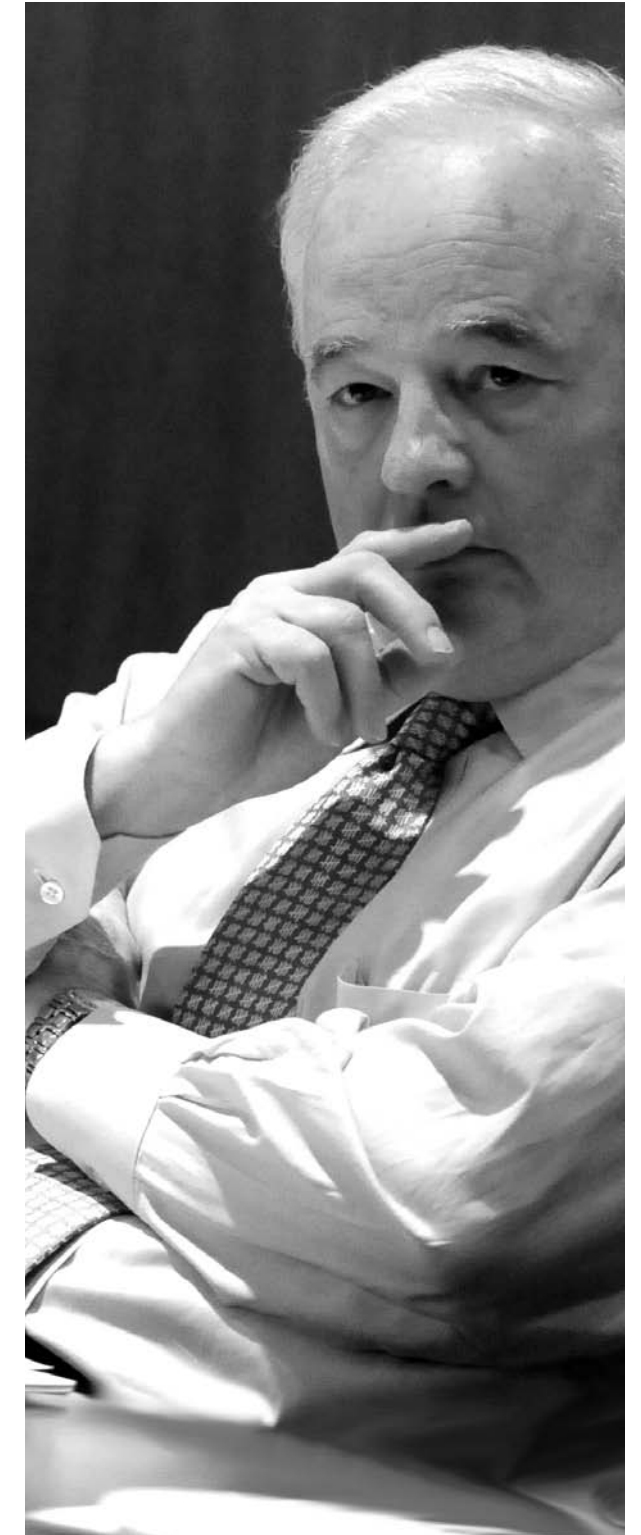
“Balance here, as in other areas of life, is critical. The board should have sufficient knowledge of the company’s business – including technical details – to ask smart questions. But the board also needs generalists who have diverse knowledge and/or experience in other fields.”

Ken Daly:

“Asymmetrical information risk is inherent with board service. The challenge is to recognize when it becomes dangerously high, and then to know what to do about it.”

“Directors can’t offer perspective in a void. They need the support of knowledge and perspective from qualified advisors, as required in specific situations.”

“Volatility and complexity are not going away. Boards need to constantly challenge their processes and ensure they have the right competencies around the table.”





Richard Daly:

“Most governance problems can be solved through a combination of transparency, alignment, and technology.”

“No one wins when a company fails. On the other hand, to earn returns and stay competitive, companies must take some risks.”

“Information is the key to success.”

“Over 75 percent of the shares of publicly held companies can be accessed through the advanced technology networks in place today across broker-dealers and other financial intermediaries.”



Charles Elson:

“Over the decades, the board has admirably moved from an advisory to a monitoring function. Unfortunately, it still has yet to meet its potential.”

“Regulations such as Sarbanes-Oxley or Dodd-Frank serve a purpose, but there is a dark side to regulation.”

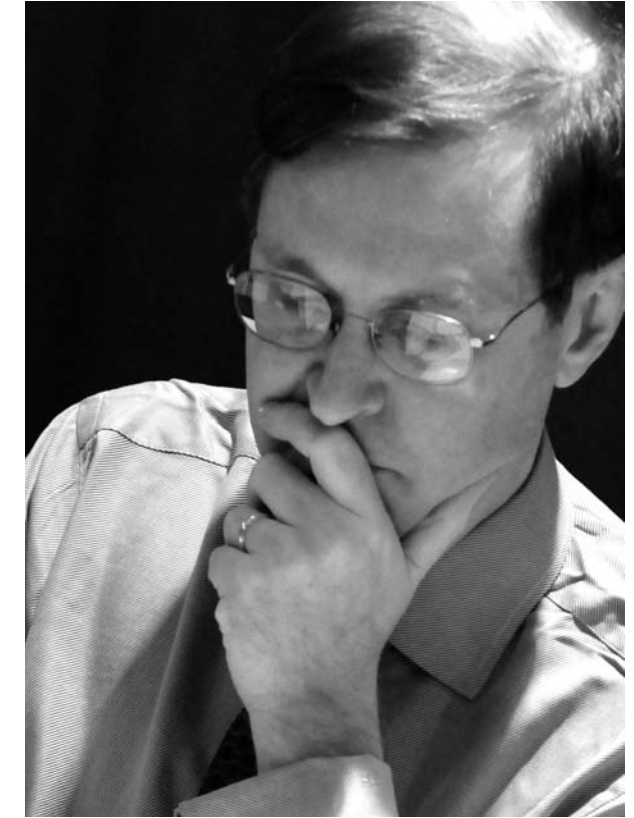
“Dissent in the boardroom, expressed respectfully in the company’s best interests, is a healthy thing for effective board oversight. Diversity of viewpoints leads to more effective decision making.”

