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NACD

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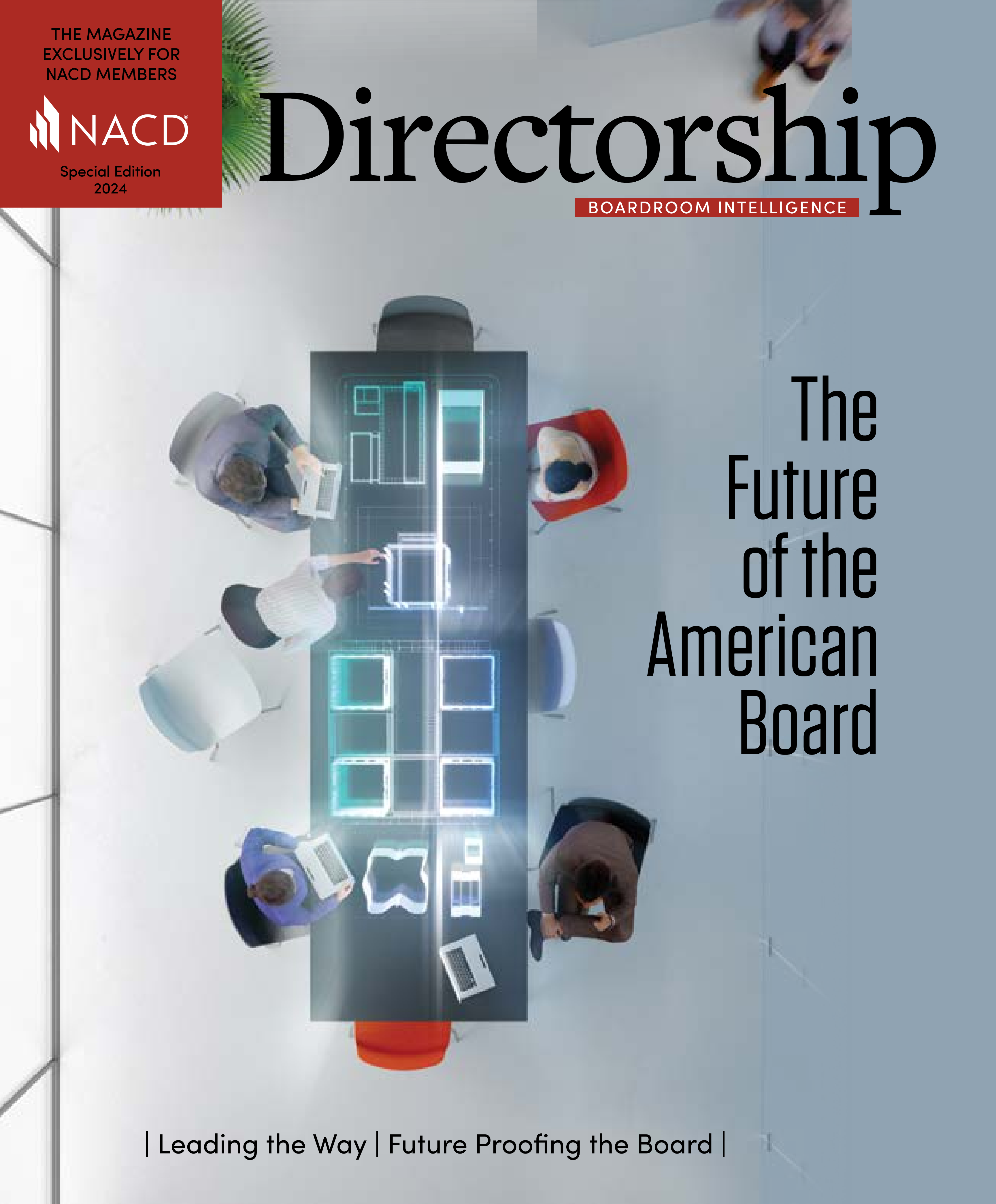
Directorship

BOARDROOM INTELLIGENCE



The Future of the American Board

| Leading the Way | Future Proofing the Board |

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CEO LETTER

The Best Governance Principles for Facing Your Company's Future

PROBABLY the most frequent word I've heard this year has been "uncertainty." The last few years have been challenging to say the least, and we all know that more challenges lie ahead. Some foreseeable challenges include the continuing economic volatility that has been upon us for the last several years. For example: How can boards and CFOs plan for their financial future if the same Federal Reserve that promised a "higher for longer" policy back in September is now rumored to be planning rate cuts? How can boards and general counsels plan for their company's regulatory future when the two leading candidates for president are diametrical opposites who are running dead-even right now? How can directors oversee supply chains when no one can predict the price of oil, and no one knows how long the wars in Ukraine and Gaza will last or how they may spread? How can directors include climate change into their strategies when it seems that every new study reveals that the planet is getting hotter much faster than predicted, with previously unforeseen results. And how can directors approving major technological investments ensure cybersecurity within a brand-new regulatory disclosure framework, while anticipating trends out of left field in artificial intelligence (AI), quantum computing, and other emerging technologies?

The questions are rhetorical, of course. Directors can try to do these things, but their success is far from assured. Yet although the future facing American boards may be less predictable than ever, it is also more navigable than ever, because of the long years of steady preparation that directors have done to improve their own performance—and in the process to become more adaptable to change. In the almost quarter century that I have served the NACD, I have seen dramatic progress delivered via our Blue Ribbon Commission reports, beginning with the then-radical concept of "professionalism" and moving on to such topics as direct board involvement in strategy; board-driven risk oversight; board and director evaluation; board diversity; board culture; and in recent years director certification.

At a time when many boards may be tempted to start recruiting narrow specialists to the board, and hiring forecasters galore, it may be helpful to recall the hopeful words attributed to American anthropologist Margaret Mead: "Never doubt that a small group of thoughtful, committed citizens can change the world. Indeed, it's the only thing that ever has."

Boards need to adapt to ensure that they are well-positioned for exercising their significant governance responsibilities. They will need to challenge their own workings and spur boardroom conversations about their own performance to position their companies for success today—and tomorrow.

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EDITOR'S NOTE

The Future-Ready Board

IN THE LAST FEW YEARS, the world has changed rapidly in unforeseen ways: a global pandemic interrupting life and work, stakeholders becoming increasingly socially conscious, geopolitical upheaval, technological advances disrupting careers and industries, and more. In a world that seems less governable from a societal perspective, ensuring the future of good corporate governance is more important than ever. The multi-year NACD initiative on The Future of the American Board developed a principle-based framework for good governance that can help directors guide their organizations toward long-term and more sustainable growth in a turbulent landscape. That initiative inspired this special digital edition of *Directorship* magazine intended to illuminate the new and sometimes provocative guidance for corporate boards.

In this special digital edition, which we are sharing beyond our members because we believe that educating directors and the greater business community about board readiness for a more demanding future and how to harness this guidance in practice is part of our mission, we gather the expertise of several commissioners who participated in the Commission on the Future of the American Board.

Co-chairs Sue Cole and Bill McNabb set the tone for this issue with "What's Needed for the Future of the American Board."

"Future Proofing the Board" by Holly Gregory provides an overview of how incorporating principles of effective corporate governance can help prepare boards to tackle challenges facing corporations and boardrooms. As Gregory writes: "Governing a company to succeed in this fast-moving, highly complex, and disruptive world of competing demands requires that the board be focused, agile, and highly attuned to the environment in which the company operates, the risks to which it is exposed, the varied and often competing expectations of key stakeholders, and the likely impact of corporate actions."

In "Sustainability Takes on New Meaning," Judy Samuelson discusses the ESG aspect of the future of corporate governance and tell us: "It's the 'G' of ESG that matters most." Furthermore, Samuelson reminds us that corporate purpose is indeed more than a mission statement: "Boards with clarity about why the company exists are better able to focus on what is material to the enterprise and to align operations with their goals and intentions."

Lynn Clarke offers a five-step approach on how to use of the principles to strengthen board performance in her article, "How to Create an Even Higher-Performing Board."

Additionally, the article "Leading the Way: Good Governance and the Future of the American Board" by Mandy Wright, senior editor of *Directorship* magazine, reminds us that "defining corporate purpose means nothing if the board cannot learn to work as a team to put that purpose into action." Truly, directors need to work in cohesion to create a high-performing board that will serve the corporation they govern for years to come.

We hope that the advice and insights shared in this special digital issue offer a clear roadmap for boards to lead into the future and can spur meaningful conversations in your boardrooms about sometimes difficult changes.

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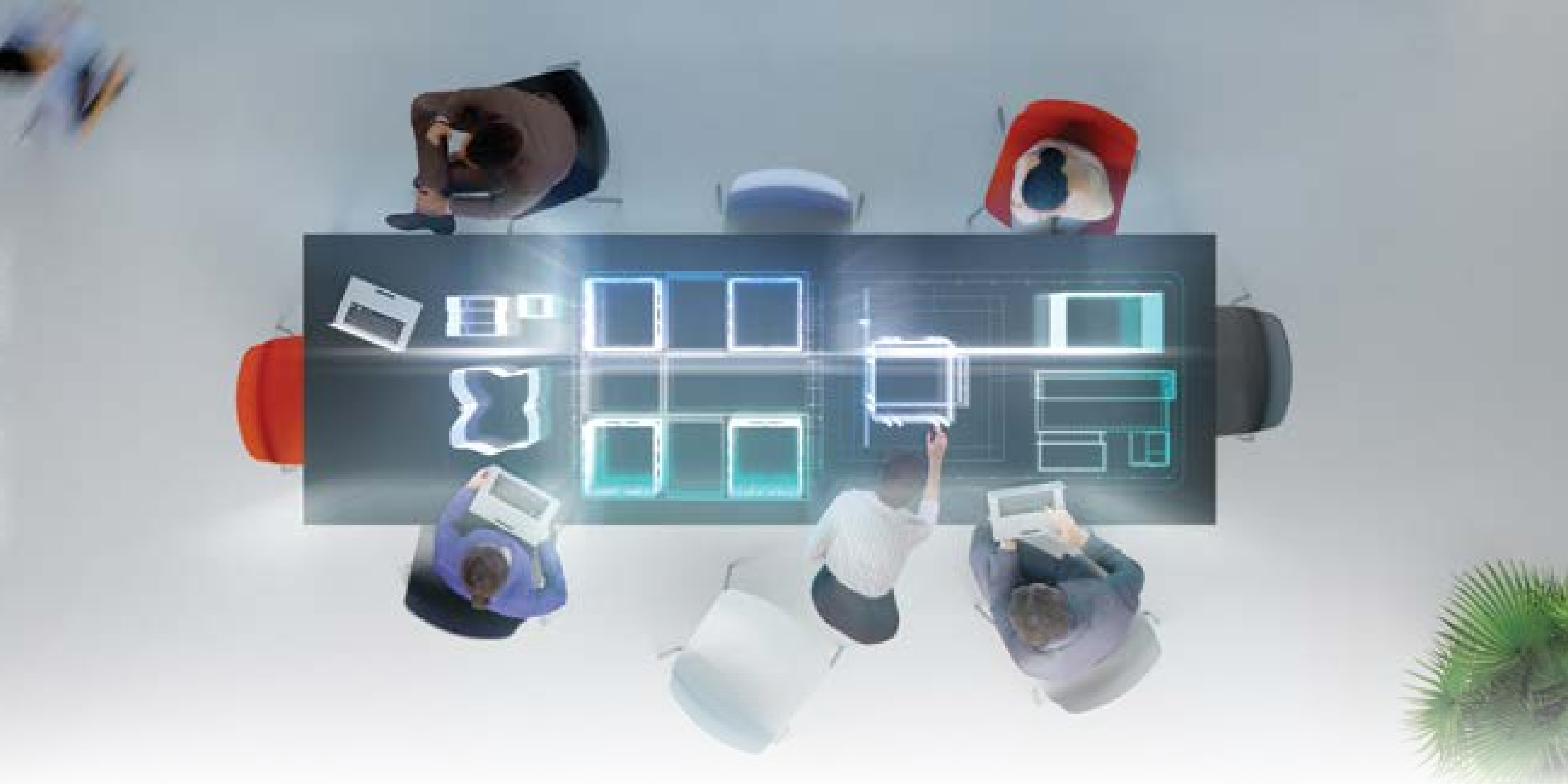

What's Needed for the Future of the American Board

By Sue Cole and William McNabb

CORPORATE BOARDS ARE AT A CRITICAL JUNCTURE: Intensifying pressures and demands will require boards to govern differently and challenge how they assess and reward performance and manage their own workings.

