Corporate Boards: 10 Ways To Be An Impactful and Effective Board Member

Corporate Counsel Women of Color Boot Camp

CCWC Chicago, Illinois

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CORPORATE BOARDS: 10 WAYS TO BE AN IMPACTFUL AND EFFECTIVE BOARD MEMBER

1. **LEARN YOUR INDUSTRY**
   - ATTEND INDUSTRY EDUCATION PROGRAMS
   - PARTICIPATE IN BOARD TRAINING SESSIONS OFFERED BY THE COMPANY
   - INVEST YOUR OWN PERSONAL RESOURCES IN CONTINUING EDUCATION

2. **REVIEW PREPARATORY MATERIALS**
   - ADVANCE MATERIALS MUST BE RECEIVED FAR ENOUGH IN ADVANCE OF BOARD MEETINGS TO ALLOW FOR IN-DEPTH REVIEW
   - ADVANCE PREPARATION IS KEY

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3. **REGULAR MEETING ATTENDANCE**
   - SOUNDS OBVIOUS
   - ATTENDANCE DATA MATTERS!

4. **EQUITY INVOLVEMENT**
   - MAKE A PERSONAL INVESTMENT IN THE STOCK OF THE COMPANY
   - PARTICIPATION, FOR EXAMPLE, IN A MUTUAL INSURANCE COMPANY, WOULD BE PURCHASING A SUBSTANTIAL POLICY

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5. **BE INDEPENDENT**
   - DO NOT ALLOW YOURSELF TO BE SWAYED BY POLITICAL CLIQUES ON THE BOARD
   - SPEAK UP AND HAVE THE COURAGE OF YOUR CONVICTIONS!

6. **MAINTAIN THE APPROPRIATE BALANCE OF ROLES IN YOUR GOVERNANCE ROLE**
   - BOARDS ADVISE; MANAGEMENT EXECUTES
   - RESIST ANY ATTEMPTS BY MANAGERS OR SENIOR EXECUTIVES TO DEVELOP A BACK–CHANNEL TO YOU

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7. EMBRACE COMMITTEE WORK

- OPPORTUNITY FOR DEEPER UNDERSTANDING OF THE BUSINESS
- OPPORTUNITY TO DEVELOP MORE COHESIVE RELATIONSHIPS WITH MANAGEMENT AND OTHER BOARD MEMBERS

8. PERFORMANCE EVALUATION

- BOARD EVALUATION OF BOARD PERFORMANCE
- COMMITTEE EVALUATION OF COMMITTEE PERFORMANCE

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9. **RESIST ANY TEMPTATION TO INSERT YOURSELF AS THE LEGAL ADVISOR TO MANAGEMENT**
   - ASSERT YOUR BUSINESS ACUMEN AND BUSINESS KNOWLEDGE
   - GIVE STRATEGIC ADVICE BASED ON YOUR GOOD JUDGMENT
10. **AMBASSADOR AND SOUNDING BOARD**
   - AS A BOARD MEMBER, YOUR ARE A REPRESENTATIVE OF THE COMPANY IN THE COMMUNITY
   - SERVE AS A SOUNDING BOARD FOR MANAGEMENT AS YOU CONVEY INFORMATION THAT MAY BE OF VALUE IN MAKING STRATEGIC BUSINESS DECISIONS
   - DIVERSITY AND INCLUSION AS A COMPONENT OF GOOD CORPORATE GOVERNANCE

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Questions?

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DELOITTE DECK AND MATERIALS

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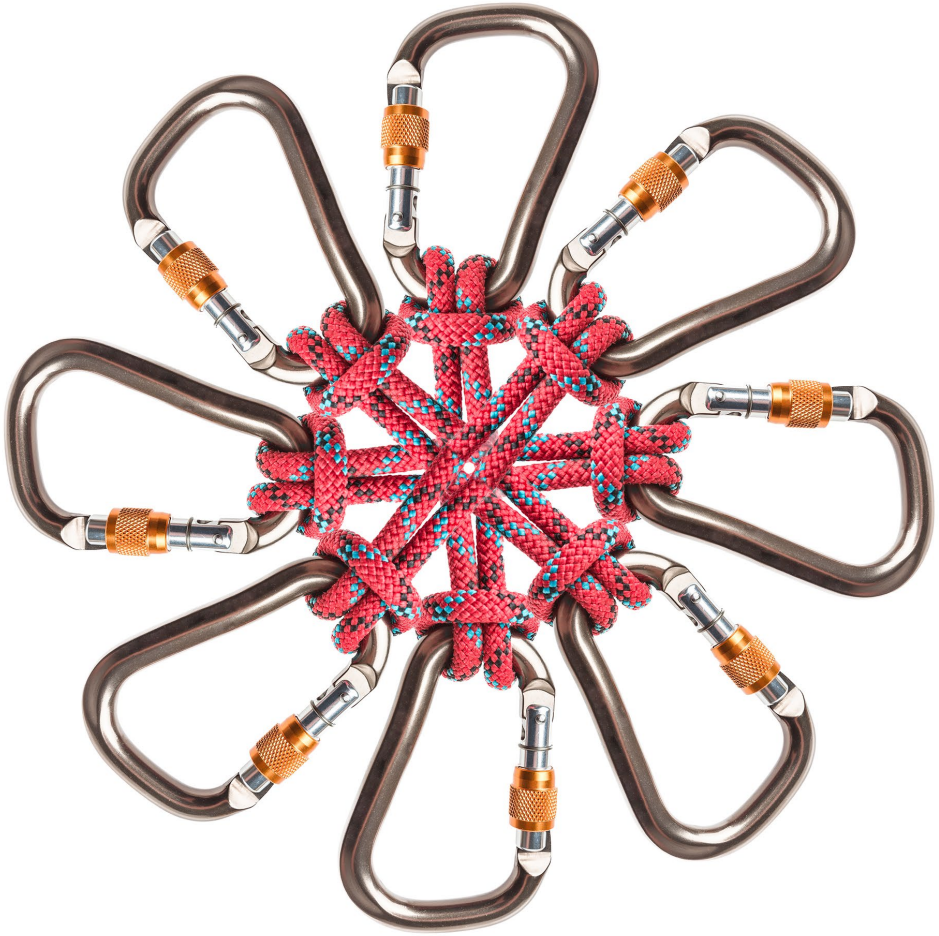


