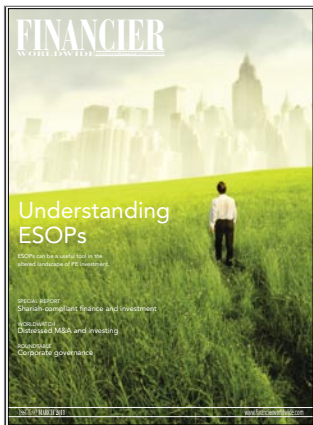


ROUNDTABLE

---

CORPORATE GOVERNANCE



REPRINTED FROM:  
MARCH 2011 ISSUE

© 2011 Financier Worldwide Limited.  
Permission to use this reprint has been granted by the publisher.

[www.financierworldwide.com](http://www.financierworldwide.com)

# C O R P O R A T E   G O V E R N A N C E

---

# R O U N D T A B L E

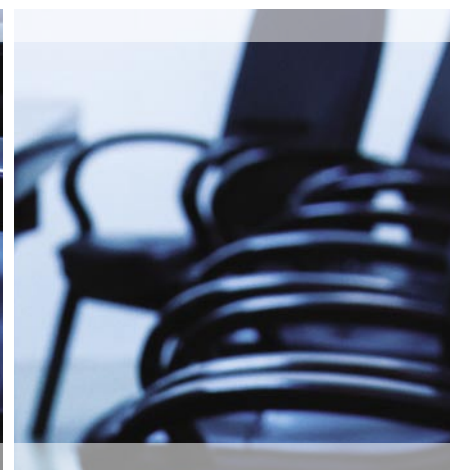
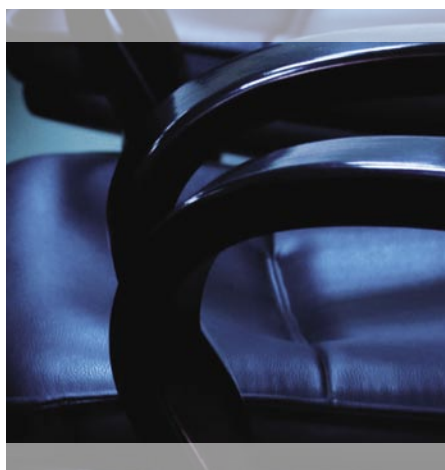
---



## C O R P O R A T E   G O V E R N A N C E

---

Corporate boards are subject to ever-increasing scrutiny, and the fallout from the financial crisis has taken transparency and disclosure to even higher levels. Regulatory developments continue to shape governance practices. Shareholders are intent on exerting greater influence and making their voices heard. It is not enough for companies to merely comply with legal requirements and formal codes, so how can boards meet the pressures and demands of today's business environment and continue to operate effectively? ►►



## THE MODERATOR



**Alexandra R. Lajoux**  
Chief Knowledge Officer, NACD  
T: +1 (202) 280 2185  
E: [arlajoux@nacdonline.org](mailto:arlajoux@nacdonline.org)  
[www.nacdonline.org](http://www.nacdonline.org)

Alexandra Reed Lajoux is chief knowledge officer at the National Association of Corporate Directors. She has three decades of experience in business information. Widely published and quoted in professional publications, Ms Lajoux has authored or co-authored five books on mergers and acquisitions for McGraw-Hill, and one book on valuation for Bloomberg. She has served on several non-profit and advisory boards.

## THE PANELLISTS



**Timothy Copnell**  
Associate Partner, KPMG LLP  
T: +1 (202) 731 1000  
E: [tim.copnell@kpmg.co.uk](mailto:tim.copnell@kpmg.co.uk)  
[www.kpmg.co.uk](http://www.kpmg.co.uk)

Timothy Copnell is an associate partner at KPMG LLP. He joined KPMG's Department of Professional Practice in 1993 where he took responsibility for corporate governance matters and KPMG's non-executive program. His role includes advising on private sector corporate governance and responding to major UK corporate governance developments. In 2003, Mr Copnell created the UK Audit Committee Institute (ACI) to communicate with audit committee members and help enhance their awareness, commitment, and ability to implement effective audit committee processes.



