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Key Priorities for Boards of Directors in 2021

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Boards of directors continue to navigate a complex, unsettling environment following a year of geopolitical turmoil, social unrest, economic volatility and the ongoing COVID-19 pandemic. At the same time, boards are challenged to establish a corporate purpose and a strategy that addresses the needs of a broad group of stakeholders that includes shareholders, employees, customers, suppliers, unions, regulators and the community from which the company draws its resources. As boards reflect upon how they have met the challenges presented in 2020, there exists an inflection point for boards to address how their companies are creating sustainable value in an ever-changing landscape. Below we discuss key priorities for boards in 2021 taking into consideration critical learnings from 2020 and offer suggestions to boards for "what to do now" to address these priorities.

1. Corporate Strategy and Purpose

As boards work through today's challenges and uncertainties, it is critical to have a clear articulation of the corporation's purpose. Even before the onset of the pandemic, key institutional investors unequivocally emphasized the link between corporate purpose and long-term profitability.

The severe impact of the pandemic, economic turbulence, social unrest and visibly disproportionate impact on low to mid-income workers and underrepresented communities, has strengthened the call upon boards to review the corporation's mission with a stakeholder-centric lens. Critical to that mission are employees, customers, investors and the broader communities in which the corporation operates. These constituencies expect the corporation to articulate a plan for how it will address not only long-term value creation, but also serve as a catalyst for broader efforts to foster diversity and inclusion, create employment opportunities, contribute to pandemic related solutions and address climate change. The question is not whether such constituencies should be taken into consideration, but how doing so will advance the corporate mission and support long-term sustainable value.

In this stakeholder-focused climate, boards must maintain their focus on long-term strategy and sustainable value creation, which remains the most important item on the board's agenda. An inflection point exists for boards to reflect and consider corporate purpose and the board's strategic vision for delivering on that purpose.

What to Do Now?

- Maintain active dialogue between the board and management on the company's purpose, understand the specific drivers of the company's purpose and be prepared to engage with investors and other key constituencies on these matters.
- Oversee management's efforts to advance the company's purpose while also advancing stakeholder interests, including amid changing social behaviors, customer demands and specific risks facing the company.
- Consider how the company's strategy is informed by the risks and opportunities presented to the company in light of various macro factors, including the COVID-19 pandemic, the global economy, environmental, social and governance (ESG) factors and market opportunities.

2. Diversity, Equity and Inclusion (DEI)

In 2021, boards will more than ever need to focus on addressing diversity, equity and inclusion (DEI) organization-wide. The sentiment that diversity – racial, ethnic, gender, socioeconomic and otherwise – is critical to business strategy became evident and pervasive in 2020. The confluence of events that put systemic racism in the spotlight have motivated corporate leaders to make public commitments to racial equality and to advance policies in support of diversity, equity and inclusion – not only because it is good for business, but because it is the right thing to do.

Institutional investors, asset managers and other stakeholders have made clear that they view diversity and inclusion as a significant means of mitigating risks and achieving long-term growth, stability and value creation. Several institutional investors are seeking commitments from companies to make available publicly "hard data," such as Consolidated EEO-Reports, to enable investors to evaluate and compare companies' performance on diversity and track their progress. Boards should expect workforce diversity disclosure to proliferate, and for disclosure of pay-equity data to gain traction in 2021. Boards will need to make employee diversity initiatives central to the organization's overall human-capital-management strategy, and oversight of such initiatives should be a regular part of the board's agenda.

Momentum began to build for boardroom diversity in 2020, and we expect to see significant progress in 2021 as institutional investors continue to focus on board gender, racial and ethnic diversity. Directors on boards that do not enhance and disclose their own diversity should expect to be publicly targeted by investors in director elections – including by BlackRock, which voted against over 1,500 directors in 2020 due to lack of board diversity, and State Street, which indicated it will vote against nominating and governance committee chairs of S&P 500 companies that do not disclose the racial and ethnic composition of their boards. Proxy advisory firms, ISS and Glass Lewis, have also updated their proxy voting guidelines to address board racial and ethnic diversity, as well as gender diversity. Moreover, in a game-changing move, in December 2020, Nasdaq proposed a new rule requiring listed companies to have, or explain why they do not have, two "diverse" directors (one self-identified as female and one self-identified as being from an underrepresented racial or ethnic group or as LGBTQ+). At the state level, a number of states have enacted or are currently considering mandatory board-diversity legislation.

