

# GUIDE TO **BOARD ASSESSMENTS**



**“The whole activist industry exists because public boards are often seen as inadequately equipped to meet shareholder interests.”**

—Stephen Murray, Former President and CEO, CCMP Capital



## PAST TO PRESENT: A BRIEF HISTORY OF BOARD ASSESSMENTS

In 1992, the Cadbury Code of Best Practices launched a global movement to improve corporate governance. The Sarbanes-Oxley Act was U.S. lawmakers' response to the costly corporate failures of the early 2000s. As a result, public company boards and management faced a new set of standards intended to mitigate the incidence of fraud. Because Enron and other like failures were such a disaster for the investment community, institutional investors began taking a stand on board effectiveness. The expectation for the board's role expanded to monitoring overall corporate performance, CEO and executive compensation, audit and financials.

Then came 2008 and the more than \$10 trillion loss incurred during the Global Financial Crisis. Since the breakup of Arthur Andersen and the many listed-company failures between 2000 and 2010, corporate governance and leadership expectations have shifted again. The board's role has, and will continue to evolve. As the average tenure of public company CEOs decreases, the board's responsibility for managing business continuity and succession has increased. Similarly, as the board's role in the corporation has expanded, so have the expectations for board effectiveness and the board's commitment to assessing its performance.

## THE HIGHLY EFFECTIVE BOARD

**Governance excellence encourages strategic thinking and board-management alignment.**

Good governance is grounded on self-awareness and commitment to continuous improvement. Inadequate governance often limits an organization's profitability and long-term sustainability. A highly effective board:

- fosters positive group-board dynamics
- establishes strong governance practices
- promotes board member engagement
- maintains a healthy relationship with management
- ensures focus on mission and strategy
- cultivates a healthy organizational culture
- routinely gauges its effectiveness through robust assessment processes

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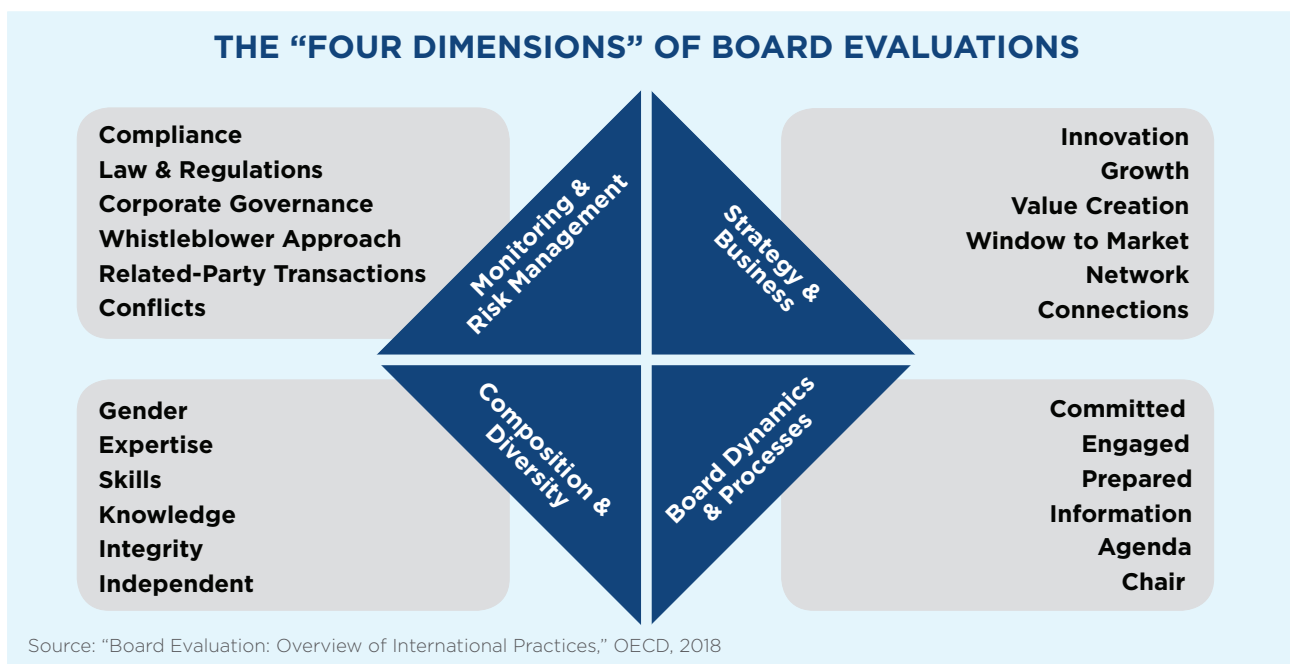
***“We would expect a company's board to be deeply engaged in the oversight of a company's strategy and the defining of a company's purpose—to help ensure the effective strategic implementation of HCM throughout their organization. Companies that can better articulate their purpose are more likely to build strong relationships with their employees (and customers) and have a clear sense of their strategic objectives. These are essential components of long-term growth.”***

