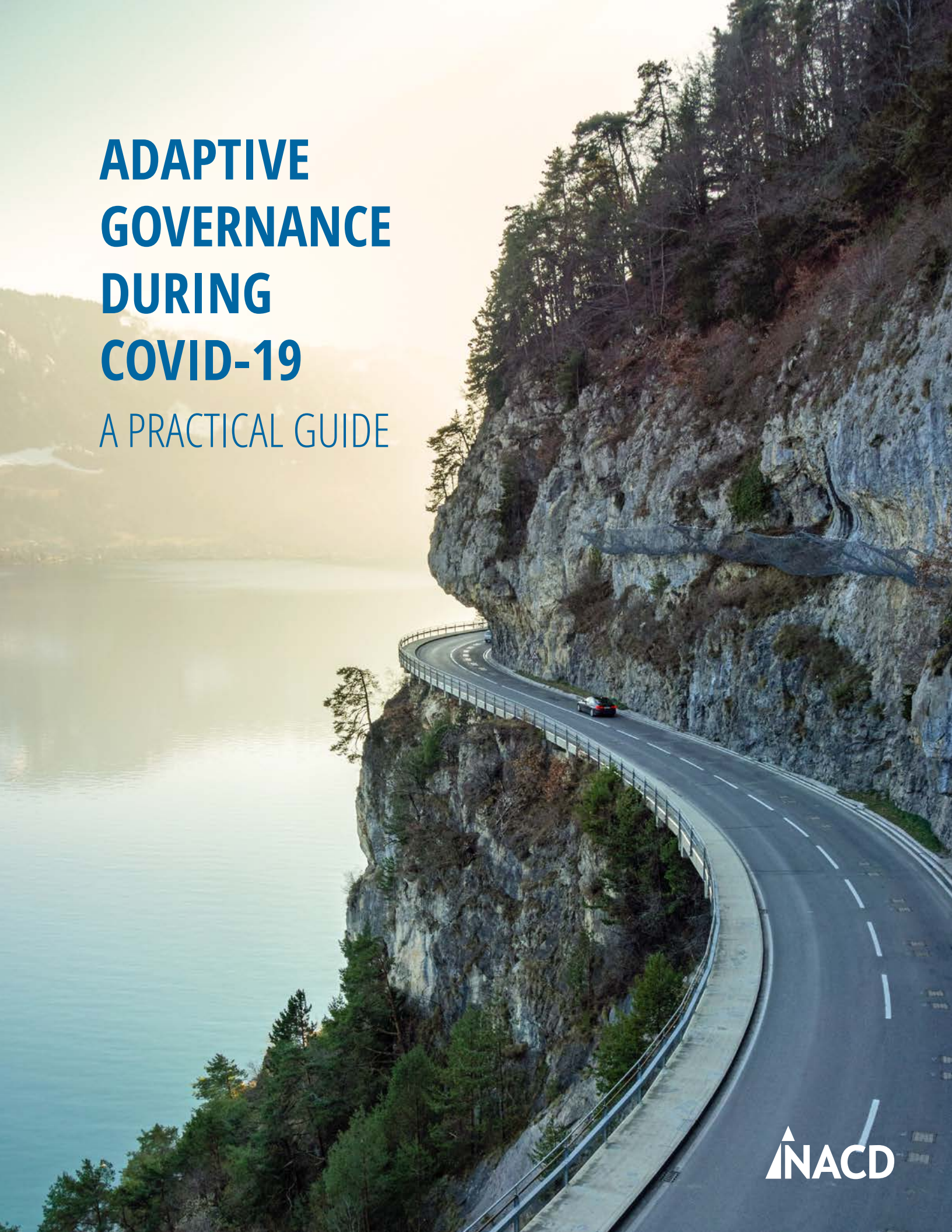
ADAPTIVE GOVERNANCE DURING COVID-19

A PRACTICAL GUIDE



NACD

NACD would like to thank the following members for their thoughtful discussion on the topics presented here. They helped to make this report better than it otherwise would have been. Any errors or omissions remain our own.

Andrea Bonime-Blanc
Cari Dominguez
Lester Lyles
Michael Marquardt
Kathleen Taylor

CEO Peter R. Gleason
Senior Vice President, Content Friso van der Oord
Director, Strategic Content Marcel Bucsescu
Associate Director, Governance Analytics Barton Edgerton
Senior Research Manager Leah Rozin
Manager, Benchmarking and Data Insights Ted Sikora
Senior Research Analyst Reaa Chadha
Research Analyst Andrew Lepczyk
Art Director Patricia W. Smith
Manager, Copy Editing and Print Production Margaret Suslick
Senior Graphic Designer Alex Nguyen

Table of Contents

Applying Adaptive Governance **4**

SECTION 1
Ensuring Effective Board-Management Engagement Throughout the Crisis **7**

