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A director's seat will soon feel a bit warmer

Posted by [SherylNash01](#) in sec, proxy season, corporate governance, corporate boards



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Nasdaq	2329.63	3.28
S & P 500	1138.54	-0.15
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Citigroup Chairman Richard Parson's recent shake-up of the bank's board or directors can be dismissed as a product of the heavy hand of government. So can the changes seen elsewhere in the governance of TARP-assisted companies.

But Uncle Sam isn't the only source of pressure on cozy boards. Experts say new Securities and Exchange Commission rules will help ordinary shareholders exert more influence, and some of it is likely to be felt in the upcoming proxy season.

In perhaps the most far-reaching change, the SEC has proposed rules that will allow shareholders to nominate directors for the first time and elect them by majority votes instead of pluralities. And the commission has stated it intends to vote on the proposal this year.

"That will assist shareholders in their ability to nominate and vote on directors," says Roger Coffin, associate director of the Weinberg Center for Corporate Governance at the University of Delaware.

While the vote won't come in time to affect the coming proxy season, other changes will.

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For instance, this is the first proxy season where brokers won't be able to vote for shareholders without their express instruction. Until now, brokers could do that and would typically vote in line with the company's management.

Annalisa Barrett, a senior research associate with The Corporate Library, which provides independent corporate governance research, says this alone could change the face of some boards. "If a director is close to getting a majority of the votes, but can't rely on votes from brokers, we could see some board movement," Barrett says.

Then, too, new SEC rules that kick in this proxy season will require that results of director elections will have to be reported within four days. "I believe this will impact subsequent votes because people tend to follow suit. There will be more focus on annual meetings and shareholder proposals. With the technical changes and increased scrutiny, the next few months should be interesting," says Barrett.

So if board membership isn't a hot seat just yet, it is about to get a bit warmer. And the TARP experience does have some indirect bearing, in so far as boards failed to prevent big banks' meltdowns and the need for taxpayer bailouts.

In addition to the financial reform legislation making its way through Congress, the SEC has recently issued new reporting and disclosure requirements regarding CEO compensation, director qualifications and risk management, to name a few key areas.



While the details of the requirements have yet to be released, experts expect them to have wide-ranging impact. "It is clear these changes are enormous and probably the most wide-sweeping corporate governance legislation that we have seen in our lifetime," says Gail Lieberman, managing partner of Rudder Capital and a former director of TriPath Imaging, Inc. and Breeze-Eastern Corporation.

The pressure has also increased the demand for outside directors. Recently Apple, after criticism that its board was too chummy, named outsider Andrea Jung, CEO of Avon Products as co-lead director. "The mega trend in the last couple of years has been for independent directors, particularly on the audit and compensation committees," says Ralph Ward, editor of *Boardroom Insider*.

Fewer than a quarter of the companies in the Corporate Library's database have an independent board chair. But other data shows a movement in that direction. The 24th annual Spencer Stuart Board Index study of S&P 500 corporations released late last year found active CEOs among new directors accounted for 26 percent in 2009, versus 53 percent 10 years ago. It also found that the CEO is the sole insider on 50 percent of boards, compared with 21 percent in 1999.

While corporations are designed to grow over a long period of time, public companies report quarterly and are traded minute by minute. "The pressure is on board members to help senior management make good long term decisions, especially in these times of national economic uncertainty, yet to do so in a way

that is congruent with the daily impressions of stock analysts, many of which have never held a line position in a company in their life," says Rick Chess, managing partner, Chess Law Firm, and president elect, Real Estate Investment Securities Association.

The top two issues facing boards, says Lieberman, is CEO compensation and risk management. "The issues with CEO compensation is balancing keeping the CEO motivated and his expectations in check on one hand, and looking out for the interest of the shareholders," she explains. That involves tying compensation to performance, including enterprise risk and other objectives, and instituting deferred components to compensation with claw back provisions on the other.

But that may lead to some uncomfortable confrontations, says Lieberman. For example, how eager would boards be to tell a CEO that a compensation consultant recommends that he or she be paid at the median level of a compensation range based on those considerations? "What CEO wants to be considered average and have that communicated to shareholders?" she asks.

The challenges of dealing with risk may be even more formidable. For one thing, risk isn't easily defined. Compliance with regulations and having adequate insurance is just the beginning of risk management, says Michael Bechara, a CPA and managing director of Granite Consulting Group, a governance, risk and control consultancy. "Managing risk starts with an awareness of what the risks are, followed by an ability to prioritize them in

accordance with the board's prevailing view or business conditions. As the old saying goes, 'what you don't know can kill you'," adds Bechara.

Even if a board gains a firm grasp of what risk a company faces, and what its appetite is, it still faces is the challenge of incorporate that appetite into performance, internal and external reporting, and culture. "And even if we have these discussions and implement oversight procedures, what happens when something slips through the safety net?" she asks.

Nevertheless, boards will find it increasingly difficult to avoid dealing with the issue, says Joel Kurtzman, author, *Common Purpose: How Great Leaders Get Organizations to Achieve the Extraordinary*. "Bear Stearns, Lehman and AIG all had boards. But the boards probably didn't understand the amount of risks their firms had taken on. Were they asleep? Maybe. But most likely they just didn't understand the risks. That's unconscionable. Not everyone is suited to be on a board."

All of that means longer and more rigorous hours for board members than they once may have been used to, running anywhere from 20 to 30 hours a month or more. "They must be engaged," says Kurtz. "You can't just read the financials on the plane on your way to the meeting."

Certainly, such pressure has not yet led to a mass exodus at boards. What shifts there have been of late besides those at banks and auto companies seem relatively routine. Ameren, for example, changed out three directors in February, but those are not considered

unusual. "That move was driven by the usual suspects-exiting CEO, mandatory retirement/change in professional status," says Pat McGurn, special counsel, RiskMetrics - ISS Governance Services.

Similarly, McGurn describes recent changes at Blockbuster and Yahoo as a product of overboarding, personal reasons, or other business obligations.

Overall, board turnover of late has been about normal, according to Ted Dysart, managing partner with executive search firm Heidrick & Struggles. Dysart says that may be due in part to people waiting out the recession before making a move. "Over the next 12 to 24 months I expect there will be a fair amount of acceleration in turnover as the economy moderates. After a company comes through trauma you see corporate renewal and that can mean changes to the board."

Meanwhile, Ward says board tenure is getting shorter. According to the Spencer Stuart Board Index Study, one-year terms for directors are now the norm in 68 percent of S&P 500 corporations, compared with 38 percent ten years ago.

Boards now typically have 8 to 11 members, down from the 18 to 20 of years past. "It's harder to get people to sit on boards and good governance standards say that a director should have only one or two seats, so it limits the pool. It draws proxy attention if a director has too many seats and is viewed as spreading themselves thin," Ward explains.

Ideally, of course, board seats require a commitment to shareholders that goes beyond

the pay, networking and knowledge that goes with the job. Who wants that responsibility? People who see board membership as "a mission," says Kurtz: "You're acting on behalf of the shareholders. You're representing them. Consider who owns your stock - mostly people's retirement accounts."

While that type of commitment on the part of all or even most board members remains elusive, the coming proxy season is likely to see demands for at least a bit more.

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