—Michelle Edkins, Managing Director and Global Head of BlackRock Investment Stewardship

## WHY SHOULD BOARDS CONDUCT SELF-ASSESSMENTS?

Boards face internal and external pressures.

- Exchange listing rules require annual board assessments.
- The UK Corporate Governance Code mandates annual board assessments.
- Many regulators and jurisdictions globally require annual board assessments.
- Investors today expect annual board assessments of all public companies.
- A board that commits to a well-designed assessment process will achieve improvement and outperform peers who do not.
- A board signals to all of management and employees that they care about everyone's performance within the company.



## WHAT ARE THE BENEFITS?

A board that takes action based on the findings of the board assessment and shows continuous improvement in performance and effectiveness sends a positive message to all stakeholders.

- Agenda improvements
- Proper allocation of time to prioritized topics
- Deeper CEO and board interaction
- Board culture improvements
- Opportunity to bring attention to important topics that were previously not discussed
- Improvement of board-management alignment
- Opportunity to highlight collective board and individual director strengths and weaknesses
- Identification of board composition needs

## WHAT ARE THE DIFFERENT TYPES OF BOARD ASSESSMENTS?

Boards that are committed to governance excellence establish a proper cadence for conducting each of the following types of assessments:

- Full Board Assessment
- Committee Assessment
- Peer Assessment
- Director Self-Assessment



## MAKING THE CASE FOR INDIVIDUAL DIRECTOR ASSESSMENTS

Including individual peer and self-assessments in the board assessment process has many benefits. Yet, a recent study conducted by Spencer Stuart has found that just over one-third of S&P 500 companies conduct director assessments (peer or self). While directors may hesitate to critique their fellow board members for fear of damaging relationships, an effective peer and self-assessment process is able to maintain director anonymity, encourage reflection, candor and constructive feedback, and promote efforts to strengthen each director's contribution as a member of the board.

A well-designed and managed assessment process results in stronger, more collaborative relationships among board members. Incorporating a skills matrix into the assessment can illuminate the board's need to provide specific continuing education programs to support its members' efforts to contribute more effectively to board discussions and decision-making. The assessment itself serves to underscore the priorities and expectations for directors in their roles as members of the board.

Great leadership mandates a willingness to expand and explore deeper self-awareness. Most leading directors today agree that this is emerging as an essential aspect of individual board member improvement.

### When was the last director evaluation conducted?

<b>37%</b>	Less than six months ago
<b>41%</b>	Six to 12 months ago
<b>4%</b>	More than a year ago
<b>9%</b>	I have not yet had an evaluation on this board
<b>9%</b>	This board does not conduct individual director evaluations

\*Percentages may not add up due to rounding.

Source: *Corporate Board Member/Grant Thornton What Directors Think Survey 2019*

## HOW SHOULD BOARDS CONDUCT ASSESSMENTS?

Corporate governance is not one-size-fits-all. Every board is unique, and its assessment process should be appropriately tailored. The following can serve as a starting point for developing the appropriate assessment that aligns with the board's goals for continuous improvement.

