PwC's 2014 Annual Corporate Directors Survey

Trends shaping governance and the board of the future

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Please note: Charts may not all add to 100 percent due to rounding

Executive Summary

Over the last several years, we've observed certain trends that are shaping corporate governance and which we believe will impact the board of the future. We structured our 2014 Annual Corporate Directors Survey to get directors' views on these trends and other topics including:

Board performance takes center stage
Many boards are giving even more attention to enhancing their own performance and acting on issues identified in their self-assessments.

Board composition is scrutinized
Board composition is under pressure to evolve to meet new business challenges and stakeholder expectations. Today's directors are more focused than ever on ensuring their boards have the right expertise and experience to be effective.

Board diversity gets attention
Stakeholders are more interested in board diversity, and boards are increasingly focused on recruiting directors with diversity of background and experience.

More pressure on board priorities and practices
Director performance continues to face scrutiny from investors, regulators, and other stakeholders, causing board practices to remain in the spotlight.

Activist shareholders get active
With over $100 billion in assets under activist management[1], more directors are discussing how to deal with potential activist campaigns.

The influence of emerging IT grows
Companies and directors increasingly see IT as inextricably wed to corporate strategy and the company's business. IT is now a business issue, not just a technology issue.

Increased concerns about the Achilles' heel of IT—cybersecurity
Cybersecurity breaches are regularly and prominently in the news. And directors are searching for answers on how to provide effective oversight in this area.

It's still all about risk management
Risk management is a top priority for investors, and they have high expectations of boards in this regard.

Investors question company strategies
Effective oversight requires that the board receive the right information from management to effectively address key elements of strategy.

Executive compensation remains a hot topic
Boards are devoting even more time and attention to the critical issue of appropriate compensation.

Stakeholders are showing continuing interest in how proxy advisory firms operate.
The interest of stakeholders in the proxy advisory industry is a key trend.

Increasing expectations about director communications
In response, boards must determine their role in stakeholder communications—and evaluate their processes and procedures governing such communications.

In the summer of 2014, 863 public company directors responded to our survey. Of those directors, 70% serve on the boards of companies with more than $1 billion in annual revenue. Participants were 86% male and 14% female—closely aligning with gender distribution averages of public company directors. The board tenure of participants was distributed relatively evenly. Participants represented nearly two-dozen industries.

[1]Hedge Fund Research

Here are some of the highlights of our research:

- Consistent with the last several years, financial, industry, and operational expertise are seen as the most important director attributes. This year, financial expertise tops the list (described as very important by 93% of directors). Industry, operational, and risk management expertise follow in importance.

- Directors are more sensitive about low support for board nominees. Fifty-six percent of directors now say that negative voting in the 11-25% range would cause them to be concerned about re-nomination, compared to less than half last year. The percentage of directors who say that only negative shareholder voting in excess of 40% would cause them to rethink re-nomination decreased five percentage points.

- Thirty-six percent of directors say someone on their board should be replaced—a jump from 31% only two years ago. Less tenured directors are the most likely to believe someone on their board should be replaced—nine percentage points more so than those serving ten or more years. Diminished performance due to aging, lack of expertise, and not being prepared for meetings are the top reasons for dissatisfaction with peers.

- The percentage of directors who see impediments to replacing an underperforming director grew to 53% from 48% last year. A higher proportion of directors said the biggest reason was that board leadership was uncomfortable addressing the issue. Directors also cited a lack of director assessments and ineffective board assessment processes as impediments to addressing director underperformance.

- Male and female directors have differing views about the importance of gender and racial diversity on their boards. Female directors are far more likely to consider board diversity important, with over 60% of them describing gender diversity as very important, compared to only one-third of males. Similarly, over 40% of female directors describe racial diversity as very important versus only one-quarter of their male counterparts.

- The evolution of gender diversity on boards continues. Almost one-third of male participants in PwC's survey have been on their board for more than ten years, compared to only 10% of females. In the Fortune 50, female directors tend to be younger, with an average age of 60—compared to 63 for males. Further, 24% of all new S&P 500 directors named in the last two years have been women, while female composition of boards is currently 18%. Given the facts that current female board members are younger and less tenured than their male counterparts and that a higher percentage of new directors are women, it is reasonable to project that the board of the future will include a higher proportion of women than is seen today.

- Directors want to spend more time on strategy: 62% want at least some additional boardroom time and focus, and almost one in five want much more time and focus. They also want to give more attention to the IT issues that are closely linked to strategy; 65% of directors want at least some increased focus on cybersecurity and 47% want more attention on IT strategy.

- Topping the list of director concerns regarding proposed and recent regulatory and shareholder initiatives are the CEO/median employee pay ratio disclosure and shareholder proposals for proxy access: (65% and 46% of directors are at least somewhat concerned with these topics, respectively). Mega-cap company directors are three and a half times more likely than small-cap company directors to express substantial concern with shareholder proposals for proxy access.

- Directors strongly prefer internal CEO candidates, but only 27% have much confidence in their company's CEO talent pipeline: And nearly one in five believe their company's CEO talent pipeline is not adequate.

- The vast majority of directors favorably view board and committee self-evaluations: 91% believe their self-evaluation processes are at least somewhat effective. However, a majority of directors have a difficult time speaking their minds—70% say it is at least somewhat difficult to be frank in their self-evaluations and nearly one-in-five think it's very difficult. Further, almost two-thirds of directors believe self-evaluations are at least somewhat a "check the box" exercise.

- More than seven-in-ten directors describe their board leadership as very effective in gaining and maintaining the respect of other directors and obtaining board consensus. However, less than one-third say their leadership is very effective in anticipating emerging trends.

- Nearly one-in-three directors say their board has interacted with an activist shareholder (and held extensive board discussions about activism) during the last twelve months: An additional 14% of boards have not had activist interactions but have extensively discussed this topic. Mega-cap company boards are twice as likely to have interacted with activists as small-cap company boards.

- Forty-one percent of directors say they are now at least moderately engaged in overseeing the company's monitoring of social media for adverse publicity—compared to 31% in 2012. There was also an 11 percentage point increase in directors who are at least somewhat engaged in overseeing employee social media training and policies. Similarly, almost half of directors are now at least somewhat engaged in overseeing employee use of mobile technologies—double that of two years ago.

- Forty-two percent of directors are at least somewhat concerned about the impact of the new Department of Homeland Security/NIST cybersecurity framework, but many directors may not yet be aware of the protocols or their potential impact.

- Directors acknowledge that big data and cloud technologies are two areas that could use more of their attention; with over a quarter saying they are not sufficiently engaged. Only 53% of directors say their company's IT strategy and IT risk mitigation approach "at least moderately" take sufficient advantage of big data.

- Nearly half of directors have not discussed their company's crisis response plan in the event of a security breach, and more than two-thirds have not discussed their company's cybersecurity insurance coverage.

- There was a noteworthy year-over-year improvement in directors' views about their company's IT strategy and IT risk mitigation approach. Forty-five percent now believe their company's approach very much contributes to, and is aligned with, setting overall company strategy, while 26% of directors very much believe it provides the board with adequate information for effective oversight (compared to 37% and 22%, respectively, in 2013). About two-thirds of directors believe their company's approach is supported by a sufficient understanding of IT at the board level (compared to 64% in 2013).

- Female directors are more skeptical about whether their company's IT strategy and IT risk mitigation approach is supported by a sufficient understanding of IT at the board level (only 13% say "very much" compared to 22% of male directors). Female directors are also more skeptical about whether their company's approach provides the board with adequate information for effective oversight (15% say "very much" compared to 28% of male directors).

- The use of external IT advisors to assist boards is on the rise, with 38% of directors now saying their boards use external IT consultants—compared to 26% in 2012.

- Over 90% of directors are at least somewhat satisfied with the information they get to fulfill their strategic oversight responsibilities. However, in some areas there is room for improvement. More than one-quarter of directors are either dissatisfied with or do not receive information on competitor strategy and customer satisfaction research.

- Directors are less comfortable with their understanding of the company's risk appetite; 51% say they understand the company's risk appetite "very well"—over ten percentage points less than two years ago.

- Over 70% of directors say they made changes to their approach to fraud risk over the last 12 months. The most common actions were holding board discussions of "tone at the top," increasing the amount of time spent on board discussions of risks embedded in compensation plans and having board members interact with members of management below the executive level. Over the last three years, there has been a significant increase in the percentage of directors who say they have had interactions with members of management below the executive level: 50% said so this year—compared to 31% in 2012.

- Over the last three years, directors have become more comfortable with the allocation of specific responsibility for overseeing major risks between the board and its committees. In 2014, 84% said there was a clear allocation of responsibility, up from 80% in 2013 and 63% in 2012.

- While a number of organizations have identified issues like sustainability and climate change as societal imperatives, about three-quarters of directors say they have not had substantial discussions about human rights, climate change, carbon emissions, and resource scarcity.

- Compensation consultants continue to have the strongest influence on director decisions about executive compensation. Forty-eight percent of directors describe them as very influential—up 12 percentage points from 2013. Proxy advisory firms also saw their influence increase, albeit modestly, as 51% of directors describe them as at least moderately influential—compared to 49% last year. CEO pressure has declined as an influence; only 39% of directors describe it as moderately or very influential—compared to 45% last year.

- Eighty-four percent of directors at least somewhat agree that "say-on-pay" voting caused their board to look at compensation disclosures in a different way, and 83% say it increased the influence of proxy advisory firms. Nearly three-quarters at least somewhat agree that "say-on-pay" increased shareholder dialogue—but 66% don't believe it effected a "right-sizing" of CEO compensation.

- More than eight-in-ten directors believe proxy advisory firms use a "one-size-fits-all" approach to governance and that their business model creates potential conflicts of interest. A similar percentage say proxy advisory firm policies don't align with company needs or investors' best interests.

- Director communications with stakeholders increased across all constituencies. Particularly noteworthy is that 30% of directors say they enhanced communications with the company's employees—the largest year-over-year increase of any individual group. Also, a greater percentage of directors are communicating with institutional investors—66% now say they do so compared to 62% last year.

- Despite increased director-stakeholder communications, directors still have many concerns. Ninety-four percent are at least "somewhat concerned" about the potential for mixed messages, and nearly nine in ten are concerned about the "agendas" of some investors. Directors also continue to be worried about violating Reg FD (Regulation Fair Disclosure)—89% are at least "somewhat concerned."

- More than half of directors have not held discussions about company protocols and practices in preparation for director-shareholder interactions. This is particularly interesting considering recent efforts to address engagement protocols by groups like the Shareholder-Director Exchange (SDX).

- Almost half of directors have not discussed company protocols and practices regarding the process by which shareholders can request direct dialogue with the board, the particular director(s) who would participate in such a dialogue, and the permissible topics for discussion.

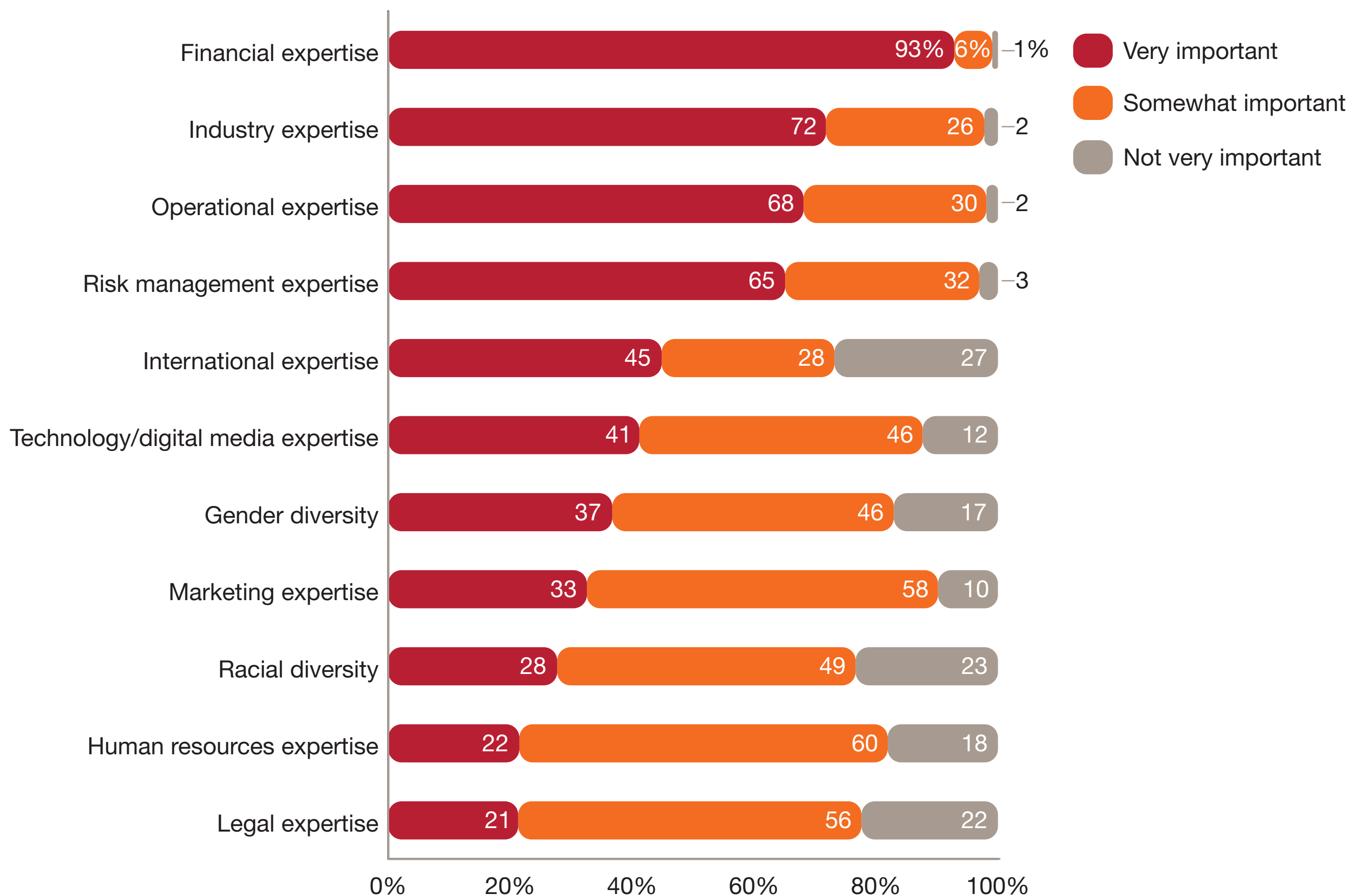
Board performance takes center stage

One of the clearest examples of a governance trend is the focus on board composition and performance. Effective oversight of public companies requires boards to collectively possess the skills to exercise their fiduciary responsibilities. And board composition is under pressure to evolve to meet new business challenges and stakeholder expectations. Today's directors are more focused than ever on ensuring their boards have the right expertise and experience to be effective. At the same time, many boards are giving significant attention to their own performance.

What director attributes are viewed as most important?

Consistent with what directors have said over the last several years, financial, industry, and operational expertise are seen as the most important director attributes. Financial expertise tops the list (described as very important by 93% of directors). This is followed by industry and operational expertise (described as very important by 72% and 68% of directors, respectively). This is not surprising given the primary role of boards in the oversight of the financial statements, strategy, and operational execution. Also consistent with results from the last several years, legal and human resources expertise rate lowest in importance, with only about one-in-five directors describing these attributes as very important.

