THE CORPORATE BOARD

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What Has Changed In Your Boardroom?

by Adarsh Mantravadi

A year and a half after the COVID pandemic first turned much of our world upside down, companies and their boards are still working their way through changes. Along with the new technology and board challenges, you are also wrestling with massive new strategic, ESG and diversity demands. How is all this turmoil shifting the way your board meets, and how it governs? Can you change for the better?

The tremendous challenges of COVID-19 have propelled progress for boards working across a variety of sectors. Directors, administrators, and others have tackled pandemic-related difficulties with staunch resolve.

At a fundamental level, the pandemic accelerated the digital transformation of boards, and helped them to realize the many benefits that technology has to offer in enabling them to better serve their missions. In the twelve months from March 2020 to March 2021, boards became more effective, more collaborative, and are spending more time on vital strategic issues than prior to the pandemic. This, according to a survey of 282 board directors, administrators, and staff members in more than six countries.

Despite its many challenges, the COVID-19 pandemic has helped drive progress for boards across the country.

A majority plan to push for additional improvements in the months ahead in areas such as board engagement, diversity, and building enhanced focus on environmental, social, and governance issues. The survey spanned a variety of boards, large and small, across numerous industries. These include public companies, non-profits, education, higher education, financial services, healthcare, life sciences, professional associations, and others.

Despite its many challenges, the COVID-19 pandemic has helped drive progress for boards across the country. Boards that previously had been reluctant or slow to embrace digital transformation suddenly were forced to shift to virtual formats. As a result of this and other factors, our survey found:

- 79 percent said their boards have improved effectiveness in the past 12 months.
- 66 percent have seen improvements in board collaboration.
- 47 percent have spent more time discussing strategic issues.

Many said the shift to digital significantly contributed to their success, yet only 57 percent of respondents use specialized board management software. Results show that boards that use such software are more likely to have achieved positive governance outcomes, and to have board members who are more prepared for meetings. They also are more likely to have evaluated themselves on environmental, social, and governance issues, in part because the software gives them the tools to conduct such evaluations easily and efficiently.

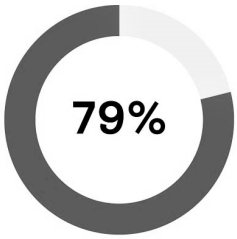
Moving forward, board leaders must build upon the lessons of the past year. Organizations should seek to fully leverage the advantages that board management software and other technology advancements have to offer in helping their boards be more effective in serving their communities and their missions.

☐ ***COVID-19 as a catalyst for digital transformation.*** The onset of the COVID-19 pandemic in March 2020 sent shock waves through boards in every industry around the globe. Many were forced to rapidly adjust their outlooks and operating models to adapt to widespread social and economic disrup-

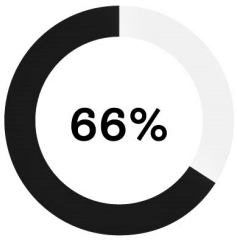
Adarsh Mantravadi *is general counsel for governance technology company OnBoard. www.onboardmeetings.com*

Tough Times Bring Better Governance

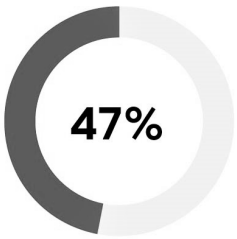
Past 18 Months Saw Board Progress



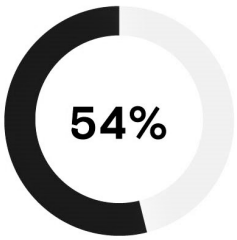
79% said their boards have **improved effectiveness** in the past 12 months



66% have seen **improvements in board collaboration**



47% have spent more time **discussing strategic issues**



54% have **achieved good governance under challenging conditions**

tions. Schools, businesses, government offices, and other organizations underwent shutdowns or shifted abruptly to remote operations.

Many boards that previously had been reluctant or slow to join the digital transformation already underway in other sectors were forced to transition to digital platforms. Board administrators quickly cancelled in-person meeting plans and moved to all-virtual board and committee meetings. Survey respondents said the rapid shift to a remote environment created many challenges for boards, including:

- Difficulties recreating casual or face-to-face interactions.
- Lack of opportunities for *ad hoc* and post-meeting conversations.
- A less conducive format for engaging in complex discussions.
- A need to use and adapt to new technologies.

Despite the myriad challenges, 79 percent of respondents said their boards have improved effectiveness in the past 12 months, including 56 percent who said they have improved slightly and 23 percent who have seen significant improvements in effectiveness. The remaining 21 percent said their boards have slightly or significantly decreased in effectiveness since the early months of the pandemic.

Many said the shift to digital contributed to their success, with two-thirds of respondents saying board collaboration has improved, and half spending more time on strategic issues.

The responses were consistent across different categories of respondents, whether they were executive directors, non-executive directors, or board administrators and staff members.

Many said the shift to digital contributed to their success. When asked which factors most influenced the change in effectiveness, 59 percent indicated the move to a remote work and virtual meeting environment had a major impact. Forty percent attributed it to a change in the general business environment, and 34 percent said the performance of the company changed significantly.

A full two-thirds of survey respondents said board collaboration has improved since the shift to remote work and meetings, with 54 percent saying they have seen some improvement, and 12 percent seeing a lot of improvement.

About half said their boards have spent more time discussing strategic issues over the past 12 months than prior to the pandemic, while 39 percent indicated they spend about the same amount of time discussing such issues. Four in ten respondents said they have spent more time discussing organizational risk over the past year. Other areas such as fiduciary topics, investments, talent, board reinvention, and board education generally have received about the same amount of attention compared to before the pandemic.

When asked to describe the effectiveness of their board's governance in a virtual environment, 54 percent of respondents said they have achieved good governance under challenging conditions. Board administrators and staff were slightly more affirming, with nearly 60 percent of non-directors saying good governance had been achieved, versus 53 percent of executive and non-executive directors.

Thirty-eight percent of overall respondents said their boards have maintained consistent levels of governance compared to pre-COVID times, while eight percent said governance has been difficult and challenging throughout the pandemic.

☐ ***Greater focus on critical issues.*** In addition to the challenges of the pandemic, widespread social and political turmoil over the past year have fueled a groundswell of support for assessing and advancing fundamental structural changes. A majority of respondents to the OnBoard survey said their boards have significant room for improvement in areas such as diversity, and the level of focus on environmental, social, and governance issues.

Less than a quarter (21 percent) rated their boards as very diverse, while 56 percent said they are somewhat diverse, and 23 percent said they are not diverse. Nearly half (48 percent) said increasing board diversity is a serious strategic priority with specific actions planned, while another 39 percent said their boards have discussed the issue, but have not developed plans to address diversity.

More than three-quarters of respondents said their boards are highly or somewhat focused on environmental, social, and governance issues. Yet 58 percent said their organizations have not evaluated themselves on those issues, and 28 percent said they have only partially assessed such issues internally. Eighty-seven percent said their boards do not have committees dedicated to addressing environmental, social, or governance issues, and only nine percent have plans to establish such committees in the future.

Respondents cited several areas of high importance to their boards moving forward including:

- ☐ Ethics and compliance.
- ☐ COVID-19 response.
- ☐ Diversity, inclusion and culture.
- ☐ Cybersecurity.
- ☐ Local impact.

The need to increase diversity on boards to make them more representative of the communities they serve is nothing new. "Over the last 20 years, there's no governance topic that's gotten more coverage and conversation than board diversity," says Matt Fullbrook, of the Rotman School of Management. "Despite the fact that it's gotten so much airtime, if you take a snapshot, the numbers are still really low."

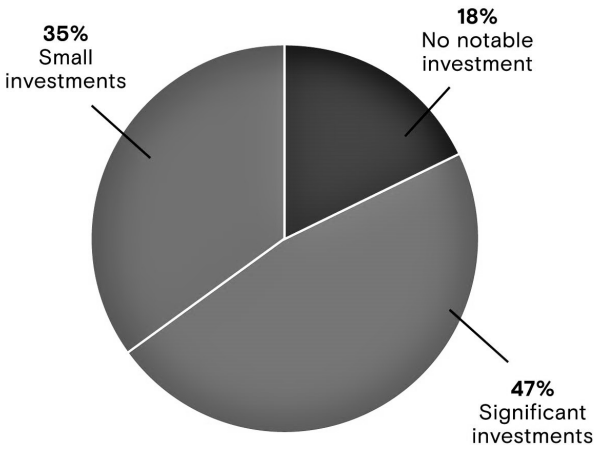
While overall diversity is lacking, there have been clear gains when looking at new directors coming onto boards. Compared to 10 or 15 years ago, board members today are much more likely to be younger, female, or a person of color, he explains.

For example, a recent Rotman study found that, after boards on the S&P/TSX Composite Index changed their approach to recruiting new directors, the percent of new, first-time directors increased from 57 percent in 2008 to 72 percent in 2018. Among those, the percent of visible minorities increased from two percent to 15 percent, and the percent of female directors rose from 15 percent to 38 percent. While turnover on boards is historically slow, such trends will lead to significant, long-term changes in board composition.

More and more, organizations are realizing that they benefit from having a broader range of experience, with people from a variety of industries and backgrounds represented on their boards. "When

Building Board Capacity

Are You Making Significant Investments In Your Board?



they're looking for a new director, boards in general are casting their nets wider," Fullbrook says. "There is a slow, but meaningful evolution on the part of board nominating committees in their understanding of what actually makes a good director."

Two-thirds anticipate their boards will spend more time discussing strategy over the next 12 months, and more than 80 percent are investing in their boards.

While different boards have had varying levels of successes or failures over the course of the past year, the survey results indicate that a majority have embraced digital transformation and made important gains in the face of immense adversity. Many boards strive to make further progress in a post-pandemic environment.

Two-thirds (67 percent) said they anticipate their boards will spend more time discussing strategy over the next 12 months, and more than 80 percent said their organizations are investing in their boards. That includes 47 percent that are making significant investments to improve board composition, engagement, and education.

☐ ***Are you making significant investments in your board?*** Asked to rate the current effectiveness of their boards, 63 percent chose between 6-8 on a 10-point scale, for an average rating of 7.1. The responses were the same regardless of whether respondents were executive or non-executive directors, or non-director administrators or staff members.

Ninety-one percent said their boards have potential to reach an effectiveness level of 8-10, for an average achievable score of 8.9. Making those gains will require that they remain diligent in identifying shortfalls, and establishing and acting upon clear goals for enhancing the effectiveness of their boards. Leveraging technology has the potential to help boards maximize their gains and continue to accelerate their forward progress.

Optimizing board management tools is essential for boards seeking to maintain momentum and build upon advancements they have made over the past 12 months. While more than half of survey respondents said they use board management software, the degree to which boards use such tools varies widely.

Of those that have board management software, 56 percent said they use it primarily for board meetings. Only 10 percent fully leverage the software to conduct meetings, actions, annual activities, and board education.

The survey results show that organizations that use specialized board management software are more likely to:

- Have achieved positive governance outcomes during the pandemic.
- Distribute meeting materials to board members earlier.
- Have board members who are well prepared for meetings.

Those organizations also were more likely to have evaluated themselves on environmental, social, and governance issues, in part because the software provides readily available tools for them to conduct such evaluations. More than half of firms that use board management software had partially or fully evaluated themselves on such issues, compared to 29 percent of those without software.

Used optimally, board management solutions have

the potential to drive further progress by enhancing collaboration, and helping boards make more informed, timely decisions. Continued digital transformation in the boardroom also has the potential to enable companies to more easily compare their performance to that of their peers.

Among those who use board management software:

- 81 percent believed they increased board effectiveness in the last 12 months. For those without board management software, 58 percent believed they increased board effectiveness.
- 91 percent receive board materials three or more days in advance versus 78 percent for those with no software.
- 94 percent have board members who are prepared for meetings versus 88 percent for those who do not use board management software.

