ACC DOCKET
INFORMED. INDISPENSABLE. IN-HOUSE.

# All Aboard! Facing the Challenges of Recruiting and Onboarding Directors

**Corporate, Securities, and Governance**

## CHEAT SHEET

- ***Conduct a self-assessment.*** The recruiting process for a prospective director should begin with an internal review of the board's strengths and weaknesses to identify desirable and complementary skills in a candidate.
- ***Ask the right questions.*** Supply the prospective director with a detailed questionnaire that has been updated to comply with current federal securities and state corporate law.
- ***Tailor your program.*** Orientation should be a tailored program that covers the basics of the company and the board (e.g., business overview, board structure, compliance, and company culture), while also satisfying the information needs of the new director.
- ***Obtain feedback.*** Have new directors evaluate their first year of service on the board and the effectiveness of the orientation program to make improvements for future onboarding.

The recruitment, orientation, and integration of new members of the board of directors is one of the most significant governance obligations that company boards face. One of the hallmarks of a successful board (and a successful company) is the ability to recruit and effectively integrate new directors into its culture and processes through director succession discussions, as well as a well-crafted director selection and an orientation and education program.

## The recruiting dilemma

Boards are currently recruiting new directors in a complex, rapidly-changing, and volatile business environment. In addition to swiftly-evolving technology and business, legal and regulatory changes have imposed enhanced standards of diligence and responsibility on corporate boards, while enterprise risks such as increasingly sophisticated and costly cyber threats are prompting investors and regulators to demand more accountability from management and boards. The investment community also expects to see the composition of corporate boards become more reflective of society at large, with increasing demands for diversity in the boardroom.

Simply put, the job of the independent director has become far more difficult, complicated, and time-consuming in recent years. Meanwhile, many CEOs and other seasoned executives are curtailing their service on outside boards, shrinking the talent pool at a time when the job of an outside director has become more crucial than ever.

## Board action plan

To meet these challenges, the recruiting process should begin long before the company makes initial contact with a prospective director. The board should begin the process with a rigorous self-examination about the board's strengths and weaknesses to identify the particular skills and qualifications desired in the new director. These may range across industry and market expertise, experience, ethics and values, and the ability to provide meaningful and practical advice and guidance to management. Beside any immediate vacancy, this analysis should take into account the role of any directors who are expected to leave the board in the near future. It is important for the board to view additions as part of a continuing strategic approach to board makeup rather than simply as a one-off replacement.

While it is important for the board to close “competency gaps” when selecting new directors, boards must be careful to avoid drawing their search parameters too narrowly. The board should examine its current and future composition and needs holistically. Boards should resist the temptation to adopt a “check the box” view and should not limit the search strictly to one particular competency.

The board should also review its selection process and composition from the viewpoint of several major stakeholders. The investment community, including institutional investors, activist shareholders, and the proxy advisory services, will carefully examine the selection process and the resulting nomination. Boards that are perceived to have become stale and unresponsive to shareholders may see more shareholder proxy proposals and are also more likely to become targets of activist campaigns. In addition to investor relations concerns, the financial media will pay close attention to the recruitment of new directors by public companies with respect to matters such as diversity, board composition, and director tenure.

> Boards that are perceived to have become stale and unresponsive to shareholders may see more shareholder proxy proposals and are also more likely to become targets of activist campaigns.

In many companies, the selection process for director candidates belongs to the nominating or governance committee. In conducting its due diligence, the committee must be mindful of independence issues and potential conflicts of interest. The committee must also be aware that any director candidate is likely fielding other inquiries at the same time. Director recruitment and due diligence in a competitive environment have certainly become a two-way street, as both the company and the candidate must carefully evaluate the opportunity to determine if it is a mutually beneficial fit.

After an individual has been identified as a serious candidate, the company should supply the prospective director with a detailed questionnaire. The process facilitates compliance with Exchange Act requirements and the rules of the relevant listing stock exchange. The form also supplies baseline information for the company’s proxy statement and annual report on Form 10-K. It is important for the company to review and update the questionnaire regularly to reflect current federal securities laws, state corporate law regulatory changes, and exchange requirements, and to capture other information the board would like to consider.

