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Board Structure and Composition

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An overview of the nominating and corporate governance committee

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In many ways, the nominating and corporate governance committee is the backbone of a public company's board of directors. The committee frames the very functioning of the board—by designing its structure, recruiting its members, ensuring that directors have the necessary tools and are poised to succeed, evaluating their performance, and shaping corporate governance norms.

Overview of New York Stock Exchange requirements

The New York Stock Exchange ("NYSE") requires companies listed on the exchange, other than "controlled" companies, to have a nominating/corporate governance committee (the "NCGC"). The NCGC must be composed entirely of "independent" directors, operating under a written charter framing the committee's purpose and responsibilities, including an annual performance evaluation of the committee. At a minimum, the purpose of the committee is to (i) identify individuals qualified to become board members consistent with board-approved criteria, (ii) select, or to recommend that the board select, the director nominees for the company's next annual meeting of shareholders, (iii) develop and recommend to the board a set of corporate governance guidelines, and (iv) oversee the evaluation of the board and management.[1]

The responsibilities of most NCGCs, however, extend beyond the above core requirements to address other legal and practical issues, of which one of the most important and common is an extensive role in corporate governance that goes beyond developing guidelines. This expanded role is a response to increased pressure from institutional investors and proxy advisory firms. The voting recommendations of the two largest proxy advisory firms, Institutional Shareholder Services ("ISS") and Glass Lewis ("GL"), play a significant role in the proxy voting process and often influence the outcome of shareholder votes. For example, a recent study in the Journal of Financial Economics finds that ISS and GL control over 90% of the proxy advisory market, and when a proxy advisory firm issues a recommendation opposing management, their customers are 20% more likely to also oppose management compared to other investors.[2] In addition, large institutional investors have become more active in recent years in promoting their corporate governance agendas by developing their own policies and engaging companies with respect to perceived deficiencies.

These proxy advisory firms and institutional investors all have their own unique and slightly different approaches to governance matters. For instance, ISS will generally recommend voting against or withholding the vote from the chair of the NCGC (or other directors on a case-by-case basis) at companies where there are no women on the company's board and, in the case of companies in the Russell 3000 or S&P 500, where the board has no apparent racially or ethnically diverse members.[3] Blackrock, on the other hand, has a policy that it may vote against members of the NCGC to the extent that, based on its assessment of corporate disclosures, a company has not adequately explained their approach to diversity on their board composition. Helping companies navigate this sometimes conflicting sea of policies, overseeing shareholder engagement and responses to shareholder proposals and considering environmental, social and governance (ESG) matters generally are additional key responsibilities of the NCGC.

Key roles and responsibilities

Building an effective and balanced board

A basic tenet of corporate governance is that board composition drives board effectiveness, and therefore one of the NCGC's core roles is to analyze the mix of board member's individual skills and experiences with the strategic priorities of the company and the needs of its various stakeholders. Underscoring the importance of this role, the "Big Three" institutional investors (BlackRock, Vanguard, and State Street Global Advisors, who collectively represented a 24.9% portion of votes cast at annual meetings for S&P 500 companies in 2021)[4] all have policies regarding board composition. For instance, absent a compelling reason, Vanguard will generally vote *against* the NCGC chair, or another relevant board member, if the NCGC chair is not up for re-election, "if a company's board is not taking action to achieve board composition that is appropriately representative, relative to their markets and the needs of their long term strategies."[5] In addition, institutional investors and proxy advisory firms keep a close eye on average board tenure and board refreshment policies to ensure companies actually have the ability to onboard new directors in a thoughtful manner.

In thinking about the right mix of individuals, the NCGC must be mindful of all applicable regulatory requirements. There are two important rules of the Securities and Exchange Commission ("SEC") that come to bear here: the first is the requirement to disclose any specific minimum qualifications that the NCGC believes must be met by a nominee and any specific qualities or skills that the NCGC believes are necessary for one or more of the company's directors to possess.[6] The second is the requirement to disclose the specific experience, qualifications, attributes, or skills that led to the conclusion that the nominee should serve as a director in light of the company's business and structure.[7] In addition, the NYSE requires listed companies to have a majority of independent directors, on the premise that boards of directors are more likely to be effective and engage in high quality oversight when they are able to exercise independent judgment and are less likely to have potential conflicts of interest.[8]

Simultaneously complying with these requirements can be challenging. However, there are various tools the NCGC can use to ensure a balanced board. One such tool is a skills matrix. By distilling the qualifications of each board member into a visual reference tool, a skills matrix can help the NCGC holistically evaluate the board's collective experience and skills. From there, the NCGC can use the skills matrix to pinpoint gaps in the board's skills or expertise, select candidates that fill those gaps, or augment the board's makeup based on the company's strategic objectives and future goals and develop targeted succession plans.

