NOMINATING AND GOVERNANCE COMMITTEE PRIORITIES FOR 2022

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Contents

The war on talent, shifts in corporate strategy and operations, reporting and compliance demands and more will challenge boards in the year ahead. To properly set their organizations up for future success, nominating and governance committees must remain adaptable and resilient in this evolving landscape. Below are five key areas that should be top of mind for **nominating and governance committees** in the year ahead.

1 Evolving Roles and Responsibilities

In 2022, the nominating and governance committee's core responsibilities of oversight of the board governance system, board composition and organization, board and director evaluation, and succession and board refreshment are expected to be more complex than in previous years. Limits on professional resources and evolving skill and experience requirements complicate succession planning for both the CEO and the directors of the board. The nominating and governance (nom/gov) committee needs to identify the skills and experience necessary to support their unique corporate strategy and address the associated risks and opportunities identified and anticipated. That is, the current competency profile of the bord should be assessed against competency requirements needed to provide effective oversight in the future. This complicated process will require creativity as corporate needs evolve and ideal candidates may become more difficult to attract and retain.

In addition, board oversight has garnered more interest and is subject to closer scrutiny by a broader faction of stakeholders. With the increased focus on environmental, social and governance (ESG) values, the role of governance (the "G" in ESG) has become more high profile. Board composition, strategy, risks and opportunities identified and addressed as well as general governance oversight and accountability, are all under the microscope. Shareholders and other stakeholders are especially interested in how the nominating and governance committee approaches:

- **Fiduciary responsibilities.** The nom/gov committee is expected to work with the general counsel to ensure that fiduciary responsibilities are a critical focus of director onboarding and subsequently upheld and addressed by directors according to the terms of the various charters of the board. Fiduciary responsibility requires judgment as it is grounded in accountability to shareholders for oversight responsibilities.
- **Operations and performance.** The nom/gov committee is commonly tasked with ensuring board responsibilities are allocated appropriately and equitably among committees, and that committee assignments are made with director experience, skills, attributes, current workload and board assignments in mind. Further, board leadership positions should be filled with careful consideration of not only qualifications but demeanor. The committee collaborates with those responsible for enterprise risk management (and those charged with its oversight, generally a responsibility of the audit committee) to help determine that risks and opportunities have been addressed; while recognizing that ultimate responsibility lies with the full board, which requires deliberate and continual communication among committees and the full board. A conscious effort to remain apprised of current events will help the committee recommend appropriate governance updates, which may include adjustments to committee structure, size or responsibilities. This may further require formation of special committees to address emerging issues (e.g., Covid-19, ESG).

  Other committee responsibilities include the evaluation of governance — e.g., performing regular self-evaluations of the board and directors, assessing everything from the board's size, composition, culture, structural and procedural policies to the efficacy of individual directors. A 2020 Spencer Stuart survey of S&P 500 nominating and governance committee chairs reported that 35% had one or more underperforming directors in the past three years, further reinforcing the importance of governance evaluations. Additionally, there are emerging best practices for director/board evaluations and disclosure such as including a description of the process within the company's proxy statement. Emphasis should be placed on the critical responsibility the nom/gov committees assumes in the oversight of the board evaluation process and its role in improving the governance posture of the company.

- **Policies, documents and charters.** The nom/gov committee generally reviews and assesses the board's corporate governance policies and documents to ensure they accurately depict the governance in action, which consist of fiduciary responsibility, regulatory requirements, company specific actions, and stakeholder expectations, including expanding risk responsibilities delegated at the committee level. Governance guidelines dictate frequency of meetings and director-related concerns, including director independence, committee assignments, number of directors per committee and policies related to directors' service on other boards. A comprehensive committee charter incorporates lessons learned – for example, from COVID-19, such as rules regarding additional and emergency meetings (whether live or in-person) and emergency preparedness considerations. The inclusion of planned and practiced responses will help boards to mitigate risks and navigate uncertainty. Specific committee charters should be frequently reviewed and updated to address emerging risk areas and specific risk oversight assignments. For example, the responsibility for ESG oversight is commonly allocated to the nom/gov committee and therefore should be reflected in its charter; while oversight of specific elements of an ESG framework, such as certain human capital priorities related to diversity and corporate culture may be delegated to the **compensation committee**. As risks emerge and roles evolve to address them, committees are not only expected to do the work, but share the results with the full board, and document such efforts through minutes and agendas.

