KPMG

On the 2020 nom/gov committee agenda

Board Leadership Center

The nominating and governance (nom/gov) committee agenda for 2020 needs to be sharp, focused, and executed with resolve. The nom/gov committee is operating in a business environment shaped by technological and digital innovation, cybersecurity risks, and scrutiny of corporate culture, as well as growing demands to address environmental and social issues and activism by shareholders, employees, and other stakeholders—all against a backdrop of geopolitical volatility and economic uncertainty. The demands on boards have never been greater, and in the year ahead, the nom/gov committee will be under intense pressure to help the board lead with excellence by optimizing the board's composition, structure, operations, and policies.

Drawing on insights from our work and interactions with nom/gov committee members, board chairs, lead directors, and board governance and business leaders, we highlight seven items for nom/gov committees to keep in mind as they consider and carry out their 2020 agendas:

- Focus on board composition, prioritizing diversity and alignment with strategy.
- Consider whether the board's committee structure brings focus to the issues most critical to the company's success.
- Conduct rigorous assessments to drive continuous improvement in board and individual director performance.
- Update the approach to new-director onboarding and continuing director education.
- Review and enhance the efficiency and relevance of board operations and policies.
- Develop succession plans for committee chairs and the lead director.
- Encourage robust disclosure regarding issues that are top of mind for investors.

Focus on board composition, prioritizing diversity and alignment with strategy.

Effective board governance begins with the composition of the board, and the stakes are high. The average board turnover rate of only 0.88 new directors per year[1] suggests that a fresh look at board composition should be a priority for 2020. Consider a clean-sheet approach: Begin with a skills matrix without reference to who currently serves on the board, outlining the skills, experience, decision-making styles, mix of tenures, and demographic backgrounds that would best align with the company's strategy and future needs. If current board composition does not match this ideal matrix, develop a plan to move toward it. Strong leadership from the nom/gov committee is needed, and setting expectations up front and clearly linking renomination to future needs can help to avoid any potential stigma associated with stepping off of a board.

Diversity is a critical component of board composition. Given the business case for diversity, it continues to be top of mind for nom/gov committees as stakeholders increase pressure on boards to make improvements. Expectations for gender diversity continue to move from interest to action, including institutional investors adopting policies (and proxy advisors issuing recommendations) to vote against the nom/gov committee chair or all committee members when progress on board gender diversity is lagging; state laws considering—and in some instances implementing—board diversity reporting requirements and/or mandates; and the federal government holding hearings, among other activities. Keep an eye on California—as of December 31, 2019, all covered

companies are required to have at least one woman on their boards, and two factors are in play: companies are gearing up for heightened requirements[2] and the law has been challenged in court by two lawsuits as of the date of this publication. Other state laws and pending bills, such as the one passed by the legislature in New York, require reporting on the gender makeup of the board.[3]

In addition to gender,[4] expectations are growing for increased racial and ethnic diversity in the boardroom. The calls for disclosure of board diversity continue to increase among investors, and a new law requires boards of companies with principal executive offices in Illinois to report board gender and race/ethnicity (based on self-identification) by the end of 2020. And as leading board-diversity organizations work to enhance and highlight the pipeline of qualified female, African American, Latino, Asian, LGBT+, and other diverse candidates, stakeholders (including employees as well as investors and regulators) are becoming less tolerant of all-male and/or all-white boards.

Consider whether the board's committee structure brings focus to the issues most critical to the company's success.

How is the board's committee structure calibrated to handle the growing complexity of board oversight? Does the committee structure enable the board to bring the right focus and attention to those issues that are most critical to the company's success and long-term value creation? Are there gaps? Is the workload balanced? Nom/gov committees should consider whether important emerging issues are receiving the right level of focus within the existing committee structure, or whether a new board committee would be helpful, either as a standing committee or as an ad hoc committee with a sunset date. Consider how the committee structure can support the board's oversight of issues relating to data governance, such as protection of privacy and ethical collection and use of data. Also consider the growing discussion about companies' accountability to stakeholders as referenced in the August 2019 Business Roundtable Statement on the Purpose of a Corporation. Corporate purpose is a nuanced issue that should be discussed by the full board, and the nom/gov committee can play a key role in assuring that the critical issues that roll up to this discussion—environmental issues, employment practices, and ethical and sustainable supply chains, to name just a few—are aligned to appropriate committees for oversight.

