THE CONFERENCE BOARD

Just What Is the Corporate Director's Job?

HIGHLIGHTS OF PERSPECTIVES ON THE BOARD MEMBER'S JOB DESCRIPTION

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Executive Summary

> "We need to have a serious discussion on what exactly directors are supposed to be doing and come to some kind of common understanding. We're spending all of this time debating who should have the right to appoint people to the board when we can't even agree on what the job description is!"
>
> **Douglas Chia**, executive director of The Conference Board Governance Center.

To Chia's point, the fact is that the role of the corporate director has been evolving for some time. Over the past 65 years, we have seen structural changes in our capital markets—most dramatically, a shift in the ownership of public companies from individual retail shareholders to institutional investors that has influenced what is expected of boards.

Major corporate crises and the reforms in their aftermath have also changed what is expected of boards. Accounting scandals at Enron and WorldCom and extreme lack of controls and procedures at Tyco in the early 2000s led to the Sarbanes-Oxley Act. Risky and overleveraged investment schemes in the mid-to-late 2000s at Lehman Brothers, Bear Stearns, AIG, and the mortgage banking industry resulted in the Dodd-Frank Act. And during each crisis, the questions from investors and governance experts were the same: "Where was the board?" and "What did they know, and when did they know it?"

As part of a key business initiative project, The Conference Board Governance Center is holding roundtables with different corporate stakeholders to define the job description and expectations of the role of the public company director in today's environment. Those stakeholders include proxy advisors, directors, active and passive investors, hedge funds, academia, the Delaware bench and bar, the media, corporate secretaries, auditors, and regulators. Following each roundtable, The Conference Board Governance Center has published a report of the discussion.

Proxy advisors

(published June 2017)

Proxy advisors agreed that a company's engagement with shareholders is now trending toward more in-person meetings that include board members Until recently, shareholder engagement typically only happened around proxy voting, proxy fights, and shareholder lawsuits. Now, companies and investors are communicating about a whole litany of strategy, ESG, and governance-related topics, and more board members are becoming directly involved.

Proxy advisors are concerned by the trends of a lower refreshment rate, higher director age, and predominance of white males on public company boards The average director tenure on S&P 500 boards in 2016 was seven years for white male directors versus six years for minorities and five years for women; the average age for those same boards in 2016 was 62.8 for white males, 60.8 for minorities, and 60.2 for females. Some are worried that boards lack the composition of younger and more global directors that their companies will need to be competitive in a more technological and international marketplace. While the board refreshment rate at S&P 500 companies has increased over the past eight years, it has taken a new direction over the past year as the number of companies with zero new nominees rose 3 percentage points and the rate of companies with 10 percent refreshment fell more than 3 percentage points.

This roundtable took place on March 1, 2017, in Washington, DC, and featured the following proxy advisors: Institutional Shareholder Services (ISS), Glass Lewis, Egan-Jones Proxy Services, MSCI, and Segal Marco Advisors. It was held under the Chatham House Rule.

Directors

(published August 2017)

Directors need to communicate to each other and management about complex issues on a regular basis to be effective They also need the skills necessary to compromise and gain consensus on important issues like executive compensation, capital allocation, and shareholder engagement.

CEO succession planning is one of the corporate board's most important jobs Essentially, our director panelists agreed that there has to be a regular process the board and management stick to over several years, and that it needs to go beyond just the CEO.

Boards can stand to develop a gap analysis of what skills directors have and what skills they need One director explained the reason for a third-party evaluation: "The skills of board members from 15 years ago may not be what the board needs now."

Board diversity should not be considered a separate goal, but rather it should be part of the regular talent search At least two directors we spoke to agreed that the best way to address the issue of having a low number of women and minorities on a board is to consider a larger talent pool of director nominees that doesn't have to always include CEOs.

This roundtable, which was part of the Committee for Economic Development (CED) 2017 Spring Policy Conference, included three independent directors who participated in a corporate governance panel discussion on April 20, 2017, in Washington, DC. It was held under the Chatham House Rule. Additionally, we separately interviewed two other independent directors.

