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**Timely Commentary on Critical Events  
and Regulatory Developments**

## Big Board or Your Board: Governance Still Rules

As every corporate director knows, there has been a changing of the guards at the **New York Stock Exchange** ([www.nyse.com](http://www.nyse.com)). The question for directors is twofold: 1) how can the NYSE restore confidence in equity markets, and 2) how can corporate boards themselves learn from these events? The answer is one and the same. Whether a board is governing the “Big Board,” a corporate board, or a not-for-profit entity, boards must adhere to certain best practices of corporate governance.

### Recommendations in Retrospect

This *DMX* quotes the 10 recommendations NACD submitted to the NYSE and to **NASDAQ** last year, explains how they apply to recent NYSE events, and provides retrospective lessons. All of our original recommendations were reflected (along with similar recommendations from other groups) in the NYSE’s 13 proposed listing standards, so they remain relevant. (The **Securities and Exchange Commission** has asked the NYSE and NASDAQ to come up with a unified set of listing standards, and we anticipate that all of NACD’s recommendations will be reflected in these final standards.)

1. *NACD Recommendation*: “Boards should be composed of a substantial majority of independent directors. . . . Furthermore, boards should formulate and adhere to clear conflict of interest policies applicable to all board members.”

*NYSE Event*: The NYSE board is not truly independent. The board’s structure, combined with waivers, has created an insider board. The structure requires that 15 of 27 directors be insiders, and the rest outsiders (representing the public). Furthermore, the board voted for waivers to a policy prohibiting NYSE employees to serve on member company boards.

*Lesson Learned*: Boards should establish strong conflict of interest policies. When charges of a conflict arise, boards should state what they plan to do to resolve the conflict. They should also reexamine their policies periodically.

2. *NACD Recommendation*: “Boards should require that key committees. . . be composed entirely of independent directors, and are free to hire independent advisors as necessary.”

*NYSE Event*: Some allege that the members of the NYSE compensation committee were not independent. Although the board reportedly had a supposed safeguard here (no discussions between the CEO and the committee), the safeguard did not work. Arms-length compensation negotiations should be a two-way street involving the board and the CEO.

*Lesson Learned*: The board should disclose any mechanisms it uses for independence—both to provide assurance of independence, and to solicit constructive criticism.

3. *NACD Recommendation*: “Each key committee should have a board-approved charter detailing its duties.”

*NYSE Event*: Only recently did the NYSE board decide to disclose committee charters on the NYSE website.

*Lesson Learned*: All committees should be knowledgeable about their responsibilities and perform their duties in accordance with committee charters.

4. *NACD Recommendation*: “Boards should consider formally designating an independent director as chairman or lead director. If they do not make such a designation, they should designate, regardless of title, an independent member to lead the board in its most critical functions.”

*NYSE Event*: This recommendation is particularly important for the NYSE, which combines the CEO and chairman positions. Some reformers are calling for these two roles to be split. However, an independent committee represents a viable alternative. Although last spring the NYSE did form a special committee on governance of the NYSE, some have questioned the committee’s independence.

**Director  
Summary**



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*Lesson Learned:* Having independent directors in a position of authority can be extremely helpful in resolving controversies before they become crises.

5. *NACD Recommendation:* “Boards should regularly and formally evaluate the performance of the CEO.... Independent directors should control the method and criteria for this evaluation.”

*NYSE Event:* No one denies that the former CEO of the NYSE performed well. Under his watch, the number of companies listed on the NYSE increased, as did the price of their seats. The CEO had positive relations with most of the Big Board's multiple constituents. In fact, his positive performance makes his sudden departure all the more unfortunate. (Few would rue the loss of an inept CEO.)

*Lesson Learned:* The controversy at the NYSE arose primarily due to the lack of independence and disclosure – as well as the fact that the CEO's compensation (both annual and deferred) was high in relation to public company CEOs. Clearly, independence, disclosure, and benchmarking are keys to evaluation—and its connection to compensation.

6. *NACD Recommendation:* “Boards should review the adequacy of their compliance and reporting systems at least annually. In particular, boards should ensure... compliance with [their own] internal governing documents.”

*NYSE Event:* The former CEO presided over the creation of what is arguably the most comprehensive, cogent, and constituency-serving set of governance principles ever devised, yet it did not live up to them fully. One problem may be the internal contradiction of the exchange itself, which has two major “relationships” – one with the public, as a setter of standards for listed companies; the other with companies, as a provider of listing services. Each of these relationships is valid, but when they tangle, this can cause problems.

*Lesson Learned:* Practice what you preach. Standard setters should not only meet but beat their own standards.

7. *NACD Recommendation:* “Boards should adopt a policy of holding periodic sessions of independent directors only.”

*NYSE Event:* The NYSE board had instituted this practice, and it held them in good stead during the recent controversy.

*Lesson Learned:* Actions of independent directors, as a group or through a committee, can be an excellent insurance policy against potential crises.

8. *NACD Recommendation:* “Audit committees should meet independently with both the internal and the independent auditors.”

*NYSE Event:* Here, too, the NYSE gets high marks. The NYSE had recently upgraded its audit committee charter, and beefed up independence of its members. The lack of accounting scandal at the Big Board prevented the controversy over CEO pay from becoming catastrophic.

*Lesson Learned:* An independent audit function can help keep a good board going through a time of turmoil.

9. *NACD Recommendation:* “Boards should be constructively engaged with management in... their company's strategies.”

*NYSE Event:* All reports indicate that the board of the NYSE met this standard in spades. Again, this helped prevent a crisis.

*Lesson Learned:* A strategically engaged board can respond to turmoil quickly and effectively.

10. *NACD Recommendation:* “Boards should provide new directors with a director orientation program [and] ensure that directors are continually updated.”

*NYSE Event:* The NYSE board has championed director education for member companies. Indeed, it was under the previous CEO's watch that the NYSE became more involved in director education, partnering with the NACD to provide educational programs for boards through major universities. This commitment to director education will be one of the keys to the NYSE's role as a governance leader going forward. Clearly, the NYSE should also ensure the continuing education of its own board.

*Lesson Learned:* A commitment to director education can strengthen the governance of any board, including the board of the NYSE itself.

## Real Life

The Big Board can be commended for the standards it set for its member companies, as well as for the standards it has set for itself. Now comes the hard work of living up to those standards by being an exemplary model for listed companies.

This will not be easy: In the words of the NYSE's own governance committee, “given the unique, member-owned self-regulatory structure of the NYSE, there are certain areas where the practices recommended [by the NYSE] necessarily differ from that of an NYSE-listed company.” As long as the NYSE stays on the high road of good governance, these standards will surely meet the test of time.

As the NYSE looks to appoint a permanent CEO, we hope that the board will consider individuals who have experience in corporate governance—and an ability to learn from real-life experience. ■

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, private, and closely held firms. NACD lists all interested members on The Director's Registry, which is used by member companies and others that seek qualified directors. With chapter 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 Director of the Year Award.

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