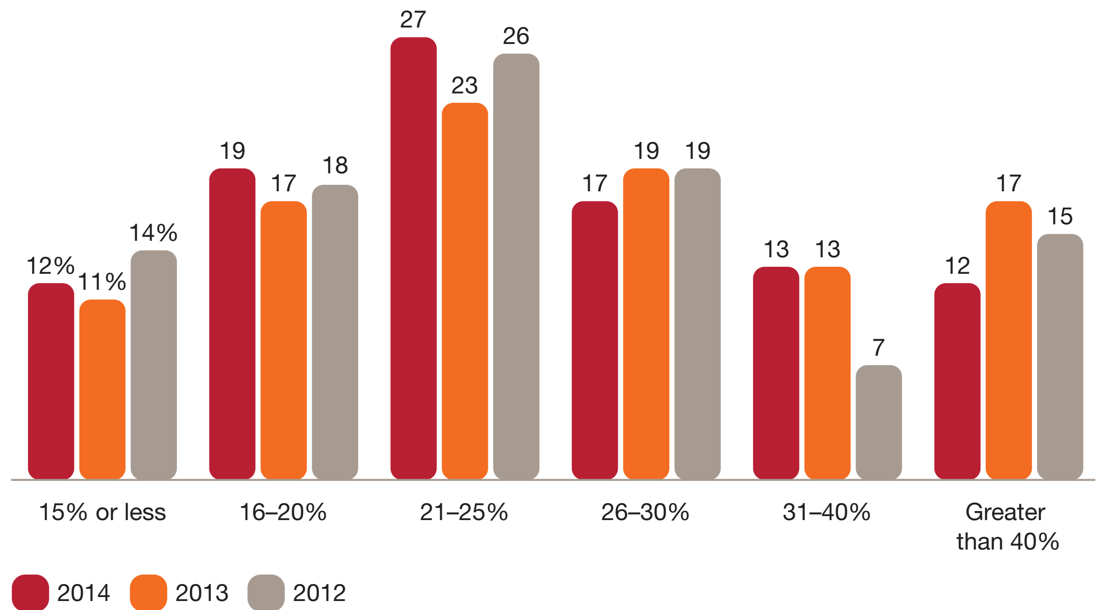
How would you describe the importance of having the following attributes on your board?



Directors more sensitive about low support for board nominees

Shareholders continue to support the vast majority of directors up for election; during the 2014 proxy season, average shareholder support for directors was 96%. However, about ten percent of directors failed to receive at least 70% support in 2014[2]. Directors are more sensitive to the level of negative shareholder voting in comparison to the prior year. In fact, 58% of directors now say that negative voting in the 11-25% range would cause them to be concerned about re-nomination, compared to only 48% last year. The percentage of directors who say that only negative voting in excess of 40% would cause them to rethink re-nomination decreased by five percentage points to 12%. Consistent with 2013, the longer a director serves on the board, the less sensitive he/she is to the level of negative shareholder voting.

At what level of negative shareholder voting for individual director nominations should the board be concerned about re-nominating a director?



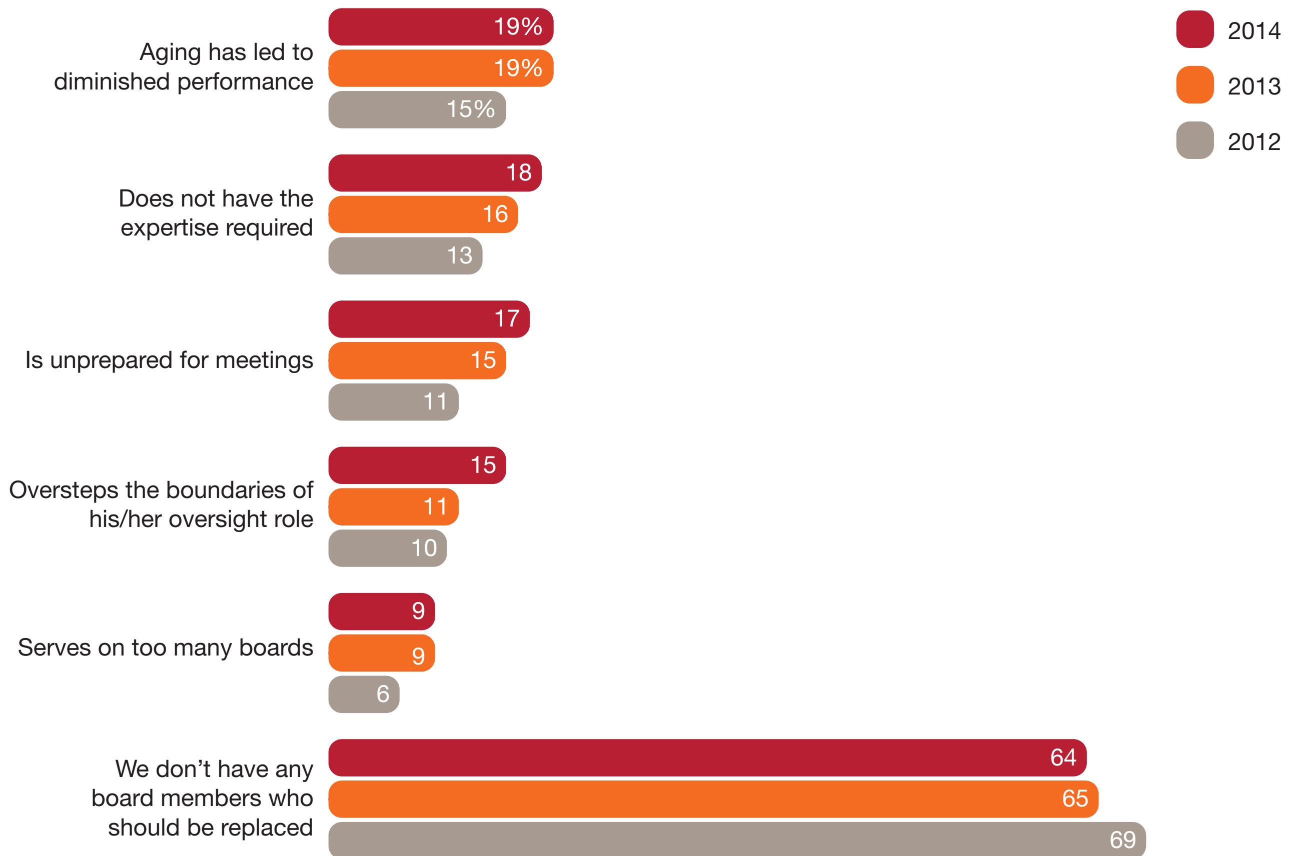
2 *PwC + Broadridge ProxyPulse October 2014*

Greater dissatisfaction with peers

The level of dissatisfaction directors express with their fellow directors continues to increase. Thirty-six percent of directors now say someone on their board should be replaced—a jump from 31% only two years ago. And less-tenured directors are more likely to believe someone on their board should be replaced—nine percentage points more so than those serving ten or more years. This could be because less tenured directors bring more skepticism and different perspectives about existing board performance than veterans of the board.

Directors continue to cite diminished performance due to aging, lack of expertise, and not being prepared for meetings as the top reasons for their dissatisfaction with peers' performance. There was also a four percentage point increase in directors who believe a fellow director should be replaced for overstepping his/her oversight role.

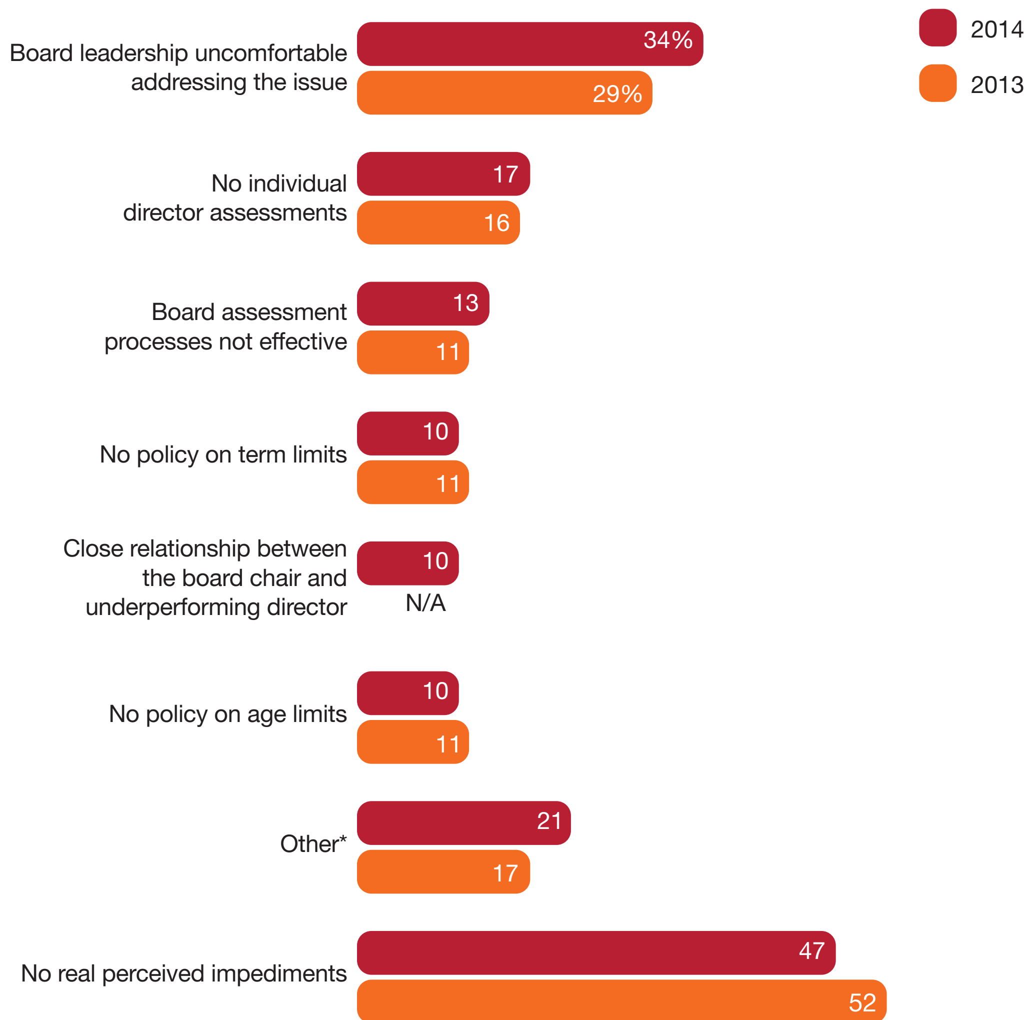
Do you believe that any of your board members should be replaced for the following reasons?



Impediments to board renewal

While director dissatisfaction with peer performance grew this year, so did the percentage of directors who recognize impediments to replacing underperforming fellow directors (53% compared to 48% last year). More than one-third of directors say the biggest impediment to replacing an underperforming director is that board leadership is uncomfortable addressing the issue (an increase of five percentage points from 2013). Lack of director assessments and ineffective board assessment processes are also considered impediments. Nine percent of directors cite a close personal relationship between the underperforming director and the CEO as an impediment. Interestingly, male directors are more likely than female directors to believe there are impediments to replacing an underperforming director.

What are the impediments to replacing an underperforming director?



*Other includes the total of: close relationship between CEO and underperforming director (9%), underperforming directors are soon retiring (9%), and not having annual re-election of directors (3%).

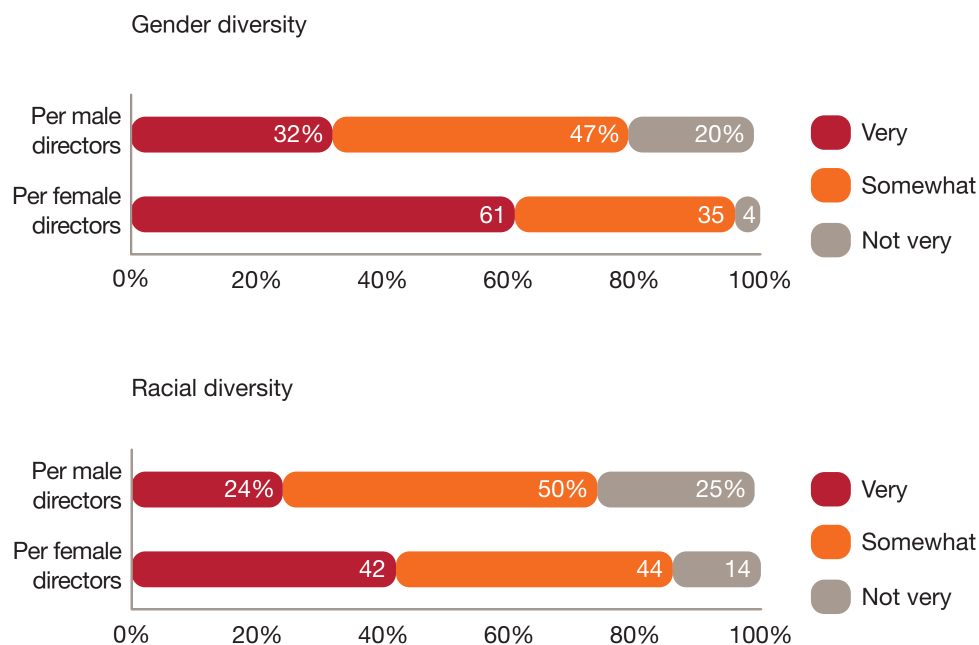
The evolution of board diversity

Stakeholders are more interested in board diversity than ever. A number of organizations and shareholder groups in the US have undertaken efforts to increase diverse representation on public company boards. As a result, US boards are increasingly focused on recruiting directors with diversity of background and experience. In addition, the last several years have seen gender diversity quotas instituted in some European countries.

The importance of diversity

Male and female directors have differing views about the importance of having gender and racial diversity on their boards. Female directors are far more likely to consider board diversity important. For example, 61% of female directors describe gender diversity as very important, compared to only 32% of male directors. Similarly, 42% of female directors describe racial diversity as very important compared to only 24% of their male counterparts. These differences may be contributing factors to why diversity on public company boards has not increased substantially in the last five years.

How would you describe the importance of having the following attributes on your board?



Impediments to gender diversity

Despite a growing focus on the importance of board diversity, the number of women serving on public company boards has remained relatively unchanged over the past five years (18% of all S&P 500 directors are now female compared to 16% in 2008[3]). A majority of directors say there are no perceived impediments to increasing gender diversity. Of those directors who do believe there are impediments, a lack of awareness of qualified diverse candidates and little appetite for changing current board composition are the top two factors cited.

In general, what impedes a board's ability to increase diversity?*

	Gender diversity		Other aspects of diversity
1)	Directors are unaware of many qualified diverse candidates	1)	Board leadership is not invested in recruiting diverse directors
2)	Directors don't want to change the current board composition to create a position for a diverse candidate	2)	Directors don't want to change the current board composition to create a position for a diverse candidate
3)	There are insufficient numbers of qualified diverse candidates	3)	Directors are unaware of many qualified diverse candidates
4)	Directors don't view adding diversity as important	4)	Directors don't view adding diversity as important
5)	Board leadership is not invested in recruiting diverse directors	5)	There are insufficient numbers of qualified diverse candidates

*Results shown from top impediment to lowest impediment

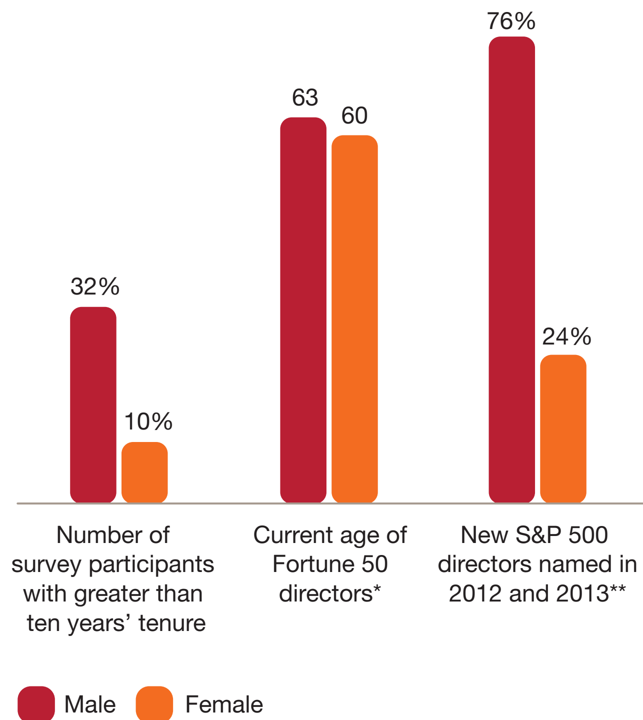
3 *Spencer Stuart Board Index 2013*

The future of gender diversity

Current trends point to an evolution that will likely impact gender diversity on future boards. Almost one-third of the male participants in our survey have been on their board more than ten years compared to only ten percent of females. In the Fortune 50, female directors tend to be younger, with an average age of 60 yrs.—compared to 63 yrs. for males.[4] Additionally, 24% of all new S&P 500 directors named in the last two years have been women—as compared to the current board composition of 18% women.[5] Given the fact that the women currently on boards are younger and less-tenured than their male counterparts, and a higher percentage of new directors are women, it's reasonable to project that the boards of the future will include a higher proportion of women than today's boards.

