Getting Governance Right

2017 | A Handbook for Today's CEOs and the Board of Directors

CORPORATE COMPLIANCE INSIGHTS

Getting Governance Right 2017: A Handbook for Today's CEO and the Board of Directors

PUBLISHER
Maurice Gilbert
maurice@corporatecomplianceinsights.com

MANAGING EDITOR
Sarah Hadden
sarah@corporatecomplianceinsights.com

EDITOR
Emily Ellis
emily@corporatecomplianceinsights.com

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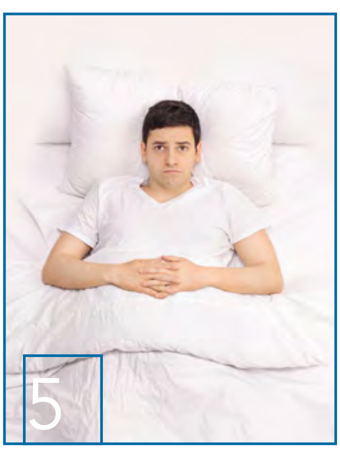

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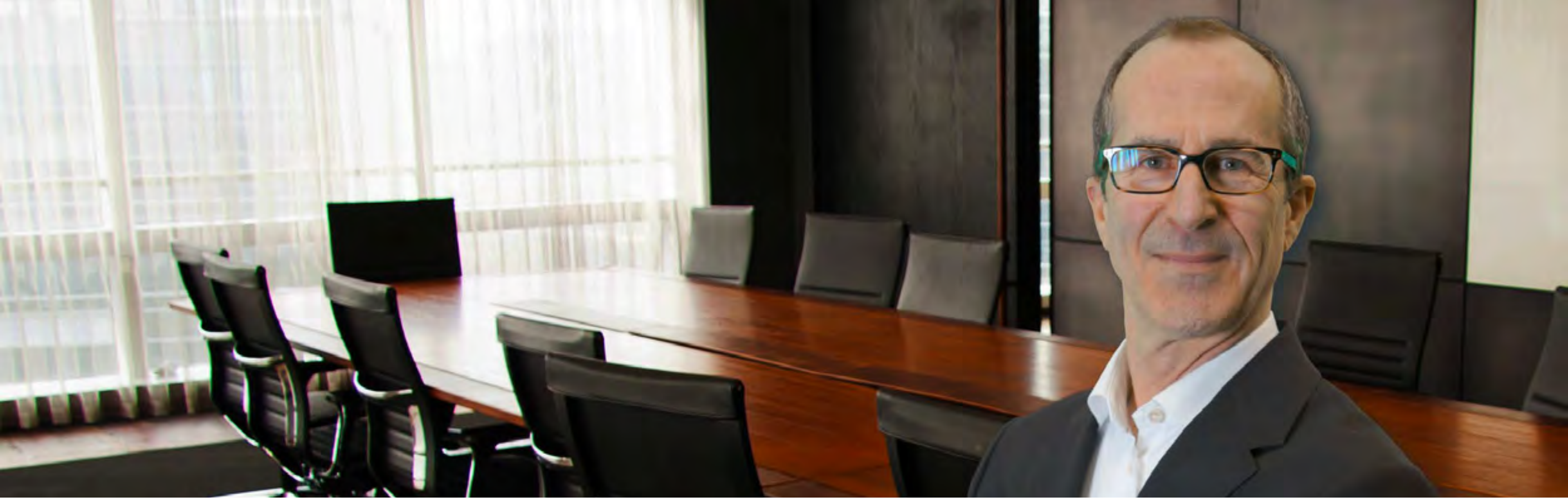


Corporate governance has been the focus of regulators' attention of late, and the performance of the board of directors is increasingly integral to an organization's success in the marketplace. It's no wonder, then, that companies are striving to enhance their governance practices and position their Boards to excel.

This book brings together expertise on all things Board related, exploring topics from cyber risk to the importance of meaningful Board evaluations and thoughtful sucession planning. In this comprehensive guide, our expert authors explore the top issues plaguing Boards and prescribe actionable solutions.

You'll find no platitudes here. Nor do we avoid the uncomfortable topics.

CCI features thought leadership from some of the greatest minds in the governance, risk management and compliance fields, so we're pleased to present this work, a compendium on Boards.

Maurice Gilbert | Publisher, Corporate Compliance Insights
CEO, Conselium Executive Search

CORPORATE COMPLIANCE INSIGHTS

Conselium
Compliance-focused Executive Search

What Keeps Boards Up at Night?

EMILY LEITCH

With contributing authors Aaron Carlson, Sean Gorman and Kate McGregor

With pressures from regulators, shareholders and proxy advisory firms to improve disclosure, increase board diversity, enhance corporate governance and stave off cyberattacks, directors must stay abreast in a constantly evolving corporate environment.

Demands on corporate directors are greater than ever. With pressures from regulators, shareholders and proxy advisory firms to improve disclosure, increase board diversity, enhance corporate governance and stave off cyberattacks, directors must stay abreast in a constantly evolving corporate environment. This article offers insight and practical tips on the topics that keep boards up at night.

PROXY ACCESS

In 2015 and 2016, the corporate governance spotlight has been on proxy access. Proxy access proposals have received strong shareholder support and as of August 31, 2016, 39 percent of S&P 500 companies provide a proxy access right.[1] A general consensus has emerged among companies that have adopted proxy access bylaws to permit a shareholder or group of shareholders who have held 3 percent of the company's stock for three years to nominate up to 20 percent of the board.

In 2017, expect to see a shift in tactics from shareholder proposals seeking to implement proxy access to proposals seeking to tweak the "fine print" of existing proxy access provisions. Examples include counting the same mutual fund family as one shareholder, restricting renomination of failed director nominees and requiring disclosure of or prohibiting third-party director compensation arrangements. SEC Division of Corporation Finance Director Keith Higgins has indicated that the SEC views a company's bylaws

as fundamentally "the domain of the shareholders" under Delaware law and implied that shareholders may be given wide latitude to adopt amendments.[2] The SEC has demonstrated reluctance to issue no-action letters to companies looking to exclude shareholder proposals to amend their existing proxy access provisions.[3] The SEC staff has indicated that they will evaluate shareholder proposals to change proxy access provisions on the totality of the circumstances rather than relying on a strict numerical test. While shareholder proposals to change proxy access provisions may be difficult for companies to exclude, they can often be defeated by early and effective shareholder engagement. A company that has adopted a proxy access provision should consider engaging with key shareholders to communicate the details of the provision and explain why the proposed changes are not necessary.

EXECUTIVE COMPENSATION

As the SEC continues to implement Dodd-Frank rulemaking requirements, expect to see continued focus on executive compensation, including pay ratio disclosure, clawbacks and pay-for-performance.

Pay Ratio

Beginning in 2018, companies will be required to make new disclosures of the chief executive officer's total annual compensation, the total annual compensation of the median employee and the ratio of the two. It is important for a company to start preparing early: this process is complicated, difficult and painstakingly detailed. Leave time to practice collecting the necessary data and navigating the company's payroll system. If it is appropriate for the company's business model, consider using statistical sampling to generate the required information on the median employee.

