2021 Governance Outlook

PROJECTIONS ON EMERGING BOARD MATTERS

NACD

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Baker Tilly
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ABOUT THIS REPORT

The *2021 Governance Outlook: Projections on Emerging Board Matters* is designed to give corporate directors and senior executives a comprehensive overview of major business and governance issues that are likely to demand board focus over the coming year. The report begins with an introduction from NACD that highlights survey findings about leading board priorities for 2021 and follows with five partner contributions that provide distinct insights and projections on the following themes: strategic business risks, legal risks, data privacy, M&A oversight, and virtual shareholder engagement.

Each partner contribution provides (1) an overview of key trends in a particular area of governance, (2) an outlook for how those trends will play out in 2021, and (3) relevant implications and questions for boards to consider. The *2021 Governance Outlook: Projections on Emerging Board Matters* is designed as a collection of observations to help corporate boards to prioritize their focus in 2021 and increase their awareness of emerging issues through both detailed topical analysis and coverage of broader governance implications.

National Association of Corporate Directors

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The Future of the Virtual Board Room

By Andrew Lepczyk, Research Analyst, NACD

Since the beginning of the COVID-19–induced lockdowns, there has been no shortage of experts forecasting drastic shifts in the way that work gets done—including the work of the board. In the second half of the year, NACD surveyed 749 directors to better understand the impact of COVID-19 on corporate governance. Although there were initial challenges in adapting to a virtual working environment, directors were able to continue to govern effectively. Directors reported major shifts in the role that digital technology played in corporate governance, suggesting that the virtual setting for board meetings will be more popular following the pandemic. This increased adoption could show up first in committee meetings in the near term, but long term, it has the potential for increasing adoption for full-board meetings as directors become more comfortable with the technology.

Most of these changes are due to the abrupt shift to working remotely, sparked by the pandemic, and the relatively seamless ability for directors, and society as a whole, to adapt to these new circumstances. Recent survey data from NACD confirms this effect in corporate governance, suggesting that the adaptation of working remotely is here to stay.

Organizational weaknesses in companies' response to the COVID-19 crisis

36%
Digital competence

30%
Opportunity management

27%
Technology infrastructure

5%
Organizational values/purpose

4%
Crisis management

3%
Staff commitment

Source: NACD, from the upcoming *American Board Practices and Oversight Report* (2021), p. 7.

DIRECTORS ADAPTED QUICKLY TO THE VIRTUAL ENVIRONMENT

In the beginning of the COVID-19 pandemic, boards saw abrupt change in their board operations with no way to go back. This proved to be a challenge, with technological preparedness being a weakness of many organizations. According to the survey, 36 percent of respondents listed their organization's digital competency as a weakness as opposed to a strength, and 27 percent described their organization's technology infrastructure as a weakness.[1]

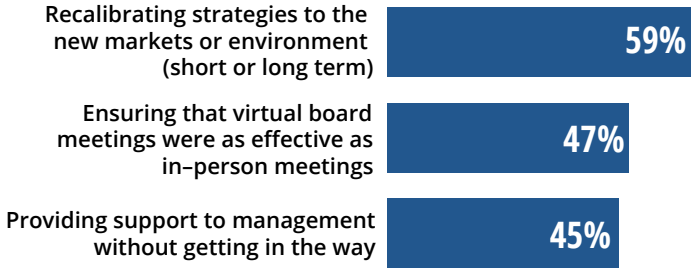
But despite this baseline expectation, many directors were surprised by their ability to adapt and adapt quickly. While NACD learned from conversations with directors that in the beginning of the lockdown many boards and IT teams were nervous about the rollout of virtual board work, directors adjusted to the changing circumstances.

TECHNOLOGY CREATES BIGGEST CHALLENGES FOR DIRECTORS

During the pandemic, directors reported that the challenges posed by the virtual environment were largely operational in nature and can be addressed through technology that makes virtual meetings more efficient. When asked what the top three overall challenges were for boards in responding to the COVID-19 pandemic, 47 percent of directors responded with "ensuring that virtual board meetings were as effective as in-person meetings."[2] Improvements in the efficiency of virtual meetings may ultimately lead to their wider adoption.

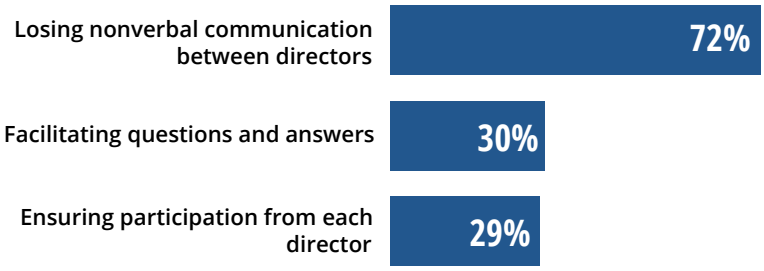
[1] NACD, from the upcoming *American Board Practices and Oversight Report* (Arlington, VA: NACD, 2021), p. 7.
[2] Ibid., p. 8.

Top Three Challenges in Responding to the COVID-19 Crisis



2020 Poll, n=744

Top Three Challenges in Adapting Meetings to a Virtual Setting



2020 Poll, n=740

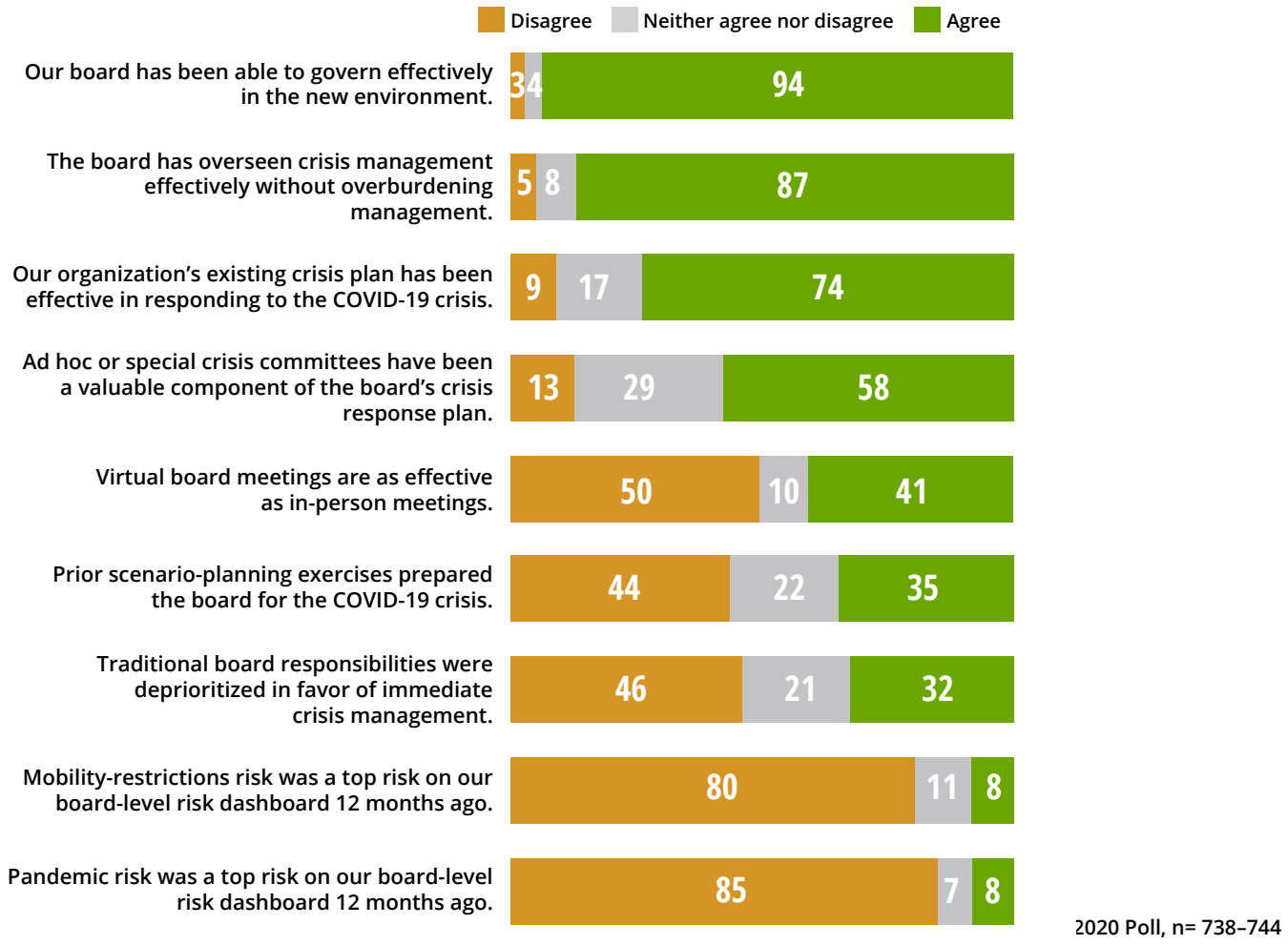
Source: NACD, from the upcoming *American Board Practices and Oversight Report* (2021), p. 8.

Digging deeper, we find that 72 percent of directors responded that it was a challenge losing nonverbal communication between directors, while 30 percent responded that it was tough facilitating questions and answers. On the other hand, just under 14 percent said that background noise was a challenge, and only 19 percent said keeping directors attentive throughout the whole meeting was difficult.[3]

This shows that the biggest problems can be fixed. With better communication platforms, the lack of nonverbal communication can be mitigated, if not completely resolved. Furthermore, the challenges of a virtual environment which were outside of the board leader's control were not significantly problematic—the real challenges were operational issues that can be solved through better technology. There is a case to be made that with better technology, there will be better communication and less-challenging virtual board meetings.

[3] NACD, from the upcoming *American Board Practices and Oversight Report* (Arlington, VA: NACD, 2021), p. 8.

COVID-19 Preparedness (percentage of directors)



Source: NACD, from the upcoming *American Board Practices and Oversight Report* (2021), p. 9.

Despite these challenges, boards were still effective. The technology worked well enough that directors' efforts were not significantly hindered by having to meet in a virtual setting. Ninety-four percent of respondents said that they were able to govern effectively in the new environment, demonstrating that the shift to virtual meetings did not interfere with the board's ability to perform their duties.[4] This would suggest that—despite a number of setbacks and the inability to meet in person—directors were able to adapt and felt able to govern effectively. On the other hand, only

[4] NACD, from the upcoming *American Board Practices and Oversight Report* (Arlington, VA: NACD, 2021), p. 4.

41 percent of respondents agreed that virtual meetings are as effective as in-person meetings; 50 percent of respondents disagreed.[5]

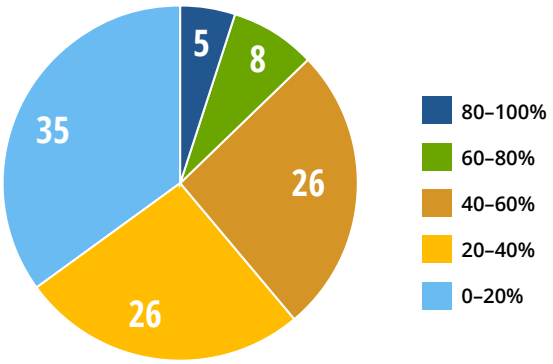
These seemingly contradictory data suggest that while the meetings were effective in helping directors to get their work done, ultimately, directors felt that they were not as productive as they could have been. It could also mean that directors are overestimating the value of in-person meetings, and that virtual meetings are satisfactory in helping directors to govern effectively. This points to a conclusion: while the technical issues that disrupt the facilitation of the meetings makes them less effective than they could be, the meetings are still "good enough"—or perhaps virtual meetings work better for some aspects of corporate governance than they do for other aspects.

Even though directors felt that virtual meetings weren't as effective, they acknowledge that digital communication is here to stay, as evidenced by the 90 percent who answered that they think digital board engagement will be a helpful tool for board operations moving forward. We feel that this paradox could be remedied or even eliminated by increased innovation in digital technology.

VIRTUAL MEETINGS TO BE A GREATER FORCE IN THE FUTURE

NACD surveyed directors about whether or not their board plans to utilize virtual meetings following the crisis, and the results show that virtual meetings will have more staying power at the committee level than at the full-board level, at least initially. Sixty-five percent of directors expect

Percentage of Virtual Full-Board Meetings



Percentages may be +/– 100 due to rounding **2020 Poll, n= 707**

Source: NACD, from the upcoming American Board Practices and Oversight Report (2021), p. 14.

