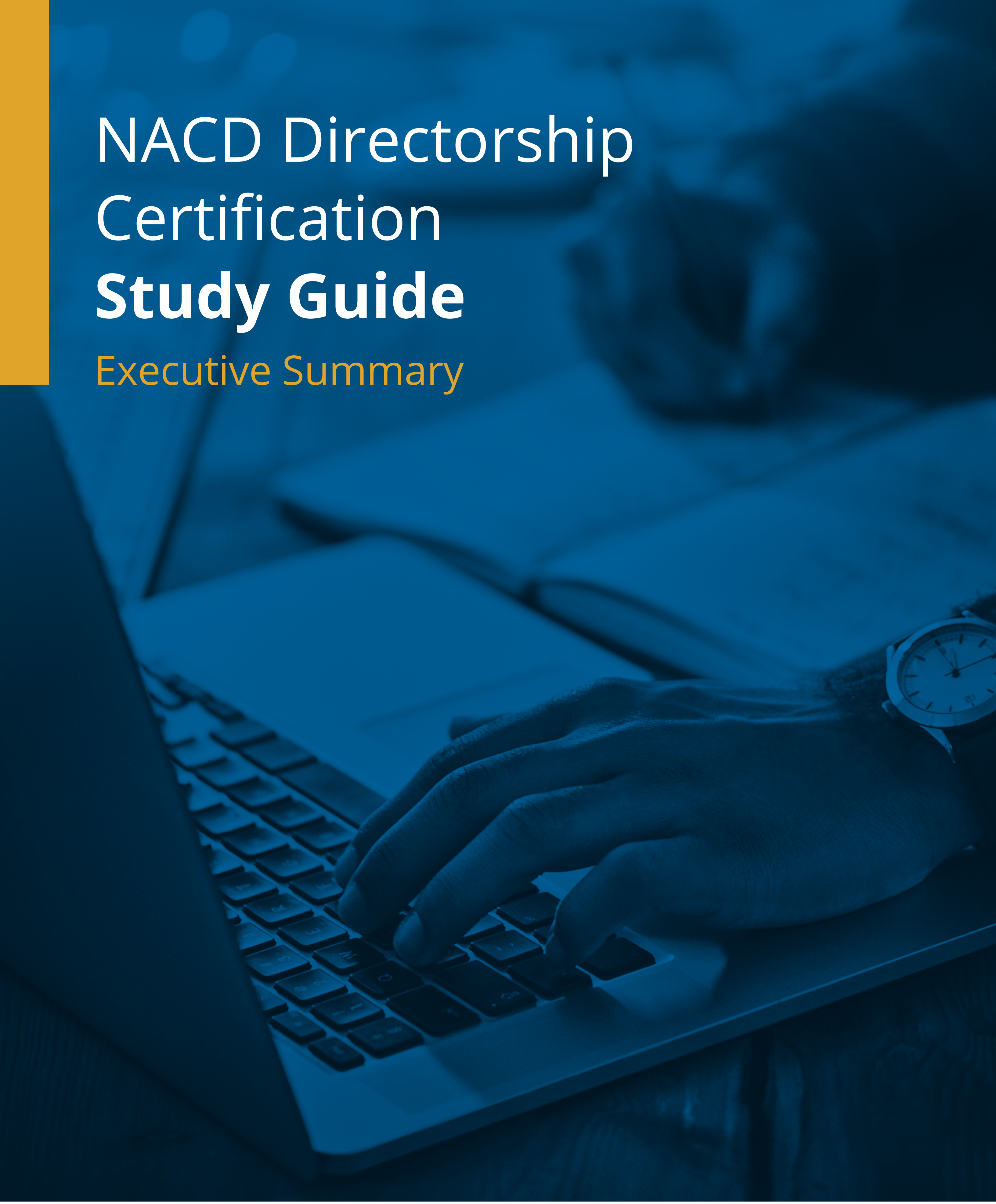

# NACD Directorship Certification **Study Guide**

## Executive Summary

NACD | DIRECTORSHIP CERTIFICATION

# CHAPTER 1 THE ROLE OF THE BOARD

Topic 1.1

## Directors' Fiduciary Duties

A corporate director must uphold the fiduciary duties of care and loyalty, approaching decisions in an informed, rational, and prudent manner, and disclosing conflicts of interest. This can provide protection under the Business Judgment rule. To make informed decisions, directors must have good information. In his 1996 *Caremark* decision, Chancellor William T. Allen of the Delaware Chancery Court stated that directors must "attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists," and found that the Caremark board had met that standard.