Additionally, 17% of directors say their board has already considered recruiting new directors with diverse backgrounds over the last 12 months, and 57% say they are talking about doing so going forward—another likely contributing factor to more diversity in the board of the future.

Trends on director tenure, age and gender



* Per PwC review of most recent proxy statements as of August 31, 2014
** *Spencer Stuart Board Index 2013*

4 Per PwC review of most recent proxy statements as of August 31, 2014

5 *Spencer Stuart Board Index 2013*

Pressure on board priorities and practices

Directors continue to face scrutiny from investors, regulators, and other stakeholders, causing board practices to remain in the spotlight. In response to this governance trend, boards are reassessing their practices in order to gauge their effectiveness. At the same time, board leadership is being challenged to ensure that they address areas identified for improvement in their annual self-assessment processes.

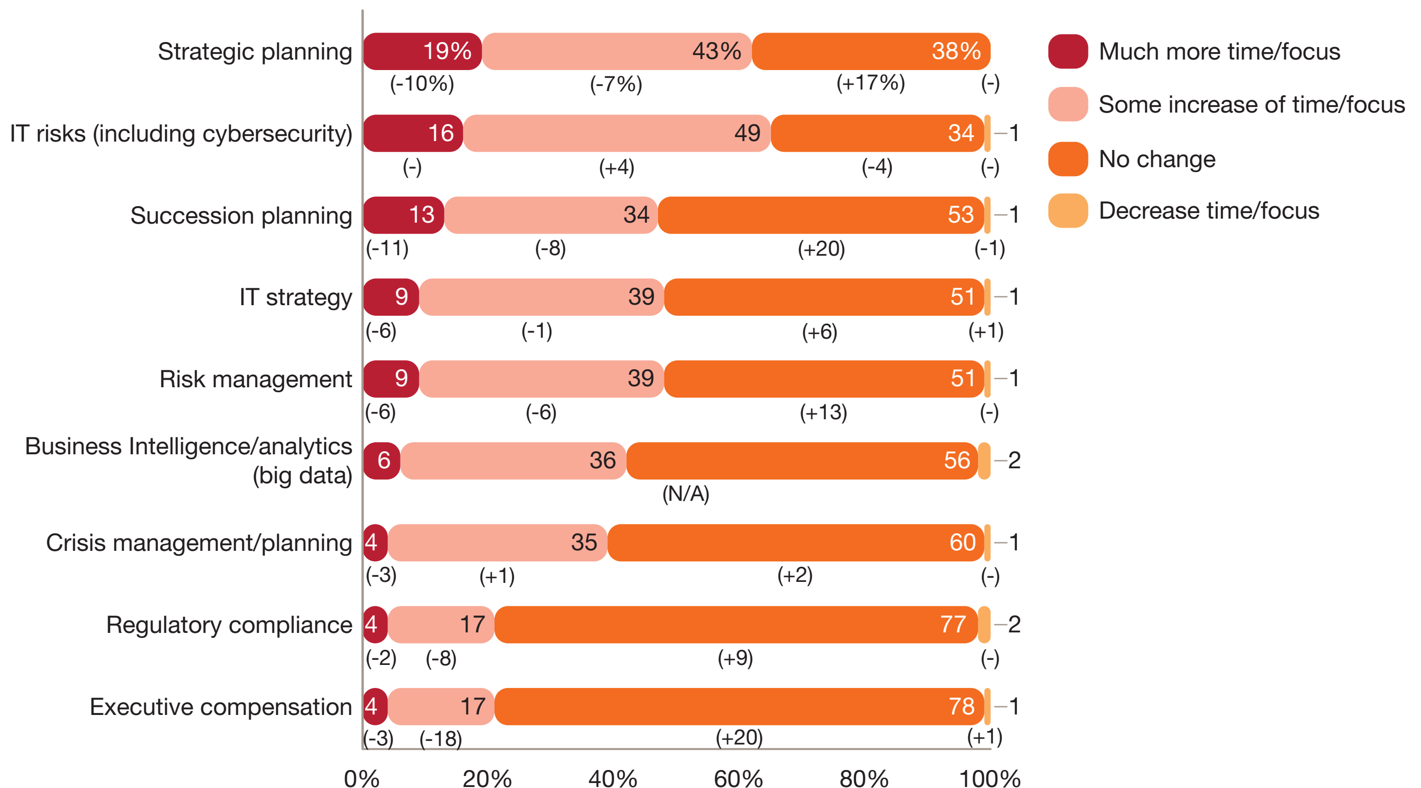
Where do directors want to spend more time?

The average time commitment of public company directors continues to increase. It was 219 hours in 2013, compared to 205 hours in 2010.[6] And strategy and IT risk are now the top areas in which directors want to spend more time.

Consistent with previous years, directors want to spend more time on strategic planning; 62% want at least some additional boardroom time and focus; of those, nearly one-in-three want much more time and focus. They also want to give more attention to the IT issues closely linked to strategy. In fact, 65% want more focus on IT risks including cybersecurity, and 48% want more attention given to IT strategy. Female directors want more focus on IT strategy than male directors: 60% compared to 45% of male directors.

Please indicate if you believe your board should change the amount of time it spends on the following?

Amounts shown in parentheses represent the change in percentage points from the 2013 survey. N/A indicates the question was not asked in the 2013 survey.



6 *NACD Public Company Governance Survey 2013*

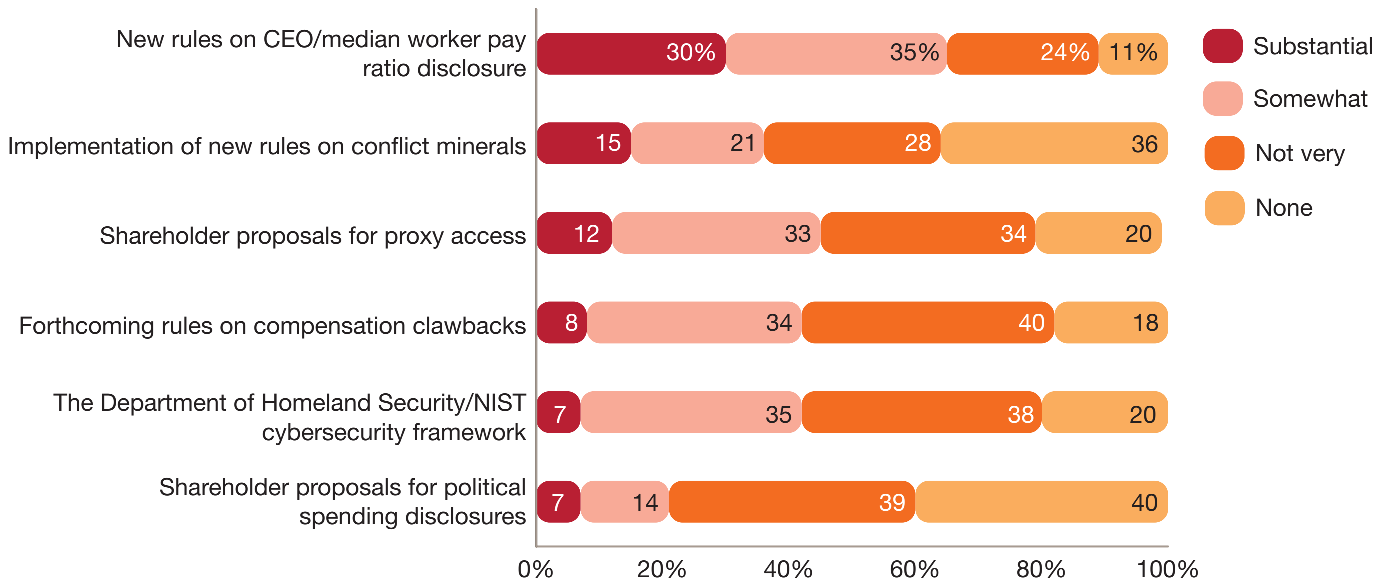
Although still a priority, there was a decline in the percentage of directors who want much more time and focus on CEO succession (13% compared to 24% in 2013). This may speak to the significant investment of time already made by boards in this area over the last several years. Mega-cap company directors are more satisfied with their current level of attention to CEO succession than small-cap company directors.

Top director concerns

Considering that only about half of the Dodd-Frank Act rules are final, and that there were a record number of shareholder proposals in 2014, directors have plenty of concerns regarding future initiatives. Topping their list are the new disclosures on the CEO/median employee pay ratio and shareholder proposals for proxy access (65% and 45% of directors are at least somewhat concerned with these topics, respectively).

Forty-two percent of directors are at least somewhat concerned about the new Department of Homeland Security/National Institute of Standards and Technology (NIST) cybersecurity framework. It may be that some directors are not yet aware of the protocols or their potential impact. Mega-cap company directors are more than three times as likely as small-cap company directors to express substantial concern about shareholder proposals for proxy access. This makes sense, as larger companies receive the vast majority of these proposals.

How significant is your level of concern with the following?

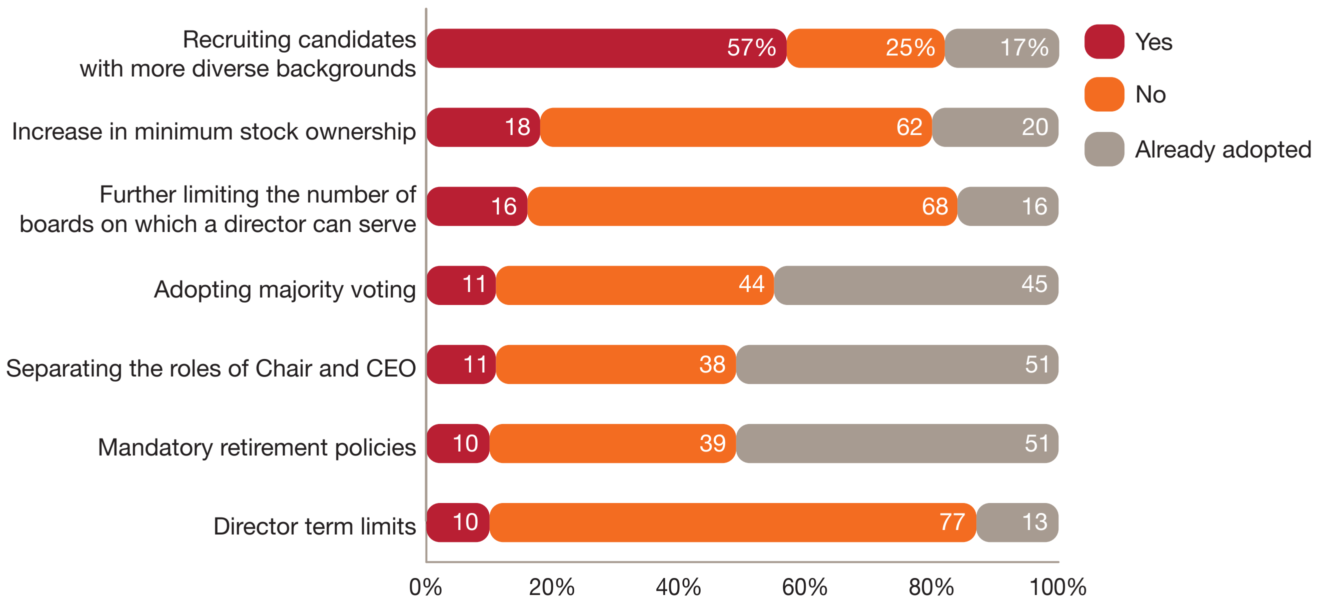


Initiatives impacting board service

Some investors are looking more closely at whether they will consider long-serving directors independent. And some boards are considering a mandatory retirement age and/or term limits. A mandatory retirement age is a more common practice; 51% of directors say their board has adopted such a policy and an additional ten percent are having discussions about doing so. Term limits are much less common, as only 13% of directors say their boards have them.

In recent years, a growing number of companies have chosen to separate the roles of CEO and board Chair. The 2014 proxy season saw 66 related shareholder proposals.[7] Fifty-one percent of directors say their company has already separated the roles; an additional 11% say their board is considering doing so. Boards often consider this change when there is a CEO succession.

Is your board considering/discussing any of the following?

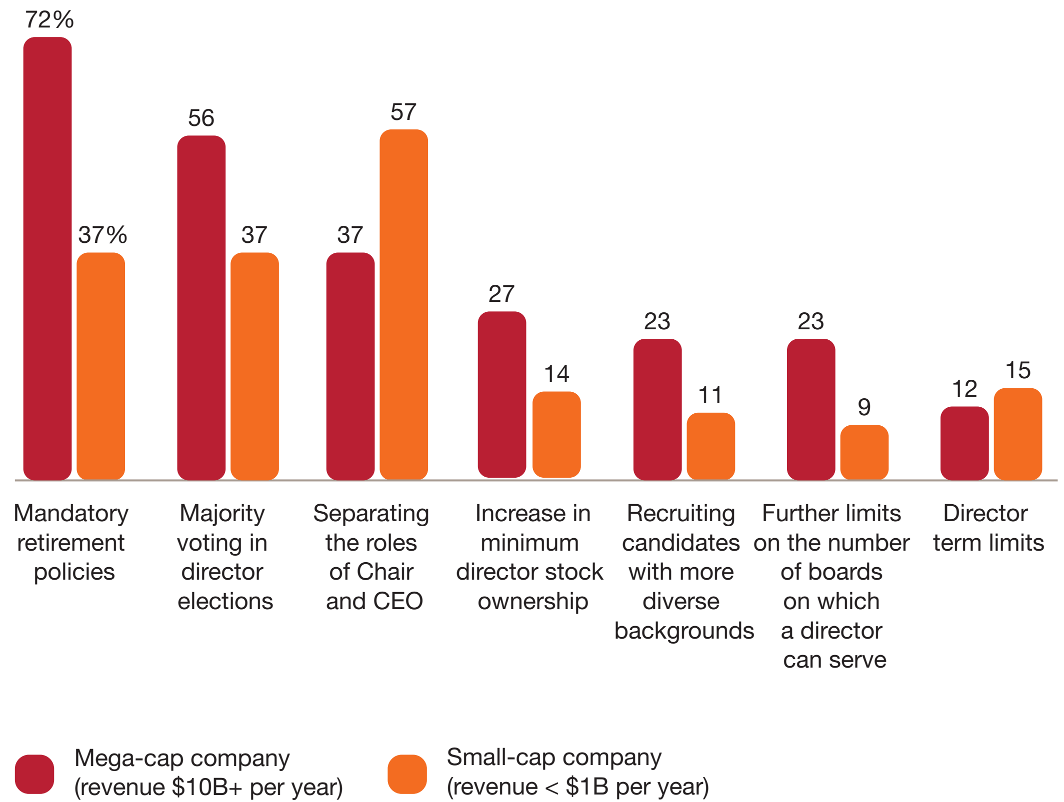


7 *PwC + Broadridge ProxyPulse October 2014*

Mega-cap company boards are much more likely than small-cap company boards to have mandatory retirement policies (72% versus 37%). They are also more likely to have adopted majority voting, increased minimum director stock ownership, recruited directors with more diverse backgrounds, and limited the number of boards on which a director can serve.

