THE BOARDROOM GUIDE

For New Directors

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NACD Directorship

Are you preparing for a new board or committee role? The Vegas odds makers have already bet their stash on a "yes." Chances are you are needed to fill a space someone left empty or vacated due to the long hours or the headaches. Whichever it is, you are not alone. The NACD this year estimates there will be between 4,000 and 6,000 new board positions to fill.

Survey data tell the story. Years ago, it was not uncommon for a director to serve for a decade or two. But today average tenure on a board is less than seven years, thanks to several oft-simultaneous contributors to turnover: peer evaluation, mandatory resignation upon job change or age limit—and even term limits. Directors don't fade away, they just retire, as MacArthur might have said.

A growing number of boards even mandate committee turnover—with membership typically five years long and tenure for a chairman only three to five years, according to NACD data. Regarding age, about 50 percent of boards persist in setting a mandatory retirement age. This means that as soon as a good director blows out 72 candles, thousands of companies without such a mandate can make this loss of human capital their gain. Yet another factor increasing movement in the boardroom is the dawning realization that there is tremendous untapped talent outside the circles of the usual suspects—"diverse" leaders are getting their first boardroom calls right now.

Are you prepared to answer that call? Read and succeed.

ILLUSTRATION BY TED HAMMOND

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A Message to New Directors From Duncan L. Niederauer

The corporate governance and responsibilities of public companies have never been more important to our financial system. Today, more than half of American households own stocks, and while it takes years to build investor trust, as we learned during the crisis it takes only a short time to destroy it.

The role of corporate directors will be extremely important to restoring trust and protecting average investors in the post-crisis period. Transparency and accountability are more important than ever before. Board directors must invest a substantial amount of time to discussing and assessing various risks throughout the company. Directors must understand and deliberate on the company's corporate strategy and medium to long-term goals. Furthermore, directors should be proactive about meeting a diverse group of employees and clients to get a complete understanding of what is going on within the company.

As we reassess aspects of corporate governance, we must emphasize the dangers of an over-reliance on short term profits, which often leads to too much risk-taking. An overemphasis on producing short-term profits is at least partly responsible for getting us into the crisis. Short-term focus caused many firms to lever themselves to unprecedented levels, play speculatively in complex financial instruments and become less sensitive to risk-taking in general.

Managers and directors must think beyond quarterly earnings and balance the demand for visible short-term success with long-term value creation. A lot of money can be made or lost in an instant in today's sophisticated financial market place. There is nothing wrong with that in principle: Short-term gains can spur long-term value. The problem occurs when long-term investment decisions are sacrificed in favor of short-term gains. Short-term goals should never loose sight of long-term strategy, and companies and their boards should work together to articulate and communicate their long-term vision.

"The problem occurs when long-term investment decisions are sacrificed in favor of short-term gains." —Duncan Niederauer, *CEO and director,* NYSE Euronext

Also, compensation practices should be aligned with long-term performance. We believe executive compensation is not something that should be legislated but instead is the responsibility of the full board of directors (and more specifically, the board's independent compensation committees) who have fiduciary duties to represent the interests of shareholders.

There have been many proposals floated in Washington recently with regard to corporate governance reform. We think it is important to keep in mind that the financial crisis was not caused by a failure of corporate governance, and as we strive to learn the lessons of 2008 and fix what failed, we should avoid over-reacting and adopting a one-size-fits-all approach. Federalization of corporate governance is not the answer. Managers need sufficient flexibility to run their companies, and neither investors nor directors want the same set of detailed rules to apply across the board. For instance, a chairman/CEO split does not make sense for all companies and not all companies need a risk committee.

We have found that many of our listed companies are very concerned about federal legislation reaching too far into the boardroom. As a result, we have launched a new advisory commission to demonstrate that there can be private-sector alternatives to federal legislation. Last fall, we announced the formation of an independent commission to examine U.S. corporate governance and the proxy process. This commission is taking a comprehensive look at strengthening U.S. best practices for corporate governance. We will look forward to reporting the results of their hard work.