Also carefully consider the audience for this information. Institutional investors and proxy advisory firms seem relatively uninterested in the pay ratio disclosure, except as it may reveal outliers or major year-to-year changes. The main consumer of this information will be the company's own employees. Employees are likely to focus on the median compensation more than the ratio, as half of the employees will learn they are compensated below the median and they can easily compare the company's median to its peers who may be competing for their talent. Since employees are more likely to get their information from the media than the proxy statement, a company should control the narrative on the pay ratio and median compensation. Tell the company's story before the media tells it for you. Also consider reaching out to employees outside of the proxy to discuss the narrative with them.

Clawbacks

While most companies have already adopted some form of compensation clawback, clawbacks are back in the spotlight due to recent high-profile events such as Wells Fargo's clawback of $41 million from its chief executive officer (who subsequently resigned). The SEC's successful implementation of its whistleblower program has also increased the importance of clawbacks: with more whistleblowers come more restatements, which means more clawbacks. The SEC has proposed rules that would require stock exchanges to adopt listing standards that would clawback performance-based compensation when a restatement is required. The standards will likely go beyond a company's existing clawback policy and would apply to all executive officers, current and former, with a three-year look-back period and would not be limited to executive officers who engaged in misconduct (it is a no-fault policy). The amount of a clawback would be pre-tax, and executives may or may not be able to deduct the taxes already paid on the amount clawed back. It is also important to note that the Department of Justice does not allow companies to indemnify for clawbacks. A company should check its indemnification and mandatory arbitration clauses for potential clawback issues.

> "Since employees are more likely to get their information from the media than the proxy statement, a company should control the narrative..."

Pay-for-Performance

The SEC has proposed rules requiring disclosure of the relationship between executive compensation actually paid and the financial performance of the company. This pay-for-performance disclosure is meant to be a company's supporting statement for a shareholders say-on-pay vote. Up to this point, many companies have developed their own pay-for-performance disclosures, but concern has been raised that these are difficult to compare across companies. The proposed rules focus on executive compensation, its relationship to total shareholder return (TSR) and comparison to a company's peers. The SEC has received numerous comments on these proposed rules and a company has the option to continue with current compensation disclosure practices until the rules have been finalized. In the meantime, stay abreast of what peers are disclosing and continue to evaluate whether the company's disclosure is accurately telling your pay-for-performance story.

BOARD COMPOSITION

Board composition, in terms of diversity, skills and tenure, has become a key area of interest for some shareholders. With average director age increasing and turnover remaining flat on large-cap public company boards[4], investors, and even directors themselves, are calling for change. In a director-community survey by KPMG, 43 percent of respondents cited resistance to change and status quo thinking as significant barriers to board performance.[5] While shareholders and directors agree board diversity is important, progress has been slow. SEC Chair Mary Jo White has announced that the staff is working on recommendations regarding amendments to the SEC's existing board diversity disclosure rule to require companies to include more meaningful board diversity information in their proxy statements when it is voluntarily reported by directors.[6] In October 2016, proxy advisory firm Institutional Shareholder Services Inc. (ISS) announced that it has revised its rating system and added board diversity and refreshment questions to its scoring criteria. Given ISS's influence on shareholder voting, a company would be wise to proactively improve its board diversity and increase disclosures related to its efforts.

SHAREHOLDER ENGAGEMENT

Shareholder engagement has become the norm, not the exception, and boards are increasingly adopting shareholder engagement policies. Best practice is to reach out early and often — many engagements begin immediately following a vote. When meeting with shareholders, maximize the value of their time. Have an agenda and circulate it to the shareholder prior to the meeting so they can add any items that you may not have realized are a concern for them, and include independent directors rather than management to avoid any awkwardness. Make sure the company "gets credit" for what it has done by highlighting your shareholder engagement efforts and responsiveness to shareholders in the proxy. Consider using a chart to emphasize "here's what we heard" and "here's what we did." Finally, proactively address ISS concerns. Depending on the company's shareholder profile, ISS can significantly influence votes, so it is important to address their concerns head-on.

CYBERSECURITY

Cybersecurity remains a top priority for directors, as the sophistication and number of attacks continues to increase. The costs of cyber attacks are high and include business disruption, reputational harm and response costs, with the average consolidated cost of a data breach estimated at $4 million[7]. There has also been an increase in derivative suits against companies, officers and directors relating to data breaches. While the SEC has investigated instances of cybersecurity breaches, there have not yet been any public cases. However, a company needs to be ready to respond to an investigation based on the company's obligation to have internal controls and to take reasonable efforts to protect against cyber threats. In the event of a cyber breach, a company will face a number of challenges. While the company is the victim of the attack, it immediately comes under the threat of liability; careful, complete disclosure is key to avoiding this liability.

CONCLUSION

The speed at which demands on corporate directors are evolving does not appear to be slowing. Corporate directors must continually educate themselves on the legal and corporate governance landscape in order to effectively respond to and lead through these changes.

[1] The Finer Points of Proxy Access Bylaws Come Under the Microscope, posted by Peter Kimball and Alexandra Higgins, ISS Corporate Solutions, on September 12, 2016.

[2] Keith Higgins, "Keith Higgins Speaks: The Latest from the SEC," TheCorporateCounsel.net's Proxy Conference and Say on Pay Workshop, October 24, 2016.

[3] This past July and September, the SEC rejected no-action requests from H&R Block and Microsoft under Rule 14a-8(i)(10), which allows companies to exclude proposals that they have "substantially implemented."

[4] Carol Hymowitz, "The one place it's okay to be old is in the boardroom," Bloomberg, August 21, 2015.

[5] KPMG Audit Committee Institute, Building a Great Board: KPMG's Audit Committee Institute Global Pulse Survey (KPMG, 2016), p.7.

[6] Mary Jo White, "Keynote Address, International Corporate Governance Network Annual Conference: Focusing the Lens of Disclosure to Set the Path Forward on Board Diversity, Non-GAAP, and Sustainability," June 27, 2016.

[7] Ponemon Institute Cost of a Data Breach Study, June 15, 2016.

Enhancing Board Oversight of Cyber Risk

TOD NORTHMAN
With co-author Joseph A. Dickinson

Cybersecurity danger looms regardless of business or industry. Threats come from all directions – foreign hackers, domestic criminals and insiders – and damages caused by cyber breaches are skyrocketing. Consequently, it's become imperative that the board of directors play a role in identifying and managing the risk.

Following a presidential campaign dominated by talk of hacked email and unsecured servers, businesses are emphatically reminded of the potential cybersecurity danger no matter the business or industry. Threats come from all directions. Criminals and foreign hackers have grabbed headlines with personal financial data thefts from Target and Home Depot. Yet a 2016 IBM-sponsored study concluded that 60 percent of all attacks come from internal sources, with the majority carried out with malicious intent and a quarter of the breaches resulting from error. Compounding the problem, the damages caused by cyber breaches are skyrocketing: the average cost of a data breach is more than $4 million and growing annually, according to the IBM study.