SECTION 2
Maintaining Board Effectiveness Throughout the Crisis **9**

SECTION 3
Executive Pay and Performance **11**

SECTION 4
The Board's Role in Stakeholder Engagement **13**

SECTION 5
Identifying Risk and Opportunity in the Short and Long Term **17**

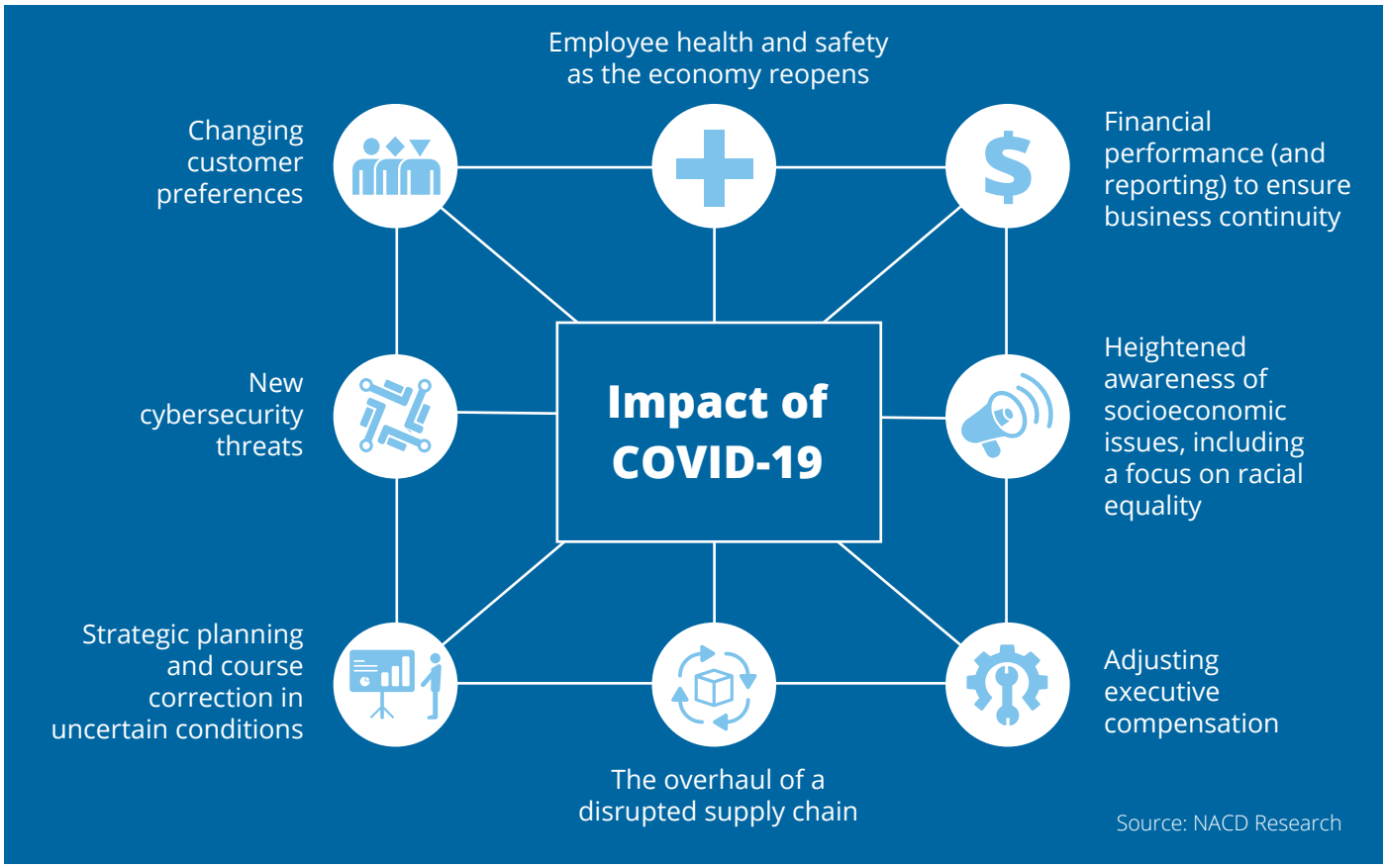
Applying Adaptive Governance

The COVID-19 pandemic has disrupted every aspect of social and economic life. The effects of the crisis are both wide and deep and challenge nearly every business financially, strategically, operationally, and culturally. The major challenge that directors and their boards face is in adapting their governance to the demands of this extremely uncertain environment. This requires a constant reassessment of the board's engagement with management; of its internal workings, oversight practices, and priorities; and ultimately of its own performance. In other words, boards will need to become fit for a much more turbulent future.

Most Significant Governance Challenges Over the Next Three Months—Percentage of Directors.

NACD COVID-19 Member Poll, May 2020, n=267

Wide Range of Governance Responsibilities Impacted by COVID-19



In support of our members, NACD has developed practical guidance to help boards navigate the many dimensions of this crisis, and to help them prepare their companies for a (slow) recovery. We have drawn upon our network of more than 21,000 directors through recommendations from our most-relevant, director-led Blue Ribbon Commission reports; other thought-leadership publications; extensive director interviews; and data analysis. To help turn these rich and diverse insights into action, each section includes a complementary set of resources and tools.

Our guidance is centered on the concept of adaptive governance and outlines five key questions that boards must address in order to govern effectively through this challenging period.

In the disruptive environment caused by the COVID-19 pandemic, boards can apply adaptive governance in the five key areas that are most critical at the present time.