For directors new to your roles, congratulations, and I hope to meet you at the New Directors' Summit on June 7th at the Exchange.

To meet Duncan Niederauer at The New Director Summit on June 7th at the NYSE, please email events@directorship.com.

Managing New Roles

Straight talk from seasoned directors and experts on navigating the boardroom.

Catherine L. Bromilow, Norman R. Augustine and John F. Morrow

A spirited group of outstanding directors and corporate governance professionals convened at NYSE Euronext to discuss how companies and their boards are developing fresh approaches to help orient new directors. The methods range from the early-stage specification of a search to properly integrating with the management team, to learning the subtleties of a company's culture and character. NACD Directorship chairman and editorial director, Jeffrey M. Cunningham, moderated the discussion.

NACD Directorship:* *Has the boardroom of 2010 undergone a sea change?

Noski: Yes and maybe no. I think we have the Sarbanes-Oxley compliance aspect nailed down. We spend a great deal of time with strategy and succession. If a business isn't in duress, the board's work is fairly straightforward. But if you pick the wrong CEO, you have just wasted the next five years because it takes a few years to assess and terminate the current CEO and then a few years for a successor to get up to speed. So to me, succession is a key skill and a critical responsibility that is sometimes overlooked in the regulatory frenzy.

NACD Directorship:* *What are some of the challenges for new directors?

Bromilow: I have seen new directors struggle in some areas. It's important for directors to understand the culture. Different companies operate in very different ways, so understanding how to work within that framework is important. To the extent the company is in a unique industry, it may also be a challenge to understand the business model and the special risks. New directors should also understand how the board approaches its oversight role.

For directors new to the audit committee, there is an additional layer of challenge. Financial reporting is complex and audit committee members should understand how the company deals with it. It includes understanding how financial information rolls up, the key players in the finance function and the applicable regulatory and compliance matters.

NACD Directorship:* *Pfizer is a leader in corporate governance, how do you orient new directors?

Kenney: Pfizer has a very robust director orientation process with scheduled meetings with each of our division heads and other senior leaders over the course of six to nine months. We give directors a significant amount of information to contact any member of senior management, including the controller and treasurer. We provide not only office contact information but also their home contact information. This is management's way of saying to our directors, "We have confidence that you can go directly to any of these people with questions."

***NACD Directorship:* Norm, suggestions for the new director?**

Augustine: When I served on one board, we had a board dinner the night before each meeting. At every dinner we would assign one member to talk about his or her life. It changed the tone of the board and its effectiveness. We all looked at each other quite differently when we knew more about each other. It helped us work together much more effectively.

***NACD Directorship:* How much time do directors now need to devote to board duty?**

Kopelman: The surveys indicate this has increased significantly over the last decade, but recently leveled off. Trying to overlay upwards of 175 hours of annual board service—including review and preparation, travel, board and committee meetings, plus informal calls and emails on top of a full-time staff or line job is surely a challenge both for the executive and his or her employer. Recently retired, seasoned executives seem to be able to get up to speed quickly and devote the ongoing time.

***NACD Directorship:* Are there specific skills for new directors?**

Levine: Independent judgment. The proxy rules from December 16 now require for the first time that boards explain their selection criteria philosophy. For me, that is key—does that person have the ability to have a challenging discussion without becoming too personal? Directors need to keep their cool but also know when to strike it hot. I would also add that they should have a burning curiosity about the important things. It's important to understand their individual potential contribution as well as how they will impact on the creation of meaningful board dialogue.

Barry: Boards look for specific skills in new directors that may be currently lacking—which can reflect the sector or the company's condition at the time. So while the specific skills being sought will differ from company to company, there are skills and attributes that are important for all directors. First, directors should bring broad business experience and an appreciation for contemporary management techniques and leading practices. Second, directors need to demonstrate leadership. This encompasses strategic thinking and planning, decision making, negotiation and problem solving. They also must have the courage to ask tough questions and to probe management when they are uneasy. Third, it's important for directors to have insight, judgment, integrity and a sound professional demeanor—to disagree without being disagreeable.