Respondents, by size, whose boards have already adopted the following policies/practices

Is your board considering/discussing any of the following?

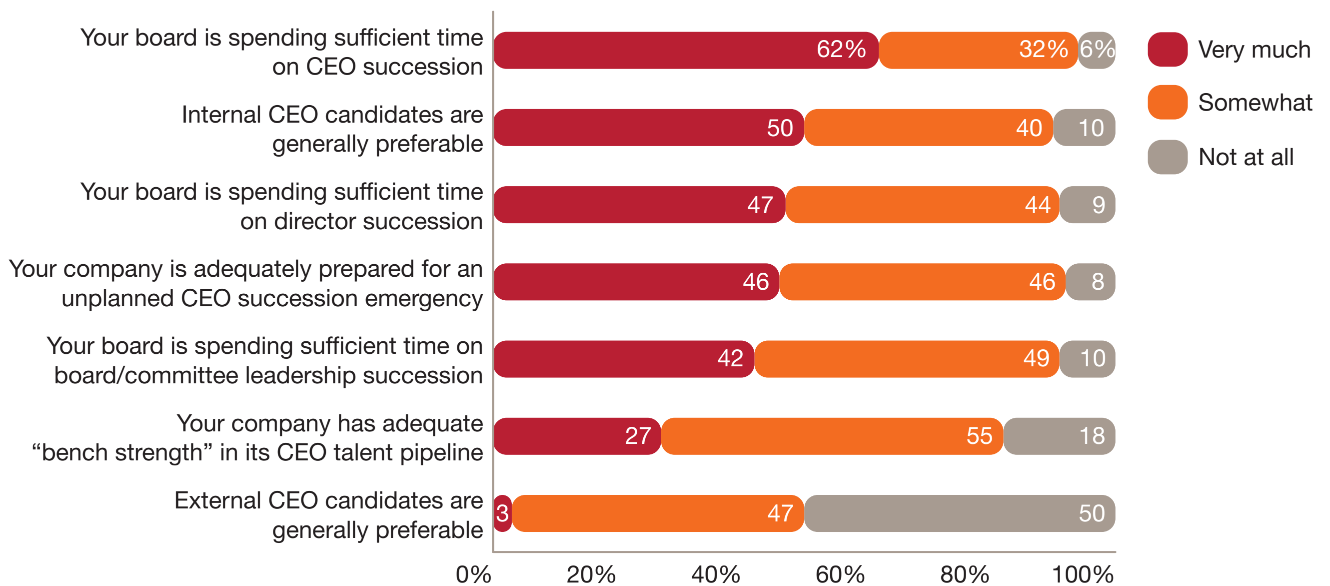


Considerations for CEO succession planning

An important responsibility of the board is successfully identifying potential internal candidates for the CEO role—or attracting the right CEO from outside of the organization. Sixty-two percent of directors strongly believe their board is spending sufficient time on this important topic. Furthermore, 92% of directors say their company is at least somewhat prepared in the case of an unplanned CEO succession emergency.

Directors strongly prefer internal CEO candidates; 50% say they "very much" do. But only 27% are "very much" confident that their company's CEO talent pipeline has adequate "bench strength" and nearly one-in-five believe their company's CEO pipeline is not at all adequate. Directors from mega-cap companies have the strongest preference for internal CEO candidates (61% "very much" have a preference compared to 37% of small-cap company directors).

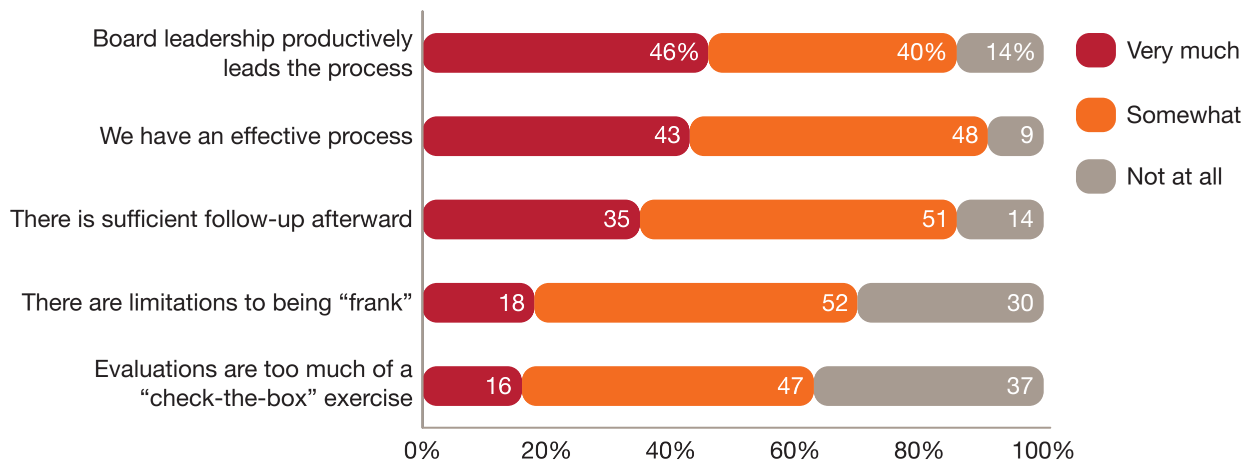
To what extent do you agree with the following?



How good are self-evaluations?

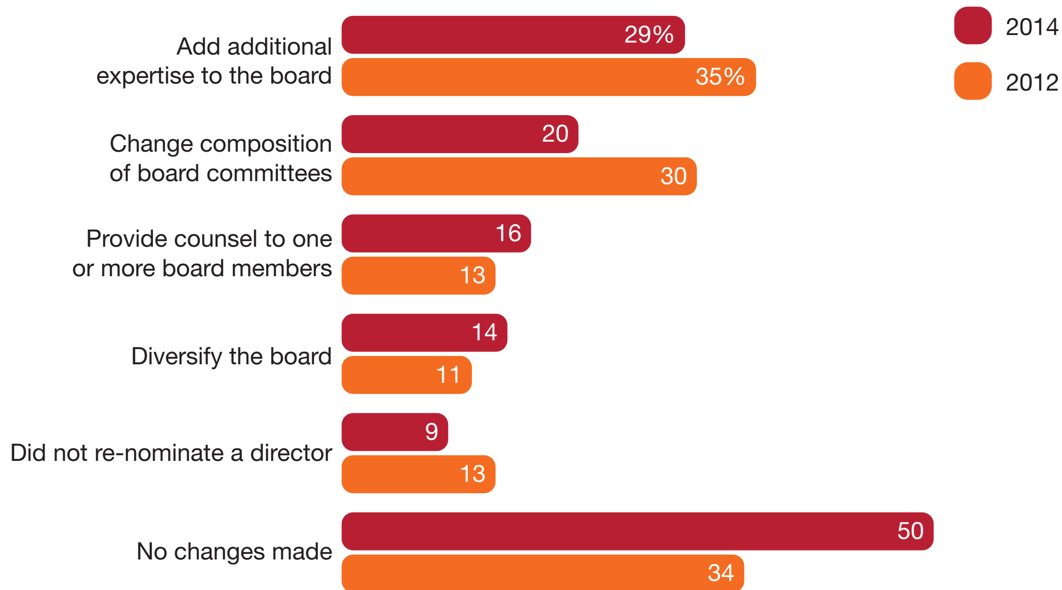
High-performing boards use the annual board and committee self-evaluation processes to examine their performance and look for areas for improvement. An effective self-evaluation requires strong leadership and the willingness to have potentially difficult conversations about peer performance. The vast majority of directors view their board's self-evaluations favorably—over 90% believe their processes are at least somewhat effective and 86% find board leadership at least somewhat effective in leading the process. However, a majority of directors have a difficult time speaking their minds—70% believe it's at least somewhat difficult to be frank in their self-evaluations, and nearly one-in-five think it's very difficult. Further, almost two-thirds of directors believe self-evaluations are at least somewhat of a "check-the-box" exercise.

Regarding board/committee self-evaluations, to what extent do you believe the following?



Compared to prior years, a smaller percentage of directors say changes are being made as a result of their self-evaluation processes. Only half of directors say they made changes in 2014 compared to two-thirds who said so just two years ago. This could be because a greater percentage of boards are more satisfied with their overall composition and processes. The most common changes are adding additional expertise to the board (29%), changing committee composition (20%), and providing counsel to one or more board members (16%).

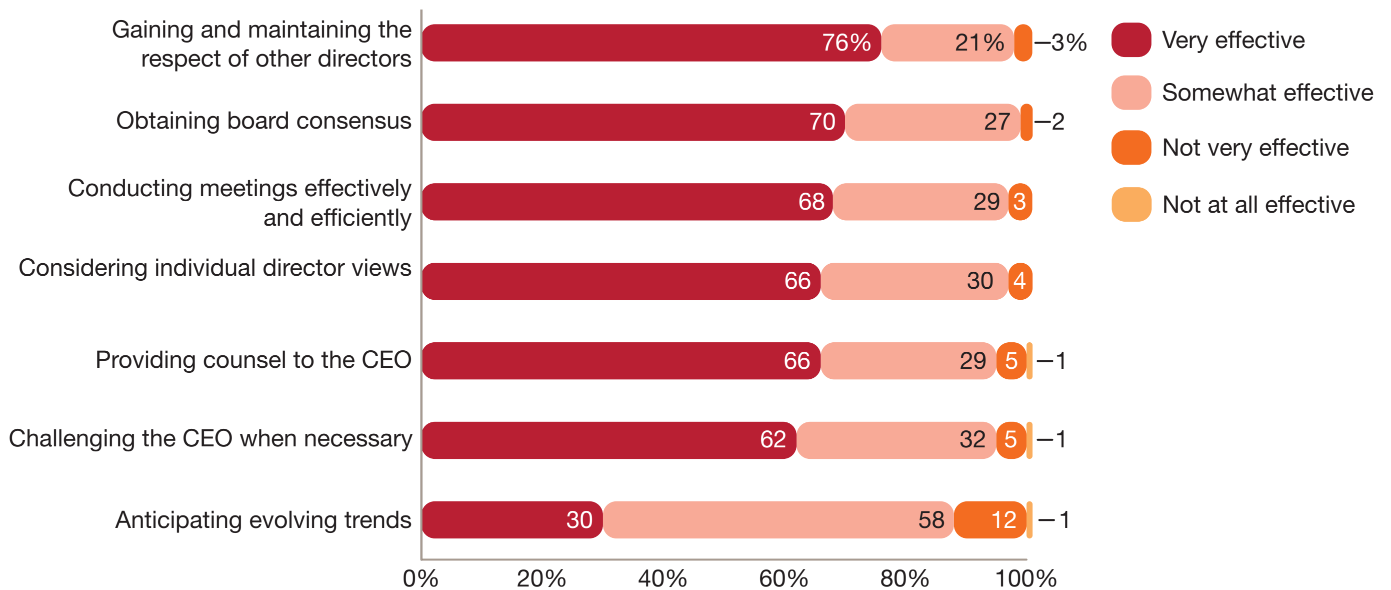
In response to issues identified during your last board/committee self-evaluation process, did your board/committee decide to do any of the following?



Sharing views on the effectiveness of board leadership

The Chair or Lead Director's responsibilities include setting the agenda, presiding over meetings, and serving as a sounding board for the CEO. The majority of directors are pleased with the quality of their board's leadership. More than three-in-four directors describe their board leadership as very effective in gaining and maintaining the respect of other directors. At least two-thirds say the same about their board leadership's effectiveness conducting meetings, considering individual director views and providing counsel to the CEO. But when it comes to anticipating emerging trends, less than one-third indicate their board leadership is very effective. Mega-cap company directors view board leadership as more effective than small-cap company directors in areas like considering individual director views, providing counsel to the CEO, and conducting meetings efficiently and effectively.

How effective is your board leadership (Chair/Lead Director/Presiding Director) in the following areas?



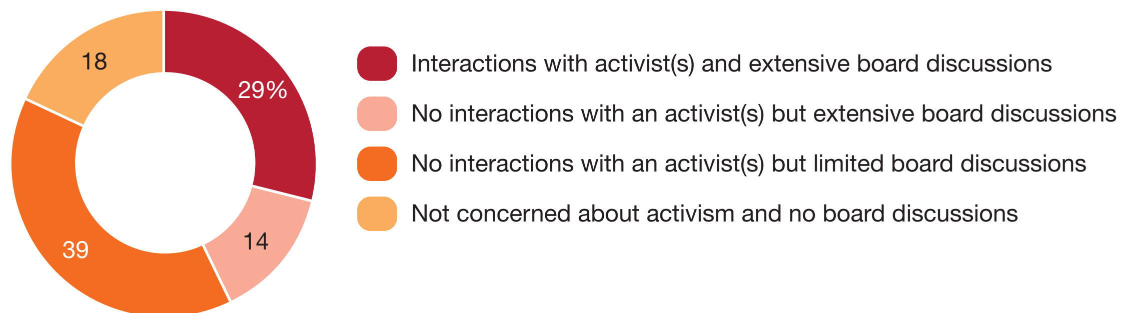
Activist shareholders get active

Shareholder activism has become more pervasive. Boards are more frequently faced with having to respond to activists and a significant percentage of directors say they are having board discussions about potential situations in advance of being approached. We expect this trend to continue.

Dealing with shareholder activism

The shareholder activism environment has intensified over the last several years, and activist investors now have more than $100 billion in assets under management.[8] The total number of actual proxy contests increased over the last two years, and the number of exempt solicitations (i.e., "no vote" campaigns against directors) nearly doubled.[9] Twenty-nine percent of directors say their board interacted with activists and held extensive board discussions about activism last year. An additional 14% of directors say their board has not had activist interactions, but has extensively discussed the topic.

How would you describe your board's preparation for and actual experience with shareholder activism?

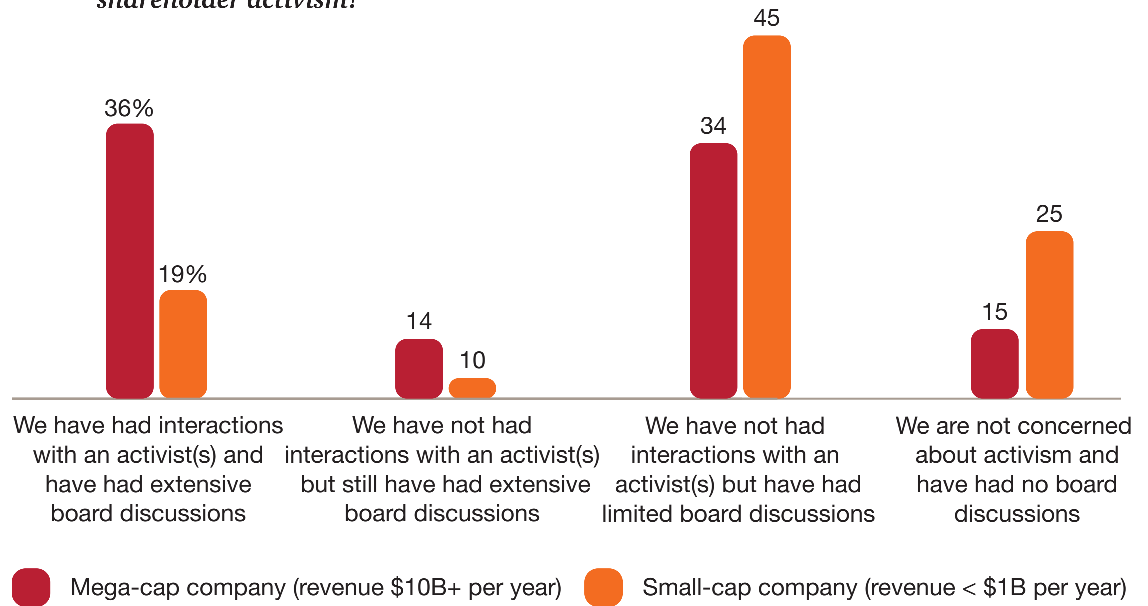


8 Hedge Fund Research (HFR)

9 *PwC + Broadridge ProxyPulse October 2014*

Mega-cap company boards are almost twice as likely to have interacted with activists as small-cap company boards—which is likely why small-cap company directors express the least concern about activists. While shareholder activists have historically targeted larger companies, this may be beginning to change and should prompt all directors to examine their board's preparedness to deal with an activism campaign.