The COVID-19 pandemic compelled many companies to make much-needed and long-overdue changes to integrate technology into their everyday board management.

Moving board work from the boardroom to the "Zoom room" enabled those that were lagging in digital transformation to experience its benefits firsthand. Board leaders now face the critical decision of whether to continue their momentum and lean into that digital transformation, or to push away and revert to a traditional governance approach.

Those who continue to optimize board management software and other technology tools in the years ahead have the potential to move well beyond basic digital table stakes. They can achieve real change, including making advancements in economic, social, and governance issues, and promoting diversity, equity, and inclusion.

However, 43 percent of organizations still do not utilize even basic board management software in any way, and therefore have no opportunity to reap its benefits. The digital transformation is well underway and moving forward at full steam, with or without them. After all, it is now 2021. We are flying helicopters on Mars. Should your company use board management software to empower your board to accomplish more and be more effective? ■

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Understanding The Ransomware Threat

by David Kennedy and Tyler Hudak

When massive ransomware attacks such as that at Colonial Pipeline cripple whole segments of the economy, directors get the message that this is a boardroom concern. While your board needs to assure itself on data threat defenses and information security, a more existential governance issue also arises. Could fiduciary duty compel us to pay a digital ransom?

Ransomware has long posed a significant threat to business operations. These attacks have skyrocketed of late. Over the past few months, we have seen several high-profile ransomware incidents, such as Colonial Pipeline and JBS, that show how bold hackers are becoming, and that any company can be a victim.

Increasingly brazen attacks being carried out through ransomware-as-a-service (RaaS) syndicates suggest that the trend is likely to continue—even amid government efforts to shut down RaaS infrastructure.

Ransomware is extremely profitable for cybercriminals, and it is also relatively easy for them to carry out.

Ransomware is a type of malware that effectively hijacks a business by encrypting its data. The only way to decrypt the data is by using a decryption key, and in many cases, the only way to get that key is by paying a ransom. Hence, the name.

These cyber attacks are much more than a nuisance—they can totally disrupt any company that falls victim to them. In the case of Colonial Pipeline, its pipeline operations were halted for roughly a week after this attack. Cities like Atlanta and Baltimore suffered weeks of outages in government services due to their attacks.

Ransomware is extremely profitable for cybercriminals, and it is also relatively easy for them to carry out. This has made it extremely popular among the world's various criminal groups.

In spite of the blowback that the DarkSide group faced after its attack on Colonial Pipeline, do not expect to see this crimewave diminish anytime soon. On the contrary, we are likely to see even more of these attacks carried out in the coming months, as well as more dangerous and destructive versions of this malware. This includes ransomware that can infect industrial control systems (ICS) and "wipers" that encrypt data without any intention of releasing a decryption key.

☐ ***How does it happen?*** Most ransomware attacks begin with a phishing email that contains a malicious file or link, but this is not the only way a company can become compromised. Another common method is through an organization's own remote access portal. During the pandemic, many companies rushed to set up remote access. This was often done insecurely using Windows Remote Desktop Protocol (RDP), or without multi-factor authentication.

If companies have unpatched servers, or vulnerable devices that are unwittingly exposed to the Internet, hackers can attack them and gain extensive, and perhaps even unfettered, access to the corporate network. This allows the attacker to install ransomware very quickly.

Cybercriminals can also simply buy access to your company if it has already been compromised by other malware families. It is important for companies to understand that cybercrime is its own economy, and it has a division of labor just like any other business or industry. There are many criminal groups that specialize in targeting businesses with a type of malware called a "backdoor," which they can then

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www.trustedsec.com

rent out to other hackers. The criminals will infect hundreds or thousands of business and personal computer networks, in what is known as a "botnet." Once it reaches a certain scale they then lease the botnet to other criminal groups, such as ransomware gangs.

The ransomware gangs buy access to the backdoor, which allows them access. From there, they can move throughout the network, gain administrative credentials, obtain access to backups, and send out sensitive information—all before deploying the ransomware.

What makes this attack so troubling is that backdoors will often lay dormant on a network for days, weeks, perhaps even years before being called into action. If companies are not aware they have been compromised by a backdoor, they never see these attacks coming. With the level of access that most botnets provide, a ransomware group will very quickly encrypt large swathes of the victim company's network before they have a chance to respond.

Not all criminal groups will keep their word and hand over the decryption key. Your company may be out several million dollars, with the entire network still unusable.

Once your company has been infected with ransomware, we move to the second stage of the attack—extortion. In a traditional ransomware attack, the malware encrypts all of the data and systems it can. The hackers will then demand a large payment in cryptocurrency in order to provide a decryption key.

Understand that not all criminal groups will keep their word and hand over the decryption key. This is definitely a gamble, as a company may simply be out several million dollars in addition to having their entire network encrypted and unusable. That said, it is in the interest of most criminal groups to honor their commitment and release the decryption key in order to keep a "good" reputation so that future victims will pay the ransom as well.

However, even if a company is given the decryption key, the actual decryption of the compromised data can be painstakingly slow. It will take weeks, if not more, to fully decrypt all of the hijacked data. During this time, the business cannot run at full speed, if at all.

Another issue is that ransomware attacks have evolved to include not just data encryption but also data theft. This is known as a "double extortion" ransomware attack. Before hackers encrypt the company's data, they first exfiltrate it to servers under their control. Then they will launch the encryption stage of the attack and threaten to release the data in the dark web or on a public Internet site if not paid the ransom—in addition to not decrypting the company's data.

Double-extortion greatly increases the complexity of dealing with these attacks. Although companies may succeed in preventing the hackers from releasing the data publicly, they have no way of knowing if the hackers are still storing the stolen data or selling it privately to other criminals. Assume that they are.

☐ ***What are the major types?*** Ransomware can be classified into two specific categories, *Locker* and C*rypto* ransomware.

Locker ransomware blocks basic computer functions. For example, you may be denied access to the desktop, while the mouse and keyboard are partially disabled. This allows you to continue to interact with the window containing the ransom demand to make the payment.

Crypto ransomware is used to encrypt your important data, such as documents, pictures, and videos, but not to interfere with basic computer functions. Crypto developers often add a countdown to their ransom demand: "If you don't pay the ransom by the deadline, all your files will be deleted, leaked, or sold."

☐ ***Most effective prevention methods.*** Ransomware is an equal-opportunity attack, and any organization can become a target. Therefore, every company should be preparing for this threat, not only using preventive measures like malware detection, network traffic analysis, data leak prevention, and data backups, but also anticipating the costs they should expect to pay. The good news is that fundamental security controls and practices go a long way toward preventing a ransomware outbreak.

▫ *Harden external access methods.* Any external access, such as RDP or VPN, should require two-

factor authentication and should lock accounts (or at least generate an alert) after a number of unsuccessful login attempts.

□ *Ensure your IT or security teams have visibility into the organization*. Traditional anti-virus software is no longer sufficient. Enterprise Detection and Response (EDR) software is needed to detect attackers.

□ *Restrict account privileges and use unique passwords*. By employing a model of least-privilege on all accounts, plus a unique password for each account, you can hinder an attacker's ability to move within an environment.

□ *Obtain an accurate asset inventory.* You cannot protect what you do not know about.

□ *Protect your backups* with physically offsite and offline backups, or backup software that includes immutable backup capabilities.

□ *Provide user security awareness training for ransomware threats.* Your user community is the first line of defense in thwarting the phishing tools used by ransomware operators.

☐ ***What are the board's fiduciary responsibilities in dealing with a ransomware demand?*** Dealing with ransomware is never going to be easy. No company wants to pay millions of dollars to a criminal organization, and law enforcement agencies may actively discourage any payment to them at all. However, boards will need to consider the situation from a fiduciary standpoint, and decide whether it is in the company's best interests (as well as its customers and the industry it serves) to try and reduce the downtime by paying for a decryption key.

Before a board makes this decision, it needs to consider several questions:

□ Has your IT team confirmed that the data is irrecoverable? For instance, are you sure it is not stored in backups? Also, are you unable to retrieve it by removing the malware or decrypting it through your in-house security team or outside consultants?

□ Do you know which ransomware group you are dealing with? Certain criminals have a reputation for releasing the decryption keys, whereas other groups pose a higher risk of reneging on the deal once paid.

□ Does your cyber insurance cover a ransomware payment?

□ Have you determined if the hackers have other footholds in your network that they could use afterward to re-infect your network again?

□ Has your data been exfiltrated as part of the attack, or is this a traditional encryption-only event?

□ Are the attackers on the Office of Foreign Assets Control (OFAC) Sanctions List, making it illegal to pay the ransomware?

Boards must consider the possibility that they will pay a ransom and the criminals either will not release the decryption key, or will turn around and hack the company again. This is simply a risk it will have to accept if it is in a position where there is no other option but to pay a ransom.

Ransomware attacks are very expensive, even when the criminals provide a decryption key. There are many other costs beyond the ransom.

☐ ***The true cost of a ransomware attack.*** Paying a ransom means your company may be paying a lot of other costs from this attack. Ransomware attacks are expensive, even when the criminals provide a decryption key. Most companies do not realize all the potential costs they may incur.

Here is a list of some of the costs that companies need to prepare for now, before they get attacked:

□ *1. Cyber insurance.* Cyber insurance can be a savior when it comes to a devastating ransomware attack, but it will only help if it is in place before attackers strike. Depending on your policy, insurance may provide many of the services listed below (which you may or may not need to pay for). Know what your deductible is as well. While this is not a direct cost, it will still cost you money.

□ *2. Incident response.* The ransomware did not just appear in your network. You need to figure out the root cause, what the attackers did in your network, and what (if any) data was taken. There are likely compromised users or systems with backdoors not yet affected by the ransomware still on your network. If you do not find them, this attack will happen again in a few weeks.

Incident response (IR) companies help you figure

The Real Costs Of Ransomware

Lost Money, Lost Data, Lost Trust

** Source: Binary Defense*

all of this out. They come into your organization, investigate the attack, and give you the assistance you need to make it through containment, eradication, and recovery of the incident. If you lack an internal IR team, get an IR retainer. This will have someone available to you 24x7x365 to assist if you have an incident.

□ *3. Legal.* When dealing with ransomware, legal counsel is a must. They can tell you how to navigate the minefield of reporting obligations, ensure your communications are privileged (so opposing counsel cannot see them if you get sued), and advise you on whether paying the ransom is legal.

You also want to assure that your internal legal team knows how to handle cyber incidents, or that you work with external legal counsel that has this experience. Expect to pay anywhere from $250 to $700 an hour for external counsel, with the total bill easily reaching $75,000 for most companies (if your attack does not go into litigation).

□ *4. Crisis communications.* Your company probably has a communications team, but has it ever dealt with a crisis? How will you notify your customers? What will you say? How will you say it? What do you say to employees? How do you control the flow of information? If your team has never gone through this, you will need a qualified crisis communications firm to tell you what to do and how to do it.

You will not recover from a ransomware attack over the weekend. Recovery is a 24x7 operation that will last for a while, and staff can burn out.

□ *5. IT support.* You have an information technology (IT) department, and it will be a crucial part of your ransomware response plan. However, you will not recover from a ransomware attack over the weekend (if you do it correctly, at least). Recovering from a ransomware attack is a 24x7 operation that will last for a while, and staff will burn out if expected to work long hours for days/weeks/months on end. Consider adding extra help and expertise to rebuild things properly and quickly. Bringing in IT support costs in the range of $200 to $500 an hour, depending on the type of expertise needed.

□ *Ransom.* Every company that gets hit with

ransomware has to make the decision on whether to pay the ransom or not. Sometimes, this is the only way to get your data back or prevent highly sensitive data from being leaked. Ransoms can range from a few thousand dollars to $2 million to $5 million. I hope you never have to pay, but if you do need to, you should also get a negotiator.

▫ *6. Ransomware negotiator.* These are firms that specialize in helping reduce the ransom amount, assist in purchasing cryptocurrency, and ensuring your data is deleted (although attackers often do not completely delete your data). Having one can help save you a large amount of money.