1. **BOARD-MANAGEMENT ENGAGEMENT:** How can the board be a strategic asset to their companies in this crisis without overburdening management?
2. **BOARD EFFECTIVENESS:** How can the board maintain its own effectiveness?
3. **PERFORMANCE AND PAY:** How should the board evaluate management's performance, leadership, and pay?
4. **COMMUNICATION:** How should our companies communicate with shareholders and stakeholders? What should the role of the board be in regard to company communications?
5. **LONG-TERM RISKS AND OPPORTUNITIES**: What new risks and opportunities, unleashed by a new operating environment, should the board be anticipating? How should the board be responding to them?

In this guide, we break down each of these five areas, offering concrete guidance and supporting tools that directors can immediately apply in their boardrooms.

ADAPTIVE GOVERNANCE DEFINED

We believe that directors can aid the management team by helping the organization to see around corners and prepare for the longer term. Board members' experiences, coupled with their part-time role, allow them to take a step back and reflect on the bigger picture their companies face. As one commissioner from the 2018 *Report of the NACD Blue Ribbon Commission on Adaptive Governance* described the board's role in a crisis, *"Think of a kaleidoscope—many different pieces that are constantly shifting. The board's job is to help company leaders step back and put those pieces into a pattern that yields new insights."*[1]

The 2018 Blue Ribbon Commission defined adaptive governance as follows:

Active Directorship: Active directorship was defined as active involvement by directors in setting and maintaining a boardroom culture that is centered on open discussion, constructive challenge, and active self-reflection. Commissioners agreed that the unwillingness of directors to rock the boat is a major contributor to blind spots with respect to disruptive risks. One stated simply, *"The virtues of collegiality in the boardroom are outweighed by the vice of complacency."*[2]

Closing Skill Gaps: Adaptive governance requires board skills that remain fit for purpose in a rapidly evolving business environment. The baseline requirement here is a board composition that is diverse in background, skills, perspectives, and experiences: *"Many boards are locked into a lagging mind-set in part because of composition. This is why diversity is essential."* But while diversity is necessary, diversity alone is not sufficient. Keeping board skills fit for purpose also requires that each director make a commitment to continuous improvement: staying current with changes in your industry, new technologies, and emerging societal and other trends that will have a significant impact on the organization's strategy, competitive position, and risk profile.

Effective Board Agendas: Ample time on board agendas should be devoted to looking at the future—including discussing the potential for disruptive risks to affect long-term strategy and value creation—and to avoiding excessive focus on reviews of past performance or "box-checking" activities.

Building Resilience: The board should be taking an active role in guiding the company toward improvements in its resiliency. As a Commissioner said, *"We won't be able to predict or defend against everything. How well the company responds to disruptive situations may make the difference between profitable growth or becoming an also-ran."*

[1] NACD, *Report of the NACD Blue Ribbon Commission on Adaptive Governance: Board Oversight of Disruptive Risks Governance* (Arlington, VA: NACD, 2018), p. 13.

[2] Quotes in italics throughout this sidebar are from members of the 2018 NACD Blue Ribbon Commission.

SECTION 1

Ensuring Effective Board-Management Engagement Throughout the Crisis

As stated in the NACD and McKinsey coauthored report on crisis dynamics between boards and management, "A crisis scenario, whatever its origins or specific circumstances, is the ultimate test of resilience for any institution, its board, and its top executives. Senior executives and directors of a stricken organization can find themselves exposed to unrelenting external scrutiny from the media, the legal profession, regulators, and other stakeholders for months or even years."[3]

In a crisis, senior executives and board members, acting as individuals and in teams, are under the most intense pressure to make quick decisions, issues clear statements, and act to mollify or reassure shareholders. During the early stages of the COVID-19 pandemic, organizations acted quickly, making many material decisions in rapid succession with much less time than normal order allows, intensifying board and management engagement. Many directors expect that some increased engagement with management will be part of the "new normal" going forward.

Following the crisis, the board will continue more regular communication with management than it had before the crisis.

However, most directors we have spoken with are conscious of the danger of a heightened burden on an already crisis-fatigued management team to communicate frequently with the board. Given the intense focus most management teams have on day-to-day crisis management, directors should be careful not to add unnecessary reporting requirements on top of this exhausting workload. As one director put it, "You have to be careful not to give management more homework when they are already overwhelmed."[4] Yet, at the same time, boards rely on management to provide the information necessary to ensure appropriate oversight. The key is to find the right balance between being a well-informed board and giving management the freedom to focus on managing the company through the crisis.

[3] McKinsey & Co. and NACD, *Building Board-Management Dynamics to Withstand a Crisis: Addressing the Fault Lines* (September 2019), p. 3.

[4] NACD research conversation with a member, May 2020.

KEY MEMBER CHALLENGE

HOW CAN THE BOARD BE A STRATEGIC ASSET TO THEIR COMPANIES IN THIS CRISIS WITHOUT OVERBURDENING MANAGEMENT?

SOLUTIONS

Streamline board and management communication to create a single board point of contact to engage with management, and agree to a regular time and format for the board to receive management communications.

If they have not already done so, boards and management teams should work together outside of traditional board meetings to ensure that management has timely information to provide effective oversight. In the current environment, weekly or biweekly meetings are common. It is important for management and the board to agree about the timing and purpose of these nontraditional meetings. However, keeping traditional committee and full-board meetings on the calendar creates an occasion to review the timing and content of crisis-focused board and management communications.

Understanding the objectives of these meetings and the key metrics that should be reported during them are critical to making them productive in this more-intense working environment. This may also change the nature and purpose of more traditional meetings. The board may want to identify the types of events that might trigger a change in meeting cadence and content, such as a sudden change in cash flow, or worsening of employee's health and safety conditions.

