

NOMINATING & GOVERNANCE COMMITTEE PRIORITIES FOR 2023



CEO and director succession and refreshment, governance policies and procedures, reporting and stakeholder engagement historically have defined responsibilities of the nomination and governance (N&G) committee. However, many such committees are seeing their expected roles expand to further encompass certain material environmental, social and governance (ESG) factors as these become more complex business issues.

Additionally, the role of the individual director continues to change and evolve. Directorship today requires more involvement, agility, dedication, accountability and engagement than in prior years. The Board, and each individual director serving on it, is being held accountable to a more broad-based community of stakeholders operating in a dynamic environment where priorities shift frequently.

CEO Succession

CEO succession planning, a full Board responsibility and arguably one of the most significant activities of the Board, is often led by the N&G committee. As of [July 2022](#), S&P 500 CEO annualized succession rates were 11.4% up from 10% in 2021. Retirement age CEOs departed at even higher rates: for S&P 500 31.5% and for Russell 3000 24.2% (both up from 2021 percentages). The rate of forced succession rates continues to be low in 2022 at just 2.3% for Russell 3000 and 0% for the S&P 500.

These numbers highlight the need for companies to be maintaining at-the-ready CEO succession plans — which don't simply include a named new CEO but encompass the candidate pipeline identification process, any needed “grooming” of skills and experience that is strategically “future-focused” along with company-wide transitional and internal/external communication plans.



Director Succession and Refreshment

Director refreshment and succession continues to challenge N&G committees as the expectations for Board composition — including diversity, skills and specific knowledge — evolve with the rapidly changing business operating environment. While individual priorities vary between companies, stakeholders agree that diversity of thought is essential to boardroom success. The challenge is to piece together an intricate puzzle of director skillsets and attributes that support corporate strategy and long-term value creation.

SUCCESSION STRATEGY

[Spencer Stuart](#) reports the top three Board composition priorities over the next three years are:



58% developing a boardroom succession strategy



54% enhancing racial/ethnic diversity



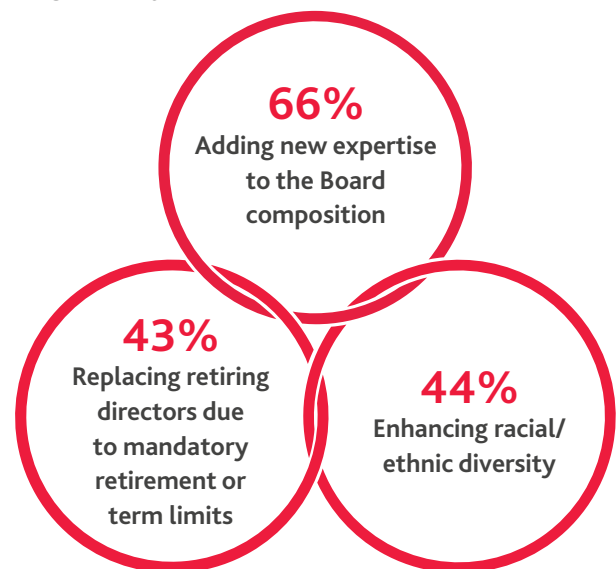
24% enhancing gender diversity

The N&G committee needs to consider, as part of their annual self-evaluation, “Do we have the right people around the table to collaborate with the leadership team on execution of our strategy?” The answer to this question should inform an intentional succession plan supported by a continually evolving set of needed skills and attributes mapped to corporate strategy and identified risks — both of which will need to be continually corroborated with the full Board and leadership team. Consider the detriment to companies directly impacted by international rules, regulations and economic turmoil in the face of a [noted](#) decline in the percentage of sitting directors who have relevant international experience. This misalignment may present a missed opportunity for the Board to be supportive of and advise management on existing or emerging issues of importance to their business.

Similarly, as discussed in our recent publication [What's on the Minds of Directors Heading into 2023](#), oversight through a strategic lens is paramount and Boards need to exercise caution in the tradeoff of placing recruitment emphasis on specific functional experience over core strategic experience. This is poignant as the [reported percentage](#) of Board members with strategic proficiency has also been declining.

