



**LEADING YOUR BOARD
TO BETTER PRACTICES:
STRUCTURE FOLLOWS STRATEGY**

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Overview of Presentation

- A. Refresher on Some Basics of Corporate Governance
- B. How To Engage the Board in the Important Matters
- C. Importance of Focusing the Board's Attention on the Correct Fundamentals
- D. Strategies for a Board to Consider in the Current Environment
- E. Using The Strategic Plan to Build an "Expertise" Board



A. Refresher on Some Basics of Corporate Governance

- Roles in Corporate Governance
- Three Basic Principles of Corporate Governance
- Standard Functions of Directors
- Function of Management



Roles in corporate governance

- For the board to give *direction*, which it does by granting authority and setting limits
- For management to *execute* direction, which it does by exercising that authority subject to those limits



Three basic principles of corporate governance

1. All authority for
 - ***Decision making*** as to matters of policy, direction, strategy and governance; and
 - ***Oversight*** as to matters critical to the health of the organization for its various stakeholdersis to be exercised under the ***direction*** of the organization's board; and



Three basic principles of corporate governance

2. A board functions only as a board as determined by a majority of its members at meetings in which a quorum is present
3. State corporation law expects, and gives protection for, directors' reliance on officers or employees of the organization as to matters for which they are reasonably believed to be reliable and competent



Standard functions of directors

- ***Decision making*** as to matters of policy, direction, strategy and governance;
- ***Oversight*** as to matters critical to the health of the organization for its various stakeholders; and
- ***Mentorship*** of the CEO and senior management.

i.e., the function of boards is to oversee the direction of the “***important matters.***”



Function of management

- While the role of the board is to oversee direction of the *important matters*
- The function of management is to
 - *Provide input* to help the board give direction on the important matters; and
 - *Execute* that direction



B. How To Engage the Board in the “Important Matters”

- Educate the Board
- Components of the Strategic Plan
- Engage the Board
- Steps for Creating the Strategic Plan



Educate the board

- On the importance of their involvement in strategic planning and other important matters
- Failure to do so can lead to disagreements between the board and the CEO



Engage the board

- Explain to the board the need for each director to be constructively involved in determining strategic direction
- Urge the board's involvement as a whole, rather than via a board committee
- Clarify that the planning process is a joint effort with management – both should participate in establishing the process and determining the strategies



Components of the strategic plan

- ***Mission*** – Why we exist
- ***Values*** – What we believe in and how we behave
- ***Vision*** – What we want to be
- ***Strategies*** – What our game plan is to become what we want to be
- ***Scorecard*** – How we monitor and implement the plan



Steps for creating the strategic plan

1. Agree upon the elements that are going to be considered in the process — which includes the background, experience and expertise among management and the board to achieve the strategic direction
2. Management should lead the process by suggesting the strategies for consideration



Steps for creating the strategic plan

3. The role of the board is to ask essential questions regarding each strategy
 - **Why are we doing it?** (i.e., why is the business considering taking the strategy?)
 - Whose interests are benefited by this strategy? Shareholders? Policyholders? Employees? Producers?
 - What red flags are there?
 - What circumstances require this strategy to be taken now?



Steps for creating the strategic plan

3. The role of the board is to ask essential questions regarding each strategy
 - **How are we accomplishing it?** (i.e., what financial, legal, ethical, strategic, and reputational issues are involved in the strategy and how is it taken?)
 - What are the risks to Net Worth? Liquidity? Legal compliance? Ethical behavior? Strategic direction? Reputation (with policyholders, regulators, producers, and other business partners)?



Steps for creating the strategic plan

3. The role of the board is to ask essential questions regarding each strategy
 - **What is being asked of the board?** (i.e., what is the board's role with respect to the strategy?)
 - Is the board to implement the strategy?
 - Or is the board to oversee management's implementation of the strategy?



Steps for creating the strategic plan

3. The role of the board is to ask essential questions regarding each strategy
 - **What is to be expected of management?**
 - What discretion does management have to execute or not execute the strategy?
 - What additional authority does management need from the board in the future and when?
 - What is expected of management in terms of reporting back to the board?



Steps for creating the strategic plan

4. Management may need to refine or reformulate the strategy, consistent with the guidelines given by the Board
5. Determine the background, experience, and expertise that will be needed among management and the Board to successfully implement the strategic plan



C. Strategies for a Board to Consider in the Current Environment

- Strategies for providing assurance for
 - Renewed Focus on the Fundamentals
 - Authority and Accountability
 - Compensation and Incentives
 - Appropriate Expertise
 - Commitment of Board Members
 - Leadership of Board in a Crisis
 - Board, Management and Assets are Protected
 - Information is Accurate and Complete
 - Operations and Practices are Reviewed



Strategies providing assurance that

- There is consistent focus from the top on the correct fundamentals:
 - Long term growth and stability, including consideration of how every decision will effect net worth, surplus, and capital;
 - Compliance with legal and ethical standards; and
 - Continuous improvement in operations and practices.