Last year NACD brought together board leaders and governance experts to discuss what will strengthen board performance in the coming years and what longstanding governance practices and norms may need to change. This work culminated with the release of *The Future of the American Board*, a report about leading boards into the future and about positioning them to become better stewards of long-term value creation for all stakeholders.

Re-envisioning what it takes to be a successful board (and not just a strong individual director) that can significantly influence sustainable business performance will not be an easy process. It will involve challenging discussions about the purpose of the corporation and the accountabilities of the board. It will entail uncomfortable decisions about board members who are not fit for the future, and difficult changes to reinvent board processes and reshape behaviors. It will demand a commitment to continuous and fast learning on new drivers and derailers of value and to creating room for diverse voices and perspectives.

Why now?

And this work by boards is urgent. The intensity and accelerating pace of change is real, leading to a fundamentally different operating reality than incumbent executives and directors have experienced in their careers and shifting how businesses generate, preserve, and report value. Disruptions involving economic conditions, the geopolitical order, technology advancements, labor market dynamics, supply chains, regulation, climate change, and social and investor activism are reshaping society and business in powerful ways and, perhaps most important for this work, are transforming the role of business and how companies are governed. The reward is clear: in a world that seems less governable, the quality of board governance is increasingly vital to the sustainability of our enterprises and trust in our market economy.

The Commission's Focus

In early 2022, NACD established the Commission on the Future of the American Board to reassess the Key Agreed Principles it issued in 2011 and refresh its guidance to help boards future proof themselves. The Commission—comprised of experienced board leaders, investors, CEOs, academics, and former regulators—met

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repeatedly over a six-month period to discuss several fundamental questions that are acute today and will become even more urgent in the coming years:

- How do we expect external pressures and forces affecting board governance to change in the coming years?
- Are there long-standing norms and practices that we must forcefully challenge?
- How can we solve for the critical inherent tensions in board governance? In particular, the growing need for deep, proactive board engagement while preserving independence; the focus on long-term strategy and value creation in the face of short-term pressures; and the tension between retaining institutional knowledge and injecting fresh, new, and diverse perspectives and experiences on the board.
- How must we adapt the workings of the board to be more agile and more prepared to engage management on high-stakes, complex, and often new issues and inform fast but high-quality decisions?
- How can the board be assured that it has appropriate visibility into issues that affect the workforce?

These extensive discussions offered vastly different viewpoints and surfaced emerging board practices from leading companies were the foundation as of the new "Framework for Governing into the Future" based on a revision of the Key Agreed Principles. This Framework is intended to be utilized by public and private companies as well as by investors and advisors interested in strengthening board quality in the coming years. Each one of the principles is supported by key implications for boards, relevant context, and implementation guidance, including key questions for boards to consider.

Our Key Takeaways

To advance their performance, boards must now focus on the more nuanced and difficult issues: issues of purpose, accountability, objectivity, information, relationships, talent, culture, commitment, refreshment, and engagement that are highly context dependent and to a large degree rely on the collective behaviors of individual directors. Focusing on these 10 areas can help boards thrive:

Purpose: View corporate purpose as a motivating and unifying force and rethink corporate success through a long-term lens.

Accountability: Recognize that consideration of employee, customer, and other stakeholder interests is key to acting in the corporation's best interests and delivering value over the long term to shareholders.

Objectivity and Oversight: Embrace board self-determination regarding both governance and agenda priorities.

Information: Position the board for informed, deliberative, and agile decision-making through board determination of information needs, and fit-for-purpose information and reporting systems.

Relationships: Bolster trust in board and board-management relationships through agreed norms of behavior.

Talent: Pay attention to issues impacting the workforce and understand the link between strategic imperatives and officer and employee capabilities and constraints.

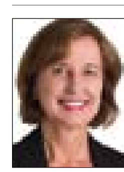
Culture: Define the parameters of desired corporate and board culture and monitor them.

Commitment: Recognize that more is required of directors to stay well informed and to be available on a far more frequent and flexible basis.

Refreshment: Avoid defaulting to renomination rather than undertaking tough decisions.

Engagement: Value interactions with shareholders, employees, and other key stakeholders as opportunities to learn about their interests and concerns and to build relationships of trust.

We predict that the work of the board will become more complex in an ever-more-turbulent environment. These principles provide guidance to help boards reassess their priorities and governance approach in the interests of ensuring that the US corporation remains fit for purpose in providing goods and services in a manner that benefits stakeholders and society at large.



SUE COLE is the cochair of the NACD Future of the American Board Commission and chair of the NACD Board of Directors. Cole is currently the managing partner of SAGE Leadership & Strategy LLC, a boutique advisory firm she founded in 2011 to advise family businesses and large non-profits on strategy, leadership development, and governance. She is a director for Biscuitville, Diversified Trust Co., Martin Marietta Materials; she has more than 35 years of experience in the financial services industry, including corporate lending and wealth management.

F. WILLIAM MCNABB III is the cochair of the NACD Future of the American Board Commission and is the former chair and CEO of Vanguard. He stepped down as CEO at the end of 2017 and as chair at the end of 2018. He is a board member of UnitedHealth Group and chair of EY's Independent Audit Quality Committee, and he also chairs the board of the Zoological Society of Philadelphia. In addition, McNabb is a board member of CECP: The CEO Force for Good and of the Philadelphia School Partnership. He is the executive in residence at the Raj & Kamla Gupta Governance Institute at the LeBow College of Business. He serves on the advisory boards of the Ira M. Millstein Center for Global Markets and Corporate Ownership at Columbia Law School, the Wharton Leadership Advisory Board, and the Dartmouth Athletic Advisory Board. He is also a member of The Wharton School's Graduate Executive Board.

Leading THE Way

Good Governance and the Future of the American Board

The nature of life and work has changed drastically since early 2020, with stakeholders becoming increasingly socially conscious, technological advances disrupting careers and industries, and more. In a world that seems less governable from a societal perspective, corporate governance has become even more important. The NACD initiative on The Future of the American Board identified 10 core principles of good governance that can help boards guide their organizations toward making the best decisions for the company and for society. There seems to be no better time for championing effective corporate governance than now.

BY MANDY WRIGHT

LAST YEAR, how many people would have bet on the downfall of one-time wunderkind Sam Bankman-Fried and his cryptocurrency exchange FTX, or the collapse of multiple regional banks, including Silicon Valley Bank, a few months later? How many board members could have predicted that the use of artificial intelligence would increase suddenly and exponentially with the release of publicly facing tools in November 2022? How many boards were discussing the potential ramifications of the debt limit crisis that would play out the following spring?

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Geopolitical tensions, soaring inflation, supply chain issues, changing workforce dynamics, and more were challenging boards then as well as now. But the problems facing businesses and their boards are only growing more intricate and numerous.

In 2011, NACD published the *Key Agreed Principles to Strengthen Corporate Governance for US Publicly Traded Companies*, which listed 10 principles that represented the governance best practices of the time. The enormous change that the world of business and beyond has experienced over the past few years called for a reassessment of the way boards approach their responsibilities, leading to NACD's formation in 2922 of the Future of the American Board Commission.

"Disruptions involving shifting economic conditions, the geopolitical order, advancements in technology, labor market dynamics, supply chains, regulation, climate change, and social and investor activism are reshaping society and are transforming the role of business," said commission cochair Bill McNabb, former chair and CEO of Vanguard and coauthor of *Talent, Strategy, Risk: How Investors and Boards Are Redefining Risks*. "The boards of directors who guide corporate activity also need to adapt to assure that corporate governance keeps pace."

"I would suggest that the work that the Future of the American Board Commission did is actually prescient in some ways given the additional challenges that we have faced," said Donna F. Zarcone, president and CEO of DF Zarcone & Associates and a director of CDW Corp., Cigna Group, The Duchossois Group, and Quinnox. She is also a member of the Smithsonian National Board.

"The dynamics that the [Future of the American Board] framework talks about ... are myriad factors that every company is having to deal with. And they're having to deal with it in the spotlight, for the most part, and they're having to deal with it in a way that requires them to move more quickly and with more agility," said Luis A. Aguilar, former commissioner of the US Securities and Exchange Commission, a board member at Donnelley Financial Solutions and Envestnet, and a principal at Falcon Cyber Investments. "To me, that's almost a definition of a critical juncture point. The status quo, the way you've done things, isn't really going to work in today's present and in the future. And the way you go about dealing with it will define whether or not people outside objectively see you as having been on the winning side."

"It's an emphasis on a different dynamic for how the engagement should happen," added Orlando D. Ashford, chief people officer of Fanatics, chair of Perrigo Co., and a director of Array Technologies and Syndio Solutions. "Businesses have always had different challenges to manage.... I just think that the issues are faster pace, more complex, and they anchor a lot on talent, people, [and] culture, and we call it out in ways that we did not in the past."

Purpose at the Core

The *Future of the American Board* report centers on such thematic issues perhaps more than the *Key Agreed Principles*, which focused almost entirely on board operations, and it sets corporate purpose as the overarching principle. But don't just take the commissioners' word for the importance of purpose to the future

About the Future of the American Board Commission

NACD RELEASED the *Future of the American Board: A Framework for Governing into the Future* report to help guide boards into the future, position them to become better stewards of long-term value creation for all stakeholders, and meet broadening expectations at a time when business is being called on to address an increasing number of challenges facing the nation and the planet.

In January 2022, NACD assembled a Commission of 19 experienced board leaders, investors, CEOs, academics, and former regulators to discuss how intensifying pressures and demands on boards will affect their governance in the coming years and how boards can best adapt their workings. The Commission's purpose was to develop guiding principles to help boards build toward high performance in a more demanding, inclusive, and turbulent future. The result of the intensive work of the Commission is the *Future of the American Board: A Framework for Governing into the Future*, which was released in fall 2022.

The report offers a principles-based framework to build toward high performance that invites each board to discuss how it can best adapt to a different future, rather than a detailed prescription on how boards must change their practices, processes, and structures. The report's guiding principles, each with companion questions that boards can use to spur discussion, focus on the importance of corporate purpose, accountability to all relevant stakeholders, board-management relationships, and agility in how the board operates and acts.