How would you describe your board's preparation for and actual experience with shareholder activism?



The influence of emerging IT

The influence of emerging technologies and increasing cybersecurity concerns are two trends impacting governance and the board of the future. It's clear that employees' use of their personal mobile devices, computers, and social media as they do their jobs, together with the increased use of cloud computing services are changing the relationship between "old line" IT organizations and the business as a whole. A lot of back office IT infrastructure has been displaced. More and more companies and directors see IT as inextricably wed to corporate strategy and the company's business. IT is now a business issue, not just a technology issue.

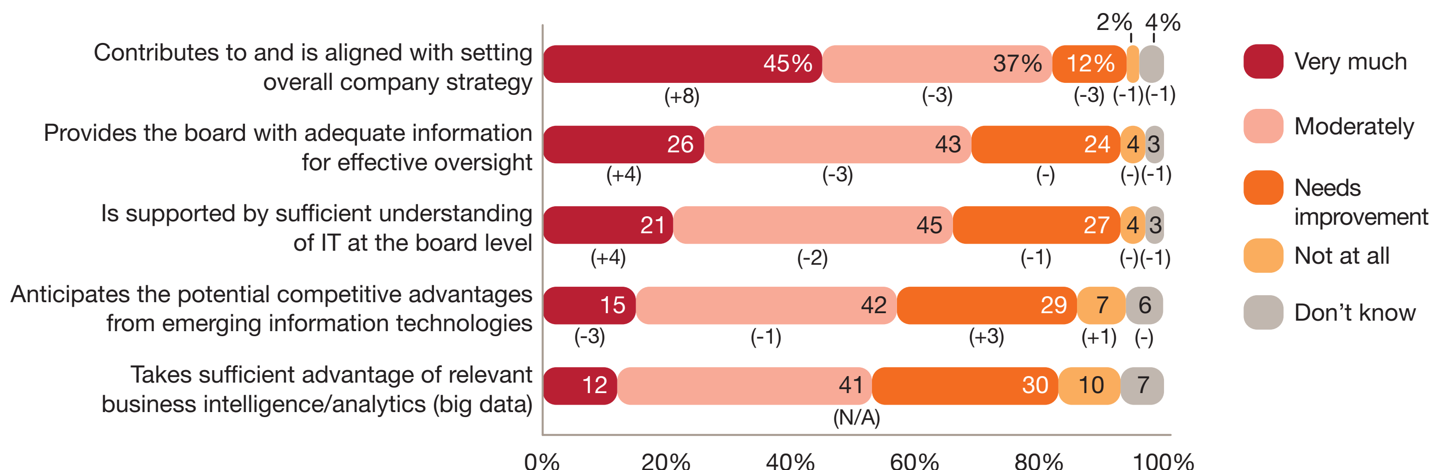
Cybersecurity breaches are regularly and prominently in the news. And directors are increasingly focused on how to provide effective oversight in this area.

IT strategy and risk mitigation

There was a noteworthy year-over-year increase in directors' satisfaction with their company's IT strategy and IT risk mitigation approach. More directors now believe their company's approach very much contributes to, and is aligned with, setting overall company strategy as well as providing the board with adequate information for effective oversight. A greater percentage also believe that their company's approach is supported by a sufficient understanding of IT at the board level. However, there was a decline in the percentage of directors who believe their company's approach "very much" or "moderately" anticipates competitive advantages from emerging information technologies. This may be due to increased awareness of the potential opportunities afforded by using big data and cloud computing as tools.

Directors with longer tenure are more likely to believe the company's IT strategy and IT risk mitigation approach contributes to and is aligned with overall company strategy.

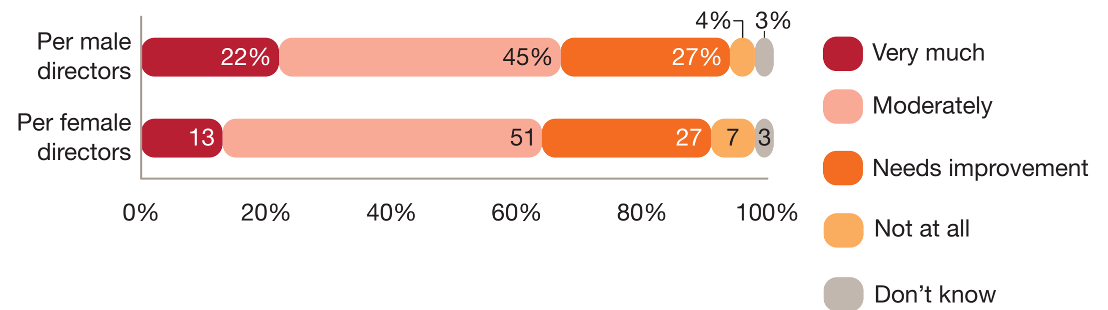
Do you believe your company's IT strategy and IT risk mitigation approach?



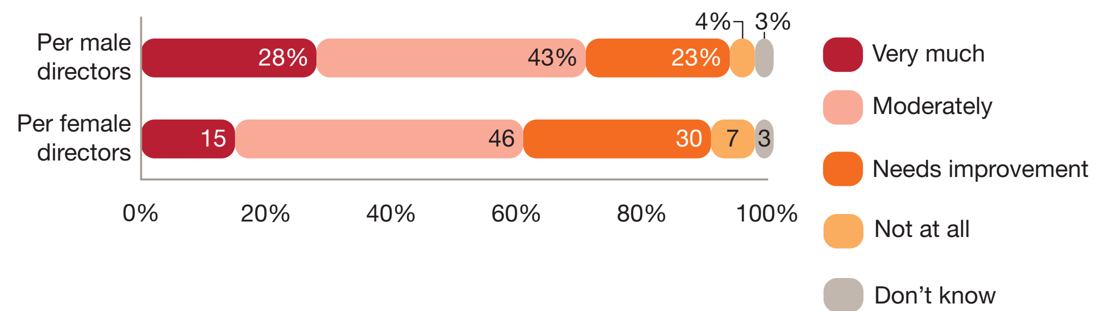
Female directors are more skeptical about whether their company's IT strategy and IT risk mitigation approach is supported by a sufficient understanding of IT at the board level and whether the approach provides the board with adequate information for effective oversight.

Do you believe that your company's IT strategy and IT risk mitigation approach:

Is supported by sufficient understanding of IT at the board level?



Provides the board with adequate information for effective oversight?



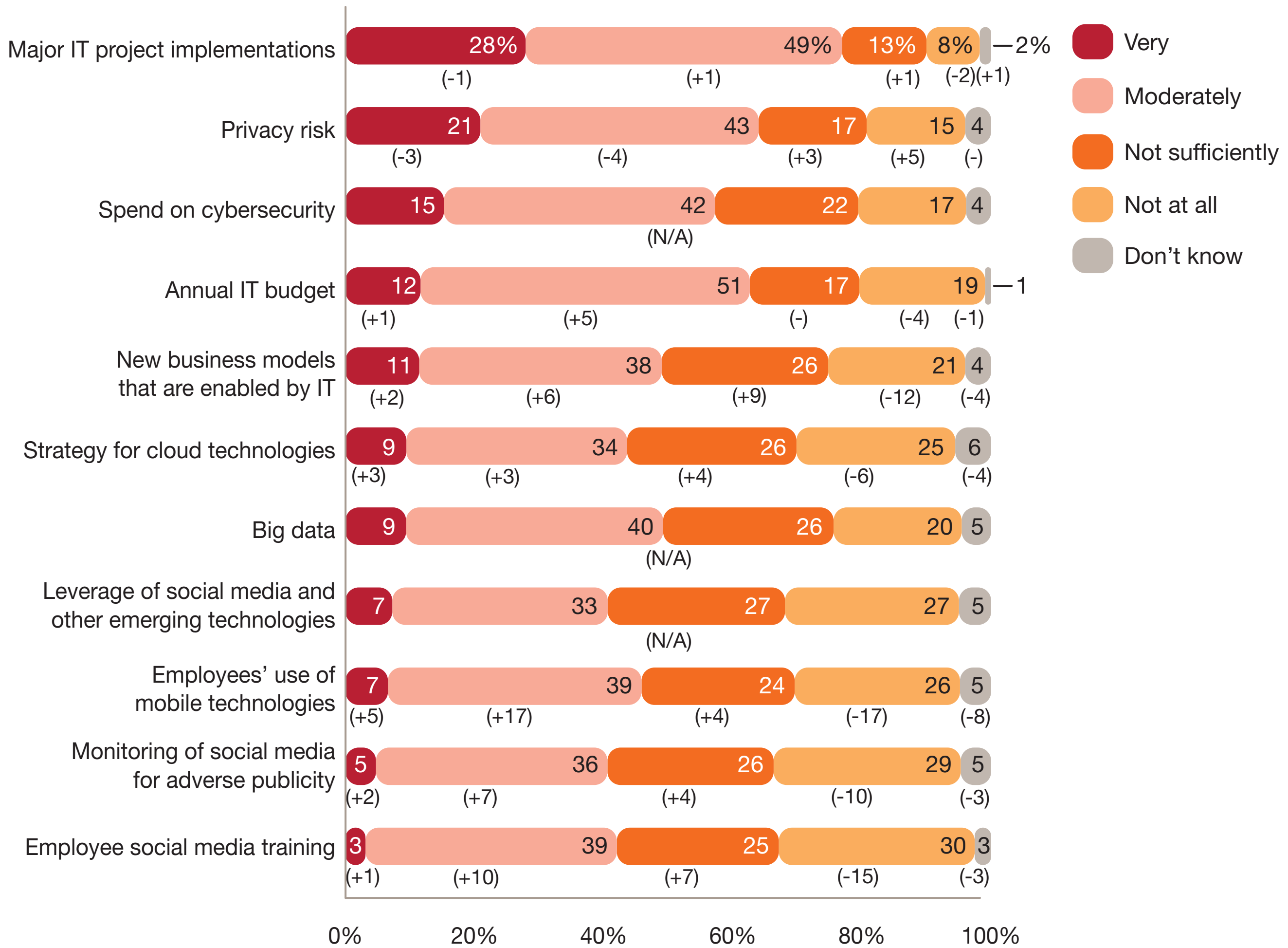
IT oversight beyond the basics

During the last two years directors indicated high levels of engagement with traditional IT areas like overseeing the annual IT budget and the status of major IT project implementations. They are now also indicating an increased focus on certain less-traditional IT areas such as social media and employee use of mobile technologies. Forty-one percent of directors say they are now at least "moderately" engaged in overseeing the company's monitoring of social media for adverse publicity—compared to only 32% in 2012. There was also an 11 percentage point increase in directors who say they are at least "moderately" engaged in overseeing employee social media training and policies. Similarly, 46% of directors say they are now at least "moderately" engaged in overseeing employee use of mobile technologies (compared to 24% two years ago). This increased focus may be recognition by directors of the importance of these emerging technologies on their companies.

On the flip side, directors recognize that big data and cloud technologies could use more attention—over a quarter say they are not sufficiently engaged in these areas. And, only 53% of directors indicate their company's IT strategy and IT risk mitigation approach even "moderately" takes sufficient advantage of big data.

How engaged is your board or its committees with overseeing/understanding the following?

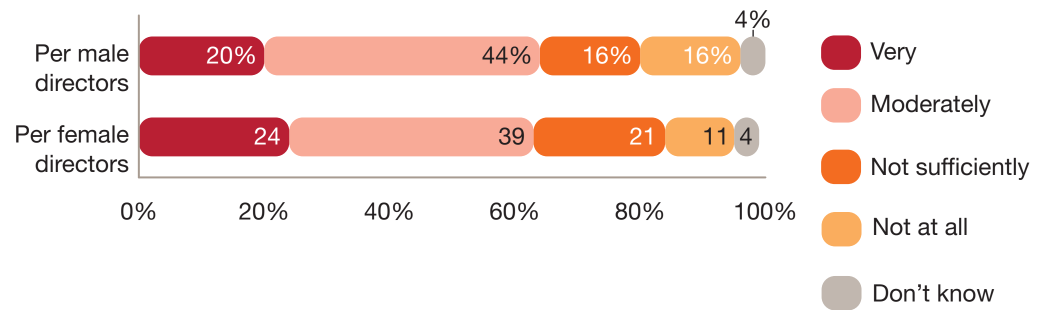
Amounts shown in parentheses represent the change in percentage points from the 2012 survey. N/A indicates the question was not asked in the 2012 survey.



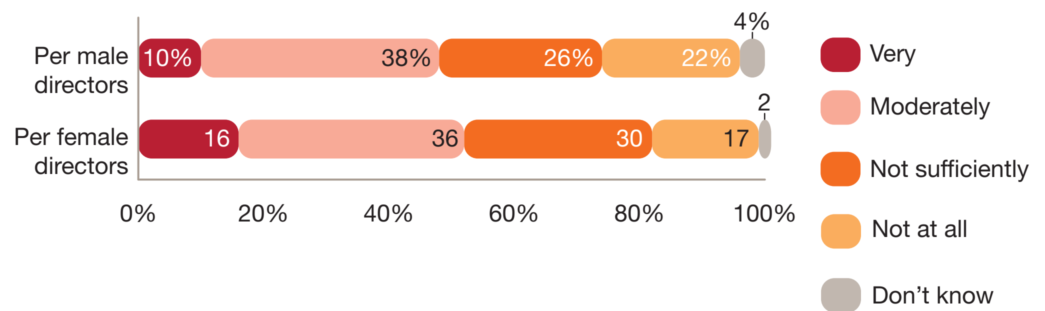
Female directors indicated their boards have higher levels of engagement with oversight of the risk of loss of customer data and with new business models enabled by IT. They also generally expressed a desire to focus more attention on most IT issues.

How engaged is your board or its committees with overseeing/understanding the following:

Risk of compromising customer data (privacy)?



New business models that are enabled by IT?



The Achilles' heel of IT—cybersecurity

The increasing complexity of directors' IT oversight roles, a number of recent high-profile data breaches and the new Department of Homeland Security/NIST cybersecurity framework all contribute to our next major governance trend—the spotlight on cybersecurity is getting brighter. We believe this trend will grow in prominence as directors say they want to allocate more time and attention to this area. Almost two-thirds of directors want at least "some" increased focus on IT risks like cybersecurity.