Scott R. Cutler and Charles H. Noski

***NACD Directorship:* Should "onboarding" be a formal process? What special recommendations would you have?**

Noski: What I ended up doing was to design my own onboarding. Once I understood the organization, I would advise the CEO or lead director that these are the people that I want to go and spend time with. My early experience was largely trial and error. Now, I work with the board chair or lead director and we have designed a program for incoming directors. Another novel approach is to have a policy of not assigning new directors to serve on committees in their first year.

Bromilow: Boards don't turn over that quickly, so companies often have an ad hoc onboarding program. Director candidates should conduct due diligence before accepting any nominations, so they will already have some insight into the company. But that doesn't preclude the need for proper orientation, which should include, at a minimum: the company's strategic plan; a discussion about the key risks the company faces, how it mitigates those risks and the board's role in risk oversight; and an introduction to the management team and an understanding of the succession plan.

From PwC's perspective, audit committee orientation for new members should start with a discussion of financial reporting, including areas of key judgment. Then it should introduce the key players from finance, internal audit and the external audit team. It should also cover how the audit committee discharges its other core responsibilities over areas like compliance.

Kopelman: We have to make a distinction between folks who have never sat on a public board before and those who have a couple of directorships under their belt. You need to make sure that new directors get a grounding in governance—that they thoroughly understand the board's role

and especially how it differs from management's, both legally and practically. I have seen an informal buddy system—assigning a sitting director to each newcomer—work well. Also, I'm involved with onboarding directors for companies coming out of Chapter 11: You're parachuting people in who need to start functioning as a team. It will take time for them to gel and function effectively as a group—just look at the Yankees over the last eight years!

***NACD Directorship:* Norm, what have you seen that works?**

Augustine: The best example I can think of comes from Procter & Gamble. As the board would travel to various parts of the world, P&G would arrange for us to visit people in their homes and sit down with real customers—housewives, children and families. We'd ask them about Tide—why don't you buy Tide? In one case, the reason was that when the housewife had to buy soap she had to walk a considerable distance home with a huge box—so she wanted small packages even if they were less economical. The result was Tide produced and sold in smaller boxes. You can't merely have the corporate staff tell you what the business is about you have to get out and see it.

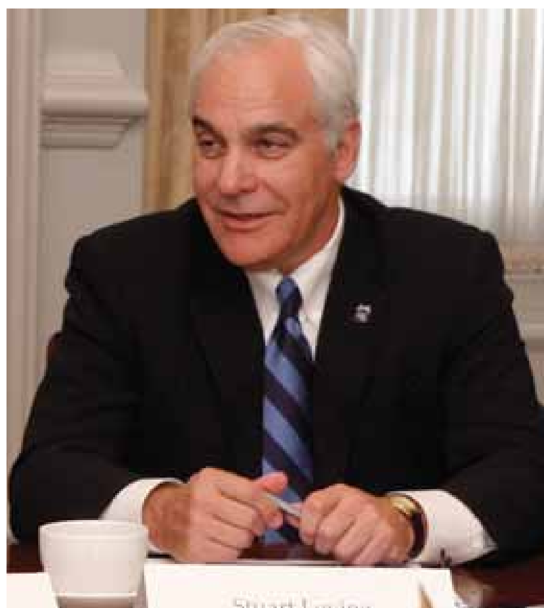
***NACD Directorship:* Scott and Glenn, do you or the NYSE have a view to share?**

Cutler: I agree that relationships with management, service providers and customers are extremely important for directors, as is having an understanding of governance. But more than ever, corporate boards have to focus on the company's stock, its shareholders and what influences their decision-making. There aren't enough boards that have an active dialogue with shareholders, and boards ought to think more about that.