Communicating with the Board of Directors

Prepared for Corporate Counsel Women of Color – September 2019

The CLO Program

What is corporate governance?

Corporate governance – What is it?

It depends who you ask

"The system by which organizations are directed and controlled."

Cadbury Report – 1992

"A set of relationships between a company's management, its board, its shareholders and other stakeholders…[and] provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined."

Organization for Economic Co-operation and Development, OECD Principles of Corporate Governance – 2004

"A system of checks and balances between the board, management, and investors that should produce an efficiently functioning corporation, ideally geared to produce long-term value."

The Conference Board, Corporate Governance Handbook 2005

Corporate governance – What is it?

What is corporate governance?

Set of rules, processes, and practices by which a company is directed and controlled

Involves balancing interests of many stakeholders, including shareholders, boards of directors, management, employees, customers, suppliers, lenders and creditors, communities and government

Not just legal requirements; should reflect business/industry perspectives, culture, personality, and perception

Shaped by scandals and economic downturns, leading to:

- Legislation/regulation
- Institutional investor empowerment (and activism)

The board, its committees, and management

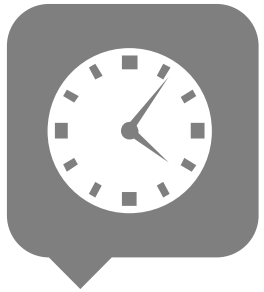
Key considerations for Directors

Under state laws, company is managed "by or under the direction of" the board

Modern boards cannot manage – they <u>oversee</u> (except in crisis)

Fiduciary duties are key

- Duty of care
- Duty of loyalty – undivided
- No separate duty of good faith; it's implicit



Business judgment rule

- Courts don't like to second-guess boards and won't, unless failure to exercise duty of loyalty (e.g., conflict of interest) or duty of care (lack of process).

Board and management relationship

Focus on the checks and balances between the board and management

Management

The team that runs the enterprise on a day-to-day basis

- Developing strategy and collaborating with the board to set long-term vision
- Managing to achieve the vision
- Acting as a liaison between the board and operating units
- Providing information that allows the board to evaluate performance
- Execution of strategy

Constructive Tension

Board

Charged with an oversight role – direct, review, and assess the actions of management on behalf of the shareholders

- Legal and fiduciary responsibility as the organization's ultimate internal overseers
- Advising on/approving/monitoring progress on long-term vision and strategy
- Governance: overseeing policy and process
- Hiring, evaluating, and succession planning of the CEO and C-Suite

Board committee types/prevalence

Committees
In the modern public company, much of the board's work is handled by committees

Key committees:

- Audit
- Compensation
- Nominating/ corporate governance

Other committees:

- Risk (Dodd-Frank requirement for most financial institutions)
- Technology
- Corporate responsibility
- Advisory boards/committees

Responsibilities of standing board committees

Audit	Compensation	Nominating and Governance
• Oversee internal controls and financial reporting • Discuss the company's policies and processes for risk assessment and risk management • Oversee the independent auditor • Interact with the internal auditors • Oversee ethics and compliance: whistleblower provisions and fraud • Prepare the annual audit committee report in the proxy • Evaluate the CFO and finance staff, and discuss succession planning and bench strength • Oversee corporate tax planning, compliance, and other related matters	• Develop the compensation philosophy • Review and approve the CEO's goals, approve the CEOs compensation and evaluate the CEO's performance • Recommend compensation for the Named Executive Officers • Assist with and review the Compensation Discussion and Analysis • Oversee equity compensation grant policy • Retain and terminate outside consultants and evaluate whether any advisors have a conflict of interest • Determine board compensation (?)	• Establish corporate board governance practices and principles • Recruitment, recommendation and nomination of board candidates, including the slate of directors that the Board proposes for election by stockholders at the Annual Meeting. • Evaluation of directors and board as a whole • Review program for orientation and training for board members • Provide update on governance trends and practices • Determine board compensation (?)

Hot topics/areas of board focus

BOARD COMPOSITION/ REFRESHMENT/ DIVERSITY	PREPARING FOR/DEALING WITH ACTIVISM	EFFECTIVE DISCLOSURE	RISK OVERSIGHT/ ERM
PROXY ACCESS	ROLE OF THE BOARD IN STRATEGY	SUSTAINABILITY	EXECUTIVE COMPENSATION
CYBER RISK	CAPITAL ALLOCATION	POLITICAL CONTRIBUTIONS AND LOBBYING	CEO SUCCESSION PLANNING

SHAREHOLDER ENGAGEMENT – KNOW YOUR SHAREHOLDERS

Where/how does the CLO fit in?