### ① Design

- **Scope of assessment:** board assessments, committee assessments, director peer and self-assessments through written questionnaires, interviews
- **Areas to be assessed:** mission, ethics, accountability, board composition, strategy relationship with management
- **Participants:** directors, executives, managers
- **Questionnaire content and format:** rated questions and open-ended questions to elicit clear and candid responses
- **Facilitation:** internal resource (e.g., general counsel) or experienced third-party facilitator

### ② Set-Up

- **Questionnaire:** layout and formatting for optimal time required and quality of responses
- **Process for distribution:** paper, online or individual interviews (by telephone or in person)
- **Deadlines:** set to ensure timely completion

### ③ Distribution and Completion of Questionnaire and Interviews

- **Implement distribution:** appropriate for the assessment format
- **Troubleshooting:** timely assistance and resolution to directors' questions
- **Monitoring and follow-up:** ongoing monitoring of completions and reminders
- **Interviews:** conducted as directors complete and submit questionnaires

### ④ Report Compilation

- **Content:** timely and relevant; visually compelling and interesting to read; maintains director anonymity throughout
- **Objectivity:** data-driven reporting and analysis
- **Organization:** promotes understanding and open discussion

### ⑤ Report Distribution, Presentation and Review

- **Pre-distribution:** discussion between chair and general counsel or third-party facilitator
- **Distribution:** meeting pre-read; led by the chair, sharing directly with board members
- **Review:** chair reviews individual results with each director; board reviews collective results together
- **Presentation:** facilitates more in-depth board discussion

### ⑥ Benchmarking

- **Board:** year-over-year improvement on key metrics
- **Competitors:** industry/market comparisons
- **Individual directors:** opportunity for improvement

### ⑦ Action Points and Follow-Up

- **Beyond reporting:** identify and prioritize action areas
- **Memorializing and disclosure:** consider key items for board meeting minutes; disclosure in proxy and annual reports
- **Maintaining momentum:** include action areas as an agenda item for future board meetings

### ⑧ Future Assessments

- **Process:** establish future timelines
- **Format and metrics:** consider appropriate, value-adding modifications
- **Scope:** expand beyond board assessment to include committee and director assessments



**45%** believe at least one of their board members should be replaced



**66%** say their board has taken action from their last board assessment

Source: PwC, 2018 Annual Corporate Directors Survey

## WORKING WITH A THIRD-PARTY FACILITATOR

When boards first began to conduct self-assessments, the task of managing the process fell most often to general counsel and corporate secretaries, which imposed additional burden and risked altering the candor in responses and the anonymity of the process. As the value of a more robust and transparent assessment process—one that includes committee and director self-assessments—is better understood, boards are recognizing the benefits of using an experienced third party to facilitate the process.

### Benefits of Engaging an Experienced Third-Party Facilitator

- Knowledge of governance trends and best practices
- Preservation of board resources for other governance tasks
- Enhanced candor due to assurance of director anonymity
- Timely and accurate collection, compilation and distribution of results
- Objectivity and integrity in the analysis of results and benchmarking ability
- Facilitation of open discussion and committing to action
- Reduced risk of discoverability due to embedded safeguards
- Preclusion of the appearance of bias, manipulation or favoritism
- Independent, objective, expert perspective from a facilitator whose primary role is the board assessment

## ADDITIONAL CONSIDERATIONS

A robust board assessment process should not unduly burden the board or its support team. An experienced third-party facilitator provides value by managing the process from beginning to end, while working collaboratively to ensure the assessment meets the board's needs. With respect to cost, as with most products and services, boards should be wary of companies quoting a price that is too high or too low. Contact references, consider experience and evaluate samples of deliverables. Ask yourself: What is the return on investment and the cost-benefit of engaging a third party to effectively facilitate the board assessment process?