“To function effectively as a monitor to protect corporate value, boards must refresh their membership on a periodic basis.”



Jon F. Hanson:

“It all boils down to integrity. Do you believe your management team has integrity? If not, it’s time to change.”



Glenn Hubbard:

“Many of the contributions to corporate governance in recent years focused inward to the board’s operations rather than outward to the board’s work in areas such as risk.”

“There are two kinds of gaps that boards must address: gaps in oversight and gaps in expertise.”



Olivia Kirtley:

“Disclosure can go a long way in addressing many issues.”

“The board needs to test sensitivities in critical areas, such as incentive compensation and new initiatives.”

“Information is the lifeblood of effective governance.”

Peter Langerman:

“Good governance has a human element. More than anything else, boards need practical solutions grounded in experience.”

Arthur Levitt:

“Job creation is America’s most important economic priority. Governance is a vital catalyst in producing that outcome.”

“Good governance is an essential part of a fair and transparent business environment.”

Eugene Ludwig:

“If we take away the board’s discretion, we will wind up with a bad environment. To make progress, boards must think out of the box and try new ideas.”

“It is important to build a relationship with managers beyond the CEO.”

Reuben Mark:

“Boards need to empower individual directors. Too often, a director will raise a concern about a motion on the table, and the response is, Thank you for sharing. Do we have a second for the motion? All in favor? Next.”

“Board behavior varies. It falls along a normal curve. Our goal is to move the curve in the direction of progress.”

“A good CEO will make the board look good; a bad CEO will make the board look bad.”

Paul O’Neill:

“Most governance problems can be traced to a lack of ethical values at some level of the organization. Boards can change corporate culture through example and action.”

Damon Silvers:

“More often than not, long-term shareholders and stakeholders share common interests – and it is the role of thoughtful directors to work with management to set the corporation on that course toward long-term value creation.”

“Managing corporations is complicated – strong boards are much better at managing complexity than regulators or courts or shareholder votes are – but history shows that without regulators and courts and shareholder votes, we won’t have strong boards.”

“Boards ultimately cannot look to anyone else to tell them what their values must be. But when boards get values wrong, both board members personally and everyone else associated with the corporation pays the price in terms of reputation, litigation, and lost time and money. That is one of the deep meanings of being a fiduciary subject to the business judgment rule.”

E. Norman Veasey:

“Corporations are managed under the direction of a board of directors for the purpose of protecting and enhancing the corporation’s long-term value to stockholders. The directors’ fiduciary duties of care and loyalty, carried out in good faith, are the indispensable means to that end.”

“The key to a board’s informed decision making is that the directors should probe until they fully understand the issues, information, and advice presented, to the point where they can explain it to others.”



Paul Washington:

“Shareholders have the power to hold boards accountable for everything, but boards can’t and shouldn’t do everything.”

“Those who favor a split between the Chair and CEO roles assume that there is a clear distinction between boards and management, but this is not true for many issues like strategy.”

“Boards want to hear from the CEO in an unfiltered way.”

“The board should focus on management processes; leaders can’t react by gut instinct alone.”

Ralph Whitworth:

“Poor boardroom dynamics cause most of our problems. Authority is concentrated among too few, and there is too much deference to authority.”

“One problem with bright-line standards is that, although they are meant as minimums, they become the norm.”

“Maybe we should rename directors’ shareholder representatives’ – then they would pull up to the table in the right mind set.”

“It is not enough to allow dissent. You have to encourage and welcome it.”



Deborah Wright:

“Playing a meaningful role in properly influencing long-term value is fundamental but challenging. A critical link is advice from trusted sources. Getting out of the boardroom to meet management with different opinions is also very important. And good judgment and common sense are a must.”

“Many directors I talk to about board service today believe that expectations of board members are increasingly inconsistent with a model based on part-time service. At some point, the gap must be examined and addressed.”

Frank Zarb:

“There is too great a gap between the popular notion of what boards do and the reality of what they are capable of doing. Furthermore, the existing system limits the depth of board oversight. We must either change the system or change expectations.”

“In the early 1970s, the stock market began to democratize, and today it includes tens of millions of middle-class investors. Over the same period, the basic structure and process of corporate board governance has improved somewhat, but it is essentially the same as it was in 1970. Is this a reality we have to live with?”

APPENDICES

A. NACD Key Agreed Principles to Strengthen Corporate Governance for U.S. Publicly Traded Companies

B. Topics of Blue Ribbon Commissions of the National Association of Corporate Directors 1993 to 2011 (in order of original publication)

C. Report of the New York Stock Exchange Commission on Corporate Governance (September 23, 2010) – Summary

D. Know Your Shareholders: Technology and the Boardroom

E. Risk Oversight: 25 Questions Directors May Wish to Consider

APPENDIX A

NACD Key Agreed Principles to Strengthen Corporate Governance for U.S. Publicly Traded Companies

The National Association of Corporate Directors (NACD) puts forth these Key Agreed Principles, grounded in the common interest of shareholders, boards, and corporate management teams, to provide a blueprint to corporate boards and thereby to help improve the quality of discussion and debate about governance issues moving forward.