The roles of the CLO vis-à-vis the board and committees

- Advise on legal obligations/requirements and prohibitions
- Keep current on recent and anticipated developments (e.g., regulation, legal proceedings)
- Avoid surprises and give board/committees time and information to exercise due care

- Handle timely dissemination of materials/other information; seek to assure information is complete and balanced
- Orchestrate roles of many departments – HR, financial, etc.
- Extensive logistical/administrative responsibilities (e.g., Mr. Smith's banana)
- See that board/committees take proper action on a timely basis

- Explain potential risks of action/inaction
- Advise on legal duties
- Advocate proper course of action (business and legal advice)

A closer look at the roles of the CLO and the board

Mapping the two frameworks

The Four Faces of the CLO	Governance Framework elements
Catalyst Provide critical legal guidance and innovative solutions that drive the organization forward.	**Performance, Strategy, and Integrity**
Strategist Align legal and business strategies to enable value creation.	**Performance, Strategy, and Integrity**
Guardian Guide legal and regulatory matters for the business, mitigate risk, and protect brand and reputation.	**Governance, Integrity, Culture, and Risk**
Operator Optimize legal efficiency, effectiveness and structure to best serve the business.	**Performance, Strategy, Governance, Talent, Culture, and Risk**

Key points – Getting your message across

CLO role

CLO Tools

1 Information

- Legal/regulatory
- Business
- Actions/ decisions needed

2 Preparation

- Prepare/ review/edit materials
- Disseminate materials
- Understand issues where advice required

3 Coordination

- Socialize with c-suite
- Understand individual roles
- Assure necessary actions taken/ decisions made

Summing it up

Summing it up

Board vs. Management
Board Role: Oversight
Management Role: Execution

CLO Role
Advisor
Facilitator
Protector

Tools
Information
Preparation
Coordination

Appendix 1

Deloitte Governance Framework

Board and Committee Specifics

Takeaways

Our view on corporate governance

The Deloitte Governance Framework was developed to help boards and executive management assess the effectiveness of the organization's governance programs

The Framework defines board and management activities that support effective governance.

Each area of governance can be considered in the context of four attributes:

- Skills and knowledge
- Process
- Information
- Behavior

Deloitte Governance Framework

Objectives and activities of an effective board

Performance
- Review and approve company strategy, annual operating plans, and financial plans.
- Monitor management execution against established budgets as well as alignment with strategic objectives of the organization.

Strategy
- Advise management in the development of strategic priorities and plans
- Actively monitor management's execution of approved strategic plans
- Actively monitor the transparency and adequacy of internal and external communication of strategic plans

Governance
- Establish structures and processes to fulfill board responsibilities that considers viewpoints of stakeholders
- Select members and leaders via an inclusive, independent, and thoughtful process.

Talent
- Select, evaluate, and compensate CEO
- Oversee company talent programs
- Communicate executive compensation and succession decisions

Integrity
- Set the ethical tenor for the company
- Actively participates in programs designed to promote legal and regulatory compliance and appropriate standards of honesty, integrity, and ethics throughout the organization.

Risk
- Understand and appropriately monitors the company's strategic, operational, financial and compliance risk exposures, applying a risk intelligent mindset to its deliberations.
- Collaborates with management in setting risk appetite, tolerances and the alignment of risk with the organization's strategic priorities.

CLO-Board interactions

Leading practices and considerations

Leading practices

- Be a trusted advisor to the CEO and the board.
- Interact directly with the board.
- Meet regularly with the board and relevant board committees and hold executive sessions without management present.
- Establish and formalize the role of the CLO and how the CLO will interact with the board.

Opportunities for the CLO to support the board include:

- Leading the preparation of regulatory filings, such as the proxy statement, 10Q, and 10k.
- Consulting with CFO and Investor Relations team on matters related to activism and shareholder engagement.
- Regularly updating the board on matters related to risk (legal and other) and governance.
- Reporting to the board on legal proceedings.
- Keeping the board abreast of legal and regulatory developments.
- Updating the board on pending transactions.

Source: 2014 Board Practices Report – Deloitte and Society of Corporate Secretaries and Governance Frofessionals.

Board committees closely aligned with CLO role

Audit committee

Other Reports/Topics Discussed

Audit Committee	
Some key areas of oversight	• Internal controls and financial reporting. • Risk oversight and understanding the business. • External/Internal audit and management. • Ethics and compliance.
Ongoing and emerging areas of emphasis	• IT strategy and risk, including cybersecurity. • Global tax planning, treasury and cash management. • Finance talent/succession planning. • Emerging markets, including FCPA implications. • Delegations of authority. • Effective utilization of internal audit. • COSO Framework. • Revenue recognition standard.

Opportunities for the CLO to support the audit committee include:

- Keeping the committee updated on ethics compliance matters – such as those pertaining to the whistleblower hotline, code of ethics, code of conduct, and on the company's antifraud program.
- Updating the committee on regulatory developments relating to the committee's role (e.g., SEC concept release on audit committee disclosure) as well as other relevant matters.
- Helping to ensure the committee is compliant with regulatory requirements.

Board committees closely aligned with CLO role

Compensation committee

Other Reports/Topics Discussed

Compensation Committee	
Some key areas of oversight	• Develop and oversee implementation of the compensation philosophy. • Review and approve the CEO's goals, approve the CEOs compensation and evaluate the CEO's performance. • Recommend compensation for the Named Executive Officers (NEOs). • Assist with and review the Compensation Discussion and Analysis (CD&A). • Oversee equity compensation grant policy. • Retain and terminate outside consultants and evaluate whether any advisors have a conflict of interest.
Ongoing and emerging areas of emphasis	• Pending pay vs. performance, clawback rules. • Pay ratio rule. • Increased focus on proxy and specifically, CD&A disclosures. • Continual monitoring of pay vs. performance incentive structuring.

