Director Dialogue With Shareholders

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Investors want to hear what their boards of directors have to say on company results, strategy and leadership. Yet most boards remain shy about dialogue with shareholders, partly through inertia, but partly due to uncertainty and legal concerns. A new report from PwC's Center for Board Governance and Weil, Gotshal & Manges explores how corporate boards are slowly coming out of the boardroom and talking with investors.

Shareholders have access to a considerable amount of information about how public companies are governed, from SEC-prescribed proxy statement disclosures to corporate governance descriptions on company websites. Yet over the past few years we have seen rising interest (primarily from shareholders but also at times from directors) in more direct communication between shareholders and directors.

Shareholders may seek greater insight about issues of interest to them, or just want to ensure their concerns are heard, unfiltered, at the board level. Similarly, boards may seek an unvarnished understanding of how shareholders view the company and the particular issues it faces.

In most companies, management handles investor relations and shareholder communications, subject to oversight by the board. However, at times, direct dialogue between the board and shareholders can be beneficial. Over time, periodic direct interaction may help to build trust on both sides. It may also reduce the risk of unpleasant surprises by encouraging major shareholders to reach out when they have concerns, instead of submitting shareholder proposals or launching withhold vote campaigns.

Shareholder influence has increased over the last decade for a host of reasons. Ownership is now more concentrated in the hands of institutional investors. Shareholders have say-on-pay votes and can seek proxy access on a company-by-company basis. Brokers are prohibited from voting uninstructed shares for say-on-pay votes and in uncontested director elections.

More companies have adopted majority voting for director elections. Plus, many institutional investors use the same two proxy advisory firms, so if they follow those firms' voting recommendations, they may end up voting largely the same way.

Shareholders are increasingly willing to communicate their viewpoints and to try to effect change in the boardroom, often through shareholder proposals. Common proposals urge boards to declassify, to adopt majority voting, or to split CEO and board chair roles. The advent of social media has made it easier for interested parties to get their message out and connect with others who have similar concerns.

Shareholders say communicating with the board is the most effective way to get a company's attention if they have a corporate governance concern.

PwC's 2013 Investor Survey asked institutional investors how important various corporate governance concerns are in determining whether they would communicate with a company. Seventy-four percent selected executive compensation, 68 percent said the board's overall governance profile, 55 percent said CEO succession, and 54 percent said company strategy. Fifty-four percent also said relative performance, and 48 percent said proposed mergers or acquisitions.

Shareholders say communicating with the board is the most effective way to get a company's attention if they do have a corporate governance concern—45 percent selected this approach in the survey. Lower

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Quotes From Directors
Insight On Speaking With Investors

❝I've always gotten information from the corporate secretary, general counsel, or CEO on what shareholders were thinking, but to get it [through meeting shareholders] directly, unfiltered, was particularly valuable."

❝It's important for the board to understand the company's investor relations program. If management only contacts shareholders when there's a crisis, that's not good."

❝After proxy season, we [directors] met with major shareholders who voted against our say on pay. Those conversations were useful, and sometimes surprising."

❝A director who is meeting with a shareholder should listen more than speak."

❝I can't imagine any board categorically saying it would never meet with a major shareholder. At the end of the day, directors are shareholders' agents."

❝I found that meeting with large shareholders was very informative and healthy. I would tell other directors: Don't be afraid of doing it and don't avoid it."

down the list are contacting the executive team, contacting investor relations, submitting a shareholder proposal, and launching a withhold vote campaign against directors.

Those shareholders who do have concerns about a company are often satisfied if they can communicate with a company executive or investor relations personnel. For certain sensitive topics, though, shareholders want to communicate with directors. Shareholders appreciate the opportunity for a more nuanced understanding that dialogue may provide. They also value having a director hear their concerns unfiltered by management.

Therefore, it is not surprising that the majority of boards are communicating directly with certain shareholders. PwC's 2013 Annual Corporate Directors Survey (ACDS) shows 61 percent of boards had substantive communications with institutional investors, a finding that was largely consistent with the prior year's survey results.

Shareholders are often cautious of meeting with directors. It may be challenging to build a relationship between shareholders and the board over time.

Just as boards should fully understand the purpose behind a meeting request from a shareholder, boards should expect that shareholders will seek to understand the subject matter and purpose of a company's meeting request. The purpose may be evident if there was a close (or failed) vote or if there is another similarly compelling reason. However, shareholders are often cautious of meeting with directors if there are no matters of concern to them, given their limited time and resources. As a result, director-shareholder communication more typically occurs when there is a sensitive situation.