TOOL
Assessing Internal Controls During the COVID-19 Crisis (NACD and IIA)

Recognize and work to mitigate management fatigue when possible.

To help minimize management fatigue, the board leader should facilitate and prioritize director questions to management and communicate those to the CEO or crisis team, rather than having individual directors reach out directly. This can help to focus communication on issues that are most important to the full board, eliminate duplicate requests, and triage questions to ensure that less relevant or urgent questions do not distract management.

Before asking management for additional information, board leaders might consider the opportunity costs when management gathers information and prepares multiple board reports. Fatigued management teams will produce lower-quality information that may be repetitive, inaccurate, or incomplete. These may be best viewed as warning signs and can be used to consider how the board can work to reduce the burden on management. The board should also be conscious of the number of individuals reporting to the board and rotate participants out to offer a break.

TOOL
Identifying and Reducing Management Fatigue (NACD)

SECTION 2

Maintaining Board Effectiveness Throughout the Crisis

Crises can strain even the most highly functioning boards. They can also exacerbate existing board dysfunction or expose a lack of clear leadership. The COVID-19 pandemic, perhaps more than most crises, challenges boards to maintain effectiveness despite meeting more often, engaging virtually, and making many material decisions more quickly than they normally would. Few directors have experience with operating this intensely, potentially making it difficult for boards to do their work effectively and to maintain their responsibilities as fiduciaries. There is much more work now—possibly double the hours—and some directors find themselves in a very different situation than what they had expected when they joined their board.

While some directors may thrive in a crisis, others may not, leading to potential tensions in the boardroom. This upheaval can impact board dynamics and exacerbate difficulties that previously sat quietly under the surface. In the words of one board leader, "Directors come into the board as individuals, from different backgrounds, and we only meet in person five times a year. If poor dynamics exist, lots of time will be wasted in unproductive conversations—there's likely to be a lack of trust and uncertainty about different directors' strengths and weaknesses."[5] This is simply not something that most boards can spend time on during fast-paced, virtual board meetings.

> "If there are any preexisting tensions or poor dynamics, it will be much more difficult to be successful in a crisis." -Director interviewed by McKinsey & Co. and NACD.

Before the crisis, some boards spent significant time on business-continuity planning and crisis preparation, but some did not. It may be more difficult for boards to function well in the current environment if they are confronting business-continuity challenges for the first time during this crisis.

Strong board leadership—an independent chair or a lead independent director—is indispensable to facilitate the right dynamics during the crisis. However, in the words of one NACD member, "If the lead director is not particularly strong, and the CEO is the one who's really in charge, that's a problem. The voice of the independent directors might not be heard—they'll be kept more at bay."[6] Yet, for even the most sophisticated and experienced board leader, COVID-19 is likely impacting many processes not touched by more-traditional crises. Topics such as board recruitment, onboarding, and evaluations—which may become virtual—may require more frequent board engagement for the foreseeable future.

KEY MEMBER CHALLENGE

HOW CAN THE BOARD MAINTAIN ITS OWN EFFECTIVENESS?

SOLUTIONS

Clarify board, committee, and individual-director roles and responsibilities during and after the crisis.

The shifting dimensions of crisis place a renewed importance on board agility. Boards and their leaders should prepare to move beyond rigid and traditional structures to allow for faster decision making and for ensuring that the diversity of skills and experiences in the boardroom are fully exploited. Boards must optimize how they use their time between board meetings to build effective collaboration between committees, and they should make effective use of ad hoc or crisis committees. They might also consider reviewing their information flows and decision-making structures to determine if they are fit for purpose in the present environment. This is especially true of ad hoc committees or emergency structures that have formed during the crisis.

Board leaders should identify which activities can be given to committees so that the full board can focus on the highest-

[5] McKinsey & Co. and NACD, *Building Board-Management Dynamics to Withstand a Crisis: Addressing the Fault Lines* (September 2019), p. 5.
[6] Ibid.

priority issues. Leaders can also use time at the end of each board or committee meeting to briefly evaluate the meeting's effectiveness.

TOOL
Board Effectiveness Checklist (NACD)

Build flexibility into virtual board meetings to keep the board focused on high-priority items during the crisis.

Virtual meetings are likely to be shorter and more frequent than traditional pre–COVID-19 board meetings. Board leaders may need to alter their traditional board and committee agendas to fit the constraints of virtual meetings, organizational needs, and attention spans during the crisis. Where necessary, leaders may consider shifting management reporting and status updates to pre-reading to maximize discussion between board members on the issues that matter most. Board leaders should also take care to ensure that all voices are heard, and they should look for ways to engage all members when nonverbal cues may be more difficult to identify. This may be especially challenging for directors new to the board who may struggle to find their voice and contribute as effectively as they might have done in a traditional, in-person setting.

TOOL
Director FAQ: Virtual Board Meetings (NACD)

Identify and mitigate common pitfalls when pressure testing COVID-19 assumptions.