As the risk grows, the board of directors role in identifying and managing the risk becomes more imperative. The obligation to protect the business is the same as with other business risks, but in this case is overlaid with the obligation to ensure the business's legal compliance. The intersection highlights the opportunity – cybersecurity risk cuts across a business and requires oversight from a similarly multifaceted perspective. The National Association of Corporate Directors' Cyber Risk Oversight Handbook, published in 2014, identifies "enterprise-wide risk management" as an indispensable component of cybersecurity. Boards must echo this viewpoint with a specific focus on the cyber risk management program.

GET YOUR PRIORITIES STRAIGHT

Establishing ownership for cybersecurity risk is the first step. Ultimately, the board is responsible for ensuring that the organization's cybersecurity program is adequately resourced. A board can delegate governance to a risk committee, but maintaining a businesswide view of the threat is critical. The awareness of the danger must be tempered by a realistic strategy that prioritizes protection of the business's assets. FBI Director James Comey asserted: "There are two kinds of big companies in the United States. There are those who've been hacked by the Chinese and those who don't know they've been hacked by the Chinese." The threats are too pervasive to be eliminated; instead, businesses must determine which assets to prioritize for protection. This undertaking must start at the board level.

In that light, a risk-based strategy focused only on prevention may divert critical resources from the needed holistic approach to protecting the business's most important assets. A thorough program should address cyber risks at all levels, including infiltration, propagation and exfiltration. The board should require that management ensure regular evaluation and prioritization of assets and the cyber risks to those assets. The board should lead the process of determining the appropriate strategy for identifying and prioritizing the risks, as well as defining the organization's plan for which risks to accept and which risks to mitigate.

POLICIES AND PROCEDURES

Because internal threats, including human error, constitute such a significant portion of cyber beaches, establishing well-designed policies and procedures for handling electronic information is a critical component of any cybersecurity program. Training employees in how to handle information yields significant benefits. Training helps establish the organization's culture and demonstrates the importance of good cyber practices to the organization. Directors and C-Suite leadership should also receive training and regular updates on the organization's cyber program.

Given the frequency of breaches caused by internal sources, the organization can improve the effectiveness of the cybersecurity program by monitoring and enforcing compliance with policies and procedures. Doing so also helps reinforce the culture of safety. Equally important is making sure that appropriate sanctions are included in the policies to effectively deal with those employees involved with causing breaches.

DETECTION AND DEFENSE

The bad guys are continually adapting their methods. Consequently, the board should require that the organization periodically evaluate the latest technologies and techniques for responding to cyber attacks and update the board on the results of those efforts. Strategies must be business specific and based on the industry, size of business and type of information processed and stored, among numerous other factors. The board should also be involved with the evaluation of the business's detection systems to ensure that resources are devoted appropriately to respond to the high-priority threats.

> "A risk-based strategy focused only on prevention may divert critical resources from the needed holistic approach to protecting the business's most important assets."

DEVELOP AN INCIDENT RESPONSE PLAN

As a key component of any cybersecurity program, businesses must establish an incident response plan. Being prepared to respond to a cyber breach significantly helps reduce the potential damage by improving the speed and quality of response. Some of the most damaging breaches, such as at Sony, have escalated when the target appears not to understand the threat. This lack of understanding can often be traced to inadequate incident response planning. Having a plan in place enables the business to respond more quickly, mitigating the impact on the data, and also helps the business to identify and initiate the necessary response to regain control. FTC guidance released in the fall of 2016 emphasized that establishing an incident response plan is a critical aspect of any cybersecurity program.

The plan should be detailed, including identifying parties inside and outside the organization who can be called upon to help. The board should facilitate prompt access to adequate cybersecurity expertise in advance. The plan should also document the thresholds that would require reporting a breach to law enforcement or other regulatory bodies. Both the FBI and the Department of Justice have cybercrime units that can be valuable allies in combating or preventing a cyber breach.

Once established, the board should regularly review the plan. The company should consider using tabletop exercises and simulated breaches to test and improve its plan.

The plan ought to require a formal assessment of the damage from any cyber event and that assessment should be shared promptly with the board. The board should use the assessment to evaluate and improve the incident response plan.

Compliance Expertise in the Boardroom

MICHAEL VOLKOV

Companies who have a director on the board with a background in compliance are instantly more likely to have a strong compliance program.

In this era of corporate accountability, regulators and prosecutors are looking for opportunities to hold board members, individually and collectively, accountable for corporate misconduct. The list of improper oversight, bordering on recklessness to deliberate intent, is well known in the Department of Justice. You can rest assured when presented with the right set of facts and evidence, the Justice Department will pull the trigger and charge a corporate board member with a criminal offense.

In response, many have advocated for improvement of corporate governance, increased training of corporate board members and specific guidance on the board's obligations to oversee and monitor a company's compliance program. No longer can companies rely on the old model of inserting outside counsel to make sure that the board embraces a defensive strategy aimed at avoiding litigation and risks. Instead, a new model is being crafted with the push from compliance advocates, prosecutors, shareholders and other key stakeholders that advances corporate accountability and responsibility for a company's ethics and compliance program.

One important aspect of this new approach to corporate governance is to insist on appointing a board member with compliance expertise.

I have witnessed firsthand that companies that have a board member with compliance expertise usually have a more aggressive and effective compliance program. In this situation, a Chief Compliance Officer has to answer to the board for the company's compliance program, while receiving the resources and support to accomplish compliance tasks.

Companies spend time and resources to nominate board members who bring a real value to the boardroom. The mix of board members reflects the company's overall strategic priorities and focus for governance. For example, the nominating committee will locate a board candidate with financial reporting, audit and SOX expertise to manage the audit committee. Each board member should be considered for a strategic purpose and benefit.

A board member with a compliance background advances a company's compliance program by multiple factors. It is an investment with significant benefits to the compliance program and the company overall. The board member can educate other board members on compliance issues, facilitate CCO presentations and communications to the board and improve the company's tone at the top, as well as its ethical culture and other elements of a compliance program.

A requirement to include a board member with compliance expertise is fast becoming a governance best practice. While it is easy to brush aside compliance in favor of other significant topics and risks – cybersecurity, financial reporting, SOX – relegating compliance to a lower priority is a real and significant missed opportunity.

Chief compliance officers have to maintain a robust reporting relationship with the audit or compliance committee. A CCO cannot be afforded 10 or 15 minutes at the end of a quarterly meeting. Rather, a CCO has to be treated in a manner commensurate with the importance of compliance to the company's operations. If there is no tone at the top, the CCO will probably be given a short slot at the end of the meeting.

A board member responsible for compliance with prior experience in compliance will ensure that the board devotes adequate time and attention to the company's compliance program. No longer will the CCO have to devote energy and time to "educate" the board on the importance of compliance issues. The CCO will have a built-in support system and advocate for compliance issue on the board itself.

Five Ways Board Portals Help With Corporate Governance

WAN-LIK LEE

Board portals are increasingly used as a part of forward-thinking business practices. How can they help you with corporate governance? And what does being able to access instant board packs, efficiency gains and clearer levels of accountability and reporting mean for your business?

Strong corporate governance is the foundation on which all large companies can establish clear accountabilities, drive smart objectives and implement effective processes throughout their organization. Without strong corporate governance at all levels, companies can quickly find themselves in a state of flux, unable to do what they need to do in order to achieve the objectives they have set for themselves. Indeed, a lack of corporate governance can even make the objective-setting process inefficient.

