LAW IN THE BOARDROOM IN 2014

Cyber risk, M&A, shareholder engagement, and compliance dominate today's legal oversight environment. Here are the results of our nationwide survey of directors and general counsel on the risks that matter most in 2014.

Given the burgeoning role risk, compliance, and shareholder activism play in today's boardroom, the relationship between the board and its legal counsel has never been more important. Directors are being held to an increasingly greater degree of responsibility, making the support of their company's general counsel vital to meeting their fiduciary duties.

With that in mind, we designed our annual Law in the Boardroom study, a co-venture with longtime partner FTI Consulting, to elicit information on the key issues directors and general counsel are facing and to help us identify the latest governance trends. Earlier this year, nearly 500 directors and general counsel responded to our survey request, allowing us to gather data and compare and contrast each group's perspectives on these important issues.

FIGURE 1
WHAT KEEPS YOU UP AT NIGHT?

DIRECTORS SAY:

1 **Data security**
2 **Succession planning**
3 **Operational efficiency**
4 **Regulatory compliance**
5 (TIE)
Corporate reputation and Crisis preparedness

GCs SAY:

1 **Regulatory compliance**
2 **Data security**
3 **Corporate reputation**
4 **Crisis preparedness**
5 **FCPA**

BROAD THEMES

Beyond the traditional topics of compliance and compensation, which are still key issues for directors, the biggest trends that emerged from the 2014 Law in the Boardroom study involve ongoing concern over newer issues such as IT/cyber risk, shareholder engagement, and social media, along with a continuing surge in time spent on M&A and other competitive factors. In fact, this year M&A outstripped executive compensation as the issue likely to require the greatest time commitment of directors; M&A also ranked ahead of compensation in terms of expected time required of general counsel, trailing only litigation. Meanwhile IT/cyber risk was chosen by 41% of directors and 33% of general counsel as an issue they will spend significant time on, up appreciably from last year.

Other issues of focus include operational efficiency, succession and talent management, ethics and anticorruption, corporate reputation, crisis management, and strategic planning. The latter was noted once again this year as an area directors will spend a good deal of their time on and need better information on to manage more effectively.

To report on our results, we've broken down the key areas of concern in the following sections. Read on for more information about the interaction between directors and general counsel and how they approach these important topics.

FIGURE 2
HOW EFFECTIVE IS YOUR LEGAL DEPARTMENT'S OVERSIGHT OF...?

DIRECTORS SAY:

Ethics & compliance culture
Very effective **46%**
Effective **45%**
Somewhat effective **7%**
Ineffective **1%**

Whistleblower process
Very effective **33%**
Effective **54%**
Somewhat effective **12%**
Ineffective **1%**

BOARDS AND THEIR LEGAL TEAM

Boards and their legal advisers have to work hand in glove to solve the increasingly complex issues of a global workplace. With more regulation, more transparency,

BY KIMBERLY S. CROWE

and more competition, the stakes are higher than ever, making the need for a strong relationship between the board and its GC crucial in numerous legal and governance areas. In addition to M&A, directors and general counsel we surveyed agreed they'll be spending a good deal of time on executive compensation. Furthermore, both directors and GCs pointed to data security as one of the primary concerns that keeps them up at night, similar to 2013, but in notably higher percentages this year (Figure 1).

One of the most important dynamics in the boardroom is the amount of respect management, the legal team, and the board have for each other and the jobs they are doing. Therefore, our survey asked directors and GCs to rate each others' effectiveness on a variety of topics. In the opinion of the directors we surveyed, general counsel and their legal team are most capable at compliance, specifically overseeing the ethics and compliance culture (91% said effective or very effective) and FCPA/anticorruption compliance (89% said effective or very effective). GCs, in directors' opinion, also do a good job at managing the whistleblower process, shareholder communications, and ensuring the accuracy of financial reporting (Figure 2). Meanwhile, general counsel we surveyed likewise pointed to the board's ability to oversee the accuracy of financial reporting, which may be a direct result of the SEC's requirement to have a financial expert on the audit committee. Other areas of high effectiveness noted by GCs include capital management and executive compensation.

Finally, in terms of assessing the GC's role within the boardroom, we asked both directors and GCs whether they believe a GC of a public company should accept a seat as an outside director at another public company. The increased amount of compliance oversight has led many boards to feel that having a trained legal professional among their ranks is a prudent decision, and while directors are split in their opinion, it appears that most general counsel agree. Fully 75% of GCs we surveyed said this was a good idea, while only 44% of directors agreed (Figure 3).