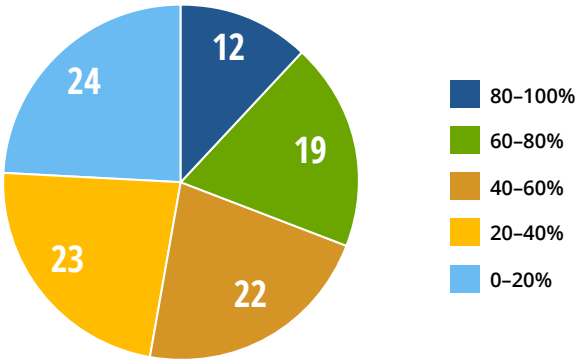
[5] NACD, from the upcoming *American Board Practices and Oversight Report* (Arlington, VA: NACD, 2021), p. 9.

at least 20 percent of future board meetings to be virtual, and 13 percent expect at least 60 percent of board meetings to be virtual.[6]

Percentage of Virtual Meetings Post Crisis

These findings show how much of a shift to virtual board work we might expect to see in the future. Even if just 1 in every 10 boards holds a majority of their meetings virtually, it would lead to a drastic shift in board operations. Seventy-six percent of respondents say that they expect that at least 20 percent of committee meetings will be virtual in the future, with 30 percent saying that at least 60 percent of committee meetings will be virtual.[7]

Percentage of Virtual Committee Meetings



Percentages may be +/– 100 due to rounding **2020 Poll, n= 708**

Source: NACD, from the upcoming American Board Practices and Oversight Report (2021), p. 14.

Furthermore, in a May 2020 COVID-19 Pulse Survey, NACD found that 54 percent of responding directors thought that the changing way in which work gets done would be one of the key influences that most impact the post-recovery period, and 32 percent said that the acceleration in digital technology would be yet another.[8]

Directors foresee that virtual meetings will be more common at the committee level than they will be at the full-board level. As with full-board meetings, even a modest change in the frequency of virtual com-

[6] NACD, from the upcoming *American Board Practices and Oversight Report* (Arlington, VA: NACD, 2021), p. 14.
[7] Ibid., p. 14.
[8] Barton Edgerton, "Strategy, Workforce Issues Top Director Concerns Post-Crisis, Survey Finds," *NACD BoardTalk* (blog), June 9, 2020.

mittee meetings would likely make them a factor in the boardroom for years to come.

While the extent to which virtual board meetings will become an accepted and effective tool for corporate governance is unknown, future board meetings are likely to feature more virtual communication. NACD survey data showed that directors were able to adapt in real time to changes in digital communication; that the challenges posed by digital technology that directors face now can likely be remedied with better platforms; and that committee work will see more virtual meetings, which may influence the frequency of virtual full-board meetings.

The pathway forward to greater adoption of virtual communication methods may first chart its way through committee meetings, where the technology will first be introduced and then tweaked so that it becomes more conducive to efficient meetings. From there, full boards, which are largely made up of those same committee members, could apply this efficiency to their meetings, as well.

Every board will not stay virtual following the crisis; however, the trends point toward greater adoption, both in the near term and in the longer term. ■


Andrew Lepczyk

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2021 Strategic Risks for Boards

By Erich Bergen, Ann E. Blakely, Jeff Jorge, Mark Ross, Raina Rose Tagle, Frank Walker, and Kim Wylam, Baker Tilly

At the beginning of 2020, the United States was approaching 10 years of slow and steady—but uneven—growth. According to the Center on Budget and Policy Priorities, economic growth had averaged 2.3 percent per year from mid-2009 through 2019. This growth stalled when the economy started shutting down in March 2020 due to the COVID-19 pandemic, resulting in a decline of 5 percent in the annual rate of real GDP in 2020's first quarter, and 31.4 percent in the second quarter.

The challenges that the pandemic unleashed on businesses were numerous—the sudden closure of workplaces and schools, shortages of key personal protective equipment, inconsistent and confusing local regulations on the definition of "essential workers," supply-chain disruptions, and devastating disruption in the travel and hospitality sectors.

As we move into 2021, the economy has improved in some ways but remains stagnant or depressed in others. Organizations—and their boards—have had three quarters of experience in pivoting not only to sustain their businesses, but also to align with the new business landscape to enable growth.

This viewpoint focuses on three key risks facing organizations—financial resiliency, supply chains, and the workforce—with an emphasis on how boards can help support and inspire organizational transformation in a time of uncertain, uneven recovery.

Boards without a holistic view of forward-looking fiscal scenarios, including worst-case assumptions, were likely taken by surprise when the tide turned so dramatically.

KEY PROJECTIONS

1. The pandemic has spotlighted the value of liquidity.
Prior to March 2020, businesses in the United States were at peak earnings as the United States was enjoying the longest expansionary period in its history. All the hallmarks were in place: significant M&A activity, recapitalizations, IPOs, new start-ups, and general growth investments. The long expansion also meant that corporate leverage was at its peak, with the amount of non-investment-grade, leveraged debt in the United States more than doubling to $1.3 trillion between 2007 and 2020, and the dollar-denominated, high-yield bond market rising above 65 percent to $1.6 trillion during the same time period.[1]

The combination of solid growth prospects, decreasing regulation, increasing valuation multiples, and an abundance of available capital fueled this growth. Credit markets were robust—bank and burgeoning nonbank lenders were very much open for business.

Liquidity is a little like oxygen: organizations do not know how much they need until the supply is cut off. While leverage can be an incredibly cost-effective way to use capital to earn and to amplify returns, if an organization does not have a sound plan to survive a cash flow crisis, leverage becomes an anchor. Once growth stops, as happened in 2020 due to the pandemic, organizations must reevaluate the value of having a strong balance sheet and a prudent capital structure.

In some instances, the economic shock created by the pandemic exacerbated trends already in place before March 2020. Boards without a holistic view of forward-looking fiscal scenarios, including worst-case assumptions, were likely taken by surprise when the tide turned so dramatically. In more prosperous times, boards may not have been interested in seeing something as simple as a forward-looking cash flow analysis. As the tide has turned, this type of information has become a lifeline for the board and senior leaders, informing the tough decisions required by quickly-changing circumstances.

Several months into the COVID-19 pandemic, some winners and losers had become obvious. Technology companies that enable working from home, e-commerce, and online consumer services were some of the winners. Travel and hospitality, brick-and-mortar retail, higher education, and the energy market were among the obvious losers.

Freeing up credit

The full economic impact of the pandemic was blunted by trillions of dollars of federal funding through the Coronavirus Aid, Relief, and Economic

[1] Bob Diamond and Ty Wallach, "Coronavirus is igniting a devastating crisis for highly indebted companies," *Fortune*, April 4, 2020.

Security Act (CARES Act) and the Paycheck Protection Program, directed at individuals, small businesses, and large sectors like the airlines.[2] The Department of Health and Human Services provided health care providers with billions of dollars in either direct grants or advanced Medicare payments. The Federal Reserve intervened by cutting interest rates to their effective lowest level, conducting unprecedented quantities of asset purchases, and establishing a range of emergency lending facilities to free up credit to households, businesses, and state and local governments. Opening up credit markets has allowed at-risk companies to refinance existing debt—a lifeline to some as they work to reimagine their businesses and ride out a period of decreased business activity.

In addition, specialty finance and nonbank lenders that were active before the pandemic probably had sufficient liquidity to invest once the economy started opening up again.

Keys to a rapid recovery

Regardless of industry, certain key ingredients will be required for an organization to execute a successful recovery after the blunt force economic trauma of the pandemic. While the ingredients for recovery are intuitive and simple, they can be elusive during a time of crisis:

- the right management team for a crisis
- liquidity
- a viable core business
- quick and astute decision making

In highly functioning organizations, management will come to the board with their plan for coming out of or even thriving as the economy rebounds. The governing body will serve as a sounding board and provide their advice and perspective on the reliability of that plan.

The board is probably in the best position to assess the effectiveness and results of the organization's crisis management. They may determine that the CEO's skills are no longer best suited for the fast-changing environment or that the business may require a supporting role such as a chief restructuring officer. The chief financial officer should know all of the financial levers to support business needs and be able to run different scenario analyses to best support the liquidity of the business.

Because the pandemic has altered so much of the business landscape, the board should work with management to reassess the relevancy of the organization's current strategic plan. Organizations need to do more forward-looking financial analysis and engage in more scenario planning

[2] The Congressional Budget Office, *The Budgetary Effects of Laws Enacted in Response to the 2020 Coronavirus Pandemic*, March and April 2020, June 2020.

to figure out where they're going to be one, three, and five years from now based on different underlying assumptions. Understanding a variety of possible outcomes will help organizations to become more flexible, more proactive, and less reactive.

2. Visibility into all supply-chain tiers will remain key to company resiliency.

Supply chains have been dramatically tested domestically and globally in recent years by tariffs, trade pressures, natural disasters, and (most recently) the pandemic. Because of these pressures, which have been accelerated by the pandemic, manufacturers and others have actively looked for alternatives to China for key supplies. According to the US Census Bureau, from 2018 to 2019, imports of manufactured goods from China declined by about $90 billion, a 17 percent drop. Through August of 2020, imports from China were down 13 percent compared to a similar point in 2019.[3]

Most organizations depend on multitier supply chains. Tier 1 suppliers provide key goods to the organization. Tier 2 suppliers are the suppliers to the Tier 1 companies, and so on. Organizations often do not have a clear vision beyond their Tier 1 suppliers; an organization may not recognize the impact of supply chain disruption on any supplier beyond Tier 1 until it is too late.

As the impact of the pandemic spread, organizations with limited supply chains were at a decided disadvantage. They had a harder time replacing a supplier, in part because they could not physically meet with possible new suppliers and investigate environments and in part because (even if these organizations understood the interconnectivity of their supply chain tiers) they may not have had a process in place to make a thoughtful assessment of an alternative supplier.

Organizations with diversified supply chains were able to shift quickly from one supplier to another if one tier of their supply chain shut down or slowed down due to the pandemic.

Boards should inquire regarding management's visibility into all tiers of the supply chain, the supply chain's critical elements and dependencies, the organization's degree of reliance on critical vendors, and the organization's ability to access alternative suppliers. In other words, boards should receive an assessment from management of the risk to the supply chain and of management's ability to mitigate that risk.

Management should present scenario analysis around supply chains with recommendations that may lead to entertaining the possibility of reshoring or moving the supply chain away from Asia and closer to the United States. While reshoring is not for everyone, a 2020 study from Foley & Lardner noted that 70 percent of manufacturing executives agree

Boards should inquire regarding management's visibility into all tiers of the supply chain.

[3] United States Census Bureau, "Trade in Goods with China," on census.gov.

that because of the pandemic, companies will reduce their focus on sourcing from the lowest-cost supplier in favor of higher supply chain resiliency.[4]

Accelerating supply chain investment

Boards should ask their management teams what sort of investments they have made to upgrade visibility into and flexibility of their supply chains. Some businesses took advantage of the slowdown caused by the pandemic to accelerate investment in technology, deciding that deploying new technology when plants were idle or running at reduced capacity was a smart investment to prepare for when the effects of the pandemic eased and the economy opened up again. Some organizations took advantage of video-based technology to help with the selection and validation of new suppliers, where one person with a camera would visit a supplier and the rest of the supply-chain team would evaluate certain supplier criteria. Sometimes, an organization did not have to employ "new" technology; all they had to do was fully utilize technology it already had in place, such as cloud-based platforms.

The pandemic has revealed the stark differences in organizations' ability to adapt their workforces.

3. Challenges stemming from the changing workplace landscape will continue.

At the beginning of 2020, organizations faced a significant talent problem. Low unemployment, high turnover, outdated or inefficient human resources (HR) technology and systems, and insufficient employee-benefits systems combined to make it hard for organizations to find the best talent. The rapid shutdown of local economies due to the COVID-19 pandemic temporarily overshadowed these issues.

The pandemic has revealed the stark differences in organizations' ability to adapt their workforces. Some made the transition to remote work almost seamlessly because they already had the right systems in place: Their employees worked on laptops versus desktops. They were using, if only infrequently, meeting software such as Skype, Zoom, or WebEx. Their key programs and files were accessible in the cloud—not just in on-site servers.

In addition, these organizations likely offered flexible work schedules and were able to encourage a healthy work/life balance among their employees. Some organizations already had key parts of their workforce organized in teams, or used job shares, so that there were some skill redundancies already in place. Companies not prepared to shift to a remote work environment faced two immediate barriers: the cost to put the infrastructure in place to go remote, and the implementation time to get personnel working efficiently and safely in a remote environment.