REFRESHMENT

Refreshment is the key action of an intentional boardroom succession strategy. [Spencer Stuart](#) reports that refreshment is being driven by:



This data suggests that progress is being made via additions to the Board, but not necessarily via evaluating the current Board to ensure standing directors remain the best fit. Timing of refreshment should align with needs, but companies may be abdicating such responsibilities in favor of expiring age or term limits. [Twenty two percent](#) of N&G chairs recently surveyed report that one or more directors should no longer be on the Board, with [79%](#) of those citing director skills and expertise as no longer current or no longer aligned with corporate strategy. Business needs are changing and the composition of the Board needs to change as well. Proxy advisors ISS and Glass Lewis are not supportive of age limits for directors and typically will vote against age limits to promote director refreshment centered around succession planning. Boards need a formalized refreshment process, together with strong culture and values, that includes robust and candid Board and director evaluations that are aligned with a skills and experience needs assessment.

DIVERSITY PROGRESS

Enhancing racial/ethnic and gender diversity continues. The S&P 500 [welcomed](#) 395 new independent directors with 72% of such seats filled by directors from underrepresented groups:

- ▶ 46% of those identifying as women — up from 43% in 2021;
- ▶ 46% identified as Black/African American, Asian Hispanic/Latino/a, American Indian/Alaska Native, Native Hawaiian/Pacific Islander or two or more races (multiracial) — down from 47% in 2021
- ▶ 1% as LGBTQ+ (when disclosed).

Additionally, in terms of disclosure, 93% of these Boards disclosed their racial/ethnic composition and 50% reported having a diversity policy akin to the NFL's "Rooney Rule" that aims to increase the number of minorities hired into leadership positions (up from 60% and 39%, respectively, in 2021).

With respect to smaller company Boards, as of [Q2 2022](#), 27.9% of the 26,341 Russell 3000 Board seats were occupied by women. In [Q1 2022](#), 26% of such directors reported their race and ethnicity, up from 21% in Q4, 19% in Q3 and 17% in Q2 2021. However, people of color, especially Hispanics/Latinos, remain significantly underrepresented on corporate Boards.

Governance Processes, Policies and Documentation

GOVERNANCE OVERSIGHT RESPONSIBILITIES AND DOCUMENTATION

Governance processes and policies drive successful governance and should be established, clearly documented and communicated and revisited annually or more frequently if necessary. The N&G committee ensures that oversight responsibilities are captured within the appropriate charters. This requires alignment with succession planning and collaboration efforts with other committees and the full Board to ensure significant and emerging risks are allocated equitably and documented appropriately. For example, the N&G committee should consider the overall risk allocation among committees to determine if one or more committees are overburdened and whether there may be a need to recommend reallocation of responsibilities; and further may collaborate with the compensation committee to ensure committee retainers are commensurate with responsibility.

EYE ON EMERGING ESG TRENDS

57% of directors in BDO's [2022 Fall Board Pulse survey](#) indicated that ESG matters are the responsibility of the N&G committee. However, the oversight of ESG matters may be thought of as an extension of the oversight of risk management. For that reason, many Boards choose to allocate material ESG risks among the committees of and within the management leadership team. There is currently no one-size-fits-all approach. The allocation differs from company to company depending on a variety of factors including the complexity, impact and prioritization of specific ESG factors along with the capability and capacity of directors, committees and management teams. For more information, refer to BDO's [Understanding the Board's ESG Mandate](#).

CORPORATE POLICY

Dynamic environments call for equally dynamic policy. There is a heightened interest in corporate political spending and response to social issues. The N&G committee can help to Board by focusing on the design and communication of policies governing these sensitive areas to ensure that they align with corporate culture and values and that corporate actions comply with such policies.

GOVERNANCE PROCESSES & PROCEDURES

Corporate scandals and evolving risks keep boardroom responsibility and accountability under close review. The N&G committee generally takes responsibility for certain governance processes and procedures, such as the vetting of Board candidates, onboarding of new directors, and conducting annual Board evaluations that support and evaluate the quality of Board service and may require significant judgment. Independence reviews, for example, are not to be treated as a “check the box” exercise. The concept of the “[gray director](#)”, which denotes how matters of independence may not always be “black and white,” is an increasing area of risk for Boards that may be too cozy or lack independence of thought. Consideration should be given to the new [SEC universal proxy rules](#), which may increase individual director scrutiny, as a shareholders' ability to put forward their own board candidate nominations becomes easier.

Onboarding of directors has become increasingly important for companies where Board diversity has led to more first-time directors and more directors from non-traditional talent pools (e.g., outside the C-Suite). The availability of onboarding support is instrumental in empowering directors for success in their roles through assimilation into the culture of the organization, understanding of individual roles and becoming effective participants in the boardroom. This includes having an onboarding process that provides resources, education and information on both immediate issues impacting the company and emerging areas of risk and opportunities that should be on the Board's radar. Further processes that include mentorship — e.g., assigning “Board buddies,” shadowing experienced board members, and observing meetings of committees that the director does not serve on — can be highly successful tools in forming effective Boards.