Designing director orientation and continuing education programs

As discussed above, companies will often onboard new members to expand the board's collective knowledge and secure fresh and diverse perspectives. According to Spencer Stuart, 34% of directors appointed at S&P 500 companies in 2024 are first-time directors.[9] The transition to a first time public company director is not a straightforward or easy one. The NCGC plays a central role helping shepherd directors through this process, coordinating with management, and, ultimately, helping ensure their successful integration into the board.

The NCGCs role in director orientation can vary. In total, 63.1% of Russell 3000 companies perform director orientation in-house, with 22.6% performing director orientation with both in-house and outside resources.[10]

The concerns and practices of public companies evolve continuously, driven in part by changing expectations on the part of institutional investors and other stakeholders, in part by cultural and political changes, and in part by changing economic conditions. Each year, boards face a host of new and developing business issues and a large array of regulatory developments, from new and growing risks and opportunities from the adoption of artificial intelligence, to ever-changing ESG issues and backlash, as well as enhanced focus on government enforcement and review. Another important role of the NCGC is giving directors the tools to keep up with these developments by designing continuing education programs for directors. Again, this can take many different forms depending on the particular needs of the board or an individual director. At times, re-boarding sessions may be appropriate; other times, inviting external experts may be the best way to identify company blind spots or biases and provide insights into best practices from other companies and industries. In particular, board tabletop exercises that simulate real-word scenarios are becoming an increasingly common method of training and allow boards to practice how to respond in critical situations.

Evaluating the board and its committees

The NYSE requires all boards and their audit, compensation, and nominating committees to perform self-evaluations of the board itself and each committee, and the NCGC is specifically tasked with overseeing evaluations of the board and management.[11] In addition, shareholders are increasingly demanding with respect to board performance management. For instance, State Street believes that boards should "have a regular evaluation process in place to assess the effectiveness of the board and the skills of board members to address issues, such as emerging risks, changes to corporate strategy, and diversification of operations and geographic footprint."[12] Certain large institutional investors are also pushing for greater transparency with respect to these processes. Blackrock, for example, encourages boards to "disclose their approach to evaluations, including objectives of the evaluation; if an external party conducts the evaluation; the frequency of the evaluations; and, whether that evaluation occurs on an individual director basis." Some believe that evaluation practices should be linked with board refreshment.[13]

The purpose of the evaluation will vary depending on the audience. For purposes of the board, evaluations should aim to assess the company's performance, the board's structure, policies and procedures, including its corporate governance guidelines, and the board's role in effectively overseeing corporate culture and strategy and any crisis or significant events that occurred that year. Committee evaluations, on the other hand, should aim to assess whether they have an adequate structure and procedures and sufficient access to the full board and to management, whether the committee is sufficiently integrated into the board and well-positioned to contribute and whether the committee's charter is designed to facilitate all these purposes.

How these evaluations are carried out in practice is left to the discretion of boards and NCGCs. In this camp, there is no one-size-fits-all solution, and various practices have developed. Standard written board evaluations may be an efficient way to comply with annual obligations to self-assess, but they may not elicit enough information to provide meaningful insights into board effectiveness or provide a path forward to increased efficacy. For example, 37.8% of Russell 3000 companies evaluated the full board, committees and individual directors in 2024 (up from 17.6% in 2018), with 17.0% of Russell 3000 companies hiring an independent facilitator to conduct the assessments.[14] It is also possible that an approach that worked one year might not be appropriate the following year. In light of this, NCGCs have the difficult task of creating processes that are meaningful yet manageable and that "fit" the company's particular needs as those needs evolve over time. In designing the right processes, NCGCs should consider several factors, including the board's culture and personalities, whether the board is dominated by one or two influential directors, industry practices, a company's status (e.g. stable or going through an important transition) and similarly that of the board, as well as management's ability to provide support.