Tyranski: What does the investing public think? Investors are really counting on boards to reach out and meet with the right person beforehand and ask the right questions.

***NACD Directorship:* John, in terms of understanding risk, what extra measures should the audit committee be taking?**

Morrow: I can't overstate the importance for audit committee members to get to know the people in the finance function, including the CFO, controller and other significant players. There is so much that can go wrong within the finance function—so much opportunity for fraud and malfeasance—that audit committee members should get to know the character and integrity of individuals in key finance function roles.



Stuart R. Levine

***NACD Directorship:* What about new directors and that highest profile of subjects, compensation?**

Ferracone: The compensation committee is certainly where the accountability resides, and the workload has increased due to added regulation and scrutiny. The board members on the compensation committee really do need some structured training. It is often said that many board directors have skills from their careers that are quite relevant but ironically, few have experience with executive compensation. So at Farient, our orientation begins with the framework that provides the new director with a strong but basic background—looking first at a detailed view of the external landscape. We then also capture the compensation history in the company, its peer group, its pay philosophy, its plan designs, as well as internal issues. We then take new compensation committee members through the alphabet soup of technical items: 162(m), 280G, 409A, SEC disclosure rules and long-term incentive valuation models.

Our overarching goal in this exercise is to train the new director to be on the lookout for program design features and scenarios that develop into outliers. Finally, with respect to performance and pay alignment, we show how to test to what extent their company's performance and pay are aligned.

***NACD Directorship:* What are some of the smart compensation practices you have seen?**

Augustine: The first question many people outside the corporate world ask is whether the CEO for this or that company is worth 250 times the wage of the lowest paid worker. That may seem like quite a disparity. But take the experience at P&G where A.G. Lafley led an effort that rewarded shareholders with billions of dollars in what was essentially a "turnaround." What was he and his team worth to a shareholder?

I'm a believer in pay for performance, but that is not always so simple. What if companies perform poorly, not because of CEO performance but because of a poor

Todd M. Gershkowitz

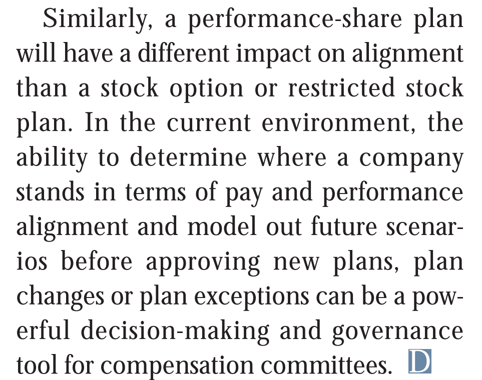
economy? Should the CEO and management then be penalized? When things are going badly management is not enjoying life; the job is much more arduous—dealing with constituencies that are quite unforgiving. This is the last time one would want to risk losing a good CEO. But if we pay generously when things go up, do we not cut pay when things are in decline? It is also noteworthy that in the military they give medals for bravery in retreats, too.

***NACD Directorship:* Norm, it is nuanced as you say, but we have to deal with it. Any suggestions?**

Augustine: Many of the issues around compensation can be resolved through a few smarter practices. "Holding periods" are an example. I strongly believe management should hold the stock resulting from the exercise of options, after selling the necessary amount to pay taxes, for at least three years. I also favor certain clawback provisions, which can be an excellent reminder of the need for long-term performance. Whatever the case, judgment is crucial; don't trap yourself with formulas alone.

Gershkowitz: The most important issue we are helping clients to address is how to truly ensure that pay is aligned with performance. Virtually every company makes this claim but we now know that it is much harder to achieve than one thinks. Farient has developed a visual representation of alignment that is underpinned by a quantitative model that we use with compensation committees to take a snapshot of their current degree of alignment relative to the broad market, their industry and even a specific peer group.

