BlackRock / TIAA Governance Conference:
Shareholder-Director Dialogue on Board Practices - Performance and Assessment

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We are working with boards and leading institutional investors to improve board performance and governance

- In June 2016 at the Shareholder-Director Dialogue on Boardroom Practices hosted by BlackRock and TIAA, Russell Reynolds Associates led a 3 hour session on board performance and board assessment with approximately 60 of the leading institutional investors and numerous Fortune 500 directors. We also conducted interviews/meetings with institutional investors before and after the conference in June and July. Some of the participating investors included:
  - AllianceBernstein
  - AXA
  - BlackRock
  - Capital Group
  - Canada Pension Plan Investment Board
  - Hermes
  - J.P. Morgan Asset Management
  - Legal & General
  - Morgan Stanley
  - Northern Trust Company
  - NYC Public Pension Funds
  - Ontario Teachers' Pension Plan
  - State Street Global Advisors
  - TIAA
  - Vanguard
  - Voya Investment Management
  - Wellington
Findings and insights from institutional investors

- Companies should expect questions from some governance teams at leading institutional investors about the company’s board refreshment and assessment processes. Additionally, a few institutional investors may urge companies to occasionally conduct external board evaluations in addition to a robust internal assessment process. Expected questions to boards are found on page 11 of this document.

- Across the institutional investors, common expectations included:
  - **Investors want to better understand the process by which boards evaluate themselves and improve their effectiveness.**
    Many investors see a robust evaluation process as a good indicator of strong corporate governance and expect meaningful board assessments to occur at regular intervals.
  - **CEO succession planning should be one of the board’s top priorities**
    Investors want insights into the CEO succession process and broader executive succession planning. Investors view this as a risk, but strong succession planning processes are seen as risk mitigation.
  - **Board skills matrices are useful in helping investors understand composition rationale**
    Several investors cited detailed board skills matrices as a helpful tool for this purpose.
  - **Engagement is about proactive (not reactive) relationship building**
    Investors assess the willingness of boards to engage with shareholders as a signal around effectiveness and culture. Most investors want boards to be willing to build a relationship that allows for ongoing dialogue, but at the right pace and timing.

- Additionally, both ISS and Glass Lewis are beginning to focus on board evaluations and urge external evaluations every third year as a sign of strong governance. ISS has started looking at whether external board evaluations are being conducted every third year which is used in calculating a board’s QuickScore (ISS - Question 41).
Assessments offer benefits to boards and investors alike

Board assessments strengthen the ability of the board to deliver on its mandate and provide investors with a signal the board is listening to governance concerns.

**Benefits to boards**
- Increase accountability
- Clarify and align on roles, responsibilities and expectations
- Enhance board processes, dynamics, communication, and teamwork
- Identify competency gaps for future director recruitment
- Test alignment around long-term thinking on strategic direction
- Help focus on continuous improvement

**Benefits to investors**
- Increase board’s awareness of what investors care about, what they’re looking for, and how to better engage with shareholders
- Maintain/develop investor confidence in board composition, succession, and governance
- Independent and objective identification of board’s development needs
- Benefits increase if evaluation process is disclosed
Areas to assess to improve board effectiveness and performance

Boards need to be clear in determining the scope of assessments and communicating that scope to the full board. Internal or external processes can review these areas:

- **Diagnostic of Board Effectiveness & Investor Perspective**
- **Strategic Alignment & Board Composition Development**
- **Board Structure & Processes Review**
- **Organizational Alignment & Board Culture Review**
- **Individual Director Performance Review**

Results of board assessments usually include:

- Based on the diagnostic work, insights from the investor-perspective regarding governance
- Summary of key findings – strengths and weaknesses identified during the work in each area
- Competitor and best practice benchmarking
- Specific, actionable recommendations to help the board address key issues and opportunities in each area
- Prioritized set of most important recommendations
Investors want a thoughtful customized approach: High-level assessment process overview

**Define project and goals**
- Work with project sponsor to define scope and clarify work plan
- Conduct due diligence interviews with select directors and members of management
- Review relevant bylaws, minutes, etc.
- Benchmark against peer and best-in-class organizations

**Due Diligence**
- Conduct due diligence interviews with select directors and members of management
- Test and refine findings with project sponsors

**Board Survey**
- Conduct electronic board survey
- Test and refine findings with project sponsors

**Customize Interview Guide**
- Leverage findings from board survey and due diligence interviews to determine focus of detailed interviews/who should be interviewed
- Create customized interview guide

**Detailed Interviews**
- Conduct detailed interviews
- Listen for the unexpected and the “issues behind the issues” – and shift the discussion scope accordingly to test for those issues

**Create Deliverables, Recommendations, and Next Steps**
- Develop initial summary and test with client and key stakeholders
- Refine based on feedback
- Present to full board
- Capture next steps

