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WILL BOARDS BE “FREED” FROM DECISIONMAKING?

In writing about corporate board issues over the years, I keep coming back to one point -- we make contradictory, unfulfillable demands of directors (fulfill short-term and long-term goals that battle each other, etc.) Now, the past year has increased the pressures on governance massively. Just since our last issue, the federal pay czar has unilaterally cut the exec pay set by the boards of bailed-out financial companies (and hinted that such would be a good policy for all corporations). Also, the SEC has proposed allowing proxy proposals that in the past were viewed as part of the corporation’s everyday business (succession planning and risk management).

The two threads above may be coming together in the boardroom in a way that is either ominous or soothing, depending on one’s viewpoint. One of the most popular clichés I hear from directors is that there is “no one size fits all” approach to governance. But the traditional, bespoke style of governance, with all those classical contradictions, plus new legal demands, is going from the impractical to the impossible. The regulatory and compliance problems of boards making their own governance decisions grow overwhelming.

“One size fits all” governance” then begins to look pretty tempting. CEO paysetting may demand no more than looking up formulas approved by some federal bureaucrat. Proxy ballot access, takeover defenses, splitting the roles of CEO and board chair, or strategic risk issues would just be aligned with whatever is prescribed by proxy advisory services, shareholder voting blocs, SEC rules, or a particular regulatory czar.

Yes, the board’s work would be so much easier if it didn’t have to make its own decisions. Whether the results would be *better* is another matter.

-- **RDW**

6 “MUST HAVES” FOR 2010 EXEC COMP DISCLOSURES

So you thought that maybe the spotlight on executive pay would fade, a year after the U.S. market crash? Just within the last few days, federal bailout czar Ken Feinberg has ordered major pay cuts for top execs at TARP companies, and the U.S. Federal Reserve proposed rules to limit pay for thousands of bank employees if it could encourage “undue risk.” With proxy season 2010 just around the corner, what messages on executive pay will your shareholders be demanding -- messages your board had better be able to deliver?:

- “Risk” issues are top of mind with everyone now, and investors will closely comb your disclosures for “how

the compensation committee looks at pay as a risk factor for the company,” says Mark Borges, of the Compensia comp consulting firm. Mike Stevens, of the Alston & Bird law firm, also sees a shift in *how* the risk/pay quotient will need to be expressed. “The focus isn’t just on the ‘named’ employees [the 5 top officers of the corporation], but on *all* employees whose compensation risk could prove material.” That includes folks packaging financial products which could sink the company if all goes badly. For financials, observes Stevens, you’ll need to cover “employees who are paid on how many mortgages they generate, without looking at the quality.” (PS... detail on your comp clawback policies is important here).

- Of course, the biggest pay disclosure concern is the most basic -- how much, and how. “First, investors want to know is how you design and operate incentive plans, the annual and the long-term,” notes Borges. Since this is such a huge part of most top exec’s takeaway, detail is demanded. Most focus here is on upsides, but Borges sees investors wanting solid details on how pay tracks *down* with falling results. “Everyone talks about pay for performance,” says Borges “but the comp committee must show how its program also adjusts downward.”

- Perks and related goodies often draw shareholder attention out of proportion to their actual \$ value, so spell these out with care. Also, be sure to give the rationale. Why are they provided? Do they make good business sense?

- Golden parachutes, especially for execs leaving companies in a tailspin, have generated huge investor wrath over the past year, so Stevens urges careful disclosure of “executives’ ‘walkaway’ numbers.” That is, the value of all compensation and equity an executive can get should he or she leave right now. The problem here is that there are various ways of calculating a walkaway number, and if items like supplemental retirement benefits figure in, numbers can look huge. “It gets reported like lottery winnings,” says Stevens. One approach -- give two figures, first the gross walkaway amount, and then a more realistic figure based on what the exec actually made this year.

- This points out a problem with pay disclosure trends. Investors and regulators want more and more information, but the result is a growing mass of data, 15 or 20 pages of info that still can’t give an absolute figure. The “talley sheet” approach, launched as a simplification, has grown to become a really *long* talley sheet. This creates a lump of pay data “that institutions can work through, but creates a hopeless maze for retail investors,” notes Borges. More investors are saying they want a simple to use, tabular snapshot on pay (but will then say they want to know more -- you’ll have to try pleasing everybody here).