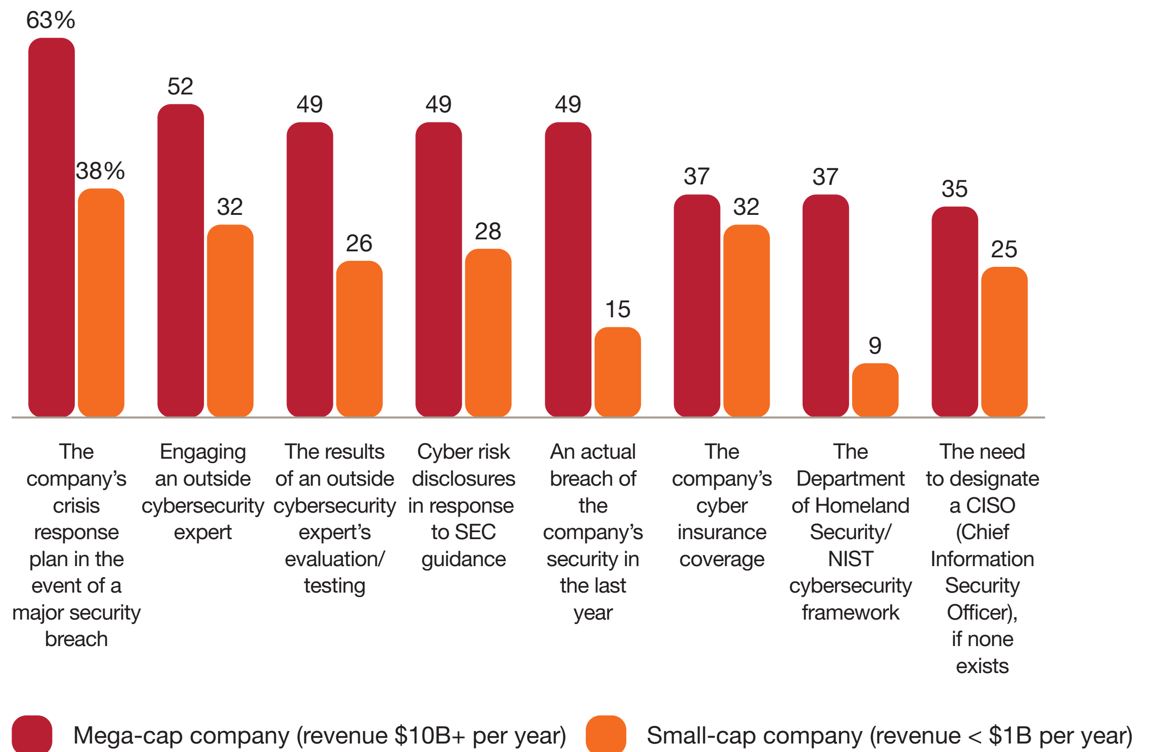
Boards concerned about cybersecurity

Cybersecurity breaches are at an all-time high. However, nearly half of directors have not discussed the company's crisis response plan in the event of a breach and 67% have not discussed the company's cybersecurity insurance coverage. Directors may want to consider adding these topics to their board agendas.

With regard to cybersecurity issues, has your board or its committees discussed:

Mega-cap company directors are three times more likely than small-cap directors to have discussed an actual breach of their company's security in the last year. This may be because the largest companies have greater resources available to dedicate toward detection capabilities. And, mega-cap company directors are four times more likely than small-cap companies to have discussed the Department of Homeland Security/NIST framework.

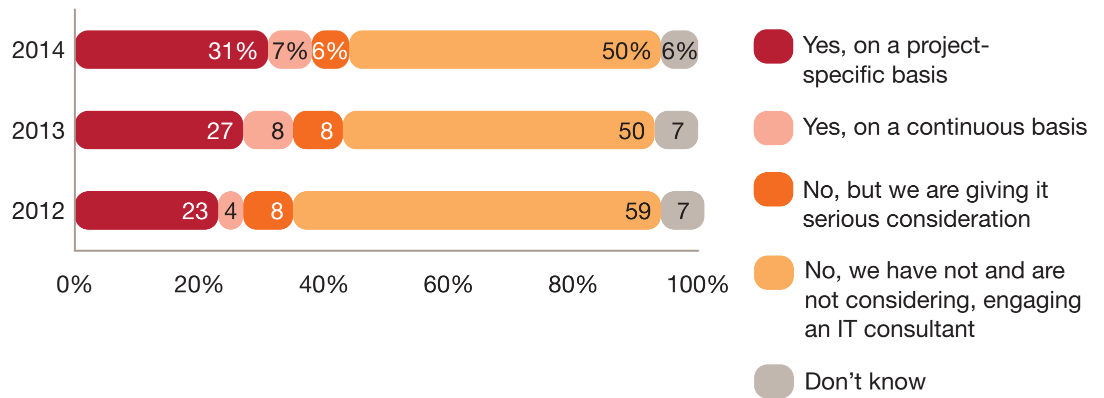
With regard to cybersecurity issues, has your board or its committees discussed:



Thirty-eight percent of directors now say their boards use external IT consultants—compared to 27% in 2012. In the last twelve months, 42% of directors say they discussed engaging an outside cybersecurity expert, and nearly four-in-ten actually reviewed the results of an outside cybersecurity expert's evaluation and testing of their company's systems.

Mega-cap company directors are 20 percentage points more likely than small-cap company directors to say their board has engaged an outside expert to help them fulfill their IT oversight responsibilities—perhaps not surprising, as directors from the largest companies may believe the higher value of their intellectual property and the volume of private data they retain makes their company more of a target.

During the last 12 months, has your board or its committees engaged an outside consultant to advise on IT strategy, opportunities, or risks?



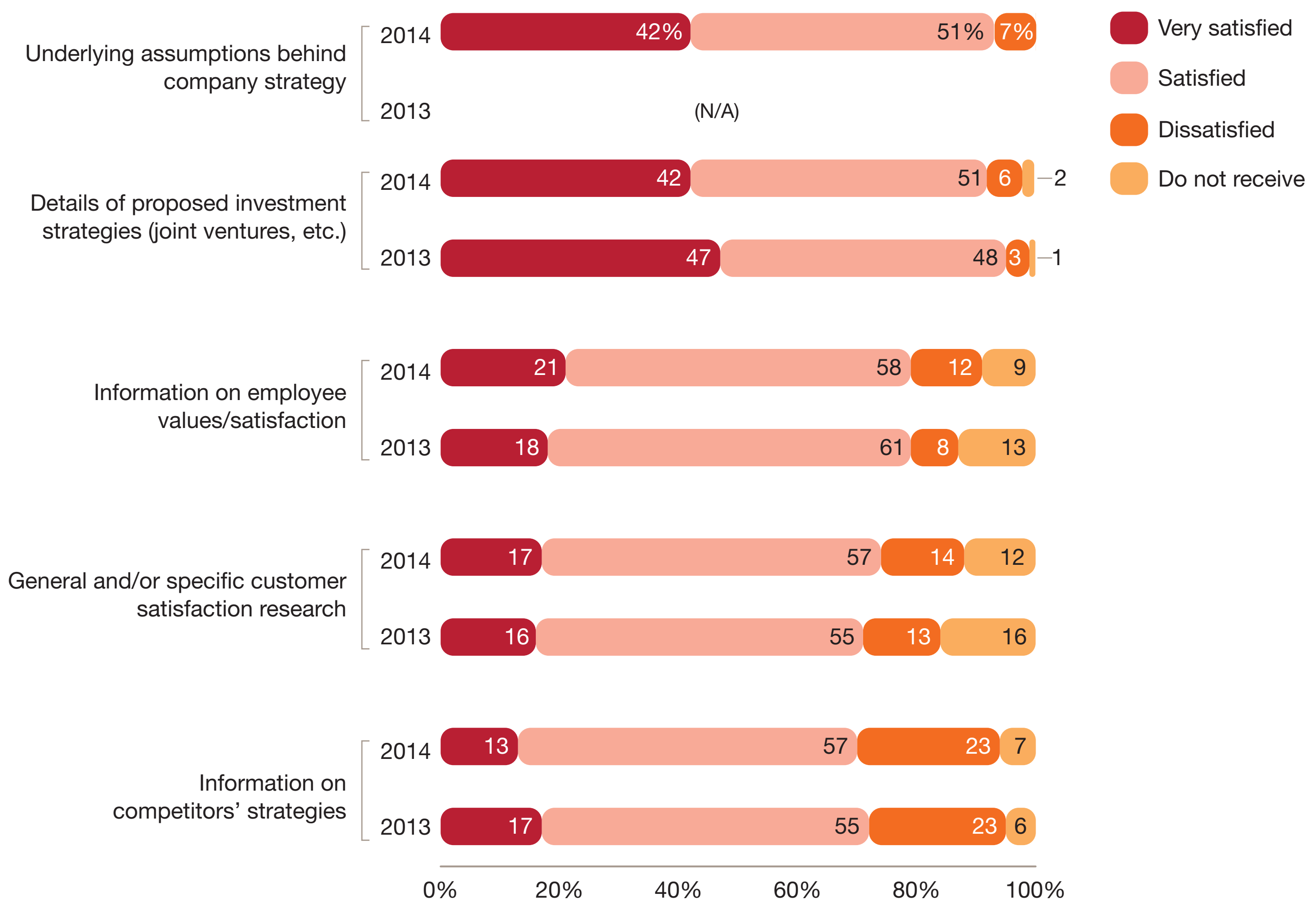
It's still all about strategy and risk

Some governance trends continue the evolution of themes we have seen in recent years and will further define the board of the future. Risk management is a top priority of investors and they have high expectations of boards. Public company directors also remain focused on strategy. Effective oversight requires that the board receive the right information from management at the right level of detail. Only then can a board effectively address key elements of its strategy and risk oversight responsibilities, such as risk appetite.

Am I getting what I want?

As a whole, directors are pleased with the strategic information they receive from management. More than nine-out-of-ten directors are at least somewhat satisfied with the information they are provided on the underlying assumptions supporting company strategy and details of proposed investment strategies. However, in other areas, there is room for improvement. For example, more than one-quarter of directors are either dissatisfied with or do not receive information on competitor strategy and customer satisfaction research. Female directors are less satisfied than male directors with the information they receive from management.

How satisfied are you with the following information provided to your board?



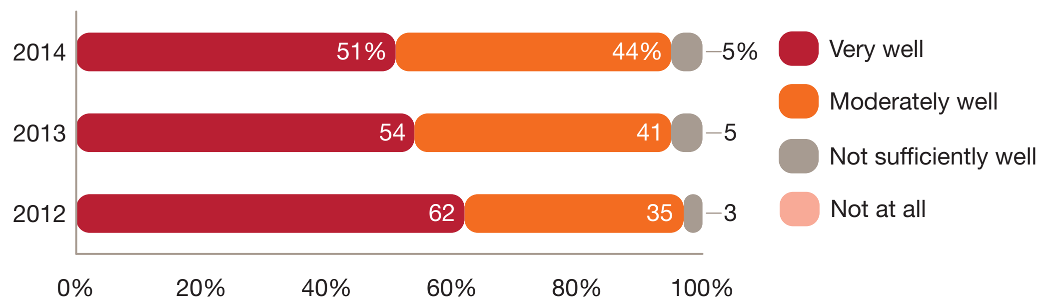
Less comfort about risk appetite

As the risk oversight landscape becomes increasingly complex, directors are less comfortable with their understanding of their company's risk appetite; 51% say their board understands the company's risk appetite "very well"—a drop of 11 percentage points from two years ago. This may be due to any number of factors including uncertainty about the impact of new technologies and risks on the business, an increasingly dynamic global economy, political uncertainty and an active mergers & acquisitions environment. It may be possible that directors' commitment to enhanced board effectiveness and increased scrutiny of director performance have led to greater self-awareness about possible areas for improvement. Male directors express more comfort than female directors regarding how well their board understands the company's risk appetite.

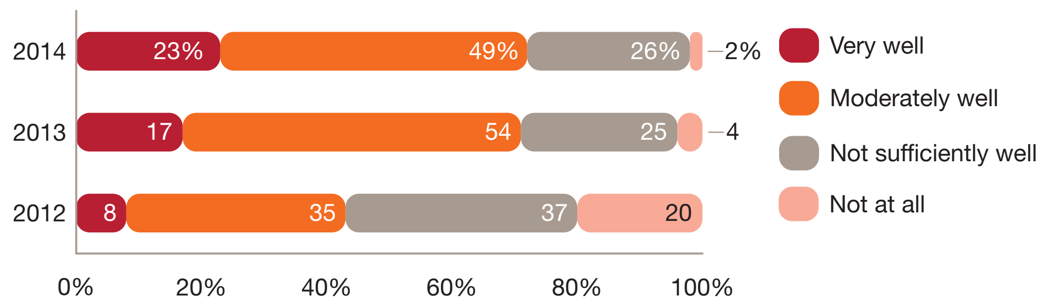
However, boards now say they have a much better understanding of the company's communication response plan in the event of a crisis; 72% of directors describe their understanding as at least "moderately well"—a substantial increase from only 43% who said this in 2012. This improvement may be due to additional board focus on crisis communications plans after lessons learned from some recent high-profile situations that caused companies reputational damage and adversely affected shareholder value.

In your opinion, how well does your board understand:

Your company's risk appetite?



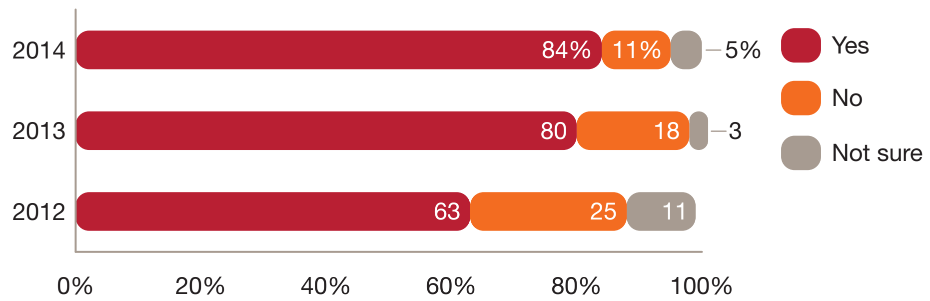
The company's communication response plan in the event of a crisis?



Who's got what risk?

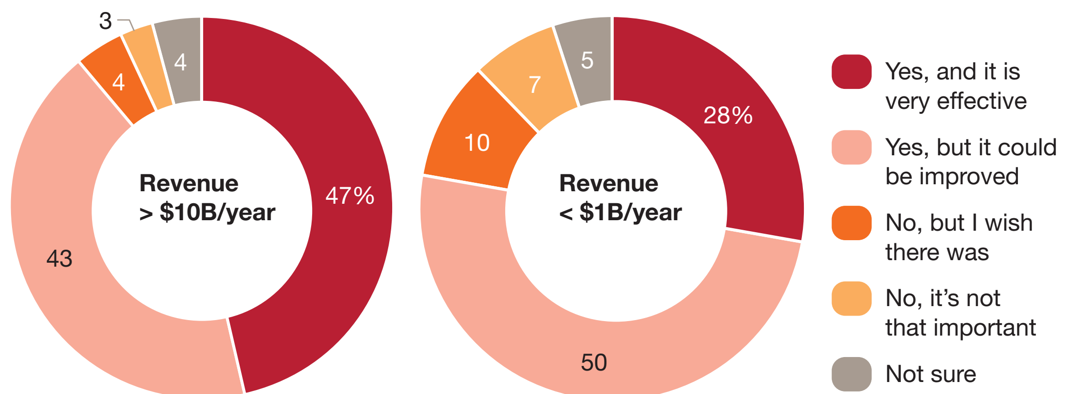
While boards frequently assign certain high-level risk oversight responsibilities to a specific committee, other risks are often overseen by the whole board. Clarity about the allocation of responsibilities is essential to ensure coverage and understanding. Over the last three years, directors have become more comfortable with the allocation of specific responsibility for overseeing major risks between the board and its committees. In 2014, 84% said there was a clear allocation of responsibility, up from 80% in 2013 and 63% in 2012. However, of those directors who say there is a clear allocation of responsibility this year, 55% still think it can be improved. The larger the company, the more likely a director is to believe there is a clear allocation of responsibilities for risk oversight.

Is there currently a clear allocation of specific responsibilities for overseeing major risks among your entire board versus its individual committees?



Is there currently a clear allocation of specific responsibilities for overseeing major risks among your entire board versus its individual committees?