A key objective of the information gathering is to allow the company to assess the candidate’s independence as required by the federal securities laws and stock exchange requirements. The questions directed to candidates should be aimed at eliciting conflicts and potential related persons transactions, with an expansive scope, sweeping in, on the one side, subsidiaries and affiliated companies, and on the other side, family members. The nominating committee should receive the candidate’s responses in time to consider them and to seek clarifications if needed, sufficiently in advance of votes on appointment or election.

These questions should be designed to prompt careful consideration and complete responses from the candidates as to their roles elsewhere as director, officer, auditor, legal advisor, consultant, and the like, and whether there are any contractual, family, employment, ownership interests, compensation received, securities holdings, or other arrangements that might affect the person’s independence or that require proper disclosure.

Interviews with the candidates also afford the members of the nominating committee and other directors to become more familiar with each candidate, to probe each candidate's background and experience, and explore any possible legal impediments to or conflicts raised by board service. These interviews also afford the board representatives the opportunity to make the "value pitch" to the candidates to present the case for accepting a proffered nomination from other competitive offers.

During interviews, the company should verify that candidates:

- Have obtained any required clearances from any other board on which they serve;
- Have no other conflicts of time or commitment that cannot be managed;
- Have no contractual limits on their service, including employment arrangements, or other commitments or agreements, or regulatory limits; and,
- Do not face "overboarding" issues (serving on so many boards that they are overextended).

Finally, the nominating committee, with the assistance of counsel, should specifically confirm the candidate's independence, or fully understand the consequences if the candidate is not independent. An independence failure could raise governance problems under state and federal law and under stock exchange rules, and would likely prompt adverse ratings on governance issues from the proxy advisory services. In addition, a lack of independence limits the new director's ability to serve on key committees, such as the audit and compensation committees.

> It is far better to discover any negative information at an early stage of the process than after the nomination has been presented publicly.

As it is difficult and potentially embarrassing to unwind a director's election, the committee should carefully check the candidate's background, credentials, and all references. It is far better to discover any negative information at an early stage of the process than after the nomination has been presented publicly.

## Due diligence by director candidates

From the moment a company approaches a potential director, the candidate must work diligently to become familiar with the company. Candidates must consider whether their skills and experience are appropriate to the role in question, and whether they would find the assignment to be sufficiently interesting or rewarding to justify the time commitment over a period of years. Being considered for a nonexecutive board seat is a significant career milestone for an executive, and it is crucial not to let the excitement overwhelm the need for proper diligence.

The candidate should closely examine the publicly available information about the company, including SEC filings, the company's website, media stories, and analyst reports. The candidate should review available information on its board and governance structures and current board makeup, the company's financial position, business models and strategies, and details on the management team. If still interested, the candidate should then meet with members of the nominating committee and other members of the board.

In addition to delving into the company's business and how the candidate might add value, the candidate should ask extensive questions, among other items, about:

- The company's financial position;

- Significant risk factors;
- The relationship between the board, CEO, and other members of senior management;
- The company's investor relations program;
- The culture of the board;
- Significant litigation exposure; and,
- The company's indemnification and insurance policies.

## The onboarding process

Successfully bringing directors up to speed quickly will help the company with the new director's immediate contributions, help the board see things from the new director's fresh and diverse perspective, help management gain insights into the areas that the new director can contribute, and help the new director feel like a valued new board member. However, because boards typically turn over infrequently, general counsel and others responsible for the onboarding process often have to dust off an old process document to avoid missing an important step.

Companies will generally welcome new directors to the board with a letter setting forth the schedule for board activities, compensation information, and the necessary forms and details for Exchange Act §16 compliance. The letter will also likely include necessary forms that must be completed before the orientation session.

The next step is to understand that onboarding is indeed a process and not an event. A one-and-done session in the boardroom with a stack of papers and several slide decks is not an effective onboarding program.