- **Stakeholder engagement and strong communication.** The **Business Roundtable** has redefined the purpose of a corporation to serve all Americans, while the sustainability movement has identified a broad range of **stakeholders who are key drivers to profitability in a capitalist market**. Stakeholders have both greater interest in and greater ability to effect change in corporations. In recent years, "stakeholder" has expanded beyond traditional shareholders to encompass employees, regulators, customers, suppliers and — depending on your product or service — society at large. The nom/gov committee is involved in the process of identifying key stakeholders and developing a strategy for interfacing and engaging with them. This should be a collaborative effort with management, particularly the CEO, who generally serves as the key spokesperson for the company with support from the board.

One element of engagement is reporting which involves collaboration to ensure timely, accurate and robust communication. While typical governance guidelines require the **audit committee** take primary responsibility for required financial reporting, including any mandated disclosures it recommends to the board, disclosure expectations are rapidly expanding to encompass non-traditional, non-financial topics (e.g., ESG). The full board should oversee communications that may be integrated within financial statements or that may be outside of such documents including proxy statements, the rise of ESG has resulted in evolving voluntary disclosures that require a great deal of judgment. The ***2021 BDO Fall Board Pulse Survey*** notes, *"as the company executes on strategy, it's increasingly important to outline opportunities for invested parties and disclose any risks anticipated or encountered along the way. Doing so will continue to build stakeholder trust and ultimately lead to better outcomes, thereby ensuring a cohesive vision for the organization's future."*

The pressure to communicate is tangible. Institutional investors are increasingly acting to replace directors in attempts to influence board composition and action; proxy advisors are making voting recommendations against those who are not executing on ESG initiatives; **activists** are evaluating board effectiveness and company performance in attempts to influence corporate strategy. These shareholder proposal and campaign trends provide indicators for nom/gov committees, where such actions may initially fall under the purview of the nom/gov committee. Strategies for proactive shareholder engagement need to be developed and implemented. This will allow boards to better understand perspectives of shareholders and vulnerabilities of the company, that may be addressed prior to a shareholder proposal or in lieu of a proxy fight.

2 Succession, Refreshment and Recruitment

The committee must ensure that the leadership and the board are evolving with the company. Board composition and **refreshment planning** should be treated as a priority and normal part of oversight responsibilities. Continual refreshment also serves as a reminder to board members that appointments are not life tenancies. Clear expectations should be outlined for directors about tenure, capacity, and participation. The ***2019 BDO Board Survey*** noted that roughly one third of public company directors (30%) say their company places limits on the number of boards upon which a director can serve, up from 27% in 2018. These guidelines appear to be promoting change effectively, as only 37% of directors report serving on two or more boards. ***Spencer Stuart's 2021 U.S. Board Index*** indicates that on average, independent directors on S&P 500 boards have 2.1 public corporate board affiliations, but that only 31 S&P 500 boards, or 6%, report having explicit term limits. A director's efficacy and value must be viewed from both the stakeholder's perspective and balanced with the needs of the organization in terms of experience and skill. Boards should endeavor to keep stakeholders apprised of strategy shifts in board composition and refreshment planning.

A good refreshment strategy aligns board composition with both current and future strategic business needs, often through regular and intentional use of competency and professional experience profiles. It is designed with the flexibility to allow for periodic adjustments as the business evolves, assisted by regularly performed gap analysis of what the board currently has, what it needs and how to fill identified gaps (e.g., via new directors, advisors and/or continuing education). A refreshment strategy should also include a longer-term, multi-year view that anticipates departures, leadership changes, illness, etc.