Strategies providing assurance that

- There is authority and accountability for assessing and managing risks.
 - Boards should consider authorizing an officer or officers (e.g., the CFO and general counsel) to identify, assess, and advise management and the board of risks.
 - Management should be required to consider risks in making decisions, and their consideration of such risks should be reported to the board for any decision requiring board approval or authorization.
 - Without authorization of the board, management should by policy avoid or mitigate known material risks.



Strategies providing assurance that

- Compensation and other incentives are aligned with the fundamentals and with managing risks.
 - Boards should assure that compensation is consistent with pay-for-performance standards. For example, performance periods of two or more years; or performance measures that include desired changes in net worth, surplus, and capital;
 - There should be no incentives for management to take large risks not authorized by the board; and
 - These strategies should be reviewed annually.



Strategies providing assurance that

- Appropriate expertise is present on, or otherwise available to, the board.

Boards should evaluate and inventory the individual skills, experience and other expertise of each of its members; determine the expertise needed in the foreseeable future; and then determine whether to fill any gaps in such expertise through:

- Recruitment of new or additional directors
- Education of directors to enhance expertise
- Availability of advice from outside advisers -- to provide missing expertise



Strategies providing assurance that

- Board members are committed in terms of time and freedom of conflicts.
 - Boards should review the willingness and ability of individual directors to spend the time, free of conflicts, required for the best interests of the organization. This includes periodic evaluations of each director's outside interests, including other directorships; do these make it difficult for a director to devote the time needed, or to act in the company's best interest?



Strategies providing assurance that

- The board is prepared to lead in a crisis.
 - At least one outside director, such as a lead outside director, should regularly participate in preparing agenda for meetings and approving information being provided to directors. Outside directors should assure their ability under applicable governing documents to call and preside at meetings, including where appropriate executive sessions. Boards should have strategies for providing succession.



Strategies providing assurance that

- The board and management are reasonably protected against liability.
 - Boards should assure that members of the board and management are periodically reminded of what precautions to take to reduce risks of liability, including what to do upon becoming aware of any claim or potential claim.
 - Indemnification provisions should be reviewed periodically with the extent that indemnification is currently permitted by law.
 - D&O coverage should be reviewed regularly.



Strategies providing assurance that

- The organization's other resources, including reputation, are adequately protected.
 - Consider adoption of strategies to prevent bargain hunters taking advantage of low valuations or under-performance to force divestures, distributions, or changes in control.
 - Consider adoption of strategies to reduce the risk of competition or head hunters in soliciting employees, customers, suppliers and other resources.
 - Consider business decisions in light of damages to reputation if the decision results in a headline in the news or financial media.



Strategies providing assurance that

- Necessary or required information is being provided and it is accurate and complete.
 - Board should assure that there are periodic evaluations of whether all necessary information is being provided to the board and management and whether it is accurate and complete; whether all required information is being provided to other stakeholders and whether it is accurate and complete; and whether there are safeguards to provide corrected information when information provided becomes materially misleading, because of adverse events or otherwise.



Strategies providing assurance that

- Operations and practices are continuously reviewed for compliance and improvement.
 - Boards should assure that strategies are in place for continuous review of operation practices for legal and ethical compliance and in comparison with peer or better practices for improvement.



Structure follows strategy

- Board composition and structure should be reviewed to determine how best to accomplish the strategies
- The last and most important step of the strategic plan is determining the background, experience, and expertise that will be needed among management and the Board to achieve the strategic plan
- Perform a ***director and management self-evaluation*** to inventory the current background, experience and expertise of the current composition of the board and management to build an “expertise” board



An “expertise” board is

- Composed of persons each having particular skills or expertise needed for the board as a whole, to have all of the skills and expertise necessary to achieve its future objectives; and
- A Board whose members have “expertise” not present among the current management team
 - This contrasts with a “*constituency*” board which is composed of persons who represent the view of a particular constituency based (a “political” model such as the U.S. Congress or State legislature



An “expertise” board requires

The company to:

- Assess the core competencies present among its current board
- Prioritize the additional competencies necessary for future operations
- Recruit persons having those competencies for nomination as board members
- Have “buy-in” from the entire Board to implement the process



Benefits of the board-driven process

- When the board implements the process, then over time Board members replace themselves without having to resort to term limits and mandatory retirement
- Board members thus concur with the change:
 - Rather than change for what may be perceived as management's reasons; or
 - Because of term limits or age which may be perceived as arbitrary



Benefits of an “expertise” board

- Focus on the best interest of the organization as a whole because its members are selected on the basis of particular skills or expertise that, when added to the skills and expertise of the other members, are likely to achieve the goals established by the board itself
- The board fulfills one of its most important duties, which is critical to the life of any organization: succession of board members



Questions?



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