NATIONAL DIRECTORS INSTITUTE | NDI Checkpoint

DIRECTOR AND CEO PERFORMANCE REVIEW

KEY TAKEAWAYS

1. CEO Evaluations and the Relationship to "Say on Pay." The CEO evaluation process, including the questions asked and the form that the evaluation takes, should be reevaluated in light of "say on pay" proxy disclosure and the potential for litigation. If CEO evaluations become discoverable, then low or mediocre marks for the CEO combined with increased compensation could bolster plaintiffs' arguments that the CEO was paid without performing (and that the pay without performance made the CD&A disclosure of the company's pay-for-performance philosophy materially misleading). Alternatively, evaluations showing high marks for the CEO's performance could potentially help the Board's defense in such a lawsuit.

2. Litigation Risks. Information that is gathered during the Board and/or CEO evaluation process is potentially discoverable in litigation. Therefore, companies must be careful in the preparation of any report summarizing the results of the evaluation process. Companies must also exercise care relative to the application of document retention policies to the raw data generated by the evaluation process. To help minimize these risks, a Board may consider involving inside or outside counsel in the evaluation process to maintain the attorney-client privilege.

3. Recruiting and Retention Tool. Board evaluations have the potential to function as recruiting and retention tools. In terms of recruiting, Board evaluations should identify specific skills and experiences necessary to create a higher-functioning Board, which that skills and experiences may need to be developed through the recruitment of additional directors. In terms of retention, Boards generally consist of current and past senior executives who have been successful in business and have served on other boards of directors. As such, directors typically have their own ideas regarding desired board composition and function, as well as how best to oversee, and create goals towards the accomplishment of, the company's strategic plan. The Board evaluation process provides one mechanism to let each director "be heard" on these and various other issues, which may in turn result in increased engagement.

4. Forms of Evaluations. While Board evaluations have in the past typically been conducted by individuals within the company, it is becoming more common for companies to hire individuals outside their company to develop and/or execute the evaluations. Companies vary in their approaches with respect to third party involvement, sometimes bringing in outside evaluators annually, and other times using their services every two to three years.

Practices in this area depend on individual company needs, and the form that evaluations take should be reassessed annually, and in particular as the company grows or encounters changes that may merit increased (or decreased) areas for evaluation.

5. Individual vs. Full Board Evaluations. A large number of companies choose to evaluate individual directors as well as the full Board, utilizing either peer questionnaires or, more commonly, self-assessment questionnaires. As a part of a peer evaluation process, directors are asked to evaluate one another by completing questionnaires relating to a colleague's performance and relevant skills. Anecdotally, it seems that the peer-evaluation process can be more difficult for directors to accept than the traditional self-evaluation process for reasons such as a fear of a loss in collegiality. Self-assessments appear to be on the rise, perhaps in light of the new SEC disclosures relating to diversity and the qualifications, attributes and skills that make an individual qualified to serve as a director.

6. Implementation. Boards need to take seriously their responsibility to follow through on the results of evaluations, and implement change where necessary or desirable. It is key that either the lead director, the chair of the corporate governance committee or someone playing a similar role introduce the follow through action items on the Board's and committees' agendas so that they are acknowledged and addressed. Some companies use the results of full Board evaluations to initiate conversations with each individual director, underscoring the strengths and weaknesses that exist so that each director is able to identify opportunities for improvement.