According to Spencer Stuart, S&P 500 companies have, on average, 4.2 standing committees. Aside from the three mandatory standing committees, the most common committees established by S&P 500 boards are executive (30%), finance (30%), risk (12%), science and technology (10%), and environment, health, and safety (10%).[5] Of course, there is no "right" number of committees. Standing committees can help bring the right focus and attention to critical issues; however, an overly complex committee structure poses the risk of a balkanized board environment where no one has the big-picture view of the company's strategy and risks. The key is for the nom/gov committee to take a thoughtful look at the committee structure.

Conduct rigorous assessments to drive continuous improvement in board and individual director performance.

Perhaps not surprisingly, enhancing board and individual director evaluations now ranks as one of the top five priorities for nom/gov committees in the next three years.[6] If the board has not already defined its expectations for individual directors, this is a good place for the nom/gov committee to start, by creating a detailed director role description outlining responsibilities, performance standards, and expectations inside and outside the boardroom. Expectations should be clear not only as to preparation for and attendance at meetings but also that each director must become a student of the company and its strategy. While it's management's role to educate the board about the competitive environment and the implications for strategy, directors need to take control of their own education—reading, visiting facilities, and experiencing the business firsthand—to make sure they understand the strategy and its risks. Reaching a collective understanding of what the board expects from its members can help set the tone for a high-performing board and form the basis for individual director evaluation and action in the future.

As a matter of best practice, board, committee, and individual director evaluations should periodically be undertaken by an independent third party who conducts one-on-one interviews with directors and senior executives and provides benchmarking against peers. Some boards find it helpful to take a deep dive on a particular area—e.g., CEO succession, oversight of disruptive risk, or oversight of talent development—in addition to the standard board assessment. And, of course, follow-through—particularly if removal of an underperforming director is called for—is critical and a test of board leadership.

Update the approach to new-director onboarding and continuing director education.

The complexity of the business and risk environment and the speed of change today throws new directors into strategic conversations on day one, making the onboarding process particularly important and challenging. Adding to this, more than one quarter of the independent directors joining S&P 500 boards in 2019 were new to public company board service.[7] Keeping in mind the director's background, the company's key issues, and the role(s) the new director will fill on the board or committees, what are the most important areas for the new director to know about up front? Highlight these areas and work with management to shape a tailored program. The new director should also play an active role in onboarding, requesting meetings or materials as needed. Onboarding should be an ongoing process rather than a once-and-done event. New directors may be paired with a board mentor for the first year or so, and a second "onboarding" program after 18 months can be helpful to fill information gaps and to provide an opportunity to ask questions about the company based on a more nuanced understanding of the company's strategy and operations.

Directors should be expected to participate in continuing education, and the nom/gov committee should consider how to enable collaboration and coordination to maximize value. For example, the committee may suggest key areas for board

education, identify top-tier programs covering each topic, and establish a process by which individual directors (or small groups) each cover different topics, followed by a debrief to the full board. The board or a committee may also choose to attend a board governance or industry conference together, followed by a robust discussion with management about the implications for the company.

Review and enhance the efficiency and relevance of board operations and policies.

As the nom/gov committee helps the board sharpen its focus on key priorities and manage a challenging workload, assessing *how the board's work is carried out* is essential. In addition to ongoing incremental adjustments, an intensive review of all aspects of board operations can yield value. Since board materials can be subject to volume creep and loss of focus, consider *ab initio* assessment of the information the board receives from management—contents, format, and timing—and work with management to implement practices to promote more efficient use of the board's time. Boards can increase meeting productivity, for example, by holding virtual/telephonic off-cycle meetings to provide updates and address less critical agenda items—both keeping the board connected throughout the year and maximizing the time available in face-to-face meetings for more strategic and discussion-oriented topics.