There are two threshold problems that companies typically face in designing an effective orientation program. The first is the problem of information overload. Companies no longer have the luxury of allowing new directors to "learn on the job," and board members must become conversant with the company's business and operations in a short period of time. This may lead to new directors feeling as if they are "drinking from the fire hose" and are overwhelmed by the influx of information. While many directors have substantial business experience, the key is how that experience translates to strategic guidance for this company.

This problem may be mitigated in several ways. The board may want to establish an onboarding portal, where relevant information may be prioritized and stored, for new directors to access at their convenience. The information made available to new directors on the portal should include, among other items:

- Recent SEC filings;
- Earnings releases;
- Codes of ethics and conduct;
- Board meeting books;
- Strategic plans;
- Organizational charts;
- The company's charter and bylaws; and,
- Other key corporate policies.

The portal could also include contact information of carefully selected individuals for new directors to contact with any questions. Finally, the board may want to consider assigning an experienced mentor to new directors to assist them in making the transition.

The second problem is the “one size fits all” dilemma. Companies should strive for their orientation programs to be consistent in their approach and scope, but consistency without caution and care can lead to a generic approach that satisfies none in an attempt to satisfy all. It is necessary to understand that directors come into their service with many different experiences. Directors new to board service may need assistance on transitioning from managing day-to-day business operations to the general oversight role of the director. Some candidates may be unfamiliar with the company’s business model, while others will come to the boardroom well-versed in the company’s operations and industry environment.

The challenge for the owner of the orientation program, often the corporate secretary or the general counsel, is to create a tailored program that reasonably covers the basics of the company and the board while satisfying the information needs of all new directors without being rote and repetitive. It is insufficient to simply change the dates and names from last year’s program.

While orientation programs must be tailored to fit the needs of each company and their new directors, all introductory sessions should cover the following basic information:

- A business overview, including sales, marketing, finance, manufacturing, R&D support, etc.;
- Board structure, committee assignments, and director duties;
- Compliance with fiduciary duties and insider and short-swing trading laws;
- Managing material non-public information;
- Independence and related-party transactions guidelines; and,
- Company culture.

## Final steps

The election of a new director triggers several housekeeping requirements, including SEC filings, investor relations updates, and press releases. The corporate secretary or another person should also:

- Provide new directors with electronic board book access and instructions and training on the system;
- Provide access to background or resource materials, or send the materials to the new director;
- Provide an updated board calendar, confirm no conflicts with board and committee meetings, and ensure the director is on distribution lists for any updates (which would typically be made through the usual board distribution);
- Brief new directors on other resources available, such as subscriptions or mailings (and add the new director to board subscriptions such as the National Association of Corporate Directors programs);
- Inform new board members of director education programs resources and materials, and brief them on the board’s obligations and the corporation’s support (e.g., reimbursement for director training seminar and reasonable travel expenses); and,
- Schedule new director orientation as well as any site visits, sales meeting participation, off-site strategy meetings, and product demonstrations.

Finally, one of the best educational resources available to the company for developing its new director orientation programs is the directors who have recently been through the experience. The company should have new directors evaluate their first year of service on the board and the effectiveness of the orientation program. The evaluation process should seek input on what worked and, perhaps more importantly, what did not work and what was missing from the program.