We also work with committees to run different scenarios to see how it might be possible to improve alignment by introducing new programs or redesigning some features of current programs. For example, using a fixed-share approach to stock option awards will have a different impact on alignment going forward than a value-based approach.



Similarly, a performance-share plan will have a different impact on alignment than a stock option or restricted stock plan. In the current environment, the ability to determine where a company stands in terms of pay and performance alignment and model out future scenarios before approving new plans, plan changes or plan exceptions can be a powerful decision-making and governance tool for compensation committees. D

The Boardroom Guide for the New Director Advisory Council

Norman R. Augustine, former chairman and CEO, Lockheed Martin

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Catherine L. Bromilow, partner, corporate governance group, PricewaterhouseCoopers

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Glenn W. Tyranski, *SVP, financial compliance*, NYSE Euronext

Judy Warner, *chief content officer*, Directorship

A Renaissance in Succession Planning and Board Recruiting

A leading recruiter provides a primer on how to succeed at boardroom succession.

How can a new director assess a board's chemistry and culture?

Julie Daum: While most boards have orientation programs, new directors should also look for somebody on the board as a mentor—either formally or informally—spending time before or after meetings to get a sense of how the board works, makes decisions and the history.

Should the board put together a succession-planning framework?

Succession should always be on the board's agenda, and so they need a formal framework as a guide, which should be reviewed no less than annually. Some of the specifics depend on where they are in their CEOs career cycle. If you're coming up to a succession event, you should review it at every board meeting. Importantly, boards should have in place an emergency succession plan as well.

For the new director, what other board roles are subject to succession-planning?

Board leadership is very important, and that has implications for succession. There should certainly be a framework for succession of the lead director or a non-executive chair. For committee chairs, there should be communication about succession—at least annually.

What is the talent pool like for new directors these days?

A decade ago, chief executives, chief operating officers, chairmen, presidents and vice-chairmen represented roughly half of the pool of new independent directors. In 2009, the proportion of new directors with these backgrounds was only 26 percent. A primary driver is the drop in the number of active CEOs serving on outside boards. The increasing demands of board service have also triggered a greater reliance on retirees as potential directors.

What are the qualities boards look for now in CEO candidates?

At the start of the CEO search process, it can be tempting for companies to assemble a "dream sheet" for their ideal chief executive. But the size, scale and complexity of many organizations today can make it impossible for a single person to offer every competency. Instead, boards should first look at where the company is and where it needs to go. A corporation that is underperforming likely needs a strategic, transformational CEO. A fundamentally sound organization seeking to advance its existing position, on the other hand, might need a strong operator who can continue to improve on the organization's operating model. These two kinds of leader aren't mutually exclusive, but the best strategists may not have equal skills as world-class operators, and the best operators aren't necessarily the best strategists.

Julie Hembrock Daum co-leads the North American board and CEO succession practice at Spencer Stuart.

What is the CEO talent atmosphere like today for high-risk organizations?

The talent pool for suitable leaders is not always tremendously deep. However, we are still seeing strong interest from candidates willing to tackle extremely difficult opportunities.The CEO role may be more challenging than ever, but it is still highly attractive to many.

With the SEC and investors demanding greater transparency on succession plans, how are you advising boards?

Companies will, of course, now be moving to make shareholders more aware of their efforts. We are reminding boards that the most important priority is to have compelling and comprehensive plans across the various scenarios they may face. The issue of what aspects of those plans get disclosed, and how and when, is far easier to work out with the informed advice of counsel.

How are boards approaching diversity in light of recent SEC rules?

Boards recognize that it is good to have people in the room who don't all look alike—so that might mean, for example, having a director from overseas. For some boards, that is the diversity they need. Others are still trying to make more basic strides.

Do you see a power shift from insiders to independent directors? Will this continue and why?

Most boards no longer have insiders other than the CEO so I think we've already seen a shift toward totally independent boards. I find boards are taking greater responsibility for the governance of the companies and so there has been a slight shift of power towards the board as it relates to governance. Given the experience of the past two years, boards and management are working more closely than ever.

