

From the Public Company Advisory Group of Weil, Gotshal & Manges LLP

March 5, 2019

Board Priorities for 2019: Looking Inward and Outward to Meet Stakeholder Expectations

Each year, the proxy season puts a spotlight on how well public company boards of directors are meeting investor and regulatory expectations. For 2019, these expectations call for directors to look both inward and outward to foster a company culture that supports long-term value creation, improve the diversity of the board, focus on corporate sustainability issues affecting the company's long-term strategy, enhance oversight of internal controls over risk, and strengthen engagement efforts with stakeholders. This Alert discusses current expectations for boards of directors and offers practical suggestions on "what to do now" to meet these expectations. We address key issues in financial reporting for boards and audit committees in our prior alert [available here](#).

Corporate Purpose and Culture: Top of the Board's Agenda

The past year saw an alarming number of corporate missteps and scandals leading to CEO shakeups, government investigations, market value destruction and loss of confidence by investors, consumers and employees. In response, the institutional investor community is encouraging boards of directors to embrace their leadership roles in establishing corporate "purpose" and "culture". The annual letters released by the CEOs of [BlackRock](#) and [State Street](#) are public calls for CEOs and boards to look inward to establish a strategic purpose and define corporate culture in order to preserve and enhance long-term value for the company's numerous stakeholders.

BlackRock's Larry Fink, recognizing that "society is increasingly looking to companies . . . to address pressing social and economic issues," reminds CEOs: "the world needs your leadership," and asks them to demonstrate their commitment to the communities in which they operate. Fink posits that "purpose" will guide a company to function with focus and strategic discipline thereby enhancing long-term profitability, unifying management, employees and communities, and driving ethical behavior to create an essential check on actions that would go against the best interests of stakeholders. State Street's letter similarly emphasizes a commitment to the creation of sustainable long-term value. State Street focuses on corporate culture as one of the intangible value drivers that affects a company's ability to execute on its strategy. It calls on directors to take proactive steps to review and monitor corporate culture, evaluate its alignment with strategy, and incentivize management to take corrective action, if necessary. Boards and company management should expect that BlackRock, State Street and other significant investors will probe deeper into issues of purpose, culture and sustainable value creation in 2019 and beyond.

What to do now?

- **Put Corporate Purpose and Culture on the Board's Agenda.** Directors should embrace oversight of culture as a key board responsibility in light of growing investor conviction that culture is inextricably linked with strategy and risk oversight. Directors should consider how various components of corporate culture, such as human capital management, can create opportunities to manage risk and drive results.
- **Set the Tone for the Entire Organization.** Boards should set the tone for the entire organization, establishing their commitment to good governance, integrity and a robust ethics, risk management and compliance program. Management should be encouraged to foster a “speak up” culture at all levels of the organization where employees feel confident that violations of workplace policies will not be tolerated.
- **Ensure Effective Escalation Processes.** Boards should ask probing questions about their company's systems for reporting, escalating and responding to workplace complaints and require that senior human resources personnel regularly report on significant risks – and opportunities. One way boards can keep a watchful eye on culture is to monitor the types and frequency of concerns coming through the company's hotline and other internal reporting mechanisms, and management's analysis and response. Boards should recognize that the absence of reported concerns may be as concerning as the prevalence of reported concerns.

Spotlight on Board Composition Gets Wider and Brighter: Emphasis on Diversity

Boards of directors, and nominating and governance committees in particular, are under mounting pressure from institutional investors, pension funds and proxy advisory firms to look inward to evaluate whether the board as a whole has the appropriate make-up to align with the strategic objectives of the company and provide appropriate risk oversight. Perhaps most significant is a growing view that having a diverse board leads to more thoughtful, well-considered decisions, sets a stronger tone from the top and contributes to overall company performance. Investors have ratcheted up the pressure on public companies to increase gender diversity and are exerting their influence in director elections. State governments are also stepping in, with California becoming the first U.S. state to require listed companies with a principal executive office in the state to have a minimum number of women on their boards. New Jersey, following California's example, recently [proposed](#) a similar bill.

Washington D.C. is now also speaking up, and possibly influencing proxy statement disclosures for the upcoming proxy season, with a push for board diversity from the SEC and Congress. The SEC Staff has issued two new C&Ds addressing what the SEC “expects” relating to disclosure of diversity characteristics of directors and director nominees when such individuals have “consented” to the company's disclosure of certain “self-identified” characteristics. Companion bills were introduced into the U.S. House of Representatives and the U.S. Senate that would require every public company to disclose in proxy statements, among other things, data regarding the racial, ethnic and gender composition of its directors, director nominees and executive officers.