**Thomas Ball**  
Senior Managing Director, Morrow & Co., LLC  
T: +1 (203) 658 9400  
E: [tomball@morrowco.com](mailto:tomball@morrowco.com)  
[www.morrowco.com](http://www.morrowco.com)

Thomas Ball is a senior managing director with Morrow & Co, LLC, head of the Proxy Solicitation Group at Morrow & Co., and co-head of the Special Situations Group. He has 30 years of experience in the proxy solicitation business, with extensive experience in corporate control transactions and corporate governance. Mr Ball has provided strategic counsel and directed many high-profile hostile fights, both defending corporate clients and forwarding the objectives of dissident groups.



**Lucinda McConathy**  
Partner, Richards Kibbe & Orbe LLP  
T: +1 (202) 261 2992  
E: [lmconathy@rkollp.com](mailto:lmconathy@rkollp.com)  
[www.rkollp.com](http://www.rkollp.com)

Lucinda McConathy is a partner at Richards Kibbe & Orbe LLP. She joined the firm in 1998, after having served for 10 years as a senior appellate lawyer for the SEC. While at the SEC, Ms McConathy was responsible for developing and advocating the Commission's positions on a broad range of securities law, accounting, arbitration and administrative law issues. Her practice focuses on securities litigation, regulatory investigations and counselling.



**Deborah Hicks Midanek (Bailey)**  
President, Solon Group Inc.  
T: +1 (917) 853 3598  
E: [DHMidanek@SolonGroup.com](mailto:DHMidanek@SolonGroup.com)  
[www.SolonGroup.com](http://www.SolonGroup.com)

Deborah Midanek counsels imperilled companies and their constituents and has led various businesses through strategic, operating and financial challenges. She enjoys a reputation for thinking creatively, and contributing to realising unusually strong results. Ms Midanek holds an MBA from Wharton and an AB from Bryn Mawr College.



**Holly J. Gregory**  
Partner, Weil Gotshal & Manges LLP  
T: +1 (212) 310 8038  
E: [holly.gregory@weil.com](mailto:holly.gregory@weil.com)  
[www.weil.com](http://www.weil.com)

Holly J. Gregory is a partner in the international law firm of Weil Gotshal & Manges LLP where she counsels companies and boards of directors on the full range of governance issues, including fiduciary duties, risk oversight, conflicts of interest, board and committee structure, board leadership structure, audit committee investigations, board audits and self-evaluation processes, shareholder initiatives, proxy contests, relationships with shareholders and proxy advisory firms.

**Lajoux:** How important is it for today's boards to demonstrate good governance? To what extent does this require bespoke governance procedures communicated to all employees across multiple jurisdictions?

**Ball:** The best way to demonstrate good corporate governance is to practice good corporate governance, and today that can be very important for companies facing an increasingly volatile environment of shareholder activism, new regulation and disclosure, and challenging markets. That said, each company is different and what is good for one company may not be good for another. We continue to advise boards that they should not make governance changes because they are deemed to be good governance by institutional activists or proxy advisory firms, rather they should do what is right for their particular company and shareholders. Additionally, boards and senior management need to make a concerted effort to know their investors, communicate with them to understand their views and concerns, and to maintain an open line of communication. Part of good governance is good communication.

**Copnell:** Whatever the role of corporate governance in the recent financial crisis, there has not been a systemic failure of any one corporate governance system. No single governance model has emerged as being better or more capable of dealing with the issues leading to the crisis than the others. What we have seen, however, is the marked difference in behaviours employed by different companies. This should come as no surprise as good governance has always relied on people behaving appropriately. Simply complying with rigid legal requirements and formal codes of best practice is not enough. Organisations need to consider how they behave in practice and what is appropriate in the particular circumstances of the company – and by definition, this requires bespoke governance procedures.

**McConathy:** For US public companies, Dodd-Frank has focused a spotlight on corporate governance and given investors and regulators more tools to monitor, influence, and challenge practices perceived to be inadequate. Boards have a much greater burden to explain what they are doing and why. Although activist institutional investors and others are pressing for implementation of what they believe to be best practices, one size does not fit all. Each board must address governance and other issues in light of its own particular company culture, organisation, resources, shareholder base, industry and markets. Implementation and compliance issues are even more challenging for companies operating in multiple parts of the globe. What works in one place cannot be expected necessarily to work in another. There is no shortcut. Boards should carefully evaluate their current governance practices in light of the new regulatory regime. These efforts can benefit and strengthen the company.