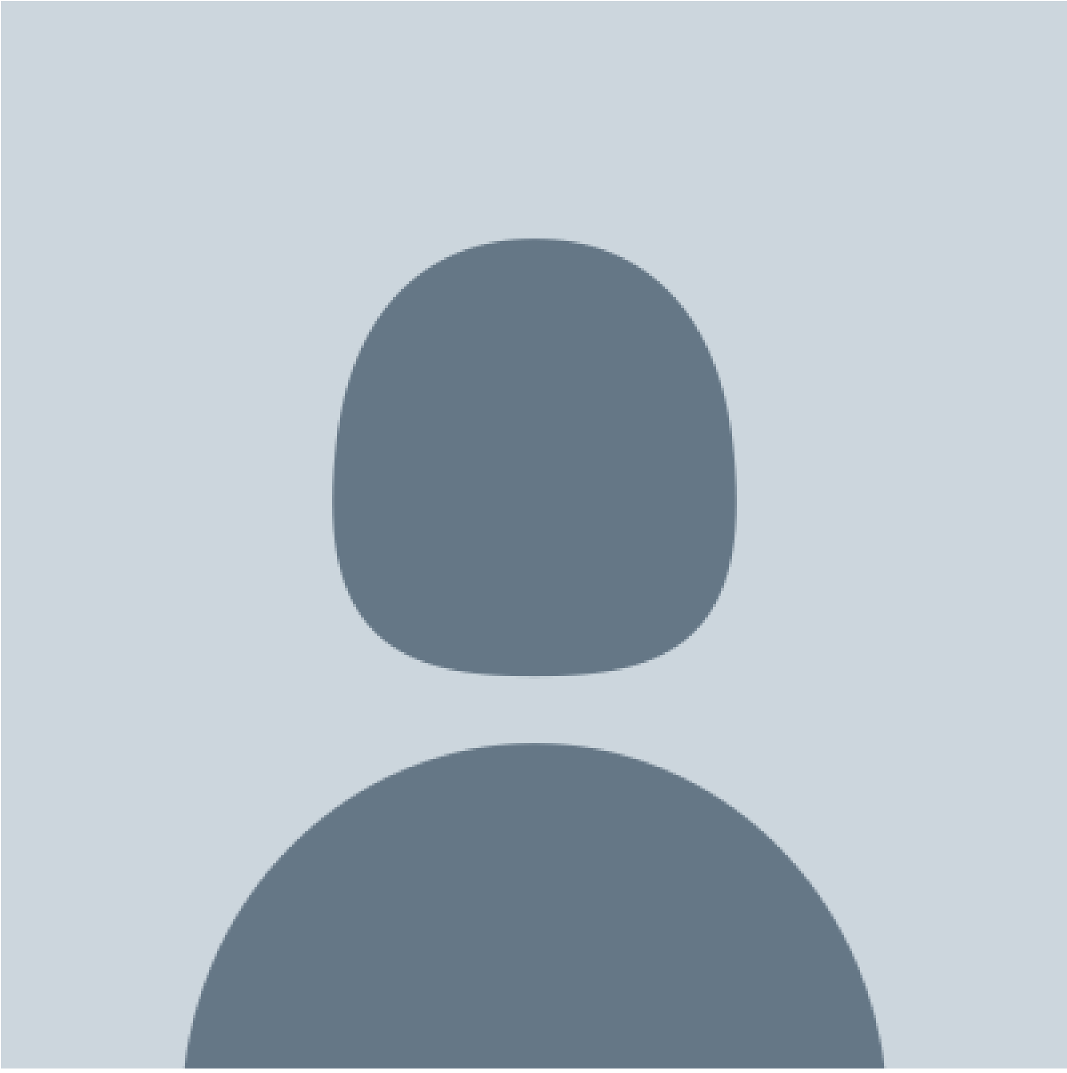
[Jeff Levinson ]

Vice President, General Counsel, and Secretary

NetScout Systems, Inc.

**Jeff Levinson** is the vice president, general counsel, and secretary for NetScout Systems, Inc., a public company that provides cybersecurity and application and network service assurance solutions as “Guardians of the Connected World.” He is the author of *Managing the Corporate Legal Department: How to Create Plans, Develop Processes, and Lead the In-House Legal Team* published by Bloomberg/BNA, “All Aboard! Facing the Challenges of Recruiting and Onboarding Directors,” a 2018 ACC *Docket* article, and the award-winning book, *The Dad Checklist: Practical Skills to Teach Your Children* published by Starting Nine, a History Compass imprint.

Scott Hodgdon



Senior Director, Corporate and Securities Counsel

NetScout

He is currently chair of ACC’s Corporate and Securities Law Network. He holds degrees from

William & Mary, Johns Hopkins University, and the University of Virginia School of Law.

N. Peter Rasmussen

Senior Legal Editor

Bloomberg Law

Rasmussen concentrates on corporate transactions and federal securities law. He is a graduate of DePauw University, the Graduate College of Liberal Arts of the University of Illinois at Chicago, and the University of Illinois College of Law.