Congratulations, You're the Audit Committee Chair. Now What?

Seven keys to success for a new audit committee chair.

By Catherine L. Bromilow

Few roles are as demanding in the boardroom as chairing the audit committee. That said, the audit committee provides an ideal venue to understand the company, its operations and its challenges. And so, if you are new to the audit committee and have been asked to chair it, what should you be thinking about early in your tenure?

The Basic Blocking and Tackling

Understand how the financial reporting works. This includes meeting key individuals in the finance department, understanding critical accounting policies and ensuring that you get an appreciation for the areas requiring the most judgment. Review the company's key annual and quarterly filings with the SEC. Review recent press releases and listen to a sample of archived analyst calls to get a better sense of what information the company is focusing on when it reports results, and how market observers are viewing the company. Also understand the status of any open issues: comment letters from the SEC that the company is addressing, the status of any major new accounting standards the company is implementing, and reporting considerations for significant transactions being undertaken. The CFO, controller, chief accounting officer and external audit partner will all play roles in helping you get a deeper appreciation of the financial reports your committee is responsible for overseeing.

Meet with the external audit partner. The external audit partner can be a great resource to you as you transition into your chair role. Get an appreciation for his or her experience, not only with the company, but also within the industry and in dealing with the types of issues the company faces. The audit partner can also provide useful insight into how the company functions, where the reporting risks are and the bench strength of both the finance department and the internal audit function. Additionally, he or she may have perspectives on how the audit committee could be more effective. Understand how the partner ensures that the right team is available to serve the client—particularly important if you have geographically diverse operations.

Use your staff support. Who from the company (corporate secretary, internal audit director, controller or other individual) is assigned to help you with agendas, meeting materials, and general scheduling? Whom can you call with questions? When and where are the meetings, what topics do they typically cover and how long do they usually run? Are there any constraints (such as schedules for other committee meetings) on how long your meetings can run?

> Don't go it alone. It's likely you're in the chair role because you qualify as an expert. That doesn't mean you need to have all the answers or that you should ask all the questions.

Differentiators for Effectiveness

Focus on critical aspects of risk management. This may be the most significant challenge: How can your audit committee play a central role in risk management without being tagged to oversee all areas of risk within the company? One way is to think of your role as an air traffic controller: knowing what the key risks are and allocating each of them to be overseen by the appropriate committee or the full board. Then you can focus your agendas over the year on overseeing the key risks assigned to the audit committee. Obviously, the audit committee takes the lead in areas such as risk relating to financial report-

ing. Your committee is also likely to find itself assigned oversight of compliance risks, and perhaps IT and privacy risks, too.

On a related note, you'll want to think about the best ways for your committee to interact with the compensation committee, as focus grows on the link between risk and compensation. The better the audit committee understands the performance metrics the compensation committee tags to incentive pay, the better the audit committee can monitor the integrity of those metrics—in particular, by focusing on whether the ability to achieve performance targets significantly affects management's financial reporting judgments. This sharing of information between the two committees is especially critical if there is no cross-committee membership.

Forge strong ties with your internal auditors. Internal audit can be the eyes and ears of the audit committee—giving you an objective view of issues facing the company. But it can do that only if you have the right leadership in the internal audit function and if the audit committee supports internal audit's effectiveness. Get a sense of how company executives and your external auditors view internal audit.

Also get to know the internal audit director and form your own opinion on his or her effectiveness. Understand how internal audit uses its resources and what additional assurance it could provide if it had more resources. Set aside time for periodic, informal contact with internal audit. Be clear that you are open to hearing about any serious issues, including sensitive ones. Many chairs aim for regular between-meeting contact—a call or coffee—to keep the communication lines open.

Tackle the tough stuff. It's human nature to focus time and attention on the items we already understand and can grasp easily. It takes discipline to ensure the more challenging issues are included in your agenda.