Therefore it may be challenging to build a relationship between directors and shareholders over time. While ongoing engagement can help establish a level of mutual trust, not all investors are interested in meeting if things are fine. Boards should consider other ways to maintain a relationship between meetings, such as periodic letters to emphasize a publicly announced initiative that relates to a shareholder's expressed interest or concern.

If your board is discussing whether it should communicate with shareholders, it may be helpful to consider a series of questions.

☐ ***Which topics are appropriate for director communications?*** The majority of directors generally are comfortable with communications about their boards' activities relating to governance policies, executive compensation, and director nominations.

However, the majority do not believe it is appropriate for their board to discuss strategy, key risks, earnings results, capital expenditures, or use of cash or other corporate resources. This may be because directors believe executives should take the lead in addressing matters relating to company operations.

☐ ***Which directors should be involved in share-***

holder communications? Determining which directors to involve depends largely on the topic.

For example, if the topic is executive compensation, often the most effective director to participate would be the compensation committee chair. The independent board chair or the lead director/governance committee chair would be a logical participant for discussions involving succession, board composition, or general governance concerns. Board and committee leadership positions lend credibility, but other factors to consider include the director's understanding of the issue and his or her ability to communicate, make connections, and diffuse tension.

☐ ***Who else from the company should attend the meeting?*** With rare exception, a director should never meet alone with a shareholder. Someone else, most commonly inside or outside counsel, should attend. Depending on the topic for discussion, it is also common for someone from investor relations, human resources, or finance (and often the CEO) to attend as well. Other advisors, such as compensation consultants or investment bankers, may also be present if warranted.

Regardless of who attends, the various meeting participants representing the company should determine in advance who will address which topics and questions. Directors need to be able to answer the questions that investors would expect them to know and not redirect those questions to others.

☐ ***How should directors prepare for these meetings?*** Whether the meeting is happening at the company's or a shareholder's request, the directors should be fully briefed on:

▫ The purpose of the meeting.

▫ The investor's voting policies and procedures, voting history, and approach to activism on the issues that will be discussed.

▫ Whether the investor actively manages its funds. (If, instead, the investor is indexed, it generally lacks an option to sell.)

▫ Who from the investor's organization will attend the meeting, and whether those people make voting or investment decisions.

▫ How the investor's goals, if known, may conflict with other shareholders' goals.

▫ What information is in the public domain on the issues, and what undisclosed information might be considered "material" from investors' perspectives.

▫ Whether the discussion will be confidential.

As part of its preparation, management should connect with the shareholder ahead of time to ensure both parties understand the high-level agenda for the meeting and any particular agreed-upon protocols.

Based on the planned agenda, management should also draft a list of potential questions that might arise and provide talking points on what the company has previously communicated in each area.

A pre-meeting discussion among all company attendees is valuable to help map out who will do what. Each person at the meeting should have a clear role. The group should also discuss responses to expected questions and try to anticipate "surprise" questions.

Directors can communicate with a shareholder in many different ways: an in-person meeting, or by conference call or video conference.

☐ ***How will meeting logistics work?*** Directors can communicate with a shareholder in many different ways: an in-person meeting, or by conference call or video conference. Each has advantages and drawbacks, and directors will want to tailor their preparation accordingly. Regardless of how the communication occurs, directors and shareholders should agree on whether the interchange is to be considered confidential.

Some observers suggest there are other ways to hold these communications, for example via web chat, or shareholder-only portals. Note there may be legal concerns that arise from holding discussions in a venue that could capture the discussion in a permanent record (electronic audio recordings, etc.).

As with any type of informal corporate communication (oral, written, or electronic), careful consideration also should be given to compliance with Regulation FD's ban on "selective disclosure" of material, non-public information.

☐ ***When should directors get involved in shareholder communications?*** A board needs to consider

Talking The Talk

Tips For Board And Investor Discussion

Throughout the interviews and at various corporate governance programs, both investors and directors recommended practices for more productive meetings and described common mistakes they have witnessed. These distill down to some basic "Dos" and "Don'ts" for directors.

Do

☐ Listen and try to understand a shareholder's stated concerns from the shareholder's viewpoint. Shareholders understand that just because directors listen, it does not mean they agree.

☐ Recognize that concerns or opinions of one or a few investors are not necessarily shared by all investors.

☐ Be alert to what you hear from shareholders, especially when they have a genuine interest in getting more insight into an issue. This feedback could indicate an opportunity for management to expand company disclosures in a way that will be helpful to all investors.

