

# Lead Director Network ViewPoints

July 18, 2013



## Effective board and committee leadership

### Executive summary

During their first-ever joint meeting on June 5, 2013 in New York, members of the Lead Director Network (LDN) and the Audit Committee Leadership Network (ACLN) discussed effective leadership of boards and committees.<sup>1</sup> The joint setting afforded members an opportunity to speak across roles as they exchanged ideas about effective governance practices for boards and committees. Three key themes emerged during the conversation, and are described in more detail within this issue of *ViewPoints*.<sup>2</sup> For further information about the ACLN and LDN, see “About this document” on page 8. For a list of participants, see the Appendix on pages 9.

#### ■ **Committee coordination** (*page 2*)

Seventy percent of S&P 500 companies have at least four board committees; 14% have six or more.<sup>3</sup> Boards must determine the number and authority of committees and then decide how to effectively coordinate their activities. Lead directors and audit chairs discussed a number of questions to consider in evaluating committee coordination, such as: Should committee meetings be scheduled sequentially or concurrently? How are board and committee agendas set? Are written and oral committee reports to the full board effective? Do executive committees tend to sharpen agenda-setting, or do they tend toward introducing an unwanted element of two different classes of directors? Views and practices varied among the group depending on a number of factors, including board size, industry, limitations on directors’ schedules, and level of management involvement with board preparation.

#### ■ **Matching directors with board roles** (*page 5*)

Boards and committees work best with the right people in the right roles. Although circumstances will dictate which director is best suited to serve as audit committee chair or lead director, both roles require strong communication and interpersonal skills. Some audit committees limit membership to financial experts or those who have served on the board for a set period of time; others do not. The “best” lead directors view themselves as servants of the boards whose main role is to facilitate good governance through coordinating with their fellow directors and CEOs.

#### ■ **Rotation, retirement, and removal** (*page 7*)

Lead directors, audit committee chairs, and board members eventually leave their positions. Boards seek to balance the benefits of continuity and tenure against the energy and new ideas that new directors bring to the boardroom. Members agreed that rotation and retirement policies should not be seen as substitutes for squarely addressing performance problems at the board level.

<sup>1</sup> Lead Director Network documents use the term “lead director” to refer interchangeably to the titles *lead director*, *presiding director*, and *non-executive chairman* unless otherwise stated.

<sup>2</sup> *ViewPoints* reflects the LDN’s and ACLN’s use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments are not attributed to individuals or corporations. Italicized quotations reflect comments made in connection with the meeting by network members and other meeting participants.

<sup>3</sup> Spencer Stuart, *2012 Spencer Stuart Board Index*. (Chicago: Spencer Stuart, 2012), 29.

# Lead Director Network

## ViewPoints



### Committee coordination

The board must establish certain committees to satisfy regulatory and exchange listing requirements. As a result, nearly all boards have standing committees responsible for audit, compensation, and nomination and corporate governance matters. There is significant variation beyond these three core committees, and views likewise vary among directors as to whether “more is better.”

S&P 500 companies average 4.2 standing committees.<sup>4</sup> Seventy percent have at least four committees; 14% have six or more.<sup>5</sup> Boards represented by LDN and ACLN members include finance, risk, corporate social responsibility, innovation and technology, and safety, health, and environmental affairs committees, among others.

Members suggested that each committee should have a clearly defined scope and be confident that it has the full support of the board. *“Committees only work when the board has made a commitment to give them responsibility and authority,”* one director said.