Unfortunately, there are many other costs associated with ransomware attacks, such as hardware and software recovery, additional protections, loss of productivity, lawsuits, loss of customers, and ongoing monitoring. The good news is that many of these expenditures can be reduced or eliminated with proper planning and preparation.

☐ ***What are the legal and ethical issues to consider in paying the ransom?*** While there are some potential legal issues from paying a ransom if the threat actor is on the OFAC sanctions list, most of the time companies may not be legally restricted from paying a ransom. However, they will need to consult their cyber insurance provider to see if a ransom payment is covered by the policy, and what percentage will be reimbursed.

There is an ethical quandary in agreeing to pay a ransom, but this is a matter that needs to be considered objectively and from a purely business standpoint. Can your business resume normal operations without getting a decryption key from the hackers? If it cannot, it should consider paying the ransom.

Companies face other legal issues as a result of a ransomware attack, particularly if it is a double-extortion attack. In most cases where consumer data is exposed, the company will have to file a data breach disclosure to the appropriate authorities. It will also be subject to lawsuits and potential fines. For publicly listed companies, a ransomware attack certainly counts as a materially significant cyber event, so they will most likely need to include this in an 8-K filing, as well as the annual 10-K report.

☐ ***How do you explain your decisions to investors?*** A company's investor relations team should be prepared to deal with the reputational aftermath of a ransomware attack. The affected company should expect criticism for not preventing the attack, for the length of time it took to recover normal operations and for paying the ransom (or for not paying the ransom).

In this situation, it is best to work with a crisis communications team to be forthright with your investors and explain the situation as clearly as you can. The public is now more aware of the risks of hacking, and ransomware in particular, so there is more understanding for the corporate victims. Instead of seeing this as a company-specific problem, the public understands that it is a systemic threat—and any business can be attacked.

Companies need to explain to their investors how the attack happened, and how they are fixing the problem to avoid future attacks. They should also explain the rationale for paying the ransom. Ultimately, when companies pay a ransom, they do so to limit the disruption and financial toll on the business, an argument that investors should certainly understand. They also need to offer new solutions going forward that will reduce the company's overall risk to these and other attacks. ■

Five Board Questions About Black Lives Matter

By Roger M. Kenny, Angela Brock-Kyle and William J. Holstein

The past year has seen much discussion and soul searching on the way business has left Black Americans behind—but what about results? The authors take a deep dive into the ways our traditional corporate structures and assumptions have shut out generations of Black talent, and how boards can now drive change.

According to Equal Opportunity Commission data, only three percent of Black employees are managers at companies in the United States and only one percent of them are at the very top tier. Although there has been an uptick in hiring and promoting African-Americans over the past year, there is a widespread consensus that not enough has been done.

The statistics, along with inequalities revealed by the Black Lives Matter movement, demonstrate just how systematic the patterns of racism have remained for decades. For change to occur, there must be a systematic response.

In business, responsibility starts at the board level. Boards must recognize that *they* own the problem, and that responsibility for a solution cannot be delegated. Management typically takes a narrower view of a corporation's boundaries, focusing on customers, employees and shareholders. Well-constructed boards, however, represent perspectives from a broader cross-section of stakeholders, including government, non-profit and educational leaders. As a result, boards have the ability to create the true company-wide and community-wide discussions necessary to achieve tangible progress.

This is not just about addressing social, political or cultural goals. Directors should also realize that it may be good for the company's share price. The rise of the Environmental, Social and Governance (ESG) shareholder movement has rewarded companies that have taken leadership positions on these issues.

Following are five questions boards should be asking themselves and their top managements.

☐ ***1. What is actually happening now in our company?*** What does greater racial equity mean to our company, its stockholders, customers, board of directors, managers and employees? Do we truly wish to be known as a Black-friendly company in everything we do? Can we show proof in our actions, especially in our hiring, promotion, purchasing and partnering policies, that contribute to such a reputation? Have we settled for less? If so, why?

When done properly, recruiting a Black board member is the start of a process which helps retain Black managers and further assists in recruiting other Black talent.

Some affirmative action targets have not worked in part because they were too superficial. They often thrust people of color into positions for which they were not adequately trained. Businesses need a new, broader form of affirmative action that requires greater internal preparation as well as lasting connections in the communities where a company does business. Not only must companies provide opportunities for professional advancement, they must also recognize the need for security and good schools for *all* employees and their families and, whenever possible, assist them in securing both.

☐ ***2. Is the composition of our board right for the challenge?*** Many companies have recruited a single Black director and appear to be content with what amounts to tokenism. However, when done properly, recruiting a Black board member is the

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start of a process which helps retain Black managers and further assists in recruiting other Black talent at both the board and management levels.

There are, of course, right ways and wrong ways to recruit Black directors. If a candidate suspects he or she is being considered simply because of skin color, that is obviously offensive. There must be a business rationale for why any director is added to a board.

The traditional problem in identifying and recruiting more Black directors has been that the "pool" of candidates where executive search firms seek candidates has been relatively restricted to people who fit certain traditional profiles. "One way to look at it is that these boards are basically fishing from the same pond instead of looking at the broader ocean," says Linda Akutagawa, chair for the Alliance for Board Diversity.

Non-traditional candidates are available below the C-suite level, and have deep skills not only in traditional disciplines such as finance but also in newer areas such as information technology, risk management and ESG.

That is why boards must be explicit in demanding that search firms present slates of candidates that include Black candidates. There are some signs this is beginning to happen. Both large and small search firms are diversifying their ranks, employing more Black recruiters, or establishing practice areas focused on Black candidates. Diversity that includes Blacks, not just non-Americans and women, should be emphasized. Another encouraging indicator: Organizations that identify Black director candidates and market their availability are playing larger roles.

The onboarding process can be critically important, particularly if a Black director comes from a non-traditional background. Any new director needs to understand the written (and unwritten) rules of how a board functions. Moreover, incumbent directors should be sensitive to the social signals that are sent to a new Black director over meals or cocktails associated with board meetings. A strong lead director could play an important role in smoothing the path of entry.

With the recruitment of a Black board member, a board can establish or enhance its pipeline to increase the number of Blacks in all areas of the company's business. The role of mentorship is crucial. It should be part of any director's portfolio, but particularly Black directors. Black directors who serve as mentors to many others, regardless of color, are highly sought after.

Two such leaders respected for their leadership on these issues are Kenneth Frazier, retired chief executive officer of Merck and lead director at ExxonMobil, and Ursula Burns, former Xerox chief executive, a director at Diageo and Uber, and now board chair at Teneo.

There never was a directive to look for a white board candidate. Unless a "person of color," "Black executive," or a woman, was specified, a white male was tacitly implied.

☐ ***3. Is the need for greater diversity deeply imbedded in our management succession planning?*** Diversity should be included at every level of succession planning, starting at the CEO level and cascading down through the organization. A convenient excuse that some boards have used in the past is that Black candidates simply do not exist within the company. Boards then wash their hands of the issue and move on. In the early days of recruiting members for boards, there never was a directive to look for a white candidate. Unless a "person of color," a "Black executive," or a woman, was specified, a white male was tacitly implied.

This is similar to the argument about why there are not more Black directors in the directors' pool. The pool for managers and executives itself must be made to grow. Companies should develop reserves of executives with more non-white leaders. If a board engaged in succession planning finds there are not sufficient numbers of able, trained Black employees, they should be asking: "Why haven't we established sufficient pools? Have we truly searched?"

It often boils down to whether a candidate is "ready." Yet how is readiness defined? White managers are often assumed to be ready whether they have served in a similar role or not. Black managers should have

the benefit of the same assumption. If senior managers and executives realize they have no Black personnel who could be promoted, they should engage in sponsorship development activities to get those people into the company and prepare them for advancement.

Everyone in positions of responsibility should be aware of the subtle, informal mechanisms which can hold Blacks and other minorities back. "Too many promotions in companies are informally decided before jobs are ever posted, leaving Black people and more marginalized talent without the chance to compete," says Ron Williams, the Black former CEO of Aetna. He has served on 14 boards over his career, and currently sits on the boards of Boeing and American Express. "People don't get the chance to work their way into a position where they are a reasonable candidate for a role."

To correct that situation, companies should broaden their methods of ascertaining and assessing skills. Place candidates into training programs each year, assign mentors and expose the candidates to multiple roles. After rotating through various positions, their talents will become clear. The highly placed mentors who coach them should be compensated for their successes and given the necessary time to do the job right. Investments are always necessary to help investigate, select, engage, mentor and promote candidates every year, no matter what their color may be.

If boards are equipped with the right tools, they can monitor whether a company is making racial progress or not. Direction is more important than statistics.

To help, boards should receive statistics which include all racial and ethnic groups, detailing employment, pay and promotion opportunities for each group. Boards also need to understand why people leave the corporation. Only then can disparities begin to be fairly redressed. While views differ on the effectiveness of specific diversity targets, if boards are equipped with the right tools, they can monitor whether a company is making progress or not. Direction is more important than statistics.

"Challenge Companies To Act"

Being A Boardroom Ally

Excerpts from Women in the Boardroom's *Antiracist Interview Series with Angela Brock-Kyle:*

☐ **Why is antiracism essential in the corporate board environment and what strategies have you witnessed that are being used to respond to these challenges?**

"Leadership in the boardroom is essential on every major issue, particularly those that don't align with the tried and 'true' tactics that have been in place for years. Antiracisim is a cultural issue on the third rail. As a result, you need to have someone step up and directly address that. There are different ways to do that, and it's important you read your business to understand what approach to take.

Each of the boards I sit on has required a different engagement approach ranging from having a conversation with the chair of the board, asking questions of leadership well in advance of a board meeting, and ensuring the conversation is started at the meeting. Challenging companies to act in ways that are aligned with expanding their business opportunity and sustainability while supporting the minority community is a strategic and cultural decision that must be customized in order to be sustained."

☐ **What is the one piece of advice you would give to women of color who are interested in corporate board service?**

"I'd advise women to speak up. I speak up about what I think makes sense that I don't see people doing. I speak about what I want to do. There are people who don't. I think if they don't, they're doing themselves a disservice. Think of yourself as a white male—they speak up all the time—they aren't always right, and that's OK. If you're bringing your perspective and doing it in a respectful way, it's valuable. Sharing your knowledge and talent is valuable and that's why you're in the room—whether a boardroom or corporate setting. If you want to get into a different room or continue to stay in the room, you have to add value."

As for management, C-level pay packages should be adjusted so that top managers have a direct financial stake in measurable outcomes. Managers and employees need to recognize behaviors that discourage diversity, and their Black counterparts should be trained in how to communicate when they encounter behaviors they perceive as discriminatory. Coaching

also may be required, which costs time and money.

Hiring "diversity vice presidents" has proven to be largely unsuccessful, particularly if a board and top management do not fully buy into the process. If one senior executive is in charge of diversity but other managers lack clear diversity responsibilities reflected in their compensation, the business will continue to be run the same way it always has been.

Most diversity officers prove to be short-lived. While they may represent a good-will attempt to deal with a difficult problem, their ineffectiveness could also be interpreted as another form of institutional tokenism. Diversity consultants tend to be even less effective.

Research shows that more diverse companies perform better financially. The single biggest variable is leadership appointments.

How a company talks about management diversity in its internal communications is another important tool. Companies typically acknowledge or celebrate many types of business achievement. Publicizing achievement in hiring, retaining or promoting Black employees and talking about "safe" listening and sharing events is positive.

Externally, companies can communicate to outside constituencies not only about internal progress but also about, for example, new vendor relationships. The net effect of these communications is a virtuous cycle that can attract new employees, vendors and customers.

Creating more diverse management teams is not just about responding to societal pressures. There is also a solid business case for it. "Research shows that more diverse organizations perform better financially-and the single biggest variable inside a company is leadership appointments," says Dame Vivian Hunt, a senior partner at McKinsey & Co. "Companies with diverse executive teams are more likely to be profitable; 25 percent more likely for gender diversity and 36 percent more likely for ethnic diversity. Diverse executive teams are particularly important as they are the primary drivers of company strategy and organizational transformation."