**Midanek:** It is very important for boards to demonstrate good governance. The art required of directors mindful of this lies in interpreting individually the meaning of good governance, and then being able to translate that definition into group behaviour and processes that achieve the goal of good governance. Though it is helpful to provide clear descriptions of governance policies that can easily be understood by all employees of the enterprise, they will not be effective unless the board as a group is seriously engaged in a constant effort to define and refine its own definitions of good governance.

**Gregory:** Boards of directors of public companies are subject to

## Organisations need to consider how they behave in practice and what is appropriate in the particular circumstances of the company – and by definition, this requires bespoke governance procedures.

TIMOTHY COPNELL

ever-increasing scrutiny from shareholders, regulators and the media. However, the effectiveness of a board in providing oversight and guidance, in other words, the quality of board decisions or good governance, can usually only be judged over a span of time. Efforts by a board to communicate its governance approach – for example, through the adoption of recognised governance practices – may reassure observers that the board understands its role in holding management accountable. But these efforts should not be confused with a demonstration of good governance. And given the unique nature of each company, care should be given to tailor governance practices to the specific needs of the entity rather than following a specific formula.

**Lajoux:** What major legal and regulatory developments are shaping corporate governance practices? Is there a trend towards enhanced transparency and disclosure?

**Copnell:** There is certainly a trend towards transparency and disclosure, but in no way is this a substitute for getting the behavioural aspects of governance right. It wasn't too long ago that some companies now synonymous with 'poor governance' were winning awards for good governance reporting. In the UK, the focus is on the role of audit and the audit committee; and the Financial Reporting Council (FRC) have recently released proposals aimed to increase transparency with respect to how audit committees discharge their responsibilities. Bland boilerplate reporting is no longer acceptable. Audit committees should be reporting on the key areas of sensitivity or risk; matters of material significance identified by the auditors; the steps taken to assess the effectiveness of the audit; the policies adopted in relation to the provision of non-audit services; the process by which the committee reached their recommendation to appoint the external auditors; and the nature of any 'audit related' dialogue with investors.

**McConathy:** Dodd-Frank seeks to increase transparency, accountability, and meaningful oversight of corporate management in a number of ways, including: enhancing shareholders' ability to become involved in executive compensation issues and to oust directors who are not responsive to shareholder concerns; ensuring that the directors and consultants involved in making decisions about executive compensation are independent and are themselves subject to scrutiny; improving disclosures regarding executive compensation with the aim of making it more transparent whether and how incentive compensation is linked to performance; and imposing a consequence for erroneously inflated performance in the form of a claw-back from company officers of ►

excess compensation founded on a mistake. While it is too soon to know all the different ways Dodd-Frank and the implementing rules may affect corporate governance practices, we have already seen substantial efforts by boards to expand disclosures relating to executive compensation practices.

**Midanek:** Generally, it seems that greater disclosure with respect to executive compensation, and greater shareholder participation in setting it, is occurring. Continuing focus on audit committee performance and on accounting standards themselves is also occurring. Greater focus via changing proxy rules on board composition is occurring, and as a result of a number of factors, greater focus on director education and professionalism is occurring as a result of the changing legal environment. All of these are good, healthy changes, and appropriately improve the accountability of boards of directors.

**Gregory:** As the fog lifts from months of wide-ranging debate over reform proposals in the US, it is now clear that the Dodd-Frank Act, along with related SEC and listing rules that must be adopted to fully implement the legislation, will accelerate a fundamental change in the balance of governance power. Taken together, the corporate governance provisions of the Dodd-Frank Act will give shareholders of US publicly-traded companies, and their advisers, a significantly greater voice in corporate affairs, while also expanding the disclosure obligations on public companies.

**Ball:** One major development, of course, is the Dodd-Frank Act. The Act mandates that for shareholder meetings in 2011 and beyond, public US companies, except for smaller reporting companies – those with less than \$75m public float – submit two non-binding proposals: a management say on pay proposal and a say on frequency proposal giving shareholders a choice of whether they prefer a say on pay vote every one, two, or three years. This has resulted in an increase in both required disclosure that relates to the mandated proposals and enhanced disclosure on compensation practices and policies. In an effort to gain shareholder support for say on pay and say on frequency proposals, many companies are enhancing their disclosure in the CD&A section to tell their story on executive compensation; going beyond the numbers to explain the ‘whys’ of their compensation policies. Companies are taking the opportunity to outline their operational and economic successes to help show the alignment between pay and performance.