**Refine Findings**
- Develop initial summary and test with client and key stakeholders
- Refine based on feedback

**Present Full Findings**
- Present to full board
- Capture next steps

**Check-In**
- Check in (ideally) a year later
Key investor takeaways around each type/area of assessment (1/3)

Diagnostic of Board Effectiveness & Investor Perspective

- Understanding the strategy, business goals, investor perspective and competitive environment is an important context for understanding a board’s effectiveness
- Many boards are interested in what their long-term investors think of the board’s performance, but have no idea how to find that out
- Falling back on governance ratings agencies/proxy advisors is not the best solution – but it is the easiest
- There is no one-size-fits-all diagnostic:
  - Boards should focus on several areas in the diagnostic to understand potential issues
  - Each diagnostic needs to be customized based on the due diligence work
  - A survey only approach is insufficient to gain real insights on board performance and effectiveness

Strategic Alignment & Board Composition Development

- Board composition needs to be driven by the strategy: the preferred future state of the board has to be based on the strategy for the next 3-5 years and beyond
- The best boards conduct a composition analysis as a key part of board talent management and succession planning
- Board composition should be refreshed every 3 or so years, as the company’s strategy and market evolve. Age and tenure policies can be helpful, but are part of a larger refreshment strategy
- Composition analysis is an art and a science:
  - It is hard to rely on desk research to analyze composition – even harder with poor quality disclosure
  - If you ask directors, a limited number may over-inflate their experience and subject matter expertise
  - Objectivity is essential, but clear definitions are a key starting point
Key investor takeaways around each type/area of assessment (2/3)

Board Structure & Processes Review

- Review of the board’s role in the CEO/executive succession planning process as well as the strategy development process (when they get involved) is critical in any review of board processes. It is what institutional investors care about the most.
- Most of the work is conducted in committees – reviewing how they work and how they report up to the full board is essential. Having highly effective committee chairs makes a huge difference.
- Information flow to and from the board is a critical process. Sometimes, there is too much information and/or not the insight-driven information. Boards also need to balance useful summaries that foster board discussions with classic presentation.

Organizational Alignment & Board Culture Review

- Boards need to define the culture they want and monitor behaviors against it. The chair’s and/or CEO’s behavior is critical to board culture and sets the overall tone.
- Sometimes, there is a tension between collegiality, diversity, and tolerance of dissent, which can lead to boards not tackling tough conversations.
- Director underperformance is both a symptom of and contributor to poor board culture.
Key investor takeaways around each type/area of assessment (3/3)

**Individual Director Performance Review**

- Individual director assessment is much less common in the US and Asian markets. In some markets, litigation risk has to be taken into account (e.g., US)
- The key is to determine who should run the process and provide the feedback: independent chair, lead director or Nominating & Governance chair? General Counsel? External facilitator?
- Individual director assessments can be a worthwhile exercise to move towards a more continuous improvement-focused board, and it can create more openness around discussions of board composition, skills and overall refreshment
- Electronic surveys are typically the least effective approach to assessing individual directors and for gathering meaningful feedback
- Dignity, respect and confidentiality are critical values in the process
10 questions investors will be asking directors and management about a company’s board evaluation process

1. Is there a board evaluation process and who manages the process?
2. How does it work and is it more than an on-line survey?
3. What topics does the board assessment cover? (e.g., strategy driven composition, structure & process, culture, individual director contributions, and/or activism risk/external perception)
4. Does the board’s process include review of the board’s role in setting strategy and the effectiveness of the CEO succession planning process?
5. Does it include individual director assessment? If not, why not?
6. What happens to the results and recommendations? Is there a check-in on progress?
7. Do you believe that it is a rigorous process?
8. Have you considered using independent third parties to conduct the review every third year?
9. Can you provide examples of something that changed as a result of the review (e.g., board composition, board roles, process & structure, culture & behavior)?
10. Would you consider disclosing the process the company uses in its proxy?
Our speakers

Rusty O’Kelley

Jack “Rusty” O’Kelley III is a Managing Director and is the Global Head of the Board Consulting and Effectiveness Practice. Based in New York, Rusty has significant experience in financial services, retail, energy, and healthcare. His areas of expertise are board effectiveness and governance, CEO succession planning, and board search.

Professional Experience
Rusty has led multiple board effectiveness and consulting engagements helping companies improve board governance, overall effectiveness, and board culture. Rusty has designed and supported long and short term CEO succession plans for Fortune 500 companies and large scale family businesses.

Rusty has served as a Director for Seventy-Fifth Avenue Investments and Trak Chicago 1 Investments. He has served on the boards of trustees of Hampton University, Bennett College, and the Yale Law School Fund.

Anthony Goodman

Anthony Goodman is a member of the firm's Board Effectiveness Practice. Based in Boston, he has significant experience working with Board Directors and their stakeholders across sectors in the United States and Europe.

Professional Experience
Prior to joining the firm, Anthony was a partner at Tapestry Networks for more than twelve years. Tapestry convenes Board Directors, investors and regulators in small, private meetings for peer learning and to develop mutual understanding. While at Tapestry, Anthony created and led many corporate governance networks, including those for Fortune 500 lead Directors and audit committee chairs. Anthony was also co-chair of the Shareholder-Director Exchange (SDX) and is a Board Director of America SCORES New England which provides after-school programs in Boston public schools.