☐ ***4. How should our company's hiring practices change?*** In the past, boards focused heavily on annual and quarterly financial results, leaving directors with little or no time to consider how other factors, such as hiring practices, could dramatically reshape a corporation.

Some enlightened corporate leaders are now saying that millions of jobs requiring a four-year college degree can be done without that level of education. Black Americans, in particular, are often left unprepared by the United States education system. Companies could help by hiring workers without a four-year degree and giving them training, according to Kenneth Frazier.

At a CEO summit meeting, Frazier was seconded in his opinion by former IBM Chief Executive Virginia Rometty. Both executives called on companies to re-evaluate their hiring criteria and said they supported traditional college education for some people, but that many entry-level positions can begin without a four-year degree. "The jobs are there and there's one structural barrier we can remove," said Rometty.

At IBM, Rometty notes, propensity to learn became the company's number one hiring criterion, not pedigree, as the company struggled to fill open positions. Over time and with training, the "new-collar employees" as she called those without a four-year degree, had performance results that were equal to or better to those of workers with a traditional education.

Frazier pointed to his own company as an example. Although Merck employs many scientists with Ph.D's and other advanced degrees, the company has also expanded hiring in other areas. "We get many people who are cheaper, they're just as good, they're very loyal because this gives them an opportunity," he said.

Rometty suggested that companies hire dozens of people without a degree in large cohorts instead of one or two hires as an experiment. At IBM, when hiring people without bachelor's degrees, the company still tested for cognitive and technical skills, and put in place training for managers supervising such employees. She denied that the company was "dumbing down the workforce."

☐ ***5. What are the mechanics for how a board achieves diversity and inclusion goals?*** There is a

limit to the number of issues a board can wrestle with successfully on an annual basis. Therefore, every year, a board must have an annual board plan which highlights four or five top priorities to be referred to at every meeting as a determinant of progress. Diversity must be on that list.

The board has the ultimate responsibility for assuring diversity. Undertaking the task requires introspection, honesty, the ability to recognize and learn from past mistakes and taken-for-granted practices, along with the detection and elimination of subtle prejudicial views.

The nominating and governance committee oversees the company's hiring practices. However, no single committee can carry the full diversity load. The compensation committee and human resources also must be part of the equation. In effect, this means the entire company is engaged. If the solutions do not permeate the entire organization, they will not work.

When properly conducted, annual board assessment is the best opportunity for a board to judge whether they are meeting their stated goals. It is the one time each year when directors have an opportunity to level with themselves, hear feedback from every director, learn about their own personal progress and evaluate the progress of both management and the board. These discussions should include questions about diversity, and also serve as a reminder that no board seat is forever—room must be made for future Black candidates.

Organizational transformation starts with healthy, open dialogue at the board level, and should filter down to every team in the company. Cultural sensitivity is not a subject often discussed in the corporate world, but is important in identifying, hiring and promoting Black people at all levels. Companies must each find their own formulas. A company's observance of Martin Luther King Day, or the new federal holiday, Juneteenth, are opportunities to learn about the contributions of Black employees and to communicate internally and externally on that progress.

In the quest for diversity, mistakes will be made. There will be challenges to overcome and lessons to be learned, but boards must keep in mind that there is solid business logic behind persevering. One is management effectiveness. Another is share price. For example, not all companies can achieve tangible environmental gains because of the nature of their business, particularly those that are major users of non-renewable energy or resources. If they can achieve progress on the diversity front, it may help blunt criticism from activist shareholders that the company is not responding to the ESG movement.

The very legitimacy of American corporations has come into question in some political circles. By demonstrating true commitment to diversity, equity and inclusion of African-Americans, boards can demonstrate that their companies are not just profit-making machines for a relative handful of people. Rather, they can be a positive force for the broader American good. We believe the payoff from that will be enormous. ■

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Trends In ESG And Shareholder Activism

by Kai H.E. Liekefett, Holly J. Gregory and Leonard Wood

Environmental, social and governance (ESG) issues have exploded as governance and operational concerns for companies. However, ESG is moving beyond even these broad confines. The depth, structures and regulation of ESG disclosure, and how these are related to your shareholder base, may become your next boardroom challenge.

The successes of shareholder activists against Big Oil this proxy season are one of many signs of mounting and effective pressure from investors on public companies to enhance their performance and disclosures on environmental, social, and governance (ESG) criteria. As ESG rises in prominence, activist shareholders have new and potent themes from ESG's repertoire of concepts and criteria to use in campaigns to change control and strategy at companies.

By integrating criticisms of ESG failures into campaign narratives, activists may gain additional traction with institutional investors at the ballot box. This article provides background on the potential for increased integration of ESG in activism campaigns, and offers practical guidance for companies to preempt ESG-themed shareholder activism.

☐ ***The promise of ESG.*** Investors increasingly view corporate attention to ESG criteria as closely linked with business resilience, competitive strength, and financial performance. The world's largest institutional investors and pension funds have stated their faith in the potential of ESG to unlock shareholder value and make companies and markets more sustainable.

Institutional investors have, in turn, developed new ESG-themed investment products. In 2020, we saw a record influx of investor capital in ESG-themed funds, bolstered by the moral prospects of ESG investing in light of the COVID-19 pandemic, and positive financial results reported by the media and researchers.

It was reported that "sustainable equity funds finished 2020 with a clear performance advantage relative to traditional equity funds." It was further noted that in the same period, "three out of four sustainable equity funds beat their Morningstar Category average," and 25 of 26 ESG equity index funds followed by Morningstar "beat index funds tracking the most common traditional benchmarks in their category."

The SEC and other U.S. regulators have given clear signals that they intend to issue regulations and guidance to facilitate the integration of ESG into the market.

Institutional investors have intensified engagement with public companies to advocate for ESG-oriented policies and disclosures. They have also adjusted their proxy voting policies correspondingly. Investor support for ESG-themed shareholder proposals has generally increased in the past five years. Investors have meanwhile lobbied governments and regulators, requesting that they impose further requirements on companies to expand their ESG disclosures and deepen their commitments to ESG operating principles.

Since the arrival of the Biden administration, the SEC and other federal regulatory agencies in the U.S. have given clear signals to the public that they intend to follow suit by issuing regulations and other guidance to facilitate the integration of ESG into the market.

☐ ***Reasons for the integration of ESG in shareholder activism.*** Shareholder activists deploy ESG concepts in their campaigns for various reasons. An activist investor might genuinely believe that greater focus on environmental and social factors de-risks

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operations, makes business more sustainable, and creates opportunities. An activist could support a specific ESG value thesis, for example, that a carbon transition plan is necessary for a given company to enjoy sustainable growth. Depending on the fund's priorities, policies, and agreements with its investors, a fund could be required through contractual obligations to integrate ESG into its investment strategy. In some circumstances, the activist investor may claim an ethical duty to integrate an ESG concept into its campaign.

Activist investors also understand that certain institutional investors may find an ESG-themed campaign difficult to resist at the ballot box. Activists recognize that certain clients of institutional investors are demanding ESG in investment platforms, and that some institutions have committed to ESG stewardship. For an institutional investor to turn its back on an ESG-themed activism campaign could mean the risk of being criticized for disregarding the financial and ethical priorities of its clients.

It remains to be seen which ESG themes will resonate with investors at the ballot box during activism campaigns.

There is also a public relations dimension at work. Historically, the general public has seldom noticed when an institutional investor declined to support an activist campaign that was calling for a sale of the company, changes to capital allocation, or the termination of a CEO. In coming years, though, the general public may pay attention when the same institution declines to support a campaign that is calling for greenhouse gas emissions reductions or other ESG-themed measures.

There are also unknowns and potential pitfalls for the integration of ESG concepts into shareholder activism. It remains to be seen which ESG themes will resonate with investors at the ballot box during activism campaigns.

It is not clear yet whether activists will incorporate ESG themes as a core pillar of their campaigns, or if such themes will mainly serve as a tool to be used when convenient to support a larger purpose. This would be like calls for declassifying the board alongside of a campaign to replace directors. Activists could harm their campaigns if investors view the use of ESG themes as disingenuous. Perhaps most significantly, there are open questions as to how shareholder activists can reconcile their relatively short-term investment horizons with ESG theses. These characteristically involve long-term value propositions.

☐ ***New themes in governance best practices.*** Proponents of ESG-conscious operations are elaborating new standards and "best practices" for corporate governance. Most prominently, these investors are looking into how boards and management teams oversee environmental and social performance. How is ESG oversight allocated among board committees? Does the board have sufficient expertise in environmental issues and social issues?

It is often incorrectly said that the "G" in ESG, for governance, is old news for shareholder activism. True, certain governance themes have been present in activist campaigns for a decade or more. Such themes include enhanced director independence, separation of the CEO and board chair roles, declassification of the board, and other measures to increase shareholder rights. However, part of the "G" in today's ESG thinking focuses on the governance of environmental and social aspects of a business.

Certain ESG rating groups observe how ESG oversight is allocated among the board and its committees, and whether a dedicated committee has been established for this purpose. A memo by BlackRock concerning its proxy voting policies set an expectation that directors will "have sufficient fluency in climate risk and the energy transition to enable the whole board—rather than a single director who is a 'climate expert'—to provide appropriate oversight of the company's plan and targets." This expectation for corporate governance, rooted in ESG thinking, is new and far-reaching compared to activists' more traditional governance demands.

Establishing board and management oversight of ESG to keep up with investor expectations involves a certain amount of chasing a moving target. Investor

ESG Reporting

Select Voluntary Standards And Frameworks For ESG Disclosures

☐ *CDP (previously the Carbon Disclosure Project).*
An international nonprofit established in 2000, CDP scores companies on environmental risks and opportunities related to climate change, water security, and deforestation. CDP obtains information by sending annual questionnaires to companies and investors.

☐ *Global Reporting Initiative (GRI).*
An international nonprofit established in 1997, GRI created the first international guidelines for sustainability reporting in 2000, and issued new sustainability reporting standards in 2016. Under the GRI disclosure regime, companies determine independently which GRI standards to apply to their disclosures.

☐ *Value Reporting Foundation.*
In June 2021, the International Integrated Reporting Council (IIRC) and Sustainability Accounting Standards Board (SASB) merged into the Value Reporting Foundation. IIRC developed an International Integrated Reporting Framework that elicits information about strategy, governance and performance. SASB developed ESG reporting standards for 77 industries. The foundation is working with the International Financial Reporting Standards Foundation (IFRS) as it prepares to launch an International Sustainability Stnadards Board.

☐ *Task Force on Climate-related Financial Disclosures (TCFD).*
Established by the Financial Stability Board in 2015 to make recommendations for improving practices for voluntary climate change disclosure, the TCFD released a framework in 2017 to help companies evaluate and disclose financial risks posed to their business by climate change.

☐ *United Nations Global Compact.*
Established in 2000, the United Nations Global Compact encourages participating companies to adopt sustainable and socially responsible policies, and to report on their implementation. Participants commit to the compact's "Ten Principles" regarding human rights, labor, environment, and anticorruption.

**Source: Sidley Austin LLP*

expectations and company practices on corporate governance are evolving rapidly, along with other ESG-related trends.

Companies and investors are converging around certain practices and expectations. Among other things, boards and management teams are increasingly expected to ensure that ESG is a component of strategic decision-making. They should identify ESG risks and opportunities, understand differences between the ESG priorities of shareholders and other stakeholders, oversee ESG-related disclosures, and allocate oversight of ESG among the board and its committees.

Boards are also being expected to focus on aspects of ESG-related oversight that only a board can perform.

There is evolving discussion around the role of audit committee oversight of some ESG-related matters, such as the identification of material ESG factors and oversight of disclosures and disclosure controls. Boards are also being expected to focus on aspects of ESG-related oversight that only a board can perform, such as oversight of management, setting executive pay, and auditing and internal controls.