Director and executive candidates can be viewed through the lens of diversity, in thought that considers broadly, experience, skills, attributes and matters of gender, race and ethnicity along with matters of tenure and capacity. Attaining diversity of thought through a complement of varying skillsets and lived experiences enhances the board's overall reach and productivity and should be continually evaluated and improved. Representation of women on boards remains low but companies are making steady progress. According to BDO statistics on 600 middle-market public companies, on an aggregate basis, **women comprised 23% of boards in 2021, up from 21%** in 2019, and ***Bloomberg*** reported that women hit a record share of seats in S&P 500 boardrooms in 2021. The ***2021 BDO Fall Board Pulse Survey*** revealed that building a more diverse board and leadership team is a near term (12 to 18 months) priority for 55% of individual public company directors. Pressure for diversity is moving beyond shareholder pressure to include a variety of stakeholders who are using various means to effect change by influencing shareholder voting, regulatory requirements and corporate governance policies. Board diversity is further reinforced through both regulatory and disclosure requirements. The recently **approved** Nasdaq rules require listed companies to disclose in a standardized matrix their board diversity composition beginning in 2022. Beginning in 2023, listed companies are expected to have at least one female and one underrepresented minority or LGBTQ+ individual on their boards or explain why they do not. Additionally, there are state laws mandating board diversity, including effective California legislation requiring increasing diversity based on gender and certain identified underrepresented communities.

Board entrenchment is a further consideration where significant institutional knowledge may have been amassed by long-seated directors that serve the company well, particularly in a highly functioning board. However, as disruption, innovation and rapid change impact the business world, long or indefinite tenures for the majority of board directors may not allow for the introduction of new perspectives in the board room.

3 Director Sourcing, Onboarding, Development and Retention

The role of the director is more demanding than ever. Companies seek those in positions of oversight to have significant experience understanding the current and future risk profile of the company. Sources for director candidates need to expand with the varying skills and perspectives needed to complement the existing composition of the board. Just as the compensation committee is tasked with continual CEO succession planning, so too must the nom/gov committee approach the development of a director talent pool with an intentional and thoughtful approach that aligns with corporate strategy. Sourcing eligible director candidates needs to be done well in advance and with a prepared value proposition (e.g., compensation, impact opportunities, professional collaboration) to attract the best candidates, which likely requires collaboration with other committees and the full board. Seeking such candidates beyond the directors' personal or traditional networks of CEOs may require assistance of third parties, such as executive search firms, advisors (e.g., attorneys, accountants, etc.), governance societies or other organizations.

The development of a formal and validated onboarding program will enhance the contribution of new directors. Onboarding includes formal and informal processes designed to not only educate and familiarize incoming directors with the company's operations, policies and procedures but to further indoctrinate them into the culture of the board and the organization and introduce them to key contacts throughout the organization.

As with any significant role, continuous education, development and upskilling are an effective means to ensure directors remain current on evolving matters of importance and are equipped with the skills and knowledge necessary to perform their duties. The nom/gov committee has the responsibility for preparing an ongoing education and development plan for the directors, with input from the other committees, on committee specific requirements. While the development topics will be specific to the company, some common areas include regulatory compliance, strategy and the competitive landscape, governance frameworks, CEO and executive team oversight, industry trends and risk management including cybersecurity and financial oversight.

A company's approach to director compensation and workload will directly impact its ability to attract and retain competent board members. Simultaneously, the number of meetings and volume of directors' workloads have increased, particularly during the COVID-19 pandemic, and there has been intensifying scrutiny around compensation practices for boards. The ***2021 BDO 600***, a study of 2020 board compensation practices, found that total director compensation increased by 2.3% in fiscal year 2020 over fiscal year 2019, while the NACD's 2020-2021 Annual Survey of Governance Trends and Priorities noted increased time spent at meetings and reviewing reporting and materials. This creates complexities for companies struggling to win the war for talented directors as they seek to understand and balance the competitiveness of board compensation with stakeholder expectations of such roles.