I. Board Responsibility for Governance

Governance structures and practices should be designed by the board to position the board to fulfill its duties effectively and efficiently.

II. Corporate Governance Transparency

Governance structures and practices should be transparent – and transparency is more important than strictly following any particular set of best practice recommendations.

III. Director Competency and Commitment

Governance structures and practices should be designed to ensure the competency and commitment of directors.

IV. Board Accountability and Objectivity

Governance structures and practices should be designed to ensure the accountability of the board to shareholders and the objectivity of board decisions.

V. Independent Board Leadership

Governance structures and practices should be designed to provide some form of leadership for the board distinct from management.

VI. Integrity, Ethics, and Responsibility

Governance structures and practices should be designed to promote an appropriate corporate culture of integrity, ethics, and corporate social responsibility.

VII. Attention to Information, Agenda, and Strategy

Governance structures and practices should be designed to support the board in determining its own priorities, resultant agenda, and information needs; and to assist the board in focusing on strategy (and associated risks).

VIII. Protection Against Board Entrenchment

Governance structures and practices should encourage the board to refresh itself.

IX. Shareholder Input in Director Selection

Governance structures and practices should be designed to encourage meaningful shareholder involvement in the selection of directors.

X. Shareholder Communications

Governance structures and practices should be designed to encourage communication with shareholders.

To learn more, visit
www.nacdonline.org/keyprinciples.

APPENDIX B

Topics of Blue Ribbon Commissions of the National Association of Corporate Directors 1993 to 2011 (in order of original publication)

Executive Compensation: Guidelines for Corporate Directors

Jean Head Sisco, Chair

Performance Evaluation of Chief Executives, Boards, and Directors

Boris Yavitz, Chair

Director Compensation: Purposes, Principles, and Best Practices

Robert B. Stobaugh, Chair

Director Professionalism

Ira M. Millstein, Chair

CEO Succession

Jeffrey Sonnenfeld, Chair

Audit Committees: A Practical Guide

A.A. Sommer, Jr., Chair

The Role of the Board in Corporate Strategy

Warren L. Batts and
Robert B. Stobaugh, Co-Chairs

Board Evaluation: Improving Director Effectiveness

Robert E. Hallagan and
B. Kenneth West, Co-Chairs

Risk Oversight: Board Lessons for Turbulent Times

Norman R. Augustine and
Ira M. Millstein, Co-Chairs

Executive Compensation and the Role of the Compensation Committee

Hon. Barbara Hackman Franklin and
William W. George, Co-Chairs

Board Leadership

Jay W. Lorsch and
David A. Nadler, Co-Chairs

Director Liability: Myths, Realities, and Prevention

Justice E. Norman Veasey, Chair

The Governance Committee

Hon. Barbara Hackman Franklin, Chair

Board-Shareholder Communications

Dennis R. Beresford and
Richard H. Koppes, Co-Chairs

Risk Governance: Balancing Risk and Reward

Adm. William Fallon and
Dr. Reatha Clark King, Co-Chairs

The Audit Committee

Dennis R. Beresford and
Michele Hooper, Co-Chairs

Corporate Performance Metrics: Understanding the Board's Role

John Dillon and
William White, Co-Chairs

The Lead Director*

Hon. Barbara Hackman Franklin and
Irvine O. Hockaday, Co-Chairs

To learn more, visit www.nacdonline.org.

*Working title.

APPENDIX C

Report of the New York Stock Exchange Commission on Corporate Governance (September 23, 2010) – Summary

The New York Stock Exchange Commission on Corporate Governance has worked to develop a consensus view on a core set of governance principles for boards, management, and shareholders. The group agreed on ten key principles of solid corporate governance.

1) The board's fundamental objective should be to build long-term sustainable growth in shareholder value for the corporation and its shareholders, and the board is accountable to shareholders in its effort to achieve this objective.

2) While the board's responsibility for corporate governance has long been established, the critical role of management in establishing proper corporate governance has not been sufficiently recognized. The Commission believes that a key aspect of successful governance depends upon successful management of the company, as management has primary responsibility for creating an environment in which a culture of performance with integrity can flourish.

3) Shareholders have the right, a responsibility, and a long-term economic interest to vote their shares in a thoughtful manner, in recognition of the fact that voting decisions influence director behavior, corporate governance, and conduct, and that voting decisions are one of the primary means of communicating with companies on issues of concern.

4) Good corporate governance should be integrated with the company's business strategy and objectives and should not be viewed simply as a compliance obligation separate from the company's long-term business prospects.

5) Legislation and agency rule making are important to establish the basic tenets of corporate governance and ensure the efficiency of our markets. Beyond these fundamental principles, however, the Commission has a preference for market-based solutions whenever possible.

6) Good corporate governance includes transparency for corporations and investors, sound disclosure policies, and communication beyond disclosure through dialogue and engagement as necessary and appropriate.

7) While independence and objectivity are necessary attributes of board members, companies must also strike the right balance between the appointment of independent and non-independent directors to ensure that there is an appropriate range and mix of expertise, diversity, and knowledge on the board.

8) The Commission recognizes the influence that proxy advisory firms have on the market and believes that such firms should be held to appropriate standards of transparency and accountability. The Commission commends the SEC for its issuance of the Concept Release on the U.S. Proxy System, which includes inviting comment on how such firms should be regulated.

9) The SEC should work with the NYSE and other exchanges to ease the burden of proxy voting and communication while encouraging greater participation by individual investors in the proxy voting process.

10) The SEC and/or the NYSE should consider a wide range of views to determine the impact of major corporate governance reforms on corporate performance over the last decade. The SEC and/or the NYSE should periodically assess the impact of major corporate governance reforms on the promotion of sustainable long-term corporate growth and sustained profitability.