☐ ***A look to the future.*** The new age of ESG may bring other innovations in shareholder activism. Additional corporate disclosures on environmental and social issues can provide shareholder activists with new material to use in their campaigns.

Successive editions of sustainability reports issued by companies over a course of several years will provide investors with an ability to compare ESG performance over time and to compare companies. Over 90 percent of S&P 500 companies and 65 percent of Russell 1000 Index companies already produce sustainability reports. The SEC has signaled that it will likely develop additional requirements for ESG-related disclosures of public companies.

Environmental and climate-related topics are currently the most common ESG topics to be integrated into activist campaigns. A further stage in ESG activism is the incorporation of social- and social-

justice-related concepts into activism strategies.

Social justice and public health themes came to the foreground of public interest in 2020. This led to burgeoning discussion on the direction of social aspects of ESG, particularly as they relate to diversity and inclusion.

Prominent institutional investors have advocated for companies to disclose workforce diversity statistics. California and other states adopted legislation promoting gender and racial diversity on boards. The Nasdaq Stock Market has proposed listing standards to increase board diversity. Meanwhile, the current direction of the Biden administration indicates that it is becoming a business risk for companies to not have processes in place to address their carbon footprint in minority communities.

Another ESG-driven innovation would be increased shareholder activist solicitation of proxies at shareholder meetings for their own business proposals. In the United States, the vast majority of shareholder proposals are made pursuant to Rule 14a-8 under the Securities Exchange Act of 1934, which imposes topical limitations on proposals.

In contrast, shareholders who solicit proxies for their own proposals have a comparatively free hand to make proposals on the topics of their choice, and to say what they want to say about their proposals. Coupling a proposal to elect dissident directors with an environmental or shareholder proposal could increase the probability that an activist's proposal to replace directors would succeed.

Companies deemed ESG laggards are low-hanging fruit for activists looking to work ESG themes into their campaigns.

☐ ***Practical guidance for public companies.*** Pursuing ESG-related goals brings benefits for a company. Good ESG performance creates a line of defense against shareholder activism. Boards of public companies should set oversight of ESG issues as a priority. Companies should review their ESG-related disclosure practices to ensure that investors or ESG ratings agencies do not deem them laggards. Companies deemed ESG laggards are low-hanging fruit for activists looking to work ESG themes into their campaigns.

On ESG policies and disclosures, consider also the following practical guidance:

▫ *Public companies should treat activist shareholders with ESG-themed inquiries and criticisms respectfully.* Treat them the same as "regular" institutional investors seeking routine engagement. While there may come a time to push back, companies should expect to be in "listening mode" for the first meeting.

▫ *Work ESG concepts and talking points into emergency plans for shareholder activism preparedness.* Being respectful of investors does not mean companies should be unprepared to respond to criticism, particularly if made in a surprise press release. While finer points can be ironed out once specific criticisms are made, a company should be ready to speak at a high level about material areas of its ESG program. If a company lacks an emergency plan for shareholder activism, it should be in touch with experienced activism defense counsel that has experience with ESG.

▫ *Be cautious when making changes to governance or policy against the background of an ESG-themed activist campaign.* Boards facing demands to admit dissident directors commonly appoint directors of their own choosing, or adopt new ESG-related measures, prior to the annual meeting and without previewing these actions with the activist.

These measures are often justified because, among other reasons, a company was already in the process of making changes before a dissident campaign arose. In the context of an ESG-themed campaign, however, these measures can backfire. Even if without basis, the activist can portray such changes as reactive, hasty, insincere, and incomplete.

▫ *Companies should have shareholder activism defense counsel review their ESG disclosures.* This review of activism preparedness is distinct from a wide-ranging review of the company's overall ESG profile. If a company is already advanced in its ESG policies and disclosures, the goal is not to reinvent the wheel or second-guess existing programs. Rather,

the goal is to identify and preempt ESG themes that may be exploited by an activist campaign, even if (and especially if) the company has already addressed those themes.

□ *Public companies should continuously improve ESG initiatives, oversight, and disclosures as well as ratings with ESG data collection ratings and services.* Most companies are well aware that good performance in these regards helps to avoid unwanted pressure from institutional investors, and can create a path to higher liquidity and a lower cost of capital.

ESG scores and reports, however, are also roadmaps for activists searching for weaknesses in a company's ESG profile. If these initiatives are lagging, they should be stepped up in the areas that are most vulnerable to ESG-themed activist criticism.

□ *Companies should stay near the curve, or at least their peers, in making voluntary disclosures.* ESG data collection and ratings services are monitoring the extent of companies' alignment with voluntary disclosure regimes such as the Task Force on Climate-related Financial Disclosures, the Value Reporting Foundation, and the Global Reporting Initiative. As mentioned, disclosure laggards may become easy targets for ESG-themed criticism.

□ *Be cautious about integrating environmental and social information from voluntary reports into regulatory filings.* The coming years are likely to see increasing pressure on companies to integrate their sustainability reports into filings with regulators, such as annual reports and proxy statements. This creates legal risks, and should be pursued only after close coordination within the company among appropriate departments (the legal department and sustainability team), and in consultation with counsel specialized in securities law and ESG disclosures. ■

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Boards And Their Stakeholders

by William Sisson

The idea that today corporate boards need to consider the company's stakeholders in their governance is now well accepted. The bigger question is: How should boards actually do this—learn who their key stakeholders are, their concerns, and how to properly incorporate this knowledge into company strategy?

In today's complex and uncertain world, focusing on near-term shareholder value alone is no longer enough to ensure long-term business success. Governance is evolving fast, and investors alongside other stakeholders are demanding greater transparency and improved oversight. There is also an expectation that directors not only understand and engage with their key stakeholders, but that they consider the impacts and dependencies they have on those stakeholders when making strategic decisions.

World Business Council for Sustainable Development (WBCSD) and risk management consultant DNV carried out a survey with input from over 100 directors, executive management and functional staff which sought to understand how companies and their boards are engaging with key stakeholders. The survey was supplemented by one-to-one interviews with directors and executive management to understand in more detail what is happening in practice.

Following is a summary of the findings, as well as some practical actions for the board to take to understand the importance of robust stakeholder engagement, and to develop a network of relationships that build resilience, support strategic decision-making and drive value creation and long-term growth.

The focus on corporate purpose has prompted many discussions and a shift to a more stakeholder inclusive model of capitalism. The World Economic Forum (WEF) set out *The Great Reset,* a response to the global COVID-19 crisis, as an opportunity to shape the recovery and reduce the "inconsistencies, inadequacies and contradictions of multiple systems, from health and financial to energy and education."

In January 2021, the WEF issued a report on the "Future of the Corporation" in collaboration with Baker McKenzie, which further underscores the imperative of good stakeholder governance, the importance of business resilience and the need to align on "values and outcomes at the boardroom level" to enable "prosperity for all."

Sustainable business models depend on the quality of relationships between a company and its key stakeholders. It is not an adjunct to running a successful business, but an essential element. Creating and capturing value relies on good relationships with employees, customers, suppliers, capital providers, governments and civil society.

Directors have a duty to act in the best interest of the company, and by implication this means its long-term success. That includes its stakeholders and society overall.

It is no longer a matter of trading off one group of stakeholders against another. Rather, the focus has shifted towards enhancing value for all. What counts is the interdependencies between stakeholders for value creation. That network of relationships builds resilience and identifies new opportunities for growth.

At the heart of good corporate governance is sound and informed decision making, both in the boardroom and across the company. Decisions that do not consider key stakeholders and societal concerns could later be proven bad decisions. Directors have a duty to act in the best interest of the company, and by implication this means its long-term success. While existing laws have not changed, practice is evolving. In light of the potential magnitude of environmental, social and governance (ESG)-related issues, failure

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to take these risks into account could be viewed as a breach of fiduciary duty.

☐ ***Defining key stakeholders.*** According to Kalus Schwab, of the WEF, "the most important characteristic of the stakeholder model today is that the stakes of our system are now more clearly global. Economies, societies, and the environment are more closely linked to each other now than 50 years ago."

The building blocks of the "new story of business" are formed by understanding that business can have both profit and purpose, that operating activities are embedded in society and that both stakeholders and shareholders can benefit from company value creation.

How a company defines its key stakeholders is specific to that organization, but the board should take an active role in identifying those stakeholders, and consider them when making strategic decisions.

Identifying stakeholders should be undertaken alongside the company business model and strategy by understanding the resources, relationships, impacts and dependencies of the business. This allows the business to determine which groups or individuals are material to it.

Respondents in our study highlighted, perhaps unsurprisingly, investors, customers, employees, governments and local communities as their *key* stakeholders. Suppliers and NGOs were considered lower in priority.

How a company defines its key stakeholders is specific to that organization, but the board should take an active role in identifying those stakeholders, and consider them when making strategic decisions.

☐ ***Why and how are boards engaging with stakeholders?*** Although practice is still in its infancy, this is an area of growing importance. Improving engagement with stakeholders serves as an opportunity to increase business resilience and long-term success. The evolving landscape continues to shift expectations and increases the prominence of stakeholders, forcing companies to adopt a more inclusive approach.

Our research showed that functional teams and senior management engage with stakeholders most commonly. Board-level committees or the whole board rarely engage with stakeholders, with the exception of investors, where close to 20 percent of respondents indicated that the whole board is engaged. The percentage remains low despite investors increasingly asking for evidence of stakeholder engagement as part of their wider ESG analysis. This raises the question on the role of the board versus that of management when engaging with stakeholders beyond the investor community.

Some interviewees felt that the process of stakeholder engagement should sit with management and functional teams, and the board should provide challenge, oversight and direction. However, a changing attitude from some was apparent. It was suggested that, to have a clear and well-informed overview of a business, board members need to have more direct contact with stakeholders and be more present in the process of stakeholder engagement activities to understand and manage the business risks and opportunities.

When it comes to how the engagement takes place, the key channels identified were reports, presentations and interviews. For customers, investors, governments, employees, local communities and suppliers, the main method of engagement was through reports.

Our interviews suggested that often these reports are prepared by management and presented to the board. Advisory groups or forums were much less common, with the highest percentage of engagement (15 percent) through this channel with employees and unions. In some countries, investors and employees are viewed as "inner stakeholders" that are critical to the business and other voices fall outside of this central scope.

Our survey asked respondents what they foresee as the potential consequences of not taking stakeholder views into account in decision-making. Unsurprisingly, failure to manage reputational risks (75 percent) and missing opportunities (68 percent) were the most common. Other consequences included loss of customers, talent and investment as well as being unable to deliver on the purpose of the company.

These views were echoed in our interviews, where

Listen To Stakeholders—Or Else

What Consequences Do You See For Failing To Take Account Of Stakeholder Views?

respondents indicated that the board needs to have a good understanding of ESG if they want to understand new and emerging risks; 'It's not about looking at risks with a backwards view, it's about understanding what might be coming your way and incorporating that into your decision-making and strategy."

This is aligned more than 70 percent of respondents who felt stakeholder engagement was important to "[identify] issues and manage reputation," and "satisfy stakeholder expectations." Other reasons for improved stakeholder engagement were to inform future decision-making (65 percent), co-create solutions and solve problems (55 percent) and gather unfiltered views and perspectives (51 percent).

Though most boards do not engage directly with their stakeholders, they were primarily given the information provided by management. Less than 50 percent of engagements with stakeholders (excluding investors and governments) inform strategic decision-making.

Our interviews also stressed that investor views are highly valued by the board, but there was a trend towards incorporating other stakeholders' views, with greater emphasis placed on boards' responsibility to oversee stakeholder engagement. The growing prominence of concepts such as stakeholder capitalism, inclusive capitalism, and conscious capitalism are highlighting the importance of stakeholders in strategic and tactical decision-making.