Investor Push for Gender Diversity at a Glance

- State Street will [vote against](#) the entire nominating committee of a company with no female directors that has not engaged with State Street on gender diversity for three consecutive years beginning in 2020.¹
- BlackRock [stated](#) it “would normally expect to see at least two women directors on every board.”
- Vanguard [joined](#) the 30% Club, a global organization that advocates greater representation of women in boardrooms and leadership roles.
- CalPERS [withheld votes](#) or voted against 271 directors at 85 companies due to board diversity concerns.

ISS and Glass Lewis have adopted voting policies that hold the nominating and governance committee chair accountable for a lack of board gender diversity. Beginning with annual meetings held on or after January 1, 2019, Glass Lewis will recommend against the nominating committee chair at companies with no female directors. A similar ISS policy will apply to annual meetings held on or after February 2020.

Boards should expect investors to expand their focus on diversity to include management and the broader employee base as part of their attention to both diversity and human capital management. This year, ISS added new categories to its QualityScore that evaluate the number of women on the board serving in leadership positions such as lead director or committee chair, as well as the number of women that serve in named executive officer (NEO) positions.

What to do now?

- **Assess Director Skills, Diversity, Tenure and Independence.** Recognizing that circumstances and needs can change, boards and their nominating committees should take a proactive approach to board composition and succession planning by reviewing the skills, diversity, tenure and independence of board members in connection with the annual nomination process.
- **Enhance Proxy Statement Disclosure.** Companies should consider using graphics to make both required and voluntary proxy information about directors accessible to the reader at a glance. Investors are seeking to understand how each director's experiences and qualifications align with company strategy and key areas of risk. Consider whether to include disclosure addressing the SEC's "expectation" that to the extent the board or nominating committee considered the self-identified diversity characteristics of directors and director nominees, the company's disclosure identify those characteristics and how they were considered. Companies will also want to consider whether and how to revise director and officer questionnaires to request that director and director nominees provide "self-identifying information" and consent to proxy statement disclosure of such information.
- **Review and Vary Board Evaluation Process.** The nominating and governance committee and/or the independent chair or lead director should review the effectiveness of board and committee self-evaluations. For companies that have traditionally used questionnaires, consider varying this method periodically with one-on-one discussions with the independent chair/lead independent director/nominating committee chair or an external evaluator. The New York City Comptroller has criticized the robustness of board self-evaluations and is engaging with companies on the board's refreshment and self-evaluation process.

Sustainability: Human Capital Management at the Forefront

The term "sustainability" refers to a wide – and widening – range of environmental, social and governance (ESG) considerations. Institutional investors are increasingly calling for transparency regarding the identification and management of material sustainability risks by portfolio companies. Larry Fink's annual letter to CEOs, for example, promises continued engagement by BlackRock on issues of board diversity, corporate strategy and capital allocation, compensation that promotes long-termism, environmental risks and opportunities, and human capital management. Fink cautions that BlackRock is devoting considerable resources to improving the data and analytics for measuring ESG issues, integrating such issues across its entire investment platform, and continuing to engage with companies to better understand their approach to ESG issues. This investor focus is also reflected in shareholder voting patterns, developments in investor "stewardship" codes and a pronounced increase in "voluntary" corporate sustainability reporting. We expect this trend to accelerate in 2019, as private equity and venture capital fund investors and managers around the world are urged to incorporate responsible ESG investment principles into their portfolio management practices. We also expect that environmental and social (E&S) proposals will continue to grow in number and will focus on climate change, sustainability reporting, and employment and human capital issues.

Boards of directors are facing increasing demands from investors to prioritize what is the most significant asset for many companies – its people. Human capital management covers a panoply of issues including workforce diversity and inclusion, pay equity, recruitment, retention, training and engagement, and employee health and safety. Investors link these human capital management issues directly to corporate culture and are increasingly urging companies to

engage on the role of human capital management as part of the company's long-term strategy. BlackRock, for example, has identified human capital management as one of its top five investment stewardship priorities, emphasizing that it "is both a board and a management issue." Not to be overlooked is the impact of the #MeToo movement and the emphasis on corporate culture, which has underscored the board's role in the oversight of reputation and business risk relating to human capital management matters. There were 71 shareholder proposals submitted on labor, workforce diversity, pay equity and other human capital issues during the 2018 proxy season and we expect more to come.