The current crisis places a premium on both quick decision-making and thoughtful scenario planning. However, this comes with its own set of risks. Boards are in a unique position to help management recognize potential blind spots and pressure test critical assumptions that underly strategic planning. Boards can also look critically at their own work as a means to help inoculate themselves from unforced errors that might arise from both groupthink and cognitive bias. Boards that proceed too quickly can be dominated by loud voices that unintentionally shut out other opinions that could sway a board majority. In other instances, directors may overvalue recent experiences, giving less weight to countervailing, more-distant ones.

This can help to improve the rigor with which the board tests both its own assumptions and those of management, especially when they are considering COVID-19 recovery scenarios, changing customer preferences, and reopening their business. Further, when reviewing COVID-19 scenarios, directors should ensure that predictions are clear, time-bound, probabilistic, and can be evaluated based on empirical facts.

TOOL
Heuristics and Cognitive Biases in the Board's COVID-19 Response (NACD)

SECTION 3

Executive Pay and Performance

Organizations with a calendar fiscal year may have set CEO and executive performance goals before an understanding of the broad impacts of COVID-19. As the business environment and how companies operate both change, boards may need to revisit executive pay and performance expectations. As one director noted, "We will simply not be able to achieve much of what we planned for at the start of the year. Surviving is the focus now. Thriving comes next."[7] Tasked with assessing and rewarding executive leadership appropriately, boards face challenges on a variety of fronts, including a volatile stock market and many unknowns regarding the health, economic, and business conditions for the remainder of the year and beyond. Boards and their compensation committee face several challenges when trying to deal with these persistent uncertainties Pay and performance goals need to be flexible enough to reflect the economic reality firms face for most of the year. At the same time, they should be fixed enough to guide executive behaviors.

> "This is a time for compensation committees to use their judgment and rely on their wisdom. But always guided by the values of the company and by good governance principles."[8]

Mapping out which pay and performance decisions need to be made when, and then gathering data to inform those decisions, can be a valuable framework at any time. In times of volatility, when boards and compensation committees may feel pressure to make decisions more quickly than they usually would, a strong framework can help to avoid bad decisions.

Board leaders and compensation committee chairs should consider what issues need to be addressed now because of their urgency, which questions are better left to the midyear discussions as the situation plays out, and which decisions are best handled at the end of the year, when you will have the benefit of full perspective.

KEY MEMBER CHALLENGE

HOW SHOULD THE BOARD REASSESS MANAGEMENT PERFORMANCE, LEADERSHIP, AND PAY?

SOLUTION

Assess the effectiveness of executive leadership during the crisis.

The COVID-19 pandemic has placed extraordinary pressure on CEOs and management teams. Nearly all executives have had to transform the ways in which they work and engage with their organization. With many working around the clock to manage the evolving crisis. No executive team has training or experience to help with type of crisis. Some are energized and thrive in these circumstances. Others have failed to meet the expectations of stakeholders. Boards can use this unique opportunity to evaluate the effectiveness of leaders during this crisis. They may consider the executive team's ability to adapt to changing circumstances, retain the trust of employees and other stakeholders, and communicate effective internally and externally.

TOOLS

"COVID-19: Inside the Corner Office," (Korn Ferry)

Homayoun Hatami, Pal Erik Sjatil, and Kevin Sneader, "The Toughest Leadership Test," McKinsey & Co., May 28, 2020.

[7] NACD research conversation with a member, May 2020.

[8] Advisory Council Delegate, Compensation Committee Chair Advisory Council Brief, April 2020, p. 1.

Consider resetting performance goals for the business in light of the COVID-19 pandemic.

The profound impact of COVID-19 on nearly every American enterprise means that many of the expectations that organizations started the year with will not come to be. As boards reconsider performance goals, they may need to consider how even revised objectives may change over the second half of the year. Crisis not only tests leadership capabilities, but can also reveal it in unexpected locations.

TOOL

Scott A. Barshay, Brad S. Karp, and Jean M. McLoughlin, "The Impact of COVID-19 on Performance-Based Compensation Programs," Paul, Weiss, Rifkind, Wharton & Garrison LLP, *The Harvard Law School Forum on Corporate Governance* (blog), March 24, 2020.

Review executive compensation with a structured framework.

By applying a strong, structured framework to crisis-related compensation decisions, boards can help to avoid hasty decisions that might not adequately take into account important, but perhaps nonobvious, variables. For example, establishing nonqualified deferred compensation in place of cash. Boards might consider what the right thing to do for the business is now, such as pay adjustments, while also considering the long-term impact of these changes on scenarios in the company's strategy.

Boards may wish to consider four factors when applying this framework: the plans that connect business strategy to compensation design; the people from stakeholder groups ranging from peers, management teams, directors, and advisors; the process to stress testing, talent development, and board governance; and perspective from both internal and external sources as well as historical and forward-looking perspectives.

TOOLS

Four Operating Principles for Developing Resilient Executive-Compensation Programs (Pearl Meyer)

COVID-19 Implications: Compensation Committee Chair Advisory Council Brief (NACD)

SECTION 4

The Board's Role in Stakeholder Engagement

Effective communication during a crisis can make the difference between successfully handling or unintentionally exacerbating the situation. Even small mistakes in messaging can create significant reputational damage. As companies now execute their crisis communication plans, it is important to ensure that they coordinate and reinforce the purpose and image that the organization would like to reflect.