☐ Be careful to follow the agreed-upon message. At the end of the day, the board and management must speak with one voice.

Don't

☐ Don't be quick to react to or reject messages or criticisms that may not align with your own views or may contain messages you might not want to hear.

☐ Don't give undue weight to conversations with a limited set of shareholders.

☐ Don't subordinate your own business judgment to the views of shareholders. Directors cannot simply defer to the wishes of shareholders.

☐ Don't share details about the board's internal deliberations, imply the board was split on an issue, or indicate disagreement with management.

☐ Don't focus too much attention on proxy advisory firms' recommendations or spend too much meeting time criticizing or rebutting their point of view. Investors make up their own minds.

☐ Don't suggest shareholders simply sell shares if they are unhappy. Many consider this response to be inappropriate at best, and evasive or insulting at worst.

☐ Don't try to set up a meeting at the height of proxy season unless there are special circumstances. If you have a choice, summer and fall are often the best time to have these communications with shareholders.

☐ Don't contradict information in the proxy or other public filings.

☐ Don't bring too many directors. The risk is that all will want to speak, and the more who speak the higher the chance that some statements will be contradictory or off-message.

☐ Don't do all the talking.

☐ Don't expect senior managers from the investor group to attend. Although the analysts you meet may be young, they may be the ones making the voting decisions.

☐ Don't let an outsider, such as a compensation consultant, do all the talking. It undermines confidence that the director understands the issue.

☐ Don't use a meeting with a shareholder only to try to win a shareholder vote. The goal of communication should be to share information and perspectives.

☐ Be arrogant. Remember, shareholders own the company.

which situations truly warrant a director's involvement. Your board may get numerous requests for directors to participate in discussions. Everyone's time is limited, though, so even boards that are willing to communicate directly with shareholders may choose not to engage in certain circumstances. Directors should be comfortable, though, that the company is responding to the request, even if that response is to decline a meeting.

Some boards have a policy on director communication. In PwC's 2013 survey, just over half of directors (53 percent) say their companies have a specific director policy regarding communications with stakeholders and that the policy is very useful. One-third do not have such a policy, and an additional 10 percent indicate they do not, but should.

Some companies have a stand-alone policy for director communications. Others may address the issue within the body of other company policies on communications or Regulation FD compliance, or in corporate governance guidelines, for example. Wherever the guidelines on director communications are lodged, a policy can be helpful to ensure everyone understands the company's expectations.

Regulation FD does not bar private meetings between directors and shareholders, but boards need to use caution.

Some directors and board advisors have pointed to Regulation Fair Disclosure's ban on selective disclosure as a key reason to avoid director-shareholder communication. Reg FD prohibits a public company from disclosing material, non-public information to analysts or investors unless that information is simultaneously, or was previously, released to the public by a Form 8-K, a press release, or another non-exclusionary means that is reasonably designed to distribute the information broadly. Both Reg FD and the antifraud provisions of the federal securities laws (including Rule 10b-5, which bars insider trading and tipping) apply to all communications made by or on behalf of the company regardless of whether the particular communication is oral, written or electronic (which in most cases the SEC treats as a written communication). They apply whether these communications are made by a director or a member of management, or any other company personnel who owe the company a duty of trust and confidence.

Although the SEC has clarified that Reg FD does not bar private meetings between directors and one or more shareholders, directors and companies do need to use caution when having such meetings. This applies whether the meetings are in person, over the telephone, or held via videoconference. Also use caution in written communications with one or more select shareholders. As noted, Reg FD and the antifraud provisions of the federal securities apply regardless of the form of communication—oral or written, including e-mail, tweets, Facebook postings, etc.

Groups other than shareholders may want information from the company, especially on matters of interest to them. These communications are typically handled by management, yet sometimes directors play a role.

For instance, a director might be better positioned than an executive to handle communications with key stakeholders in a crisis. We have seen directors get involved in a number of crisis situations, from environmental disasters and scandals involving executives to unplanned CEO succession issues.

When communicating with stakeholders, directors need to understand how the federal securities laws apply. For example, Regulation Fair Disclosure treats analysts in the same manner as shareholders. Plus, the SEC generally views proxy advisory firms as potentially falling into the "shareholder" category because they influence shareholder voting, and in some cases, have delegated voting authority for institutional investor clients.

Company communications with employees and the media generally are not covered by Reg FD. If employees are also shareholders, however, the rules can get tricky. Also, there will always be concern about violating insider trading policy provisions which bar "tipping" of material, non-public information to anyone who might trade on the basis of such information, or tip others who may do so. ■

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