[4] Foley & Lardner LLP, *2020 Global Supply Chain Disruption and Future Strategies Survey Report*, September 2020, p. 7.

Boards need to work closely with the organization's leaders to ensure that they are adapting both their workplaces and their talent management processes to keep the current staff productive.

Talent retention

HR professionals and recruiters recognize that the successes shown by flexible work hours and remote workforces have increased the pressures on organizations to retain key talent. Employees have shown during the pandemic that they can stay on task and drive projects forward, even when working from home, with teams spread out in different parts of a region or country, and with flexible hours.

Employees in many industries now have more leverage than they had before. Employees generally do not leave a job because of money; they usually leave because of problems with the culture of an organization or the relationships they had with their manager and their coworkers. Over the last several months, even organizations with strong cultures have had to work hard to replicate their cultures in a virtual space. The laptop became the break room, the place where people from all different disciplines and levels within the organization could meet virtually.

Boards should understand management's assessment of workforce retention challenges and evaluate any necessary shifts in retention strategies.

Talent recruitment

While boards of directors are not too often involved in the operations of an organization, they should pay attention to how workforce shifts will impact the future of the company. Boards need to be aware that with a shift to working from home in many sectors of the economy, recruiters now have the opportunity to reach a broader spectrum of people and regions of the country to find the right talent. In addition, there is a nationwide call for organizations to find a more diverse workforce. And a more geographically dispersed workforce may also lead to lower compensation costs, if compensation is not based on an office located in a metropolitan area.

The challenge for boards is to recognize that the talent landscape has changed for both retention and recruitment. Boards need to work closely with the organization's leaders to ensure that they are adapting both their workplaces and their talent management processes to keep the current staff productive and to fill important skills gaps that will support growth.

CONCLUSION

Now that organization leaders and boards have experienced a pandemic-fueled economic slowdown, what can they do differently to emerge on the other side stronger? The organization's leaders need a board that will support difficult but necessary actions like furloughs or layoffs, closing plants or health-care centers, discontinuing product lines, or other actions where there might be negative implications for the organization's public relations.

The pandemic has underscored why size, scale, and liquidity are so important. Over the next year, organizations in the hospitality and health care sectors will be looking at cost-saving initiatives that include consolidation, mergers, or acquisition by another company—all strategic matters that require board-level leadership and guidance. Organizations' reactions to the pandemic will accelerate succession issues, as well, as the pace of change will convince some employees near retirement age that the necessity of adopting new skill sets or adapting to new work environments is not worth the effort. Board leadership and oversight regarding executive succession planning will become even more critical in this environment.

Many organizations that had the liquidity necessary to do so took advantage of the economic slowdown to accelerate their investment in technology in key parts of the organization. Whether this involved finding new supply-chain partners or updating HR platforms and policies, many organizations took advantage of the downtime created by the pandemic to better equip themselves—not only for the economic bounce back, but also for the 2021 equivalent of a trade war, pandemic, or natural disaster. Now more than ever, board oversight of enterprise risk—including supply chain risk—is critical to the organization's future sustainability. ■

QUESTIONS FOR DIRECTORS TO ASK THEMSELVES

Financial resiliency

- Is our strategy still appropriate considering all that we have already experienced and our projections for 2021?
- Do we need to consider M&A targets, divestiture of certain business units, or layoffs or furloughs, not only from a strategic perspective but also with an eye toward reputational risk?
- Does the organization have the appropriate capital structure and resources to execute its plans?

Supply chain

- Do we as the governing board have a clear picture of all supply-chain tiers to ensure resiliency?
- What measures have the organization's leaders put in place to ensure that the business is not affected in the same manner if a systemic disruption happens in the future?

Workforce issues

- Does the organization have the right talent-management system in place, including up-to-date talent profiles, to support any changes to the workforce that may be necessary to handle a COVID-19–type situation in the future?
- What did we learn from the pandemic slowdown in terms of hiring practices and flexible work arrangements that should be permanently incorporated into the HR strategy?


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Shareholder Engagement in a Virtual World

By Dorothy Flynn, Broadridge Financial Solutions

INTRODUCTION

New technologies continue to change the corporate governance landscape for directors, especially when it comes to shareholder engagement. Even before COVID-19 forced annual shareholder meetings online, retail investors were increasingly participating in them[1] and voting their shares on their mobile phones, on their brokers' websites, and through new apps.[2] The pandemic is accelerating these trends, and innovation is ushering in an era of broader and deeper shareholder engagement.

Directors will welcome the opportunity to deepen their engagement with new and long-term retail investors who, as a group, own nearly 30 percent of the shares of listed companies.[3] Companies are using digital technologies to engage investors, including the next generation of shareholders. The retail shareholders are learning that their votes matter and that companies want them to participate. Boards need to ensure that their company is using emerging technology to improve transparency and drive investor engagement with a broader set of shareholders. It's time for directors to think outside the institutional shareholder box.

KEY PROJECTIONS

1. New brokerage business models will continue to create new shareholders.

New brokerage models will continue to create millions of new shareowners for issuers and investment funds in 2021. Together with a rising stock market, there is record growth in the number of new stockholder "positions" held by investors.[4] Many of the new owners are millennials and first-time shareholders, where digital communication from the company and the board is expected.

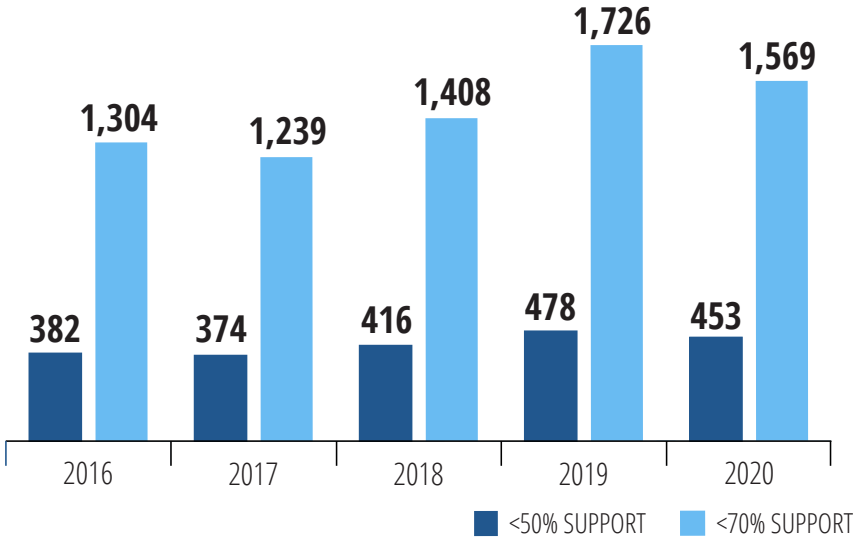
Robo-advisers—digital platforms that provide automated, algorithm-driven financial planning services with little to no human supervision—will continue to attract new customers in 2021 because they make investing accessible and easy. These automated platforms often allow first-time investors to purchase listed stocks and exchange-traded funds with zero commission.[5] The intergenerational transfer of wealth, which will see tens of trillions of dollars[6] change hands between various genera-

[1] Broadridge Financial Solutions, *Virtual shareholder meetings: 2020 mid-year facts and figures*, p. 1.
[2] Broadridge Financial Solutions, "Be Counted. Be Heard." on broadridge.com.
[3] Broadridge Financial Solutions, "2019 Proxy Season Review," *ProxyPulse*, p. 4.
[4] Kate Rooney, "Fintech app Robinhood is driving a retail trading renaissance during the stock market's wild ride," cnbc.com, June 17, 2020.
[5] Bailey McCann, "Robo Advisers Keep Adding On Services," the *Wall Street Journal*, March 8, 2020.
[6] Roubini Thought Lab in conjunction with Bank of Montreal, Broadridge, CFA Institute, Cisco, eToro, Schroders, SEI, and State Street, *Wealth and Asset Management 2021: Preparing for Transformative Change*, p. 3.

tions in the next 25 years, is also spurring stock ownership by millennials. This demographic needs to be educated on the importance of their participation in the governance process.

Companies can foster long-term holding by engaging these individuals and letting them know that their votes matter. Typically, retail investors own 30 percent of outstanding shares in public companies, while institutional investors own 70 percent.[7] However, retail investors only vote 29 percent of their shares, while institutional investors vote 91 percent of their shares. The balance of un-voted shares (comprising 20% of all shares outstanding) can make a difference, including when it comes to surpassing thresholds set by proxy advisers. For example, in proxy season 2020, 453 directors failed to attain majority support.[8] Engaging the support of retail shareholders who are often supportive of management may have changed the outcome in some of these instances.

Number of Directors Failing to Receive Support



Source: *ProxyPulse*, a Broadridge and PwC Initiative, 2020 Edition. Used with permission.

New investors appreciate knowing that directors want to understand their sentiment and that of all their shareholders, yet many retail investors find proxies daunting. Companies can use microsites to present information extracted from the proxy filings in a more attractive and inviting manner. Microsites enable shareholders to find the information they are looking for more easily and allow them to navigate quickly to voting mechanisms.

[7] Broadridge and PwC, "2019 Proxy Season Review," *ProxyPulse*, p. 4.
[8] PR Newswire, "Most Active Shareholder Participation and Voting in 14 Years, According to ProxyPulse Report," press release, November 10, 2020.

In 2021, issuers and brokers will also drive engagement by continuing to adopt mobile apps that make it easier for investors to vote their shares. They will leverage broker Application Program Interface (API) software, which allows computer programs to interact with each other to integrate shareowner proxy information and voting into broker-dealers' websites and mobile apps. One-click authentication and access will continue to boost the number of positions voted from enhanced emails, which are more appealing than static emails.[9]

Digital platforms will continue to have a positive impact on shareholder engagement and voting. The 2020 proxy season saw the highest voting levels in 14 years as a record 97 percent of the voted shares were cast electronically; over 3 million retail positions were voted by mobile phones, which was up from 2.7 million in the 2019 season.[10]

Digital voting platforms are helping issuers to save millions of dollars on reductions in paper and postage costs. With 81 percent of the paper taken out of the system this season (as a result of investors consolidating accounts, e-delivery, and reducing duplicative mailings to households), issuers and fund companies saved an estimated $1.8 billion on printing and postage costs in comparison to mailing full proxy packages.[11] This is up from 55 percent with savings of $445 million in 2010. Issuers will increasingly make use of Quick Response (QR) codes on proxy notices that are replacing full packages for the dwindling percentage of proxies that are still mailed.[12]

Digital platforms will continue to have a positive impact on shareholder engagement and voting.

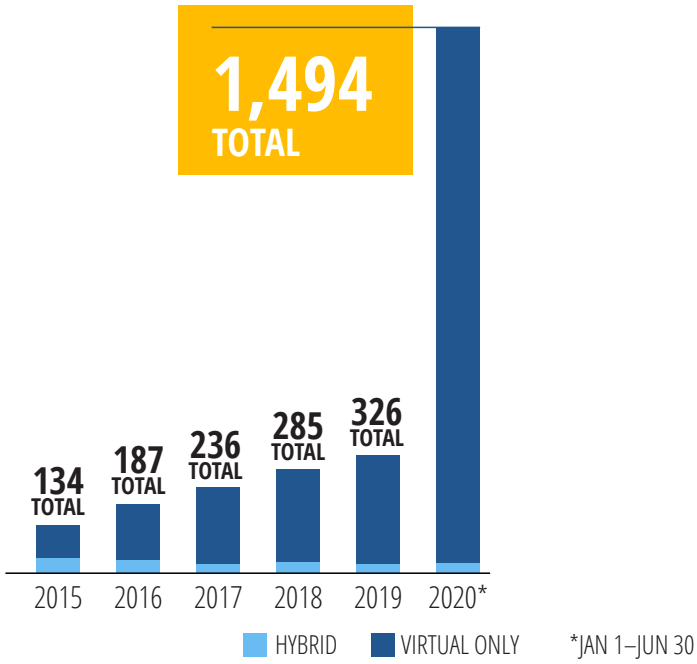
2. Virtual shareholder meetings will continue to drive engagement. In 2021 and beyond, companies and shareholders will continue to evolve their use of technology to meet their needs and circumstances. Technology continues to make shareholder meetings more accessible. Ongoing concerns about COVID-19 will result in the continued use and evolution of virtual shareholder meeting (VSM) technologies. These web-based meetings fulfill the regulatory obligations of enabling validated shareholders to attend and vote. Beyond boosting accessibility and engagement, a VSM offers boards substantial cost savings in comparison to an in-person event.