Opportunities for the CLO to support the compensation committee include:

- Preparing the Compensation Discussion and Analysis for inclusion in the proxy statement.
- Ensuring committee is compliant with regulatory requirements such as those pertaining to committee composition and independence.
- Informing the committee of new and pending regulations.

Board committees closely aligned with CLO role

Nominating and governance committee

Other Reports/Topics Discussed

Nominating and Governance Committee		Opportunities for the CLO to support the nom/gov committee include:
Some key areas of oversight	• Establish corporate board governance practices and policies (e.g., conflict of interest, D&O insurance). • Recruitment, recommendation and nomination of board candidates, including the slate of directors that the board proposes for election by stockholders at the annual meeting. Use of skills matrix, engaging search firms. • Evaluation/assessment of directors, committees and board as a whole. • Review board member orientation and training program. • Monitor governance trends and practices.	• Assisting the committee in the preparation of board policies (e.g., conflict of interest, D&O insurance). • Supporting committee efforts related to director recruitment (e.g., using a board skills matrix and search firm engagement). • Participating in the onboarding process for new directors and the preparation of associated material. • Coordinating investor concerns, including investor outreach activities.
Ongoing and emerging areas of emphasis	• Board "refreshment" – increasing focus on board composition: tenure, independence, qualifications, diversity, age and term limits. • Voting recommendations by proxy advisors and institutional investors regarding director elections and other voting matters. • Proxy access proposals and varying responses.	

Key points – Getting your message across

CLO role

Getting your message across

- Written communications:
  - Follow a consistent format
  - Don’t be such a lawyer
    - Don’t build to a conclusion; state objectives and conclusions first
    - Avoid providing every fact and supporting reason
    - Use plain English; avoid legalese
  - Be brief; 20-page memos will not work
- Oral communications
  - Same as above
  - Don’t repeat pre-reads; directors are assumed to have read materials
  - Allow interruptions for questions; it’s about them, not about you
- All communications
  - Know your audience
  - Treat them as individuals and take personal preferences into account

Key points – Getting your message across

CLO role

Key points - Summary

1. Candor and promptness are critical; directors should hear all news (good and bad) and should hear it from the company before hearing it from others.
2. Any time there's a development, think:
   a. Do we tell the board?
   b. When do we tell the board?
   c. What do we tell the board?
   d. How do we tell the board?
3. The CLO serves in multiple capacities and needs to be clear as to the capacity in which s/he is acting at any given time.
4. When acting in his/her legal capacity, the CLO needs to have a clear understanding of who the client is and how that can change.
5. The CLO's relationship with the board extends beyond the formalities of the boardroom; s/he must develop a broader relationship with individual directors, including all-important trust.
6. Never underestimate the importance of good relationships with each director's support group – assistants, spouses/partners and others.

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Insights

FEATURE

Bringing digital to the boardroom

The impact of digital transformation on companies' boards

Val Srinivas, Robert Lamm, and Tiffany Ramsay

THE DELOITTE CENTER FOR FINANCIAL SERVICES AND THE DELOITTE CENTER FOR BOARD EFFECTIVENESS

Digital transformation is changing the way businesses operate in many ways—including how boards of directors engage with management teams. What opportunities exist to enhance board effectiveness through digital technologies?

DIGITAL TRANSFORMATION IS *not* just about adopting new technologies. Its significance, especially in the business world, extends to how technology can be used to create—and sustain—a competitive advantage.[1]

As such, digital transformation, along with the potential for disruption, is high on the agenda for executives at many financial institutions, as well as their boards of directors. Boards are increasingly discussing the topic,[2] not just with management, but also with line employees. Many boards are keeping a close eye on the latest technological innovations, such as artificial intelligence (AI) and blockchain, and they are taking a strong interest in their businesses' strategic choices around technology.

However, though boards are paying more attention to digital transformation, their discussions tend to focus on the potential impacts that digital presents to the organization as a whole. Rarely, if ever, according to our research, do they consider the question of how digital transformation may affect the role of the board itself, and how board members engage with each other and with management. Yet boards are not immune to the impact of digital on the organizations they oversee.

We posit that digital transformation can have a marked influence on how boards function and communicate, and that boards could have much to gain from the thoughtful use of digital technologies to execute their role. At the same time, however, digital can also raise new challenges and hinder what boards are able to accomplish.

To explore these challenges, we interviewed board members and corporate secretaries from select major financial institutions, including banks, insurers, and investment management firms, to determine how digital technologies may affect boards and what boards should keep in mind as they embrace digital transformation.

The board's role: How is digital affecting what boards do?