**Lajoux:** Is it fair to say that shareholders are enjoying great-

**Directors are charged with overseeing the management of the business and representing shareholders’ long-term interests. They must listen to shareholders but, ultimately, they still must exercise their own independent judgment.**

LUCINDA MCCONATHY

**er access to boards and exerting more influence over them? What are the practical implications of this shift and how should boards respond?**

**McConathy:** If the early results of the proxy season are any indication, shareholders are exerting more influence over at least some board decisions. Where shareholders have rejected proposed triennial say on pay votes and sought annual votes instead, some boards have agreed to the annual vote and other boards watching the early returns have changed their recommendation from a triennial vote to an annual vote. But on more substantive and complex issues, the degree and character of shareholder influence is uncertain. Corporations are not pure democracies run by shareholders. The directors are charged with overseeing the management of the business and representing shareholders’ long-term interests. They must listen to shareholders but, ultimately, they still must exercise their own independent judgment. Dodd-Frank does not change these principles, but it does impose obligations on boards to increase the level of transparency.

**Midanek:** I believe that the importance of serving shareholder interests is being heavily emphasised, as in, for example, the say on pay and proxy voting initiatives. I think it is still hard, though, for boards to be able to interact with shareholders effectively. For one thing, shareholders are free to come and go, while the board is the perpetual guardian of the enterprise, charged with taking a longer term view than many shareholders can see. For another, the views of all shareholders at any given point may differ widely, and the board needs to determine the course for the company that is most likely to benefit all of them. For another, some sophisticated shareholders, fiduciaries themselves and determined to earn a profit for their own constituents, have the ability to invest throughout the capital structure in positions both long and short. These efforts to earn a profit may have nothing to do with the greater good of the corporation and its shareholders in general. All of that said, however, there is to my mind a design flaw in the way most investor relations functions are set up. All communications to and from shareholders are generally run through the CEO’s office. The board members rarely have direct information about what is on the minds of those whose interests they are charged with representing, except at the annual meeting.

**Gregory:** Institutional shareholder influence and board access have increased significantly over the past decade, for a host of reasons. Certain provisions of the Dodd-Frank Act and related SEC rules are likely to strengthen institutional shareholder power through provisions that lower the cost of contests for board seats and provide for a shareholder advisory vote on executive compensation. These changes will play out in an environment of ever increasing disclosures about a wide range of governance matters and ever more rigid views from activist investors and their proxy advisers on what constitutes good governance practices. In this environment, boards will need to spend more time and resources on communicating with shareholders both to understand shareholder viewpoints on matters like board composition and executive compensation and to attempt to communicate the board’s view of the company and approach to governance to maintain shareholder support.

**Ball:** I think there is actually another dynamic here, which is boards seeking more access to shareholders. Corporate governance and communications with shareholders should no longer be confined to the two months before the annual meeting. We are ►►

encouraging our clients to view corporate governance as a year-round process. Maintaining an ongoing dialogue with your shareholders is part of good governance. Our clients have found that having an open line of communication with their larger investors can be of critical importance when a company faces activism or a difficult shareholder vote. As a result, we are seeing more issuers seeking access to their investors. And we are advising clients that, at certain institutions, they should seek out not only the portfolio manager or analyst, but also the individuals responsible for corporate governance and proxy voting. Both sides of the house should be involved.

**Copnell:** The FRC should be congratulated on publishing the Stewardship Code in an attempt to enhance the quality of engagement between institutional investors and companies. The UK has also seen the publication of the new UK Corporate Governance Code which calls for the annual re-election of all directors. This provides a further means for shareholders to demonstrate their strength of feeling on any number of issues; however, it is important that this does not drive short-term thinking. If I do have a worry in this area it is that governments and regulators appear more concerned than investors themselves. Investors should hold boards to account – and it is right that they have the means to do that – but they should also let executives get on with the job of running businesses on their behalf.

**Lajoux:** **The debate over executive compensation has intensified in recent years. What changes are you seeing in pay structures and the decision-making process that surrounds them, such as say on pay?**

**Midanek:** There is a healthy and much needed focus on making pay structures rational and defensible. Though the CEO's job has never been harder, and the capable people willing to do the job deserve handsome rewards if the companies they lead prosper, the notion that one man deserves many multiples of the compensation paid to other executives seems absurd. The CEO is like a turtle on top of a fence post: he did not get there alone.

