they wish to start, or to redirect, their ESG disclosure and ESG risk oversight journeys. Because of the myriad of ESG disclosure frameworks, standards and metrics that exist today, a key decision for boards and management will be whether to follow what is becoming an emerging consensus around the TCFD framework and SASB standards. By focusing more attention on the oversight and disclosure of ESG factors that are material to the long term sustainability of their companies, directors can avoid negative voting recommendations from ISS and also can make it easier for their companies to attract capital from Canadian as well as international institutional investors that are integrating ESG factors into their investment decisions.

THE FUTURE OF THE BOARD

By Bill Ultan and Trevor Fetter

Bill Ultan is Morrow Sodali's Managing Director and head of Corporate Governance. He recently spoke with Trevor Fetter, who is a Senior Lecturer at Harvard Business School, Lead Independent Director at The Hartford Financial Services Group, and former Chairman and CEO at Tenet Healthcare and former CFO at Metro-Goldwyn-Mayer Inc., about the evolving role of the board of directors.

Bill Ultan: I'd like to talk about what it means to be on the board of a public company these days. As you look back over the last couple of decades during which you've served on and interacted with boards, I wonder what has changed in the role of being a director, and in the dynamic and culture of a board.

Trevor Fetter: I'd actually like to go back farther than that, using a case study that I particularly like on this topic, one that we use in Harvard Business School in a variety of courses. This case examines the board of directors of Coca-Cola going back to 1919. It's fascinating because in the very beginning, the CEO, Robert Woodruff, controlled the board. Through a series of trusts, he controlled shares in the company that were sufficient to appoint the entire board. His control remained fully intact for the next thirty years. For another two decades after he retired as CEO, he exercised control by chairing the finance committee of the board. The CFO reported directly to that committee, and the committee had to approve any expenditures over a nominal amount, initially $5,000.

In the case of Coca-Cola, we've seen literally a hundred years of evolution of the board of directors. It went from being controlled by the CEO in the 1920s, to collaborating with the CEO and controlled by the chairman of the finance committee in the 1960s and 1970s, to a largely interlocked board overseeing the CEO in the 1980s. It then transitioned to a modern board, with a respectful and collaborative relationship with the CEO. That is consistent with my personal experience over 35 years of being in and around boards. I've seen them become more independent and professional, recognizing that being a director is a job rather than an honor or a club membership.

Today, the biggest trends in boards are for more skills, more independence and more diversity, and at the same time fewer conflicts of interest and fewer insiders and related parties. If you look back far enough at some of these board case studies, you'll find people on boards who had extensive business dealings with the company through their outside business interests. You just don't see that anymore. The board has essentially become professionalized, which is probably the biggest trend; that and much more independence.

Ultan: Do you think the demands that are being placed on directors are realistic? I'm wondering whether directors are being held accountable, whether rightly or wrongly, for more than can be accomplished in only six to 12 meetings a year (and perhaps some conversations in between); will the nature of the commitment of being a corporate director continue to change?

Fetter: Oh yes. It has become a real job, but the job pays pretty well, especially if you are expecting, as you said, only six to 12 meetings a year. I think that is often understated because there are plenty of board engagements that are not technically meetings, so the time commitment to do the job well is certainly much greater than it ever was.

The demands for remaining educated about the job and continually monitoring what's going on in the company are also greater. That means that the obligations of management in relation to the board are also a lot greater. Management teams spend much more time working with the board of directors than they ever did before, but this is what investors and stakeholders including regulators and governance advisers expect. It shouldn't be a surprise to anybody that it's a more demanding job, and that the responsibilities are more dispersed and accountability is greater as well.

Ultan: We've certainly seen a push among investors on the "overboarding" of public company directors, and this topic continues to get a lot of attention. However, I note that to date there has not been a lot of scrutiny around private commitments of directors, and a lot of directors have any assortment of commitments to private companies, not-for-profits and other organizations. With so many commitments, what happens when a company goes into crisis? How can shareholders and other stakeholders be comfortable that directors are still going to be sufficiently focused on their company?