Some directors are opposed to increasing the number of standing committees beyond the usual three. One director lamented that *“every time an issue comes up, the answer is to form another committee.”*

Members gave several reasons not to be too quick to establish a new committee:

- **Attenuation of full board oversight.** *“Some topics [often assigned to special committees] like cybersecurity and public relations shouldn’t be delegated,”* one member said.
- **Pressure to expand board numbers.** One director said, *“More committees means that you need more people, and after a certain number of directors, the board becomes unwieldy.”*
- **Inertia.** *“Boards are good at creating committees, but not at killing them,”* one member said. As another said, this is *“particularly true if the committees aren’t carefully defined and limited.”*

Adding to the number of committees also tends to increase the challenge of coordinating committee meetings and responsibilities. That challenge can become particularly acute when two or more committees find themselves with overlapping responsibilities. As one director noted, coordination is difficult enough even with just three core committees: *“The lines between comp, audit, and nom/gov are blurring.”*

Members identified four key questions to address:

- Should committee meetings be scheduled sequentially or concurrently?
- How are board and committee agendas set?
- Are written and oral committee reports to the board effective?
- Would an executive committee be a benefit or detriment to the board?

---

<sup>4</sup> Spencer Stuart, *2012 Spencer Stuart Board Index*. (Chicago: Spencer Stuart, 2012), 29.

<sup>5</sup> *Ibid.*

# Lead Director Network

## ViewPoints



### Committee scheduling

Members opined on three options for committee scheduling:

- **Sequential scheduling.** Many members strongly supported scheduling committee meetings sequentially. *“It takes more time, but [with sequential scheduling] there’s no wasted time briefing members, no risk of conflicting agendas,”* one member noted. *“All board members know all the issues.”* Sequential scheduling is particularly beneficial for the CEO, board chairman, or lead director who wants to attend every committee meeting. As one director noted, *“Sequential scheduling’s biggest beneficiary is the CEO.”*
- **Concurrent scheduling.** Some members prefer to schedule meetings concurrently, often citing efficiency as their motivation. *“We’d have to meet an additional day to schedule meetings sequentially,”* one lead director said. An audit chair said that time required to schedule sequential meetings may *“limit the board to only have a few committees.”* Some members expressed the view that concurrent meetings limit committees to the core board members most involved in the committee work. The effect of eliminating “spectators” allows the committee to operate in a more focused and consistent manner.
- **A combination.** Some members schedule certain committee meetings concurrently or sequentially depending on committee membership and interest. One member’s board schedules *“finance and audit at different times because a lot of the same people want to attend, but governance and compensation have less overlap so those can be scheduled at the same time.”* Others may schedule meetings on an issue-by-issue basis, such as one lead director who invites all members to *“the portion of the audit committee meeting devoted to discussing financial results, something that everyone wants to hear. It prevents duplicating the conversation at the committee and board.”* When committee agendas have significant overlap, another option is to schedule a joint meeting for committees to address areas of overlapping jurisdiction.<sup>6</sup> Members offered examples of audit committees meeting with compensation, risk, finance, and other standing committees of the board. Not surprisingly, joint meetings often focus on risk.

LDN and ACLN members said that directors should try to minimize the downside of whichever scheduling system prevails on their board. If non-committee members attend a committee meeting, one director advised that *“they should be prepared. Read the materials.”* Another said *“there should be an understanding that non-committee members are in the committee as observers, not as active participants. They generally should only speak if it is a really important point.”* When committees meet concurrently, members recommended that directors actively engage during committee reports to the full board, in order to assure themselves that they have a sufficient grasp of the issues.

---

<sup>6</sup> See, for example, Audit Committee Leadership Network, *“Compensation, Risk, And The Role Of The Audit Committee.” ViewPoints*, November 30, 2009.