To further the work of the report, NACD and select partners released several blueprints to assist the work of specific board committees with a future-focused lens.

of governance: according to the *2023 NACD Trends and Priorities Survey*, 44.1 percent of director respondents said that they expect to see a much stronger focus on corporate purpose in the pursuit of long-term value creation over the next three years. Consider also the Business Roundtable's "Statement on the Purpose of a Corporation," issued in August 2019, which emphasized the role of companies as a benefactor to all stakeholders, not just shareholders, and society at large.

"The fact of the matter is, boards need to be much more explicit about having the good fight, about how they are viewing the landscape of stakeholders, and that relates very much to whether we're going to be more short term or long term about certain issues," said Linda A. Hill, cofounder of Paradox Strategies, the Wallace Brett Donham Professor of Business Administration at Harvard Business School, and faculty chair of the school's Leadership Initiative.

"If customers are not happy with your products, they're not

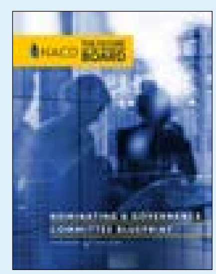
Audit Committee Blueprint

Audit committee responsibilities have moved beyond the numbers, with the committee taking on oversight related to cybersecurity, ESG, and talent management. This blueprint looks at 10 essential areas of audit committee focus and provides members of the audit committee and the board of directors' insight into what is happening now and what to expect in the future. The report, developed by KPMG and NACD in collaboration with a seasoned group of directors, provides key insights into the growing complexities that audit committee members must manage outside of their core responsibilities on financial and audit matters, as well as discussion related to internal audit, transparency in proxy disclosures, and risk management.

Compensation Committee Blueprint

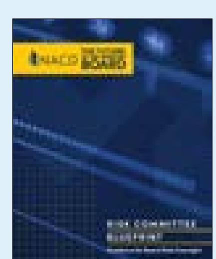
To further the work of the Future of the American Board Commission, a panel of experts composed of NACD-affiliated directors and senior leaders from Pearl Meyer have authored the *Compensation Committee Blueprint*. Members of compensation committees—at public and private companies—can refer to this blueprint to understand the changing implications for their own boards and use the report's questions, tools, and checklists to determine what changes may be warranted for their committee and charter and how to implement and manage these changes. A key finding of the Compensation Committee Working Group is that companies are increasingly signaling the expanding oversight role of their compensation committees by updating the committee's name, charter, or both.

Nominating & Governance Committee Blueprint



Korn Ferry and NACD, in collaboration with a diverse working group of leading nominating and governance committee chairs, developed this blueprint report to help nominating and governance committees navigate the various forces they will confront in the future. The blueprint identifies five focus areas for nominating and governance committees with key insights and best practices that committee chairs and members can use to improve board culture, director recruitment and renomination, director and board education, and stakeholder and shareholder engagement. As the working group identified, "board performance, composition, and culture can be either a corporate asset or a liability, depending on how effectively the board fulfills its responsibilities and supports the company's long-term success." This blueprint provides the actionable guidance nominating and governance committees need to make this statement a reality.

Risk Committee Blueprint



NACD, in partnership with Marsh McLennan, developed this blueprint report as both a call to action for boards to elevate their risk oversight and as an assessment tool for boards—with or without risk committees—to use to help them execute on expanded risk oversight responsibilities. NACD and Marsh McLennan led a working group of corporate board leaders from NACD-affiliated organizations as well as senior leaders from Marsh McLennan to identify four critical areas of focus for boards seeking to expand their risk oversight responsibilities: Oversight Structure, Expertise and Board Composition, Reporting and Communications, and Calendar and Committee Agenda.

A FRAMEWORK FOR GOVERNING INTO THE FUTURE

How to Use the Future of the American Board report's 10 Principles in the Boardroom

- Spur discussion about specific changes your board is considering in its governance approach.
- Strengthen the board evaluation process.
- Test expectations with management on reporting on strategy, risk, and human capital.
- Strengthen the narrative about the role of the board in engagement with investors.

PRINCIPLE ONE

CORPORATE PURPOSE

The company's purpose, as defined by the problems addressed and the needs filled by its goods and/or services, should drive its behavior, shape its governance, and position the company to create sustainable long-term value.

PRINCIPLE TWO

RESPONSIBILITY & ACCOUNTABILITY

The board is responsible for the long-term sustainable performance of the company, and governance structures and practices should be designed by the board to position it to function effectively, efficiently, and in an accountable manner.

PRINCIPLE THREE

OBJECTIVITY & OVERSIGHT

Governance structures and practices should position the board to provide objective judgment and active oversight, supported by board leadership that is distinct from management.

PRINCIPLE FOUR

AGENDA & INFORMATION

Governance structures and practices should be designed to support the board in determining its own priorities, agendas, and information needs, and to assist the board in focusing on priority issues.

PRINCIPLE FIVE

BOARD-MANAGEMENT RELATIONS

Governance structures and practices should support a relationship between the board and senior management that is open, objective, and both constructively supportive and challenging.

PRINCIPLE SIX

STRATEGY & RISK

Governance structures and practices should support the board as adaptive and agile, focused on strategy and risk, and prepared to take appropriate action in a crisis.

PRINCIPLE SEVEN

TALENT & COMPENSATION

Governance structures and practices should support board focus on the corporate policies and practices that support the attraction, retention, development, compensation, and well-being of the talented and motivated workforce required for the corporation to succeed.

PRINCIPLE EIGHT

CORPORATE & BOARD CULTURE

Governance structures and practices should position the board to provide oversight of corporate and board culture, with the objective of promoting integrity, inclusion, and responsibility.

PRINCIPLE NINE

COMPOSITION, REFRESHMENT & DIVERSITY

Governance structures and practices should be designed to ensure that board and committee composition align with changing needs and that directors are competent, committed, and diverse.

PRINCIPLE TEN

TRANSPARENCY, COMMUNICATIONS & ENGAGEMENT

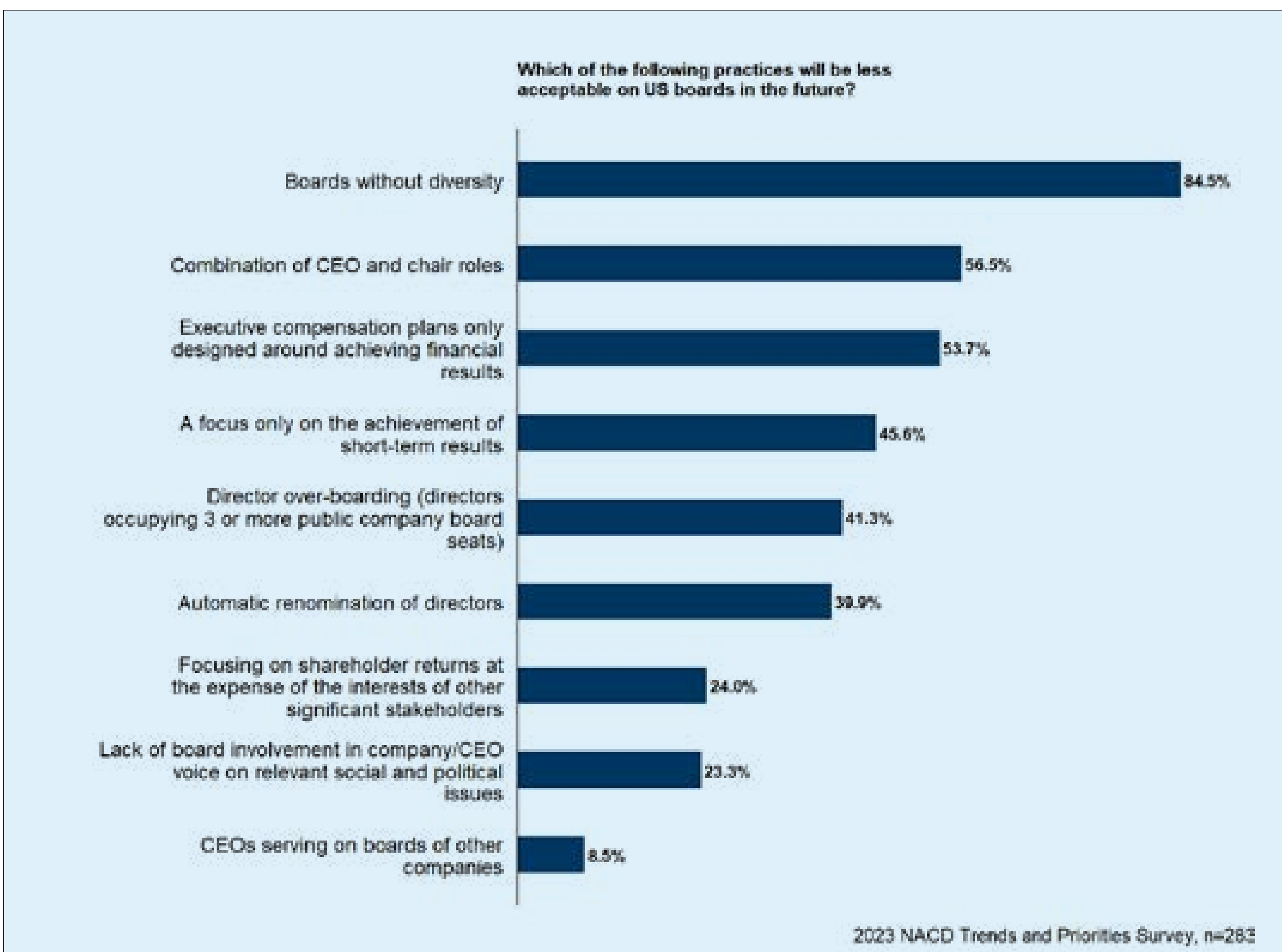
Governance structures and practices should be transparent and designed to encourage communication and engagement with shareholders and other key stakeholders on matters of importance.

going to buy them. Paying heed to the views of stakeholders is not putting them above shareholders. It's simply recognizing that they're an important component of success in any company," said Aguilar. "And you need to listen to them, you need to pay attention to them. If they've got concerns about your operations, you need to sit down and talk with them. You may learn something; they may learn something from you. But ignoring them because you're so focused on shareholders will ultimately ... be detrimental to the value of the company and detrimental to the shareholders."

Especially post-pandemic, when employees and consumers expect far more from companies, corporate purpose and long-term sustainability are inextricably linked to stakeholder interests. But corporate purpose isn't just about meeting demands for wider societal consideration and impact. When discussed thoughtfully and laid out transparently, purpose informs company culture as well as the company's strategy.

"Having companies that are grounded in purpose, an inherent value that's being delivered behind what the business does, which is a little bit bigger than the simple, 'Buy this because it's cool, or use this because you need it or want it'... if we can connect it to a purpose that's a bit bigger in terms of society or community, we think those businesses have more strength and are sustainable longer," said Ashford.

"There were some different views on what the hierarchy or the ordering should be of the principles," said Aguilar. "They're all interconnected, they're all interrelated, they're all important. But no one argued that corporate purpose shouldn't be at the top.... Corporate purpose as a driver for decision-making is a powerful, powerful tool."