**Gregory:** Under the say on pay provisions of the Dodd-Frank Act and related rules from the SEC, companies must now conduct a shareholder 'advisory vote' on executive compensation. In light of this, shareholders are likely to review compensation disclosures in a greater level of detail than in the past. Given the complexity of compensation, institutional shareholders will likely rely to a greater degree on proxy advisers such as Institutional Shareholder Services Inc. (ISS). Boards should consider what aspects of compensation are likely to cause shareholders concerns in a say on pay vote and either prepare to communicate about the board's rationale more effectively or adjust where necessary. Companies should anticipate considerable shareholder scrutiny of compensation committee decisions and independence, committee adviser independence and the pay-performance link (especially for CEOs). For executive compensation decisions to pass muster with shareholders and their advisers, companies should ensure that compensation programs, as well as the rationale behind executive compensation decisions, are transparent and easily understood. This may call for simplifying overly complex and esoteric arrangements. The shareholder advisory vote is also likely to increase the trend to linking a significant portion of incentive compensation to longer term performance metrics.

**Ball:** From our perspective as an adviser to companies on proxy

## Companies should anticipate considerable shareholder scrutiny of compensation committee decisions and independence, committee adviser independence and the pay-performance link (especially for CEOs).

HOLLY J. GREGORY

solicitation and voting, we are seeing changes to compensation practices in an effort to obtain better voting results, as well as to reduce our clients' vulnerability to shareholder activism and/or negative recommendations from institutional proxy analysis firms – ISS and Glass Lewis – or institutions. For example, we have been advising clients to clean up poor pay practices such as tax gross-ups, perquisites, and single-trigger change-in-control provisions that may result in withhold recommendations on board members – especially members of the compensation committee who are particularly vulnerable – or against recommendations on compensation plans or say on pay. In addition, for clients seeking shareholder approval of compensation plans, we are seeing a reassessment of the mix of awards to deal with issues such as dilution and burn-rate that could result in a plan failing to meet the guidelines of ISS, Glass Lewis, or institutions.

**Copnell:** In the past, there has perhaps been a tendency to make remuneration decisions based largely on market practice with not enough emphasis on a company's own particular circumstances. Shareholders must take some responsibility for this, as they have tended to outline their preferred approach and there has been a degree of unwillingness to accept arrangements which are different. By contrast, there is now a danger that, although there may be less reliance on market data, regulatory and compliance issues will drive the discussion, and this is not a desirable position either. Nevertheless, raising basic salaries simply because the market has gone up is becoming increasingly unacceptable and after a period of increasing annual bonus maximums, there is pressure on target setting and calls from shareholders for greater disclosure to explain payments which don't appear to reflect corporate performance. Long-term incentive plans also need looking at as many are seen as ineffective in terms of motivation and driving achievement of the company's strategy.

**McConathy:** It became apparent early in this year's proxy season that activist shareholders are taking full advantage of the say on pay and say on frequency votes. Beginning with Monsanto, shareholders have generally rejected company recommendations for a triennial vote on pay. Although such a shareholder vote is non-binding, in practical terms it is hard to ignore. Monsanto's board responded by issuing a press release acquiescing to an annual say on pay vote. In say on pay votes so far, shareholders have also turned thumbs down on executive compensation in surprising numbers, even if in most cases the majority supported the compensation package. This may have been partly the product of shareholders flexing their new-found power. But it also demon- ►

strates the importance of shareholder communications and thorough analysis of how compensation is linked to performance and is designed to give management the right incentives.

**Lajoux: Are companies paying more attention to the composition and structure of their boards? Is this based on a desire to build a culture of independence and accountability at the highest level?**

**Gregory:** The need to keep board composition relevant to fast moving businesses, together with new disclosure requirements, increased interest in diversity, the potential for proxy access and the enhanced scrutiny on boards generally, are causing boards to review director skill sets and the board's structure – including leadership structure.

**Ball:** There is no question that companies are paying more attention to the structure and composition of their boards. We have witnessed a number of such situations, particularly when a company is facing the potential for activism or a hostile proxy situation – a vote-no campaign or proxy fight. In these cases, the board is doing an assessment to make sure they are best positioned in the event of a proxy fight to show that new, dissident directors are not needed. In these cases, one of the first things the board should assess is the mix of skill sets on the board to see if there are any areas where there may be a questionable or missing skill set that makes the company vulnerable to attack. We also think the board must be able to demonstrate that the board is an active and engaged board that allows for healthy debate and is not beholden to the CEO.