The challenge for corporate leaders will be to follow through on public commitments made on DEI efforts. At the same time, directors should understand that the Company's public statements made on DEI should match its efforts. Shareholders have turned to litigation alleging that the company's commitments to diversity appearing in proxy statements and other disclosures were materially false and misleading. Shareholders are also alleging that directors violated their fiduciary duties for failing to have racial diversity on their boards, failing to take action on DEI issues, and for tolerance of racially discriminatory practices at their companies. While it remains to be seen how these lawsuits will fare, shareholders are likely to continue to use litigation as another means to press for greater board and workforce diversity.

What to Do Now?

- Use the current climate as an opportunity to review and, if necessary, refresh board composition to address gender, racial and other diversity on the board, the absence of which will attract increasingly unforgiving scrutiny, internally and externally.
- Put oversight of diversity, equity and inclusion on the recurring board agenda.
- Prepare for heightened expectations around board oversight of diversity at all levels of the organization and understand management's efforts to drive meaningful opportunities for inclusion, pay equity and any appropriate changes throughout the organization.
- Engage with investors to understand their positions and policies, and be prepared to disclose the board's diverse attributes and articulate the company's strategy on diversity, equity and inclusion.
- Work with management to understand and align the company's public commitments to its DEI efforts and its actions toward meeting those commitments.
- Consider encouraging DEI and other ESG goals through quantitative compensation metrics.

3. Culture, Human Capital and Workforce Transformation

The COVID-19 pandemic has underscored the heightened focus on what many companies refer to as their "greatest asset": their employees. In addition to critical health and safety concerns relating to the pandemic, the range of human-capital issues for management to tackle includes employee retention, compensation, training and development, diversity and inclusion, and adapting the workforce to remote environments. The impact of 2020 on human capital issues will likely be long lasting and remain at the top of the board's oversight agenda as a driver of long-term value.

Specifically, boards working together with management must focus on the key human capital metrics that drive the company's business. Recently adopted SEC rules require disclosure of the company's human capital resources, including any human capital measures or objectives used in managing the business to the extent material to an understanding of the company's business as a whole. While this principles-based requirement gives companies latitude in determining what is material and how to characterize its human capital, the SEC has stated that it expects meaningful qualitative and quantitative disclosure, including, metrics that companies actually use in managing their affairs. Investors and other stakeholders are also looking for more insight into how companies manage the human capital assets. The World Economic Forum recently proposed a core set of ESG metrics organized in four pillars (Principles of Governance, Planet, People and Prosperity) to be included in company disclosures that may serve as a guide for crafting this disclosure.

The pandemic has accelerated virtual work and redefined how people think about innovation, technology, skills and optimization. These dynamics have also created risk, including relating to cybersecurity, compliance, employee training and leadership succession and development, which can impact the oversight and execution of the company's strategy.

What to Do Now?

- Continue to monitor COVID-19 related health and safety risks and management's effort to protect employees, customers and business partners.
- Oversee management's efforts to (i) identify the human capital metrics that are most closely aligned with the company's business strategy, such as recruitment, retention, attrition, diversity, engagement, training, pay equity and compensation, (ii) ensure that internal controls are recalibrated for proper oversight of these matters and (iii) monitor and address human capital matters, as appropriate.
- Receive reports on the human-capital metrics tracked by management, as investors and the SEC are looking for meaningful disclosure of these metrics. The company's efforts and successes should not be exaggerated, as regulators, investors and shareholders public disclosure will continue to scrutinize public disclosure.
- Consider how evolving workforce dynamics are impacting corporate culture, especially during an ongoing global crisis when employees at all levels are feeling increasingly disconnected and managing heightened levels of stress.
- Review, and where necessary refresh, the company's policies and procedures that set the "tone at the top," including the reporting/whistleblower policy, code of conduct, anti-harassment policy, and reinforce them with training at all levels of the organization.
- Consider whether a board committee should be delegated the responsibility to oversee key human capital issues.

4. Overall ESG Strategy and Engagement

Boards should expect that investors will continue to focus on ESG-focused investing as sustainability, climate change and social responsibility themes continue to gain momentum. Large institutional investors and asset managers have made ESG and sustainability initiatives a significant engagement priority making it critical for companies to address and disclose board-level oversight of ESG issues in 2021.

In particular, investors want public companies to provide more meaningful and easily comparable ESG reporting metrics, especially on climate-change. Stating that "climate risk is investment risk," BlackRock, State Street and others are calling for a "clearer picture" of how companies are managing their climate change and related risks. With the goal of "more widespread and standardized" reporting on sustainability, BlackRock expects companies in which it is invested to publish disclosure in line with industry-specific Sustainability Accounting Standards Board (SASB) guidelines in the upcoming annual report on Form 10-K and disclose climate-related risks in line with the recommendations of the Climate-related Financial Disclosures (TCFD). BlackRock is also asking companies to disclose their plans for adapting their business models to a "net zero" economy – i.e., an economy where global warming is limited to 2 degrees Celsius and consistent with a goal of net zero greenhouse gas emissions by 2050 – and how that plan is part of the company's long-term strategy and reviewed by the board. State Street continues to evaluate companies using its SASB-based proprietary R-Factor scoring and to ask companies to use the TCFD framework. Although, the disparity in industries and company practices has made it difficult for companies to adopt comparable and useful metrics, standards developed by SASB, TCFD and the Global Reporting Initiative (GRI) appear to have the most significant momentum, and companies should expect that pressure to adopt one or more of these standards will continue to mount.