If the company's internal culture and priorities do not include a broad range of stakeholders, this makes the shift toward stakeholder engagement challenging.

☐ ***The challenges of stakeholder engagement.*** Company culture is one of the most significant barriers to effective stakeholder engagement. If the company's historical internal culture and priorities do not include a broader range of stakeholders, this makes a shift toward stakeholder engagement challenging as the necessary mechanisms must be put in place.

This is aligned with another key barrier—the lack of priority placed on stakeholder engagement at the board level. More than 30 percent of respondents felt that there was limited or no engagement by the board with key stakeholders, and that the board had insufficient skills and capability to effectively engage

with stakeholders. Over 20 percent of respondents felt that stakeholder engagement was not a priority for the board.

The top-down influence of company culture and a lack of board engagement with stakeholders are linked as company culture starts with the board and flows down to management. Having a "directive" from the board could help drive better engagement. Some interviewees indicated that the support of the board in engaging with stakeholders was needed to further the work of management.

Some companies have processes to oversee stakeholder engagement, using tools such as stakeholder mapping and materiality assessments (though these materiality assessments may only be conducted every few years), but often the board relies on management to have the day-to-day interface with stakeholders. It was generally felt that the board has oversight of ensuring sufficient stakeholder engagement. It was unclear how much direct contact the board is required to have with stakeholders.

Management may have concerns about the board engaging on an *ad hoc* basis with stakeholders, so they may prefer to manage the interactions. Management may be cautious of the board setting expectations among stakeholder groups that the company may later find it difficult to fulfill.

However, it is important that if this is a business priority and these stakeholder groups are material to the business model, the agenda should allow time for discussion. Integration of the impact on these stakeholders should also be part of the strategic decision making that takes place during board meetings.

☐ ***Opportunities for improving stakeholder egagement.*** There is no one-size-fits all approach to stakeholder engagement, and companies in different sectors, industries and geographies will manage this differently. Some examples include stakeholder advisory panels, materiality assessments, understanding the macro landscape to identify risks and opportunities, presentations, external consultants, and engagement with employees, unions or suppliers in site visits.

Businesses need a social license to operate in their community and trust among stakeholders is important. Although the uptake of stakeholder engagement practice and integration into decisionmaking varies from company to company, there is a consensus that boards need better engagement, expertise and to be asking for more information on stakeholder opinions and how this should direct company strategy.

Companies that have invested in building strong and effective relationships with their stakeholders have been more resilient and generally performed better than those with weak relationships.

It is important for boards to understand why they are engaging with stakeholders, and how that engagement can build relationships and networks that support the delivery of the company's objectives and contribute to the operating model. Failure to manage the relationships with key stakeholders will likely prove detrimental to the business.

The pandemic has amply illustrated that companies that have invested in building strong and effective relationships with their stakeholders have been more resilient and generally performed better than those with weak relationships and where the board has not seen the strategic connections.

Here are some practical ways to improve the effectiveness of engaging with stakeholders.

▫ *Know your stakeholders.* Identify the key stakeholders that will influence and are influenced by your business model and strategy. Many companies already undertake materiality assessments or stakeholder mapping exercises where groups of stakeholders are considered to understand the interest and impact that they may have on the business. Those that have a high influence and high interest should be considered material. The business should also consider the stakeholders that it directly impacts by conducting its operations, for example local communities or the environment.

▫ *Understand the expectations of and impact on those stakeholders.* Identifying your key stakeholders is only the first step. Consider what expectations those stakeholders have, and how they are impacted by de-

cisions taken by management. Once the stakeholders are known, discussions can take place on how best to engage with those groups as well as identifying potential risks and opportunities.

□ *Ensure key stakeholders are consulted in decisionmaking.* Oftentimes, boardroom discussions fail to take into account stakeholder groups when making strategic decisions. Necessary stakeholders should be consulted through the appropriate mechanisms, for example focus groups, annual meetings, advisory panels, dialogues or site visits, on decisions that are likely to affect them.

□ *Establish appropriate governance mechanisms to formalize operational relationships with stakeholders.* The board should work with management to understand the formal operational relationships that management and functional departments in the company have. Ensure the board has appropriate governance over the mechanisms that formalize this process. The board needs unfiltered views and opinions from stakeholders when those views may affect or inform the decision-making process. Continuous dialogue and exchange may be conducted by management. The role of the board versus the role of management when it comes to stakeholders depends on the importance of that stakeholder to the business model.

□ *Embed important stakeholder discussions into the board agenda*. Board directors often refer to having insufficient time during meetings for discussion on ESG or sustainability topics. Yet it is important that time is taken to consider material sustainability topics alongside other items. The agenda and time of the board is managed by the CEO, therefore management should ensure it is using director time in the most effective way. The agenda is set in advance, and as a group the board should be focused on the long-term. Sustainability should not be considered or discussed outside of existing business strategy and risk management.

□ *Trust the views of stakeholders.* Trust presents a challenge. The board and management want to trust the views and opinions of stakeholders, but often the view of the representative may not be reflective of the collective view of stakeholders. Consider how more effective engagement and more robust relationships can support the trust and confidence in the views of key stakeholders.

When arbitrating stakeholder tensions and dilemmas, the board should consider the interest of the company as a whole, rather than those of each stakeholder.

□ *Act in the long-term interest of the company.* Fiduciary duties dictate that directors should act in the long-term interest of the company. When arbitrating stakeholder tensions and managing dilemmas, the board should consider the interest of the company as a whole, rather than those of each stakeholder.

□ *Acknowledge existing tools and resources that can further embed sustainability.* Activities and exercises such as the materiality assessment, risk management, data collection and reporting can support the board in understanding stakeholder views. The board may also consider the role that external consultants, advisors and experts can play in improving their education and knowledge.

There is acknowledgement from companies and their boards that the integration of ESG considerations and stakeholder views in decisionmaking is necessary to help build resilience, manage risk and explore opportunity for long-term value creation.

Business needs to recognize the interconnectedness of its operations with stakeholders to move beyond the model of shareholder primacy. In order to do this, a mindset shift is required on the purpose of business, resilience and operating regeneratively to create long-term sustainable growth. ■

For additional board resources, please visit:
https://wbcsdpublications.org/board-director-resources/

In Review

Recent Notes & Events

Audit

Climate change will require accountants to rethink "risk management."

The Association of Chartered Certified Accountants (ACCA) has published a report, *Rethinking Risk for the Future,* examining the unique role of the accounting profession in effective risk management amid crises presented by climate change, the COVID-19 pandemic, and resulting economic turbulence.

The report explains that while COVID-19 is the biggest crisis in a generation, business and society also face huge risks from rapid climate change. Risk management has therefore been forced center stage like never before. Accountants now have an unmissable opportunity to reassess how they can add more value in a post-COVID world where myriad environmental, social and economic risks are prevalent.

The report reveals members' concerns about industry disruption being the biggest risk over the next two years, followed by international trade, cyber threats and extreme weather.

"This year, the pandemic required us all to learn new and vital lessons about effective risk management, and disruption preparedness is now top of organizations' priority list," said an ACCA spokesman. "The challenge is now about how this readiness is sustained by organizations in the face of other crises, including climate change, creating an opportunity for the accounting profession to show its value in rethinking risk."

Boardroom Composition

Fortune 500 boards could take decades to achieve women, minority representation by population.

The number of Fortune 500 companies with over 40 percent diversity on their boards is nearly four times higher than it was in 2010, according to the sixth edition of the *Missing Pieces Report: A Board Diversity Census of Women and Minorities on Fortune 500 Boards,* a multiyear study published by the Alliance for Board Diversity (ABD), in collaboration with Deloitte.

It will take until 2074 before the number of Fortune 500 board seats held by minorities reaches the ABD's aspirational 40 percent board representation rate. While women and minorities made more progress in board representation for the Fortune 500 between 2016 and 2020 than between 2010 and 2016, the average growth for minority representation on boards since 2004 is less than 0.5 percent per year.

Fortune 500 board representation for women and minorities continues to climb, up from 34 percent (1,929 board seats) in 2018 to 38.3 percent (2,253 board seats) in 2020. Since 2010, the number of companies with greater than 40 percent diversity has nearly quadrupled.

Additional findings include:

☐ African American/Black women gained 29 seats in 2020, an increase of 18.8 percent from 2018. Surprisingly, African American/Black men lost five seats in 2020, a decrease of 1.5 percent from 2018. Combining men and women, these board members hold 8.7 percent (510 seats) as of June 30, 2020 per the report's methodology.

☐ Hispanic/Latino men gained 13 seats in 2020, an increase of 7.7 percent from 2018. Hispanic/Latina women gained 14 seats in 2020, an increase of 31.1 percent from 2018. Hispanic/Latino(a) board members hold 4.1 percent (240 seats).

☐ Asian/Pacific Islander men gained 33 seats in 2020, an increase of 22.3 percent from 2018. Asian/Pacific Islander women gained 28 seats, an increase of 45.9 percent from 2018, with total board membership of 4.6 percent (270 seats).

☐ White women made gained 209 board seats in 2020 for an increase of 20.6 percent from 2018.

Analysis of the data from 2016, 2018, and 2020 shows the impact of placing women and minorities into the positions of board chair and nominating or governance chair can pay immediate and future dividends for the promotion of board diversity.

The study also showed that boards more frequently will pull from a pool of existing minority board members instead of bringing in new directors. Two out of every five African American/Black board members serve on multiple Fortune 500 boards.

Said Linda Akutagawa, chair for the Alliance for Board Diversity, "Despite heightened focus on board diversity the past year, not a single Fortune 500 boardroom is representative of the population of the U.S."

The Fortune 100 lead the way, exceeding the rate of board seats held by minorities in the Fortune 500, which was close to 18 percent. The Alliance for Board Diversity initial goal for 40 percent of all board seats in the Fortune 500 occupied by women and minorities has now been met in the Fortune 100.

Other findings for the Fortune 100:

☐ In 2020, slightly more than 20 percent of board seats in the Fortune 100 were held by African American/Black, Asian/Pacific Islander, and Hispanic/Latino(a) members.

☐ The total number of companies with greater than 40 percent diversity increased from 46 companies in 2018 to 53 companies in 2020. In other words, over half of companies have 40 percent of their boards composed of women and minorities.

☐ The total number of companies with over 50 percent diversity on their boards has nearly doubled in two years, from 10 in 2018 to 19 in 2020.

Boardroom Practice

Boards are returning to the boardroom.

While boards of directors are eager to return to in-person meetings, a new trend has emerged—many will incorporate virtual meetings in their long-term strategy. According to a report from board governance software and services firm Boardspan, boards are now mov-

ing to a hybrid model, interspersing in-person and remote meetings with greater comfort.

Boardspan's *Back to the Boardroom* report, based on a June 2021 survey of 78 board members across the country from all industry sectors, also reveals that nearly all boards will have met in person by the end of Q1 2022, despite some concerns about their leadership's preparation ahead of such meetings.

"Board members are genuinely looking forward to returning to the boardroom," said a Boardspan spokesman. "Nearly 18 months of virtual meetings has meant missing out on important face-to-face interactions that significantly influence effective board dynamics, alignment and collaboration. Nonetheless, boards have shown their adaptability and a material number are embracing new meeting strategies going forward."

Some key report highlights:

☐ While less than 20 percent of boards have met in person in the first half of 2021, 100 percent of respondents expect to have met by Q1 2022.

☐ One-quarter of the boards surveyed have already adopted a hybrid approach with virtual and in-person board meetings, while one-third will move committees to a hybrid meeting model.

☐ Nearly 90 percent of boards are planning new safety protocols or reserve the right to do so.

☐ Three-quarters of respondents felt satisfied with how preparations to return are being handled although one-quarter are dissatisfied with leadership's actions.

Compensation & Recruitment

CEO pay fell among the largest U.S. companies in 2020.

CEO pay fell 1.5 percent in 2020 to $12 million, down from $12.2 million the year prior, according to a report from Equilar and Meridian Compensation Partners. The report analyzed total reported compensation for chief executives of the Equilar 500, the largest U.S. companies by revenue.