Identify what these issues are—they may, for example, relate to IT security, derivative transactions, complex technical accounting issues or treasury operations. Ask for more in-depth information on these areas. If they represent major risks, consider relevant training sessions for the entire committee. Insist on getting the information in plain English.

Summing It Up

Don't go it alone. It's likely you're in the chair role because you qualify as an audit committee financial expert. That doesn't mean you need to have all the answers or that you should ask all the questions. Ensure that all your committee members have a voice. Consider involving them in some of your between-meeting discussions—particularly if there is a reporting issue you're monitoring. And watch for the dynamics in the meetings themselves, recognizing that it can be difficult to build a cohesive committee when you're only together five or six times a year in a fairly scripted setting. It might mean privately soliciting views from each director after the meeting, especially if a member has been largely silent during the meeting. It definitely means insisting on time for executive sessions of just the committee members, so that committee members have an alternative venue for sharing what they're thinking. Consider occasionally visiting one-on-one with committee members between meetings to better understand what issues they are concerned about.

As you work with your committee over time, you'll develop a better appreciation for the additional information you and your committee members need. You can determine if additional training sessions would be appropriate. You also may identify additional skill sets or experience that would be useful, and that ultimately may dictate a shift in committee composition.

At the end of the day, the committee's effectiveness is largely up to you. Ensure that you have the relationships, information and members you need to effectively fulfill all the committee's responsibilities.

Catherine L. Bromilow is a partner in the corporate governance group at PricewaterhouseCoopers LLP.

Earn the Certificate of Director Education at NACD's Director Professionalism course for public company directorships. For upcoming dates and locations, visit the Director Education section of www.nacdonline.org. Experienced public company directors, particularly lead directors and committee chairs, will find information about Director Professionalism—The Master Class.

The Transition to Chair

If you're fortunate enough to have been a member of the audit committee before assuming the chair role, your task is easier. You already understand the financial reporting process and the players. And you'll already have a view on how the meetings should run and whether the materials could be improved. You may also have a perspective on the committee membership.

But you might not have realized just how much the chair did between meetings.

You'll want to schedule time to meet separately with the internal and external auditors and with key members of the finance team, to solidify those relationships. You'll want to identify areas to dig deeper, and start tailoring the committee's agenda to reflect your vision.

Performance and Pay Alignment: A Top Priority for Compensation Committees

The ABCs of onboarding and educating directors new to the compensation committee.

By Robin A. Ferracone and Todd M. Gershkowitz

One of the legacies of the recent financial crisis is a sharpened focus on ensuring genuine alignment between executive compensation and performance. There is an ongoing debate as to the role that executive compensation played in intensifying the financial crisis by rewarding short-term performance that had little to do with long-term value creation. The key constituencies to this debate (the government, shareholders, boards and management) are now particularly concerned with ensuring that executive compensation programs significantly strengthen the degree to which performance and pay are aligned going forward. Whether this takes the form of a "say on pay vote," increased shareholder activism or companies proactively redesigning their executive compensation plans, the demands on compensation committees will continue to increase. As a result, new compensation committee members will need to hit the ground running, and the entire committee will need to establish a common foundation for future decisions that will enhance performance and pay alignment.

A good compensation committee education process will to some extent include new as well as current members. New members can learn not only about the substance of the compensation system, but also the context for past compensation committee decisions. Current members will have an opportunity to take an inventory of the company's executive compensation plans and decisions. Further, they will be forced to articulate answers to probing questions. Within this context, we suggest that the education process include the five components shown below, which we refer to as the ABCs of educating new compensation committee members:

Articulate the company's business strategy and performance and their link to executive pay.

Bring in current information on the external executive compensation environment.

Catalog the company's executive compensation strategy and programs.

Discuss the degree to which the company's performance and pay are aligned.

Explain the roles of the board, the committee, management and the compensation consultant.