The board's function has traditionally been—and fundamentally remains—one of supervision and stewardship. As supervisors, boards are expected to take ownership of CEO appointments, approve organizational strategies and their implementation, and oversee risk and compliance.[3] And as stewards, boards are tasked with "informing and helping to shape the future direction and health of the organization; advising on areas of investment; fostering greater innovation; responding to the changing geopolitical and technological environment; and developing organization talent and culture."[4]

However, changing market dynamics and regulatory actions are placing additional expectations upon today's boards. The National Association of Corporate Directors (NACD) Blue Ribbon Commission report urged directors "to keep finding ways to tap into fresh, unconventional thinking in order to improve oversight of the risks and opportunities posed by disruptive forces and events, including, but not limited to, the seismic shifts in the way we live and work that are being accelerated by new and emerging technologies."[5]

Indeed, "new and emerging technologies" have added a layer of complexity to boards' governance responsibilities, seemingly bringing more questions than answers. Our interviews suggest that digital raises fundamental questions about the board's role. For instance, as digital brings a new level of visibility into a company's day-to-day operations, how much information is necessary for boards to do their jobs? And do boards need to acquire new skills to keep abreast of digital developments and trends? In particular, several directors who we interviewed felt that digital transformation was blurring the line between the roles of boards and management as

This blurring of board and management roles is being heightened by increasing expectations around board oversight.

information access and distribution become easier, causing marked tension.

This blurring of board and management roles is being heightened by increasing expectations around board oversight. One director asserted that board members may need more transparency and greater access to information during times of stress and regulatory inquiries because simply asking questions of management—informally known as the "noses in, fingers out" approach6 —only works until the company is undergoing stress. "As a board member, when the company has a big problem, the shareholders, employees, and customers hold boards accountable, so it becomes 'fingers in' as well," said the director.

Consequently, as digital continues to increase boards' access to information, many boards today are providing guidance on a range of rapidly growing and morphing topics. Directors are increasingly engaging more deeply on a diverse set of issues, such as strategy, mergers and acquisitions (M&A), risk, talent, information technology (IT), and even marketing.

The mounting pressure to push beyond oversight has boosted the importance of hands-on board stewardship. Many boards are trying to be better stewards by being more thoughtful and bringing their best judgment to the table on a variety of issues. One board director we interviewed even pondered if boards would be able to challenge management with new and more detailed information that big data and analytics may provide.

The directors and corporate secretaries we interviewed acknowledged that, in this changing landscape, they could face an uphill battle. Many felt that their jobs might become significantly harder in the short term before getting easier in the long run. Nevertheless, boards will have to find a way to strike the right balance between oversight and stewardship to maximize their effectiveness while maintaining their objectivity. Despite the questions that it raises, digital can empower board members with new information and tools to more effectively do their jobs. Much of this will depend on how technology is implemented and used in the boardroom, as well as how well management teams and boards understand both its benefits and its risks.

Communication and information exchange: Is digital a blessing or a curse?

Board members depend on communication and information exchange to do their job: communication from the management to the board, from the board to the management, and between board members. In this regard, our interviews revealed that digital technologies, while they have facilitated

more effective communication in some respects, have been a mixed blessing.

THE TOOLS: THE ADVANTAGES AND CHALLENGES OF BOARD PORTALS

Recent technological advancements have led to the rapid adoption of board portals as a vehicle for board communications. These portals are intended to support the easy sharing of documents and data between board members and management. In fact, many written board communications today happen via board portals.

Board portals deliver several benefits over old-school paper-based communications, and even over electronic document-sharing without a mechanism for coordination and centralization. For one thing, board portals are designed to be protected, trackable electronic tools that cannot easily be lost as paper documents can. On the pragmatic side, board portals give directors a single place to go for information, eliminating the need to keep track of multiple communications delivered in hard copy or through email.

However, board portals have also brought their own set of challenges. While many boards use some kind of portal application, interviewees revealed they may exhibit some variability in features and functionality. For instance, information in certain portals might only be accessible on laptops and not through tablets or smartphones, or vice versa. This issue is especially complicated for those directors who sit on multiple boards. The use of several board portals with different security parameters and device requirements typically forces them to use more than one device to access information.

Directors who sat on multiple boards also indicated that there was no standardization across portals in how information is organized and presented, forcing them to spend extra time becoming familiar with different portals' features. For instance, some portals might display information summarized in a dashboard, while others do not. Additionally, some portals organized and restricted certain information to board committee members (such as the audit or risk committee); others shared all information with all board members.

Security was another concern. Although, generally deemed to be more secure than paper communications, board portals—like any online information repository—are vulnerable to cyberattacks. In some cases, too, a company might disable some of the portal's functionality or features—such as the ability to mark up communications between board members—to reduce legal risks. And notably, it was not uncommon for board members interviewed to use personal email accounts to access board portals and transmit documents, which could pose additional cyber risk challenges.

Overall, the consensus view from our interviewees was that many current board portals need further development, especially with regard to usability and consistency, and that improvements in these areas would help board portals to become more effective tools.

THE CONTENT: TOO MUCH INFORMATION, NOT ENOUGH TIME

It is well known that boards receive a great deal of information to digest in a limited amount of time. In fact, the aforementioned Fed proposal on enhancing board effectiveness noted that "boards of large financial institutions face significant information flow challenges [and can be] overwhelmed by the quantity and complexity of information they receive. Although boards have oversight responsibilities over senior management, they are inherently disadvantaged given their dependence on senior management for the quality and availability of information."[7]

Digital communications technologies are a big driver—perhaps even the biggest driver—of this information overload.

For the most part, the directors we interviewed shared that the information they received varied widely in both quantity and quality. As a result, most felt the effectiveness of these communications was somewhat mixed. Most directors also felt that they were often deluged with information, and that this information overload was especially severe when dealing with companies in the financial services industry with its highly regulated environment. One interviewee lamented that directors continuously receive "reams and reams of information," often impeding their ability to ask probing questions and potentially diluting their judgment.