Designing an optimal corporate governance structure

Last but certainly not the least, the reference to "corporate governance" in the title of the committee is a nod to the increasing number of responsibilities assumed by the committee relating to corporate governance matters. In fact, the NYSE originally designated this committee as a "nominating committee"; however, along with the increased focus on governance, the name formally changed to the "nominating/*corporate governance* committee." Corporate governance has many meanings ascribed to it, but generally it is understood to be the discipline of establishing procedures and norms that, together, establish the rights, powers, and obligations of a company's various stakeholders and that facilitate well-considered and well-informed decision making in a manner that minimizes or eliminates conflicts of interest. There is no one-size-fits-all approach; instead, boards must tailor their corporate governance structure to the specific company, bearing in mind factors unique to the company such as its business, long term goals and strategy, culture, and dynamics among principal stakeholders. Boards must also take into account the laws of a company's jurisdiction of incorporation, which can play a role in defining the parameters of a company's corporate governance framework. For example, Delaware, the state of incorporation for 68.5% of US companies in the Russell 3000, has state laws impacting the input shareholders have with respect to certain corporate governance matters such as the right to nominate directors for election.

Typical corporate governance responsibilities of the NCGC include the development and implementation of corporate governance guidelines, engagement with shareholders, consideration of shareholder proposals, and oversight of ESG matters.

Some of the attributes of a company's corporate governance structure are expressed by the board in its corporate governance guidelines. Companies listed on the NYSE are required to adopt and disclose corporate governance guidelines, and the NCGC is specifically required to develop and recommend these guidelines to the board. In accordance with NYSE guidance, no single set of guidelines would be appropriate for every listed company, but areas of universal importance include director qualifications and responsibilities, responsibilities of key board committees, and director compensation.[15] As such, the role of the NCGC committee is to review, assess, and consider evolving "best practices" alongside the interests of the company and its various stakeholders, and recommend a set of guidelines applicable to the company based on its own assessment as to the company's optimal corporate governance structure. In a similar fashion, the NCGC periodically reviews the company's charter and bylaws and policies relating to transactions among related parties and insider trading.

Members of the NCGC are uniquely positioned to participate in shareholder engagement given their deep understanding of a company's corporate governance structure. Shareholder engagement is the process of communication and relationship building between a company's board of directors and its shareholders, which is particularly important because 72% of investors in a recent survey expect that stewardship activities will have an impact on an investment's performance over the next 3–4 years.[16] The process often takes place following a company's annual meeting of shareholders and is a helpful way of understanding shareholder perspectives, engaging proactively in a transparent and communicative way and creating long-term value. Often, management leads a company's shareholder engagement efforts but may find it useful for the chair of the NCGC to participate in select meetings given the chair's specific governance responsibilities and insight into issues at the top of most shareholders' agenda today: board effectiveness and refreshment, director accountability and performance, and—for an increasing number of NCGC—oversight of sustainability.

Relatedly, the NCGC often is tasked with overseeing the handling of shareholder proposals related to governance. This is proving to be an increasingly burdensome task as shareholder proponents continue to submit proposals at a record rate. The 2024 proxy season saw yet another increase in the number of shareholder proposal submissions, surpassing 2023's record number (including a 17% increase in governance-related shareholder proposal submissions).[17] Notably, the continued increase of shareholder proposals has caused some at the SEC to wonder if there is a "shareholder proposal overload."[18] While average investor support for shareholder proposals has declined in recent proxy seasons, 2024 saw a notable increase in average investor support for governance-related proposals. This is indicative of the recent focus on governance as a foundation for a company's success. For companies that have seen a proliferation of shareholder proposals in recent years, the high volume and specificity of governance proposals can place significant demands on NCGCs evaluating the company's response to the proposal. When assessing shareholder proposals related to governance matters, the NCGC must consider the fiduciary duties of the board, the accountability to shareholders, the materiality of the issue at hand, whether the proposal proposes good governance practice, if it advances long-term shareholder interests, and the constantly evolving thinking on corporate governance matters. Therefore, the proposed response to a governance proposal must be reviewed by the NCGC on a case-by-case basis and with great care in order to deliver a recommendation to the board.