APPENDIX D

Know Your Shareholders: Technology and the Boardroom

The current proxy voting system is a complex network highly dependent on technology, as noted in a recent SEC Concept Release on the U.S. Proxy Voting System.⁴⁴ The SEC is currently soliciting comments from the private sector to see if regulatory changes are in order.

Meanwhile, one solution does lie in the hands of the private sector – namely, advanced communications networks at brokerage firms, which can provide significantly enhanced levels of transparency and enable greater participation in annual meetings through electronic shareholder forums on the Internet.

Transparency

With respect to transparency, these broker-hosted networks can be used to understand and/or survey the unique perspectives, sentiments, and opinions of institutional and retail shareholders as a group and of key segments. For example, with “sentiment” technology, boards can quickly absorb and comprehend a multitude of comments from shareholders – and have a high level of confidence of being in touch – with little or no administrative effort. Boards and management can use these networks to facilitate communications with and among validated shareholders on a range of topics.

By adapting networks in this way, directors will have a new channel to understand shareholder perspectives on how the company is performing and where there may be concerns, and they can obtain a better flow of information overall. Shareholders will have an opportunity for dialogue in an environment that has the controls, accountability, and access provided uniquely by brokerage firm technology networks.

Participation

With respect to participation, these networks can create greater engagement and more convenience, which should lead to significantly higher levels of engagement. Companies can use this same technology to hold virtual annual meetings in combination with live meetings.⁴⁵ Based on the experience of some companies, adding a virtual component can expand participation by as much as ten times.⁴⁶

Note: From a regulatory viewpoint, there is no roadblock to the operation of such networks. The SEC paved the way for these types of networks in 2008, when it expanded on existing exemptions available for shareholder-to-shareholder communications and clarified that broker nominees and other network hosts would not be liable for statements made by others on electronic shareholder forums.⁴⁷

APPENDIX E

Risk Oversight: 25 Questions Every Director May Wish to Consider

Corporate profitability is driven by taking prudent risks after a well-thought-out strategy is developed. Opportunities may be lost if corporate decision makers are unduly risk averse. Maintaining the status quo is a choice, but not always the best one. Companies require strong and effective assessment and management of financial, operational, enterprise, and reputational risk. The entire board of directors has a key role in developing strategy, assessing risk, and overseeing risk management. In developing corporate strategy and a focus on risk, directors should probe management, advisors, and each other by asking at least the following 25 questions (though not necessarily in this order):

Strategy and Information

1. What are we aiming to accomplish, and how (corporate strategy)?
2. What alternative strategies have been considered/explored?
3. Do the directors receive risk material that adequately distills vast quantities of risk information into prioritized summaries with proposed actions?
4. Are the risks associated with business units presented to the board in a comprehensive, holistic manner?

Financial Analysis

5. How do the losses that have occurred compare to the risks that have been identified? Are the losses consistent in magnitude and frequency with what one could expect, given the risk profile presented to the board?
6. Can management and the board tie profits, as well as losses, to the presented risk profile?
7. How actively are resources – capital, balance sheet, talent – redeployed? Does the organization consistently, and on a timely basis, feed its winners and starve its losers?

What-Ifs, Assumptions, and Processes

8. What could go wrong or derail our strategy? For example, could multiple problems arise simultaneously or sequentially (the “perfect storm”)?
9. Has management been forthcoming about any differences among senior leadership regarding material strategic recommendations and decisions?
10. What assumptions underlie our strategy, and which of those assumptions could change/be wrong?
11. What processes did management use to develop strategy and identify risk?
12. Have we achieved a common understanding of what triggers bring an issue to the board’s attention?

Human Capital

13. What capabilities are required to address risks? Where do we have capability gaps?
14. Is there a common understanding among management, the board, and board committees about their respective roles, responsibilities, and accountabilities on strategy and risk oversight?
15. Does the board have a clear understanding of where strategy and risk oversight are delegated and what processes are used within management and among business units?

Board and Committee Structure

16. Do the board and the appropriate committees discuss risk appetite with management?
17. How can this discussion become a part of the board’s regular routine?
18. Are the board and the appropriate committees meeting regularly with a chief risk officer (CRO)?
19. If there is a CRO, has the board ensured that the CRO and general counsel have adequate resources and appropriate reporting lines to bring any changes in material risks to the board’s attention?
20. Does the board have the appropriate committee structure for its significant oversight obligations in the risk area?

Other Issues

21. Does the board have sufficient personnel (including advisors) and financial resources in place to enable it to fulfill its risk engagement responsibilities?
22. Has the board adopted a board leadership structure that ensures that the independent directors have a clearly defined leader?
23. Do the board and the appropriate committees have access to the information they need to provide oversight in troubled financial times?
24. Have the board and the appropriate committees reviewed the incentive structure with strategy and risks in mind?
25. Have the board and the appropriate committees reviewed board composition and director skill sets in relation to up-to-date competencies for oversight of the company’s strategy, business lines, and material risks?

Source: *Report of the NACD Blue Ribbon Commission on Risk Governance* (Washington, DC, 2009). (Subtitles added.)

NOTES

¹Summary of the discussions held May 20-21, September 14-15, and December 1, 2010, with additional comments provided by Study Group members in early 2011.