Digital communications technologies are a big driver—perhaps even the biggest driver—of this information overload. The cost of transmitting information digitally is often minimal, so there is less incentive to prioritize or cut back, unlike in the past when paper communications were more prominent. As one interviewee put it: "It doesn't cost to add more slides." On the positive side, digital communications have eliminated the need for directors to lug around pounds of paper materials—but at the cost of receiving substantially more information in electronic form.

Although some management teams are conscious of the volume of information they share with board members, said another director, many executives tend to share more rather than less because they view providing more information as less risky. Another challenge some interviewees identified is the tendency for management to provide a great deal of information in an undigested form, assuming that different board members will want to analyze and classify it in their own way. However, this assumption is rarely accurate: The directors we interviewed stressed the importance of management sending cogent, concise reports and summaries to allow them to do their jobs efficiently.

One director also felt that the digitization of communications has led management to shorten their expectations for document review time. "Management teams do not give directors enough of a time window to review all the materials sent," said the director. The expectation of faster, real-time, "anytime, anywhere" communication in individuals' private lives seems to have spilled over into the business world, as boards face not just a growing volume of information but a growing demand to respond to it more quickly.

Even though digitization makes sharing information easier, these points suggest that management should be mindful of when and how much information to share so that it does not overwhelm board members and dilute their ability to process information and do their jobs effectively.

Digital in the future: How might emerging technologies further impact boards?

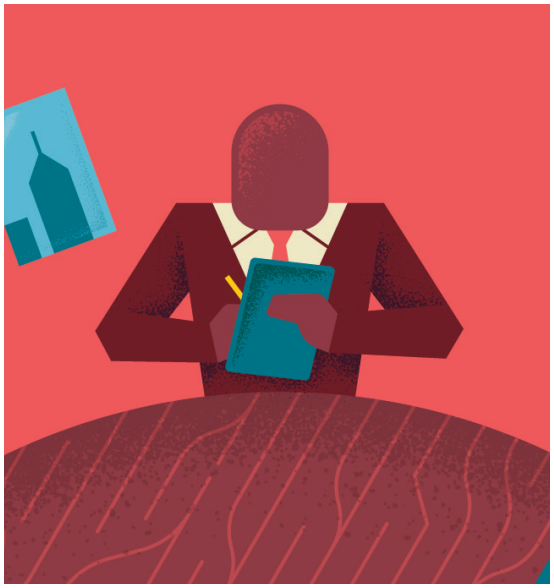
We expect that emerging technologies such as AI, cloud, and potentially blockchain will continue

to change how information is produced, transmitted, consumed, and analyzed. Some interviewees also worried that the fast pace of technological change could potentially decrease the value of industry experience that board members bring to the table.

One way in which advancing technologies could be useful to boards is to enable data-driven decision-making. AI, for example, could be used to track an organization's capital allocation patterns so that boards can identify potential concerns, like if a company is cutting research and development spending while most of its competitors are increasing it. AI could also be used to review and process press releases to help management and boards spot new competitors in specific product areas. In such cases, the technology might even be able to suggest appropriate investments to protect the organization's market share.[8]

The directors we interviewed appreciated, in principle, the value that advanced technologies could bring to strategic decision-making. But there was less agreement on the extent to which board members specifically could benefit from such tools. Given the heterogeneity in directors' technical capabilities and inclinations, some thought that systems or tools for applying advanced technologies might be too complex or demanding for all directors to use, at least without proper training. Directors also differed in the extent of information they wanted; some interviewees emphasized their lack of desire to take a deep dive into the details of the data supporting management decisions, while others wanted to have greater transparency into the data (such as risk or performance data).

In the short term, the board members we interviewed generally felt that it was management, not boards, who should use advanced technologies to better access, collate, analyze, and communicate information to boards. That said, many interviewees also indicated that they would appreciate receiving continuing education on emerging technological developments that could affect boards in the future. In the words of one corporate secretary, "This education should be a management responsibility."



Key considerations for boards as they consider digital enablement

Digital transformation will continue to affect organizations in a myriad of ways. However, digitization is still a work in progress for many organizations, and its full impact, especially on boards, are not yet known. As one director mentioned, some boards have not yet broached the subject of digital transformation as it relates to how the board itself operates. The onus is on both directors and management to be more proactive in understanding how digital can affect their responsibilities—in both scope and execution.

Before future digital solutions are adopted or implemented, what should boards do to better understand the impacts of digital transformation on board processes?

- Get smarter about the current technologies in place and new technologies on the horizon.
- Task working groups or committees with identifying the risks and the rewards of applying these new technologies to board operations.
- Be clear on what problems you are trying to solve. Avoid the temptation to implement "shiny new object" technologies that may not be most effective for the problem at hand.
- Work with management to define the boundary between oversight and decision-making amid the implementation of new technologies.
- When the appropriate technology tools are identified for implementation, put proper training mechanisms in place to get board members up to speed.
- Develop guidelines that will help management identify the most pertinent pieces of information to share with the board, allowing board members to make the best use of their time.
- Engage in dialogue with industry associations about digitizing board processes.

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On the board's agenda | US

The 2019 boardroom agenda: Something old, something new?

The end of an old year may cause some to heave a sigh of relief—another year is in the rearview mirror. However, board members and those who work with boards may be looking toward the horizon and wondering what challenges may arise in the coming year. Some challenges never seem to go away, and new ones seem to pop up all the time. Even challenges presumed to be over and done with can return, sometimes in a different guise or with a new twist. And, regardless of whether a challenge is new or old, the board will be expected to deal with it—even if it is something beyond the board's control or outside the scope of its responsibility—because investors, the media and others will ask "where was the board?"