Active investors

(published September 2017)

Attorneys, general counsels, and investors at the active investor roundtable agreed that board oversight is guided by specific long-term strategic planning and risk management processes and plans Those plans relate to CEO succession, capital allocation, mergers and acquisitions, and crisis management. They aid boards in making important decisions on executive changes, merger agreements, shareholder activism, major internal wrongdoing, and widespread product and/or operational disasters.

Authority-based decision making is the primary method used by corporate boards That is because a consensus-based model is rife with problems caused by diffuse share ownership, different interests of shareholders, and their varying levels of knowledge about the company. Authority-based decision-making structures are characterized by the existence of a central decision maker to whom all firm employees ultimately report, while consensus-based structures are designed to allow all of a firm's stakeholders to participate in decision making.

During a crisis, management will actively lobby large investors to stave off any replacement of directors in upcoming elections Investors get a lot more of those calls now than in the past. The initial reaction to a crisis is that a board sees the crisis as a public relations problem. They ask management to walk them through the details of the crisis before a shareholder vote on directors is taken.

Today, shareholder proxy proposals lead to the most engagement between directors and shareholders because they serve as a powerful tool for shareholders to effect changes, especially in the area of corporate governance However, some corporate boards have begun to realize how important it is to understand the reason such proposals are filed in the first place. Almost all large and influential investors want more—almost a running dialogue. Those investors are taking advantage of the conversations with management and directors to learn more about the companies they invest in.

This roundtable took place in Los Angeles on June 8, 2017, and was co-hosted by Latham & Watkins and UCLA School of Law's Lowell Milken Institute for Business Law and Policy. It featured active investors: three investment management companies, two REITs, and one of the largest public pension funds.

Large, passive investors

(published November 2017)

Passive investors are committed to effective corporate governance policies that stress board accountability, improved shareholder engagement, and long-term value creation They advocate as much shareholder engagement for corporate directors as possible. They believe engagement has been the missing link in the corporate governance debate, which has traditionally focused on the primacy of shareholders versus directors.

Three of the largest passive investors want directors who are knowledgeable about environmental, social, and governance criteria In fact, State Street Global Advisors focused on board oversight of environmental and social sustainability in areas such as climate change, water management, supply chain management, safety issues, workplace diversity, and talent development, some or all of which may affect long-term value.

Three of the largest passive investors (Vanguard, BlackRock, and State Street Global Advisors) have greatly increased the number of engagements with companies, including directors, over the past two years Most of the engagements have focused on governance issues, such as board diversity, board declassification, and proxy access. In 2016 and 2017, these investors adopted investor stewardship principles that focus on board composition, governance structures, and director knowledge. They have even written open letters to the directors of their portfolio companies about corporate governance concerns.

This panel discussion among large passive institutional investors took place on September 13, 2017, in New York City following a keynote address by Martin Lipton, who spoke about his "New Paradigm Partnership for Corporate Governance and Long-term Value Creation." Moderated by Doug Chia, the discussion included representatives from The Vanguard Group, J.P. Morgan Asset Management, and BlackRock and was held under the Chatham House Rule. Additionally, we separately interviewed two representatives of large passive investors.

Corporate secretaries

(published February 2018)

Corporate secretaries aren't convinced that disclosure of formal board skill matrices, which some investors are vocally demanding, will necessarily improve board composition and functioning concerns The corporate secretary panelists and interviewees agreed that while a formal board skills matrix could be a good internal tool for the board to assess its skills, disclosing a table attributing specific skills and expertise to specific directors could only be used to publicly discredit directors who don't have certain boxes checked.

The corporate secretaries recommended preemptive actions boards can take to handle a potential crisis Create a predetermined list of advisors who know the company, and discuss ahead of time the role and involvement of the board in overseeing crises under different possible scenarios.

The corporate secretaries have a unique position to assess whether a board is "too collegial," with directors who are almost afraid to upset the chair and CEO Corporate secretaries agreed that having directors with a tendency to "ruffle feathers" can be beneficial as long as all directors still maintain an appropriate level of respect for each other.