**Copnell:** Getting the right mix of skills, experience and personal characteristics in the boardroom is hugely important. Many companies are starting to think about this in terms of a 'board effectiveness cycle'. First, the board members are recruited to fulfil identified skill and experience criteria based on the board's current and future direction. Appropriate induction must take place followed by professional development tailored to each director's needs. Good board practices and procedures are also required. The final part of the cycle is board evaluation – ideally focused on how the board creates value and what it can do better.

**McConathy:** It has become increasingly important to explain how a particular person is going to add value to your board in order to give investors confidence in the board. There is also a desire by

**There is no question that companies are paying more attention to the structure and composition of their boards. We have witnessed a number of such situations, particularly when a company is facing the potential for activism or a hostile proxy situation.**

THOMAS BALL

board members to share the increasing weight of responsibility with people who can be depended upon to be energetic and proactive, people who will spot and probe difficult issues and offer constructive solutions. It is in the interest of everyone involved to make certain that their board has the commitment, expertise, experience and sophistication to deal with the types of complex issues most pertinent to that board's company.

**Midanek:** There is greater emphasis on understanding the skill mix the board needs to do its job, and in looking carefully at various ways of filling gaps in skill. Though still dominated by the CEO in most cases, the nomination process is becoming much more deliberate.

**Lajoux: As part of their commitment to fulfilling oversight responsibilities, to what extent are boards drawing support from audit committees, compensation committees and finance committees? Are such mechanisms now a key element of the governance and internal control process?**

**Ball:** New regulations and disclosure requirements have put even more pressure on boards and committees. For example, many boards will be relying on the compensation committee to provide recommendations that pertain to the results of voting on the say on pay proposal at 2011 annual meetings. The Dodd-Frank Act requires issuers to disclose in the CD&A section of their proxy statement whether compensation policies and decisions have taken into account the results of the last say on pay vote, and if so, how. Thus, issuers will have additional disclosure in 2012 regarding the 2011 vote. Therefore, even moderate opposition to the say on pay proposal in 2011 could put the compensation committee in the uncomfortable position of having to recommend to the board the disclosure in next year's CD&A on how this vote factored into their compensation policies and/or practices.

**Copnell:** Audit, remuneration and nomination committees are now an established part of what is perceived to be a good governance framework. However, establishing such committees by itself does not guarantee good governance and more attention has to be paid to how such committees discharge their duties – the behavioural aspects of governance – rather than simply establishing 'correctly' constituted committees with sound charters. Risk committees are a good example of this misplaced emphasis on governance structures. Many of the failed UK banks had risk committees, but it was those very same committees that were criticised by the UK government for failing to provide an effective restraining force on the strategy of the executive directors. It's what the committees do and how they do it that makes the difference.

**McConathy:** There is an increasing emphasis on filling board positions with persons with suitable expertise. It may be expertise in the industry or in a particular function such as risk management or in governance matters themselves. Boards are trying to leverage that expertise as one way of dealing with the escalating numbers and complexity of the issues they confront.

**Midanek:** Audit committees have for a long time had a major role in board proceedings, and their increasing professionalism and independent authority are vital ingredients to improving governance. I would say that compensation committees have a more clear-cut sense of their responsibilities and may therefore have an easier time fulfilling them effectively, though measuring executive performance and developing compensation packages with appro- ►►

appropriate incentives will always be a delicate and difficult process. Finance committees are not yet broadly included in the key roster of committees; nominating and corporate governance committees have, though, gone from being the least powerful of the three key committees to being in many cases recognised as critically important and powerful committees. The Enterprise Risk Management Committee is also coming into its own as a critically important function that must be thoughtfully developed in response to each company's specific risk profile.

**Gregory:** In the US, due to listing rules that went into effect around the time of the Sarbanes-Oxley Act, audit committees, compensation committees and nominating/corporate governance committees are now commonplace. Boards rely on these committees to organise the work of the board in an efficient manner, and through the audit committee to ensure that significant attention is given to the oversight of internal controls. The Dodd-Frank Act includes a number of new provisions relating to compensation committees.

**Lajoux:** There seems to be an increasing awareness that good governance intersects with sound risk management, including the ability to respond swiftly and successfully to crisis situations. What is your advice to companies on establishing a combined governance, risk and compliance framework throughout their organisation?