# Lead Director Network

## ViewPoints



### **How are board and committee agendas set?**

Lead directors and audit committee chairs work with their boards, committees, and management teams to set the board and committee agendas. Some members said that most of the board's work is scheduled well in advance of a given meeting. *"We take a 12-month perspective on risks and strategic objectives, allocating issues to the committees and full board,"* one member said. *"As a result, 60% of both the board and committee agenda is set a year in advance."*

A major challenge for both lead directors and audit chairs is allocating adequate time for unplanned agenda items or those that become more urgent or important than they were when first placed on the agenda. However, because the job of board leaders is to ensure that each director owns and supports the agenda, its content is ultimately the responsibility of the directors themselves, regardless of what may crop up between the first draft and the meeting. In addition to regular communication with board and committee members, lead directors and audit committee chairs make use of strategic off-sites, annual board evaluations, and regular executive sessions to ensure that the agenda reflects the board's priorities. Lead directors in particular will also seek input from the CEO in order to be sure that the board meeting addresses the most current and important issues facing the company.<sup>7</sup>

### **Are the written and oral committee reports effective?**

Audit chairs and lead directors are alike in their concern for improving the flow of information from committees to the board. Many boards make a practice of sharing all committee materials (including agendas, supporting materials, and minutes) with all members of the board, a task that has become much easier with the widespread use of electronic board portals.

More important than the written communication from the committee (which some members would avoid entirely) is the committee's oral report at the board meeting. The best committee reports are characterized more by their detail than by their length: *"The amount of time for a report varies significantly based on the committee's agenda,"* one member said. *"When we were dealing with an SEC matter, the audit committee report could be 40 minutes. Today, reports are closer to five."*

One director said that *"the best [reports] identify a few of the most important things that the committee did and explain them with color and life. You need to understand what the committee wrestled with. Too many times you go to a board meeting and the committee chairman goes through nine things perfunctorily, and everyone yawns and moves on."*

Ultimately the report should *"satisfy other directors that the responsibilities they have delegated to the committee are being executed properly,"* one director said. Members said that committee chairs should seek feedback (in the form of annual board evaluations or other less formal means) to ensure that committee reporting is meaningful in both scope and delivery. Effective reporting is yet another reason that members identified good communication skill as high on the list of criteria for selecting committee chairs.

---

<sup>7</sup> Lead Director Network, ["The Relationship Between The Lead Director And The CEO,"](#) *ViewPoints*, March 24, 2011, 5.

# Lead Director Network

## ViewPoints



### Would an executive committee be a benefit or detriment to the board?

The executive committee is typically granted power in its charter to act on behalf of the full board between regularly scheduled board meetings. The Conference Board's *2013 Director Compensation and Board Practices Report*<sup>8</sup> found that more than one-third of companies with at least \$5 billion in revenue have an established executive committee of the board,<sup>9</sup> a proportion roughly equivalent to that seen in the broader S&P 500.<sup>10</sup>

The opinions of LDN and ACLN members are divided over the benefits of an executive committee, although the balance of the membership seems to be against establishing them, or would favor severely limiting their use where they do exist. Some members value the coordinating and time-saving advantages of an executive committee, which can handle routine administrative matters. As one director said, *"I believe that most directors see the executive committee as a means to better use their time."* But other members are highly critical of the executive committee, saying that technology has rendered it unnecessary, or that it tends to create two classes of directors, hampering board engagement and potentially upsetting shareholders.

### Matching directors with board roles

Boards and committees work best with the right people in the right roles. Lead directors and audit committee chairs reflected on the profile of the ideal audit committee member, audit committee chair, and lead director.

#### Audit committee member

Boards have different informal requirements for audit committee membership, all designed to ensure that the audit committee effectively handles an expansive and technically challenging agenda. LDN and ACLN members focused their discussion on two important variables to consider when placing directors on the audit committee:

- **Financial expertise.** The 2013 Conference Board Report found that two-thirds of audit committees at companies with at least \$5 billion in revenue included a member who was not a financial expert.<sup>11</sup> One lead director said, *"I generally favor having all audit committee members be financial experts."* An audit chair emphasized the importance of expertise in noting, *"For those with non-financial backgrounds, I wonder how many eyes are staring but not seeing."* Other members suggested that non-experts can bring unique perspectives and generally ask the kinds of questions that experts might not ask. One audit chair said that he would *"refuse to chair an audit committee comprised only of experts. Asking simple, out-of-the-box questions is very important."* One director emphasized that

---

<sup>8</sup> The Conference Board, in collaboration with NASDAQ OMX and NYSE Euronext, organized a board practices survey of issuers registered with the SEC. Three hundred fifty-nine corporations participated in the survey in 2012. Those responses formed the basis for Matteo Tonello, *Director Compensation and Board Practices Report: 2013 Edition* (hereafter, "2013 Conference Board Report"), February 2013.