The number of VSMs ballooned in 2020 as a result of social-distancing measures required by states in response to the COVID-19 pandemic. Approximately 75,000 people attended 1,494 VSMs hosted by Broadridge

[9] Broadridge, *2019 Proxy Season Key Statistics and Performance Rating* (2019), p. 1.
[10] Ibid.
[11] The estimated savings is based on information from the National Investor Relations Institute (Biennial Report Survey, December 2010) and USPS rates. NIRI estimates a median unit cost of $4.82 for printing. Postage is calculated at $2.04 and is based on USPS rates from Broadridge. Estimates are based on a comparison to full set delivery.
[12] Broadridge, *2019 Proxy Season Key Statistics and Performance Rating* (2019), p. 1.

during the first half of 2020.[13] This compares with 326 VSMs for all of 2019. More than 80 percent of the companies holding meetings using an online-only format this year did so for the first time.[14] Attendance at each online meeting was three times greater on average this year than it was last year and greater than what has been typically seen at in-person meetings in recent years.[15]

Total Virtual Shareholder Meetings Conducted by Broadridge.



Source: *ProxyPulse*, a Broadridge and PwC Initiative, 2020 Edition. Used with permission.

Attendees also stayed longer, voted more often, and submitted more questions than they did at last year's VSMs. Average voting participation at companies that utilized a VSM was 71 percent, exceeding participation at companies that did not provide a VSM (63.6%).[16]

VSMs involving shareholder proposals were nearly twice the length of VSMs without shareholder proposals and had an average of 14 shareholders casting 'live' votes during the meeting. Shareholders asked an

[13] Broadridge, *Virtual shareholder meetings: 2020 mid-year facts and figures*, p. 3.
[14] Ibid., p. 2.
[15] Average attendance at online meetings was 20 in 2018, 18 in 2019, and 50 January 1 through June 30 in 2020. Source: unpublished Broadridge data.
[16] Broadridge Financial Solutions, *2020 Proxy Season Key Statistics and Performance Rating*, p. 2.

average of 19 questions at VSMs with shareholder proposals and some of these VSMs had more than 1,000 participants logging in. Meetings without shareholder proposals in the first half of 2020 drew 37 attendees on average and lasted 18 minutes; they had two live votes and an average of two questions from shareholders.[17]

Virtual Only Shareholder Meeting Key Statistics

	VSMs with Proposals	VSMs without Proposals
Number of VSMs	193	1,301
Average number of attendees	146	37
Average number of votes	14	2
Average number of questions	19	2
Pre-meeting questions	25% (48 meetings)	8% (106 meetings)
Average duration	34 minutes	18 minutes

Source: *ProxyPulse*, a Broadridge and PwC Initiative, 2020 Edition. Used with permission.

Issuers and shareholders saw significant advantages to holding their meetings online—and many are not going back to in-person meetings. Although this year's growth in the number of VSMs is historic, the trend before the pandemic was already in view. The number of companies hosting annual meetings through Broadridge had grown at a 17.5 percent annual rate over the previous two years as the technologies gained appeal among issuers.[18] The use of VSMs has also come to reflect corporate governance standards that are on par with in-person meetings. A 2019 study by the Harvard Law School Forum on Corporate Governance reported comparable governance standards between Russell 3000 companies across both formats, with similar dissent levels on important voting matters.[19]

[17] Dorothy Flynn, "Opinion: Virtual AGMs bringing increased engagement," corporatesecretary.com, September 24, 2020.
[18] Broadridge, *Virtual shareholder meetings 2020: mid-year facts and figures* (2020), p. 1. The report shows that there were 236 meetings hosted through Broadridge in 2017, 285 meetings in 2018 (an increase of 21 percent over 2017), and 326 meetings in 2019 (an increase of 14 percent over 2018), yielding an average increase of 17.5 percent.
[19] Marie Clara Buellingen, "Virtual Shareholder Meetings in the US," *The Harvard Law School Forum on Corporate Governance* (blog), October 10, 2019.

Looking forward, many companies, having learned from their rapid introduction to VSMs, will have centralized, intuitive tools for administering meetings and both management and board members should expect enhanced participation. The process for shareholder questions will offer more transparency.

3. Support for ESG proposals will continue to increase.
Shareholders will continue to focus on environmental, social, and governance (ESG) disclosures, and on the standardized frameworks some companies use to evaluate their risks and practices. BlackRock's engagement priorities related to environmental risks now specifically state that they will hold members of the relevant committee or the most senior nonexecutive director accountable for inadequate disclosures and the business practices underlying them.[20] In January 2020, CalSTRS approved new ESG guidelines aimed at picking companies for engagement where CalSTRS can make a difference by influencing change and driving the stock price up.[21] In October 2019, the New York City Comptroller's office launched the Boardroom Accountability Project 3.0, aimed at encouraging diversity at both the board and executive-leadership level. The office sent letters to 56 S&P 500 companies, calling on them to adopt a search policy that requires the initial list of director candidates to include female and racially/ethnic diverse candidates.[22]

Shareholder support for social and environmental proposals increased from 25 percent in 2019 to 27 percent in 2020.

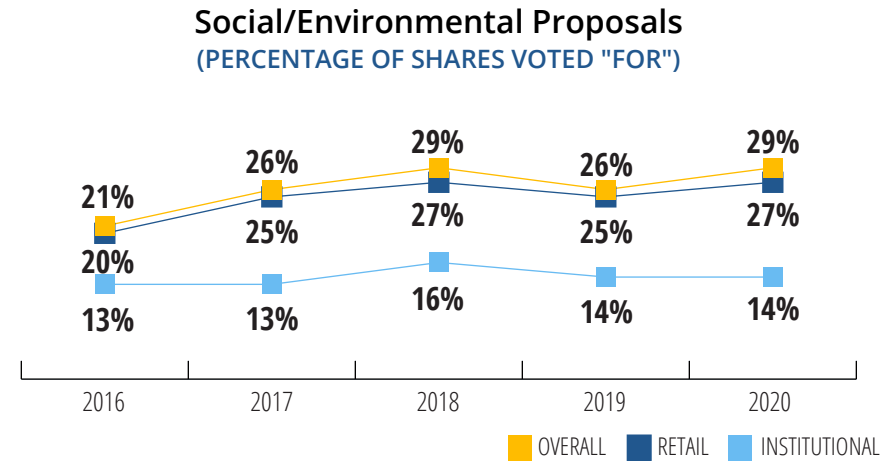
We believe directors will gain additional insight on their investors through voting analytics platforms. Newer data management and software tools will provide early indications of voting trends leading up to a general meeting and utilize the latest API- and blockchain-based technologies to address shareholder disclosure requirements.

The average level of support for all 440 shareholder proposals submitted to a vote overall in 2020 was up slightly—from 29 percent of shares voted in favor of the proposal in 2019 to 30 percent in 2020. The number of environmental and social proposals put to a vote remained flat at 114 in 2020 (vs. 115 in 2019). However, shareholder support for social and environmental proposals increased from 25 percent in 2019 to 27 percent in 2020. This was a result of an increase in support from institutional owners—from 26 percent in 2019 to 29 percent in 2020.

Third Economy CEO Chad Spitler believes that support for ESG proposals will continue to rise because a "growing body of research indicates that ESG factors have the potential for financial relevance. For example,

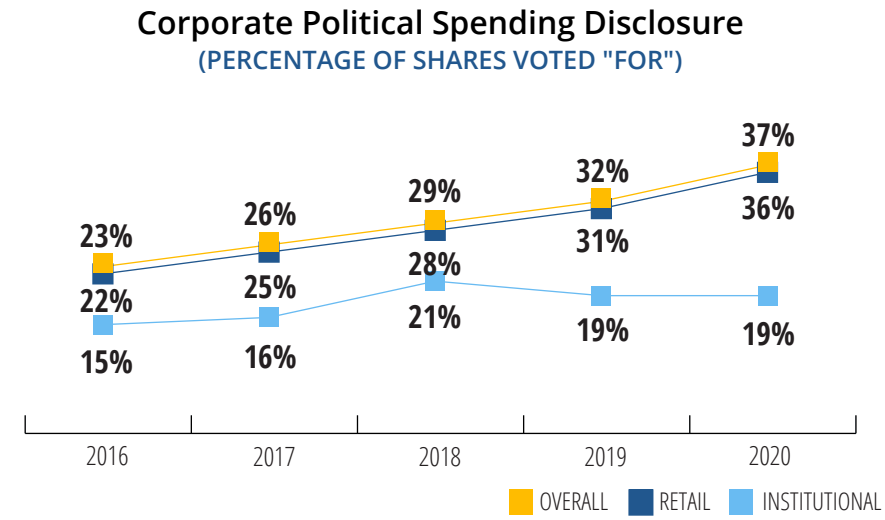
[20] Peter A. Tomasi and Michael B. Kirwan, "In the Shadows of the COVID-19 Pandemic–BlackRock's ESG Expectations," posted on Foley & Lardner LLP's blog on May 1, 2020.
[21] "CalSTRS Revamps ESG Guidelines," posted on *Chief Investment Officer*, February 10, 2020.
[22] New York City Comptroller's Office, "Comptroller Stringer Launches Boardroom Accountability Project 3.0, a First-in-the-Nation Initiative to Bring Diversity to Board and CEO Recruitment."

large institutional investors may be supportive of increased transparency in areas such as human capital management as a result."[23]



Source: *ProxyPulse*, a Broadridge and PwC Initiative, 2020 Edition. Used with permission.

Breaking it down further, certain types of proposals saw larger support increases than others—signaling potential areas of focus for 2021. For example, regarding proposals on disclosure of corporate political spending, shareholder support increased from 31 percent in 2019 to 36 percent in 2020—the largest increase seen in the last five seasons. This was driven largely by an increase in support from institutional owners—from 32 percent in 2019 to 37 percent in 2020. [24]



Source: *ProxyPulse*, a Broadridge and PwC Initiative, 2020 Edition. Used with permission.

[23] Chad Spitler, in an email interview with Broadridge conducted on October 27, 2020.

[24] Broadridge and PwC, "2020 Proxy Season Review," *ProxyPulse* (2020), p. 6.

BOARD IMPLICATIONS

In light of these trends, some boards are making time on their agendas to draw up strategies for engaging all of their shareholders, including retail investors whose voice and votes are important on governance matters. A survey by Broadridge and the National Association of Corporate Directors found that 39 percent of boards communicated with the company's top five shareholders, 39 percent communicated with institutional investors, and 4 percent communicated with retail investors.[25] Board members should consider participating in greater engagement with investors. Stronger efforts at outreach could foster a more lasting connection with shareholders and provide better information to investors about both company operations and the roles that directors fulfill.

The virtual annual general meeting will become business as usual for many firms, and not just because of travel restrictions and social distancing requirements due to the COVID-19 pandemic. This makes it incumbent on directors to build on the opportunities within the platform to spur greater engagement. The increase in the numbers of attendees, questions posed, votes cast, and overall engagement that occurred in the VSMs that were held during the 2020 proxy season is evidence that this digital experience provided more shareholders with a meaningful way to engage with the companies in which they are invested. To solidify these developments, messages via text, social media, or other channels encouraging attendance and participation in the governance process will contribute to a culture of owner voting and other engagement.

Before a board starts engaging investors on ESG matters, Spitler advises that they "make sure to educate themselves on the leading frameworks" and that they "be able to speak the language that investors speak." Spitler also cautions boards that "the field has many important nuances that can confuse directors and negatively affect how they are perceived by investors if they are not careful. It's also important to take control of your ESG narrative and move from reactive to proactive."[26]

Directors should expect growing support for ESG proposals in 2021 and beyond.

Directors should expect growing support for ESG proposals in 2021 and beyond. The Broadridge/NACD survey found that 32 percent of respondents strongly agree and 47 percent agree somewhat that ESG policies will result in greater action by companies to address ESG issues.[27] Newer shareholders will need to be engaged to have their voices and votes heard. Boards should ensure management provides a range of online tools that allow shareowners to evaluate proposals and vote accordingly. ■

[25] These statistics are drawn from unpublished data from a survey that was in the field in November 2019.
[26] Chad Spitler, in an email interview with Broadridge conducted on October 27, 2020.
[27] These statistics are drawn from unpublished data from a survey that was in the field in November 2019.