Fetter*:* The answer to the question of what it means to be overextended has changed dramatically. It's something that nobody thought about 20 years ago, when you commonly saw active CEOs of companies being on, say, three other large public company boards and several not-for-profit boards. It's not possible to devote sufficient time and attention to your responsibilities if you are spread that thinly.

A certain portion of directors are basically professional directors; it's all they do. They sit on multiple boards as their occupation. Investors and governance watchdogs have imposed fairly arbitrary limits on the number of boards they can be on without being considered overboarded. The limits are too low when everything is functioning smoothly and too high if one or more companies are dealing with a crisis.

The private company loophole you mentioned has arisen because of the convergence of three trends: the emergence of professional directors, the rise in the number of privately-owned companies, and the limits on overboarding being applied only to public companies. The growth of private equity has caused so many large companies to transition from being publicly owned to privately owned that it's hard to see that this distinction has a difference when it comes to the demands on directors.

I would imagine that over time, investors will pay more attention to private company directorships, which aren't even required to be disclosed today.

You also raise a really important point about the distinction between a normal course of business directorship, where everything's working smoothly and all the meetings are structured and they don't conflict with one another, and a crisis situation. Some of the professional directors who are really savvy on this have put together a portfolio of board engagements where the companies have different fiscal year ends, so that the peaks of activity are at different times during the calendar year.

But what happens when the house is on fire, if the job really changes and certain directors, especially the lead director, essentially become firefighters where suddenly they're out and actively engaged either with the company or with shareholders or with both? That changes everything. So I think some of the arbitrary limits probably need to be more situation-specific than many directors might think because of the need for surge capacity that you need to have if things get tough.

Ultan: It's interesting to look at companies that

fall into crisis, particularly if it's a governance related crisis, and how the focus goes right to the board. If such a company has a combined chair/CEO, one of the first things it does is separate the roles, because they're in crisis and they want the CEO to be able to focus specifically on the crisis. That has led to some conversations with shareholders about separating the roles of chairs and CEOs, some of whom ask "why wait for the crisis? A CEO should not be chair of the board and should be strictly focused on running the company." Do you agree with this perspective and do you believe a board's leadership structure can mitigate the risk of a governance related crisis?

Fetter: I have operated in every one of these configurations: non-executive chair, executive chair, chair and CEO, CEO but not chair, and lead director. The best advice I ever got on this topic was from Dennis Friedman at Gibson Dunn. In 2003 I was stepping into the CEO role at a time of crisis where the board had separated the chair and CEO roles under my predecessor. The structure that Dennis implemented was to create identical charters for the roles of the non-executive chair and the lead director. That accomplished something important: it eliminated any substantive difference between the title of non-executive chair and the title of lead director; the responsibilities were exactly the same.

I don't know any CEO who, if given the choice, would not rather also be chair. There are just so many people who still believe that there is more power and prestige in being chair and CEO rather than "just" the CEO. The title of "Chair and CEO" also eliminates, mostly for the benefit of the internal audience, any ambiguity about who is in charge of the company. That kind of ambiguity is very likely to arise if the chair was formerly CEO. So my view is to empower your CEO, for those people who think there is a difference, by titling him or her "Chair and CEO," but to have a lead director with a clearly-defined set of responsibilities whose function is equivalent to a non-executive chair.

It's so easy to do, and the lead director role is really important. They set the agenda for the board meetings in consultation with the CEO, and they lead the board discussion in the executive sessions. They are the principal conduit between the board and the CEO when there's some message that needs to be delivered one-on-one as opposed to by, or to, the entire board. It's somebody to be a sounding board for the CEO, whom the CEO wants to speak with in advance about what the sentiment of the board is and how the CEO ought to handle some particularly difficult situation. And when the difficult situation is in the boardroom—for instance a disruptive director, or a director who really doesn't acknowledge that it's beyond time to step off of the board—the lead director is crucial.

I really don't buy into the idea that somehow giving a CEO the additional title of chair leads to imperious behavior. If it does, you have larger problems. And for shareholders or governance advisors who seek to "downgrade" a chair and CEO by pressing the company to separate the roles, consider instead whether to "upgrade" the role and skills of the lead director.