Nom/gov committees should also review the board's governance policies and practices and consider how they might be updated in line with current trends and expectations. For example, given the importance of board diversity, consider whether the board's governance guidelines spell out a commitment to actively seeking director candidates who bring diversity of age, gender, nationality, race, ethnicity, and sexual orientation—and whether the company has implemented an efficient process, such as inserting a question in the annual director and officer (D&O) questionnaire, to allow board members to self-identify for disclosure purposes.[8]

Develop succession plans for committee chairs and the lead director.

While engaging in succession planning for the full board and committees, the nom/gov committee should keep a distinct focus on succession planning for committee chairs and the lead director, with an eye on interpersonal skills as well as areas of expertise. As was the focus of this year's *Report of the NACD Blue Ribbon Commission, Fit for the Future: An Urgent Imperative for Board Leadership,* today's board leaders must be capable of driving the board to meet rising shareholder and stakeholder expectations. Board leaders should be agile and quick to adapt "to help their companies meet the challenges of the future ... They need to be capable of catalyzing and orchestrating a transformation in how the board is composed and structured, how it operates and interacts with the business, and how it holds itself accountable." Through modeling personal integrity, demonstrating independence of thought, and encouraging dissenting viewpoints—as well as collaboration and reaching consensus—board leaders should set the tone for the board's overall culture. As described in KPMG's white paper, *Facilitating the board's engagement in strategy*, lead directors in particular must be strategic thinkers, always keeping the big picture in view, as well as being perceived as trusted, discrete, independent, and objective.

Encourage robust disclosure regarding issues that are top of mind for investors.

To demonstrate the board's commitment to sound governance, the committee should see that the proxy statement serves as a communication tool as well as a legally mandated document. Consider including a letter from the full board or board leader, a section with governance highlights that includes a description of the board's evaluation and improvement initiatives, and a board composition matrix showcasing the board's diversity and linkage between director skill sets and company strategy and risk. Recognize that the business implications of climate change are high on the priority lists of most investors, and consider whether the company's disclosures on this issue should be enhanced. Also make sure to stay current on the topics that are likely to be top of mind for investors in 2020, including director overboarding concerns (maximum of four boards for non-CEO board members seems to be a growing consensus), director pay (ISS policy is to recommend against voting for directors in certain circumstances if director pay is excessive relative to peers), and corporate structural issues, such as a combined chairman/CEO role and newly public companies with dual-class shares, among others.[9]

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[1] Spencer Stuart, *2019 U.S. Spencer Stuart Board Index* (2019) p. 4.

[2] By December 31, 2021, boards of listed companies with principal executive offices in California with five directors will be required to have at least two women and boards with six or more directors will be required to have at least three women.

[3] At the time of publication, N.Y. bill S4278 had not been delivered to the governor for consideration. Similar laws have been passed in Illinois and Maryland. Mandates are under consideration in Michigan and New Jersey, and a disclosure bill has been passed by the U.S. House of Representatives.

[4] For more insights on building diverse boards, see the 2019 WCD Thought Leadership Commission Report *Diversity in the boardroom: Pushing forward, reaching back* (2019).

[5] Spencer Stuart, *2019 U.S. Spencer Stuart Board Index* (2019) p. 26.

[6] Ibid, p. 37.

[7] Ibid, p. 2.

[8] Quorum, *Out Leadership's LGBT+ Board Diversity Guidelines*.

[9] Cydney Poser, "Are there clues in the last proxy season about the one to come?" Cooley PubCo (October 2, 2019).

About the KPMG Board Leadership Center

The KPMG Board Leadership Center champions outstanding governance to help drive long-term corporate value and enhance investor confidence. Through an array of programs and perspectives—including KPMG's Audit Committee Institute, the WomenCorporateDirectors Foundation, and more—the Center engages with directors and business leaders to help articulate their challenges and promote continuous improvement of public- and private-company governance. Drawing on insights from KPMG professionals and governance experts worldwide, the Center delivers practical thought leadership—on risk and strategy, talent and technology, globalization and compliance, financial reporting and audit quality, and more—all through a board lens. Learn more at kpmg.com/us/blc.

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