<sup>9</sup> *2013 Conference Board Report*, 195, Figure 13.2.

<sup>10</sup> *2012 Spencer Stuart Board Index*, 29 (reporting that 35% of S&P 500 companies have an executive committee).

<sup>11</sup> *2013 Conference Board Report*, 213, Figure 13.20.

# Lead Director Network

## ViewPoints



*“committee members do not need to be financial experts, but they certainly need to be financially literate.”*

- **Board experience.** Some boards routinely assign new board members to the audit committee. One director favorably recollected assignment to the audit committee upon joining one board: *“I certainly learned a lot very quickly.”* But one lead director reported *“a shift away from using the audit committee as training for new board members.”* Some boards require new directors to serve on the board for a set period of time, perhaps six months to one year, before they can join the audit committee. Other boards have noted a challenge in finding new board members willing or able to serve on the audit committee. Members observed that there are directors who will refuse to serve on the audit committee because of time commitment, liability exposure, or reputational risk; others are active executives at companies that prefer that their officers avoid audit committee service for the same reasons. *“Should we let a director serve on the board with those limits?”* one audit chair asked. *“I think it is unfair to the board if a director is unwilling to serve in any role that the board deems necessary.”*

### Audit committee chair

The importance of the audit committee chair can hardly be overstated. One lead director opined that *“it’s the single most important role on the board.”* Members overwhelmingly want an audit committee chair who is a financial expert – not just someone who qualifies under listing standards, but also, as one lead director said, someone who *“can go toe-to-toe with the CFO and external auditor on accounting issues, who has the stature and respect from management and outsiders.”*

Ideally, the financial expertise is based at least in part on recent experience. *“The more current you are, the quicker you can get to the right questions and focus on the right issues,”* one director said. *“A current CFO would be ideal.”* One audit chair suggested that *“serving as an audit chair on a different board should be seen as a positive factor, not a negative one,”* because that recent experience is so valuable.

It is not surprising that the 2013 Conference Board Report found that the audit committee is chaired by a CFO, finance director, or treasurer at one third of the surveyed companies with at least \$5 billion in revenue; another 15% are chaired by former accountants or auditors.<sup>12</sup> These results represent a significant change since 2002, when a different survey found that only 4% of S&P 500 audit committees were chaired by a financial executive.<sup>13</sup>

In addition to being comfortable with numbers, the ideal audit committee chair is also not shy about ruffling feathers from time to time. One director said that the audit chair *“needs to be comfortable in his or her own skin, and able to push back on management, experts, and others in a constructive way.”* As mentioned earlier, effective communication skills are essential to an audit committee chair’s success.

<sup>12</sup> *2013 Conference Board Report*, 204, Figure 13.10a.

<sup>13</sup> *2012 Spencer Stuart Board Index*, (Chicago: Spencer Stuart, 2012), 11.

# Lead Director Network

## ViewPoints



### Lead director

According to the Spencer Stuart 2012 Board Index, 43% of lead directors in the S&P 500 are retired chairmen, vice chairmen, presidents, or CEOs; another 16% of lead directors currently serve in one of those roles.<sup>14</sup> One lead director member noted that the ideal lead director's background includes "*broad business judgment, experience in all aspects of business, financial expertise, fine-tuned people skills.*" Many directors added that CEO experience would be optimal. One member said that an ideal lead director would "*have the ability to get consensus, handle different personalities, and maintain connections with every board member.*" Another observed that effective lead directors "*make sure that everyone is informed and engaged.*"