As technology becomes a larger part of overall business processes, many companies are exploring how they can use available tools to enhance their corporate governance. Board portals are one such tool that can help by making boards more effective and board members more accountable, while assisting businesses in everything from setting objectives to measuring results.

Here's a look at five ways board portals can do this:

1 INSTANT BOARD PACKS

Old-school businesses tend to be heavily reliant on couriers to deliver physical board packs to board members on time and in one piece. In today's business world where board members may not all be in the same building, city or even country other than when they meet, this can prove hugely inefficient.

Using board portals means:

Board members can receive their board packs instantly, wherever they are.
Businesses reduce courier costs as well as the risk of confidential data either going missing or being stolen.
Businesses reduce costs related to getting board members to

physical meetings if they wish to conduct them online.
Board members become more productive if they're able to attend board meetings remotely.
Board meetings and business operations in general become more flexible.

2 EFFICIENCY GAINS

Tremendous efficiency gains can be made using board portals. On top of all the advantages already explored, efficiency gains happen by allowing easy collaboration across documents, as well as ensuring your team members access only the documents and areas of your board portal that they need to, which is also a potential security gain depending on the structure of your company. Does your financial controller really need to see and know everything about what is happening in your human resources department? Does that same human resources department need to know what your IT team is working on?

Personal assistants also benefit from efficiency gains. Agendas can be collaborated and sent out digitally. Board members can be notified of and invited to meetings, with their responses logged digitally as well. Board meeting minutes can be taken, saved and archived online. Wave goodbye to unsecured, space-consuming filing of paper notes when you store them all in your board portal.

Moving to paperless board meetings brings huge efficiency gains, and we haven't even touched on the positive environmental impact.

3 ACCOUNTABILITY

Ease of collaboration is a huge benefit, and standing alongside this is the added layer of accountability both your board members and your internal teams will inherit when using board portal software.

For your board members, all the documents they access and update in the board portal are time stamped and logged, so that there's a clear record of who made the necessary edits and when they were made. This audit trail gives you details on what is happening in your organization, and whether or not objectives have been met.

You can feed down this practice through your business into your teams if you need to share different documents stored in your board portal with a variety of internal stakeholders. The audit trail ensures everyone gets to view and revise only what they are authorized to access.

4 RISK MANAGEMENT

When you go digital, you can wipe any data from remote devices should they be lost. This negates risks attached to a laptop or another device being lost or stolen. Data can be wiped remotely and automatically if password guessing or a number of unsuccessful logins are detected.

From another perspective, most board portal packages also have a wider-reaching risk management software built into them. This helps board members to manage the risks they face on a day-to-day basis and can be useful for risk managers and directors to both demonstrate risk and ensure buy in from internal teams in all departments and at all levels.

5 ADHERENCE TO REGULATIONS

While a board portal itself will not make your business come into line with whatever industry regulations you need to meet, it can help you put a variety of practices into place which then in turn could help you meet the standards you need to. Certainly, in terms of securing confidential information and data, using board portals could give you a strong advantage in terms of better efficiency gains, stronger accountability, and a clearer understanding of risk.

Try a board portal today. It may be something of a culture shock at first, requiring strong change management processes across your boardroom, but it is likely to deliver big benefits in the long term.

Post Yahoo Breach, is Your Board Now Your Weakest Link?

BRIAN STAFFORD

Roughly 30 percent of board members and directors use free email service providers (ESPs), such as Yahoo, to conduct business. In the wake of the recent Yahoo data breach, your company could be vulnerable to hacking and other online threats. In this article, learn how to limit potential exposure and re-gain critical control over the highly sensitive data handled at the board-level.

While data breaches continue to occur in record numbers, only a handful have caused fundamental shifts in the ways businesses operate; Target and Sony are among them.

The collective business world got its latest wake-up call, this time following the Yahoo breach of more than 500 million user accounts. On the surface, the breach seemed similar to countless others that had preceded it — names, email addresses, passwords and other basic PII were stolen in an alleged state-sponsored cyber attack. Yet if you take a closer look, the Yahoo breach has the potential to create a massive ripple effect, targeting the upper echelon of the business community in its wake — board members and directors in particular. To make matters worse, risk management and compliance officers might not even be aware that the vulnerability exists. Why is this so?

According to Diligent's research, roughly 30 percent of U.S. board members are using free email service providers (ESPs) like Yahoo to conduct business. Gmail is the most commonly used (44 percent), followed by AOL (17 percent), Yahoo (9 percent) and Comcast (7 percent). More alarming is that an additional 23 percent use email domains that are virtually unrecognizable by today's standards. This signals that many board members have not evolved with modern security best practices or have created their own workarounds out of personal convenience. Or worse, they have not been held to the same standards as other employees.

With hackers and other bad actors one step ahead of even the most secure organizations, email will remain a nonsecure way for board members to communicate and share files. The recent Yahoo breach underscores this point in dramatic fashion. One stolen email address, password or even a contact list belonging to a board member is all a seasoned hacker needs to carry out exploits designed to access confidential data, expose corporate secrets or carry out more sophisticated attacks, such as phishing, for personal and political gain.

With approximately one-in-three board members using free ESPs for work, it's likely that someone on your board (or someone in their network) is putting your organization at risk. In the wake of the Yahoo breach, here are three things all compliance professionals should do to limit their organization's exposure and regain critical control over the highly sensitive data handled at the board level.

AUDIT

Because web-based ESPs like Yahoo sit outside of IT's control, it's likely that executive communication sent through these channels is misaligned with the organization's own established security protocols and governance standards. The challenge for the risk and compliance function in this case not only involves knowing who on the board could be impacted, but more importantly, what information he/she has shared and with whom. In the weeks and months following the Yahoo breach, it's critical to make your board members aware of the risks they may personally face, audit their use of personal email addresses for work purposes and, if needed, involve other key stakeholders to determine if more drastic data recovery, back-up or compliance-related activities need to occur.