QUESTIONS FOR THE BOARD

Board members should ask themselves or management these questions throughout the year:

- Do we understand how technology can help us to better engage all shareholders in the governance process?
- Do we have a strategy for engaging both new and existing shareholders?
- Do we track the kinds of outreach to shareholders that strengthens their long-term relationship with the company?
- Can we make better use of technology so that communications about important company developments and company performance reach shareholders in a way that leads to greater engagement?
- How does our use of technology for engagement and governance compare to that of our peer group?

Dorothy Flynn

Dorothy Flynn is president, Corporate Issuer Solutions, at Broadridge Financial Solutions.

Rethinking the Future of Privacy

Preparing the Board for Growing Consumer Privacy Expectations

Daniel P. Frank, Deloitte & Touche LLP

Prior to the effective date of the European Union's General Data Protection Regulation (GDPR)[1], privacy was largely viewed as a "compliance" exercise, with the ramifications for a lack of "compliance" rarely, if ever, necessitating board-level attention. But when the GDPR became effective, the role of the board in consumer privacy changed significantly, whether you were a European Union-based company or not. In what seemed like the blink of an eye, the impacts of noncompliance suddenly mattered and could not be ignored. The privacy world hasn't been the same since, and it may never be the same again.

Boards must continue to educate themselves on cyber risk and privacy concerns as they work to maintain oversight and provide guidance to their management teams. Boards should be aware of four emerging privacy trends that will impact how they can help organizations manage ever-increasing consumer privacy expectations:

Boards must continue to educate themselves on cyber risk and privacy concerns as they work to maintain oversight and provide guidance to their management teams.

KEY PROJECTIONS

1. The global proliferation of privacy laws and regulations will continue.

GDPR ushered in a new era in privacy laws and regulations with "copycat" laws and regulations proliferating both domestically and globally. The California Consumer Privacy Act (CCPA)[2] has forced US-based organizations that may not have had to comply with the GDPR to fundamentally rethink their approach to privacy. CCPA-like laws are popping up in the United States at a rapid pace, with 27 out of 50 US states having passed or proposed a full-state privacy law.[3] It likely won't be long before each of the 50 states has some version of this law, making the requirements of the CCPA the new "norm."

The proliferation of privacy laws and regulations, however, does not stop here in the United States. The implementation of laws similar to the GDPR has and will continue to spread globally, as well. Brazil, for example, has passed Lei Geral de Proteção de Dados ("LGPD"), a directive that clearly took inspiration from the GDPR.[4] Australia, Japan, South Korea, Thailand, Chile, New Zealand, and India have also recently passed or proposed GDPR-like privacy laws. According to a report from Gartner, by 2023, 65 percent of the world's population will have its personal data covered under modern privacy regulations, up from 10 percent in 2020.[5]

Gone are the days when organizations only had to worry about privacy laws in effect in Europe. It won't be too long before adherence to GDPR-like requirements are a necessary part of doing business globally.

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[1] See "What is GDPR, the EU's new data protection law?" on gdpr.eu.
[2] See "California Consumer Privacy Act (CCPA)" on oag.ca.gov.
[3] Sarah Rippy, "US State Comprehensive Privacy Law Comparison," on iapp.org.
[4] Read the law in English translation: Brazilian General Data Protection Law.
[5] Susan Moore, "Gartner Predicts for the Future of Privacy 2020," January 20, 2020.

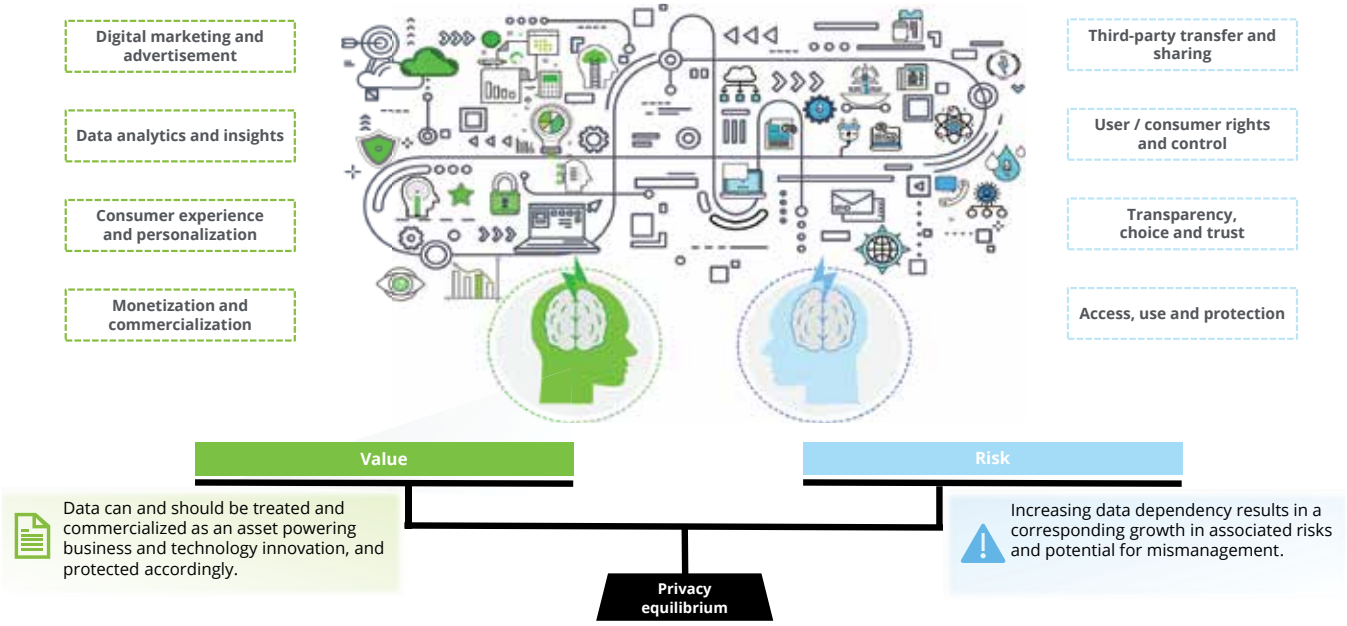
2. There will be an increased focus on data ethics vs. compliance with privacy laws.

While the global proliferation of privacy laws and regulations is certainly garnering organizations' attention, a more important fundamental shift in leading organizations' philosophy on privacy might have an even bigger impact on your business. According to Salesforce's third *State of the Connected Customer* report, 70 percent of consumers strongly associate transparency with trust while 58 percent of consumers are comfortable with relevant personal information being used in a transparent and beneficial manner.[6] Therefore, increasingly, leading organizations are not just putting privacy capabilities (people, process, and technology) in place because a privacy law or regulation says they have to (i.e., to comply). These organizations are implementing leading privacy practices because they believe consumer trust is instrumental in effectively executing their business strategy and establishing a competitive advantage. Consumer trust, from a privacy perspective is based primarily on two increasingly important organizational data-ethics necessities: full transparency and complete control.

Full transparency means that forward-looking organizations have no secrets when it comes to their consumers' privacy. These organizations are very clear about what personal information they are collecting from their consumers, why they are collecting it, how they are using it, with whom they are sharing it, whether they are selling it (and to whom), where they are sending it (geographically), and how long they are going to keep it. Complete control means that these organizations are putting consumers in full control of how their personal information is shared, sold, moved, or otherwise used. As outlined in the graphic on page 27, this transparency from the organization and the control that the consumer has over their own data helps to balance the data value versus risk equilibrium and increases consumer trust. This allows organizations to do more with their consumers' information, including using it for advanced data analytics, digital marketing and advertising, personalization of consumer experience, and data monetization.

[6] See Salesforce, *Third Edition: State of the Connected Customer* (2019).

Privacy in the Digital Age Requires Balancing Value and Risk

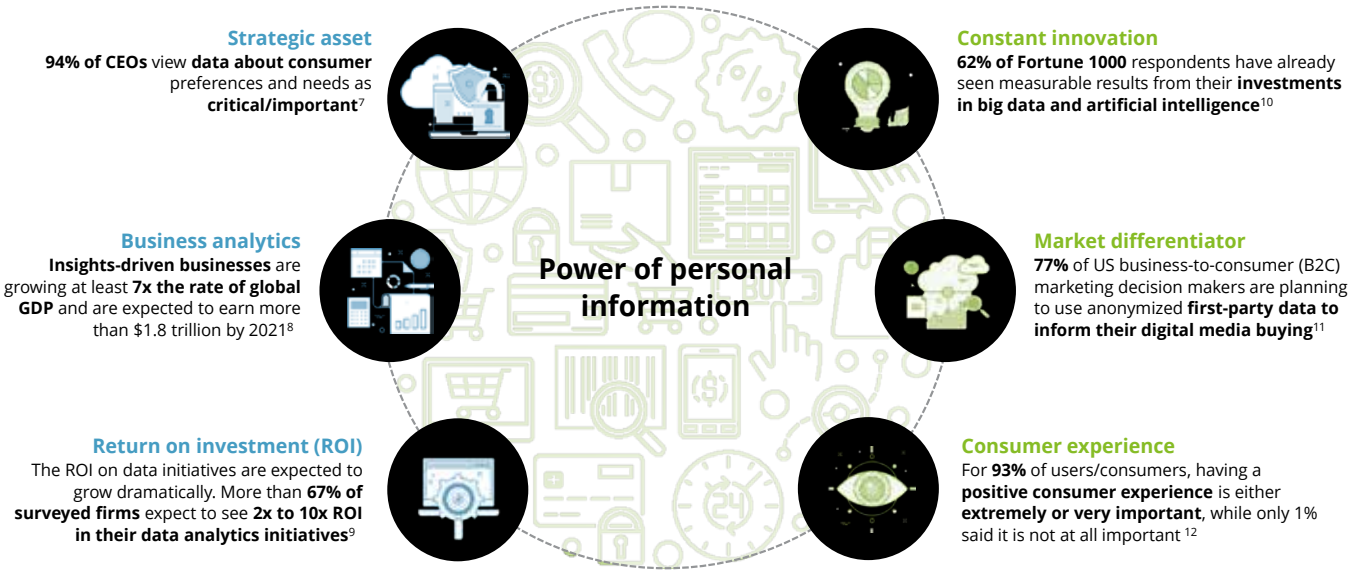


Source: Deloitte.

3. Emerging technology will rely heavily on personal information. Why are leading organizations focusing on the ethical use of personal information vs. merely focusing on legal and regulatory compliance? The answer is simple: to compete (and candidly, to survive) in today's business world, organizations, regardless of their industry, need to have a substantial focus on emerging technology innovations. As outlined in the graphic on page 28, personal information now powers technology innovation.

As a result of the availability of personal information, we have witnessed the rapid rise of technologies such as artificial intelligence (AI) and machine learning (ML), the Internet of Things (IoT), ad tech and mar tech, fintech, telehealth, etc. These technologies were developed to take advantage of vast quantities of available personal information. Technologies such as these have created unprecedented business opportunities such as data-driven consumer journeys, hyper-personalized shopping experiences, consumer behavior monitoring, and digitized loyalty programs, among others.

Personal Information Powers Both Business and Technology Innovation



Source: Deloitte.

[7] Andrew Busby, "New PwC Survey Reveals Consumer Data Is the Most Highly Valued," *Forbes*, March 4, 2019.
[8] Brian Hopkins, James McCormick, and Ted Schadler with Srividya Sridharan, Carlton A. Doty, Cinny Little, Emily Miller, and Jeremy Vale, *Insights-Driven Businesses Set the Pace for Global Growth*, available on Forrester.com, October 19, 2018.
[9] Forrester, *Unlock the Power of Data to Transform Your Business* (Cambridge, MA: Forrester, 2018), p. 6.
[10] NewVantage Partners, *Big Data and AI Executive Survey 2019: Executive Summary of Findings* (Boston, MA: NewVantage Partners, 2019), p. 2.
[11] Joanna O'Connell and Susan Bidel with Mary Pilecki, David Novitzky, and Christine Turley, *Second-Party Data Powers Customer-Focused Advertising: Another Marketer's First-Party Data Complements and Extends Yours*, available on Forrester.com, March 8, 2019.
[12] Bob Thompson, "An Inconvenient Truth: 93% of Customer Experience Initiatives Are Failing," on customerthink.com, February 7, 2018.

In the future, organizations that continue to expand their digital interaction with consumers will also need to enhance their data governance capabilities to control personal information use.