Board Effectiveness and Culture

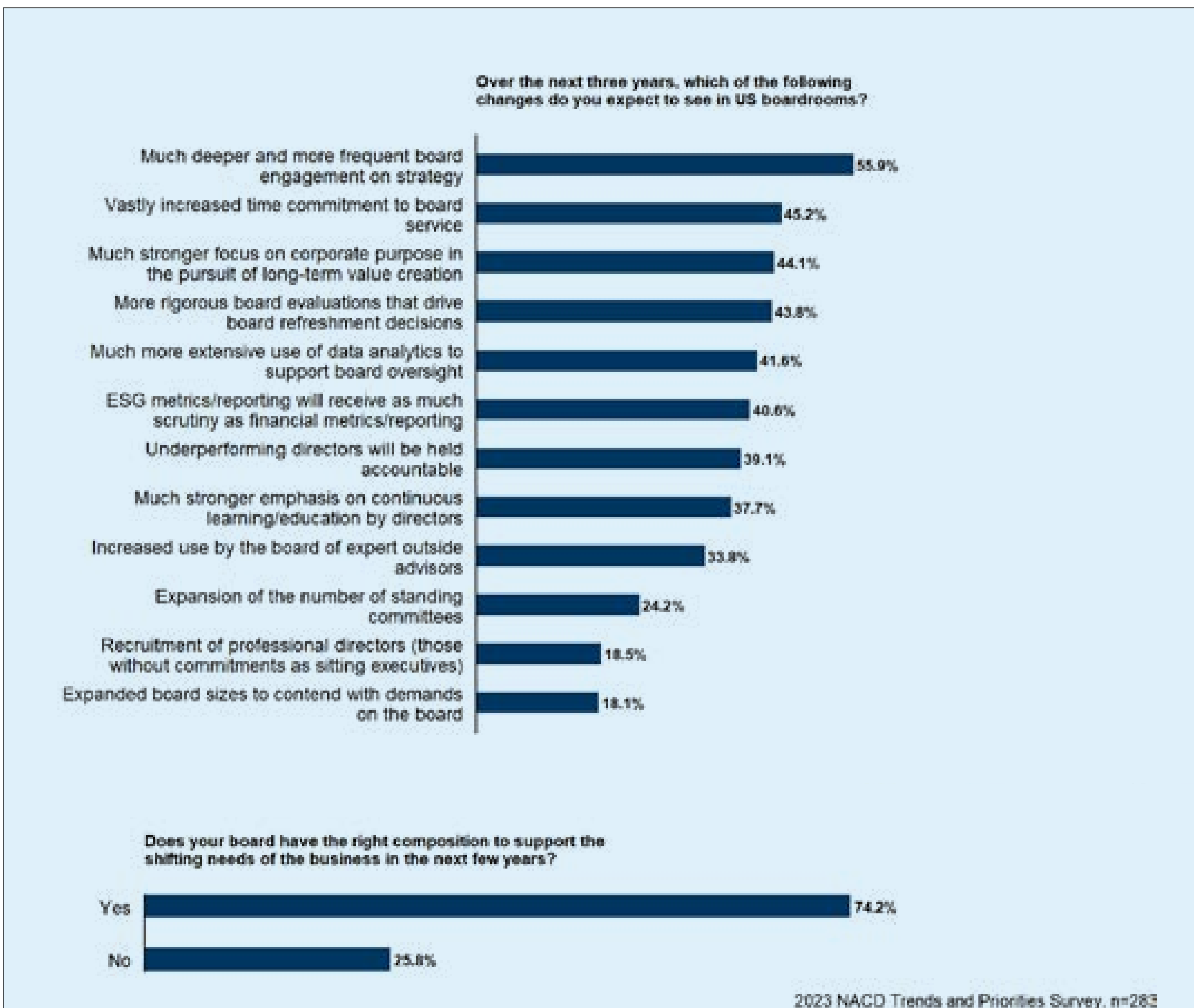
That's not to say the Future of the American Board commissioners sidelined board operations. In fact, about half of the principles deal directly with board functionality.

"The operations of the board are critical, because if you operate well and use your time well, then you can fulfill your responsibilities much more effectively," Zarcone said.

Defining corporate purpose means nothing if the board cannot learn to work as a team to put that purpose into action. But few boards seem to see themselves as a team.

"At best they'd say, 'I'm on the team,' but do we know how to work as a team?" said Hill. "Unless you really work hard at it, that group doesn't really know each other all that well. One of the things that we do see, they're not as cohesive. What I mean by that is they don't interact all that much given the nature of the kinds of decisions they're supposed to be making.... How much opportunity have they had to build trust?"

Trust, cohesion, and working as a team can foster the right dynamics to allow boards to be agile and innovative in problem-solving, according to Hill. It may seem counterintuitive, then,



to say that boards also need what Hill calls "creative abrasion," but trust should be built among board members with the goal of obtaining the ability to disagree constructively.

"There are so many topics that never get explicitly discussed, and consequently, board members are acting as if they do know what everyone thinks about X, Y, [or] Z," she said. "And there actually hasn't been the discussion."

Having uncomfortable discussions that incorporate diverse viewpoints can be supported by creating psychological safety, or the ability to speak up without fear of retribution or humiliation. "There's all this writing about psychological safety, but I think we forget that board members don't feel psychological safety either. How do you help them feel safe enough to say and do what they need to do and say?" Hill said.

"I sometimes joke [that] our discussions are sometimes lumpy, but we know the best decisions, when you're going through that lumpiness, take effort because you have to create space for the different points of view, for the debate to happen, for there to be some tension," Ashford said. "Then if you can work through the tension to different perspectives and the debate, you end up with better answers.... So, [be] more conscious about that and lean into the lumpiness or the tension or the disagreement at times to get to the better outcome."

Diversity and People

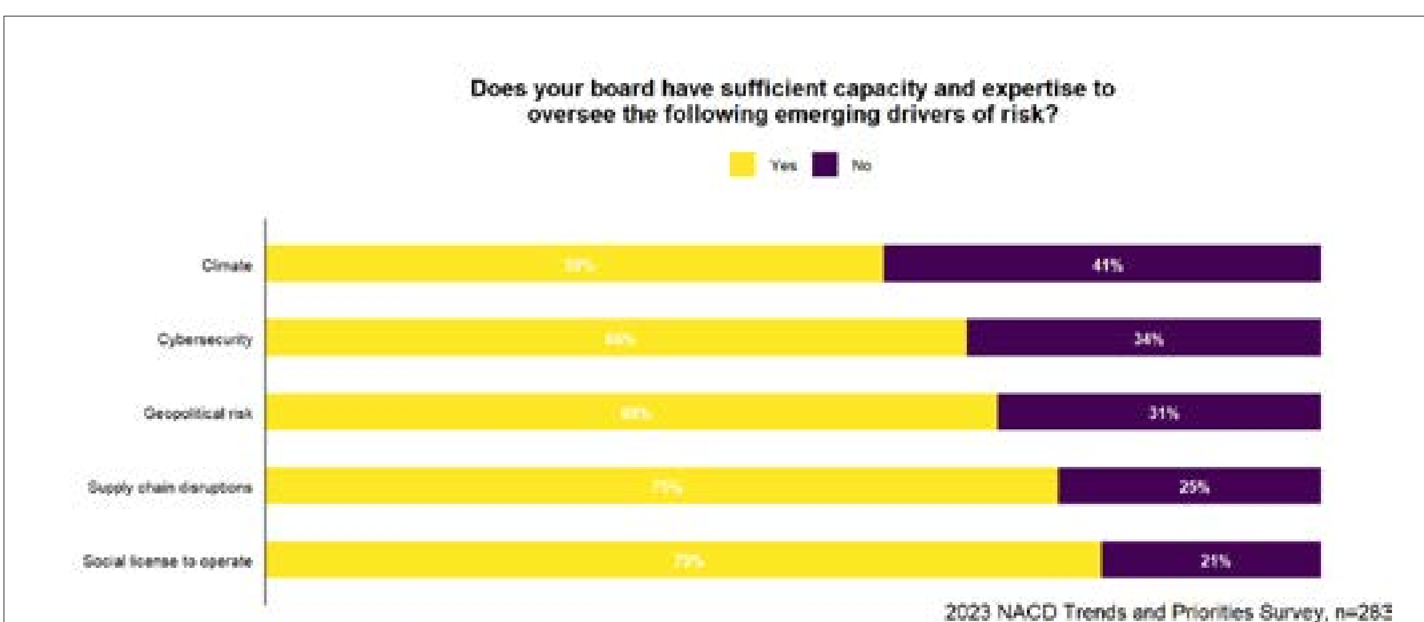
Hill sees a lack of explicit and constructive discussion especially about diversity, equity, and inclusion (DE&I). "I don't know that many boards have any kind of larger discussion about why we're doing this, what we hope to accomplish, and ... if it's going to work, what do we need to do to help it work," Hill said. "I think that those discussions are not actually had by the whole board.... It's not that anyone's not well intentioned, but you all have your own minds, your own mind-set about what it means to have [it], why we're doing this, what it's about. I know that it doesn't get discussed, so, consequently, we don't do any work."

In the 2023 *NACD Trends and Priorities Survey*, 84.5 percent of respondents said that boards without diversity will be less acceptable in the future, suggesting how imperative it is that boards have discussions about DE&I considering board members and the wider workforce.

"Boardrooms and management teams are having conversations about, 'Well, what's our response to this?' Because if there is a discussion around equal access to all people, that is going to have to come from companies," said Ashford. "We're not going to look for the government to legislate equal opportunity because they're making a decision not to. But then corporations will have to take that off, and that's boardroom discussion now."

What can also be difficult for boards to discuss when it comes to talent is how to make trade-offs between disparate groups of stakeholders. Take the example of Target Corp., which made headlines in May after its Pride Month products spurred some customers to confront and even threaten store workers. Ultimately, Target decided to focus on workers' safety and well-being by removing certain products and moving displays to the back of some stores.

"It really does depend on the organization and what you want to stand for. What does your brand mean? What is your purpose as



an organization?" Hill said. "Your role is to set the strategy for how an organization is going to proceed and also to talk and to set the risk framework."

Different Dynamics in Practice

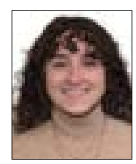
The report offers not only thematic and operational food for thought, but also a list of questions within each section. Rather than be prescriptive in recommending how boards should use the framework, the commissioners decided to pose questions for boards to discuss in an open-ended way.

"I would print the questions and just hand them out to the board members and ask, 'Can we answer these questions?' That's a way perhaps to get dialogue started," Aguilar said. "And it may be that they can recognize some or maybe all of the questions that they don't know enough about the operations of the company or the way it's being addressed to be able to answer [them]."