Ultan: Do you think there is a greater burden today on independent directors to be "out there?" I view the election of directors as a unique referendum because it's really a perception vote. When shareholders vote on "say on pay" or shareholder proposals or an equity plan, it's pretty clear what they're voting on. But with directors, no one's able to ask the challenging questions—for instance, which directors are not as well prepared as they should be, etc. How do companies, either through engagements with shareholders, disclosure in the proxy, or other means, demonstrate to shareholders that the independent directors are fulfilling their duties and representing shareholders the way they ought to be?

Fetter: You mentioned disclosure in the proxy. I think the leading practice for companies now is to say a lot about the directors. You don't have to look very far back to find proxy statements where literally all they said about the directors was their age, their occupation and any other public company directorships. Now they're including photos of the directors so you can assess the diversity of the board. They're including a biographical description that is more expansive and a statement as to what the person adds to the board.

All the companies that I know are very open to having direct engagement between investors and directors; it just poses a practical problem. Let's face it, investors just don't have the bandwidth to start meeting with individual directors extensively, absent a problem. And what kinds of problems should trigger it? Decisions that are made by the board: compensation, ESG, strategy and big transactions that the board will have approved, whether financing or M&A. They can then address personal issues—tenure, age, the overboarding issues that we've spoken about, and conflicts of interest. Maybe even perceived conflicts of interest where the CEO might appear to be too cozy with a director or directors might appear to have relationships with each other that might compromise their independence.

Investors can look at all of these things and then reach a conclusion about the perspectives, the diversity, the experience, and the decisions that the board has reached, in order to form their perception about the board as a whole. It's pretty hard to form perceptions about individual directors without actually being in the room or developing an opinion based on something very public that director has done outside the boardroom.

Ultan: That's actually a good segue to another topic. I'd love to get your thoughts on the idea of shareholder versus stakeholder, because that goes again to the perception of the board and where its focus is. Last year [2019], the Business Roundtable came out with its statement on the purpose of a corporation, and earlier this year [2020] there was the 50th anniversary and reissuing of Milton Friedman's seminal piece on the focus on profits as the social construct for companies. Is Milton Friedman still right? Maybe he just comes off as a bit callous when taken out of context? Given all the ESG issues that companies and boards are now focused on, we'd love your thoughts on how you view that dynamic.

Fetter: That's a topic we spend a lot of time discussing with our MBA students. I don't think anybody is taking Friedman out of context.

The context was 1970, a time when companies were routinely polluting the environment and turning out unsafe products. Ralph Nader's book *Unsafe at Any Speed* was written in 1965. It was a very different environment in which Friedman was thinking about these issues and writing. Today's context is totally different. I think that what we're seeing in terms of the Business Roundtable and the other stakeholder-related arguments is that they're catching up to and reflecting what leading companies have already been practicing.

The company I ran for a long time was in the social services business. We were operating healthcare facilities and helping people to overcome illness. That's a business in which you are by definition engaged deeply with society. Maybe it's something that I had been thinking about for a long time before we got to this point, but to me it just seemed like stating the obvious when the Business Roundtable came out with this revised statement. It's appropriate for the times. It's what companies, employees, customers and the communities in which the companies operate and which they serve, expect and demand. People had different kinds of expectations of companies in 1970. In many ways they expected more, in terms of paternalism toward employees, and less, in terms of care toward the environment or society.

Everyone who runs a company knows that you live every day with your employees and your customers and with society, with regulators and everyone around your ecosystem, yet your investors have special rights. They have voting rights, they have rights to block you from doing things you would like to do, or to enable you to engage in transactions that you believe are in the best interests of the corporation.

It's stating the obvious to say that you ought to care about all of your stakeholders. A successful company is likely to put its customers and employees first, but it can't forget that shareholders ultimately have these special and superior rights. But, of course, it's also stating the obvious to say that if you do right by all of your stakeholders, the shareholders will be rewarded with a superior and sustainable enterprise.