IT/CYBER RISK AND DATA SECURITY

IT and cyber risks are among the most dangerous threats a company faces, and often the hardest to spot. They also tend to be the most expensive, with the U.S. leading nine other nations in average total organizational cost per breach and, along with Australia, the largest average number of breached records, according to Ponemon Institute's 2013 Cost of Cyber Crime Study. Accordingly, corporate board audit committees are taking a greater interest in cybersecurity risks and the organization's plans for addressing them. More than 50% of directors ranked IT strategy and risk—behind only strategic planning—as the issue for which they need better information and processes to be as effective in their jobs as possible. Forty-four percent of general counsel agreed (Figure 4). This is also an area where directors and GCs questioned each other's abilities: 38% of directors found GCs only somewhat effective at IT/cyber risk oversight; similarly, 37% of GCs said the same about the board's effectiveness in this area.

When asked to rate their confidence level on a variety of statements related to IT risk and cybersecurity, an affirming 54% of general counsel were either extremely confident or

FIGURE 3

SHOULD THE GC OF A PUBLIC COMPANY ACCEPT A SEAT AS AN OUTSIDE DIRECTOR FOR ANOTHER PUBLIC COMPANY?

DIRECTORS SAY:

Yes
44%

No
56%

GCs SAY:

Yes
75%

No
25%

FIGURE 4

IN WHICH AREAS DO YOU NEED BETTER INFORMATION AND PROCESSES?

DIRECTORS SAY:

Strategic planning
56%

IT strategy & risk
52%

Competitive environment
44%

Succession planning
41%

M&A strategy
36%

GCs SAY:

ERM
48%

Regulatory compliance
46%

IT strategy & risk
44%

Social media risk management
38%

Legal & consultant fees
33%

confident that their board knows the right questions to ask management regarding the status and risks associated with the company's IT strategy; 50% of directors agreed (Figure 5). Likewise, 47% of GCs and 44% of directors believe the board has the talent and skill sets necessary to ensure sound IT decision making.

Cyber risk, though, is another story. While 45% of GCs and 43% of directors have confidence in their company's response plan in the event a breach in security occurs, 34% of general counsel and 27% of directors are not convinced their company is secure and impervious to hackers. Perhaps more troubling, though, is the fact that fully one-quarter of directors and GCs surveyed believe their company is well shielded against hackers, which brings into question how well cyber and IT risks are really understood by this segment.

The Ponemon study put the average annualized cost of cyber crime at $11.6 million per year per company studied, with a range of $1.3 million to $58 million. 2012's average annualized cost was $8.9 million, a difference of $2.7 million, which translates to a 30% increase. The 60 U.S. companies included in the study experienced 122 successful attacks per week and 2.0 successful attacks per company per week (a nearly 20% increase over last year's successful attack experience), which doesn't take into account the plethora of attempted intrusions turned away by company firewalls.

"Cyber risk's pervasive nature presents an existential threat to the operations, reputation, and bottom line of virtually every company, regardless of industry. The priority that general counsel and board members place on cybersecurity and data protection, as shown in the survey, not only reflects this reality, but is entirely in line with our experience assisting clients to address this threat," said Thomas G.A. Brown, senior managing director in the FTI Consulting Global Risk and Investigations Practice who, until recently, lead cyber crime prosecutions in the U.S. Attorney's Office in Manhattan.

"We continue to see a significant increase in our cyber investigative practice, helping companies respond to computer hacking incidents and the theft of proprietary data, including trade secrets and sensitive customer information," Brown says. To help companies manage cyber risk, he notes that FTI is assisting more and more corporations to develop incident response plans and internal controls, assess their networks for vulnerabilities, secure their data, and evaluate cyber insurance options. "Significantly, board-level concern is often confounded by the fact that the technology underlying cyber issues can be opaque to many executives, so an important part of our role is to bridge this gap in understanding."

M&A AND OTHER COMPETITIVE FACTORS

With M&A heating up across industries, along with footprint expansion and other forms of corporate growth, it's not surprising our numbers show an increase in time commitment predictions for these areas. Fifty-one percent of general counsel indicate they'll be making a large time commitment to M&A in 2014; 54% of directors agree. That's a meaningful increase from the 36% of GCs and 42% of directors who said they'd be devoting considerable time to M&A in 2013. M&A strategy also made directors' top five in terms of areas the board needs better information and processes on to be as effective as possible this year. Furthermore, 50% of general counsel and 64% of directors selected competitive factors as a significant challenge to their company's ability to meet 2014 performance goals, trailing only macroeconomic conditions for both groups.