This year, the recommendations of the major proxy advisory firms are likely to take into account E&S considerations. Under Glass Lewis' 2019 proxy voting guidelines, the proxy advisor may recommend that shareholders vote against certain board members where companies have not properly managed or mitigated E&S risks. Glass Lewis also announced that it would integrate sustainability disclosure guidance developed by the U.S.-based Sustainability Accounting Standards Board (SASB) into its proxy voting recommendations for the 2019 proxy season. SASB released the final version of its industry-specific disclosure [guidelines](#) in late 2018. Moreover, in 2018 ISS introduced its E&S QualityScore Disclosure and Transparency Signal to measure the quality of corporate disclosures on E&S issues relative to a company's peers.

What to do now?

- **Add Sustainability to the Board's Agenda.** Corporate sustainability should be considered a critical component of company culture – which means it should be part of the board's agenda. Build time on the board's agenda, on a regular basis, for discussion of what sustainability means, uniquely, for the company and then, using this lens, consider the company's sustainability risk management practices and opportunities.
- **Approach Sustainability Reporting as an Opportunity.** Approach sustainability reporting as an opportunity for the company to "control its own story" with investors and employees. Currently, there is no single, widely recognized disclosure framework governing the content of voluntary corporate sustainability reports, although many companies are looking to SASB and/or GRI. Effective disclosure can help a company communicate how its ESG strategies are aimed at creating long-term value for the company and its various stakeholders. Understand where the company stands vis-à-vis its peers with respect to sustainability reporting, as many environmental and social issues are faced not just by individual companies, but also by entire industries.
- **Build a Cross-Functional Team.** Sustainability efforts should be integrated throughout the entire company, rather than siloed. It is important to enlist the support of all departments, including business teams, finance, accounting, human resources and legal. Evaluate whether the company has the optimal mix of people, with the required skill sets, to assess sustainability issues facing the company.
- **Monitor and Mitigate Human Capital Risks.** The board and its compensation committee should oversee efforts by the human resources department to identify the company's most significant human capital risks and integrate such issues in risk management. Oversight can include regular management reports on metrics related to recruitment, retention, attrition, diversity, engagement, training and compensation. Companies should review, and where necessary refresh, their whistleblower policy, code of conduct, anti-harassment policy and other policies and procedures aimed at protecting employees, and reinforce them with across-the-board training.
- **Understand Investor Concerns and Policies Regarding Sustainability.** Engage regularly with major investors to understand their sustainability-related priorities, including their views and preferences on material issues and disclosure.

Oversight of Risk and Controls: Focus on Cyber and Social Media

Cyber and Other Material Risks

As discussed in greater detail in our alert [available here](#), the SEC has called out three areas of risk—cybersecurity, Brexit and the transition away from LIBOR—for particular attention by public companies this year. Of these risks, cyber is the most pervasive: the SEC has equated cyber’s current importance to businesses in the 21st century to the transformational effects of electricity in the 20th. Through a series of actions in 2018 (an interpretive release, an investigative report and “message” enforcement cases), the SEC has provided “fair warning” of its expectations regarding (1) the disclosure of risks and incidents to the investing public and (2) the design and implementation of controls to protect corporate assets from cyber frauds and to prevent insider trading during the highly sensitive period between initial detection of potentially material breaches and the company’s release of any required disclosures. The SEC is also emphasizing the importance of board oversight of how management addresses cybersecurity risk and, in an attempt to use “sunlight” to influence corporate behavior, calls for proxy statement disclosure of the board’s oversight role with respect to cybersecurity risk management if cyber risk is considered material (expect the SEC to be highly skeptical if the company has taken the position that it is not). Boards should also oversee management’s process in evaluating and addressing emerging risks that may be of significance to the company given its particular industry or other circumstances. Consider, for example, the impact of uncertainties in U.S. trade relations with China, disparate global regulatory approaches to addressing climate change and other evolving environmental risks, energy price volatility or other issues “ripped from the headlines.”

Use of Social Media Draws Attention

The SEC continues to scrutinize the use of social media to disseminate information by public companies. In October 2018, Elon Musk, the CEO of Tesla, became the recipient of SEC ire and enforcement for his tweets detailing his plans to take the company private – statements the SEC viewed to be false and misleading, causing significant confusion and disruption in the market. Musk and Tesla agreed to measures designed to strengthen Tesla’s disclosure controls and procedures, including Musk stepping down as Tesla’s Chairman, the establishment of a new committee of independent directors to establish additional controls and procedures and the designation of a securities lawyer to review all social media communications by Tesla’s senior officers.² In a continuation of the drama, the SEC has asked a federal court to hold Musk in contempt for violating the court-approved settlement by issuing a tweet that appears not to have been pre-approved by Tesla. The Tesla and Musk settlements are a reminder that use of social media as a primary means to distribute material news about a company requires careful application of a well-designed set of disclosure controls and procedures.