(RE)TRAIN

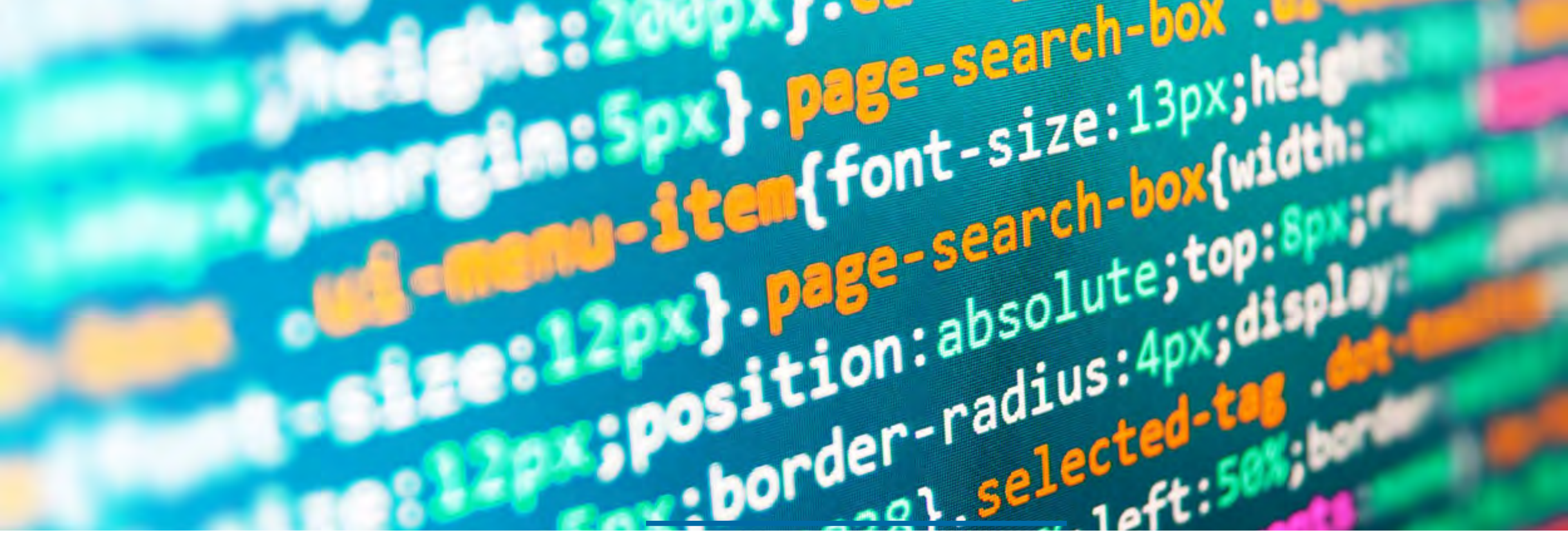
While board members play critical roles in developing and/or approving a corporation's security policies/procedures, they may not be following the letter of the law themselves. In fact, it's not uncommon to find out that board members have never received detailed training or proper instruction on security protocols and/or prohibited behaviors. As data breaches become a certainty for all businesses, no compliance or risk management professional can afford to leave security to chance. Instead, board members need to be trained or retrained at least once per year, as well as given on-demand access to security protocols and procedures. In some cases, more in-depth workshops or drills may be necessary to help educate less technologically savvy board members on the ever-evolving risks they are likely to face online.

> "With approximately one-in-three board members using free ESPs for work, it's likely that someone on your board (or someone in their network) is putting your organization at risk."

ENFORCE

The idea of governing the governance group may seem daunting, but it's essential to eliminate vulnerabilities, reduce risk and ensure companies are operating in compliance with various laws/regulations. Technology platforms designed exclusively for senior executive use, such as board portals, are an effective way to ensure that board members collaborate and share information securely no matter where in the world they are, while giving IT back the power it needs to apply controls, ensuring adherence to its corporate data protection practices. And if that doesn't work, remember: money talks. Just ask Verizon, which is reportedly seeking a $1 billion — yes, billion with a B — discount on Yahoo's $4.8 billion purchase price following its massive data breach. No board member wants to be at the source of this type of loss — whether financial, reputational or both.

In a world where hobbyist and activist hacking has quickly given way to deliberate exploits, cyber espionage, ransomware and other debilitating cyber attacks, one weak link can quickly erode even the most sophisticated security operations. Taking these three critical steps will help ensure that the highly sensitive and valuable information your most senior executives handle remains secure — no matter how big of a target is on the board's back.



SaaS on the Rise in the Boardroom

BRIAN STAFFORD

As enterprises face increased competition and regulatory challenges, industry titans have taken serious notice of pioneering governance and collaboration SaaS companies. And with recent key acquisitions, the space is heating up.

Collaboration among a company's board of directors is arguably one of the most critical functions within a public organization. So it may come as a surprise that the technology enabling more effective and secure board collaboration continues to fly under the radar – in fact, when I got my start in board governance, the space was filled with niche players. Today, as regulations become more stringent and industry leaders start to prepare for the needs of tomorrow's boards, they are building out more comprehensive product suites by acquiring smaller players. As consolidation continues, the space will continue to heat up and the technology will become a must-have for enterprises and board members around the world. It's about to get larger and louder.

For example, industry incumbents like Boardvantage and Thomson Reuters' Boardlink have been acquired by Nasdaq and our own company, Diligent, respectively. Underscoring industry momentum, these acquisitions have caught Insight Venture Partners' attention, with the recent announcement of acquisition and privatization of Diligent.

For a once behind-the-scenes industry, an increasingly mobile board, looming cybersecurity dangers and the immense pressure to follow regulations and remain compliant are bringing board governance tools to the forefront. Here's a look at how the industry has developed and how we predict it will grow.

THE RISE OF BOARD PORTALS AND SAAS TECHNOLOGY

Historically, and for those who haven't adopted a technology-based solution yet, board collaboration has been defined by heavy, paper-filled binders. With these materials, any last-minute edits would result in extra days of administrative overtime and delays for board members. As secure, mobile collaboration and productivity technology started to permeate the enterprise, the boardroom also began to demand the convenience of tools customized to meet their needs.

In the beginning, it was the widespread adoption of the iPad that catalyzed growth in board collaboration. Board members, eager to use their new gadgets, were already using their iPads for personal activities like reading and surfing the web, so the transition to reading and reviewing hefty board materials on the same platform was natural.

Having the materials on a digital platform also provided other benefits – added security, compliance and convenience. No longer would board books be forgotten at a hotel or on a plane or require a paper shredder to be securely disposed of. Digital user authentication, remote wipes and superior customer service all guaranteed a secure, high-quality experience. This peace of mind provides a sigh of relief for companies, especially as regulations tighten.

From a compliance benefits perspective, board members are now able to use their new tools to administer voting, access resource centers and securely archive books that limit compliance and legal risk. In addition, they were also able to run D&O surveys and conduct other board-related functions all from one central location.

INDUSTRY OUTLOOK AND INVESTMENT TREND

Since the initial boom of the iPad, adoption of board collaboration tools has grown exponentially, with over 90 percent of the Fortune 1000 using such a solution. Industry estimates suggest that over 300,000 board members and executives are consistently using a board portal. That said, most companies are still in the early to intermediate stages, wherein the technology is used on a meeting-to-meeting basis or during quarterly board meetings. Within the next decade, we will see the industry start to change in three main ways:

There will be more dynamic use of collaboration technology, including live analytics. As board members are asked to be more active and make quicker decisions, they will need more information cut and viewed in multiple ways in order to get a full picture. Real-time analytics on collaboration preferences and even the board materials themselves will enable companies to make the best decisions possible. The technology will also allow for more governance and compliance monitoring, spurred by the need for more transparency, stricter government regulations and the broader GRC rationale to maintain security. Service will become even more important than the product itself as the move toward advanced and dynamic use of board technology accelerates. Board SaaS in particular is geared toward a very unique set of executives who won't settle for a DIY or low-touch service model. This means that innovations in service and reliability – in addition to product – will determine who leads the industry. And as these tools become more integral to how a board functions, board members, compliance teams and corporate secretaries will need to partner with providers for expertise and guidance.

> "With more security breaches and regulatory concerns on the horizon, the need for these tools will undoubtedly continue to grow."