²Fred G. Steingraber and Karen Kane, "Corporate Leaders at Risk as Feds Take Over," *Houston Chronicle*, January 10, 2010, stated: "Today, the public at large has joined the chorus of shareholders and the financial media to ask, 'Where were the boards?' In the fall of 2008, former Medtronic CEO Bill George wrote a blog with this title (October 14, 2008) <http://www.billgeorge.org/page/where-were-the-boards>; and Papa John's CEO John Schnatter wrote an op ed (*Wall Street Journal* October 25, 2008) with the title "Where Were the Boards?" <http://online.wsj.com/article/SB122489049222968569.html>. See also *The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States, Official Government Edition Submitted Pursuant to Public Law 111-21* (Washington, DC: The Financial Crisis Inquiry Commission, January 2011). <http://www.gpo.gov/fdsys/pkg/GPO-FCIC/content-detail.html>. The report is in two parts: the main report (signed by the group's six Democrat appointees) and the dissenting report (signed by the group's four Republican appointees). The main report finds that "Compensation systems...often...encouraged the big bet... This was the case up and down the line – from the *corporate boardroom* to the mortgage broker on the street" (p. xix). Also, in institutions involved in lending, "there was a significant failure of accountability and responsibility throughout each level of the lending system. This...ranged from *corporate boardrooms* to individuals." (p. 125) (emphases added). The report acknowledges pre-crisis governance reforms at Freddie Mac and Fannie Mae (p. 122) and AIG (p. 141), but (similar to the reports surrounding the collapse of Enron, per n. 23 below), the 2011 report goes on to tell of apparently imprudent decisions at a number of financial institutions at the board level. In order of mention in the report, these include Fannie Mae (pp. 179-186, 318); Citigroup (pp. 19, 137, 186, 197, 199, 260-265, 302, 380); Moody's (pp. 208, 223); Countrywide (pp. 248-250); Merrill Lynch (pp. 258-259, 384); AIG (pp. 273, 345, 348,); Bear Stearns (pp. 284-285, 288, 290); Wachovia (pp. 304-305); Freddie Mac (p. 319); Lehman Brothers (pp. 327, 337-339); and Bank of America (p. 384). The dissenting report, found on pp. 411-538, also mentions board decisions but focuses on failures at quasi-governmental institutions Fannie Mae (pp. 506, 509, 518) and Freddie Mac (p. 518). All links in this note were accessed March 9, 2011.

³Source: U.S. Chamber of Commerce report cited in *BusinessWeek*. See Phil Mattingly, "Torturous Dodd-Frank Rulemaking Can Succeed, Regulators Say." Bloomberg *BusinessWeek*, September 30, 2010. Accessed March 9, 2011, from <http://www.businessweek.com/news/2010-09-30/torturous-dodd-frank-rulemaking-can-succeed-regulators-say.html>. For a current summary of the Dodd-Frank rules impacting the board, see "Washington Update," *NACD Directorship*, February-March 2011.

⁴Represented by Brandon Rees, Deputy Director, Office of Investment, AFL-CIO, at some meetings of the Study Group.

⁵Mr. Becker completed his planned two-year term at the SEC in February 2011. An SEC press release dated February 1, 2011, notes that "Mr. Becker has been the agency's chief legal officer and a senior advisor to Chairman Schapiro since February 2009. During his tenure, he helped shape most of the SEC's major policy and regulatory initiatives and counseled the Commission on virtually every matter that has come before it." The Study Group has been fortunate to have his counsel.

⁶According to Study Group member Chancellor William T. Allen, "The financial crisis was in no important respect a result of sloppy or inattentive corporate governance. First, it was a financial crisis, not an economy-wide governance-caused crisis. The boards of high-tech companies, industrial companies, natural resource firms, etc., were affected only because credit markets failed. The causes of the financial system problems were related to corporate governance only in a tertiary sense. They were primarily macroeconomic, political, and regulatory. Of course, boards of financial firms were affected, and some did better than others (Goldman, JPMorgan, and Wells Fargo did better than Morgan Stanley and Citigroup, which in turn did better than Lehman and Bear Sterns). But this does not necessarily mean there were systemic internal governance failures, even in the banks. Take Morgan Stanley, for example. In retrospect one might criticize the very high leverage that the firm deployed in its capital structure. But in this risky structure, its board and management were taking risks that were required to try to match the returns that highly leveraged Merrill Lynch or others were able to generate. Diversified shareholders or their representatives were not calling for more conservative strategies; they were demanding that Morgan Stanley meet the returns of others. While in retrospect there are many failures, in my view, the principal failure in the case of the securities operations of large banks was the failure of financial regulators to understand systemic risks and to regulate them, for in a highly competitive market, only systemic risk regulators can save the individual firms from excessive risk. This is especially true when shareholders believe they have the protection of cheap diversification of risk (which they do have in most states of the world).

In the circumstances that existed (including limits in human knowledge), those effects would not have prevented the 2008-09 crisis.” Chancellor William T. Allen, note of December 14, 2010. For more on the causes of the 2008 financial crisis, see Eugene A. Ludwig, *Lessons Learned from the 2008 Financial Crisis* (Washington, DC: Group of 30, 2008). Accessed March 9, 2011, from http://www.group30.org/rpt_05.shtml. Also see *The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States*, cited in note 2.

⁷Note that the applicable statute in Delaware, replicated in other states, is that the business and affairs of the corporation “shall be managed by or under the direction of a board of directors” Del. C. Ann., tit. 8, Section 141(a).

⁸Respondents to the 2010 NACD Corporate Governance Survey reported spending on average 71.5 hours in meetings, 61.8 hours reviewing reports, 36.4 hours traveling to and from meetings, 20.1 hours receiving education, 8.6 hours representing the company (or board) at events, and 13.5 hours engaged in other activities related to board service. These averages are not additive, but they indicate an average total of well over 200 hours per year for board service. As for duration of this service, it averages 6.8 years.

⁹While it is possible for individuals such as auditors or regulators to devote full time to monitoring a company without losing their independence, this is so because they are employed by a separate entity (the audit firm or the government). In the case of an individual director, devoting 2,000 hours to the oversight of a single company would make the director economically dependent on the company’s director fees and therefore not independent.