FIGURE 5

OUR BOARD KNOWS THE RIGHT QUESTIONS TO ASK ABOUT IT STRATEGY AND RISK:

DIRECTORS SAY:

Extremely confident
10%

Confident
40%

Somewhat confident
41%

Not confident
9%

Another sign the M&A market is starting to sizzle: According to data compiled by Thomson Reuters and analyzed by PwC, average monthly deal volume increased by 10% in 2013, from 808 deals per month in the first six months to 886 deals per month from July through November. In his blog on Forbes.com earlier this year, investment banking expert Jeff Golman gave six reasons 2014 will be a strong year for domestic M&A, including favorable credit markets, historically low interest rates, increased corporate cash and finite-lived private equity capital reserves, a large inventory of companies owned by private equity firms, a healthy stock market, and an uptick in cross-border M&A activity.

The value of mergers and acquisitions around the world stood at $552 billion on 4,880 deals through February 2014, the highest total since 2007, when $617 billion in deals had been completed by the same date, and up 13% from the same period in 2013, according to figures from Dealogic. Certain sectors are even more robust, according to Dealogic, which in April reported the highest deal volume for technology, $93.7 billion, since 2000.

FIGURE 6

ARE YOU COMFORTABLE WITH YOUR BOARD ENGAGING IN A DIALOGUE WITH SHAREHOLDERS ON:

GCs SAY:

	Yes	No
Board structure & director qualifications	82%	18%
Executive compensation	78%	22%
Growth strategies & M&A	54%	46%
Corporate social responsibility	54%	46%
Political contributions	51%	49%

SHAREHOLDER ENGAGEMENT

Given the latest rounds of advisory votes and continuing calls for proxy access, it's no secret the rules of engagement with shareholders have changed over the last decade. In this new paradigm, increasingly vocal shareholders expect meaningful dialogue with not only management but also the board, so we asked directors which topics have been most prevalent in such situations. Fifty-seven percent of our director respondents reported that their board has proactively engaged in a dialogue with shareholders in the last 12 months on the topic of growth strategies and M&A. Forty-nine percent indicated they have discussed board structure and director qualifications, and 46% said their board has recently discussed executive compensation with shareholders. With regard to how their company handles shareholder communications, 81% of directors said their company is quite effective at responding to shareholder concerns in a manner that deflects rather than fuels conflict, but 26% said they are only somewhat effective at developing strategic communications plans to build shareholder support and at monitoring shareholder sentiment to determine if problems are brewing, suggesting they could do a better job at being proactive and keeping their finger on the shareholders' pulse.

As a cross-check, we asked general counsel if their legal team is comfortable with the board engaging in dialogue with shareholders on a range of topics. While approximately 80% reported being comfortable with directors discussing board structure/director qualifications and executive compensation, GCs were more evenly split on whether the board should engage shareholders with regard to political contributions, growth strategies/M&A, and corporate social responsibility (Figure 6).

"The rise of shareholder activism has brought corporate governance and corporate transparency to the forefront of investor's minds," says Elizabeth Saunders, senior managing director and Americas Chairman of the Strategic Communications segment at FTI Consulting. She says board members can play an important role by proactively engaging with shareholders in a controlled forum, where they can directly listen to investors' concerns and feedback and provide insight on how they interact with management to guide the company's strategy; protect against risk; and identify and evaluate opportunities. "The key to effective shareholder engagement is to be proactive in order to build investor confidence—prior to a proxy contest or crisis. Once an issue hits, it is often too late and the board members may find themselves on their back foot," Saunders says.

SOCIAL MEDIA

Once considered a sideline issue, there is no doubt the use of social media is ingrained in the corporate culture and here to stay. Last year, in our survey's first foray into the topic of social media risk, we asked whether companies had imposed a formal policy on the use of corporate social media. Today, legal experts recommend such policies from a compliance standpoint, especially with regard to disclosures that could be deemed material information. This year, 73% of general counsel and 44% of directors said their company already has a formal policy on the use of corporate social media; another 14% and 12% respectively said they are in the process of creating one. Still, 17% of directors said their company does not have a social media policy and has no plans to create one. Perhaps more telling, 27% of directors were unsure if there company has a social media plan.