Though overall pay levels dipped slightly, the impact was inconsistent. Cash compensation was lower than the previous year as company heads took salary cuts in solidarity with their employees and trimmed discretionary bonuses when revenues and other financials missed targets for the year. These trends resulted in a two percent decrease in median salary and a 1.5 percent decrease in median annual cash bonuses when compared with 2019.

Meanwhile, the median value of stock awards increased 9.7 percent. Given that CEO pay is primarily awarded through equity, the bolstered value of company shares in a record year for the stock market kept equity values strong.

The pandemic also crowned industry favorites, while others suffered. CEOs in communication services, which primarily includes telecom, media and social media companies, saw median total pay of $22.4 million, up from $19.8 million in 2019. This sector benefited from an essential role in keeping business and home networks up and running, their ability to keep people entertained while sequestered in their homes, and the media frenzy of a presidential election year, among other factors.

The energy sector, which had already seen pay levels fall in 2019, saw further declines as COVID-19 fostered a challenging environment for the industry. With the second-lowest median total pay at $10.9 million in 2020, energy CEOs have seen a 23 percent decrease in pay at the median over the past two years.

"The impact of COVID-19 and the resulting market reaction differed significantly across industries and even across companies within the same industry," said a Meridian spokesman. "Against the backdrop of the pandemic, compensation committees and management teams had to navigate the challenge of continuing to engage executive talent while also reflecting the broader experience of all stakeholders."

When looking back at 2020, the stability of CEO pay trends may be seen as a positive sign in an otherwise volatile landscape. Though the overall structure, value and benefits of the system to all corporate stakeholders will continue to be up for debate, executive pay has evolved as a means to drive predictable, transparent results, and 2020 delivered in that regard.

Other findings from the report include:

☐ Performance-based incentives continue to be the primary vehicle for CEO compensation, with five in six companies offering this type of equity to their leading executives

☐ The pay gap widened between CEOs and their employees, as the CEO pay ratio increased at the median from 189:1 to 193:1.

Insider data leaks siphon vast revenue from companies.

As companies emerge from the pandemic, and 40 percent of employees are planning to switch jobs, corporate data is at risk. Files are being uploaded, shared, synced and emailed by employees as a normal course of everyday business or as they prepare for their next role. The very same technologies that enable the free flow of data are also the ones that make it easy for insiders to exfiltrate data.

According to a study conducted by Aberdeen and Code42, data breaches from insiders can cost as much as 20 percent of annual revenue. Perhaps just as important, the study showed that at least one in three reported data breaches involve an insider. Both accidental and malicious insider risk can cost businesses material portions of revenue on an ongoing annual basis.

Allowing the freedom of data movement and keeping trade secrets (including source code, and confidential customer lists, business plans, pricing and the like) secure from malicious and unintentional insider risks will be a continuing challenge.

The significant and growing impact of insider risk reflected in findings from the report include:

☐ At least 33 percent of reported data breaches involve an insider. Over three-quarters (78 percent) of those breaches involve unintentional data loss or exposure, demonstrating that malicious

data theft and exposure is not the most significant insider risk facing security teams.

☐ Seventy-five percent of organizations lack consistent, centralized visibility into file movements happening across their environments. This highlights that a majority of companies lack the tools they need for detail and context on their file exposure.

☐ In 2020, a data breach was 4.5 times more likely to happen on end-user endpoints than back-end servers, emphasizing the importance of endpoint security for borderless workforces.

☐ Every day, trusted insiders cause an average of 13 data exposure events by moving corporate files to untrusted locations via email, messaging, cloud or removable media.

The report also reveals the potential—and very real and material—impact of data exposure events on a business, which can cost as much as 20 percent of annual revenue.

"Data stewardship has become a boardroom imperative. And while insider risk is not a new problem in security, managing it effectively in today's open and collaborative business climate is," said a Code42 spokesman. "We know that one out of three data breaches involve an insider, though it's likely much higher."

According to the report, quantifying risk to the company came down to three valuable rules of thumb:

☐ *Organization value*. The higher the company's valuation, the greater the likelihood of an insider data breach.

☐ *Data value*. There is a one-in-four chance the corporate data breached was intellectual property (IP).

☐ *IP value*. In cases involving an IP breach, the total impact is up to 440 percent of the revenue generated by the IP.

Liability & Litigation

U.S. Supreme Court holds that "generic" statements must be considered in class certification.

Last June, the Supreme Court issued its decision in *Goldman Sachs Group, Inc., et al. v. Arkansas Teacher Retirement System, et al.* The case analyzes what the defendants considered were generic statements that did not have a price impact. A Stinson LLP advisory notes the case is important because it addresses when a securities fraud case can be certified as a class action. Once class certification is granted, the settlement value of a case increases.

Here, the plaintiffs sought to certify a class of Goldman shareholders by invoking the presumption endorsed by the Supreme Court in *Basic Inc. v. Levinson*. This presumes that investors rely on the market price of a company's security, which in an efficient market incorporates all of the company's public misrepresentations.

Satisfying the prerequisites for invoking the *Basic* presumption, however, does not guarantee class certification. Defendants may rebut the presumption at class certification by showing that an alleged misrepresentation did not actually affect the market price of the stock. If a misrepresentation had no price impact, then the fundamental premise "completely collapses, rendering class certification inappropriate."

On appeal, Goldman argued the Second Circuit erred twice:

☐ First, by holding that the generic nature of its alleged misrepresentations is irrelevant to the price impact inquiry at the class certification stage.

☐ Second, by assigning Goldman the burden of persuasion to prove a lack of price impact.

The Supreme Court noted as to the first question (whether the generic nature of a misrepresentation is relevant to price impact), the parties' dispute had largely evaporated. Plaintiffs conceded that the generic nature of an alleged misrepresentation often will be important evidence of price impact because a more general statement will affect a security's price less than a more specific statement on the same question.

The Supreme Court concurred in the parties' view. The Court stated that in assessing price impact at class certification, courts "should be open to all probative evidence on that question—qualitative as well as quantitative—aided by a good dose of common sense." The Supreme Court noted the generic nature of a misrepresentation often will be important evidence of a lack of price impact.

On the second question before the Supreme Court, Goldman argued that the Second Circuit erred by requiring Goldman, rather than plaintiffs, to bear the burden of persuasion on price impact at class certification. The Supreme Court rejected Goldman's argument that the Federal Rules of Evidence placed the burden on plaintiffs, noting that the burden of persuasion under *Basic* was a settled question.

Strategy & Finance

Global IPO momentum continues its record-breaking pace.

Hot IPO momentum from Q1 continued into Q2 resulting in the most active second quarter by deal numbers and proceeds in the last 20 years. While Q1 2021 was dominated by special purpose acquisition company (SPAC) IPOs, traditional IPOs stepped back into the spotlight in Q2 helped by a number of factors including ample liquidity in the financial systems and strong global equity market performance among others. Through the first half of 2021 there was a total of 1,070 IPOs, raising $222 billion in proceeds, increasing 150 percent and 215 percent, respectively, year-on-year.

The positive performance of the global IPO market indicates global economic recovery is well underway, although the pace of recovery varies across markets. While SPACs continue to be a hot topic, U.S. SPACs have stepped out of the driver's seat after a high level of activity for the past 12 months. At the same time, European SPAC IPO activity grew, totaling 21 SPAC IPOs through the first half of 2021.

IPO activities in the Americas continued at a fast pace through the first half of 2021, with 276 IPOs raising $93.9

billion, a 229 percent increase by volume and 282 percent rise by proceeds year-on-yeaar. In the Asia-Pacific region, IPO activity remained steady with 471 IPOs raising $74.3 billion, a 76 percent and 108 percent respective increase year-on-year.

Technology has led the sectors by deal number, accounting for over a quarter (27 percent) of all first half 2021 deals with 284 IPOs raising $90.2 billion. The health care sector followed, accounting for 17 percent of first half 2021 IPOs with 187 deals raising $33.4 billion, followed by industrials which saw 140 IPOs raise $24.3 billion.

Greater China continued at a positive pace through the first half of 2021 seeing 293 IPOs raise $60.3 billion by proceeds. Mega IPOs played a key role in Greater China, with five of the top 10 global IPOs launched on Greater Chinese exchanges.

Despite new waves of the COVID-19 pandemic in Japan, the country saw first half 2021 IPO numbers rise 59 percent to 54 deals, raising $3.0 billion by proceeds. South Korea posted two mega IPOs in the first half of 2021, including the fifth largest IPO globally in Q2 2021 by proceeds which raised $2.0 billion.

The U.K. also saw volume and proceeds rise significantly, reflecting pent-up demand from the past 18 months while the country moved past U.K. elections, Brexit and the COVID-19 pandemic. This resulted in 43 IPOs raising $12.7 billion by proceeds, a 975 percent and 385 percent respective year-on-year bump.

Entering the second half of 2021, the IPO market continues its forward momentum as more companies look to go public, taking advantage of favorable conditions. A steady pipeline of billion dollar plus IPOs is expected through the year, including tech unicorns, SPACs and companies in sectors that have already proven resilient, like technology and health care despite the COVID-19 pandemic. On the flip side, second half 2021 may prove challenging as the lingering effect of COVID-19 continues to affect companies in sectors most impacted by national lockdowns, such as traditional retail, travel, tourism and hospitality. If these sectors fail to recover, global markets will continue to fall short of a full global economic recovery.

Regardless of sectors, those companies looking to go public in second half 2021 should be well-prepared with a realistic vision of valuations while making certain to have an environmental, social and governance (ESG) strategy in place that is already part of their purpose, strategy and culture.

Retrospectives

10 years ago in *The Corporate Board.*

Directors, institutional investors, and other shareholders are asking a legitimate question: With the current governance model, can boards of directors truly meet the expectations thrust upon them? An emerging view is in the negative, concluding that today's governance model of corporate America necessarily must change.

—Richard M. Steinberg, New Models For Corporate Governance, September/October 2011

20 years ago in *The Corporate Board.*

Corporate governance would be easy if we could be assured of an endless supply of brilliant, knowledgeable men and women of experience, judgment and high character who were willing to serve. Unfortunately, such demigods are not very usual in life. We have to design systems for we lesser mortals.

—William T. Allen, The Mysterious Art Of Corporate Governance, September/October 2001

Books Received

Net Positive: How Courageous Companies Thrive by Giving More Than They Take. By Paul Polman and Andrew Winston. Harvard Business Review Press. $30. Sustainability and social concerns are typically viewed as factors to be added onto standard business matters (or not, at many companies). The authors, including a former Unilever CEO, instead call on companies to make ESG central to their business strategy.

The Power of Trust: How Companies Build It, Lose It, Regain It. By Sandra J. Sucher and Shalene Gupta. Public Affairs. $30. In a moment of turmoil and uncertainty for the world economy, corporations find many of their usual strengths—pricing, quality, market leadership—are no longer enough. Do customers, investors and employees trust the company to do the right, competent and equitable things? Companies who fail this new trust test will be tomorrow's losers.

Spoken & Written

Articles & Speeches

Some issues are clearly ESG, such as carbon emissions, employee turnover, and dual class shares, but many other issues are not ESG in the eye of every beholder. Some of what we are excitedly calling ESG, of course, is simply the same old stuff on which companies have been reporting in accordance with our existing principles-based, materiality-oriented regulatory framework. ESG readily expands, though, to include whatever the speaker or the news media are focused on at the moment. As more and more issuers and asset managers are grasping for the ESG label, they likely will press to expand the number of topics further to make it easier for them to justify calling themselves ESG. However, the broader the issue set gets, the more difficult for the SEC to prescribe precise ESG rules.