Boards should also expect investors to make their views known through voting at the annual meeting. Shareholder proposals on climate change and other ESG matters are gaining significant support and a number of institutional investors have indicated that they will vote against directors at companies that have not made sufficient progress on sustainability-related disclosures and the business practices and plans underlying them. In 2021, companies that have not yet tackled these issues will need to actively discuss the frameworks that may be most meaningful for the company, assess what measures are material to the business and engage with investors on their views.

What to Do Now?

- Oversee management's efforts to identify and prioritize ESG issues material to the company's business and consider whether appropriate to incorporate relevant climate change goals into the company's long-term strategy.
- Consider whether one or more board committees should be charged with oversight of material ESG issues and be prepared to engage on ESG and the board's oversight role.
- Understand how investors are reallocating capital toward sustainable investments.
- Anticipate that the company will continue to be pressured by investors to disclose ESG metrics in accordance with the SASB and/or TCFD frameworks and support management's efforts to adopt the reporting framework that is most meaningful for the company.

5. Risk Oversight

A critical look at risk oversight, including the board's processes and procedures for identifying and overseeing the company's "mission critical risks" and related developments should be a top priority for boards. In the current environment, risk transcends all aspects of business oversight.

Remembering that the board's role is one of risk "oversight," not risk management, the board should work with management to monitor and address risks that are central to the company's business. Although Delaware courts have generally dismissed *Caremark* claims, describing them as "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment," recent Delaware decisions have advanced *Caremark* claims beyond the motion to dismiss phase signaling expectations about board oversight over "mission critical" risks. The cases do not represent a change in Delaware law – specifically a director's duty of oversight under *Caremark*; however, they do serve as important reminders for directors to be informed and diligent, especially with respect to assessing the most critical risks facing the company.

Major institutional investors are also focusing their engagement efforts on understanding key risks to sustainable value creation. Vanguard, for example, expects directors to be fully knowledgeable about the risks and opportunities that stem from a company's strategy and to provide counsel to management executing it. At the same time, boards are expected to anticipate or otherwise be prepared for new and evolving trends and risks. For example, risks relating to digital transformation and cybersecurity, remote work, climate change, consumer/product safety, the changing regulatory environment, supply chain management, and employee mental and physical health are just some of the risks at the forefront of the board's risk oversight agenda.

> ***What to Do Now?***
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> - Take a critical look at the effectiveness of the board's oversight and the allocation of risk oversight responsibilities among the board and its committees.
> - Ensure there is a coordinated system at the board-level to monitor "mission critical" risks to the company.
> - Oversee the effectiveness of management's enterprise risk management systems to help ensure that they provide sufficient information on existing risks and raise new or evolving risks to the relevant board committee or full board on a timely basis.
> - Oversee management's efforts to ensure that the company's internal controls and financial reporting system are designed to provide management and the board with timely and accurate information to support informed business judgments.
> - Receive reports from management on business continuity plans and contingency planning.
> - Understand and discuss with management the latest developments in the company's public reporting and disclosures, including in relation to human capital resources, risk factors, MD&A and the integrity of the company's financial reporting.

6. Board Effectiveness

Boards have faced significant challenges in 2020. It will be important for the board to assess how it fared, including an assessment of its functioning during the pandemic. As part of this assessment, the board should continue to evaluate its own composition, including its leadership, competencies, independence, tenure and effectiveness, to determine whether it aligns with the company's strategic objectives. Moreover, boards should also reflect critically on their functioning and communication during the pandemic in light of the likelihood that boards will continue to meet remotely into 2021. The board should not sacrifice appropriate processes and procedures particularly during times of crisis and uncertainty.

> ***What to Do Now?***
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> - Oversee the company's strategy and key risks, and provide guidance and direction to management, as appropriate.
> - Critically review board materials to remain engaged and informed.
> - Consider the board's composition, skills, leadership and diversity and refreshment mechanisms – and openly assess the need to recruit additional directors and be prepared to have frank conversations about succession planning.
> - Periodically review corporate governance guidelines, committee charters and committee responsibilities and evaluate whether the board's work is appropriately and effectively delegated to key committees – and ensure that company disclosures appropriately describe the board's oversight function.

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