Center *for* Board Effectiveness

Board composition

Board composition has been on the boardroom agenda for quite a while, but it has become broader and more complex. Boards are expected not only to have an optimal mix of skills and other qualifications, but also be diverse in a variety of ways, including gender, race, and ethnicity, among other things.

Some progress has been made in board diversity, arguably due to institutional investor pressure. Of the 428 new independent directors joining S&P 500 boards in the year ending May 2018, women comprised 40 percent, and minority women comprised nine percent. Women now represent 24 percent of all S&P 500 directors; 87 percent of S&P 500 boards have two or more women directors (vs. 80 percent the prior year); and 10 S&P 500 boards have 50 percent or more women on their boards. On the other hand, the number of minority men (African-American, Hispanic/Latino or Asian) dropped from 14 percent in 2017 to 10 percent in 2018.[1]

Pressure for increased diversity remains strong. A number of major investors' policies, enhanced in 2018, call for voting against nominating/governance committee members of companies with all-male boards, depending upon the level of engagement with the investor or other factors. And proxy advisors have modified their voting policies accordingly.[2]

Arguably one of the most significant developments in board diversity in 2018 came in the form of a California law requiring public companies headquartered in the Golden State to have at least one female board member, with the number of required female directors increasing over time, depending upon the size of the board. It is unclear whether the law will pass constitutional muster, but for the time being, companies headquartered in California are looking into the impact of the law on their boards. And even if it is held unconstitutional, the fact that a major state has legislated mandatory board diversity may have an impact well beyond California's borders.

For these and other reasons, board composition, including improving diversity, will continue to be a leading item on the 2019 boardroom agenda.

The social purpose agenda[3]

In 2019, boards will almost certainly continue to address "social purpose" issues. These issues cover a broad swath of topics, ranging from climate change to sustainability to corporate culture to pay equity and more.

The current wave of interest in corporate social purpose began in 2016, when shareholder proposals on social issues increased to become the second most prevalent type of proposal. During the 2018 proxy season, this type of proposal constituted 43 percent of all proposals submitted.[4] In addition, throughout this period, several "mainstream" investors have communicated their belief that corporations should have a role in our society beyond a monetary return to investors.

However, investor pressure is not the only driver of the focus on corporate social purpose. First, employee activism is on the rise, with several companies experiencing work stoppages or walkouts to protest company policies and/or actions on various issues. Second, several groups are developing standards to evaluate sustainability performance by corporations.[5] Moreover, companies increasingly recognize that embracing social purpose issues provides a strong value proposition in terms of brand differentiation, talent engagement, risk mitigation, operational efficiency, and access to capital.

As a result of these and other factors, it seems almost certain that corporate social purpose will remain on board agendas in 2019.

Regulatory developments

Audit committees and boards are likely to focus on a number of regulatory developments in 2019. First and foremost is the coming change in auditor reports resulting from rules adopted by the Public Company Accounting Oversight Board (PCAOB).[6] Specifically, beginning in 2019, auditor reports for large, accelerated filers (as determined under rules of the Securities and Exchange Commission, or SEC) will have to include a new section addressing "critical audit matters" or "CAMs." As described by the PCAOB, CAMs are "matters

1. Spencer Stuart 2018 Board Index.
2. See https://www.institutionalinvestor.com/article/b1b4fh28ys3mr9/State-Street-to-Turn-Up-the-Heat-on-All-Male-Boards and https://www.issgovernance.com/iss-announces-2019-benchmark-policy-updates/.
3. For additional information on corporate social purpose, see "On the board's agenda: The board's role in corporate social purpose" (June 2018).
4. See "Shareholder Proposal Developments during the 2018 Proxy Season" at https://corpgov.law.harvard.edu/2018/08/02/shareholder-proposal-developments-during-the-2018-proxy-season/.
5. For example, see "SASB Codifies First-Ever Industry-Specific Sustainability Accounting Standards" at http://www.globenewswire.com/news-release/2018/11/07/1646736/0/en/SASB-Codifies-First-Ever-Industry-Specific-Sustainability-Accounting-Standards.html.
6. https://pcaobus.org/News/Releases/Pages/auditors-report-standard-adoption-6-1-17.aspx.

arising from the audit that required especially challenging, subjective, or complex auditor judgment, and how the auditor responded to those matters." The decision to require CAMs reporting generated considerable discussion, and the impact of such reports is unclear; consequently, audit committees and boards will continue to work with their auditors to assess the nature and extent of CAMs reports.

Audit committees and boards will also be focusing on several new accounting standards that take effect in 2019, and the SEC continues to focus on how companies use so-called "non-GAAP" disclosures.

There are many other areas of potential regulatory activity that boards and their committees may evaluate in the coming year—trade regulations and antitrust enforcement are among them. In addition, the SEC has received suggestions from issuers, investors, and others that the system by which proxies are voted is antiquated and inefficient.

Cyber and other risks

Risk is a perennial topic of board focus, and this focus is likely to increase in 2019. The number and nature of the risks overseen by boards and committees have expanded in recent years to reach virtually all aspects of business, such as brand and reputational risk, strategic risk, and a number of risks associated with technology. The latter category includes innovation and disruption, which can significantly impact companies that choose not to innovate, because they may fall behind disruptive competitors, as well as those that seek to transform their businesses, because they may incur significant losses or worse if unsuccessful.