—Hester Peirce,
U.S. Securities and Exchange Commission

CEOs need to pay greater attention to shareholders' concerns and try to prevent shareholder unrest from arising. If shareholder unrest does occur, CEOs should particularly take heed of corporate social responsibility concerns, as they are likely to have a more significant impact on their career than concerns related to wealth maximization. For shareholders, it is worth keeping in mind that while shareholder resolutions allow them to exercise greater power, they may also create costs that they will ultimately bear.

—Dr. Abhhinav Gupta,
University of Washington

Entrepreneurs are innately curious, looking to bump into ideas and people that can unearth problems to solve and opportunities to seize. But founders are unlikely to stumble into problems in sectors to which they have no exposure. And that is why the geographic diffusion of tech will change the industry at its very core. It is much harder to understand what bedevils the lives of people living in, say, Fayetteville, Ark., if your life rarely exposes you to people living outside the social and commercial networks of places like San Francisco or Cambridge, Mass.

—Steve Case,
Revolution

Even the world's smartest people and most competent governments don't possess enough knowledge to micro-manage sprawling complex systems. Instead, a diversity of opinion—in science, business and policy—helps us correct errors and climb the ladder of progress and truth.

In the past, large firms might have exerted market power. But today, hyperscale digital and financial platforms have access to, and can manipulate, information at governmental scale. They can also impose rules in a broader way than ever before.

—Bret Swanson,
Entropy Economics LLC

The way wealthy CEOs like me need to be humble is to acknowledge the truth that we have gotten a far better deal than what we deserve at the expense of fairness and justice for everybody else. The bar is pretty low; I get credit for being humble just for pointing out basic, extremely relevant facts. We're doing something that literally a nice 8-year-old would do, which is say, "Hey, the people actually creating value in a company deserve to get a fair share of that."

—Dan Price,
Gravity Payments, Inc.

When you become CEO, and you have enormous influence over people's careers, people start sort of screening what they say to you. And the bubble's walls get thicker and thicker. You as CEO have to work so hard to make sure that bubble doesn't grow up around you.

—Rich Lesser,
Boston Consulting Group

It's the investing landscape that has changed. Questions from kids used to be "What's a stock or bond?" Now they're about microcap names, blockchain, and the currencies that have evolved from that.

Meanwhile, the next generation is clamoring for its investment philosophy to be aligned with its personal goals, so we're seeing a number of families wanting to invest using an ESG lens.

—Colleen O'Callaghan,
The O'Callaghan Thomas Group

Zoom is the great equalizer. Everyone's box is the same size. It doesn't matter if you are the CEO or the summer intern, your real estate is the same. A box with a name but no title became a tool of empowerment. Your name and face are consistently visible, making you more memorable, familiar and known. When you speak it is very hard for anyone to interrupt and it is also very hard to be ignored with your face staring back.

—Jennifer Nason,
JPMorgan Chase & Co.

It is so rare for the CEO of any major company to be asked a sincere, open-ended curious question about a topic of vital importance. The dialogue that can ensue is amazing. It helps with our long-term understanding of the company and its strategy, and it helps the company to talk to other folks looking at this issue across lots of different contexts.

—Katherine Collins,
Putnam Sustainable Leaders

There's a legacy belief that ESG doesn't perform well. [Financial advisors] have been taught to tell clients to park their values at the door. That's not relevant today; ESG issues are important in terms of a company's long-term success and the health of our global economic system. The next phase of ESG will focus on how investments impact people and the planet, as well as profits.

—Jon Hale,
Morningstar, Inc.

Directors' Register

Recent Board Elections

Acuity Brands, Inc. has elected to its board ***Mark J. Sachleben,*** chief financial officer of New Relic, Inc.

Anthem, Inc. has elected to its board ***Susan Dodson DeVore,*** former chief executive officer of Premier, Inc.

Benchmark Electronics, Inc. has elected to its board ***Lynn Wentworth,*** former senior vice president, chief financial officer and treasurer of BlueLinx Holdings Inc.

The Boeing Company has elected to its board ***Lt. Gen. Stayce D. Harris,*** retired U.S. Air Force Reserve Lieutenant General and Inspector General of the Air Force, and retired Boeing 747 pilot.

Boston Scientific Corporation has elected to its board ***David S. Wichmann,*** former chief executive officer of UnitedHealth Group.

Chart Industries, Inc. has elected to its board ***Paula Harris,*** former director of global stewardship for Schlumberger Ltd., ***Linda Harty,*** former vice president, treasurer of Medtronic, and ***Roger Strauch,*** chairman of The Roda Group.

Choice Hotels International, Inc. has elected to its board ***Donna Vieira,*** executive vice president and chief commercial officer at Sallie Mae.

CTG has elected to its board ***Katie Stein,*** chief strategy officer and global business leader of enterprise services at Genpact Limited.

Dril-Quip, Inc. has elected to its board ***Darryl K. Willis,*** corporate vice president, energy of Microsoft Corporation.

FirstEnergy Corp. has elected to its board ***Lisa Winston Hicks,*** chairman and former executive vice president, general counsel and corporate secretary for MV Transporation, Inc., and ***Paul Kaleta,*** managing director of SERC Consulting LLC, and former executive vice president and general counsel at First Solar, Inc.

Freddie Mac has elected to its board ***Alberto G. Musalem,*** chief executive officer, co-chief investment officer, and a founder of Evince Asset Management LP.

Hillenbrand, Inc. has elected to its board ***Inderpreet Sawhney,*** group general counsel and chief compliance officer of Infosys Ltd.

MarketAxess Holdings Inc. has elected to its board ***Charles Li,*** former chief executive officer of Hong Kong Exchanges and Clearing Ltd.

MSA Safety, Inc. has elected to its board ***Luca Savi,*** president and chief executive officer of ITT Inc.

Murphy Oil Corporation has elected to its board ***Michelle A. Earley,*** a partner at Locke Lord LLP.

NN, Inc. has elected to its board ***Dr. Rajeev Gautam,*** president and chief executive officer of performance materials and technologies of Honeywell International Inc.

Northrop Grumman Corporation has elected to its board ***Graham Robinson,*** senior vice president of Stanley Black & Decker, Inc. and president of STANLEY Industrial.

Nucor Corporation has elected to its board ***Norma B. Clayton,*** former vice president for learning, training and development at The Boeing Company.

Ovintiv Inc. has elected to its board ***George L. Pita,*** executive vice president and chief financial officer of MasTec, Inc.

PayPal Holdings, Inc. has elected to its board ***Enrique Lores,*** president and chief executive officer of HP Inc.

Regis Corporation has elected to its board ***Michael Mansbach,*** former president of MINDBODY, Inc.

Quest Diagnostics has elected to its board ***Tracey C. Doi,*** chief financial officer of Toyota Motor North America.

S&P Global has elected to its board ***Dr. Gregory Washington,*** president of George Mason University.

The Scotts Miracle-Gro Company has elected to its board ***Gerald Volas,*** former chief executive officer of TopBuild Corp.

Target Corporation has elected to its board ***David P. Abney,*** former chairman and chief executive officer of United Parcel Service, Inc., and ***Gail K. Boudreaux,*** president and chief executive officer of Anthem, Inc.

Tenneco Inc. has elected to its board ***Michelle A. Kumbier,*** former chief operating officer at Harley-Davidson Motor Company.

TransDigm Group Incorporated has elected to its board ***Jane M. Cronin,*** senior vice president, corporate controller of Sherwin-Williams Company.

Under Armour, Inc. has elected to its board ***David Gibbs,*** chief executive officer of Yum! Brands, Inc.

Veritiv Corporation has elected to its board ***Gregory B. Morrison,*** former senior vice president and chief information officer at Cox Enterprises.

West Pharmaceutical Services, Inc. has elected to its board ***Molly Joseph,*** former chief executive officer of UnitedHealthcare Global.

Conversations

Broc Romanek: Where Is The ESG Movement Headed?

An attorney by training, Broc Romanek has worked at the Securities and Exchange Commission, including pivotal work with the SEC's Division of Corporate Finance, and was a counselor to former SEC Commissioner Laura Unger. Broc is an expert in corporate and securities law, governance, M&A and investor relations, and a seasoned business editor.

Over he past several years, he has moved strongly into online journalism and podcasting. He is a strategist with Perkins Coie LLP, where he hosts their PublicChatter.com forum on public companies. Romanek also operates the ZippyPoint.com video and podcast site on corporate law and investor activism.

ESGProfessionalsNetwork.com is his latest medium—an online watering hole and forum on his favorite topic: best practices and the future of corporate environmental, social and governance (ESG) issues.

The Corporate Board: How is ESG different when it comes to disclosure?

Romanek: ESG covers so many *intangible* assets, like human resources, and most disclosure is overwhelmingly on *tangible* matters. Some topics are just not a natural fit for traditional disclosure. We're actually looking more at matters like social issues. These issues are important, and have been ignored far too long from an SEC disclosure standpoint.

TCB: How do you handle climate disclosure?

Romanek: I come back to the way we handled Y2K guidance at the SEC in 1999. It was questionable disclosure guidance, but at that point there wasn't time for normal rulemaking. We need something like that now on climate disclosures. I'm guessing we will see proposed rulemaking on ESG disclosure from the SEC [Corporate Finance Division] in the fall. Another six months after that, something will ultimately be adopted. There have been something like 10 speeches by commissioners on ESG in the last couple of months, so it's clearly their number one topic.

TCB: What do you think SEC disclosure proposals on ESG will look like?

Romanek: My guess is that it will be "comply or explain." Companies will be allowed to select their own framework. Companies can do it industry-by-industry. The Commission probably doesn't want to micromanage the process.

TCB: Are you optimistic on how ESG disclosure and action will deal with climate and sustainability?

Romanek: On climate and sustainability matters, it's pretty clear that companies are going to be feeling financial-related, material impacts. The flipside of that is managing the companies' own impact on climate. I believe we're fighting for survival of the human race. This is happening all over the globe, so obviously there will be material impacts.

There are many well-intentioned efforts that might not be the right ones. There are the sustainability accounting frameworks from the Sustainability Accounting Standards Board, but that's still an accounting framework for investors, not the planet. I don't know if that works—it's hard to tell unless you go deep into the science of whether a group is doing the right thing. There is a real risk that most of our ESG sustainability efforts are not really doing the trick.

TCB: From a governance perspective, when it comes to improving ESG sustainability efforts, what do you suggest?

Romanek: For corporate boards, one key is to bring in some new blood that has climate expertise. There's going to be a gold rush for those people [on boards], mostly climate scientists. Smart boards are tapping that talent now, before they're all boarded up. Also, the board needs to seek outside consulting talent on this when setting strategy.

TCB: That covers the Environmental in ESG, but what about the Social and Governance aspects?

Romanek: By now, I hope governance is pretty well covered. Sarbanes-Oxley is coming up on 20 years, and that provided a lot of good governance content. On things like diversity, the process has lagged until now. Racial diversity in the workforce, equity, executive compensation and other topics are still areas where change is in process, but there is lots of room to improve. I haven't been covering it that much, though.

From the Social viewpoint, a huge point is for management to improve shareholder engagement. They really need to pick up the mantle on this. Companies also need to evolve on their social and equity aspects if they hope to keep and attract their workforce.

TCB: ESG topics have been around for decades, but really exploded in just the past couple of years. Why now?

Romanek: One factor has been politics. People are more outspoken now. There's more social activism, and you have the online social media megaphones today.

TCB: ESG was one of the big factors in proxy season 2021. What's your take on what's happening?

Romanek: There was the ExxonMobil [board] vote—that is truly a watershed, and a roadmap of where we're headed. There is a new agenda, and with models like RobinHood, investors will be bullying companies more on climate and other issues. A second factor is the rise of retail investors, and their concern for issues like climate. A third is the way the big funds, like BlackRock and State Street, have become more transparent on how they're voting. Still, if you look at the BlackRock [proxy] voting report numbers, and how they voted for ESG proposals and directors, the percentage change isn't as great as you'd imagine. Gradual change like this actually makes sense for them. ■

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Conviction is worthless unless it is converted into conduct.

— Thomas Carlyle