To get a better handle on the board's approach to social media, we asked directors to clarify their board's stance. Twenty-two percent said they have discussed the topic and have a good understanding of the strategies and risks; another 45% said their board has discussed the topic, but needs more information. Interestingly, 19% said they have no plans to discuss social media at an upcoming board meeting (Figure 7).

ERM, COMPLIANCE, COMPENSATION, AND SUCCESSION

The remaining issues boards and general counsel are dealing with are the more traditional ones, like risk management and compliance. Enterprise risk was chosen most often by general counsel as the area for which their legal department needs better information and processes to be as effective as possible in 2014 (48%), followed by regulatory compliance at 46%, which, along with data security, was the top issue general counsel said they were likely to lose sleep over. Though directors did not rate these two areas as highly, 33% of directors agreed they need better information to handle ERM and though only 26% indicated the same of regulatory compliance, nearly 40% did say regulatory compliance would be one of the most significant challenges to the company's ability to meet 2014 performance goals.

According to Erica Salmon Byrne, executive vice president, Compliance & Governance Solutions, NYSE Governance Services, the areas that are particularly poignant in terms of legal and compliance board oversight include anticorruption, data security, third-party liability, money laundering, and insider trading. She says having a superlative compliance and ethics program in-house, supported by an unflinching tone at the top, is one of the most important defenses a company can put into place.

"If you think of the compliance and ethics program as the most effective way in which a company can fully mitigate people-created risk—the risk that employees are out there doing the wrong thing on any given day—then that is, at the end of the day, the most important thing the board can do to make sure that the company is utilizing shareholder assets appropriately and effectively controlling the risk," says Salmon Byrne.

When asked specifically which issues their legal department or management had directly reviewed with the board, 77% of our director respondents chose the SEC's pay ratio disclosure rules, and 65% said they'd discussed the implications of the upcoming rules on compensation clawback policies. The latter is not surprising since compensation continues to be on boards' radar, despite dropping from first to second (and to third for GCs) in terms of the area likely to require the greatest time commitment for the board.

"Compliance concerns are at an all-time high for publicly traded companies, as GCs ranked compliance as their number one concern in terms of what keeps them up at night. With 81% of GCs listing compliance as a chief concern, it is critical that companies invest in a proactive compliance program to protect their enterprise value. In this ever-changing environment with increased regulatory inquiries, companies must remain vigilant to avoid potential violations," notes Neal Hochberg, senior managing director and global leader of FTI Consulting's Forensic and Litigation Consulting segment. "An effective compliance program, training, and continuous monitoring can play a crucial role in preventing violations that could tarnish a corporation's image. Understandably, the majority of GC respondents also anticipate more time and expenses to be spent on compliance in 2014," notes Hochberg.

One final area that cropped up for directors was succession. Succession planning was second on directors' worry list and third for requiring the greatest time commitment. Somewhat related, managing talent was in the top five in terms of the most significant company challenges in the year ahead for both directors and general counsel.

FIGURE 7

DIRECTORS' TAKE ON THEIR BOARD'S OVERSIGHT OF CORPORATE SOCIAL MEDIA:

DIRECTORS SAY:

We have discussed it and have a good understanding

22%

We have discussed it, but need more information to have a good understanding

45%

We have not discussed it, but plan to

14%

We have no plans to discuss it

19%

ON THE HORIZON

Directors and general counsel already have a lot to get their arms around, with new opportunities (and accompanying risks) just beyond the bend. In our view, a solid relationship between the board and its legal counsel is essential to determining a company's success in meeting those challenges head on.

Though it's hard to guess what the next big issue will be, it's a safe bet that the deployment of data and analytics, an increasingly more dangerous cybersecurity threat, and the emerging risks associated with the use of social media in the corporate environment, will continue to resonate on boards' and GC's radar. Most of those we surveyed indicated these are areas boards needs a firmer grasp on to help their companies move forward in today's competitive marketplace. Increasingly, regulators and corporate consultants are recommending that directors gain a better understanding of all IT-related corporate risks, including data security, intellectual property theft, and social media usage to better arm themselves against breaches and catastrophic losses.

We hope the data offered here is valuable to your board and legal team. *Corporate Board Member* appreciates the support and expertise of its of Law in the Boardroom partner FTI Consulting and the hundreds of survey respondents who participate in our research this year.