4 Defining and Refining ESG Oversight

Whereas some boards respond to the increasing need for a corporate ESG initiative by creating a standalone ESG committee, more and more are delegating the establishment and maintenance of ESG initiatives to the nom/gov committee, who already have responsibility for "G" in ESG. When implemented correctly, an ESG initiative is a holistic effort, influencing all aspects of strategy and operations and plays a specific role in supporting the overall strategy, with the nominating and governance committee acting as a project manager, ensuring all aspects of ESG management are being overseen at the board level.

Defining and further refining ESG strategy requires the committee and management keep a close eye on current events and evolving issues to ensure that the ESG factors become part of the company's strategy and are anchored by metrics that can be evaluated. **BDO's ESG Center of Excellence** identifies and supports the progression of six stages of the ESG journey for management and board consideration:

1. Starting your ESG journey
2. Identifying your most important ESG factors
3. Developing your ESG strategic roadmap
4. Managing your ESG infrastructure and ensuring the reliability of your ESG data
5. Navigating your ESG reporting and communications
6. Transforming your business to align with ESG strategies

It is important that the "E", the "S" and the "G" are reflected in company operations. The "E", of course, dictates that companies embrace environmentally sustainable practices whenever possible. The "S" applies to factors impacting human capital and societal rights. Beyond internal practices, vendors and partners should be carefully vetted to ensure that all affiliated with the company are operating in accordance with labor laws and societal standards. The "G" discussed earlier, representing the governance system, includes policies, board leadership, charters, programs and composition.

Activists evaluating board efficacy are more likely to grant a passing grade to a nominating and governance committee overseeing an ESG initiative with a strong culture of accountability. The nominating and governance committee should clearly communicate who owns the initiative and who oversees it. ESG should be an item on the agenda at every meeting, as ESG is quickly becoming integral to a company's value and sustainability.

5 Increased Disclosure/ Reporting Demands

The demand for transparency in reporting is only increasing and companies are finding these disclosures can be a constructive step toward positive stakeholder interaction. The *2021 BDO Fall Pulse Survey* found that the most important priorities from shareholder meetings in the 2021 proxy season included accountability for ESG/sustainability (13%) and DEI efforts (13%). As discussed previously, the nom/gov committee should ensure a communication strategy is in place, which is executed by the board and company leadership. Disclosures can be viewed as an opportunity to control the narrative before someone else does.

Keep in mind that a majority of the overall reporting oversight responsibility will fall to the audit committee while oversight of certain information related to human capital management will fall to the compensation committee. In this regard, it will be imperative that the board committees work collaboratively to ensure completeness and accuracy of disclosures made. Disclosures are a tool to explain the company's strategy and execution, but also for outside stakeholders to consider the impact of the company's choices.

It is important for the board to consider internal controls around data collection and tracking of data disclosed. When disclosing information such as director competency and experience matrix, collection of data can prove challenging. For example, professional experience might be easier to obtain than attributes that may rely on voluntarily discolsure by the individual director. The committee should evaluate the data shared to ensure it is accurate and that it adequately portrays the company's story. With reporting happening in various mediums (e.g., 10-Ks, proxy statements, sustainability reports, websites, etc.) it is also critical to ensure consistent messaging. Establishing processes and controls over non-financial metrics and disclosures may help in mitigating these risks but is no small task and will necessitate commitment across the company.

Next Steps

We encourage nominating and governance committees to remain up to date on evolving trends and work with your advisors on continuing education plans. For your convenience, here is a recent listing of realted board comittee resources that may be of interest to you from the BDO Center for Corporate Governance:

- Audit Committee Priorities for 2022
- Compensation Committee Priorities for 2022
- 2021 BDO Fall Pulse Survey

We encourage nom/gov committees to be thoughtful in their continued education including remaining abreast of industry trends and take advantage of the numerous opportunities available through the BDO Center for Corporate Governance. To begin receiving email notifications regarding BDO publications and event invitations (live and web-based), visit http://www.bdo.com/member/registration and create a user profile. Please reach out to a member our team with questions about content contained within this publication.


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