Finally, ESG topics, particularly climate, sustainability, labor relations and diversity, equity and inclusion matters, have in recent years been at the forefront of investor and stakeholder engagement with public companies, together with the controversy surrounding it. Increasingly, the NCGC is tasked by the board with oversight of ESG matters. In practice, this means members of the NCGC must be prepared to monitor and proactively assess a company's ESG profile, shareholder engagement strategies, and take defensive preparedness measures in light of those developments.

Conclusion

While the NCGC may have had sleepy beginnings, it has very much evolved to perform some of the key functions of a public company's board. It helps build an effective and balance board by carefully selecting and recruiting its members; it helps ensure directors remain engaged and informed through well-designed orientation and continuing education programs; it helps identify areas that need improvement and gauge the board's preparedness for the future through evaluations of the board and its committees; it serves as a critical link between the board and the company's shareholders; and it strives to promote responsible and effective governance practices that are purposefully designed to contribute to the company's overall success.

Chapter notes

1 See NYSE 303A.04 (https://nyseguide.srorules.com/listed-company-manual/09013e2c85c00748).
2 C. Shu, "The Proxy Advisory Industry: Influencing and Being Influenced" (May 2024), available at https://corpgov.law.harvard.edu/2024/05/02/the-proxy-advisory-industry-influencing-and-being-influenced/.
3 ISS "United States Proxy Voting Guidelines" (effective February 2024), available at https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf?v=1.
4 L.A. Bebchuk and S. Hirst, "Big Three Power, and Why it Matters" (December 2022), available at https://corpgov.law.harvard.edu/2022/12/13/big-three-power-and-why-it-matters/.
5 Vanguard "Proxy Voting Policy for U.S. Portfolio Companies" (February 2024), available at https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/policies-

and-reports/us_proxy_voting_policy_2024.pdf.

6 See Item 407(c)(2)(v) of Regulation S-K (https://www.ecfr.gov/current/title-17/chapter-II/part-229/subpart-229.400/section-229.407).

7 See Item 401(e)(1) of Regulation S-K (https://www.ecfr.gov/current/title-17/chapter-II/part-229/subpart-229.400/section-229.401).

8 See NYSE 303A.01 (https://nyseguide.srorules.com/listed-company-manual/09013e2c85c00744).

9 Spencer Stuart, "2024 U.S. Spencer Stuart Board Index" (as of 30 April 2024), available at https://www.spencerstuart.com/-/media/2024/09/ssbi2024/2024_us_spencer_stuart_board_index.pdf.

10 Data from ESGauge as of 13 November 2024.

11 The requirements are found in NYSE 303A.09 (https://nyseguide.srorules.com/listed-company-manual/09013e2c85c0074d; board), 303A.07 (https://nyseguide.srorules.com/listed-company-manual/09013e2c85c0074b; audit committee), 303A.05 (https://nyseguide.srorules.com/listed-company-manual/09013e2c85c00749; compensation committee), and 303A.04 (https://nyseguide.srorules.com/listed-company-manual/09013e2c85c00748; nominating committee).

12 State Street Global Advisors "Global Proxy Voting and Engagement Policy" (effective 25 March 2024), available at https://www.ssga.com/library-content/assets/pdf/global/asset-stewardship/proxy-voting-and-engagement-policy.pdf.

13 Russell Reynolds, "Is Your Board Effective?" (5 October 2022), available at https://www.russellreynolds.com/en/insights/articles/is-your-board-effective.

14 Data from ESGauge as of 13 November 2024.

15 See NYSE 303A.09 (https://nyseguide.srorules.com/listed-company-manual/09013e2c85c0074d).

16 PwC, "PwC's 2024 Stewardship Investor Survey" (2024), available at https://www.pwc.com/us/en/services/governance-insights-center/library/inaugural-stewardship-investor-survey.html.

17 The Conference Board, "2024 Proxy Season Review: Corporate Resilience in a Polarized Landscape" (12 October 2024), available at https://corpgov.law.harvard.edu/2024/10/12/2024-proxy-season-review-corporate-resilience-in-a-polarized-landscape/.

18 Commissioner Mark Uyeda, "Remarks at the Society for Corporate Governance 2023 National Conference" (21 June 2023), available at https://www.sec.gov/newsroom/speeches-statements/uyeda-remarks-society-corporate-governance-conference-062123.

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