As board responsibilities evolve, the sector will continue to grow in revenue and breadth of offerings. A trend we are seeing is that "compliance" or "GRC" is the newest line of business (LOB) being revolutionized by SaaS offerings. In the same way that sales and marketing organizations were turned upside down by companies like Salesforce and Marketo, a new breed of GRC SaaS companies will be reinventing this space by streamlining the board function within enterprises. With more security breaches and regulatory concerns on the horizon, the need for these tools will undoubtedly continue to grow.

The way boards work and collaborate is evolving. Decision-making needs to be faster and more secure. Pair this with the fact that board members sit outside of company firewalls and it's a perfect storm. New solutions and processes will continue to be created to suit this exclusive segment that is now held accountable for much more than overseeing profit.

Advancing Board Refreshment Through the Director Succession Planning Process

WILLIAM LIBIT

With co-author Todd Freier

"Board refreshment" is currently a hot corporate governance topic. A board of directors' ability to "refresh" itself on a regular basis can help ensure that the board is comprised of the proper mix of directors to meet both current and long-term needs of the board, the company and shareholders, and provide the necessary oversight of the company's evolving corporate strategy and risks.

New and fresh perspectives on the board, it is often argued, contribute to the board successfully addressing those needs and oversight responsibilities. Director succession, director tenure, mandatory retirement, proxy access, board evaluations and board diversity, among other factors, are all integral and interrelated components that either contribute to or result from board refreshment.

The ability of a board of directors to "refresh" itself on a regular basis can help ensure it maintains the proper mix of experience and expertise to meet the organization's current and long-term needs.

This corporate governance update focuses on director succession planning and the critical role it plays in board refreshment. Specifically, this update (1) provides general information concerning director succession planning; (2) summarizes the current director succession-related policies and positions of several large asset managers, pension funds and certain corporate governance advocates to provide insight into the expectations of those parties with respect to director succession planning; and (3) presents practical considerations for boards to help facilitate successful director succession.

DIRECTOR SUCCESSION PLANNING AND CORPORATE GOVERNANCE

Director succession planning is an integral component of board refreshment and focuses on the strategy, policies and procedures that boards have adopted to replace board members. Board refreshment, which is at the forefront of many investors' minds, is a critical tool to enhance board diversity (including, but not limited to, gender, race, ethnicity and age, as well as diversity of experience, skills and perspectives) and to recruit board expertise aligned with the company's evolving corporate strategy. Board refreshment also addresses issues of lengthy director tenure, board entrenchment and the interrelationship of those factors with director independence (as it is argued that a lengthy tenure may compromise a director's independence from management).

Certain studies have revealed that shareholders view a director succession plan and a regular process of board refreshment as increasingly necessary to help ensure that the board has "the necessary skills and expertise"[1] and that there is a positive correlation between some board turnover and company performance.[2] Another study noted that the third most frequently raised issue by shareholders during the 2015 proxy season (following only proxy access and disclosure of political contributions/activities) was board composition and refreshment.[3]

Although there is no Securities and Exchange Commission (SEC)[4] or national exchange[5] rule or regulation explicitly mandating that board members participate in director succession planning, a director's general fiduciary duty of care arguably requires such planning.[6]

CURRENT POLICIES AND POSITIONS OF CERTAIN INSTITUTIONAL INVESTORS AND CORPORATE GOVERNANCE ADVOCATES AS THEY RELATE TO DIRECTOR SUCCESSION PLANNING

There is no one-size-fits-all approach to corporate governance and director succession planning. The unique characteristics of the company, including those relating to corporate strategy, evolving risks and stakeholder needs and the adoption of corporate governance policies the company and its board feel are essential to generate long-term shareholder value often dictate, in part, director succession strategy. As boards evaluate their director succession strategies, it may be helpful to understand the current director succession policies and positions of several large institutional investors and certain corporate governance advocates, as this understanding provides insight into the general expectations of these parties with respect to director succession planning. A select summary of those policies and positions is provided below.

Institutional Investors – Asset Managers:

BlackRock, Inc. (BlackRock)may withhold votes from the independent chair or lead independent director, members of the corporate governance committee and/or the longest tenured director(s) when there is a lack of board responsiveness to shareholders regarding board composition concerns, evidence of board entrenchment, insufficient attention to board diversity and/or failure over time to promote adequate board succession planning in line with the company's stated strategic direction encourages boards to routinely refresh their membership to ensure the relevance of the skills, experience and attributes of each director to the work of the board believes it is beneficial for new directors to be brought onto the board periodically to refresh the group's thinking and to ensure both continuity and adequate succession planning[7]

State Street Global Advisors (SSgA): states that board refreshment and director succession planning are key functions of the board and may vote against the chair of the corpo-

rate governance committee for failing to adequately address those functions[8] recently reported that during 2014 and 2015, it engaged with over 500 portfolio companies on board refreshment and orderly director succession topics[9]

Institutional Investors – Pension Funds:

California Public Employees' Retirement System ("CalPERS"): asserts that boards should proactively lead and be accountable for the development, implementation and continual review of a director succession plan believes that, at a minimum, the director succession planning process should (1) become a routine topic of discussion by the board, (2) encompass how to address in an efficient manner both expected future board retirements or the occurrence of unexpected director turnover as a result of death, disability or untimely departure, as well as director turnover either through transitioning off the board or as a result of rotating committee assignments and leadership, (3) provide for a mechanism to solicit shareholder input and (4) be disclosed to shareholders on an annual basis and in a manner that would not jeopardize the implementation of an effective and timely director succession plan[10]

New York City Employees' Retirement System, New York City Police Pension Fund, New York City Fire Department Pension Plan and Board of Education Retirement System of the City of New York (collectively, the "New York City Pension Plans"): may oppose incumbent nominees who serve on the corporate governance committee if the board has failed to ensure adequate director succession planning and board refreshment[11]

State of Wisconsin Investment Board ("SWIB"): generally supports the disclosure of board succession planning and policies, board self-evaluations, board retirement policies, a process for discharging directors and board refreshment[12]

Certain Corporate Governance Advocates:

National Association of Corporate Directors ("NACD") (advocating on behalf of directors): believes that governance structures and practices should encourage the board to refresh itself and that boards need to ensure they are positioned to change and evolve with the needs of their companies[13]

Council of Institutional Investors ("CII") (advocating on behalf of shareholders): maintains that boards should implement and disclose a board succession plan that involves preparing for future board retirements, committee assignment rotations, committee chair nominations and overall implementation of the company's long-term business plan notes that boards should respond positively to shareholder requests seeking to discuss incumbent and potential directors[14]

The Business Roundtable ("BRT") (advocating on behalf of management): encourages boards (through their corporate governance committee) to engage in director succession planning as part of their responsibility to oversee the composition of the board further advises that the corporate governance committee should

regularly conduct an assessment of the mix of backgrounds and skills represented on the board to evaluate whether the board, as a whole, contains the right balance of professional and personal experience and includes individuals who bring industry and other relevant knowledge, financial expertise, diversity and other desired characteristics to the board[15]

CONSIDERATIONS FOR BOARDS OF DIRECTORS

To facilitate director succession planning and help determine what related policies and practices will contribute to more effective corporate governance and are in the best interests of the company and shareholders, directors may consider the following:

Examine Corporate Governance Documents

An initial step in the director succession planning process should involve the board examining the company's current governance documents (e.g., corporate governance guidelines, charter of the corporate governance committee and director nomination policy) to ensure that necessary provisions and policies in connection with such succession are included therein. Such documents should explicitly enumerate and delegate the duties and responsibilities that will permit the board to establish a director succession strategy and the assessment framework to facilitate that strategy.

