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Director Education: Cornerstone of Successful Governance Reform

By Hal Shear and Beth Boland

**A Massachusetts task force finds that
educated, informed directors hold the key
to better governance.**

One of the striking features of many of the corporate financial scandals of recent years is that they represented a problem larger than just malfeasance by a few individuals. While the behavior of some people involved was deplorable, what is perhaps just as troubling is the extent to which well-meaning board members failed to detect or stop the problems at the companies they oversaw. The bottom line: Many of the directors at scandal-ridden companies—directors themselves not engaged in any wrongdoing—simply did not perform well. This failure by a number of directors to do their jobs properly suggests that one of the most crucial corporate governance reforms is better director education.

The call for improved director education is not new. In a January 2000 article in *Directors Monthly*, Jean Head Sisco, NACD's 1999 Director of the Year, observed that continuing education for directors is needed "now more than ever" and "education and, perhaps, even some voluntary [director] certification, is a key." Later, in the aftermath of Enron's Chapter 11 filing, the NACD issued reform recommendations that included the suggestion that the self-regulatory organizations

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About NACD

National Association of Corporate Directors (NACD), an independent not-for-profit organization founded in 1977, is the country's only membership organization devoted exclusively to improving corporate board performance. The NACD conducts educational programs and standard-setting research, and provides information and guidance on a variety of board governance issues and practices. Membership comprises board members from U.S. and overseas companies ranging from large publicly held corporations to small over-the-counter, closely held, and private firms. NACD lists all interested members on The Director's Registry, which is used by member companies and others that seek qualified directors. With chapters in many major cities providing educational programs and networking opportunities, NACD operates at both a national and local level. To educate the corporate community and to provide networking links among NACD members, the NACD holds an annual Corporate Governance Conference, where it presents a Director of the Year Award.



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(the New York Stock Exchange, the American Stock Exchange, and the NASDAQ) “should be encouraged to consider making director orientation and continuing education mandatory....Mandating director education would not be difficult, and the benefits would be great.”

Then, in a November 2002 article in *Directors Monthly* titled “The Cry for Director Education Gets Louder,” Ronald I. Zall noted that “most of the known professions (such as engineering, law, and medicine) require their members to participate in educational programs at least annually in order to maintain and expand their professional expertise.” Zall also raised the question of whether directors of public companies should perhaps be required to meet continuing education requirements. He predicted that we are heading toward an “Education Era” in corporate governance that will see “centers for corporate governance education rising up around the country to serve the needs of an increasingly professional class of corporate directors.”

Indeed, the past few years have seen changes in line with Zall’s prediction. Greater pressures for better director education now come from a number of sources. Overall, the new governance environment ushered in by the passage of the Sarbanes-Oxley Act of 2002 (SOXA) is one in which directors, faced with new tasks and responsibilities, increasingly need more—and ongoing—education about their duties.

Who’s Calling For It?

The trend toward director education has gained momentum from a variety of factors. The New York Stock Exchange now requires NYSE-listed companies’ corporate governance guidelines to address director education, and director education is one of eight “core categories” that Institutional Shareholder Services (ISS) uses to calculate its influential corporate governance quotient, a rating that may affect ISS’s proxy voting recommendations to its clients that are institutional investors. (ISS accredits boardroom education programs that it will consider when determining its ratings.) Talk of director certification in the United States has begun. In addition, several underwriters of directors and officers insurance are starting to offer special rates on D&O coverage for companies based on the companies’ compliance with corporate governance best practices—a trend that is likely to create new incentives for director education about those best practices. And NACD is launching its own educational initiative in 2005. (Ed note: See Corporate Directors Institute sidebar on p. 5.)

New court decisions and changes in state laws have also, in effect, increased the importance of ongoing director education. As states and courts continue to review governance issues such as director independence and director duties, the need for continuing director education can only grow. As the accompanying box on recent

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corporate governance reforms (see p. 4) suggests, state laws affecting the operation of today’s corporate boards continue to be subject to change. New court decisions, too, contribute to a corporate governance environment that remains in flux. (For example, *The Wall Street Journal* in October reported on a recent decision by a Delaware Chancery Court judge regarding director liability. Although the WSJ article noted that “the scope of the decision is unclear, ...it has the potential to create a new standard for officers and directors, according to some legal specialists.”) In a changing governance environment, directors—and the companies they serve—cannot afford to rely reflexively on past practices and experience. Instead, ongoing education for directors about their roles and responsibilities becomes an imperative.