4. Businesses' digital focus and excess data collection will continue due to COVID-19.

Unquestionably, COVID-19 has had worldwide consequences that have impacted many businesses, regardless of their industry. The inability to interact with consumers in person has forced organizations to rethink their business model and increase their emphasis on and investment in methods to enable digital interaction with consumers such as websites, mobile apps, social media, etc. While these digital abilities are helping some companies to survive and others to thrive during the pandemic, they are also significantly increasing the amount of data that is collected from and about consumers. This abundance of consumer data can have its advantages, including for use in emerging technologies such as artificial intelligence and machine learning. However, this proliferation of data can also significantly increase business risks associated with its misuse if appropriate data governance practices are not in place. In the future, organizations that continue to expand their digital interaction with consumers will also need to enhance their data governance capabilities to control personal information use.

BOARD IMPLICATIONS

The common thread across these trends is that privacy is becoming increasingly difficult and complex. Boards should understand that while leveraging consumer data is essential to business and technology innovation and growth, it also presents considerable brand risks. Being privacy-aware is therefore essential for today's board members. A study of 1,000 privacy professionals by Thomson Reuters found that 75 percent of board members who are generally engaged on privacy issues still "struggle to understand the implications of data privacy and protection obligations."[13]

Below are some tips to assist board members in helping their organizations to unlock data's potential while managing consumers' increasing privacy expectations:

1. Approach privacy holistically.

Many organizations approach privacy in a very siloed manner. They address each privacy law, regulation, and standard individually, oftentimes spinning up teams and programs each time a new law or regulation passes. This approach is wildly inefficient, and very difficult and costly to maintain over time. It also promotes localized privacy practices, which can be a recipe for disaster for global organizations where consumers expect the same treatment.

The reality is that while each new privacy law or regulation typically has some differences, at their core, they often require similar capabilities and

[13] Thomson Reuters, *Why Boards of Directors Need to Engage on Privacy Issues*, June 13, 2019.

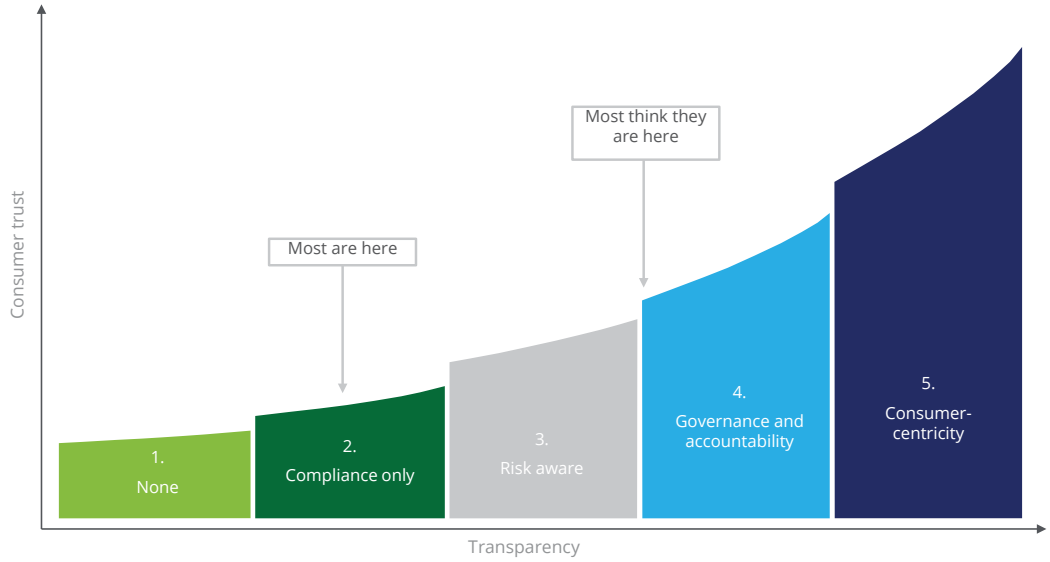
practices. This situation has increasingly been the case over the last four years as GDPR and CCPA copycat laws have been passed. Therefore, boards should work with their management teams to build and implement privacy programs based on what is commonly required across privacy laws in the countries where they operate and only deviate from global standards based on business risk tolerance.

2. Make privacy a part of the organization's brand.

Oftentimes, organizations approach privacy as a compliance exercise. They check boxes because a privacy law or regulation says they must, putting the bare minimum in place to meet requirements. As outlined in the graphic below, this compliance-only focus frequently leads to an overestimation of the organization's privacy program maturity level.

The Privacy Maturity Model of the Future

Companies often overestimate the maturity of their privacy capabilities:



Source: Deloitte.

Consumers want organizations to respect their privacy and protect their personal information, not because a privacy law or regulation made them do it, but because it is the ethical thing to do. The privacy model of the future will therefore focus on achieving consumer centricity, where organizational actions are directly influenced by consumers' privacy expectations. Achieving this level of maturity will take a considerable investment in privacy programs, and many organizations are planning ahead. According to a survey conducted by FTI Consulting, 97 percent of organizations will increase their spending on data privacy in the coming year, with nearly one-third indicating plans to increase their budget between 90 percent

and more than 100 percent.[14] Boards should therefore encourage organizations to make privacy a part of the very fabric of their business, their culture, and their brand to create a competitive advantage. For example, some organizations have taken out full-size, privacy-focused ads at airports, while others have made consumer privacy the focus of their commercials.

3. Embed data privacy and governance into new and emerging technology "by design."

There is no question that business and emerging technology innovation is essential to driving exponential growth. However, due to their use of personal information, emerging technologies are also inherently fraught with data governance, data privacy, and data protection risks. Agile software development and the need for speed to market introduce additional challenges and consistently lead to the protection of consumers' privacy and personal information being an afterthought. Boards should confirm that their organizations have the people, processes, and technologies necessary to embed privacy and personal information protection controls—such as governance over personal information use, sharing, sale, transfer, and retention—into technology innovation initiatives "by design." Boards should also ask their management teams to provide metrics related to privacy-by-design consultation requests and for data protection impact assessments for verification of proactive privacy planning related to new technology.

Boards should confirm that their organizations have privacy technology enablement strategies in place to introduce automation into currently manual processes.

4. Implement privacy technology to introduce automation.

Compliance with the GDPR and CCPA took a significant amount of time and effort for many organizations. The capabilities demanded by the GDPR and CCPA required the establishment of many new processes, as well as updates to existing processes. Unfortunately, in many cases, companies waited too long to begin their compliance efforts. The result was, and in many cases still is, a heavy use of manual, unstructured, documentation-reliant privacy processes (e.g., Microsoft Office products). These manual processes may have worked to check the box and demonstrate compliance in the short term. However, as CCPA-like laws proliferate domestically and GDPR-like laws proliferate globally, these manual processes are unlikely to be sustainable and will become increasingly prone to failure due to unmanageable operational support volumes (e.g., for consumer individual-rights requests). Forward-looking organizations are investing in privacy-enabling technologies, including those that help with data discovery and cataloging, preference and consent management, individual rights management, and compliance monitoring and testing, among others. According to research conducted by Gartner, through 2022,

[14] FTI Consulting, "FTI Consulting Survey Shares Data Privacy Budget and Solutions Forecast," press release on GlobeNewswire, May 19, 2020.

privacy-driven spending on compliance tooling will rise to $8 billion worldwide.[15] Boards should confirm that their organizations have privacy technology enablement strategies in place to introduce automation into currently manual processes, reduce the likelihood of human error, decrease effort and costs, and increase efficiency. Boards should also ask their management teams for metrics on statistics such as the average consumer individual-rights request response time that demonstrate technology automation's effectiveness and benefits.

5. Flip the script on artificial intelligence and machine learning. Privacy professionals tend to cringe when they hear the terms artificial intelligence and machine learning. Organizations use these technologies to ingest and process massive quantities of personal information, allowing organizations to make crucial (and in many cases automated) decisions related to consumers and about products to market or advertise, when to advertise them, how to advertise them, etc. This automated decision making can be in direct opposition to consumers' privacy rights, including those related to transparency and consumers' control over personal information processing. But could AI and ML actually be used to provide organizations with privacy benefits versus increased risk? For example, by using AI and ML could organizations ascertain whether consumers' individual-rights requests or preference changes and consent revocations are somehow related to marketing and advertising practices or privacy incidents or complaints?

Boards should encourage their organizations to investigate how AI and ML can potentially be utilized to provide valuable insights into consumer privacy behaviors that result from business practices, which could result in fewer consumer complaints, fewer consumer restrictions on personal information processing, and less-frequent consumer requests for deletion of personal information, among other positive outcomes.

CONCLUSION

Board members are expected to understand consumer privacy expectations well enough to credibly monitor and oversee organizational privacy and brand risks as well as the use of privacy as a competitive advantage. To do this, directors will need to motivate their organizations to approach privacy holistically, focus on data ethics vs. compliance, embed privacy into emerging technologies by design, and implement privacy technologies to automate manual processes. ■

[15] Gartner, "Gartner Says Over 40% of Privacy Compliance Technology Will Rely on Artificial Intelligence in the Next Three Years," press release, February 25, 2020.

QUESTIONS FOR DIRECTORS TO ASK MANAGEMENT TEAMS

- What are we doing to stay ahead of the rapidly evolving legal and regulatory environment around privacy?
- How does our approach to privacy focus on consumers' expectations vs. the content of privacy laws and regulations?
- How are we confirming that our use of emerging technologies is being done in an ethical manner and in a way that is consistent with our consumers' expectations?
- What are we doing about the proliferation of sensitive consumer data that has been caused by digital expansion and COVID-19?
- What privacy technologies are we implementing to introduce automation into currently manual processes, reduce the likelihood of human error, decrease effort and costs, and increase efficiency?


Daniel P. Frank

Daniel P. Frank leads Deloitte & Touche LLP's Privacy service offering in the United States. His professional experience includes more than 23 years in cybersecurity.

Strengthening Board M&A Oversight in an Uncertain Time

By Trevear Thomas, Joel Schlachtenhaufen, Andrew Wilson, Annie Adams, Deloitte & Touche LLP

INTRODUCTION

Among the matters that have the greatest relevance to the long-term success of a company is its strategy for mergers and acquisitions (M&A). Executive leadership must have the right skills to develop the strategy, pursue the deals, and execute when the time comes. Boards must fulfill their role in overseeing and guiding management's M&A pursuits—ensuring that management stays aligned with the strategy, conducts effective diligence, and actively guides value-creation efforts through completion.

None of this has been easy, to say the least, with a pandemic disrupting M&A activity and shifting priorities. As the coronavirus spread in the first quarter, dealmaking slowed almost to a halt. Markets grew volatile, and management's attention became consumed by the response to the crisis, which threw some industries into turmoil and materially affected almost every business.

While M&A activity has begun to rebound, dealmaking is occurring in a changed world. Some companies have been divesting assets to raise cash or to shed operations that no longer fit their purpose. Others in better circumstances have had the luxury of being opportunistic. Few can afford to stand still, given the uncertainty the pandemic has injected into the

business environment and the premium it puts on building resilience into every business organization.

To better understand how directors see their M&A role, how their views are changing, and where there might be need for greater attention, the National Association of Corporate Directors (NACD) and Deloitte gathered the views of directors of US companies for the second year in a row.[1] Even with the business environment having changed so dramatically in such a short time, the results of our survey allow us to track the progress boards of directors are making to strengthen their engagement with management's dealmaking and their efforts to oversee M&A strategy.

We see indications that directors are sharpening their focus on key M&A issues. Survey respondents are confident that they have the skills they need on their boards, and they report regular engagement with M&A topics as part of their ongoing oversight of the organization's strategy. They are focused on deal valuation, among other key areas, in a market environment where overpaying for assets is an obvious risk.

The COVID-19 pandemic upended many companies' plans in 2020. As the initial pressures of responding to the crisis have eased, resilient leaders have been considering what steps they will need to take to allow their companies to thrive in the current economic and business environment as well as that of a post-pandemic world. This effort to pivot has to include a reexamination of M&A strategy—and that has to include the board.

Directors are sharpening their focus on key M&A issues.

1. KEY PROJECTIONS

Boards face obstacles to engagement.

More than half of our survey respondents (53%) say the pandemic either significantly or moderately impacted their ability to pursue, finance, and close deals. Another 33 percent say there was a minimal impact in this area, while 14 percent cited no impact at all.