This panel discussion was held in Washington, DC, during the Society for Corporate Governance Middle Atlantic Chapter meeting on October 3, 2017. It featured a chief SEC and corporate governance counsel from a large US water utility, an assistant general counsel and corporate secretary from a large cash management company, and an associate general counsel and assistant secretary from a leading management and technology consulting and engineering services firm. It was moderated by Doug Chia, who once served as corporate secretary of Johnson & Johnson and board chair of the Society of Corporate Secretaries and Governance Professionals. In addition to the panel discussion, we interviewed two corporate secretaries, one on the record and another not for attribution.

Activist Hedge Funds

(published April 2018)

Hedge funds believe their directors should behave on boards "as if they own the whole company" This challenges the notion that directors have a duty to act in the interest of all shareholders, not just the ones with interests identical to the hedge fund that put them on the board.

When hedge funds look for director nominees, they like them to be knowledgeable about the portfolio company They also want the candidates to be actively involved in strategy development and engaged enough with management to understand the short-term and long-term plans of the company.

Hedge funds see no issue with having their chosen directors use their own staffs to prepare for board meetings They see the claim that this runs the risk of creating "shadow management" as a myth made up by public relations firms.

While some hedge funds have recently said they would like to see environment, social, and governance (ESG) considerations integrated into strategy and planning, this was not the case for some of the hedge fund representatives who talked with The Conference Board Rather, hedge funds addressed ESG as a separate issue that still needs to be studied by boards before it is integrated into company strategy. This could reflect that their investment time-horizons are too short to be concerned about ESG factors, which tend to have longer-term impacts.

Management's public disclosure materials need to be more succinct and concise Hedge funds would rather management deliver to the board an integrated summary report that includes a letter from the chair, the company capital asset strategy, a summary of corporate governance, and sustainability metrics—all in 50 pages or less.

Trust can become an issue when an activist hedge fund representative is placed on a board This is shown when such directors and the funds that nominated them are asked by the company to sign a nondisclosure agreement.

The latest installment of our corporate director job description series on activist hedge funds is based primarily on a panel discussion of The Conference Board Governance Center 2017 Annual Members Meeting in New York City on November 7, 2017. It featured two principals and a managing director of three activist hedge funds. It was moderated by John Wilcox, chair, Morrow Sodali. The discussion was held under the Chatham House Rule, which states that participants are free to use the information received, but neither the identity nor affiliation of the speaker(s) or participant(s) may be revealed. (For this reason, some of the quotes and viewpoints in this report are unattributed.) In addition to the panel discussion, the author interviewed a hedge fund representative: Jeff Gramm, portfolio manager of Bandera Partners.

Academia

(published June 2018)

The role of academia's influence on the job of the corporate director includes unveiling empirical evidence of distorted behaviors, conflicts of interests, and inefficiencies as well as promoting the need for periodic board refreshment and more diversified board composition.

As the responsibilities of directors continue to expand and their workload intensifies, many scholars have raised concerns about the distractions that may result from the many professional commitments of the typical board members and dispute whether they are able to serve productively on multiple boards.

While engaging directly with investors is increasingly viewed as a necessary part of the board's job, taking action in direct response to investor preferences doesn't necessarily lead to good economic decisions. Thus, "muddling through" investor preferences may be the right role for the board. Better disclosure should reduce the need for engagement.

Only when directors see and understand the operations of the business will they be able to understand the culture. There is no one way to do this; it must be a continuous effort with a multi-pronged approach.

Some in academia debate whether having more women on boards improves financial performance, while others see gender diversity as an avenue for the diversification of skills and backgrounds that corporate boards need, and all recognize the opportunity to promote "social justice" values.

The latest installment of our corporate director job description series on academia is based primarily on a roundtable co-hosted by the Millstein Center for Global Markets and Corporate Ownership at Columbia Law School at The Conference Board headquarters in New York City on January 26, 2018. It featured 11 professors from such institutions as Columbia Law School, Yale Law School, University of Pennsylvania Law School, Harvard Law School, Georgetown Law Center, the University of San Diego School of Business, and the Millstein Center for Global Markets and Corporate Ownership at Columbia Law School. It was moderated by Douglas Chia, executive director of The Conference Board Governance Center, and Prof. Eric Talley of Columbia Law School. The discussion was held under the Chatham House Rule, which states that participants are free to use the information received, but neither the identity nor affiliation of the speaker(s) or participant(s) may be revealed.