While Boards have been conducting full Board evaluations for a long time, individual director evaluations are becoming more common. 85% of large and mid-cap N&G chairs surveyed [reported](#) that their Board conducts individual director evaluations, with the majority (58%) being conducted by the Lead Director or Board Chair. The quality of the evaluation process often comes down to the quality of the boardroom culture and Board leadership, which is predicated on the values of the company and how individuals embrace these and perform within the context of the full Board. Such an approach should consider factors such as capacity, length of term and relationships that may impact a director's ability to remain independent in thought and action.

Ideally, companies should be regularly conducting robust individual director assessments focused on both performance and experience to ensure the needs of the Board and the organization are met — including encouraging fresh perspectives and the timeliness, relevance and depth of proficiencies, as necessary. There may be a very high functioning and valuable director who may no longer fit the needs of an organization. Directorship is a duty to serve an organization and directors should be self-aware of the value they bring to an organization and when it may be time to move on. For example, refreshment may be warranted because the director has fulfilled a specific role in assisting the company with a series of M&A activities or in the implementation of a cyber governance program and the director's skillset now is better suited for another company. Another scenario necessitating refreshment may be capacity-related such as increasing responsibilities in their “primary role” or overboarding concerns.

The N&G committee often may need to help the Lead Director or Board Chair broker difficult conversations, leveraging Board evaluations and skills matrices aligned with strategy needs to facilitate refreshment. Conversations that explore how long a director intends to serve and what skillsets they will provide during that time, along with the actions to take when the fit is no longer there can be highly effective in setting expectations for service up front. Two-way, candid conversations including engagement by the Lead Director or Chair to gage the temperature of the Board, how it's performing and how people are feeling about other directors and their performance levels is critical. These are not necessarily performance conversations (although occasionally they may be), but moreover strategic alignment conversations. It is important for individual directors and the Board to identify when it's time for a change.

Reporting & Communications

REPORTING & DISCLOSURE

Increased reporting requirements have enhanced transparency of Board composition, succession and refreshment policies and procedures. However, it is important that the Board remain aligned with strategy and not become overly influenced by reporting. Most of the information obtained on diversity is through disclosures which focus on director attributes and less often provide comparable skillset data. Transparent communication as to the reasons for decisions and priorities can be important to the engagement of shareholders. Communicating why decisions made are in the best interest of the long-term value of the company and its stakeholders, and sharing the process and conclusions reached can provide insight for shareholders and others.

STAKEHOLDER ENGAGEMENT

Stakeholder engagement is critical, but the Board must remember its role is that of oversight. The Board should ensure management is establishing trust with and considering and responding to feedback from stakeholders. For example, directors can support management by:

- ▶ Requesting reporting from management on stakeholder engagement including feedback received and concerns raised.
- ▶ Clearly defining who is the face of the company (in most cases it is the CEO).
- ▶ Providing a feedback loop for discussions around stakeholder engagement for directors to weigh in on the process.
- ▶ Availing themselves to engagement with stakeholders at the request of the CEO.
- ▶ Abiding by best practices in stakeholder engagement which may require a minimum for attendees present during stakeholder discussions.

The process of actively seeking and collecting stakeholder feedback, ideas and opinions helps management act strategically rather than reactionarily. This is an area where curiosity can be channeled by thinking through various scenarios, performing tabletop exercises and leveraging Board and management sessions to consider feedback while ensuring that any proposed changes to corporate strategy and priorities are appropriate and still support the purpose of the entity.

EYE ON SHAREHOLDER ACTIVISM

Activism has become an increasing presence in corporate governance for companies of all sizes. Boards are most susceptible to activists when they fail to recognize the vulnerabilities and issues that are important to stakeholders. When an activist comes, they rarely come alone. It is important to understand how activists think about the company, its operations and its leadership - including the Board and the current governance structure, policies and procedures. Engagement with activists through honest two-way conversations can help de-escalate a situation. Experience in dealing with activists can be highly valuable to a Board, especially on a small cap Board where activists may be disproportionately focused due to the distinct challenges of small cap directors. As with other crisis and risk management priorities, tabletop exercises for identifying vulnerabilities and dealing with shareholder activism should be added to the annual Board agenda.

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. Subscribe to receive future publications and events offered by the [BDO Center for Corporate Governance](#). We further invite you to review our 2023 priorities for the [full board](#), the [compensation committee](#) and the [audit committee](#).



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