**The G20/OECD Principles recommend inclusion of regular board evaluations in a country’s corporate governance framework. “The New Paradigm” recommends that the board of directors evaluate its own performance, as well as assess the performance of its directors and board committees.**

Source: “Board Evaluation: Overview of International Practices,” OECD, 2018

## **DISCLOSURE**

Today a majority of public companies are conducting some form of annual board assessment. While ten years ago the question centered around whether a board should be required to conduct an annual board assessment, today the focus is on disclosure. Investors consider the depth and quality of proxy statement disclosures about boards’ self-assessment and continuous improvement practices as an indicator of the board’s commitment to effective governance.

The Council of Institutional Investors (CII) has identified best practices for disclosures of board evaluation processes for public companies. These recommendations include:

- Conducting full board, committee, and individual director peer and self-assessments
- Guidance on the timing and format of the evaluation
- Actions boards should take in response to assessment findings



A board that undertakes a robust board assessment process signals to investors that leadership, including the board, is engaged and measuring performance. In its January 2014 report, “Best Disclosure: Board Evaluation,” CII noted differences in disclosure practices among U.S. companies compared with the much more robust practices of non-U.S. companies. A growing number of U.S. companies have since responded to investors’ demands for disclosure of board practices, including board evaluation processes. In its 2019 report, CII identified “Seven Indicators of Strength” and provided examples of companies that have demonstrated effective disclosure practices—all of them U.S. companies.

### CII’S SEVEN INDICATORS OF STRENGTH

- ① Three-tiered review
- ② Consideration of peer review
- ③ Appropriate timing and format
- ④ Evidence of follow-through
- ⑤ Linkage to succession planning
- ⑥ Strong independent director leadership
- ⑦ Prudent use of third parties and technology

***“Evolving practices in board evaluation, combined with high-profile failures of board oversight, are driving investors’ desire for stronger disclosure of their portfolio companies’ approaches to board assessment.”***

—Glenn Davis and Brandon Whitehill, Board Evaluation Disclosure Report, Council of Institutional Investors, 2019



## **PRUDENT USE OF THIRD PARTIES AND TECHNOLOGY: THE 7TH INDICATOR OF STRENGTH**

### **Prudent Use of Third Parties and Technology**

Disclosure should indicate whether the board has considered the costs and benefits of leveraging independent third parties or technology platforms to enhance the evaluation process. These supplemental methods may not work well for every company in every year. For instance, companies with smaller boards or those in industries requiring highly technical expertise may not find an external third party useful. Boards should also remain mindful of the discoverability of records related to the evaluation in litigation. Many boards, however, do find that employing these methods helps keep director responses anonymous and feedback candid.

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#### **EXAMPLE: CONOCOPHILLIPS**

The Committee on Directors' Affairs periodically retains an independent third party to manage the evaluation process to ensure it remains as thorough and transparent as possible.

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#### **EXAMPLE: MCDONALD'S**

To protect anonymity and the integrity of the board and peer evaluation process, an independent third party compiles responses to these evaluations into a report for the chair of the governance committee