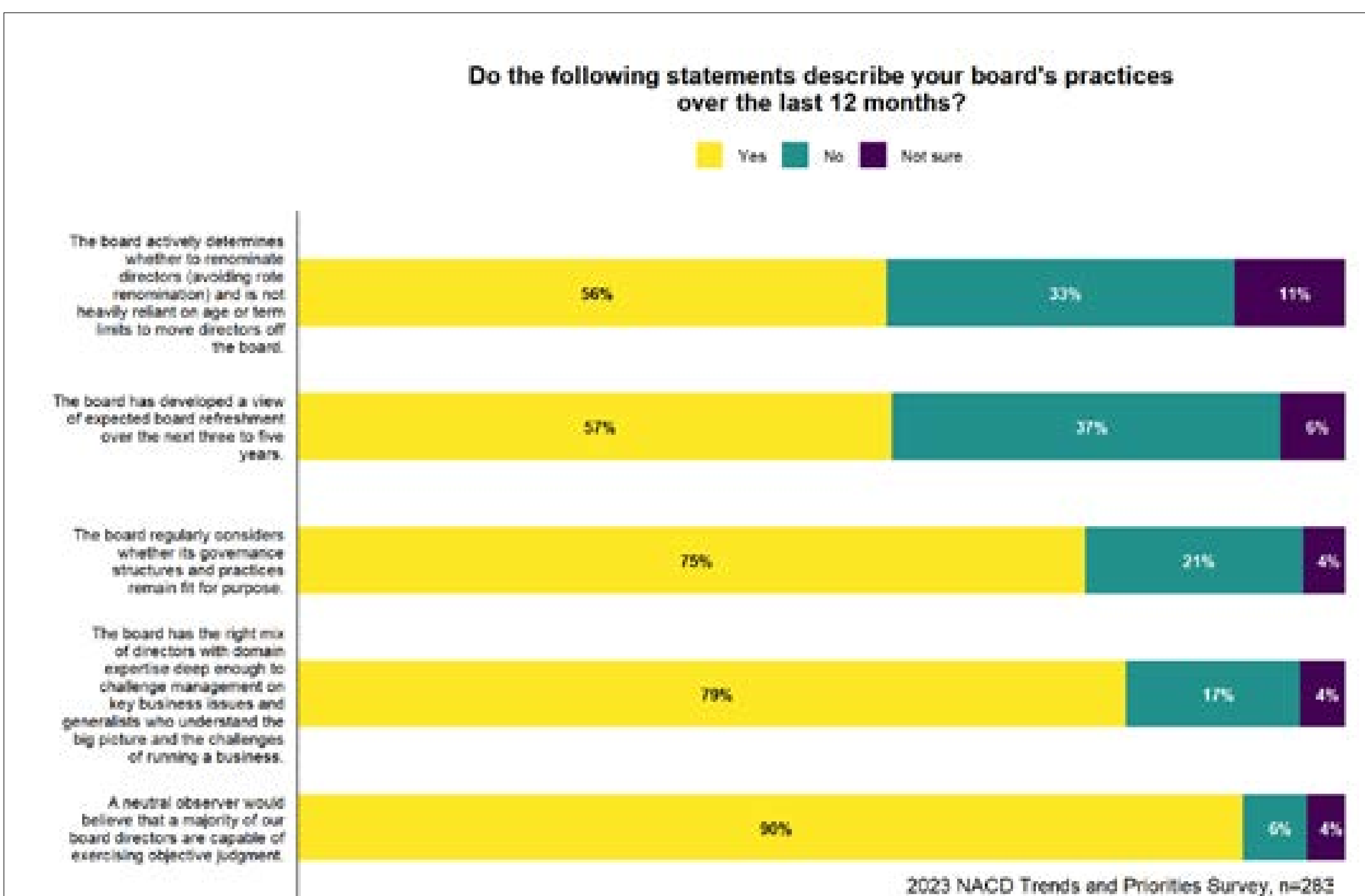
Ashford has used the report as a sort of benchmark against which he can assess his boards' practices. "Most boards go through a process of trying to assess the quality of what [we] do and how we do it, and we've been able to pull a few of these principles into those discussions," he said.

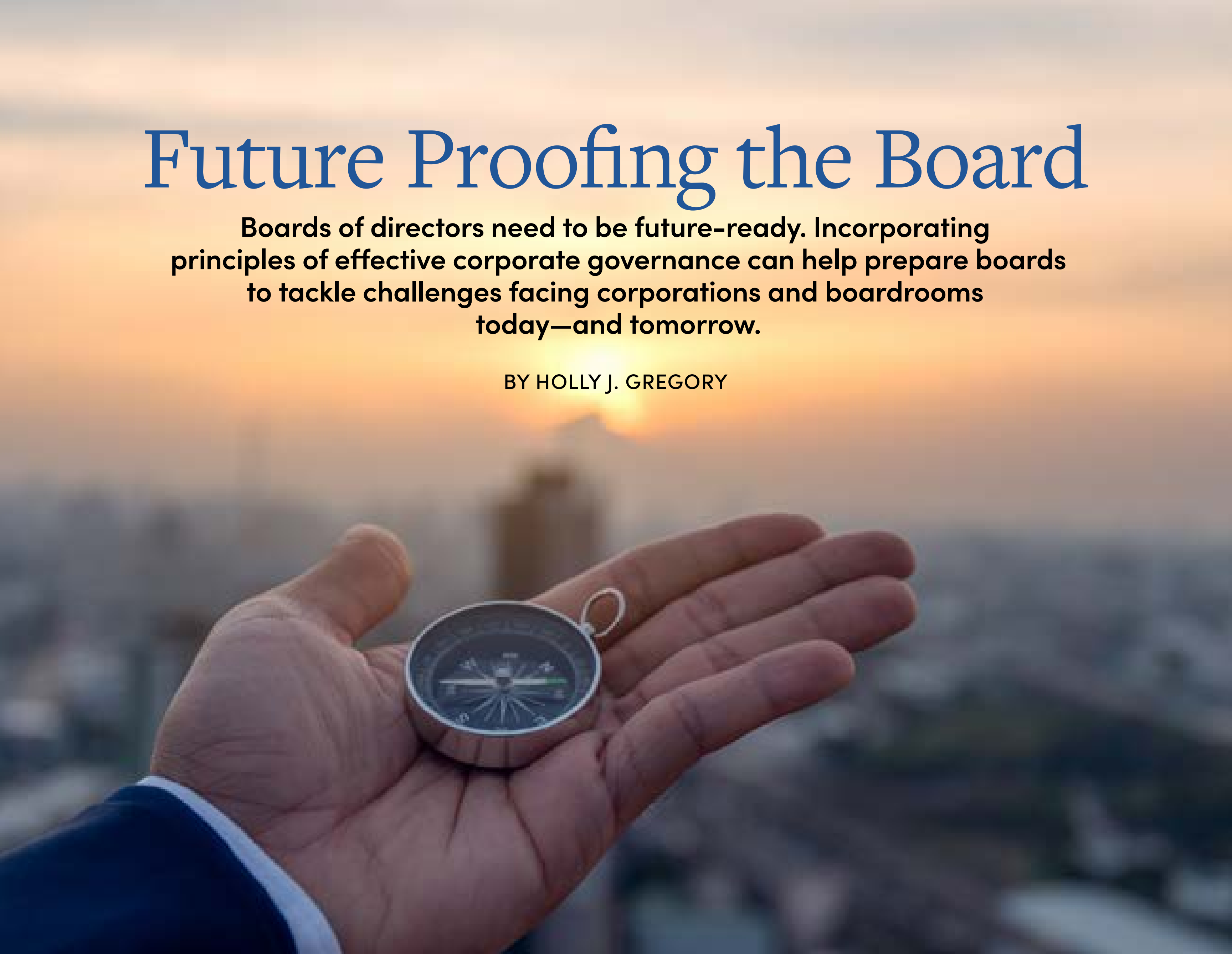
"I would hope that this report would stimulate other directors to look back, for instance, on the last three years, when we've all gone through this traumatic time, and use the report and what they actually did to reflect on, say, Are we where we need to be when the next pandemic happens, whatever that ends up being?" Hill said.

The exponential advancement and increasingly connected nature of technology and other issues demanding boards' attention require a shift in mind-set. It's never too early to work to be on the winning side. D



MANDY WRIGHT is senior editor of *Directorship* magazine.





Future Proofing the Board

Boards of directors need to be future-ready. Incorporating principles of effective corporate governance can help prepare boards to tackle challenges facing corporations and boardrooms today—and tomorrow.

BY HOLLY J. GREGORY

THE GREEK PHILOSOPHER HERACLITUS IS CREDITED WITH the adage that the only constant is change, or "one cannot step in the same river twice." Boards have long navigated change, whether from technological innovation, business model disruption, shareholder activism, or new regulation, and more recently from the global pandemic. In the current environment a particularly unique set of headwinds is challenging board capacity and ultimately corporate resiliency: inflation and higher interest rates (and a potential recession); expanding geopolitical tensions and a related global rise in national protectionism; resource scarcity, whether from supply chain bottlenecks or commodity shortages; an increase in severe weather events (drought, heatwaves, floods); and a highly competitive market for talent amid demographic change. Add to these two forces in direct tension: On the one hand, investors, customers, and employees are increasingly assessing corporations not only on financial performance, product and service quality, and employee satisfaction, but also on broader societal and environmental impact. They are demanding greater corporate transparency and accountability on issues such as climate change and diversity, equity, and inclusion. On the other hand, in the current polarized political sphere, investor and corporate attention to environmental, social, and governance (ESG) issues is criticized by those who view ESG as furthering an unduly progressive agenda. The challenges presented for boards are considerable.

As the *Future of the American Board Report: A Framework for Governing into the Future*, published by NACD, recognizes, governing a company to succeed in this fast-moving, highly complex, and disruptive world of competing demands requires that the board be focused, agile, and highly attuned to the environment in which the company operates, the risks to which it is exposed, the varied

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and often competing expectations of key stakeholders, and the likely impact of corporate actions. It requires looking beyond narrow, near-term financial measures to the company's broader purpose, and considering how to fulfill that purpose based on an understanding of the codependent relationship between long-term success and the fair interests and expectations of customers, employees, suppliers, regulators, the communities in which the company operates, and other key stakeholders.

> **Governing a company to succeed in this fast-moving, highly complex, and disruptive world of competing demands requires that the board be focused, agile, and highly attuned to the environment in which the company operates, the risks to which it is exposed, the varied and often competing expectations of key stakeholders, and the likely impact of corporate actions.**

The next level of governance improvement is not amenable to checklists. It requires fine-tuning in a nuanced and context-dependent manner, and it depends to a large degree on the collective behaviors of individual directors. *The Future of the Board Report* sets out principles intended to help boards tailor their governance for rapidly changing and challenging circumstances. For boards to set themselves up for future success, they must tailor their practices and behaviors based on an understanding of emerging norms of effective governance.

While the environment in which boards govern continues to grow in complexity—and as expectations of shareholders and other constituents broaden—the responsibility of the board and the legal duties of directors remain durable: the board must manage and direct the affairs of the business, and directors must apply prudence and diligence in the best interests of the corporation and the shareholding body. This requires active oversight of those to whom the board has delegated management authority, and the exercise of business judgment in considering strategic opportunities and risks. These obligations are durable, but they are also very context-dependent, and the context is complex and ever changing. Every board must use its own judgment as it navigates the dynamic business environment in light of intense scrutiny from institutional shareholders, hedge fund activists, key constituents and interest groups, regulators, and the media.