This significant effect on M&A activity should not come as much of a surprise. Recall how, early in the pandemic, management had to rush to figure out how to run an organization through virtual meetings and deal with the responsibility of keeping employees and customers safe while maintaining business continuity. Dealmaking was pushed aside by these demands on leadership attention, and, if that wasn't enough, the stock market plunged, ending the longest bull market on record and throwing valuations into limbo.[2]

[1] Survey conducted Aug. 5–25, 2020, with responses from 165 directors from US companies representing a cross section of industries. A majority of respondents were from companies with $5 billion or more in annual revenue.

[2] Deloitte's 2021 M&A Trends research (page 16) has further information. In our survey of executives for that study, 58 percent said COVID-19 moderately impacted their ability to pursue, finance, and close deals; 92 percent said they have paused at least one of their deals; and 78 percent said they have abandoned a deal.

Asked whether the board became more involved during the pandemic in overseeing M&A activity, 29 percent of respondents say they did, while most (71%) say the board did not become more involved.

The board's role in M&A strategy is growing.
Still, our findings suggest that directors generally have grown more comfortable with their role in overseeing M&A strategy and execution. Fully 95 percent of respondents say they consider M&A matters as a regular part of ongoing strategy discussions with management, independent of any specific deal. This is a notable increase from our 2019 study,[3] when 82 percent said the same. This perhaps signals that the complexities of the current environment may have encouraged greater board involvement in M&A strategy. It is also a sign that there could be increased opportunities in the market given the disruption. It will be interesting to see if this trend persists even after the most acute disruptions related to the pandemic have receded.

Among other responses to the question of which M&A matters the board addresses, 78 percent of directors say they obtain regular updates on the timing, challenges, and critical-issue milestones that occur during a deal's life cycle, while 61 percent question management's assumptions during all phases of the M&A life cycle.

Just as a checklist is a rigorous risk-management tool for an airplane pilot, the deal playbook for any company can help keep the M&A team's focus clearly on the most important M&A priorities and goals.

Greater use of a deal playbook may be possible.
One surprising result in this year's survey is that just 14 percent of respondents say they use a deal playbook, a similar result to last year's 17 percent. This presents an opportunity for boards. Using a deal playbook is a leading practice that many successful companies have embraced. Just as a checklist is a rigorous risk-management tool for an airplane pilot, the deal playbook for any company can help keep the M&A team's focus clearly on the most important M&A priorities and goals.

Boards are developing M&A depth.
Our survey responses suggest that boards have confidence about the level of expertise they bring to their M&A oversight function. Almost all of our respondents (96%) say they have directors on their boards with M&A experience. At the same time, 26 percent say they are considering bringing on new board members with specific M&A expertise; this is with similar to with the 24 percent who said this in our 2019 survey. This implies a recognition of the importance of the board's role in this area—and an interest in building even greater depth of M&A knowledge on the board, perhaps across different industries or transaction types.

[3] Survey conducted May 22 to June 24, 2019, with responses from 206 directors.

Executives may be relying less on the board's expertise.
Even as the board seeks to engage within M&A activities, and has become more confident in this role, executive leadership may be hesitant to take full advantage of director expertise on M&A issues. Asked whether senior management has tried to more frequently engage the board in discussions around M&A issues, 46 percent of directors in this year's survey agree with the premise; in last year's survey, 61 percent endorsed that statement.

Meanwhile, 67 percent of respondents in this year's study agree with the statement that there is a greater role and opportunity for nonexecutive board members to lend their experience to management during M&A discussions, versus 7 percent who disagree and 26 percent who neither agree nor disagree.

2. BOARD IMPLICATIONS

Directors need to pick the proper entry points for board involvement in M&A. Our survey results show where they are setting their priorities.

Boards need clear priorities.
Board members, in their role as overseers of M&A activities, need to have clear priorities. They cannot be involved—and be effective—in every aspect of the complex task of setting strategy, pursuing a deal, seeing it through to close, and then realizing the value envisioned in the deal thesis. Directors need to pick the proper entry points for board involvement in M&A. Our survey results show where many are setting their priorities.

Asked to rank the relative importance of various risks that the board might address when considering M&A transactions, survey respondents put valuation as their top priority, recognizing their concern about the possibility of overpaying for an asset in the current, volatile environment. That item is followed in second place in the respondents' rankings by value creation, as exemplified by synergy realization and execution risk.

With a majority of respondents ranking these as their top two priorities, they signal the importance of, and interest in, valuation and value creation at the board level. There's a good argument that this is as it should be.

The next three risks in the ranking are, in order, an unidentified risk such as a hidden liability, deal structure concerns, and change management and culture risks. Getting all these priorities right can (of course) help a company get the valuation calculation correct and make value realization happen, while getting them wrong can undermine the top priorities.

Responses show mixed results on size thresholds for board involvement.
Asked if there is a financial threshold above which the board tends to get involved in an M&A transaction, 60 percent of our survey participants say there is, versus 40 percent who say there is not. Boards should be focusing

on larger, material deals, and this finding suggests many do set clear priorities. Still, such guidance about when boards should be involved in M&A could be more universal.

The response in favor of a minimum financial threshold was lopsided across most of the economic sectors represented in our survey, including consumer staples and discretionary, industrials, communications services, health care, and energy. But the result was reversed in the financial sector (35% say they have a financial threshold for board involvement), information technology (34%), and utilities (25%). This may signal that board members see M&A risks differently for banks and technology firms and some other companies in these sectors.

The completion of a complex M&A transaction can be challenging, with the risk that business gets disrupted, customers lost, and value eroded while integration efforts are being refined and implemented.

Boards can do more on integration risk.

The completion of a complex M&A transaction can be challenging, with the risk that business gets disrupted, customers lost, and value eroded while integration efforts are being refined and implemented. Even so, our survey responses suggest that boards may give too little weight to the role they can play in overseeing integration and value creation post-close.

Asked about the stages in the M&A process that get discussed and addressed at the board level, 87 percent of respondents cite pre-deal M&A strategy, 69 percent say value creation, and 61 percent say due diligence. Respondents were less likely to include integration strategy (57%) and integration execution (50%).[4] The takeaway here may be that there's room for boards to embrace a bigger role in overseeing the integration phase. ■

[4] Executives surveyed for Deloitte's M&A Trends research tell a slightly different story than directors do. Asked to indicate when in the life cycle of an M&A deal boards usually get involved, executives ranked integration strategy (54%) and pre-deal M&A strategy (53%) highest, while integration execution was cited by 40 percent.

BOARD OVERSIGHT QUESTIONS

As the pandemic continues to sow uncertainty across the business landscape, businesses should be asking how dealmaking can play a role in boosting the resilience of the organization and positioning it to thrive.

For the board, this M&A effort is likely to create new challenges and raise the stakes surrounding its oversight role. The following are some questions that directors might ask of themselves or the executive leadership team. They are designed to help directors assess the role they are currently playing—and the role they might assume—in this new and rapidly shifting world.

- Is the board fully engaged with the company's M&A activities, and does the board have clear priorities to define its involvement in M&A strategy and execution through post-close integration?
- Is the executive leadership fully engaged with the board on M&A strategy and execution, and if not, how can that engagement and their relationship be strengthened?
- Does the board have the full scope of M&A skills, spanning the spectrum of deal types and industry groups, to help steward the company's activities?
- Has the board set a deal-size threshold above which the board will be involved in oversight of a specific M&A transaction, and if not, should it set one?
- Should the board be following the company's M&A playbook, or if the company does not have one, should directors be working with executive management to create one?
- Is the board giving sufficient attention to integration risk and other post-close activities where the value that's expected from a deal may be eroded?

Clearly, there are subtleties in the story of how boards see their role in dealmaking—or how they might reshape their oversight involvement.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Board Oversight 2021: "Mission Critical" Risks and the Corporate "Mission" Converge

By Adé Heyliger, Lyuba Goltser, and Ellen Odoner, Weil, Gotshal & Manges[1]

Last year, without lowering the high bar that *Caremark* set for director liability, the Delaware courts signaled their expectations about effective board oversight over "mission critical" risks by taking the unusual step of allowing two *Caremark* cases to proceed beyond the motion to dismiss stage. In 2020, the Delaware courts reinforced this message by denying motions to dismiss *Caremark* claims relating not only to board oversight of a key regulatory risk, consistent with the earlier cases, but also (in the context of egregious alleged facts) to board oversight of effective financial reporting, a risk all public companies face.

The continued emphasis on "mission critical" risks by the courts has coincided with the extraordinary and tragic events of the past year, which revealed fissures in our society and heightened calls for boards to reconsider their company's corporate "mission" and its impact on a broader range of stakeholders. There is now an even stronger impetus for directors to use a wide lens in considering what risks should be deemed "mission critical" for their company. For most, if not all, companies, that risks relating to employees, including racial and gender equity and overall safety and well-being, deserve a prominent place on the board's oversight agenda for 2021 and beyond.

[1] The authors express their appreciation to their Weil colleagues, Kaitlin Descovich and Andrew Holt.

The Delaware Supreme Court's spotlight on "mission critical" risks in its 2019 decision in *Marchand v. Barnhill* still burns bright.

KEY PROJECTIONS

1. Boards will face heightened expectations to apply a "mission critical" risk framework in oversight.

Directors are expected to establish and then monitor reporting systems reasonably designed to provide timely, accurate information sufficient to enable the board to make informed judgments about key risks to legal compliance and business performance. In order to prevail on a *Caremark* claim, however, a plaintiff needs to meet the difficult burden of showing that the board acted in bad faith—either by having "utterly failed" to implement a board-level reporting system or, having implemented one, by having "consciously failed" to monitor the system it implemented. On the infrequent occasions when this high bar has been met, the *Caremark* breach is considered a breach of the duty of loyalty, carrying potentially significant reputational and liability concerns for the board.

The Delaware Supreme Court's spotlight on "mission critical" risks in its 2019 decision in *Marchand v. Barnhill.* still burns bright[2] There the court found that plaintiffs had met their burden to show the board had failed to institute a board-level reporting system targeting the "mission critical" risk of the company's business (food safety for an ice cream company). While many *Caremark* cases continue to be dismissed, two courts this year looked to *Marchand* in denying motions to dismiss. This underscores the importance of targeting key areas for board oversight, establishing a regular oversight cadence, and keeping a careful, written record of the oversight processes and activities—including how the work of board committees measures up to their charters.

In *Inter-Marketing Group USA, Inc. v. Armstrong*,[3] plaintiff brought a *Caremark* case against the directors of the general partner of a pipeline company following a devastating oil spill. Plaintiff alleged that, as in *Marchand*, the directors "utterly failed" to ensure that a reasonable reporting system existed with respect to a compliance issue "intrinsically critical" to the company's business operations—pipeline integrity. Defendants argued that the existence of its audit committee was evidence that a monitoring system was in place because review of legal and regulatory compliance was part of its charter. However, at a trial related to the spill, the CEO and board chair testified that decisions to review problematic pipelines were made at lower managerial levels, and that neither the board nor any board committee ever discussed pipeline integrity policies or management. The Delaware Court of Chancery denied the motion to dismiss on the ground that pipeline integrity was a "mission critical" risk for a pipeline company and that plaintiff had drawn a reasonable infer-

[2] See Marchand v. Barnhill, 212 A.3d 805 (Del. 2019).

[3] Inter-Marketing Group USA, Inc on Behalf of Plains All American Pipeline, L.P. v. Armstrong, 2020 WL 756965, *11+, Del.Ch., (NO. *CV* 2017-0030-TMR) (January 31, 2020).

ence from the trial testimony that the audit committee had not lived up to the oversight responsibilities in its charter.

In *Hughes vs. Hu*,[4] plaintiff brought a *Caremark* case against the audit committee of a company that restated three years of financial statements and failed to remediate material weaknesses in internal control over financial reporting disclosed three years earlier. Informed by a Section 220 books and records investigation that preceded the case, plaintiff alleged what the Delaware Court of Chancery characterized as "chronic deficiencies": the audit committee met sporadically and briefly, the outside auditor (later sanctioned by the PCAOB) missed key issues, and the audit committee relied blindly on management despite its demonstrated inability to report accurately about related-party transactions. The court noted that the defendants did not produce any documents in the Section 220 investigation that would have rebutted this inference, and, while not explicitly describing the effectiveness of financial reporting controls as a "mission critical" risk, the court denied the motion to dismiss.

Boards should expect workforce diversity disclosure to proliferate, and for disclosure of pay-equity data to gain traction.

2. Boards will face growing demands for transparency and accountability on racial, ethnic, and gender equity within the workforce.