Ultan: I recently had an interesting discussion with the CEO of a small energy company that is in the nascent stages of interacting with shareholders on environmental issues and providing related disclosures. The reality is that a lot of the push on these disclosures and standards is coming from passive investors: the large index funds such as Vanguard, BlackRock, State Street, etc. The expression on the CEO's face was telling because he responded with something like, "well, those are index funds, right? Those aren't really the shareholders that I'm focused on." I had to explain that they're incredibly influential. They now care about these issues and you can't ignore them. Do you see a distinction between a focus on environmental or social issues coming from passive investors as opposed to the views of active money managers?

***Fetter**:* I see it slightly differently. Yes, there is a distinction, but I view it in a different framework. The active investors are owners for a shorter period of time. The passive investors are perpetual investors. They're going to be shareholders in a company literally forever, or as long as it's in whichever index they're tracking. The largest investors are going to be shareholders in thousands of companies forever.

I think the difference in time horizon is the principal difference between these types of shareholders, but active shareholders are more concerned about immediate governance issues. They were the ones really pushing for stock option expensing twenty years ago. They're the ones who will push for regime change or for governance changes regarding bylaws or special meetings that seem pretty arcane to other people. They often want to affect immediate change.

On the other hand, the broader ESG movement is being led by the perpetual shareholders who care about the company creating value over decades and mitigating existential threats. Early in my CEO tenure, a shareholder proposal was put forward by a group of nuns. They wanted us to stop disposing of PVC plastic in incinerators. Our lawyers immediately moved to disqualify the proposal. Of course, hospitals generate quite a lot of medical waste, much of which is PVC plastic. It seemed like an incredibly obscure issue, and it was coming from a group that obviously did not own material amounts of stock, but upon looking into it and understanding the issue more, we determined that burning these things in an incinerator actually did release harmful chemicals, and the cost of disposing of them in a better way was immaterial. So, we changed it.

I think that a lot of companies will look at these ESG initiatives or even ones like my PVC experience and think, "this is a waste of time; it's a nuisance. Why are these people bothering me?" But, over time, taking these issues seriously makes for a better and more sustainable enterprise. The perpetual shareholders are recognizing that if they don't do something about the biggest issues (like diversity and climate change), nobody will, and exerting influence on companies by way of proxy voting is one of the few ways of driving business to change.

Ultan: That's a great story. One thing I've seen over the years is a real change in the way companies and shareholders interact. It was antagonistic a couple of decades ago. Shareholders felt the only

way they could get the attention of a company was to submit a proposal, so they'd submit the proposal first, then they'd have the conversation and depending on how that went, they would withdraw the proposal. Now, those conversations are more ongoing and the proposal comes at the end of a conversation, and only if something cannot be resolved. I view this development as a good thing, because it used to be that companies would go right into a bunker mentality—put up their walls and resist—and the shareholders would get overly agitated and aggressive. It just was not a healthy climate in which to generate constructive solutions.

Fetter**:** Yes, and I think that in those days it was normal for the company's legal department to try to knock the proposal out without the CEO even learning that it existed. It's a much more collaborative process now, and it's a healthier way of engaging in governance for companies.

Ultan: Given this year's events, diversity is a topic that has become top of mind for a lot of shareholders, specifically with respect to the initiatives a company is taking in this important area. Not just diversity of the board, but diversity of management and diversity throughout an organization. How do you see the role of a director in ensuring that a company has a proper focus on diversity? It's not something that can change overnight; it's really a long-term evolution, so what's the proper role of a director in working with management to make sure that diversity and inclusion efforts are really being focused on in an appropriate way?

Fetter: I actually I think you *can* make changes overnight, and while it depends on the company's circumstances, there are plenty of companies where changes *should* be overnight. It is absolutely appropriate for the board to engage in this topic, just as the board would engage in any topic that's related to the culture of a company, and to risk.