**Copnell:** First and foremost is the need for a clear vision and a common culture oriented toward good governance and risk management. To do this, every organisation has to clarify its own unique risk appetite by asking: "What level of risk do we want to take in pursuit of our objectives?" The credit crisis showed what happens when organisations fail to define and control such an appetite. Of perhaps equal importance are universal standards of behaviour, or "how we do things around here". These should reflect the organisation's fundamental brand values and turn every employee into a brand ambassador.

**McConathy:** Compliance and risk management functions should not be silos. Management leading these functions should be communicating frequently, regularly, and substantively with each other, with other senior officers of the company, and with the appropriate board committees. They should operate with a shared vision of how their work supports the company's business goals and strategies. The degree to which governance, risk and compliance processes can and should be integrated, and the framework for doing that, will vary from company to company. The board should carefully consider, in light of the particular circumstances, whether integration can streamline the operation of these functions and increase their effectiveness in preventing problems, as well as facilitate more prompt remedial action when issues do arise.

**Midanek:** Risk management is indeed getting a lot of attention, but can only be effective where there is sound thought given to risk recognition. Too often risk management is focused on protecting against yesterday's risk, and not thinking about what could represent new categories of risk for which the company needs to be prepared. I believe that periodically risk management committees must address the full board with broad scope presentations on risk in all its forms so that the board can determine which risks it chooses to run, and identify those it desires to mitigate. Risk management is everyone's business, in every company. As to cri-

## Too often risk management is focused on protecting against yesterday's risk, and not thinking about what could represent new categories of risk for which the company needs to be prepared.

DEBORAH HICKS MIDANEK (BAILEY)

sis management, there are simple devices each board should put in place. In the event of a crisis, who needs to be informed, who needs to confer, who needs to speak to the public, the stakeholders, and the employees? Preparation of this kind is easy to do but still rarely done.

**Gregory:** The economic crisis generated considerable interest in the role of the board of directors in corporate efforts to manage risk. Unfortunately, confusion about the board's role – or more aptly its multiple roles – with respect to risk abounds. Lack of clarity and unrealistic expectations about the board's role may complicate what is already a challenging board task in an environment of expanding shareholder tensions and ever increasing business complexity, accelerating product cycles, technological change and globalisation. Boards should focus on three key responsibilities. First, understanding the impact of risk on strategic aspects of operations and determining the level of risk that is appropriate in the risk/reward calculus. Second, providing oversight of the processes management has been put in place to identify and manage risk, assessing and monitoring management's performance and culture; and emphasising and reviewing disclosure controls and procedures to ensure timely and accurate disclosures, as well as effective internal controls, compliance and ethics systems generally. And third, managing certain risks related to governance, management succession and delegation and executive compensation that only the board is positioned to manage, including by ensuring that risk oversight is on the board's agenda, as a matter of substance and process.

**Ball:** Good governance should be viewed as a year-round process. It should also involve multiple departments and individuals within the company. Depending on the particulars of each company, the departments involved may include legal, corporate secretary, investor relations, human resources, and, of course, the board. Having an interdisciplinary approach will allow a company to respond to a governance crisis on multiple levels at the same time. For example, someone from the legal or corporate secretary's office could reach out to their contact in the corporate governance area at an institution, while at the same time, someone from IR could reach out to the portfolio manager or analyst. This presupposes, of course, that the company has been cultivating relationships with a good communications program.

**Lajoux:** Fraud and corruption present a serious threat to any business. What regulatory trends have you seen in this area, such as changes to whistleblower provisions and increased en- ➤

**forcement and monitoring actions undertaken by government authorities? How are companies reacting?**

**McConathy:** Dodd-Frank creates strong incentives to find and root out what might seem to be small problems before they become large problems. First, the Dodd-Frank whistleblower bounty program increases the potential for disruptive allegations of securities law violations – including anti-bribery laws – if a problem has festered to the point that the potential bounty is significant and makes whistleblowing attractive. Since the passage of Dodd-Frank, the SEC has reported a large increase in high-quality tips, which could translate into more investigations and enforcement actions. Dodd-Frank also provides whistleblowers a right to sue for retaliation, adding to the potential cost of a failure to deal early and appropriately with problems. Second, Dodd-Frank requires public companies to adopt policies allowing for the potential claw-back of executive compensation where the company has to issue a financial restatement, even where a corporate officer has done nothing wrong. This gives corporate officers a personal stake in effective corporate governance and oversight to prevent problems.