Task Force Recommendations

Most state reform efforts so far in the wake of the corporate governance scandals have focused on issues like auditor independence, but in Massachusetts, the Boston Bar Association (BBA) Task Force on Corporate Governance recently took a different—and groundbreaking—approach. While issuing a number of recommendations for corporate governance reform in Massachusetts, the task force included an emphasis on director education. In its report, *Raising the Bar in the Boardroom: Massachusetts Corporate Governance in the Wake of SOXA*, the task force wrote: “it is unreasonable to expect directors to be able to do an effective job of governance without creating and maintaining an effective continuing education program.”

Director Summary: The Boston Bar Association (BBA) Task Force on Corporate Governance found that director education was key to effective governance, and offered suggestions for incentives, such as minimizing the liability of directors who have taken continuing education courses, and taking such education into account when making investment decisions by public funds.

The report included the following recommendations, among others:

- Incentives, such as provisions minimizing director liability, should be provided to directors of Massachusetts-based companies for director participation in continuing education programs.
- Massachusetts “should consider encouraging good governance practices (such as, for example, director education and appropriate involvement of independent directors) through the exercise of public pension funds’ proxy voting rights or through preferential awards of state and municipal contracts.”
- Massachusetts “should consider encouraging these good governance practices by identifying such practices as a factor which investment advisors for Commonwealth-related funds take into account when deciding whether to invest in a particular company.”

In contrast, the BBA Task Force was not able to reach agreement on contentious issues such as new state standards for whistleblower protection. It decided against recommending consideration by the Massachusetts legislature at this time of additional state law standards for whistleblower protection. Such consideration, the task force concluded, “while perhaps ultimately prudent—should be conducted after the federal standards under SOXA have been better clarified and defined.”

While it remains to be seen whether the BBA recommendations about director education will be followed by successful legislation in Massachusetts, the BBA Task Force’s recommendations represent an innovative approach to governance reform. Such an approach, if adopted widely, could help promote not only better fraud detection, but also the broader goal of better-performing boards. One oft-voiced concern about some Sarbanes-

Mini-SOX: Recent Developments in State Corporate Governance Law

The environment in which corporate boards operate continues to change. Here, for example, is a list of certain state legislation on corporate governance passed between March 10, 2003, and September 30, 2004; additional legislation is under consideration in several states. A discussion of earlier state reforms can be found in the May 12, 2003, issue of *DM Extra*; legislation is pending in several other states.

California:

- SB 821 was enacted on September 11, 2003. This bill set up a task force that is charged with developing a plan to integrate instruction in business ethics into the curriculum of all higher-education institutions in California that focus on business.
- SB 434 was enacted on October 12, 2003. This bill authorizes the attorney general to bring an action or commence an investigation against anyone who may have violated California’s securities laws.
- SB 1262 was signed by the governor on Sept. 29, 2004. This bill requires nonprofit corporations to establish independent audit committees. In addition, the bill requires a board of directors of a nonprofit to approve the compensation of both the CEO and chief financial officers of the nonprofit. Finally, this bill grants the attorney general discretion to institute regulations regarding the level of independence that is required for auditors who also perform non-audit services for a nonprofit.

Colorado: HB03-1218 was enacted on June 5, 2003. This bill states that a board of directors (or a committee of the board) shall not authorize a loan by the corporation to a director or an affiliate of a director unless 10 days have

passed since the corporation has given written notice to its stockholders of its intent to make such a loan.

Illinois:

- SB 2108 was enacted on July 2, 2004. This bill requires that, prior to an auditing firm performing contemporaneous non-auditing services for a non-public company with 500 or more employees and/or with annual revenues exceeding \$50 million, the auditing firm must present written notice to the company of the duality of its services. The president of the company must then sign an acknowledgement that he/she is aware of this duality. This bill also requires all CPA candidates in Illinois to pass an examination on professional conduct.
- SB 1530 was signed into law on August 26, 2003. This bill outlaws any firm from bidding on or entering into a contract with the State of Illinois if that business, or any senior manager of the business, has been convicted of a felony under Sarbanes-Oxley within the past five years.