> "It's important to slow down for a second during a crisis and really think through what do we want to have happen as a result of this crisis? What's our story? Many boards and management teams just immediately react to the crisis rather than thinking through it strategically."[9]

They should also resist the pressure to respond prematurely, taking care to ensure that communications from the company are thoughtful. In addition to assisting management in effective communication about the organization's response to the many dimensions of the crisis, many boards will need to be prepared to effectively communicate how they have maintained their core fiduciary duties.

Percent of Boards Challenged by Communicating the Impact of the Crisis

NACD COVID-19 Member Poll, May 2020, n=267

[9] NACD, *NACD Nominating and Governance Committee Chair Advisory Council: Communicating in Times of Crisis* (Arlington, VA: NACD, 2019), p. 1.

KEY MEMBER CHALLENGE

HOW SHOULD OUR COMPANIES COMMUNICATE WITH SHAREHOLDERS AND STAKEHOLDERS?

SOLUTIONS

Help management articulate the company's mission and values in the organization's COVID-19 message to stakeholders.

Review management's articulated themes for communicating with stakeholders, and help to ensure that the concerns of a wide variety of stakeholder groups are recognized. This includes communications to employees and key investor groups, as well as suppliers, customers, and critical communities. Given the nature of the crisis, messages concerning the health and safety of employees continue to be of the utmost importance.

The board may have a special interest in investor communications (see sidebar). Many investors will expect to be able to engage directly with board members more frequently than they had before. Visibility into the board's understanding of the company and its potential risks has become increasingly more important to investors. Investors also want to see increased disclosure on how the board is providing oversight of the company—this includes oversight of human-capital management and ensuring that the board is aligning management's short-term decisions with long-term business continuity. Many companies have increased their disclosure on board oversight of risk, but investors will look for a broader perspective on board oversight of strategy and human-capital management. Directors may want to spend some time identifying important COVID-19–related themes that are important to the investor community.

TOOLS

Communicating in Times of Crisis: Insights From Fortune 500 Committee Chairs (NACD)

Investor Engagement Expectations During COVID-19 (NACD)

Clearly communicate how the board is maintaining its ongoing fiduciary responsibilities.

Directors should ensure that while they aid management during the current crisis, they are not neglecting their other fiduciary duties. In a March 2020 update to its stewardship priorities, BlackRock states, "With regard to director responsibilities and commitments, we seek to understand the board's role in crisis management in the face of, for instance, cyber events, sudden departures of senior executives, negative media coverage, or a proxy contest given the likelihood that such events are often material and can significantly detract from a board's ability to carry out its other responsibilities."[10]

TOOL

COVID-19: SEC Filings Are a Communication Platform

[10] Barbara Novick and Michelle Edkins, BlackRock, "Engagement Priorities for 2020," *The Harvard Law School Forum on Corporate Governance* (blog), March 20, 2020.

SNAPSHOT OF COVID-19 GUIDANCE FROM INSTITUTIONAL INVESTORS

State Street Global Advisors- "Refrain from undertaking undue risks that are beneficial in the short-term but harm longer-term financial stability and the sustainability of the business model. Communicate to investors COVID-19's short- and medium-term potential impact to the business, overall operations and supply chains, including management preparedness and scenario planning and analysis. Articulate how COVID-19 might impact or influence their approach to material ESG issues as part of their long-term business strategy."[11]

BlackRock- "[O]ver the past weeks we engaged nearly 150 companies across all 11 GICS sectors and 17 countries globally on COVID-19 to understand how they are balancing short-term pressures with efforts to oversee long-term material financial and operational performance. . . . Across many of our engagements, employee health and safety were clearly key priorities. For companies, business continuity, operational challenges, and human capital management (HCM)—which have long been areas of focus for BlackRock Investment Stewardship—are top of mind for boards and management teams as they grapple with reduced or remote workforces, disrupted supply chains, and mounting financial risks. . . . We maintain our long-term focus and expectations of boards and leadership teams to manage long-term risks and opportunities, while addressing these near-term, material impacts on their companies."[12]

Vanguard- "The job of a director now requires new skills, experiences, and time commitments as boards are asked to be a key voice on strategy and identify and govern material risks—both known and unknown. An effective board should be independent and reflect both diversity of personal characteristics (such as gender, race, and ethnicity) and diversity of skill, experience, and opinion. If a company's board is capable, diverse, and experienced, good results are more likely to follow. . . . Boards should work to prevent risks from becoming governance failures. We've seen increasing evidence that non-traditional but material risks related to environmental and social topics (such as climate change, cybersecurity, and human capital management) can damage a company's long-term value. . . . For many boards, these matters [human capital management] are closely intertwined with corporate strategy, and they are often the subject of our engagements as we seek to understand how boards think beyond traditional issues such as CEO succession."[13]

[11] Carlo M. Funk, State Street Global Advisors, *COVID-19 and ESG: Four Dimensions*, p. 6.
[12] BlackRock, *Q1 2020 BlackRock Investment Stewardship Global Quarterly Stewardship Report*, April 2020, pp. 8–11.
[13] Vanguard, *Investment Stewardship: 2020 Semiannual Report*, pp. 2, 4, and 7.