¹⁰The most recent data available from the NACD show that the average frequencies for meetings were as follows:

- Board Meetings: 5.6 (9 hours average per meeting)
- Executive Sessions: 5 (1.7 hours)
- Audit Committee Meetings: 5.4 (3.1 hours)
- Compensation Committee Meetings: 4.4 (2.4 hours)
- Nominating/Governance Committee Meetings: 3.9 (2.2 hours)

¹¹“The SEC oversees more than 30,000 registrants including 12,000 public companies, 4,600 mutual funds, 11,300 investment advisers, 600 transfer agencies, and 5,500 broker dealers. We do this with a total staff of 3,600 people.” Source: Mary Schapiro, Testimony Before the Subcommittee on Financial Services and General Government, March 11, 2009. Accessed March 9, 2011, from <http://www.sec.gov/news/testimony/2009/ts031109mls.htm>.

¹²See Appendix A, a list of the NACD Key Agreed Principles to Strengthen Corporate Governance for U.S. Publicly Held Companies, and Appendix B, “Topics of Blue Ribbon Commissions of the National Association of the NACD 1993 to 2011.”

¹³New stock exchange listing rules for the New York Stock Exchange (NYSE) and NASDAQ, as directed by Sarbanes-Oxley, were approved by the SEC November 4, 2003. More recently, Dodd-Frank asked the SEC to propose and pass additional corporate governance rules, including some rules to be enforced as stock exchange listing requirements

¹⁴See Appendix C for the “Report of the New York Stock Exchange Commission on Corporate Governance” (September 23, 2010).

¹⁵See important disclaimer on p. 21 of this Report.

¹⁶State corporation statutes generally list the decisions boards must make – namely, amending the corporate charter; planning mergers or consolidation; selling, leasing, or exchanging all the company’s assets; and dissolving the corporation. In many cases, the full board must make these decisions. Some areas of board accountability can be delegated to a board committee (but not to management), namely declaring dividends; compensating directors and officers; electing officers; issuing/retiring stock, stock options, or rights; indemnifying officers, directors, employees, and agents; and reducing the corporation’s legal capital. Although the full board must ratify these decisions as a matter of procedure and may choose to elevate them to full board consideration, the board is permitted to delegate their consideration to a committee. See the *Corporate Director’s Guidebook: Sixth Edition* (New York: American Bar Association, 2011) (forthcoming).

For a guide to the business judgment rule, see Stephen A. Radin, *The Business Judgment Rule: Fiduciary Duties of Corporate Officers* (New York: Wolters Kluwer Law & Business, 2009). In addition, directors have various disclosure responsibilities under federal and state securities laws. See, for example, *Escott v. BarChris Construction Corp.* (1968); *Feit v. Leasco Data Processing Corp.* (1971); *Collins and Aikens* (2009).

¹⁷This list is based on one provided by Study Group member Chancellor William T. Allen. A number of organizations have published summaries of director duties, including the American Bar Association, the American Law Institute, The Business Roundtable, and the National Association of Corporate Directors. See, for example, the *Report of the NACD Blue Ribbon Commission on Director Professionalism* (Washington, D.C., National Association of Corporate Directors, 1996/2005). See also Stephen A. Radin, *The Business Judgment Rule: Fiduciary Duties of Corporate Officers* (New York: Wolters Kluwer Law & Business, 2009).

¹⁸“Management Turnover as Change Agent.” Liberum Research Report of October 13, 2010. Quarterly turnover numbers for CEOs, CFOs, boards of directors, and C-level executives (defined to include CEOs, boards of directors, CFOs, COOs, down to VP level) continued to show a drop in turnover for all key categories for the third quarter of 2010.

¹⁹“What really binds men together is their culture – the ideas and standards they have in common.” Ruth Benedict. *Patterns of Culture* (New York: Houghton Mifflin, 1934), 16, 46. For additional definitions, see Herve Varenne “The Culture of Culture,” Columbia University. Accessed March 9, 2011, from http://varenne.tc.columbia.edu/hv/ct/and/culture_def.html.

²⁰Directors spend more time in preparation and education than they do in meetings, but meeting hours are still by far the most important. As observed in note 8, the 2010 NACD Public Company Governance Survey showed that directors spent an average of 71.5 hours in meetings but nearly twice as many hours outside of meetings in preparation and education.

²¹*Split roles.* In about half of all U.S. public companies, the person running the full board meeting holds the title of Chair, but not CEO. Most but not all of these separate Chairs are independent. Boards that choose *split roles* reason that the board oversees the CEO, so the CEO should not lead the board. They also recognize that running a business and running a board require two different skill sets and temperaments. Individuals who become CEOs tend to have strong egos and high optimism. Motivated by vision, they aim for high growth and tolerate high risk. By contrast, the most effective Chairs tend to be consensus builders who try to balance the two. Boards that can balance the “dynamic” CEO and the “wise” (and sometimes older) Chair can have highly effective governance.

²²*Combined roles.* In about half of all U.S. public companies, the person chairing board meetings holds the title of CEO-Chair. Boards that choose combined roles understand that CEO-Chairs do not necessarily lead the board; that role can go to a designated *lead director* to preside over executive (all-independent) sessions of the board, help prepare the board meeting agenda, facilitate communication between the chair and the board, and lead parts of the full board discussions. Also, whether or not boards have an independent leader for the board, they have independent leaders for key committees – namely audit, compensation, governance, and (especially on bank boards) risk. Given these safety mechanisms, it would be difficult to increase the independence of the board. The use of combined roles underscores the close link between boards and management on issues like strategy. Boards that combine roles do so in part to achieve clarity of accountability and leadership – without necessarily weakening independence (indeed, when separate Chairs receive high compensation, this can compromise their independence – typically not a problem with lead directors).