Boards should expect workforce diversity disclosure to proliferate, and for disclosure of pay-equity data to gain traction, in 2021. In the wake of racial and social protests earlier this year, many companies have publicly affirmed their commitments to racial equality and diversity. Institutional investors are now seeking commitments from companies to make public the "hard data" that will enable investors to evaluate and compare companies' performance on diversity and track their progress.

Disclosure of Consolidated EEO-1 Reports is becoming the "gold standard" for investors. These annual reports sent to the US Equal Employment Opportunity Commission reveal the race, gender, and ethnicity of the employees filling various job categories, including senior management. The comptroller of New York City has announced commitments from 34 of the 67 S&P 100 companies it contacted this summer to adopt a policy to publicly disclose their Consolidated EEO-1 Reports.[5] The comptroller has also encouraged disclosure of broken-out data on pay. Simi-

[4] Hughes v. Hu, C.A. No. 2019-0112-JTL, 2020 WL 1987029 (Del. Ch. Apr. 27, 2020).
[5] See press release, "Comptroller Stringer and NYC Retirement Systems Announce 34 S&P 100 Companies Will Publicly Disclose Workforce Demographics," September 28, 2020. See also press release, "Comptroller Stringer and Three New York City Retirement Systems Call on 67 S&P 100 Companies Who Issued Supportive Statements on Racial Equality to Publicly Disclose the Composition of their Workforce by Race, Ethnicity and Gender," July 1, 2020; and Letter of Office of the Comptroller Scott M. Stringer to Chief Executive Officer of Amazon.com, Inc., July 1, 2020.

larly, among other institutional investors, State Street Global Advisors has called on the board chairs of public companies in its investment portfolio to disclose measures of workforce diversity using the EEO-1 Report framework.[6] Both the NYC comptroller and State Street have cautioned they are prepared to use their proxy voting authority to hold the boards accountable should they fail to meet these expectations.

3. Boards will expand their oversight mechanisms to give a more central place to human capital.

The COVID-19 pandemic and recent protests combined to underscore the need for heightened focus on what many companies refer to as their "greatest asset": their employees. In addition to critical health and safety concerns, the range of human-capital issues for management to tackle includes employee retention, compensation, training and development, diversity and inclusion, and adapting the workforce to remote environments—along with ensuring that internal controls are recalibrated for proper oversight of these matters.

Boards should expect these issues to receive more sunlight with new SEC disclosure requirements mandating that companies provide a description of their human-capital resources and any human-capital measures or objectives the company focuses on in managing its business, to the extent such disclosure would be material to an understanding of the company's business in their Form 10-K.[7] SEC chair Jay Clayton emphasized the SEC's expectation "to see meaningful qualitative and quantitative disclosure, including, as appropriate, disclosure of metrics that companies actually use in managing their affairs."[8]

Nasdaq proposed a new rule requiring most listed companies to have, or explain why they do not have, two "diverse" directors.

4. Companies will face intensified pressures on board diversity.

In December, in a major development, Nasdaq proposed a new rule requiring most listed companies to have, or explain why they do not have, two "diverse" directors (one self-identified as female and one self-identified as being from an underrepresented racial OR ethnic group or as LGBTQ+). The proposal intensifies the pressure from institutional investors for change at both the board and CEO levels.[9] The NYC comptroller's 2019 "Rooney Rule" campaign resulted in 14 companies adopting policies

[6] See form letter from State Street Global Advisors, Diversity Strategy, Goals & Disclosure: Our Expectations for Public Companies, August 27, 2020.

[7] See SEC press release, "SEC Adopts Rule Amendments to Modernize Disclosures of Business, Legal Proceedings, and Risk Factors Under Regulation S-K," August 26, 2020.

[8] See Chair Clayton's public statement, "Modernizing the Framework for Business, Legal Proceedings and Risk Factor Disclosures," posted on sec.gov, August 26, 2020.

[9] Proposal File No. SR-2020-081, "[a] proposal to advance board diversity and enhance transparency of diversity statistics through new proposed listing requirements."

requiring that the initial list of board or external CEO candidates include qualified female and racially/ethnically diverse candidates.[10] Similarly, in its August 2020 letter to board chairs, State Street requested companies to provide "diversity characteristics, including racial and ethnic makeup, of the board of directors," and "[a]rticulate goals and strategy related to racial and ethnic representation at the board level."[11]

Currently, Institutional Shareholder Services (ISS) will generally recommend against the chair of the nominating committee if the company's board does not include at least one woman (subject to limited mitigating factors). Starting in 2022, ISS will extend this voting policy to any Russell 3000 or S&P 1500 company that has no apparent racial and/or ethnic board diversity—and will cite the lack in 2021.[12]

At the state level, California has led the way with laws requiring public companies with principal executive offices located in the state to have at least two or three women directors, depending on board size, by the end of 2021, at least one director who self identifies as being from an "underrepresented community" (defined in terms of race, ethnicity, or sexual orientation) by the end of 2021 and either two or three such directors, depending upon board size, by the end of 2022.[13] Washington recently required companies incorporated in that state to meet certain gender diversity targets by January 1, 2022, or provide new diversity disclosure,[14] and a number of other states have either enacted or are currently considering mandatory board-diversity legislation.[15]

A number of states have either enacted or are currently considering mandatory board-diversity legislation.

Shareholders seeking to advance diversity have turned to litigation, alleging that directors violated their fiduciary duties by failure to have racial diversity on their boards, inaction on diversity and inclusion issues and tolerance of racially discriminatory practices at their companies, and that commitments to diversity appearing in proxy statements and other

[10] See press release, "Comptroller Stringer Launches Boardroom Accountability Project 3.0, a First-in-the-Nation Initiative to Bring Diversity to Board and CEO Recruitment," October 11, 2019. The "Rooney Rule" was originally instituted by the National Football League and requires league teams to interview ethnic-minority candidates for head coaching and senior football operation jobs.

[11] See State Street Global Advisors' August 27, 2020, letter to board chairs.

[12] See ISS, *Proxy Voting Guidelines Benchmark Policy for 2021 Recommendations*, p. 2. Proxy Voting Guidelines (effective for meetings on or after February 1, 2021)

[13] See California Senate Bill 826 and Assembly Bill 979.

[14] See Washington Business Corporation Act and Substitute Senate Bill 6037.

[15] New York, Maryland, and Illinois have enacted board diversity disclosure requirements; Hawaii, Massachusetts, Michigan, and New Jersey are currently considering mandatory board diversity legislation; Colorado has adopted a nonbinding resolution, and Pennsylvania is considering nonbinding legislation, to encourage companies to improve gender diversity on their boards. See *Washington State's New Gender Quota for Boards Reflects Broader Trends*, (Arlington, VA: NACD, 2020).

disclosures were materially false and misleading.[16] While it remains to be seen how these lawsuits will fare, shareholders are likely to continue to use litigation as another means to press for greater board and workforce diversity.

BOARD IMPLICATIONS

1. Evaluate corporate purpose with a stakeholder-centric eye. The decades-long, widely held view that a corporation's purpose is solely to enhance shareholder value is under challenge—a challenge bolstered by the severe impacts of the COVID-19 pandemic on the economy and its disproportionate impact on low- to mid-income workers. Companies are confronting a panoply of employee and human-capital management issues that are critical to long-term value creation at a time when investors and others are seeking commitments from corporations to align their governance principles with stakeholder capitalism. Many corporations have endorsed the Business Roundtable's 2019 "Statement on the Purpose of a Corporation" and the related shift away from the primacy of shareholders toward a broader view of responsibility to the corporation's wider stakeholders. This "modern standard for corporate responsibility" has seen additional support from Business Roundtable CEOs who, in October 2020, committed to a range of corporate actions and public policy initiatives in order to advance racial equity and justice within their businesses and in the broader community.[17]

The impact of the pandemic has strengthened the call upon boards to review their corporation's mission with a stakeholder-centric critical eye.

The impact of the pandemic has strengthened the call upon boards to review their corporation's mission with a stakeholder-centric critical eye.

As part of their strategic reviews, boards can engage in an active dialogue with management to understand how key company stakeholders are identified, the impact of the company on these stakeholders and related risks—all of which may evolve or change at any given time—and the processes by which these determinations are made before they are elevated to the board. Understanding these processes will enable the board to better assess whether the corporate mission is adequately addressing the needs of its stakeholders, central among whom should be the company's employees.

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[16] See complaint, Klein v. Ellison, Case No. 20-cv-4439 (N.D. Cal. July 2, 2020); Complaint, Ocegueda v. Zuckerberg, Case No. 20-cv-04444 (N.D. Cal. July 2, 2020); and Complaint, Kiger v. Mollenkopf, Case No. 20-cv-01355-LAB-MDD (S.D. Cal. July 17, 2020).

[17] See Business Roundtable, "Advancing Racial Equity and Justice." The CEO recommendations address six systems: employment, finance, education, health, housing, and criminal justice aimed principally at reducing the economic opportunity gap in communities of color, including disparities in access to financial tools and high-quality jobs, education, and health care.

2. Address diversity and inclusion at both the board level and organization-wide.
Institutional investors and other stakeholders have made clear that they view diversity and inclusion as a significant means of mitigating risks and achieving long-term growth and stability. Boards should ensure that robust employee-diversity initiatives are central to the organization's overall human-capital-management strategy, and they should make oversight of these initiatives and their effectiveness a regular part of the board's agenda. In particular, the board should understand and receive regular reports on the human-capital metrics tracked by management, as investors and the SEC are looking for meaningful disclosure of these metrics. Boards should use the current climate as an opportunity to review and, if necessary, refresh its own board composition to address gender, racial, and other diversity, the absence of which will attract increasingly unforgiving scrutiny, internally and externally.

3. Ensure that evolving "mission critical" risks are receiving proper attention from the full board and committees.
Boards must allocate appropriate agenda time to probe management regarding "mission critical" risks. It can be helpful for the board leader and the corporate secretary to review the board schedule to ensure that meetings are designed to encourage dialogue on these topics, and that an appropriate record is maintained. These records should reflect the data received and considered, follow-up steps, responses to prior follow-up steps, and reports on relevant regulatory and other developments.

Board committees can help the board fulfill its risk oversight responsibilities by shouldering and reporting on particular "mission critical" risks. For example, the work of the compensation committee could be expanded to encompass the panoply of risks relating to human capital. The nominating/corporate governance committee could address steps to achieve greater diversity in the nomination process as well as take on holistic oversight of the impact of ESG issues on the company. Alternatively, given their importance to a company, some risks may merit their own stand-alone committee (e.g., environmental or technological risk). Committee charters should be updated annually to reflect the key areas of risk for which the committees are responsible, and committees should conduct a robust, annual self-evaluation to ensure that they have fulfilled the commitments in their charters and documented their activities.

Boards must allocate appropriate agenda time to probe management regarding "mission critical" risks.

4. Most important, take a proactive approach to risk.
Boards should regularly review the effectiveness of management's enterprise risk management systems to ensure that they provide sufficient information on existing risks and raise new or evolving risks to the relevant board committee or full board, all on a timely basis. However, in addition to relying on management, boards should step back and think about risk in a common sense way—returning to *Marchand*, what could

be a more important risk for a food company than ensuring food safety? Boards should be proactive in periodically challenging their company's traditional approach to risk by capitalizing on the relevant expertise of board members and reaching out to outside advisors and other experts for a fresh look. ■

QUESTIONS FOR DIRECTORS TO ASK THEMSELVES

- When did the board last identify the company's "mission critical" risks?
- Has the board established a regular cadence for reevaluating these risks?
- Are written records of the board's risk oversight efforts—specifically with respect to "mission critical" risks—maintained in sufficient detail?
- Has the board considered whether to disclose EEO-1 or other employee data publicly and how to approach the SEC's new principles-based disclosure requirements relating to human capital?
- Has the board recently reviewed management's risk management and mitigation policies and programs? Are "reporting up" systems adequate to ensure that the board is properly informed?
- Are committees being used effectively to enhance board oversight? In particular, how is human-capital risk allocated among the board and its committees?
- Does the board take a critical look each year at how the work of the committees has measured up to their charters?


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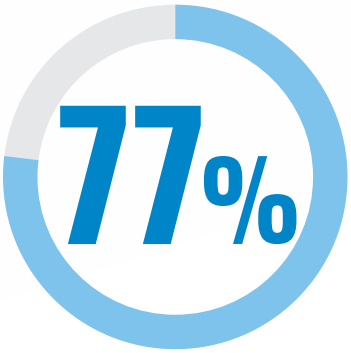

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