SELECTED EXAMPLES OF COVID-19 BOARD COMMUNICATIONS

MYLAN PROXY STATEMENT[14]

Board and Management Oversight Relating to the COVID-19 Pandemic

- Mylan's Board and executive leadership team have implemented robust processes and guidelines to ensure timely and comprehensive updates and oversight of actions and developments globally regarding the COVID-19 pandemic.
- Mylan's Board, led by the Executive Chairman, is actively overseeing management's actions and responses regarding these matters. Among other actions, our CEO has formed a pandemic nerve center team, staffed by senior leadership and informed by subject matter experts around the world, to rapidly identify and address pandemic-related topics impacting the Company, its workforce, locations of operations, customers, suppliers, markets and local communities. The nerve center team aims to advance the following principles, among others: protecting the health and welfare of Mylan's workforce; deploying the Company's scientific, manufacturing, supply chain, and commercial capabilities to continue providing critical medicines to patients without disruption; identifying additional measures to help mitigate the impact of COVID-19; providing charitable and other public support to help address the burden of the pandemic on others, including in the communities where we operate; and, of course, monitoring and maintaining the financial and operational health, resilience, and performance of the Company during the pandemic.
- The Board receives detailed monthly reports from management, the pandemic nerve center team, and/or other sources and participates in interim Board and Committee update discussions. These matters will remain a key topic during quarterly Board and Committee meetings. As recently disclosed, the Mylan Board has appointed Mr. Coury as Executive Chairman to, among many other responsibilities, partner closely with our CEO and President and the entire management team to support continuing efforts to protect our employees, maintain our supply of critical medicines, and help address public health needs amid the evolving COVID-19 crisis.

STAAR SURGICAL COMPANY PROXY STATEMENT[15]

Board of Directors' Role in Risk Oversight

The Board of Directors is charged with general oversight of the management of STAAR's risks. Our management team is responsible for enterprise risk management on a day-to-day basis. The role of our Board of Directors and its committees is to oversee the risk management activities of management. When reviewing STAAR's strategy, business plan, budgets and major transactions the Board of Directors continuously examines the elements of risk in each proposed activity. For example, the Board of Directors periodically reviews with management the Company's activities to address cyber-risk. In 2020, the Board of Directors has been monitoring the impact of COVID-19 on matters such as employee safety and business continuity via Board meetings and informal dialogues with management. Each of the Board of Directors' standing committees assists the Board of Directors in overseeing the management of risk in the area overseen by the committee. In particular, the Audit Committee assists the Board of Directors by reviewing periodic reports from management on the risks related to such matters as financial reporting, internal controls, revenue recognition, treasury management, information technology, insurable risks, and compliance with legal and regulatory requirements. The Compensation Committee oversees risks related to our compensation programs and policies. The Nominating and Corporate Governance Committee assists the Board of Directors in fulfilling its oversight responsibilities with respect to the management of risks associated with board organization, membership and structure, and succession planning for our directors.

---

[14] See the Mylan NV Proxy Statement.

[15] See the STAAR Surgical Company Proxy Statement, p. 16.

SECTION 5

Identifying Risk and Opportunity in the Short and Long Term

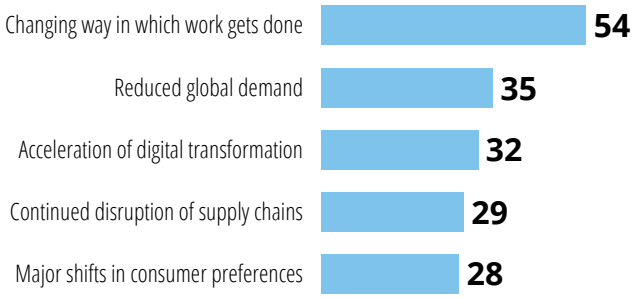
As management teams continue to confront the most-pressing immediate implications of the crisis, including employee health and safety, financial solvency, and operational risks, boards have an opportunity to start shaping the post-crisis strategy, assessing longer-term opportunities and risks in a much-changed business landscape. Boards may need to rethink the type of information they request from management. In addition to helping companies keep an eye toward the long term, boards can help management teams look around corners to see new and disruptive risks that their organizations may face. To do so, boards will need to enhance traditional ERM reporting with more forward-looking information that can inform the board about future customer preferences, business models, and competitors. Some boards do this well. Those that do not, may struggle and fixate on traditional risk management.

> "As a board, the three things to think about are: how do we emerge from this stronger than before, where are there inorganic growth opportunities, and what changes do we need to make to our strategy?"
>
> -Risk Oversight Advisory Council Brief: COVID-19 Implications, April 2020, p. 4.

Directors report increased use of scenario and contingency planning to map different paths for the company. Two-thirds of directors recently reported including a second wave of the pandemic in their planning, and nearly as many considered the increased use of remote work.[16] Others recognize that opportunities exist for companies that are able to make the necessary strategic and structural changes. "One silver lining is that this has given us the push we need to implement a number of long-delayed automation initiatives that are forcing us to rethink the opportunities that might be had on the other side of the crisis."[17] Directors have noted that some industries will be subject to regulatory changes that will reshape how their businesses operate in the years to come. Other industries may need to adjust to adapt their strategies in response to shifts in consumer preferences

Directors recognize the need to consider the potential business implications of the changing nature of work, lower global demand, digitization transformation of their enterprises, continued supply-chain disruption, shifting consumer preferences, increased industry concentration, and an amplified role for government in the economy and as a customer. These are all possible trends that could create a starkly different operating reality, and that boards should begin to anticipate and engage management on.

Top Trends that Will Most Impact the Post-Crisis Recovery of your Organization—Percentage of Directors.