**Gregory:** Three converging trends – heightened enforcement of the Foreign Corrupt Practice Act of 1977 as amended (FCPA), new Dodd-Frank Act whistleblower bounties and recent amendments to the Federal Sentencing Guidelines – are focusing attention on corporate compliance programs. Enforcement of the FCPA continues to be a priority for the Department of Justice (DOJ) and SEC, with increasing enforcement focus on imposing personal liability for FCPA compliance failures. In addition, the SEC has recently proposed a new bounty program to implement changes introduced by the Dodd-Frank Act. The changes increase the level of bounty reward payments that may be made to whistleblowers for information leading to successful enforcement actions. Companies should brace themselves for more whistleblowing and retaliation claims. At the same time, companies should also consider how to strengthen their compliance systems and controls, especially given the likely negative impact that the SEC’s bounty program will have on the company’s own internal reporting mechanisms.

**Midanek:** The greater transparency and clarity of board processes referenced above should make fraud detection somewhat easier, and whistleblower rules should be useful. It should be possible to limit or eliminate corruption. The problem with fraud, however, is that it is intentionally designed to get around the rules. No amount of greater enforcement of those rules will preclude it, especially in a world in which technology that is not easily understood by the board or the regulators plays an increasingly important role. The way to protect against fraud is to be highly mindful of its possibility in every situation.

**Copnell:** The new UK Bribery Act is potentially one of the most draconian laws of its kind. A commercial organisation is now liable for the activities of associated third parties as well as those of its own staff, and corporate ignorance offers no protection from prosecution. The only defence is that it “had in place adequate procedures designed to prevent a person associated with it from undertaking such conduct”. Corrupt practices can only be prevented by firms with a high level of self-knowledge and transparency.

**Lajoux:** In your opinion, how can boards ensure that they operate effectively as true fiduciaries in light of all the pres-

**ures and demands placed upon them in the modern business environment?**

**Gregory:** The hallmark of a fiduciary is informed judgment in the best interest of the company. This requires access to relevant information and reliance on management and advisers based on judgments about whether that reliance is justified. It also requires that directors form their own judgments about the issues facing the board. Under state corporate law, directors do not fulfil their obligations if they simply defer to the wishes of shareholders about the matters that corporate law reserves to board decision. In the face of the increasing access and influence of large institutional shareholders, directors will at times need to take decisions that are in the best interests of the company even though unpopular with certain shareholders and/or proxy advisers. This will require a certain courage – including a willingness to do what is in the interests of the company even if it may mean that re-election will be challenged.

**Ball:** In my opinion, boards maintain their operational effectiveness by staying focused on what is best for the company and the shareholders. Additionally, it’s important that boards stay current on trends in corporate governance, but don’t fall prey to chasing the latest in ‘good’ corporate governance. Governance is important, but it should not be a goal in and of itself.

**Copnell:** The purpose of the board is to create value more effectively over time than the executive of the company could do on its own. It is the interaction between the executive and the non-executive directors, with their different experience and knowledge bases, which should create a better stream of value and understanding of risk for the benefit of investors and all stakeholders. One of the tools that can help boards by facilitating more effective strategic engagement between executive directors and non-executive directors is the board mandate. The value of a mandate derives from the deep and comprehensive thinking by the board. Its primary purpose is its use as a framework against which the current condition of the business and its capacity to develop can be assessed. In effect, a mandate informs and grounds all boardroom conversations, communications, strategic choices, operational and execution processes and systems and people development.

**Midanek:** There are many complex demands on fiduciaries, and often competing priorities, conflicting rules, loud voices demanding disproportionate attention, and many issues to handle that relate to helping the business they steward to earn sustainable profits. It is easy to be intimidated by the complexity, and also easy to hide behind it and not do the job. One critical aspect of the board’s ability to be effective is its ability to work effectively as a group, speaking openly about concerns and not worrying too much about what one veteran director has called dysfunctional politeness. Each board member must participate, be informed, and speak up to be sure that all points of view are considered and all questions explored and answered.

**McConathy:** Informed judgment is the keystone. Make sure that you have the information that you need and that you understand it. Prioritise and make sure that you focus on what is important. Engage in candid self-assessment and address deficiencies. Set and control your agenda appropriately. While you must take into account the complex and rapidly changing dynamics of the current business environment, keep your focus on your own company’s particular goals, strategies and issues, and how your company can best achieve long-term value for investors. ■