Results by annual company revenues



How to reduce fraud risk

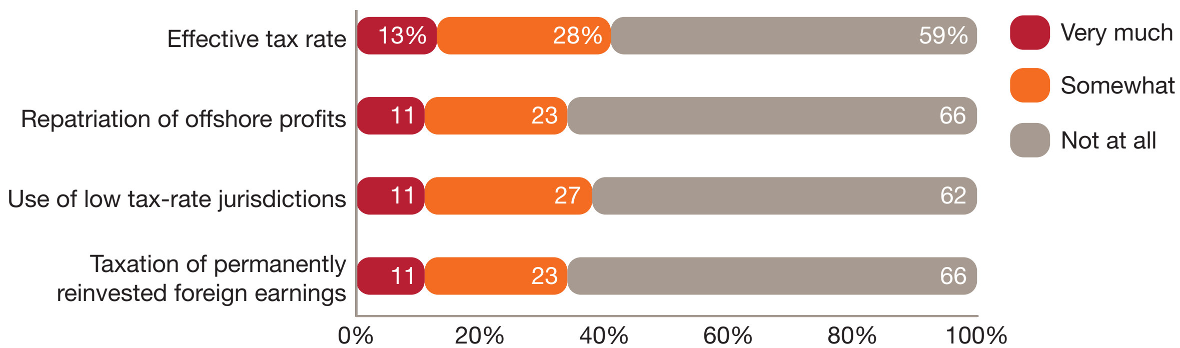
Considering the active regulatory and enforcement environment, it's no surprise that directors continue to take action to reduce fraud risk. More than seven-in-ten directors say they made changes to their approach to fraud risk over the last twelve months. The most common actions were holding board discussions of "tone at the top," having board members interact with members of management below the executive level, and increasing the amount of time spent on board discussions of risks embedded in compensation plans. Particularly noteworthy is that over the last three years, there has been a significant increase in the percentage of directors who say they have had interactions with members of management below the executive level: 50% said so this year—compared to 31% in 2012. Boards are also taking specific actions on several other fronts, giving higher levels of attention to insider trading controls, upward/peer feedback of executives and exit interviews.

Which of the following has your board done in the last 12 months to reduce fraud risk?

Boards discuss public perception of their company's tax matters

This year we asked directors about their boardroom discussions of public perception regarding their company's income tax rate and related tax issues. About six-of-ten directors say their board has not discussed public perception of their company's effective tax rate or its use of low tax rate jurisdictions. About two-thirds have not discussed public perception of their company's repatriation of offshore profits or the taxation of permanently reinvested foreign earnings.

To what extent is your board discussing public perception of the company's:

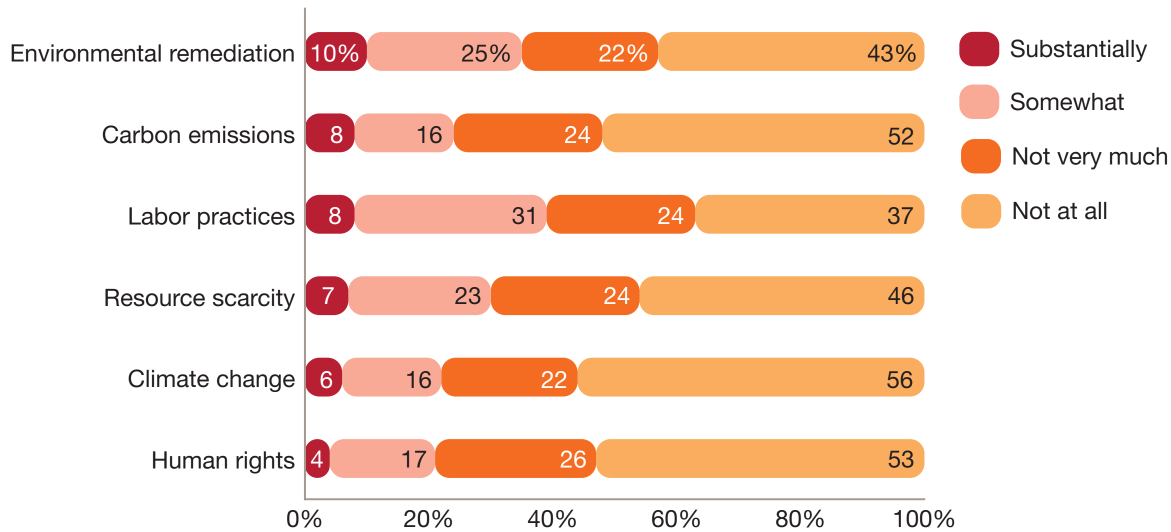


The importance of corporate social responsibility

While a number of organizations have identified issues like sustainability and climate change as societal imperatives, a majority of directors say they are not having substantial discussions about corporate social responsibility issues in their boardrooms. During the last 12 months, about three-quarters of directors say they have “not very much” or “not at all” discussed issues like human rights, climate change, carbon emissions, or resource scarcity. These topics may not be as high on the list of board priorities as other items. Many of these corporate social responsibility issues could present risks to companies. For example, potential new regulations around carbon emissions might significantly affect plant operations. Resource scarcity could make it expensive, difficult, or even impossible to produce certain products. In addition, a growing number of stakeholders—particularly investors and customers—are demanding companies operate in more socially responsible ways.

While only a minority of directors are substantially discussing corporate social responsibility issues, these discussions are most likely to occur in the boardrooms of mega-cap companies. This may be because the largest companies are more likely to already be reporting to stakeholders on their corporate social responsibility initiatives.

In the last 12 months, to what extent has your board discussed the following corporate social responsibility issues:



Executive compensation remains a hot topic

Executive pay remains a trend impacting boards. In response, boards are devoting even more time and attention to the critical issue of appropriate compensation. With three years of "say-on-pay" behind us and equity markets rising to new levels, we asked directors to give their current perspectives on compensation oversight.

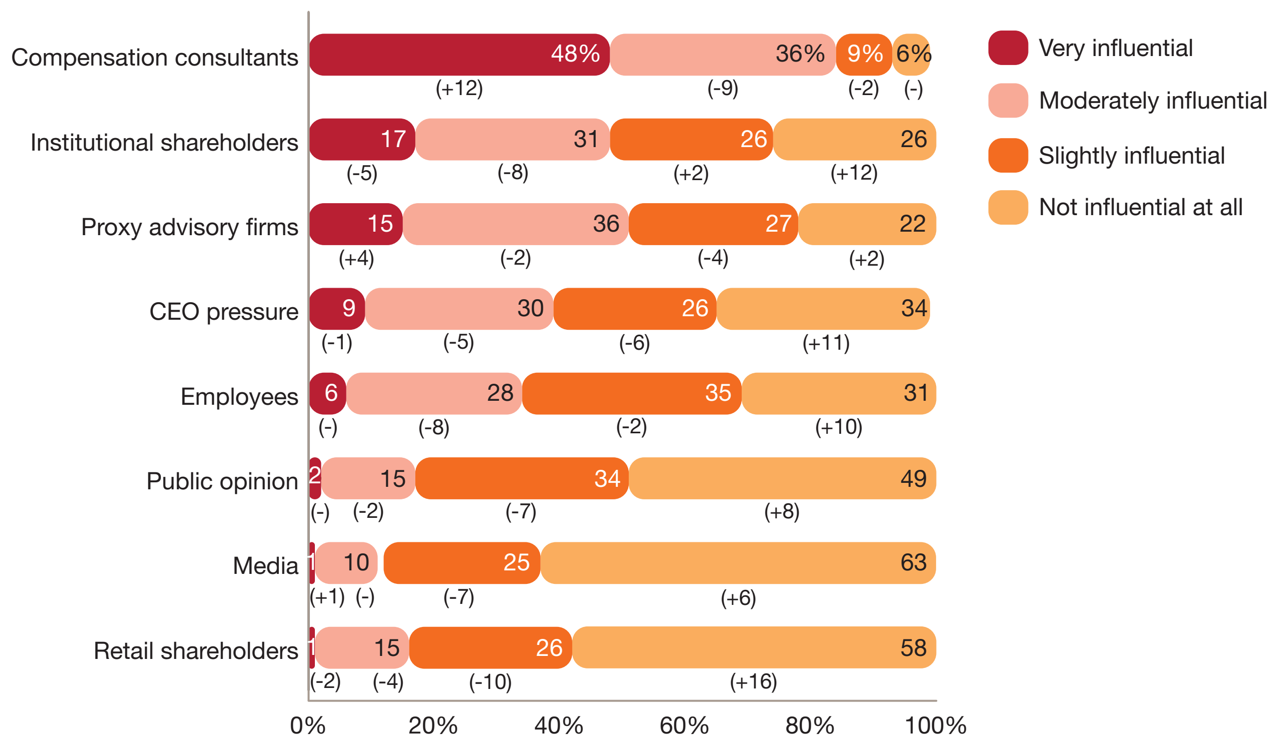
A related trend is the interest of stakeholders in the proxy advisory industry. We also asked directors their perspectives on these firms.

Who influences CEO pay?

Compensation consultants continue to have the strongest influence on director decisions about executive compensation. Forty-eight percent of directors describe them as very influential—up 12 percentage points from 2013. Proxy advisory firms also saw their influence increase, albeit modestly, as 51% of directors describe them as at least moderately influential, compared to 49% last year. CEO pressure has declined as an influence; only 39% of directors describe it as moderately or very influential, compared to 45% last year.

Rate the level of influence that the following have over your board's decisions on executive compensation:

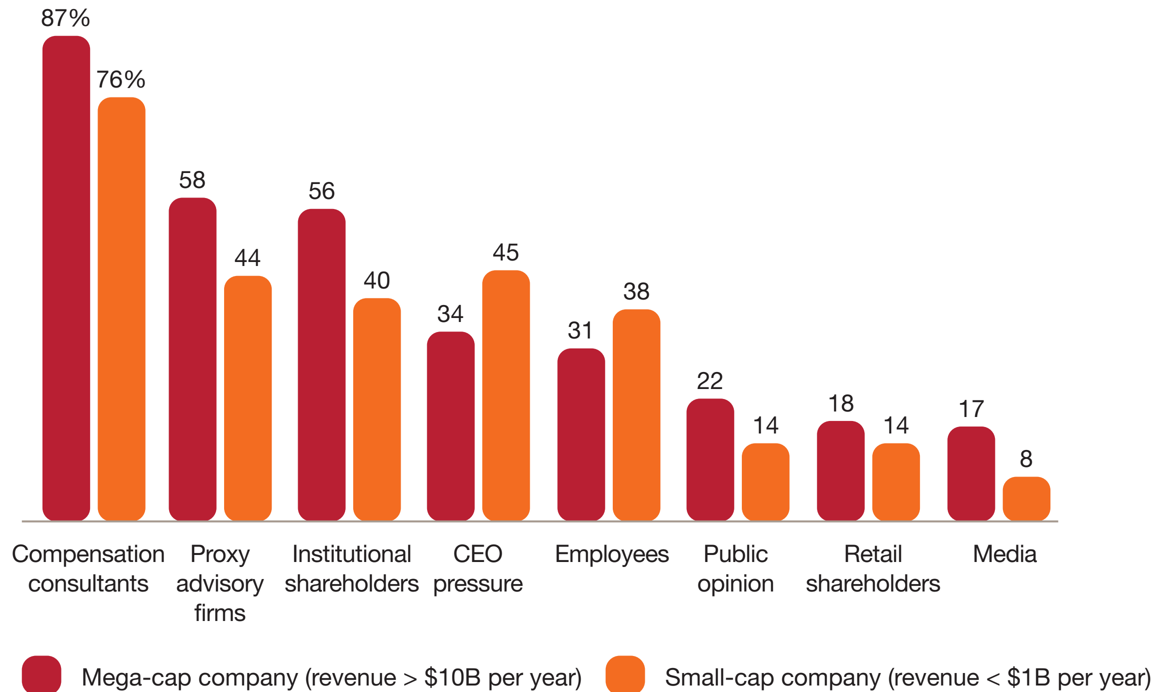
Amounts shown in parentheses represent the change in percentage points from the 2013 survey.



Mega-cap company directors believe compensation consultants, institutional shareholders, and proxy advisory firms are more influential on compensation than do small-cap company directors. Mega-cap company directors also say they are more influenced by the media; 50% say the media has at least some influence on compensation decisions, but only 28% of small-cap company directors feel the same. Directors of mega-cap companies may feel their companies are more of a target of public criticism about compensation practices.

Rate the level of influence the following have had over your board's decisions on executive compensation:

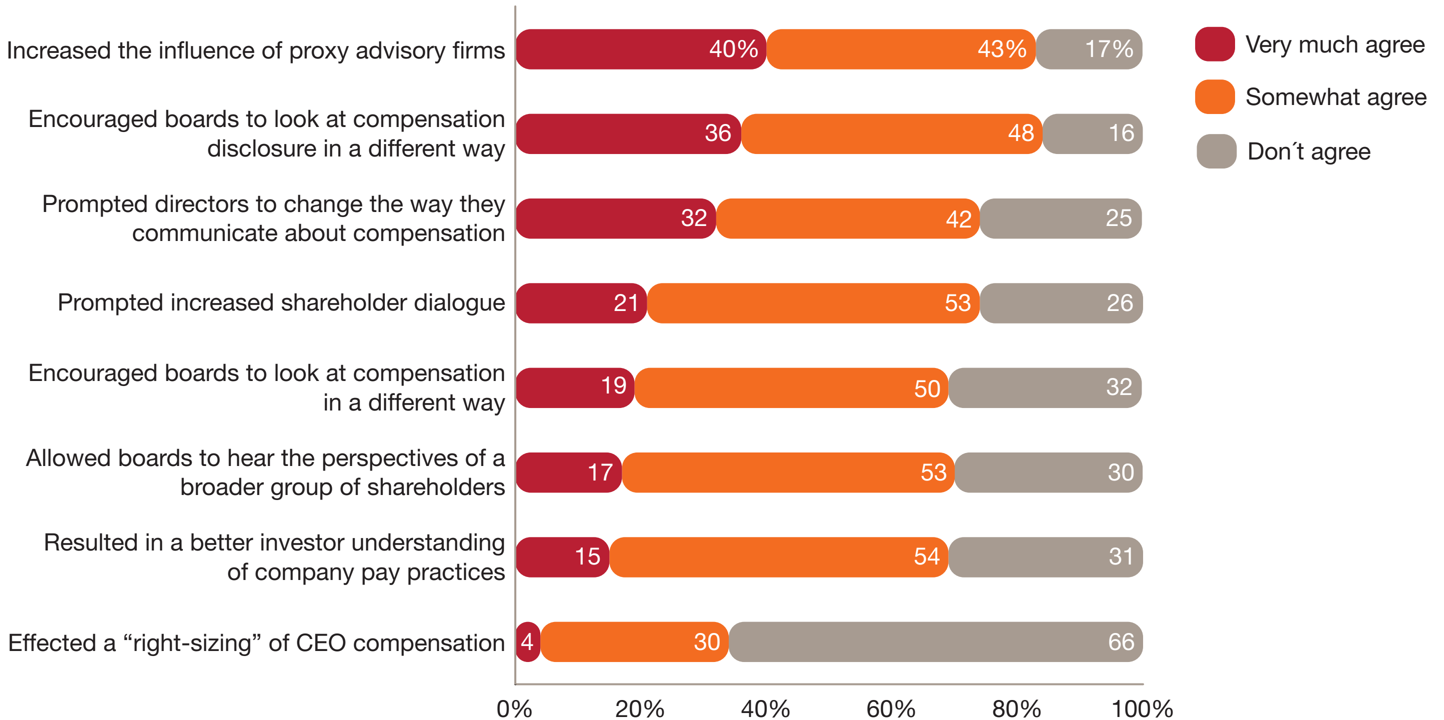
Percentage of directors who indicated the following parties are very influential or moderately influential:



What's the real impact of "say-on-pay"?

Shareholders continued to support compensation plans at high levels during the 2014 proxy season—with average affirmative voting of 89%.[10] Considering "say-on-pay" advisory voting began four years ago, this year seemed like an ideal time to ask directors to step back and assess its cumulative impact. Eighty-four percent at least "somewhat agree" that "say-on-pay" voting has caused their board to look at compensation disclosure in a different way; 83% feel it increased the influence of proxy advisory firms. Nearly three-quarters at least "somewhat agree" that "say-on-pay" increased shareholder dialogue and prompted their board to change the way it communicates about compensation. Yet two-thirds of directors don't think "say-on-pay" has effected a "right-sizing" of CEO compensation, and nearly a third don't think it resulted in a better understanding by investors of company pay practices.