Use an Assessment Frame work

Director succession is generally most effective when reviewed and planned for in an assessment framework on a regular basis. Such framework may involve board, board committee and director self-assessments, including (1) assessing the current strengths and weaknesses of the board and each board committee, (2) identifying the short- and long-term skills needs of the board (in light of the company's corporate strategy, evolving risks and shareholder and other stakeholder concerns), (3) evaluating how the board's assessment changes when retiring directors are factored in the analysis and (4) shifting the board's approach of automatically re-nominating existing directors to one that bases a director's re-nomination on a number of criteria, such as the board's evolving needs and director performance. Once the board reaches a consensus as to its current and anticipated needs, it should develop a candidate profile and initiate the process of identifying qualified potential director candidates. As part of the assessment framework for identifying qualified director candidates, the board, typically acting through its corporate governance committee, implements guidelines within which director candidates are assessed and director succession is effectuated. A director nomination policy, for example, generally provides minimum qualifications required of existing directors (to continue serving on the board) and potential new directors (to be initially nominated to the board). Specific desired qualifications, qualities and skills often sought in director candidates include:

- the highest professional and personal ethics and integrity
- industry-specific, broad experience or particular expertise in business, accounting, finance, regulatory/government, education, information technology, cybersecurity, risk management or other specialized area
- experience as a chief executive officer or other C-suite officer
- a solid record of accomplishment in their chosen fields
- the ability to develop a good working relationship with other board members
- sufficient time to effectively carry out board duties
- the ability to contribute to the board's working relationship with senior management
- the ability to provide insights, practical wisdom and diverse perspectives based on background, experience and expertise
- satisfaction of legal and regulatory requirements
- independence

A corporate governance committee should assess potential candidates in the context of the then-current composition of the board, the operating requirements of the company and the long-term interests of shareholders. In conducting this assessment, the committee should also consider diversity (including, but not limited to, gender, race, ethnicity, age, experience and skills) and such other factors as it deems appropriate given the then-current and anticipated future needs of the board, the company and stakeholders and, in order to maintain a balance of qualifications, qualities, skills and perspectives on the board. Although a board will often delegate many director succession-related responsibilities to its corporate governance committee, ultimate responsibility remains with the full board. In addition, a board should proactively engage and seek the input of significant shareholders as part of its succession assessment and related processes.

Conduct Due Diligence

Whether a director candidate is recommended through internal recommendations (by way of board members or management), formal third-party recruiters, other sources (e.g., the NACD) or a combination, the board should conduct due diligence on the candidate for purposes of evaluating, among other characteristics, his or her credentials (and confirming that stated credentials are true and accurate), independence and potential related party transactions and conflicts of interest. At a minimum, the following items should be researched and analyzed as part of the due diligence review: professional employment, directorships (at both public and private entities), other business, civic and charitable involvement, awards, education, professional certifications and personal attributes (utilizing public and private databases). Some boards engage third parties to conduct due diligence and vet potential candidates, including candidates recommended by director search firms.

Maintain a Pipeline

After conducting the director qualifications assessment and due diligence (as described above), the board should maintain a pipeline of qualified director candidates. Significant changes in director employment, health concerns or other unexpected personal or professional events may necessitate quick director succession. Having potential qualified candidates already identified will greatly assist with the effectiveness and efficiency of the succession process.

Assess Board Policies

As part of its director succession planning, a board should incorporate periodic (at least annual) assessments of its board leadership, committee membership, rotation and mandatory retirement policies. A board's corporate governance committee is typically delegated the task of recommending to the board the chairmanship and membership of each board committee after considering certain factors (including, but not limited to, board members' experience, knowledge, skills, tenure on committees, time commitments on and off the board and board and committee member self-assessments). Identifying current and future leadership and committee needs, as well as director candidates with specific expertise to fill those needs (e.g., in the fields of accounting, finance, risk or cybersecurity) will enhance effective director succession.

Disclose Strategy

As previously discussed, certain institutional investors and corporate governance advocates encourage companies to disclose their director succession strategies. Further, one recent analysis of 2015 proxy statements revealed that S&P 500 companies are becoming increasingly transparent about board composition and director succession by voluntarily disclosing director skill matrices (which should be updated annually) and board succession strategies.[16] That study also revealed a number of emerging best practices with respect to board composition and shareholder engagement, including that boards should view director recruitment in terms of ongoing board succession planning, not one-off replacements and should proactively communicate to shareholders the current skill sets and expertise in the boardroom and the strategic plan for future board succession.[17] Although not currently mandated by rule or regulation, boards should consider disclosing their director succession strategy to provide greater transparency to shareholders and other stakeholders.

Benchmark Strategy

Boards should regularly benchmark their director succession and board refreshment strategy with those of their peers and the industry in which they operate, as an outlier may become the target of activist shareholder campaigns or be identified by institutional investors as an entity with potentially problematic succession and governance practices. Such benchmarking may include the extent to which companies are disclosing formal director succession policies and strategies, director skills matrices and average board tenure. Similarly, boards should stay abreast of the evolving policies and positions of large institutional shareholders and corporate governance advocates with respect to director succession, specifically, and board refreshment, more broadly.

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See, however, SEC Final Rule: Proxy Disclosure Enhancements, Release Nos. 33-9089; 34-61175; File No. S7-13-09 (December 16, 2009) (requiring, among other disclosures, information relating to the board leadership structure, the background and qualifications of directors and director nominees, and the consideration of diversity in the process by which director candidates are considered for nomination).
See, for example, New York Stock Exchange Listed Company Manual Section 303A.09, Corporate Governance Guidelines (noting that although companies must address director qualification standards in their corporate governance guidelines, companies may also address other substantive qualification requirements in those guidelines, including director succession).
For example, neither Delaware case law nor Delaware's General Corporation Law explicitly requires board members to engage in director succession planning. Directors are, however, required to manage the business and affairs of the company (Delaware General Corporation Law, Section 141). Addressing known major risks, such as those related to director succession, is one of a board's duties.
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Board Evaluations: Getting it Right

TRACY HOUSTON

Warren Buffet says, "The best way to affect the behavior of board members is to embarrass them." While this statement may have some truth, there are better ways to advance change for competitive advantage in the boardroom. To have the board aid in creating competitive advantage is an important mindset. Even the best-managed companies aren't exempt from the inevitable clash between whirlwind change and corporate inertia.

In a noted move toward corporate transparency, a 2011 study group of public company directors and a few academics identified seven gaps on their own boardroom turf: purpose, culture, leadership, information, advice, debate and self-renewal. The report goes on to state boards should "develop policies and practices to ensure ongoing evaluation and education of current directors, using the services of independent third-party facilitators when needed."

Fundamentally, a board evaluation is an opportunity for boards as a collective body to increase their effectiveness based on feedback the evaluation provides. Continuous improvement and development of board and board committee processes and procedures is key to ensuring board effectiveness. In today's world, it is vital that a board of directors can measure its strengths and its opportunities for improvement. Board evaluation sets the foundation to purposefully identify and surmount barriers that impede effectiveness. The goal is to receive solid, actionable input.