Corporations do more than provide economic benefits. They provide goods and services that benefit society—and doing so is key to the license to do business. As Novartis CEO Vasant "Vas" Narasimhan said at the World Economic Forum in late 2022, "The reasons corporations exist at all is because we believe the profit motive enables us to advance society and solve problems. In the end, for all of us, we have to be super clear on the purpose and mission of our individual enterprises, be super clear that when we deliver on our mission in a sustainable way. . . . That's why our corporations exist." Now and in the future, corporations will be looked to for solutions to help build a better world, with success viewed through a longer and broader lens in which avoidance of undue risk and mitigation of negative impact will be critical. To quote BlackRock CEO Laurence D. Fink, "This is not about politics. It is not a social or ideological agenda. It is not 'woke.' It is capitalism, driven by mutually beneficial relationships between you and the employees, customers, suppliers, and communities your company relies on to prosper."

As *The Future of the American Board Report* conveys, the long-term success of a corporation depends on a clear sense of purpose and delivering value that satisfies the fair interests of a range of key stakeholders. Boards play a distinct and critial role in this endeavor. This report can help directors lead the way for a better future for the corporations they serve, which in turn, can yield positive benefits for society today and for years to come.

Summary of Principles

The Future of the American Board Report: A Framework for Governing into the Future lays out 10 principles for boards to consider as they tailor their governance for changing circumstances. Each principle is supported by key implications, relevant context, and key questions.

Corporate Purpose: The first principle emphasizes that the purpose of a corporation is defined by the problem or need that is met by the goods and services the corporation provides. When purpose in this respect is well articulated, it becomes a powerful force to motivate and unify corporate activity and to set priorities. It is by carrying out the corporation's purpose—by creating goods and services that customers need or want—that profit is achieved. Achieving profit requires not only satisfying customers, but also maintaining beneficial relationships with employees, suppliers, regulators, and the communities in which the company operates.

Responsibility & Accountability: The second principle has two important aspects: First, it draws on the board's legal mandate to manage and direct the affairs of the corporation by emphasizing that how the board governs and sets priorities is a matter of self-determination. Boards cannot be passive or rely wholly on others' notions of effective governance—they must work it out for themselves. Second, it recognizes that consideration of employee, customer, and other stakeholder interests is key to acting in the corporation's best interests and delivering value over the long term to shareholders.

Objectivity & Oversight: The third principle draws heavily from recent case law about what is expected of boards with respect to their oversight of mission-critical risk. It reminds the board that it needs to be distinct from management in leadership, composition, and mindset so that it brings objectivity to its decisions and oversight function. It also suggests that oversight is a continuing inquiry into whether the board's delegation of authority to management is reasonable.

Agenda & Information: The fourth principle builds on the earlier point made about governance self-determination. It emphasizes that the board itself is responsible for ensuring it is positioned for informed, deliberative, and agile decision-making. This requires board determination of priorities and information needs and board oversight of information and reporting systems. The report also emphasizes that in this complex and fast-changing world, the board must be more agile—it must have the capacity to address critical issues as they arise in a decisive and efficient yet well-informed manner. And it must be able to exercise humility and pivot when change is necessary. This requires continual learning to understand changes in the environment that may affect corporate strategy and risk. Indeed, a key theme throughout the report relates to board agility and director commitment. Simply put, much more is required of directors to stay well informed and to be available on a far more frequent and flexible basis.

Board-Management Relations: The fifth principle focuses on the importance of a clear understanding of and respect for the distinct roles of management and the board and the development of a candid, constructive relationship in which the board both supports and challenges management. Of course, the line between managing and directing may change according to the circumstances. But if directors overstep, management becomes less responsible for performance and the oversight mechanism is degraded. Overstepping can also undermine both CEO confidence and the trust with the board that is so important—and a lack of trust can result in less candor.

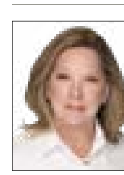
Strategy & Risk: The sixth principle emphasizes that strategy and risk must be a priority. It emphasizes again the importance of agility to the board's ability to help the company adapt to change and recognizes that given the pace and scope of change, more time is required of directors to monitor strategic milestones and stay up to date about risks, trends, developments, competition, and the environment in which the company operates. This includes understanding how environmental and social issues relate to the company's strategy, operations, risk profile, and relationships with key stakeholders.

Talent & Compensation: The seventh principle acknowledges that increasingly employees are attracted to corporations that express values and purpose they find meaningful and show respect for their contributions to the team. It calls on the board to attend to issues affecting the workforce and to understand the link between strategic imperatives and officer and employee capabilities and constraints.

Corporate & Board Culture: The eighth principle highlights the importance of both board and corporate culture to success. It calls on the board to define and monitor the parameters of the desired culture. It also recognizes that establishing a strong board culture depends on agreed-upon norms of behavior and that having such norms can be helpful in both in preventing and addressing misbehavior by a director.

Composition, Refreshment & Diversity: The ninth principle reminds the board to avoid defaulting to renomination rather than undertaking tough decisions.

Transparency, Communications & Engagement: The tenth principle suggests that the board value and recognize interactions with employees and other key stakeholders as opportunities to learn about their interests and concerns, and to build trust.



HOLLY GREGORY co-chairs Sidley's global corporate governance practice and also co-leads its *Chambers*-recognized ESG and Crisis Management teams. She counsels publicly held, private and not-for-profit corporations on the full range of governance issues, including governance structure and culture, fiduciary duties, risk oversight, conflicts of interest, board and committee structure, board leadership, special committee investigations, CEO transitions, board self-evaluation processes, shareholder activism and initiatives, proxy contests, relationships with shareholders and proxy advisory firms, compliance with legislative, regulatory and listing rule requirements and governance "best practices."

Gregory also drafted the National Association of Corporate Directors (NACD) Key Agreed Principles of Corporate Governance and most recently, as special advisor to the NACD Commission on The Future of the American Board, drafted the Commission's report: *A Framework for Governing Into the Future* (September 2022). She is widely recognized for her work, including as: one of the NACD Directorship 100, *Directorship Magazine*, 2023 and all prior years (17 years total).

Sustainability Takes on New Meaning

By Judy Samuelson

IT'S TEMPTING TO IMAGINE THAT THE OUTCRY ABOUT ESG, a now out-of-favor term for the environmental and human costs of business, will dissipate after the next presidential election, or when inflation returns to target norms, or if executives leave the social issues up to elected officials. But given the state of the economy and public confidence in our institutions, along with the drumbeat of news on the environment, and upheaval in supply chains—executives, boards, and those who advise them might want to brace for strengthening headwinds.

How should directors respond? Shareholders are not likely to illuminate the path forward. Activism is on the rise, but investor preferences are all over the map. The same can be said for consumers—who have begun to divide into "red" and "blue" camps while still making buying decisions based on price and convenience.

Meanwhile, the confusion of good intentions of actors continue to confound the investing public, from companies that claim to measure what matters most to a host of NGOs to rating entities calling for even greater transparency across a broad range of issues and priorities.

When Elon Musk called out the S&P 500 ESG Index for scoring Philip Morris International twice as high as Tesla in June 2023, he exposed just how complicated—or perhaps inadequate—the metrics behind the rating of stocks can be.

Is there a reason for the S&P index to be critical of Tesla? Sure. Musk is hardly a poster child for good management. When it comes to the "S" part of the ESG equation, he makes headlines for toxic workplace behavior and considers diversity commitments especially "woke." On the "E" side, the costs of the manufacturing process, not just the product, matter. But to equate Tesla, a company that has brazenly and aggressively paved the way for moving away from fossil fuels, with one that is innovating around smoke-free products but still commands a significant share of revenues from the sale of cigarettes reveals just how unsatisfying the ratings and rankings can be.

As Kenneth P. Pucker and Andrew King make clear in their seminal *Harvard Business Review* piece, "ESG Investing Isn't Designed to Save the Planet," the metrics behind this segment of the asset management market can have little to do with the questions that matter most in boardrooms and executive suites. Yet the keen interest of the investing public in aligning their values with their money isn't going away.

From addressing social turmoil and louder employee voices to decarbonization, heightened geopolitical tensions, and threats to democracy at home, directors are in for a wild ride, as public and employee expectations of companies change and grow.

The bottom line? It's the "G" of ESG that matters most. NACD has picked an opportune time to draw focus to its latest user manual for board members with ten guiding principles, *The Future of the American Board* report.

To respond to this moment, boards have created special-purpose committees to illuminate and consider risks reflected in shareholder activism and employee engagement. Yet it's hard to imagine confining to a subcommittee the strategic challenges of innovating around carbon emissions, de-risking the supply chain amid global tensions, or the changing norms in the employee contract.

Here's a heretical thought: Over the course of the last year, in service to the Commission and in dozens of engagements from my perch at the Aspen Institute, I have come to experience the pushback against all things ESG as useful—as it invites executives and directors to become crystal clear about what matters most to the long-term health of the enterprise. Achieving this level of clarity cannot be confined to a special purpose committee; it requires fresh questions about corporate purpose, fiduciary duty, whether the business model is built for the future, and who are the company's allies. We call it Agenda for the Prepared Board.

On the path to decarbonizing the economy, it's all-hands-on-deck, a board imperative to prioritize investments that will only prove out in time. The motivations of committed executives run the gamut—from anticipating regulation and securing the supply chain to acknowledging employee fervor to realizing the potential for real upside—i.e., to take part in massive change rather than just brace for the consequences.

The Agenda for the Prepared Board builds on the work of the Future of the American Board Commission. The last time NACD issued a set of principles about the role and responsibilities of boards was in 2011, when corporate leaders were still reckoning with the Global Financial Crisis. A new business ethic was growing, from B Corporations to conscious capitalism, but it was far from mainstream. The end game was still focused on the shareholder, aka the stock price—full stop. Boards loaded up CEOs with stock options and equivalents, "pay for performance" ringing in their ears.

But the rules are changing. A dynamic environment of social media, systemic risks, and deep uncertainty about the future underscores the need for a different brand of leader, new ways of governing, and standards for conducting business that speak to a wider set of concerns, to employees and critical partnerships.

The NACD *Future of the American Board* report poses important questions—especially for those who are new to the game.

Boomer directors who stayed at their (Zoom) posts during the pandemic are now making more room for women, people of different races, and directors with varied experience. As the updated principles make clear, who serves, for how long, and for what purpose all will be reexamined.

Boards of tomorrow have a massive task: to understand—and it will not be addressed by the old way of doing things.

Here are my key takeaways from my time on the Commission and our own work with business leaders and directors:

To future-proof the corporation requires insight from new allies in the long game. Not all answers come from the C-suite. Committee charters are being revamped to assure a better flow of insight from employees, nongovernmental organizations, and subject matter experts aligning private initiative and investment with long-term sustainability. To maintain the health of a scarce resource or to replace a commodity at risk can require a radical redesign of a product or process, and innovation at massive scale.

Trade associations that prioritize making all their members happy resist change and revert to lowest common denominator thinking. Today, the first movers in virtually any industry are engaged in complex partnerships that engage activists, scholars, business leaders, and their entire supply chain in common cause. Is the board equipped to take in signals from outsiders who may have the key to long-term stability and competitive advantage?

Corporate purpose as more than a slogan or mission statement. Boards with clarity about why the company exists are better able to focus on what is material to the enterprise and to align operations with their goals and intentions.