Some aspects of this education could take place as part of the committee's normal ongoing annual planning processes, while other aspects are better handled up front as a new committee member comes on board. Regardless of the timing of these components, we have outlined the specifics of each component, based on our experience with clients:

Articulate the company's business strategy and performance and their link to executive pay. Our view is that executive compensation should be a derivative of corporate strategy and should help drive value for shareholders. How a company creates economic value should have a direct impact on its executive compensation plans and policies including the pay mix, the selection of performance metrics and goal setting. The linkage between the company's business strategy, performance and its executive compensation programs should be something that any compensation committee member, current or new, can readily explain to fellow board members, shareholders and executives.

Bring in current information on the external executive compensation environment. The only thing constant in the world of executive compensation is change. For example, in December 2009 the SEC issued new disclosure rules, and RiskMetrics issued new proxy voting guidelines, both of which address the relationship between executive compensation and excessive risk taking behavior. It is critical that new compensation committee members be brought up to speed fast on what they need to know about the world around them. Farient suggests that compensation committees receive an environmental update as part of their annual compensation planning cycle, or more frequently if warranted by the pace of change. New committee members should be afforded this environmental update as early on in their service period as possible.

Catalog the company's executive compensation strategy and programs. Compensation committee members can't be expected to remember every aspect of the company's executive compensation programs. Therefore, we recommend that the salient aspects of the compensation strategy, programs and policies be summarized on a single sheet of paper. Farient has developed a tool for this purpose called the Executive Top Sheet. Our clients have found it to be a highly effective resource for current committee members, let alone new members, to refresh their knowledge of the company's plans.

In addition we develop glossaries for our clients as a reference tool to ensure that there is a consistently high level of technical knowledge across all committee members. The need for a glossary has intensified due to the increase in the number of laws, regulations and accounting rules that are applicable to executive compensation and the proliferation of unique acronyms and language every company develops to describe its executive compensation objectives, philosophies, programs and policies. These glossaries typically cover:

- Definitions embedded in plan descriptions
- Tax provisions (162(m), 409A, 280G)
- Accounting provisions
- Disclosure requirements
- Long-term incentive valuation parameters

Discuss the degree to which the company's performance and pay are aligned. "Aligned pay" occurs when total compensation, after performance has been factored in, is *sensitive* to company performance over time and *reasonable* relative to the market for executive talent given the performance delivered. Achieving alignment requires that compensation committees not only design performance-sensitive compensation plans, but also manage and administer them consistently over time. A pay system that is "designed to align" can still be misaligned if the committee makes exceptions to the plans or frequently changes the plans themselves. In the extreme, the company runs the risk of creating "runaway pay," which could make it a target for shareholders, the public and possibly the government. New committee members always will inherit plans that were implemented and decisions that were taken prior to their joining the committee. New members deserve to know "what they're getting into."

To provide insight to new and current committee members alike, Farient has developed a simple visual called the Alignment Report. This report shows the degree to which performance, as indicated by three-year rolling Total Shareholder Return (TSR), drives reasonable Performance-Adjusted Compensation (PAC), and the extent to which the current pay system likely will achieve alignment going forward. Further, the Alignment Report can facilitate a robust discussion between current and new committee members as to potential changes in plan design or decision-making processes that can strengthen alignment going forward.

Explain the roles of the board, the committee, management and the compensation consultant. To ensure that committee members can adequately plan and prepare for meetings, we routinely help establish an annual planning calendar, as well as a roles matrix that clearly outlines the roles of the board, the committee, management and the compensation consultant. Together, the calendar and roles matrix guide committee processes and ensure that committee members have timely information such that they can make the highest quality decisions. If a planning calendar and roles matrix has already been established, they should be reviewed with new committee members and refreshed with their input—as appropriate.

In the current environment, there can be no higher priority for compensation committees than strengthening performance and pay alignment. The appointment of a new committee member provides an ideal opportunity to ensure that all committee members are equally prepared and equipped to carry out their responsibilities in the most effective way possible.

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