Topic 1.2

## Corporate Governance Requirements

The role of the board is primarily defined by state law, with additional requirements for public companies under federal law and stock exchange listing rules. A private company board may have an all-insider board that guides management as a group. By contrast, a public company board has a majority of independent outsiders on the board, who serve not only in an advisory role but also in a monitoring role. An effective board will define the role of management vs. the role of the board, and will make effective use of committees.

Topic 1.3

## Board Processes and Culture

The effective board will set annual board and committee calendars, as well as individual meeting agendas for the board and committees. Directors should receive (or have board-portal access to) meeting materials at least one week before the meeting and they should review them carefully. During the meeting, the chair should ensure full participation in meaningful discussion that is both candid and collegial. Boards should have a document-retention policy for all board documents.

Topic 1.4

## Shareholder Engagement

Shareholder engagement is an important board priority for public companies, where directors are elected by shareholders and are expected to consider their interests. The US Securities and Exchange Commission requires public companies to disclose certain activities to shareholders through various filings. In addition, boards should be willing to engage in regular face-to-face engagement with shareholders, particularly for topics such as corporate strategy; CEO evaluation, succession, and compensation; board nomination criteria; and the set of issues known as environmental, social, and governance (ESG) issues.

# CHAPTER 2 THE BOARD'S STANDING COMMITTEES

Topic 2.1

## The Audit Committee

Audit committees play a vital role in overseeing financial reporting, internal controls, and risk management. Independent audit committees are required in public companies, and common in companies of all kinds. Stock exchange listing requirements set the criteria for audit committees' size, independence, and charters. Key areas of oversight range from audit matters (e.g., appointing, compensating, and retaining the auditors; overseeing the audit; and reviewing the auditor's report) to discussing policies for risk management.

Topic 2.2

## The Compensation Committee

Compensation committees play an important role in setting and monitoring executive compensation. Independent compensation committees are required in public companies, and common in companies of all kinds. Stock exchange listing requirements set the criteria for compensation committees' size, independence, and charters. Key areas of oversight range from review and approval of corporate goals relevant to CEO compensation to ensuring compliance with rules on executive pay, including pay clawbacks; shareholder say on pay; independence of compensation committees and their consultants; pay-ratio disclosure; and employee or director hedging.

Topic 2.3

## The Nominating and Governance Committee

Nominating and governance committees (also called directors and governance committees) nominate directors and set governance policy, typically as a single committee. The New York Stock Exchange requires such committees, which must be independent. Nasdaq has a similar requirement, with important exceptions. These committees identify individuals qualified to become board members and select director nominees for the annual meeting. They also develop corporate governance guidelines and oversee the evaluation of the board and management, unless this latter duty is performed by an independent compensation committee.

# CHAPTER 3 THE BOARD'S DUTY TO SELECT AND COMPENSATE THE CEO

Topic 3.1

## CEO Succession Planning and Evaluation

Directors oversee the CEO evaluation process, monitor the CEO succession process, and select and onboard a new CEO. To fulfill these duties, many boards follow certain recommended practices, including annual CEO evaluations with a midyear review, setting the short-term and long-term succession plan, and developing an internal talent pipeline. They also disclose the board's CEO succession process to shareholders.

Topic 3.2

## Executive Compensation

The board is responsible for setting a pay philosophy for executives, as well as for the entire organization. Working through the board's compensation committee, the board selects the elements of executive pay plans, establishes performance goals and determines payouts, and considers the impacts of current and pending executive-pay rules. Executive pay packages include both fixed elements (e.g., base salary, pension and benefits, and any perquisites) and variable elements (e.g., annual incentives and long-term incentives).