What to do now?

- **Ensure Board has, and Discloses, a Meaningful Role in Cyber Risk Oversight.** In light of the SEC’s guidance, this year the proxy statements of most companies should include disclosure of the nature of the board’s role in overseeing the management of cyber risk. As part of such oversight, the board should work with management to take a fresh look at the company’s insider trading policy, Regulation FD compliance policy and code of ethics to ensure that they reflect the heightened significance of cyber risks and incidents, and that they work together to facilitate timely analysis by responsible personnel and disclosure of cyber incidents to investors, and foreclose opportunities for illegal insider trading.
- **Refine Disclosure Controls and Procedures.** Disclosure controls and procedures should be refined, as necessary, to make sure that cyber breaches flagged by IT or other technical personnel “on the ground” will be quickly relayed to appropriate senior management charged with making materiality determinations and disclosure decisions.
- **Continuously Review Cyber Disclosure.** At each period-end, reevaluate the adequacy of the company’s cyber disclosure. When a significant cyber risk has been identified, but has not yet materialized, disclose the risk in a meaningful way that is specific to the company. Once an incident has been judged to be material, the SEC

encourages companies to disclose it promptly and to refine the disclosure in subsequent periods as the qualitative and quantitative implications emerge.

- **Monitor Use of Social Media.** Boards should consider the level of rigor applied to review and approval of not just conventional communications of material information about the company, but also social media communications, to ensure the information disclosed is accurate and complete. Social media policies should also be reviewed to ensure that the company has clearly addressed the use and misuse of social media, including who is authorized to communicate on behalf of the company and in what circumstances.

Strengthening Engagement: Understanding Stakeholder Priorities

Growing shareholder expectations not only require boards to look inward, but also to look outward to understand shareholder priorities and ensure that the company is communicating effectively with its diverse investor base. Companies that are not engaging in an active dialogue with their investors may find themselves at a disadvantage when they seek shareholder support during difficult or transformational times. At the same time, companies that have engaged in event-driven engagement, such as in response to a poor say-on-pay vote or a shareholder proposal, should take the next step to enhance their year-round engagement efforts to more frequently and strategically engage in a dialogue with investors. Companies are seeing value in building relationships with investors and communicating about the company's long-term goals, board quality and leadership, management team, and governance. Management and the board need to prepare themselves to address the ever-expanding priorities of their significant investors.

The proxy statement and other public disclosures continue to be effective tools for engagement, allowing a company to paint its own picture of the board's composition, oversight role and strategic priorities, as well as demonstrate engagement with and responsiveness to stakeholder concerns. For example, during the 2018 proxy season, to improve shareholder engagement efforts and respond to investor demands for enhanced visibility on board composition, approximately half of the S&P 500 companies included a board skills matrix or other graphics to highlight different aspects of board diversity in their proxy statements.³ Moreover, companies are also "voluntarily" enhancing disclosure through the proxy statement or separate sustainability reports to address an ever-expanding range of shareholder interests in sustainability matters.

In light of growing demands for enhanced engagement, companies contemplating holding their annual shareholder meetings by virtual-only means should carefully consider potential shareholder concerns, especially when a company is subject to significant shareholder dissent or activism based on governance or performance issues. While increasing in prevalence, with 212 companies holding virtual-only meetings during the 2018 proxy season compared to 180 in 2017, there has also been notable opposition to this format, including by the Council of Institutional Investors and the New York City Comptroller. Beginning in 2019, Glass Lewis will recommend voting against governance committee directors where the company is planning to hold a virtual-only shareholder meeting and the company does not provide robust proxy statement disclosure that assures that shareholders are afforded the same rights and opportunities to participate in a virtual-only meeting as they would at an in-person meeting. Companies considering holding virtual-only meetings should evaluate previous shareholder attendance and voting results, significant matters on the agenda that may be impacted by virtual-only shareholder participation, as well as the recommended [best practices](#) for virtual-only meetings published by a diverse group of retail and institutional investors, public company representatives, and proxy and legal service providers.

It is also important for boards to recognize increasing pressures not only from shareholders, but also from other stakeholders that may not share the same interests or expectations, including employees, suppliers, customers and the community from which the corporation draws its resources or that may otherwise be affected by its actions. Various stakeholders are vocalizing their views on the direction of businesses that impact their lives and looking to boards to better understand their concerns.

What to do now?