- For 2010, experts say comp committees will be feeling their way through disclosure, with many different approaches before common standards develop in the next few years.

WHAT’S UP WITH SAY ON PAY?

Executive pay turmoil has reached the point that boards aren’t quite sure what they should do, but that doesn’t keep them from doing it anyway. A new survey from the pay pros at Pearl Meyer & Partners looks at how companies are dealing with the Say on Pay movement. US companies that fall under the TARP umbrella are required to offer shareholders a Say on Pay vote, and legislative proposals over the summer suggest other publicly traded companies may soon have to follow. But the Pearl Meyer analysis finds both groups of companies are still struggling with the concept. Check out the full survey at the [Pearl Meyer](#) website -- key findings:

- Almost three quarters (73%) of firms surveyed think it likely a mandatory Say on Pay vote will be required for all U.S. public companies by 2011. Given the time lag in passing final legislation, regulatory rulemaking, comment periods, etc., this would mean a law needs to pass by early 2010 at the latest.

- Despite all the concerned chatter about Say on Pay, companies don’t seem to be knocking themselves out to prepare for it -- even the TARP companies who definitely must comply. Eighty percent of non-TARP firms have done nothing to prepare for a pay vote, and only a third (34%) plan to move within the next 6 months. Among those who are preparing, review of the CD&A and other proxy disclosures for clarity is the most common (82%). The TARP companies report that shareholders give their pay plans a thumbs up 90% of the time anyway.

- Among non-TARP companies, 76% are confident shareholders will endorse their pay plans, and 46% aren’t even seeking shareholder input on how their exec comp is structured.

- This lack of curiosity on how exec pay is viewed from the outside extends to other investor influencers. While two-thirds of non-TARP companies are aware of the executive comp guidelines used by the big proxy advisory firms, less than half know much about the standards used by major institutional investors.

POLL YOUR BOARD AT EVERY MEETING

Your corporate staff focuses really hard on getting board info packages that are complete and in the hands of directors a reasonable amount of time before the meetings. Good for you. But here's a thought starter -- along with the focus on info that goes *to* directors, how about assuring some feedback *from* them? Consider a *one-page director survey* that goes into each board book, asking members to complete the questions and leave it with the chair or board secretary. Make it anonymous to ensure open responses. No, this isn't a full board evaluation. We're talking about a basic, informal one-pager that focuses on the board meeting itself. These aren't narrow, tick-box answers, but instead encourage full sentence responses -- you're not seeking statistics, but a poll of what works and what doesn't. What to ask?

- Which items in the board book do you examine first? Last? Not at all?
- How well do you find the board book organized? What could make it better? Was material in the same order as in the agenda?
- Give your best guess on how long (pre-meeting) you spend reviewing board book material.
- Of the agenda items we covered today, were there some you feel received too little time? Too much? Any you would call a time waster?
- Of board presentations today, which one was the best and most useful -- and the worst and least? Why?
- Who on staff do you contact with pre-meeting questions? What are the most common of these questions?
- How could committee and full board meetings be better coordinated?

PS... let me know what items you would add.

SEC SEZ - MORE PROXY VOTES ON RISK, CEO SUCCESSION

In late-breaking governance news, on October 27 the U.S. SEC's Division of Corporate Finance released a guidance bulletin on how corporations must handle proxy proposals (find the full text at the [SEC website](#)). This guidance is of urgent interest to your board in preparing for the upcoming 2010 proxy season. Two types of proxy proposals that you could exclude without too much trouble in 2009 will now be a lot harder to say no to.

Proposals querying *how the company and board assess risk* have usually been excludable. The SEC viewed risk assessment as ordinary company business, and off limits for shareholder pestering. Now though, the Commission won't automatically give a "no action" letter on risk-related proposals, but will examine the context before deciding. If the "underlying subject matter" of the proposal is significant to the individual company (for example, environmental matters in an industry where green exposures could have a major liability impact), it can't automatically be cut.

Also, proxy proposals on the *extent and quality of CEO succession planning* likewise haven't drawn much past support from the SEC. The commission's new view is that such proposals should be permitted. The only limits would be if a CEO succession proposal "seeks to micro-manage the company by probing too deeply into matters of a complex nature" -- whatever that means.