NACD COVID-19 Member Poll, May 2020, n=272

[16] NACD COVID-19 Member Poll, May 2020, n=263.

[17] NACD research conversation with a member, March 2020.

KEY MEMBER CHALLENGE

WHAT NEW RISKS AND OPPORTUNITIES, UNLEASHED BY THE CRISIS, SHOULD THE BOARD BE ANTICIPATING AND RESPONDING TO?

SOLUTIONS

Work with management to ensure that the board has sufficient forward-looking information to effectively evaluate the risks and opportunities the organization may face coming out of the crisis.[18]

Restructure management risk reporting to allow for board and committee discussion on relevant forward-looking risks and opportunities, rather than backward-looking indicators that are often a part of traditional ERM. The audit or risk committee, or perhaps even the full board, may consider reassessing the effectiveness of the company's ERM program. To do so, boards should consider exploring mechanisms that will help the board to stay informed about the company and industry developments between board meetings. They can also set time aside regularly for the board and management to do a deep dive into disruptive risks and their implications for the organization's strategy. This may also include revising and structuring director education and engaging with advisory boards or third-party experts to brief the board on issues related to the crisis.

Start with a baseline scenario—one which is most likely to occur. Layer in best- and worst-case scenarios that may have a significant impact on the organization, even if they are much less likely to be realized. An 8-to-10-month return to normal, for example, might serve as a baseline, while a highly accelerated recovery might serve as a best-case scenario and a second or third COVID-19 wave might serve as a worst-case scenario.

Board and committee leaders should seek a structured process to guide their evaluation and discussion of a wide range of relevant scenarios to ensure that each is given appropriate weight and consideration.

TOOLS

Sample Board-Level Reporting: Scenario Analysis and Disruptive Risks

Guidelines for Scenario Analysis of Disruptive Risks

Work with management to establish a clear connection between short-term and long-term objectives.

Companies need to maintain a direct connection between short-term viability and long-term value creation. With many organizations focusing on the immediate impact of COVID-19 and the reopening of the economy, this matters more than ever before. The board's role is to ensure that this alignment is well established and clearly articulated by management. To build and maintain a sufficiently thorough understanding of the company's business model and industry context—including current conditions and emerging trends—directors need to factor substantial preparation time into their board duties.

TOOLS

Indicators of Misalignment Between Long-Term and Short-Term Strategy

Cultivating the Long-Term Habits of a Highly Effective Board

[18] See the discussion of Recommendation 10, "Ensure board-level risk reports provide forward-looking information about changing business conditions and potential risks in a format that enables productive dialogue and decision making," that appears on pp. 20–21 of *The Report of the NACD Blue Ribbon Commission on Adaptive Governance: Board Oversight of Disruptive Risks* (Arlington, VA: NACD, 2018)..

Review action plans across multiple scenarios and time horizons.

Given the high level of uncertainty about the pandemic's duration, boards must push management teams to develop supplemental action plans for longer scenarios. These might cover six months, one year, and even two years. Pulling this off requires deep trust between management and the board as well as a shared vision, which may be rapidly evolving. In light of this, the directors should ask for frequent updates, perhaps even weekly, until survival is assured. The board should be open to adopting modified operating rules during the crisis. For example, between formal meetings, each board committee might work informally with management on relevant subjects, such as revision of stock awards in the compensation committee and development of new risk disclosures in the audit committee.

Boards have an important and unique role in their strategy discussions with management, asking about the future of the business, existing business models, and competitive positioning. Probing questions can help management to consider new or different paradigms, to broaden strategic options in the current environment, and to work backward from a different future rather than building a strategy from present conditions.

TOOL

Facing Uncertainty: 25 Questions for Agile and Adaptive Directors (MMC)

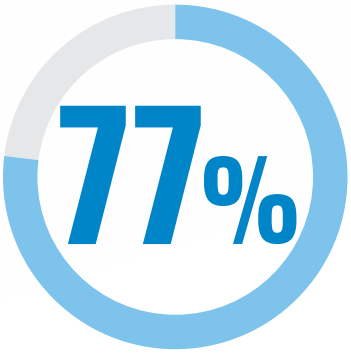
Why NACD?

NACD empowers more than 21,000 directors to lead with confidence in the boardroom. As the recognized authority on leading boardroom practices, NACD helps boards to strengthen investor's trust and the public's confidence in business by ensuring that today's directors are well prepared for tomorrow's challenges. NACD members can also take the next step to elevate their individual and board performance by becoming NACD Directorship Certified™.

OF DIRECTOR MEMBERS SAY THAT
NACD MEMBERSHIP HAS IMPROVED THEIR BOARDROOM IMPACT

NACD Directorship Certification™

NACD'S Directorship Certification distinguishes you as a director. The program is designed as a framework for continuous learning and equips certified individuals with the baseline knowledge, skills, and abilities they need to contribute to the boardroom dialogue on day one. The entire Certification experience, from registration through the exam, is available virtually and on your schedule.



OF ALL NEW, PUBLIC-COMPANY DIRECTORS
ARE SERVING ON THEIR FIRST PUBLIC-COMPANY BOARD

JOIN AND BECOME NACD DIRECTORSHIP CERTIFIED™.

Join@NACDonline.org • 571-367-3708 • NACDonline.org/Join

NACD