²³See disclaimer on p. 21 of this Report.

²⁴In some cases, weak oversight can enable fraud. See *Deterring and Detecting Financial Reporting Fraud: A Platform for Action* (Washington, DC: Center for Audit Quality, 2010). For example, it is a matter of record that the board of Enron did not receive all the information it needed to make the right decisions. See *Report of Investigation by the Special Investigative Committee of the Board of Directors of Enron Corp.*, William C. Powers, Jr., Chair; Raymond S. Toubh; and Herbert S. Winokur, Jr., February 1, 2002 (Counsel Wilmer, Cutler & Pickering) (“Powers Report”). <http://news.findlaw.com/wsj/docs/enron/sicreport/>. See also *The Role of the Board of Directors in Enron’s Collapse*, Report Prepared by the Permanent Subcommittee on Investigations of the Senate Committee on Governmental Affairs, S. Rep. No. 107-70 (2002), dated July 8, 2002. Accessed March 9, 2011, from <http://f11.findlaw.com/news.findlaw.com/hdocs/docs/enron/senpsi70802rpt.pdf>.

²⁵ Regarding management reports, this is a valuable form of information. As Friedrich von Hayek has said, “There is beyond question a body of very important but unorganized knowledge,” namely, “the knowledge of the particular circumstances of time and place.” Friedrich von Hayek, “The Use of Knowledge in Society,” *American Economic Review*. September 1945, Vol. 35, No. 4. 519-530. But directors need not limit their views to senior management, or for that matter to internal reports. Regarding disclosures to the SEC, it is widely agreed that these documents contain information that is valuable to both companies and their owners.

²⁶ Acquired solutions vary greatly by type and price. See for example “Mid-Market ERP Solutions Comparison Guide,” from Inside-ERP.com, accessed March 9, 2011, from <http://www.inside-erp.com/> (registration required).

²⁷ For example, as part of risk oversight, a company can develop a common language and even color code in an electronic dashboard showing risks to speed and clarify communications about such matters. A “3/3,” for example, presented in red, can mean high risk with high likelihood. A “1/1,” presented in blue, can mean a low risk with low likelihood. Risks with degrees in between could be presented in shades of purple.

²⁸ Proxy access is still pending as we go to press in March 2011, due to a legal challenge. See *Business Roundtable and the Chamber of Commerce of the United States of America v. the Securities and Exchange Commission*. September 29, 2010. Accessed March 9, 2011, from http://www.uschamber.com/sites/default/files/files/1009uscc_sec.pdf. Oral arguments will be heard April 7, 2011.

²⁹ After the collapse of Enron, noted governance expert Ira M. Millstein told Congress: “It may be time to consider whether boards should be encouraged to rely on a small full-time staff or regularly use outside advisors for support. Board work, for larger corporations, requires significant information, time, and attention. For the board as a collective group of individuals who convene on a part-time basis to fulfill all that we expect may require more support than traditionally has been available. It may be fruitful for some staff resources to be explicitly devoted to supporting the work of the board. Independent directors, as a group, could benefit from having staff and counsel resources of their own, distinct from staff and counsel hired by management, especially where potential conflicts with the interests of management are apparent (*i.e.*, audit and compensation).” See Testimony of Ira M. Millstein before the U.S. Committee on Banking, Housing, and Urban Affairs, February 22, 2002. Accessed March 9, 2011, from http://banking.senate.gov/02_02hr/022702/millstn.htm.

³⁰ See, e.g., 8 Del. C. Section 141(e).

³¹ Bernadette Minton, Jerome Taillard, and Rohan Williamson. “Do Independence and Financial Expertise of the Board Matter for Risk Taking and Performance?” Charles A. Dice Working Center Paper 2010-14; Fisher College Working Paper No. 2010-03-014. October 14, 2010.

³² For example, the *NACD Director Compensation Report* reports the following figures for total board compensation in 2009: Smaller companies \$489,304 (0.21% of revenues); small \$712,009 (0.10% of revenues); medium \$995,190 (0.06% of revenues); large \$1,402,636 (0.03%); “Top 200” \$2,116,000 (0.01% of revenues). There are also data on the average annual cost of external auditors, who must be retained by the audit committee of the board. These costs could be considered a board cost if boards had a budget. Publicly held companies surveyed by the Financial Executives Research Foundation paid on average \$4.8 million in total audit fees for fiscal year 2009. For public companies, the hourly audit fee rate per hour averaged \$218 (\$186 for smaller companies [“non-accelerated filers”] and \$220 for the larger companies [“large accelerated filers”]). Source: *Audit Fee Survey* cited in “FEI Survey: Companies Report Signs of Stabilization With 2009 Auditing Process,” Press Release, June 24, 2010, Financial Executives International. Accessed March 9, 2011 from <http://fei.mediaroom.com/index.php?s=43&item=241>.

³³ The meticulous attention to rules of order and parliamentary procedure seen in large groups – e.g., Robert’s Rules of Order – is not usually effective for a small group, which can dispense with such formalities. Still, the notion of due process can be helpful.

³⁴ Although some research suggests that groups trump individuals for wisdom, a number of scientific experiments have shown that groups can fall prey to conformity. How can this be avoided? Automatic negativity is not a solution, but naïve agreement is just as bad. Yet some directors seem to be too conciliatory. Given the relative rarity of newly vacant seats on boards (due to small board size and long director tenure), the temptation to “get along” becomes a syndrome.