I think it starts with a belief, and company managements and boards either have a sincere belief that diversity brings value and a better and more sustainable workplace to their company, or they don't. If they do have that view, then they need to spend time on asking the basic questions like the ones you would ask if you had an underperforming business unit and you wanted to improve the performance of that unit. What is the market we can address? How are we addressing that market? Is our pricing a problem? Is our cost structure a problem? Are there other structural problems? What do we do about them? The questions are basically the same as it relates to diversity.

I think that it is absolutely appropriate for boards to be deeply engaged in this because the board can provide a different perspective to management than management can provide amongst themselves because by definition, the management is focused on one company in one industry in one geography. The geography could be the world, but it's often a national geography and those sorts of limitations shape your thinking about what is possible. The board should be coming in with perspectives that are much broader and with experiences that include those well outside of that company, so they can bring new questions to ask and also new degrees of experience and expertise.

Ultan: That sounds like a very strong rationale for why a board should be composed of individuals of diverse backgrounds and experiences as well.

Fetter: Yes, I think so. We've all seen the same statistics around how boards are changing and the degree to which diversity is being embraced by boards and advanced. I think that's going to lead to better governance. Part of it is that you'll have people with different perspectives on every issue, including different degrees of experience, expertise and perspective, and that leads to better discussions. In our MBA classroom, we go to great lengths to construct a very diverse group of 90 students, because that leads to a richer discussion than if you had 90 people with exactly the same background, exactly the same work history, and who all looked and sounded the same.

One question is, in composing a board, do you go for expertise or experience or both? There are very different schools of thought on this. Some managements and some boards prefer to have a group of generalists. It's just like how you would put together a team to tackle any sort of challenge. Do you want a collection of people who are deep domain experts in various things like cyber security or global health or digital marketing, or do you want a group of generalists? This tension in constructing the team, I think, leads to two dimensions on which to focus: experience and expertise.

I would say that experience enables people to ask better questions, because they have experienced good situations and bad situations in a variety of industries and contexts and circumstances, but expertise allows people to give better answers. I think a really well-constructed board has a mix of both experience and expertise, so you have people who have the ability to give really good answers, but also people who have the ability to ask really good questions.

Ultimately, asking questions elicits a better result in the interaction with management, because management teams by definition are domain experts who are deeply knowledgeable about their businesses. A board is never going to know more about the company than the management knows, and it is pointless for directors to even try. But to ask questions that management may not have thought of, or that challenge them, or that require them to go back and do more homework and dig deeper into a situation—that's where the board can really add value.

SEC SPEECH: ACCREDITED INVESTORS, CRYPTO-REGULATION, AND PERSONAL LIBERTIES

By Hester M. Peirce

Hester M. Peirce is a Commissioner in the Securities and Exchange Commission. The following is adapted and edited from remarks that she gave to the Federal Society's Capital Conversations Teleforum on December 10, 2020. She opened with the standard disclaimer that her statement represented her own views and not necessarily those of the SEC or her fellow Commissioners.

[The late economist] Walter Williams persistently pointed out the inherent conflict between government power and personal liberty. That principle is too often forgotten by regulators, mired as we are in the details of particular rules, and may not be front of mind for regulated entities, who sometimes seek to use regulation to gain or retain advantages over potential competitors. Our instincts as regulators are to protect people, but protection that comes in the form of overruling personal choices is what parents do for children, not what governments ought to be doing for citizens. Financial regulation, therefore, often undercuts personal liberty. Let me give some examples to illustrate the point.

One example that has gotten quite a bit of attention over the last several years is the accredited investor standard. Accredited investors have access to private markets that are largely inaccessible to other investors. Historically, to be accredited, a person had to be wealthy or have a high income. For purposes of our rules that means having a net worth exceeding $1 million (excluding the value of one's home) or an income in excess of $200,000 in each of the two most recent years or joint income with a spouse in excess of $300,000 in each of those years. The goal of this provision was to prevent unsophisticated people from making investment decisions that could hurt them.

In a change that took effect [in December], we expanded the accredited investor category slightly to include certain financial professionals who hold a Series 7, 65, or 82 license.[1] In terms of the number of new accredited investors created by our amended rules, this change is a small step. However, that incremental step reflected an acknowledged need to look beyond wealth and income because they are