

Vetting your board members and board candidates

As the SEC establishes a 10-year 'look back' for legal proceedings, be even more comprehensive in your due-diligence assessment.

BY JAMES ROWE

A NEW RULE adopted by the Securities and Exchange Commission requiring disclosure of broader categories of legal proceedings involving directors or nominees going back 10 years (rather than only five years) is neither unexpected nor burdensome. In proposing this rule last summer, the SEC said that such enhanced disclosure would help investors understand why a director is a “good fit” for the company.

This rule relates to the last step in a corporate board’s naming of a candidate. The first step is the board’s own determination that a candidate is suitable. The second is performing a due-diligence background check on the candidate, and that’s where firms like ours come in. Our clients — the leading public and private companies, top not-for-profit institutions and international executive search firms — have customarily insisted on comprehensive background reports on C-suite executive candidates and board nominees that are much more ambitious than what the SEC is requiring.

Following the board’s initial act of assessing that a candidate is suitable, we work hand in glove with our clients in assessing the candidate’s professional and personal past. We do not interview anyone. Rather, our “look back” goes back decades, often to college graduation, and delves into educational degrees, credentialing and licensing, employment and professional affiliations, criminal/civil litigation proceedings,

regulatory sanctions, financial profiles, and in-depth media coverage.

The Key Issues to Focus On

A study by the National Association of Corporate Directors found last year that more than half of corporate boards don’t even retain a search firm to seek board candidates. Here are a few of the key issues that, based on our years of doing this kind of due-diligence work, we think those and other boards might focus on:

Advise with Consent: Board candidates are increasingly being asked to sign a consent form to initiate the public-record review of their past. While this is not a legal requirement as it is for executive positions, such consent not only facilitates certain fact-finding but also signals the candidate’s willingness to undergo more careful screening. Candidates should not balk at signing up, and alarm bells should clang if they refuse.

Trust but Verify: We look into whether the education, professional affiliations, and credentials described in the candidate’s profile are correct. If we find a mistake on a resume, half the time we’ll soon identify another problem. Did any of his jobs fall off his resume? Did she puff up her educational credentials? Does he have any undisclosed affiliations, such as a board membership he didn’t list? A small business set up for a spouse is far different from a secret side company in the same industry as his main job.

Is the Misstep an Aberration or Part of a Pattern?: Has the candidate been

tardy paying bills, been dogged by debts or tax liens, or shown other signs of trouble handling money? We worry if a candidate has sued every contractor who’s ever lifted a hammer at his house. Did the candidate disclose a confrontation with police following a traffic accident? Did she explain that her pattern of debts ended after her spouse’s business bankruptcy?

Professional Stewardship or Mismanagement?: It’s crucial to figure out the past professional controversies, or quiet accomplishments, that aren’t readily apparent in a candidate’s resume. Was the corporate executive responsible for desperately needed changes at a company, or was he a Sgt. Schultz, just along for the ride? We expect that senior corporate executives routinely are named as defendants in class-action lawsuits along with their companies; the issue is whether they were responsible for the mess at issue in the lawsuit, or were they, say, running a division far from the scene of the controversy? Did the SEC initiate an investigation, or did the U.S. Attorney follow up on the proceeding with a subpoena?

Evaluate Globally — and Locally: It is hardly exceptional nowadays for successful executives to have worked overseas, and relying on an “English-only” approach is not only old-fashioned but reckless. At the very least, a serious review of an ex-pat’s career in China, for example, requires Chinese-language news searches, and a scouring of Lawyee,

a Chinese-language litigation database, and of the China Securities Regulatory Commission filings. An experienced international investigator knows that debts and loan defaults are detailed in accessible filings in Argentina, and that Italian corporate financial statements are much more illuminating than in the U.S.

Back in this country, one must follow a candidate's footprints by looking at the public record in all the places he has worked, lived, or had vacation homes, visiting county courthouses and local public-record repositories. Why did the individual live in Texas for two years after college when his resume says he was in Iowa? Why does the state election commission, detailing his contribution to a state senator, list an unknown residence or undisclosed employer?

A Hallmark of Sound Governance

If the governing board has truly vetted the director or nominee on both suit-

ability and due diligence, it will be far better informed and prepared to then provide the investing public with more meaningful information on his or her capabilities and character — as well as following the SEC rule on listing legal proceedings going back 10 years. This is not just welcome news for investors, but is a hallmark of sound corporate governance. ■

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Before joining the Mintz Group, Rowe worked in a variety of investigative and

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