³⁵ Under most state statutes, a director is presumed to have voted for any action taken, unless he or she votes “no,” or files a written dissent during or promptly after the meeting. Courts have held that directors voting on the non-winning side of an issue may request their vote be noted in the meeting minutes. Some corporate bylaws protect this right. ICANN Corporation Bylaws approved October 31, 2002, in Section 23, “Presumption of Assent,” states as follows: “A Director present at a Board meeting at which action on any corporate matter is taken shall be presumed to have assented to the action taken unless his or her dissent or abstention is entered in the minutes of the meeting, or unless such Director files a written dissent or abstention to such action with the person acting as the secretary of the meeting before the adjournment thereof, or forwards such dissent or abstention by registered mail to the Secretary of ICANN immediately after the adjournment of the meeting. Such right to dissent or abstain shall not apply to a Director who voted in favor of such action.” Accessed March 9, 2011, from <http://www.icann.org/en/minutes/minutes-appa-31oct02.htm>. Some state statutes require this step. For example, Delaware’s corporate law says a director can “cause” his or her dissenting vote to be entered into the minutes. Courts have not generally required that minutes state the reason for dissent. When courts examine votes, they look for evidence of a thorough process, including vigorous discussion.

³⁶ See John P. Beavers and Kevin M. Kinross, “Corporate Minutes: When Less Is More.” *The Corporate Board*. March 1, 2008. Accessed March 9, 2011, from http://www.accessmylibrary.com/coms2/summary_0286-34149945_ITM. Note: If dissent leads to seemingly irreconcilable conflict, boards can consider using techniques from mediation. See Jon J. Masters and Alan A. Rudnick, *Improving Board Effectiveness: Bringing the Best of ADR into the Boardroom – A Practical Guide for Mediators* (Washington, D.C.: American Bar Association, 2005). The Federal Arbitration Act generally overrides state laws that would prevent or inhibit arbitration and requires courts to enforce arbitration agreements unless a given state law limitation applies to all kinds of contracts. On the other hand, courts can interpret arbitration agreements narrowly, which can render a previous arbitration decision moot (vacated). See *Stolt-Nielsen v. Animal Feeds*, 130 S. Ct. 1758 (2010). Accessed March 9, 2011, from <http://www.supremecourt.gov/opinions/09pdf/08-1198.pdf>.

³⁷ According to the *2010 NACD Public Company Governance Survey*, as observed earlier in note 8, the average tenure of board members in public companies is now 6.8 years. It has been at this level since 2008. Prior to that it was longer: 7.6 years in 2007 and 8.5 years in 2006.

³⁸ Research suggests, for example, that an overly heavy concentration of financial expertise on financial company boards can actually have a negative impact on performance. Bernadette Minton, Jerome Taillard, and Rohan Williamson. “Do Independence and Financial Expertise of the Board Matter for Risk Taking and Performance?” Charles A. Dice Working Center Paper 2010-14; Fisher College Working Paper No. 2010-03-014. October 14, 2010.

³⁹ See, for example, *Report of the NACD Blue Ribbon Commission on Board Evaluation* (Washington, DC: National Association of Corporate Directors, 2001/2010).

⁴⁰ For two recent articles on board self-evaluation, see Cindy Overmyer and Neal Purcell, “The Quiet Revolution: Kaiser’s Internal Audit Expands Governance Role,” *NACD Directorship* October/November 2010 (written by an internal auditor and a director); and Suzanne Hoppgood, “As the World Changes, Are We?” *NACD Directorship* October/November 2010 (written by a director and outside facilitator).

⁴¹ The “General Motors Board of Directors Corporate Governance Guidelines” (revised most recently on August 3, 2010) have stated for many years that “Consideration should be given to rotating Committee members periodically at approximately five-year intervals, but the Board does not believe that such a rotation should be mandated as a policy since there may be reasons at a given point in time to maintain an individual Director’s committee membership for a longer period.” Other companies with a flexible five-year rotation policy for committee memberships include:

- Metropolitan Health Networks
- Mutual of Omaha
- Owens-Illinois
- Whirlpool
- Woodward Governor Company

⁴²The 2010 NACD Public Company Governance Survey showed that 46.5 percent of public company boards use an executive recruiter to locate director candidates. Use of firms tends to increase with company size, presumably due to the cost involved, reported to be in the low six figures – more than the typical cash retainer for a director at even the largest firms.

⁴³The National Association of Corporate Directors has a large (3,000+) database of qualified director candidates available to nominating committees and search firm professionals for a modest charge. See Directors Registry at www.nacdonline.org.

⁴⁴See *Concept Release on the U.S. Proxy Voting System*, July 14, 2010. <http://sec.gov/rules/concept/2010/34-62495.pdf>.

⁴⁵As of January 2011, the following companies have used technology to enable online participation at their annual meetings: American Waterworks Co., ANTs Software, Artio Global Investors, Best Buy, Charles Schwab Corporation, Conexant Systems, Intel, Pico Holdings, Symantec, Warner Music, and Windland Electronics. Some shareholders have objected to annual meetings that are entirely virtual, but most shareholders welcome having a virtual-meeting option to complement a live meeting.

⁴⁶Source: Estimate by Broadridge CEO Rich Daly based on the experience of Broadridge and users of the Broadridge platform as of January 2011.

⁴⁷“Electronic Shareholder Forums,” February 25, 2008, U.S. Securities and Exchange Commission, accessed March 9, 2011, from <http://www.sec.gov/rules/final/2008/34-57172.pdf>. In this final rule, the SEC stated, “The purposes of new Rule 14a-17 and the Rule 14a-2 exemption are to facilitate experimentation, innovation, and greater use of the Internet to further shareholder communications. By facilitating such communications on the Internet among shareholders, and between shareholders and their companies, we hope to tap the potential of technology to better vindicate shareholders’ state law rights, including their right to elect directors, in ways that are potentially both more effective and less expensive for shareholders and companies.”