Audit chairs noted that an effective lead director always acts in service to the board. Some members expressed concern that a skilled lead director can sometimes be a little too willing to exercise his or her considerable executive strengths: "*The lead director at one of my companies has a lot of influence – I'd say too much,*" one audit chair noted. Nervous that directors might select an individual who would become overbearing as lead director, one audit chair was pleased to hear the newly appointed lead director declare that any such fears were misplaced: "*He put us at ease right away. When we notified him that he had been elected, he immediately said 'I'm here to serve the board.' We knew he meant it, that he was here to serve each of us. He knew he wasn't a first among equals.*"

### Rotation, retirement, and removal

Lead directors, audit committee chairs, and board members eventually leave their positions. Determining the right time to change leaders requires a balance of the benefits of continuity and tenure against periodic change that can bring energy and fresh ideas to the board. Members discussed three ways in which positions change over time: rotation, retirement, and removal.

- **Rotation.** Rotation policies are still rather rare: the 2013 Conference Board Report found that only 14% of companies with at least \$5 billion in revenue have a formal committee member rotation policy.<sup>15</sup> Some members were opposed in principle to rotating committee members or leadership positions. "*If something is working for the board, you shouldn't force rotation at an arbitrary time,*" one lead director said. But several saw benefit in periodic change and had rules of thumb for rotation, often ranging from three to seven years. Both audit chairs and lead directors said that too-frequent rotation of their roles would be damaging. According to one member, lead directors "*need to establish themselves*" to be a true counterweight to the CEO; audit committee chairs need continuity, particularly against the backdrop of five-year mandatory audit partner rotation.
- **Retirement.** One member pointed to mandatory retirement as an alternative to having a rotation policy. Mandatory retirement policies are common, particularly at larger companies. The 2013 Conference Board Report noted that 77% of companies with at least \$5 billion in revenue have an age-based mandatory director-retirement policy; 2% have policies based on tenure.<sup>16</sup> For companies

<sup>14</sup> *2012 Spencer Stuart Board Index*, 26.

<sup>15</sup> *2013 Conference Board Report*, 211, Figure 13.18.

<sup>16</sup> *2012 Spencer Stuart Board Index*, 175, Figure 12.2.

# Lead Director Network

## ViewPoints



that have such policies, the median retirement age is 72.<sup>17</sup> Spencer Stuart's Board Index notes that the average mandatory retirement age has risen over the last decade: the percentage of S&P 500 boards with a mandatory retirement age of 70 has decreased from 59% to 14% over 10 years.<sup>18</sup>

- **Removal.** Many members were concerned that rotation and retirement policies could provide a ready-made excuse for avoiding difficult conversations about (and with) an underperforming director. Members said that it is obvious to the board when someone is not pulling his or her weight. *"I don't think that boards should ignore a director who is underperforming because they only have a few years [of eligibility] left,"* one director said. Anticipated departures should *"not excuse healthy and robust board evaluation and conscious decisions about membership."* Another agreed: *"If somebody is not doing a good job, we need to surface it and deal with it."* One director said that boards should also be willing to consider replacing a director whose performance is satisfactory when *"a committee is looking for fresh ideas, growing stale, or the board needs someone with different experience."* Another director said that regular and rigorous self-evaluation was important, but that it should not focus on the individual: *"The process should not be about removing a director but about improving the performance of the board as a whole."*

### Conclusion

Regardless of industry or board size, effective board and committee leadership depends first and foremost on directors' commitment to excellence in governing the companies they have been elected to serve. The many ways that that commitment can manifest itself – from committee makeup, to agenda-setting, to policies on rotation and removal – in turn rely on thoughtful, deliberate choices made by directors in board leadership positions. Directors do not make these choices in a vacuum, however. Strong communication skills, including listening to their fellow directors and to management, therefore rank nearly as high as judgment and experience among the qualities most desired in an effective director and on an effective board.