Missouri: On June 25, 2004, HB 1617 was enacted. This bill prohibits the obstruction of securities investigations by altering, destroying, or concealing records or other evidence. The bill also grants increased powers to Missouri’s commissioner of securities and its attorney general to persecute obstructionists and increases the penalties for such obstruction.

New Mexico. In HJM 86, which was passed on March 10, 2003, the legislature petitioned the state’s auditor to study whether stricter conflict of interest standards were necessary for accountants licensed in New Mexico.

Oxley reforms is that they increase the danger that boards will focus on compliance at the expense of strategy and advice to the CEO. A focus on director education, if well executed, offers the potential to improve not only boards' fraud-detection capacity, but also their ability to function as strategic assets for the companies they serve.

All Director Education Programs Are Not Alike

Along with increasing pressure for director education, recent years have also seen an expanding supply of director education programs, ranging from multi-day university-based programs to for-profit panel discussion programs. Not all director education programs are created equal, however. Prices can vary substantially; multi-day seminars in a university setting may charge more than \$4000 per day, while some service provider firms may offer daylong seminars gratis or for modest fees.

When choosing an education program, directors should evaluate alternatives carefully. Factors to consider include issues such as the quality of the instruction; the organization's experience and track record providing governance education specifically; time spent in an interactive learning environment, rather than simply listening to a speaker; topical relevance to the current needs of the director; instructors' real-world boardroom experience as directors; in-boardroom availability; and the effective cost per hour.

Overall, the new emphasis on director education, for both new directors and experienced ones, represents an opportunity for today's directors to improve their skills, knowledge, and effectiveness. While some directors complain about the regulatory burdens imposed by Sarbanes-Oxley and other corporate governance reforms, director education initiatives offer the possibility of an additional and different type of reform. Informed, educated directors conversant in boardroom best practices can help the boards they serve on go beyond just the business of compliance and move into the business of success. That's a goal many thoughtful directors embrace. Whether they're newly elected directors or highly experienced ones, thoughtful directors recognize the importance of improving their boardroom skills. ■

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NACD Corporate Directors Institute

On October 18, 2004, at NACD's Annual Conference in Washington, D.C., president and CEO Roger Raber announced the launching of the NACD Corporate Directors Institute, beginning in Fall 2005. Following is a program overview:

The Certificate of Director Education

Step 1: Completion of the NACD's **Director Professionalism Course**. *NOTE: Experienced directors with at least three (3) consecutive years of service on a public company board may obtain the Certificate without completing this course, provided they have previously completed 8 hours of continuing education and commit to Steps 2 and 3.*

Step 2: Adoption of NACD's **Ethical Code of Conduct**.

Step 3: Completion of 8 hours of NACD-approved **continuing education** each year to maintain the Certificate.

Director Professionalism Certificate Program

The entry offering of the NACD Corporate Directors Institute is a comprehensive, 16-hour governance course which may be completed all at once in a 2-day national program, or—after October 2005—over a 24-month period in 2-hour modules. Modules will be offered regionally as live programs and online in a flexible format.

The Director Professionalism Course provides a strong foundation for director effectiveness, knowledge of corporate governance roles and responsibilities, fiduciary duties, and strategic and oversight issues. It is the definitive curriculum for new and prospective directors, as well as a solid and worthwhile review for experienced directors.

Assessments. Throughout the Director Professionalism Course, participants will be offered opportunities to self-assess, benchmarking their knowledge with questions and cases. In addition, each graduate will receive electronic access to an online assessment that can be completed over a reasonable period of time. The assessment will be confidential. Initially, it will be possible to repeat the online assessment multiple times prior to achieving the required score. The assessment applies to the Director Professionalism Course specifically, but it is also available on a voluntary basis to all directors who obtain the Certificate of Director Education without the course.

Certificate. Directors who complete the Director Professional Program (OR have served for three consecutive years on a public company board, and have already completed 8 hours of continuing education) will be awarded the nationally recognized Certificate of Director Education. This designation must be renewed annually by completing 8 hours of continuing education chosen from a comprehensive array of NACD-approved programs.

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