SUMMARY - proxy moves on both these topics have increased in recent years. The SEC changes will add much more Commission subjectivity (and corporate uncertainty) on what you can exclude. Boards will need to establish well-considered policies of their own (as they should have already) to head off proposals in 2010.

4 THINGS INVESTORS DEMAND IN CEO SUCCESSION PLANS

First, Ken Lewis resigns as CEO of Bank of America -- and this massive, troubled financial, with a new board of the best and brightest, is revealed to have no real CEO succession plan. Second, as discussed above, the SEC on Oct. 27 announced a policy change to make it easier for shareholder proxy resolutions quizzing companies on how good their succession planning is. Sounds like your board may have to answer some tough questions on the topic at this spring's annual meeting. But just saying that your board is on top of planning the CEO's successor isn't enough -- what will shareholders be seeking in a good plan?:

- Continuity. Even investors in a troubled company "want leadership continuity they can count on," counsels Sandra Davis, CEO of MDA Leadership Consulting. This also means assurance that a two-tiered plan is in place -- long-term development, plus a sound emergency plan that can kick in immediately.
- Board attention to succession planning. Investors "want to know this issue is on the board's radar screen, that directors are regularly discussing what they want in a CEO, and how they ensure the company is developing

those skills.” Davis says boards should discuss the succession plan at least quarterly (and make sure investors know that they are). As part of this, shareholders will want to know that the board is the entity in charge of assuring a workable plan, and that the current CEO isn’t simply anointing his own heir apparent, or delaying the process to ensure his irreplaceability.

- A plan... but one that keeps its options open. Make clear that the board is evaluating different scenarios for succession, depending on the circumstances. An interim CEO may make sense under some conditions. Also, clarify that internal development does not preclude seeking and considering a strong outside candidate.

- Revealing some... but not too much. If stronger CEO succession disclosure becomes the rule, expect the next battle to be over how *much* of your plan should be disclosed to the public, and when. “I think it’s negative to name names,” says Davis. “You could say that there are 3 internal candidates who will have CEO capacity in the future, and that we are providing experience to get them ready.” Naming a CEO-in-waiting publicly tells other top contenders that it’s time to call the headhunters, and gives competitors an insight on your long-term strategy.

Q&A: How Do We Evaluate Our Chairman?

Q: “I’m an outside director on the board of a major retail company in our region, and also chair of the governance committee. Our CEO is also board chairman. Our committee is working to develop better board evaluation, but I’m having trouble finding information on specific evaluation tools for the board chair. Any suggestions?”

A: You’ve noticed a frustrating aspect of board evaluation -- info on grading the leader of a corporate board is indeed hard to find. One problem is separating questions on how good the board is from how good its leadership is. Dale Rose, head of the 3D Group leadership consultants in California, finds that best practice is to focus more on “how the individual is doing the job, rather than the structure of the job itself.” He observes that “the chair should ask how well am I serving, and am I getting the board moving in the right direction.” Of course, this will include grading the functional elements of the role -- meeting logistics, agenda setting, and the operational aspects of boardmanship.

Your particular situation, a combined CEO and chair role, demands effort to distance the qualities scored in chairmanship from those of an executive. “One of the biggest questions is the balance of ‘nose in fingers out’ -- that is, understanding the difference between governance and management,” says Rose. Since the board chairmanship is just a hat that the CEO wears occasionally, you as governance committee chair will have to set the ground rules in gauging how well the CEO/chair does at segregating the roles.

Indeed, the governance committee should take the lead in your chair’s evaluation. Score him specifically on how well he works with board members. To strengthen this approach, Rose suggests limiting evaluation input to directors, and not top managers (who will likely find it impossible to separate the two roles).

A third-party intermediary is best for handling the chair evaluation process, and can serve as an interpreter for your governance committee. An outside consultant can also help with the vital process of followup -- driving action on the areas where a chair proves weak. (Turning evaluation results into solid change is hard enough for the full board -- pushing a CEO/chair to rethink the second half of his title will definitely need extra effort).

UPCOMING IN *BOARDROOM INSIDER*...

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- *TELECONFERENCE BOARD MEETINGS - ETIQUETTE, RULES, ETC.*

RALPH WARD’S BOARDROOM INSIDER is published monthly for directors, CEOs, those who work with corporate and nonprofit boards (corporate secretaries, corporate counsel, support staff, and consultants), and those who are board prospects.

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