### About this document

*The Audit Committee Leadership Network is a group of audit committee chairs drawn from leading North American companies committed to improving the performance of audit committees and enhancing trust in financial markets. The network is organized and led by Tapestry Networks with the support of EY as part of its continuing commitment to board effectiveness and good governance.*

*The Lead Director Network (LDN) is sponsored by King & Spalding and convened by Tapestry Networks. Drawn from America's leading corporations, the LDN is a group of lead independent directors, presiding directors, and non-executive chairmen who are committed to improving the performance of their companies and to earning the trust of their shareholders through more effective board leadership. The views expressed in this document do not constitute advice for any purpose (legal, financial, business, or otherwise) of network members, their companies, King & Spalding, or Tapestry Networks.*

*Copyright © 2013 Tapestry Networks, Inc., with all rights reserved. This material may be reproduced and redistributed but only in its entirety including all copyright and trademark legends.*

---

<sup>17</sup> *Ibid.*, 176.

<sup>18</sup> *Ibid.*, 10.

# Lead Director Network

## ViewPoints



### Appendix: Participants

The following non-executive directors participated in the meeting:

- Denny Beresford, Audit Committee Chair, Legg Mason
- Les Brun, Audit Committee Chair, Merck
- Aldo Cardoso, Audit Committee Chair, GDF SUEZ
- Loren Carroll, Lead Director, KBR
- Don Felsing, Lead Director, Northrop Grumman Corporation
- Gene Fife, Former Presiding Director, Caterpillar
- Ray Gilmartin, Presiding Director, General Mills
- Ann Maynard Gray, Lead Director, Duke Energy
- Michele Hooper, Audit Committee Chair, PPG Industries
- Labe Jackson, Audit Committee Chair, JPMorgan Chase
- Marie Knowles, Audit Committee Chair, McKesson
- Alex Mandl, Lead Director, Dell Inc.; Non-Executive Chairman, Gemalto
- Ellen Marram, Lead Director, Eli Lilly; Presiding Director, Ford Motor Company
- Heidi Miller, Board Member, General Mills
- Chuck Noski, Audit Committee Chair, Microsoft Corporation
- Jack O'Brien, Lead Director, TJX; Non-Executive Chairman, Cabot
- Tom O'Neill, Former Audit Committee Chair, Archer Daniels Midland
- Sandy Warner, Audit Committee Chair, General Electric Company

The following non-executive directors took part in pre- or post-meeting discussions:

- Peter Browning, Lead Director, Acuity Brands and Nucor
- Dan Feehan, Non-Executive Chairman, RadioShack
- Dick Goldstein, Former Presiding Director, Interpublic Group
- Bonnie Hill, Lead Director, The Home Depot
- Ed Kangas, Non-Executive Chairman, Tenet Healthcare; Lead Director, United Technologies
- George Munoz, Altria and Marriott International
- Oscar Munoz, United Continental Holdings

# Lead Director Network

## ViewPoints



- Bill Osborn, Audit Committee Chair, Caterpillar
- Dan Schulman, Non-Executive Chairman, Symantec Corporation
- Stephanie Shern, Presiding Director, GameStop
- Ron Williams, Audit Committee Chair, American Express

The following King & Spalding attorneys participated in all or some of the meeting:

- Bill Bates, Partner, Corporate Practice Group
- Rich Marooney, Partner, Business Litigation Practice Group
- Michael Smith, Partner, Co-Chair of the Securities Litigation Practice Group
- Chris Wray, Partner; Chair of the Special Matters and Government Investigations Practice Group

The following EY partners participated in all or some of the meeting:

- Les Brorsen, Americas Director, Office of Public Policy
- Tom Hough, Americas Vice Chair of Assurance Services
- Steve Howe, Americas Managing Partner
- Brian Loughman, Americas Leader, Fraud Investigations & Dispute Services