Perhaps the greatest technology-based risk, however, is cyber risk. Cyber attacks have become increasingly sophisticated and costly; annual global cybercrime costs are expected to grow to six trillion dollars (US) by 2021,[7] and the average cost of a data breach is expected to reach $150 million by 2020.[8] There is no reason to believe that the trend towards more complex and costly cyber attacks will subside. Significantly, cyber risk impacts virtually every aspect of a company's business, including critical relationships with customers, suppliers, regulators, and others, as well as ongoing reputational risks. Cyber risks are also impacting board composition, as nominating/governance committees and boards—as well as congress—consider the advisability of having cyber or technology "experts" on the board. And companies are increasingly aware that cyber resilience—how a company rebounds from a cyber attack and its consequences—is a critical component of addressing the risk. For these reasons and due to their evolving nature, the SEC has continued to emphasize the importance of effectively managing cyber risks and appropriately informing investors about cyber risks and cyber incidents. The SEC has indicated that it will focus on disclosures concerning cyber risk, and the board's role in cyber risk oversight.

Many boards are addressing cyber risk the way they address other challenges—through enhanced oversight, questioning assumptions, and advising management to develop more thorough and robust IT governance.

As they head into the new year, boards will likely need to be even more "risk-intelligent" than has been necessary in the past, including through vigorous enterprise risk management (ERM) programs that can help boards and management alike make more informed decisions on innovation and disruption, as well as other risks.

Culture[9]

Culture has taken on new importance in the wake of recent movements and other developments. In the past, some boards have expressed uncertainty as to how to address culture; after all, directors are only infrequently in company offices, and even then, they tend to be cloistered in boardrooms and nearby offices, making it difficult to know what the corporate culture is like.

That uncertainty is giving way to increased levels of board engagement on the subject. This is happening not only to avoid some of the problems that can result from culture risk, but also in recognition of the fact that a strong, positive culture can have an impact on the bottom line. For example, by enabling a company to become an employer of choice and a company with which others will want to do business.

Many boards are also developing and using improved tools and techniques to help assess and oversee corporate culture. They are using employee engagement surveys to perform baseline assessments of the organization's culture and to periodically reassess how that culture changes over time and in response to various events. They are asking management to provide more information on how it monitors employee conduct and behavior, in order to better foresee anomalies and potential threats and also to drive informed, strategic decisions across business lines.

7. Cybersecurity Ventures, "Cybercrime damages $6 trillion by 2021."
8. Juniper Research, "Cybercrime will cost business over $2 trillion by 2019."
9. For additional information on the board's role in addressing corporate culture, see "On the board's agenda: Corporate culture risk and the board" (April 2018).

Directors are also more capable than ever of performing their own due diligence. Where feasible, such as companies that service the general public, they can and increasingly do visit company locations to assess first-hand how employees behave and interact with customers. They can access websites on which employees post their views and opinions about their employers, to determine the nature and extent of dissatisfaction with corporate culture and behaviors. And they are doing occasional "deep dives" using tools that have been in place for years, such as listening to actual recordings of messages left on corporate hotlines, rather than summaries of messages, to assure that the summaries they receive accurately reflect the substance and tone of the messages.

Boards are also taking responsibility for their own culture in and around the boardroom. Do directors treat each other with respect? Do they encourage healthy debate and discussion? When they are not in the boardroom, do they treat employees with courtesy and seek to engage them?

The focus on culture—both inside and outside the boardroom—is likely to continue and grow with the new year.

Compensation

Compensation may well be the longest-standing item on boardroom agendas, and it shows no signs of being eclipsed as perhaps the pre-eminent item on the boardroom agenda. And in 2019, there are a number of compensation issues that may present challenges for directors, such as:

- **CEO pay ratio disclosure.** 2018 was the first year in which companies were required to disclose the ratio of CEO pay to that of a "median" employee. While these disclosures generated some media attention, they did not appear to generate interest from major institutional investors. That may change in 2019 as comparisons to the prior year ratio may generate questions. For example, executive bonuses for 2018 may be higher due to the strong economy, causing pay ratios to rise, while company stock prices may be lower. In addition, some are calling for more disclosure around pay ratios; in November 2018, a group of institutional investors sent a letter to the boards of the Fortune 500 companies asking for supplemental pay ratio data, such as the geographic location and job function of the "median employee" and a breakdown of the workforce by job function and/or business unit.

- **Pay equity.** Investors and other groups are raising questions about gender and ethnicity pay gaps, and there are indications that this is going to be a major topic of shareholder proposals in 2019.

- **Severance pay for "bad actors."** Recent incidents have raised interest in whether companies are paying severance to executives and others who have left due to violations of company policy, including inappropriate behaviors and, where severance has been paid, why.

- **Director compensation.** Director pay, which in the past has generated little attention or interest, has become something of a hot button due to large payouts resulting from rising stock prices. As a result, many boards have been examining their pay packages and considering caps on pay and other devices to minimize concerns.

- **Tax changes.** As a result of changes to Internal Revenue Code Section 162(m), compensation, the ability to deduct compensation paid to "Named Executive Officers," has been significantly limited, even if it is "performance-based." Compensation committees and boards may want to consider changing their compensation plans or metrics to reflect this change.

Wrapping it up

The topics included in this publication are just some of the items that will likely be on the boardroom agenda for 2019. Other perennial agenda items are sure to be on agendas as well and, given the rapidly changing governance and political environment, it is likely that new matters will come to the fore. In other words, serving on a board of directors will continue to be a challenging role in 2019.

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