In addition, it is a NYSE listing requirement that boards, along with their nominating/governance, compensation and audit committees, perform annual evaluations. NASDAQ highly recommends board evaluation. Annual board evaluations have become the norm for boards in many countries, with nearly all listed companies in Canada, France, the U.K. and the U.S. conducting some sort of evaluation each year. The practice is also widespread in Italy and Spain, and it is gaining attention in many Asia-Pacific markets.

Even if a company is not subject to any listing requirements, shareholders and stakeholders are asking questions and evaluating the company as though it is subject to the same requirements. Shareholders, employees and the community are expecting and even presuming the board is using an objective approach to hold themselves and the company to the "best business practices."

Key Point: *The progressive board looks for the time and resources spent on board evaluation to align with their philosophy of continuous improvement and reflective intelligence.*

At the very least, a board evaluation will focus on key functions of the board, provide a "gap" analysis that draws weak areas to the surface, provide disbursement of responses, and identify the "tone" of the responses. Board evaluation is most meaningful as a productive activity for the board when it focuses on board development rather than compliance. This requires knowledge not only of board functions, roles and responsibilities, but also of how all this information links to the current business/industry trends and market changes. In addition, a dynamic board evaluation moves the board to a higher level of performance on business issues while enhancing group dynamics. Overall, a board evaluation can transform a group of strong individuals to a collective body of focused board members who become invaluable to the CEO, senior management team and all stakeholders. A skillful board evaluation can

> "A board evaluation can transform a group of strong individuals to a collective body of focused board members who become invaluable to the CEO, senior management team and all stakeholders..."

cause directors to say "I'm glad we did that." This kind of skillful evaluation is produced from:

- Clear board objectives;
- Reports and feedback from a knowledgeable third-party facilitator where needed;
- Facilitated follow-up discussions with the board to identify board development actions;
- Integration of the board evaluation into strategic leadership and planning; and
- Insights that lead to greater team effectiveness.

DECIDING WHETHER TO USE A THIRD-PARTY FACILITATOR

As the board embarks on the evaluation process, it is important to decide whether to use a third-party facilitator. Employing a third-party consultant usually allows for greater objectivity and credibility, not least as a means of satisfying shareholders that an independent review has been carried out. The board can choose the level and the areas of engagement for any board consultant. At times, the third-party facilitator may only help with question development or simply analyze the data, or the facilitator may be assigned to run all aspects of the board evaluation. The board may want to start with a small project, such as evaluating one of the committees, to become more familiar with the consultant and process. After a trust level is established, the board can increase the engagement level.

A board may not need a consultant for every annual evaluation or while the board's agreed-upon action items from previous board evaluations are still in process. The board would probably not use a facilitator when the board chair has only been in the position for a short period of time or when the board has just recruited, or is in the process of recruiting, a number of new directors.

To choose the right methodology and provide a balanced approach, the board should understand the risks and rewards of a board evaluation.

RISKS OF ENGAGING IN A BOARD EVALUATION

Some examples of risks I have seen from board evaluations, and ways to alleviate those risks, include:

Risk: Consultant misuse of data.
Remedy: Ask how and where data is stored and for how long. If answers are unacceptable, consider using the third-party facilitator just to analyze data and provide feedback.

Risk: Loss of collegiality and negativity as a result of candidate feedback.
Remedy: Review the past methods of board evaluation and assess the level of feedback given to the board. Consider a hybrid methodology that includes a questionnaire accompanied by a self-evaluation for each director.

Risk: Directors' perception of performance is not in line with evidence that suggests otherwise.
Remedy: Consider hiring a third-party facilitator to provide feedback and possible coaching sessions with the board.

REWARDS OF ENGAGING IN A BOARD EVALUATION

Examples of rewards I have seen from board evaluations include:

- Provides a timely platform for directors to voluntarily resign, and sharpens the discussion of the experience, expertise, diversity, independence, leadership ability and character needed by the new directors;
- Identification of new or refined actions for risk reporting to the board, including crisis and reputational management;
- Clarity and enhancement of management reporting practices that affect the board; and
- Enhanced board effectiveness with identification of board dynamics and facilitation of discussion to "clear the air."

In today's world, corporations are establishing processes that have an emphasis on collective wisdom for competitive advantage. This concept can be actualized at the board level through the board evaluation process, even though evaluation techniques are still in their infancy. The process can result in high-level thinking in a structured, organized manner, and lay the foundation for continuous improvement.

AUTHORS

Emily Leitch, a partner in Bracewell's Corporate and Securities Practice, advises business clients on mergers and acquisitions, capital markets transactions and corporate restructurings. She provides counsel relating to corporate governance, SEC reporting, stock exchange compliance and the fiduciary duties of boards of directors. She is co-head of the Bracewell Women's Network. She can be reached at emily.leitch@bracewelllaw.com.

Tod A. Northman is Counsel in the Corporate and Privacy & Data Security groups at Tucker Ellis LLP. He counsels clients of all sizes in a variety of industries, with a particular focus in the areas of aviation, benefit entities and real estate.

Tracy E. Houston, M.A. is the President of Board Resources Services, LLC. She is a refined specialist in board consulting and executive coaching with a heartfelt passion for rethinking performance, teams and the boardroom. She provides a highly successful executive coaching engagement to help candidates gain a public company board seat.

Michael Volkov is the CEO of The Volkov Law Group LLC, where he provides compliance, internal investigation and white collar defense services. He can be reached at mvolkov@volkovlaw.com. His practice focuses on white collar defense, corporate compliance, internal investigations, and regulatory enforcement matters. He is a former federal prosecutor with almost 30 years of experience in a variety of government positions and private practice.

Wan-Lik Lee is the Chairman of the Board, Founder, and Managing Director of Azeus Convene Board Portal. Wan Lik helps and offers consultancy services to boards and senior leadership of enterprises all over the world to improve the meeting productivity and governance. He was a Manager in Oracle Systems Limited and a Project Team Leader in Versant Corporation (formerly Versant Object Technology Corp.) prior to founding Azeus Convene Board Portal.

Brian Stafford is Chief Executive Officer of Diligent Corporation. Brian is responsible for all day-to-day operations, with a focus on accelerating global growth and incorporating scale into the business in order to seamlessly manage the growth. He previously served as a Partner at McKinsey & Company, where he founded and led their Software as a Service Practice. Prior to his tenure at McKinsey, he was the Founder, President and CEO of CarOrder, a division of Trilogy Software based in Austin, Texas.

Bill Libit is the Chief Operating Partner of Chapman and Cutler LLP and concentrates his practice in the corporate and securities area. His corporate and securities practice includes representation of issuers and investment banks in connection with public offerings and private placements of debt and equity securities. His corporate governance practice includes advising public company boards, including audit, compensation and governance committees, as well as investigative committees.

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Corporate Compliance Insights combines featured articles written by some of the most experienced compliance and ethics professionals in the world with regular updates of important news events in the world of governance, risk, and compliance. Additionally CCI offers an events calendar, training & resource library and compliance jobs board.

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