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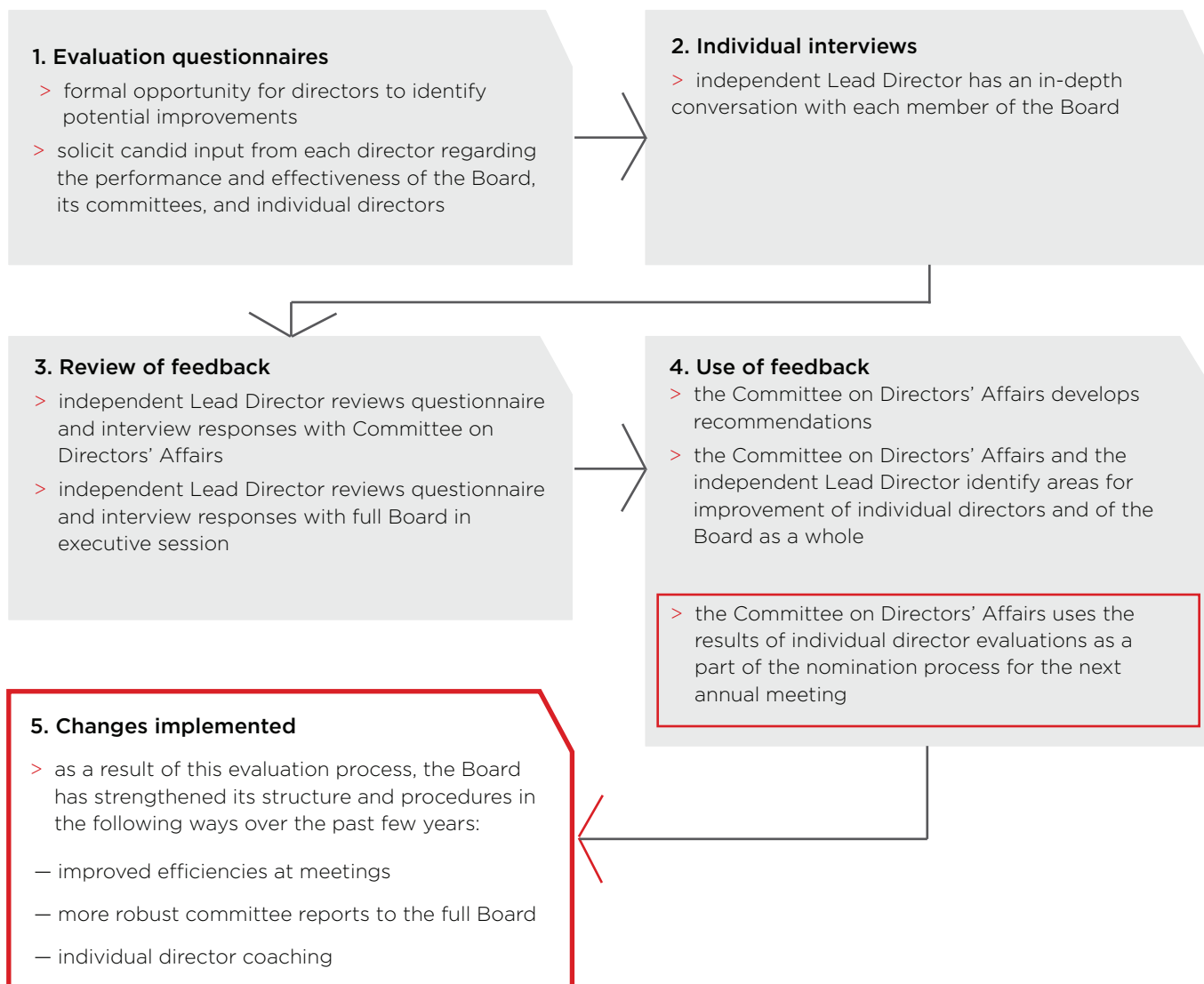
***“Today, regulators, governance codes around the globe and, increasingly, investors support or require robust board assessment practices.”***

—Byron Loflin, Global Head of Board Engagement, Nasdaq



## Board and Committee Evaluations

Each year, the Board performs a rigorous full Board evaluation, and each director performs a self-evaluation and evaluations of each peer. Generally, the evaluation process described below is managed by the Corporate Secretary's office with oversight by the Committee on Directors' Affairs. However, the Committee on Directors' Affairs periodically retains an independent third party to manage the evaluation process to ensure it remains as thorough and transparent as possible.



In addition to participating in the full Board evaluation, members of each committee also complete a detailed questionnaire annually to evaluate how well the committee is operating and to suggest improvements. The committee Chairs all summarize the responses and review them with their respective committee members.

The Committee on Directors' Affairs reviews these evaluation processes annually and develops any changes it deems necessary.

# FOR MORE INFORMATION

This guide was created for Corporate Board Member Institute, in collaboration with Nasdaq Governance Solutions.

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