# CHAPTER 4 TRADITIONAL AREAS OF BOARD OVERSIGHT

Topic 4.1

## Strategy Oversight

The board has a significant role in overseeing corporate strategy, including participation in the strategy-development process, engaging in strategy discussions with management, assessing strategic alternatives to the current or selected strategy, incorporating strategy into the board agenda, setting performance objectives related to strategy, and communicating strategy changes to shareholders and stakeholders.

Topic 4.2

## Risk Oversight

The board's role in risk oversight has broadened beyond traditional business and compliance risks to include emerging risks that range from geopolitical changes to demographic shifts. For public companies, directors' role in risk includes review of the annual report's MD&A and, for audit committee members, discussion of risk-management policies. In addition, public company directors must provide a report in the proxy statement that describes their role in risk oversight. To improve their oversight of risk, boards can monitor critical alignments of strategy, risk, controls, compliance, incentives, and people.

Topic 4.3

## Oversight of Financial Performance

The board oversees financial performance, in some cases with the help of finance committees. As a recommended practice, all directors should be financially literate, that is, able to read and understand financial statements (e.g., the balance sheet, the income statement, and the cash flow statement). This is a requirement for public company audit committees. To understand financial statements, it is important to know key financial ratios such as the debt-equity ratio and earnings per share.

Topic 4.4

## M&A Oversight

Directors work with management to create a strategy that may include mergers and acquisitions (M&A), including acquisitions that increase company size, divestitures that reduce company size, and/or mergers that combine companies of similar size. In any merger or acquisition there are several phases, beginning with strategy and ending with post-merger review. Courts set standards for director conduct in M&A, ranging from the prudence required under the Business Judgement rule to "entire fairness," a requirement for fair price and fair process (for transactions that involve a controlling owner).

Topic 4.5

## Talent Oversight

Recruiting, retaining, and developing talent is a key component to driving strategy, managing risk, and creating long-term value for the corporation. The board plays a key role here, working with the human resources function in supporting the board and business unit leaders in talent development, overseeing the hiring philosophy and incentives used to attract and retain talent, overcoming challenges related to the future of work, and supporting diversity and inclusion.

Topic 4.6

## Oversight of Ethics and Compliance

Directors must provide proper oversight for their companies' ethics and compliance programs, including hotlines for reporting violations. Public company audit committee charters require committee oversight of policies and procedures regarding legal compliance. In addition, some boards establish separate compliance committees to reinforce their oversight of the company's conformity to laws and regulations. The board should work closely with the company's chief legal officer (general counsel) to ensure strong integrity and effective compliance.

Topic 4.7

## Crisis Oversight

A corporate crisis may originate from a number of potential sources, ranging from corporate scandals to natural disasters. The board's role in a crisis not only involves providing oversight of the effectiveness of crisis preparations carried out by senior leaders, but also involves actively participating in the company's response when a crisis actually occurs, as well as conducting a postmortem to review lessons learned after a crisis.

# CHAPTER 5 EMERGING AREAS OF BOARD OVERSIGHT

Topic 5.1

## Oversight of Corporate Culture

Boards and committees can build their own positive culture by encouraging open discussion and debate. They can also ensure that the company has reward and recognition systems in place that incentivize the right behavior. Red flags for a deteriorating corporate culture include putting results above behavior and a reluctance to face bad news.

Topic 5.2

## Cybersecurity Oversight

Directors should be familiar with existing cybersecurity and data privacy laws and regulations as well as leading cybersecurity standards. In addition, they should understand the main kinds of cyberattacks, including malware, phishing, and denial-of-service (DoS) attacks. Keys to strong oversight include giving cybersecurity adequate agenda time, establishing an enterprise-wide cyber-risk management framework, and strong policies for communications and disclosure.

Topic 5.3

## Oversight of Environmental, Social, and Governance Issues

US companies are coming under increased pressure to disclose how they address environmental, social, and governance (ESG) issues, with many shareholders and other stakeholders now expecting a company's long-term strategy to create not only positive financial returns but also positive social and environmental results. Boards need to keep sustainability issues on their agendas, and they need to communicate with shareholders and other stakeholders about them—for example, through an annual sustainability report, now common practice in major public companies.