- ***Tailor Stakeholder Outreach Programs.*** In connection with engagement efforts, it is critical to understand the specific engagement priorities of their diverse stakeholders and refresh and tailor engagement programs accordingly.
- ***Use the Proxy Statement as a Communications Tool.*** The proxy statement should clearly and concisely discuss matters that shareholders consider important in formulating voting decisions, including board composition, attributes, skills and diversity, board refreshment policies and risk oversight matters. Proxy statement innovations such as the use of charts, figures and images help companies bring to life the company's board composition, management, compensation practices, sustainability issues, business practices and shareholder engagement efforts.
- ***Identify and Prepare Directors who will Communicate with Stakeholders.*** When director involvement is appropriate, identify and prepare the directors that will act as spokespeople for the board, including through mock Q&A sessions with the CEO, CFO and investor relations team. Ensure the directors are briefed on the “dos and don'ts” of meeting with stakeholders consistent with the company's overall disclosure posture.
- ***Consider Regulation FD and Proxy Rules.*** Be mindful of Regulation FD, but do not use it as a shield or barrier to director-shareholder communication. Equally important, companies should consider the need to file, as proxy materials, any written communications prepared by or on behalf of directors and provided to shareholders in this context, depending on the timing of these communications and their relationship to any matters to be submitted to a shareholder vote at an annual or other meeting of shareholders.
- ***Ensure Fair Virtual-Only Shareholder Meeting Participations.*** Companies holding virtual-only meetings should ensure that the mechanics of the meeting provide for equal access and participation for all shareholders regardless of the medium by which they participate, including the ability to ask questions of management and the board. Moreover, proxy statement disclosure should communicate the benefits of a virtual-only meeting and be clear about how shareholders can participate in the meeting virtually, the rules of conduct for the meeting and the availability of technical support.

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Additional Resources

For a more in depth analysis of the issues discussed in this Alert, see our prior publications below.

Financial Reporting Internal Controls and Social Media

- [Financial Reporting in 2019: What Management and the Audit Committee Need to Know \(and Ask\)](#)
- [Tesla/Musk Settlements Focus on Controls and Governance Improvements](#)
- [What's New for Q3 Form 10-Q and Future Periodic Reports: SEC Disclosure Update and Simplification Amendments](#)
- [The SEC Weighs in on Cybersecurity Disclosure: What's New, What Isn't, and What to Do Now](#)

Board Composition and Diversity; ISS and Glass Lewis Policies

- [California Gets Tough on Gender Diversity in the Public Company Boardroom: Requires One Woman on Every Board by 2020 and More by 2022](#)
- [D.C. Speaks Up: A Push for Board Diversity from the SEC and Congress](#)
- [State Street Escalates Policy on Board Gender Diversity and Touts Impact of its "Fearless Girl" Campaign](#)
- [Heads Up for the 2019 Proxy Season: New and Revised ISS and Glass Lewis Policies May Impact Director Elections](#)
- [Commonsense Principles 2.0: A Blueprint for U.S. Corporate Governance?](#)
- [ISS Mounts Pressure on Board Gender Diversity: Proposes New Policy for 2020](#)

Corporate Culture; Sustainability and ESG

- [BlackRock's Larry Fink Delivers Annual Message to CEOs](#)
- [Preparing for a New State of ESG Disclosure on Both Sides of the Atlantic: Perspectives from the U.S. and U.K.](#)
- [What's New for the 2019 Proxy Season: Momentum Grows for Proxy Voting Reform and Sustainability Disclosure](#)
- [Heads Up for the 2018 Proxy Season: ISS Debuts E&S QualityScore](#)
- [CII Urges Boards to Combat Sexual Harassment](#)

Executive Compensation

- [Institutional Investors and Advisors Pursue Expanded CEO Pay Ratio Disclosure](#)
- [SEC Meeting on December 19, 2018 to Consider Adopting a Disclosure Rule on Hedging by Employees or Directors](#)

ENDNOTES

- ¹ According to [State Street's Annual Stewardship Report](#), as of July 2018, State Street had voted against the re-election of nominating/governance committee directors at 500 companies in the US, UK and Australia that "failed to make any significant efforts to address the issue."
- ² A group of investors, including several U.S. state investment officials, sent a letter to Tesla calling for even more sweeping changes to the company's governance to enhance oversight of Musk. They requested that Tesla disclose a refreshment plan for Tesla's board, including timetables for the departure of several directors close to Musk. The letter also called for, among other things, a permanent separation of the CEO and board Chair positions and improved board diversity.
- ³ Source: [EY Center for Board Matters: 2018 Proxy Review Season](#)

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