Purpose reveals fiduciary duty. As the NACD principles and the Agenda for a Prepared Board make clear, the board's work starts with clarity of purpose, and that means interrogating which inputs are critical for the company's survival. In my own organization's work to respond to the conservative pushback against ESG, we identify seven key considerations for boards to play offense, rather than defense, when it comes to social or environmental commitments.

ESG standards emerged from filing shareholder proposals some 20 years ago. As the Tesla-Philip Morris example illuminates, ESG rankings and measures fail to capture the full complexity of the overhaul that's needed at the board level.

"Stakeholder theory" is hardly new. It may work in classrooms as an alternative to shareholder primacy, but it can't be an organizing principle for managers without greater specificity about ends and means. Each business is unique and has its own road map. Smart executives have learned to eliminate ESG from their vocabularies in favor of language that is specific to the business. Replacing "stakeholder" with what and who matter most to the health of the enterprise is the next step.

Incentives matter. One of the board's awesome responsibilities is structuring CEO pay, but so is figuring out succession, how the CEO and direct reports function as a team, and whether the management team is clued into company culture, customers, and the supply chain. Restructuring the CEO's pay to ensure teamwork and to prioritize what matters most is paramount. Fairness throughout the business matters.

Some boards have already taken the step by changing compensation committees into human resource committees. Watch this space—we are only at the starting block. Meanwhile, the disconnect between paying the CEO in stock while grandstanding about stakeholders is increasingly apparent.

Clarity of intention (purpose), a clear focus on the role of employees (much more than a stakeholder), and a willingness to engage at the systems level on problems that threaten the business model but can't be addressed one company at a time—these domains require fresh questions and new ways of thinking and operating on boards.

The system of democracy itself is at risk. Will boards stand up? What are the company and its executives called to do, especially when so many people question if "the system" is working on their behalf?

Is the company fully aware and transparent about where and how its political capital is spent? Are the trade groups that speak on their behalf achieving the right balance of private protections and public benefit? Are executives adequately prepared to speak up on issues that rebound to the health of the enterprise—and the system on which we all depend?

And critically, are employees receiving a fair share of the wealth they create—the baseline for trust in business and beyond?

Boards are not bystanders in this game. NACD and its allies have set the stage for a critically important conversation about the future of boards. The old ways of operating are not serving us well. New questions emerge.

Who's in?

JUDY SAMUELSON is executive director of the Aspen Institute's Business and Society Program and the author of *The Six New Rules of Business: Creating Real Value in a Changing World.*

How to Create an Even Higher-Performing Board

By Lynn Clarke

FEEDBACK FROM DIRECTORS, from both public and private companies alike, on the 10 principles outlined in the *Future of the American Board* report has been positive: comments include "thought provoking" and that it is a "useful framework." From my perspective, the report is missing one critical element: How can the 10 principles be incorporated into board operations and culture to help our boards become even higher performing? Let me address that missing in this article.

As one of the commissioners who helped to craft this timely report, I've had the opportunity to make recommendations to public and private company boards on how to use and implement the principles in the *Future of the American Board* to becoming more effective and future ready.

The 10 principles are quite extensive, covering everything from corporate purpose to board agendas to compensation and talent. Consequently, using them to drive board performance requires a practical, focused approach.

Here's my five-step approach on how to use of the principles to strengthen board performance:

1. Select and obtain agreement with board colleagues on two to three principles for board focus.
2. Determine the impact of each principle on both board and company culture and operations using questions posed in the report at the end of each principle.
3. Develop an action plan for how to use the selected principles to drive board performance.
4. Identify key performance indicators (KPIs) to monitor and track the success of this action plan.
5. Monitor and adapt the action plan for success, as needed.

Theory is helpful, but let's put it into practice. Imagine you're the chair of Company ZZZ. This global multichannel retailer targets Generation Z and younger millennials. As chair, your objective is to lead the board on a journey of higher performance, using the *Future of the American Board* principles as a tool.

Step 1: Focus on a Few Principles

For example, as chair, you decide to begin with two principles: Principle One: Corporate Purpose and Principle Seven: Talent & Compensation. Then to gain agreement from all board members, you lead a discussion on the selection of these principles. Get the perspectives of each board member.

- Are these the best two principles to focus on now, given Company ZZZ strategy, markets, operational challenges, and competitors?

How will you measure the impact of your efforts to take the board into the future and increase effectiveness?

Company ZZZ first selection: Principle One. Corporate purpose is the foundation of what we do as board members and executives. In reality, the other principles don't matter unless the board, executives, management, and employees are clear and committed to the purpose of the corporation.

In preparing the report, the commissioners had a wide range of viewpoints on the value of corporate purpose in today's world. In several discussions, the Future of the American Board commissioners even went back to business school and Peter Drucker's definition of a corporation. We debated the relevancy of this definition and decided it is still relevant, provided boards consider a few additional questions. For example, how can or should a company balance the needs of the community and shareholder value? Or, even more basic, should a corporation be concerned about anything beyond driving shareholder value? Certainly, every company needs to consider several constituencies—shareholders, consumers or customers, and employees—otherwise, purpose won't be achieved, and the company can't thrive.

Company ZZZ second selection: Principle Seven. The most significant new element of this principle is well-being. Ten or even five years ago, employee well-being was not a boardroom or management topic. Interestingly, well-being is also the most difficult to define. It's not easy to understand its role in the purpose or mission of a company. How can the board best support and inspect human capital strategies that improve employee well-being as well as approve great strategies that drive more traditional human capital objectives to attract, retain, develop, and compensate superb people?

Our theoretical organization, Company ZZZ, employs all types of people, but has a large percentage of teenage employees. Understanding their worlds is critical. What if one of your teenaged employees is being bullied? How does the board think about and provide management with good guidance related to employee well-being? What do your managers and executives do to put themselves in your employees' shoes and help their well-being?

Step 2: Lead a Robust Board Discussion

Understand how these two principles can impact board culture and performance, company strategy, company culture, and company performance. Use the questions at the end of each principle in the *Future of the American Board* report to help structure this discussion.

As part of developing Company ZZZ's action plan, your board needs to address two critical questions posed at the end of Principle One:

1. What additional constituencies, if any, should be considered in discussions about corporate purpose? (I serve as an independent director on several family-held fiduciary boards. Voting shareholders are obviously key. But what about previous shareholders or next-generation, soon-to-be shareholders?)

2. What are the anticipated net benefits and negative impacts of determining and establishing the company's corporate purpose? Helping management see around corners is an important board responsibility.

As for Principle Seven, the Company ZZZ board can start the discussion by asking and answering the following questions from the report:

Do workforce issues receive appropriate focus from the board (or a board committee), and does the board review unfiltered information about workforce satisfaction and engagement?

How does the board support the development of the company's next leaders and its employees?

Step 3: Develop an Action Plan

Now that you've selected the principles to focus on and have discussed and understand potential impacts and risks, what is needed to drive further board performance?

The board may wish to focus on a few key improvement targets. In the case of Company ZZZ, your board may determine that the business needs to be more transparent about its purpose, values, and culture so that management and the workforce understand policies that define appropriate workplace conduct and the mission that drives the business. One option is for the board to support management in crafting a statement of purpose from which the corporate strategy and culture framework will follow.

Five steps to creating high performing boards using the principles from the *Future of the American Board* report:

1. Select, discuss, and obtain agreement on two to three principles for board focus.

2. Determine the impact of each principle on both board and company culture and operations using questions posed in the report at the end of each principle.

3. Develop an action plan on how to use the selected principles to drive board performance.

4. Identify KPI's to monitor and track success of the action plan.

5. Monitor and adapt the action plan for success as needed.

Step 4: Determine KPIs

As part of the action plan, what does success look like? How do the CEO and the C-suite define success? Are definitions of success consistent between the board and management team? If not, what will you as chair do to ensure the success of using the *Future of the American Board* principles to drive high performance?

Regarding Principle Seven, the Company ZZZ board may determine that it needs better insight into workforce satisfaction metrics. Many board request results of monthly two question "pulse" surveys that supplement annual employee engagement surveys. Management can share with the board plans to address opportunities identified by these engagement surveys.

Step 5: Monitor and Adapt

Finally, how do you ensure that these principles are core to the board's work? Who owns monitoring KPIs and adjusting the plan as needed? Every board has its own approach. Some incorporate actions into committees. Others will identify a few members and create a limited-time task force to help management.

If employees feel disconnected from Company ZZZ's stated purpose or feel that it is disingenuous, or report that corporate culture has worsened, your board should be asking management why. Has management aligned strategy, policies, and company-wide goals to corporate purpose? On the positive side, if employee engagement has increased, the board can and help management to understand and learn what is driving positive results so future improvements build on these impactful learnings.

My examples and descriptions are only one approach to how a board can use the *Future of the American Board* framework. Please remember, the committee purposefully structured the report to not be prescriptive. It is not a checklist. It is not a report filled with easy answers. It is a framework of thinking that can help lead to further strengthening a board's impact. D

LYNN CLARKE is lead independent director for Vollrath Manufacturing and serves on the boards of A. Duie Pyle, Basic American Foods, Diana's Bananas, and the NACD Carolinas Chapter. She also is the operating partner for Jelly Belly Sparkling Water and was the 2021 NACD Private Company Director of the Year.

Envisioning the Audit Committee of the Future

By Stephen Dabney

The uncertain and turbulent business and risk landscape will continue to put board—and audit committee—governance and oversight processes to the test. As part of the NACD Future of the American Board Initiative, KPMG joined NACD in convening the Future of the Audit Committee Working Group to consider the internal and external forces that are having the greatest impact on the audit committee's responsibilities and workload. The group also worked to identify key areas of focus and emerging practices for audit committees to consider as they reassess the committee's oversight processes and operations.

The insights and observations shared by the members of the working group formed the basis for the Audit Committee Blueprint, which spotlights 10 critical areas for audit committee focus going forward. While the scope of audit committee oversight responsibilities has increased significantly, the committee's core oversight responsibilities—for financial reporting, related controls, disclosures, and oversight of auditors—have also become more complex and demanding. In addition, the audit committee's composition continues to evolve.

As one member of the working group noted, "We're probably past the days of audit committees being comprised only of former [chief financial officers] and those with financial backgrounds. You might still see that in the chair role, but for audit committees to oversee all the other issues on the committee's plate, you need a different mix of skill sets."

In addition, as the audit committee's oversight responsibilities continue to expand and evolve, many audit committees have added or are adding members with experience in information technology, cybersecurity, climate, or other areas critical to the business. This has resulted, in some cases, in the committee relying on one or two members, such as the chair, as experts tasked with handling the "heavy lifting" in the oversight of financial reporting and controls. For example, one working group member shared, "On my audit committee, the chair is the only real financial expert. I don't think that is unique. I'm not saying it's a bad thing, but it's an interesting evolution to be aware of."

Other themes that emerged from the working group discussions included:

Expanding risk oversight responsibilities. The increasing complexity and unexpected interconnectedness of risks has put a premium on more holistic risk management and oversight. Many audit committees today are shouldering heavy risk agendas and oversight responsibilities beyond their core responsibilities—for cybersecurity, data privacy, supply chain, geopolitical, and regulatory compliance risks, as well as oversight responsibility for all or aspects of management's enterprise risk management system and processes.

Expanding responsibilities for ESG oversight. Demands from regulators, investors, employees, customers, and other stakeholders for action as well as increased disclosure and transparency—particularly around climate, cybersecurity, and environmental, social, and governance (ESG)—continue to intensify. Many audit committees are evaluating what their role should be vis-à-vis their companies' corporate sustainability reports and other ESG disclosures, as well as the selection of disclosure frameworks (to the extent not mandated by law or regulation). The US Securities and Exchange Commission (SEC) has been aggressive in identifying deficiencies in disclosure controls and procedures and in calling out greenwashing.

Regulation of climate and other ESG disclosures by the SEC and foreign regulators. The SEC's disclosure proposals, particularly its climate proposal, as well as recent foreign sustainability reporting requirements—such as the European Union's Corporate Sustainability Reporting Directive, which has an extraterritorial reach that may touch many US multinationals—are likely a game changer for audit committees. They greatly expand the committee's workload and oversight responsibilities (including overseeing the company's compliance with differing global ESG reporting regimes, and the external auditor's attestation of greenhouse gas emissions and other information required by global regulators) and require greater coordination with other standing committees than has historically occurred.

The blueprint's 10 areas of focus—taken together with the other considerations and recommendations offered by the working group—can provide audit committees a framework for reassessing and fine-tuning their oversight practices, skill sets, and leadership. D

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Is Your Compensation Committee Ready to Expand Its Scope?

By Steve Van Putten

As compensation committees explore expanding their scope of responsibilities beyond traditional executive compensation parameters, they have realized it requires more than changing the committee's name and updating the charter.

Such tactical changes are an important signal and will overtly represent an expanded involvement in broader human capital areas. However, they should not happen before the committee has fully assessed its readiness to take on the additional responsibilities that come with an expanded remit.

Committee Commitment

The single most important readiness criteria is that the compensation committee leadership and membership be fully committed to change and growth. A majority belief that broader human capital topics—ranging from succession planning and the development of senior leaders to environmental, social, and governance and diversity, equity, and inclusion—are essential to the future of the organization is a required foundation for productive discussions. Further, the committee should have a unified appreciation that these issues cannot be addressed independent of the attraction, retention, and motivational properties of a carefully designed compensation plan.

This kind of visionary inclination on part of the committee is likely driven by directors who have experience that adds value to the conversations. Boards that pursue this expanded remit may want to include such skills in the matrixed profile of future compensation committee members.

Spirit of Partnership and Cooperation

In addition to committee engagement, the success of any talent management initiatives will hinge on support from the CEO and their direct reports. In recent years, stakeholder—including shareholder—expectations for broader human capital management has risen significantly. But for the board to effectively assess or guide in these new areas, there must be a spirit of partnership and cooperation between directors and the C-suite.

No doubt, the bright line between oversight and active management has begun to blur, at times making both sides uncomfortable or unsure. Pushing through this uncertainty and being open to evolving roles will allow boards and management teams to explore new ideas that may ultimately lead to a stronger organization—one that experiences less risk and more growth over the long-term.

Taking the First Step

One way to raise awareness and initiate broader conversations is to incorporate a "human capital update" agenda topic at each committee meeting. This update, which is typically led by the chief human resources officer, can begin to consistently shine a light on key human capital issues. While the topics can vary from meeting to meeting, they often include high-level reports on such matters as turnover, talent acquisition and development, and progress on diversity initiatives. These updates provide a great opportunity to contextualize compensation matters and often springboard into strategic discussions on key organizational imperatives. For example, by examining turnover, committee members can better understand and provide suggestions as to retention strategies and succession planning efforts.

Overcoming Potential Obstacles

Of course, the committee will face challenges in expanding its sphere of influence. One very real obstacle is accommodating the additional time that new areas of attention require. Since the core executive compensation responsibilities are not abating—if anything, they likely have increased—it is important to be as efficient as possible with the committee's allotted time. One way to achieve this is by including time allowances by topic in the agenda so that routine matters can be dispatched quickly. It can be helpful to structure certain agenda items as "discussion only" with related materials in an appendix as a "pre-read". This can mitigate the potential for too much presentation and insufficient discussion, which slows meetings down without productive results.

Going Further

As the compensation committee assesses its readiness and begins the exploration of talent and leadership issues in tandem with executive pay plans, additional ideas for furthering progress can be helpful. Documenting the committee's expectations and goals can provide milestones for achieving a measure of progress. The use of an annual committee calendar with integrated compensation and leadership topics and decisions will add routine and structure to meetings. Access to advisors with experience in guiding the integration of compensation and leadership can be highly valuable. Finally, ongoing, open conversations with the full board about the committee's expanding purview will provide critical alignment.

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Turn the Nominating and Governance Committee Into a Strategic Asset

By Anthony Goodman and Julie Norris

Over the past three years, whirlwind changes—including the global pandemic, social justice movements, geopolitical conflicts, economic uncertainty, and climate-driven disasters—have transformed board workloads and agendas. No board has been left untouched.

At the still, calm center of the storm, the nominating and governance committee has been focused on improving board performance, composition, and culture, knowing that its work would lead to the board operating either as a corporate asset or a liability, depending on how effectively the board fulfills its responsibilities and supports the company's long-term success.

Investors and other stakeholders are interested in understanding how boards operate and whether they are fulfilling their oversight responsibilities effectively. This investor and broader stakeholder scrutiny of board performance is a permanent feature of corporate governance, though the issues raised with boards will evolve over time.

As a result, the nominating and governance committee must continue to focus on evaluating directors' skills and expertise, identifying gaps in the board's capabilities, and recruiting new directors who can fill these gaps. The committee is also being challenged to increase its rigor and to broaden the scope of its work.

Based on the recently published *Future of the American Board Nominating & Governance Committee Blueprint*, below are five key areas of focus for the nominating and governance committee to turn the committee and the board itself into strategic assets for the company.

1. Setting board culture and expectations for directors. The nominating and governance committee plays a critical role in establishing and maintaining a diverse and inclusive board. The committee should help define and ensure an inclusive board culture, set (written) expectations for directors, design rigorous renomination processes, and ensure that board leadership (the board chair or lead independent director and committee chairs) reinforces the agreed-upon culture, expectations, and processes.

2. Aligning board composition with corporate strategy. The nominating and governance committee oversees the selection of the board members. A key responsibility of the committee is ensuring that board composition is aligned with the long-term corporate strategy. To do this, the committee must create a long-term succession plan, enable regular refreshment of the board, and plan for board leadership succession.

3. Fostering continuous improvement in board performance. The nominating and governance committee plays a crucial role in fostering continuous improvement in board performance. By ensuring that all board members have a thorough onboarding, enabling high-quality continuing education opportunities, and requiring rigorous board and committee self-evaluation, the committee can prepare the board to meet the challenges facing the company and deliver on its strategic objectives.

4. Improving oversight of cross-board matters that often fall to nominating and governance committees. The nominating and governance committee plays a vital role in overseeing issues that span multiple committees. Specifically, the committee may be responsible for CEO and executive succession, oversight of sustainability matters including climate risk, and decisions about whether to form new committees.

5. Overseeing board involvement with shareholders and other key stakeholders. The nominating and governance committee plays a crucial role in overseeing the involvement of the board—at the request of management—with shareholders and other key stakeholders, including employees, customers, suppliers, regulators, and the broader community. The ever-changing environment that companies operate within has required boards to be more attentive and aligned with the increasing expectations among stakeholder groups in recent years. Effective engagement with these stakeholders is essential for the organization's success, and the committee can help ensure that the board is prepared to carry out this role.

The next step is for the nominating and governance committees to discuss the blueprint and decide which of its recommendations make sense for their own boards. Given the continuous disruptions to the business environment, this exercise is only likely to be the start of a continuous process of updating and modifying the nominating and governance committee's charter and processes to ensure the committee and the board remain strategic assets. D

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A Call to Action: Elevate Board Risk Oversight

By Reid Sawyer

Boards and their organizations face an increasingly complex risk environment, a demanding risk agenda, and rising stakeholder expectations. Against this backdrop, the demands and scrutiny on risk oversight and governance effectiveness are expanding across three dimensions. First, the breadth and range of issues requiring board oversight continue to expand. Second, boards must explore with greater rigor how their organizations are responding to and managing individual risks, risk aggregation, risk concentration, and complex risk interconnections. Third, oversight perimeters are expanding to include risks inherited from across the enterprise value network—for example, cyber risks within critical third parties.

Boards can elevate the execution of risk governance and oversight to meet these challenges by focusing on the four critical areas below.

Oversight Structure

The expanding risk agenda requires boards to reconsider how to allocate oversight responsibilities. Many boards are responding to this challenge by expanding existing committee mandates, establishing new committees, or establishing a risk committee. However, this puts greater demands on committee and full board coordination.

Boards must ensure that there are clear committee charters that define risk oversight responsibilities, roles, and management structure and processes to support those responsibilities. It is important to avoid both gaps and overlapping responsibilities that could occur through overly inclusive charters.

Committee chairs play a vital role in ensuring effective committee alignment by structuring calendars and agendas. In addition, their formal and informal communications support information flow between committees and the full board to avoid information silos.

Expertise and Board Composition

Boards need the capacity to provide oversight of an array of risks. Some boards may need to increase board education and the use of external advisors or refresh board composition.

The *NACD 2023 Board Trends and Priorities Survey* flags a mismatch between director skills and top issues that could impact organizations over the next three to five years, such as cybersecurity and climate risks. Boards should assess director expertise and board composition against the evolving risk landscape, the entity's risk profile, and the ideal skills matrix to identify gaps to address.

Directors should also consider whether they have experience with robust risk management processes. Organizations' enterprise risk management approaches, as well as the board's capacity to probe management on the maturity of its risk management framework and the systemization of complex processes around risk identification, assessment, quantification, and modeling, must evolve.

Reporting and Communications

Directors rated "information flow issues between the board and management" as the second biggest barrier to a board's high performance in the *2022 NACD Public Company Board Practices and Oversight Survey*. Directors' challenges with risk reporting are primarily caused by insufficient information on the aggregated and correlated impacts of dynamic risks on strategy and performance.

Improving risk reporting starts with gaining clarity on the board's risk responsibilities as they guide the content, structure, and cadence of information flow. A clearly defined risk appetite is also important as it helps the board and management identify, assess, and monitor relative risk impacts against the organization's risk capacity and resilience. Many organizations may also need to mature risk identification and assessment processes by increasing quantitative risk metrics and the use of scenarios, war-gaming, and other assessment tools. These improvements can advance risk reporting and dialogue so that the board can better help management "see around corners."

Calendar and Committee Agenda

Careful consideration of the board and committee calendars and agendas enables directors to prioritize their focus, address a wide risk agenda, and remain in sync with internal processes and external reporting requirements. Agenda structure is particularly important for risk oversight, where information flow and committee activities must be sequenced.

Despite crowded board agendas, directors should ensure that they allow time for discussions on emerging and evolving risks and impacts. In addition, agendas should allow for independent insight from external experts, such as academics and industry specialists. They can provide insights into emerging trends and risks and the evolution of best risk management practices at other organizations, helping directors upgrade their knowledge and challenge management's "conventional wisdom."

Directors can use the *Future of the American Board Risk Oversight Blueprint* to assess if their board and its committees have the mandate, members, information, and agenda that allow them to execute on their expanded risk oversight responsibilities. D

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