What is your assessment of the cumulative impact of "say-on-pay" voting?



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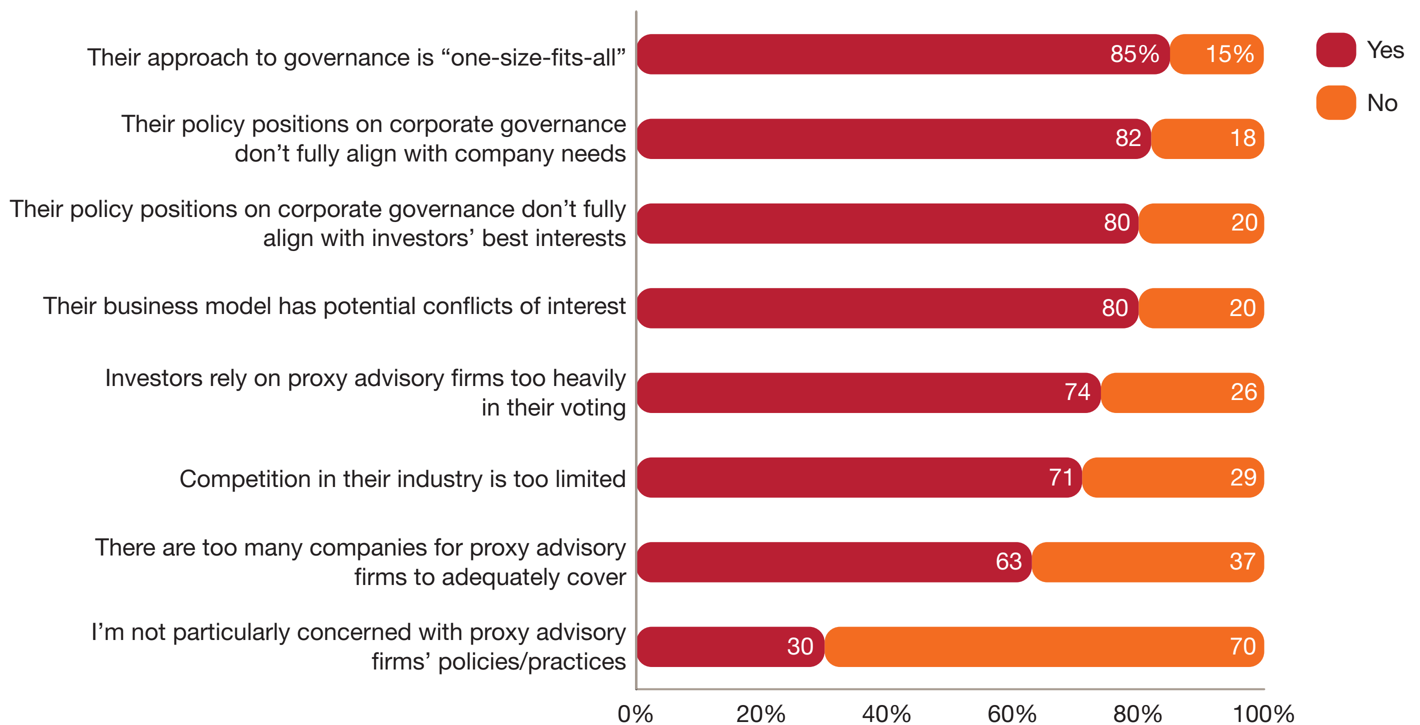
Proxy advisory firms in the spotlight

Directors continue to express significant concerns with the independence, thoroughness, and voting recommendations of proxy advisory firms. And proxy advisors have the attention of regulators. In June 2014, the SEC issued guidance to investment advisers regarding their responsibilities in voting client proxies and their reliance upon the recommendations of proxy advisors.

We asked directors about their specific concerns with proxy advisory firms. At least eight in ten believe proxy advisory firms use a "one-size-fits-all" approach to governance and that their business model has potential conflicts of interest. A similar percentage says proxy advisory firm policies don't align with company needs or investors' best interests. The larger the company and more tenured the director, the more likely he/she is to have these concerns.

Considering recent public discussions, do you have any of the following concerns regarding proxy advisory firms?



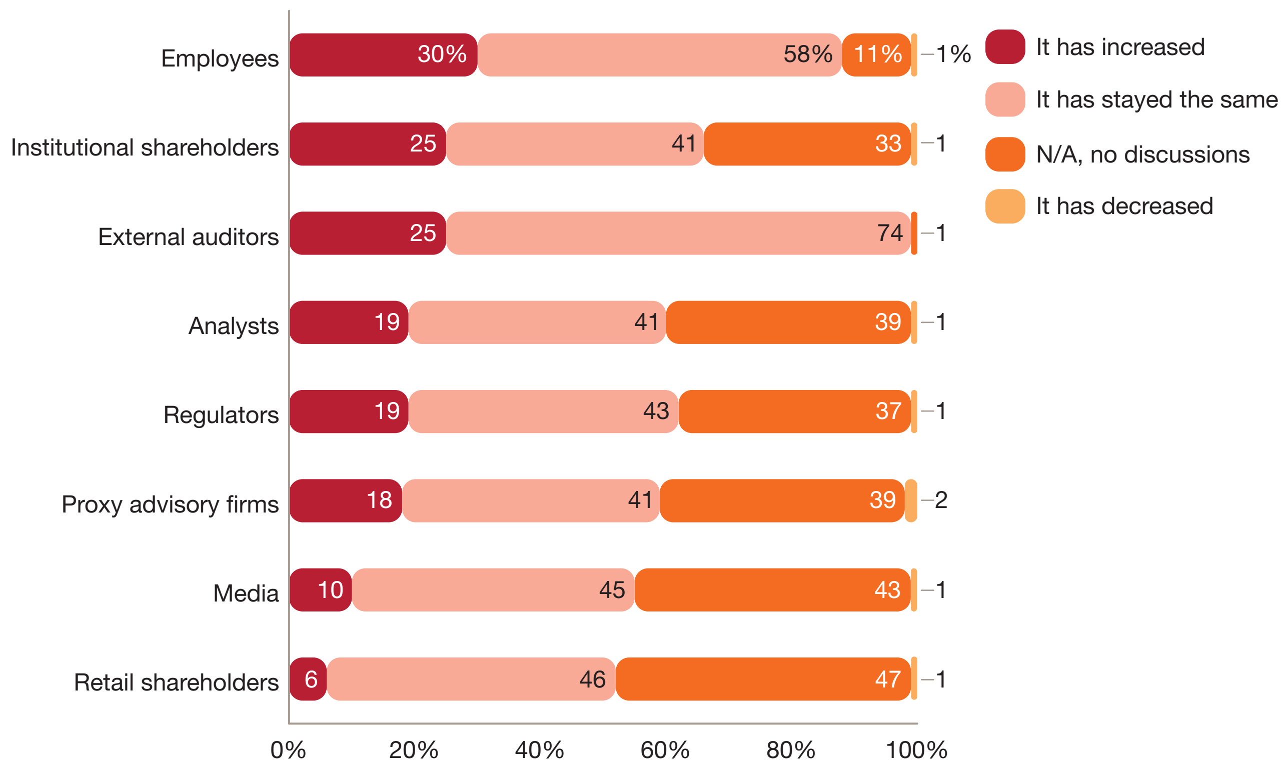
Increasing expectations about director communications

Increasing expectations about director communications is another trend shaping the board of the future. Boards need to determine their role in stakeholder communications—and evaluate their processes and procedures governing such communications. We asked directors about their current behaviors and views on this important trend.

Director communications increase

Compared to last year, director communications with stakeholders increased across all constituencies. Particularly noteworthy is that 30% of directors say they enhanced communications with the company's employees—the largest year-over-year increase of any individual group. Also, a greater percentage of directors are communicating with institutional investors—66% now say they do so compared to 62% last year.

During the last 12 months, how would you describe the level of your board's direct communication with:

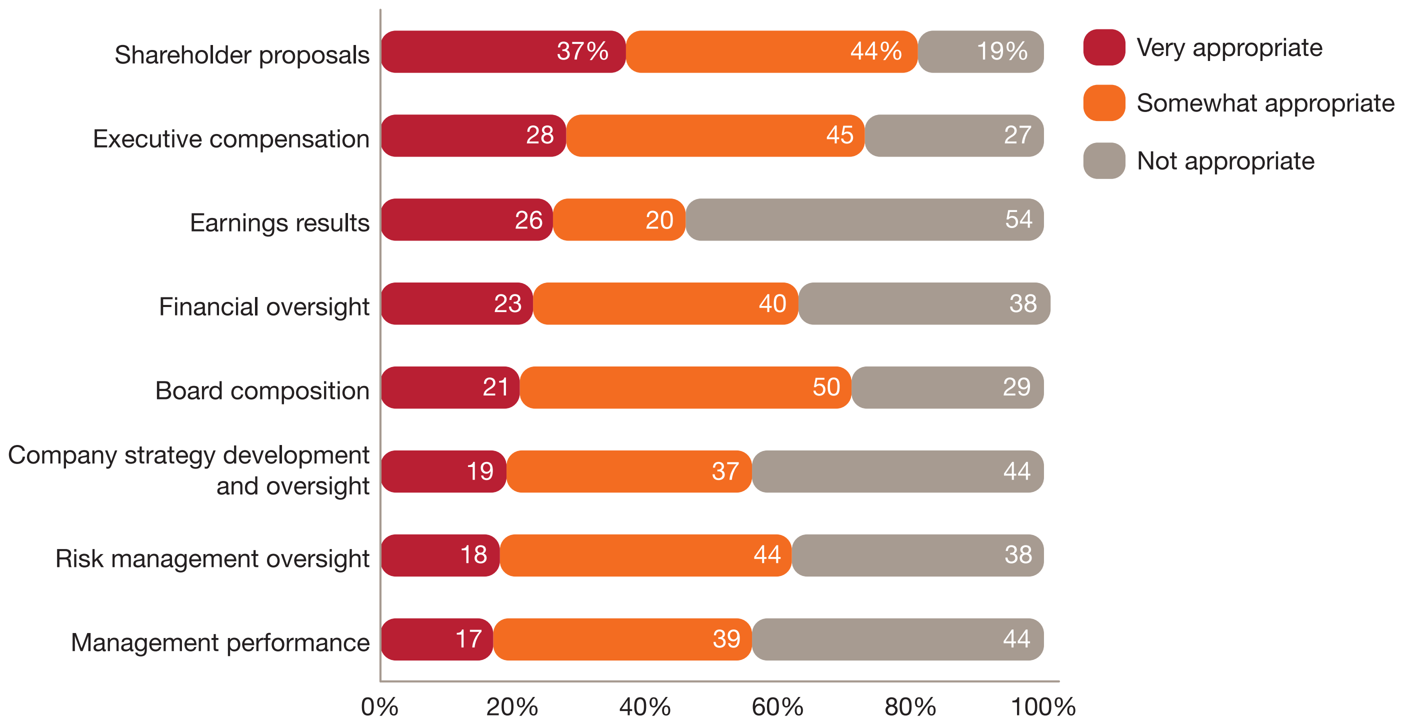


Appropriate topics for director-shareholder dialogue

Seventy-three percent of directors now believe it is at least "somewhat appropriate" to discuss executive compensation with shareholders, compared to only 66% last year. Similarly, a majority of directors (56%) say it's appropriate to communicate with investors about strategy, compared to 45% last year. It's possible that some of this increase may be attributable to positive experiences directors have had communicating about "say-on-pay." This also may be due to the activist shareholder environment.

Almost 30% of directors don't believe it is appropriate to discuss board composition with shareholders, which may include matters like director attributes, board succession, board tenure, and diversity.

Regarding the following topics, how appropriate is it for boards to engage in direct communication with shareholders?

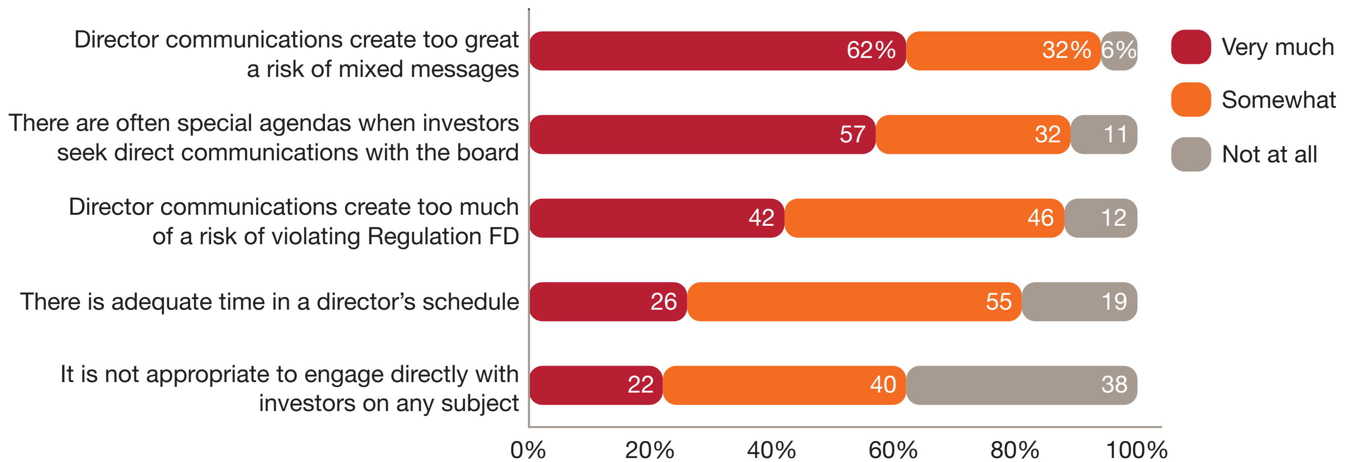


What about the risks of director communications?

Many directors have been reluctant to participate in direct communication with shareholders for a variety of reasons, including the concerns about having too many voices speaking on behalf of the company. Other concerns relate to fears that some investors have "agendas" and worry that discussions may inadvertently violate Regulation Fair Disclosure (Reg FD). Despite increased director-shareholder communications, many of these concerns remain. In fact, 94% of directors are at least "somewhat" concerned about the potential for mixed messages, and nearly nine-in-ten are concerned about investors having special agendas. Directors also continue to be worried about violating Reg FD—88% are at least somewhat concerned.

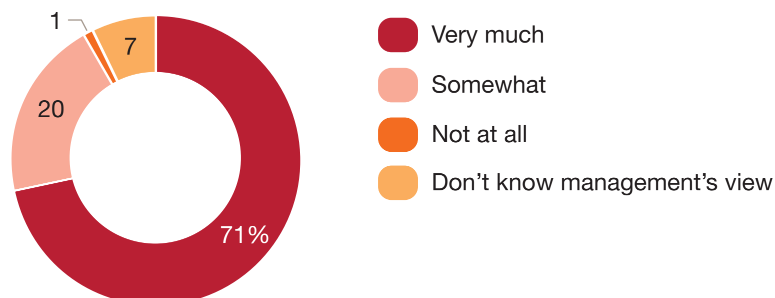
Overall, male directors are more likely to express trepidation about director-shareholder communications; 65% believe it creates too great a risk of mixed messages, compared to 51% of female directors. And 23% of male directors don't believe it's appropriate to communicate directly with shareholders on any topic—compared to just 12% of female directors.

To what extent do you agree with the following regarding director/shareholder communications?



Regardless of the approach to director-shareholder engagement, it's imperative that the board and management have an understanding of each other's respective views. This appears to be the case, as 71% say the board and management are very much aligned. Directors of larger companies say they are more aligned than do those of smaller companies.

How aligned is your board with management regarding each party's respective views on director engagement with shareholders?

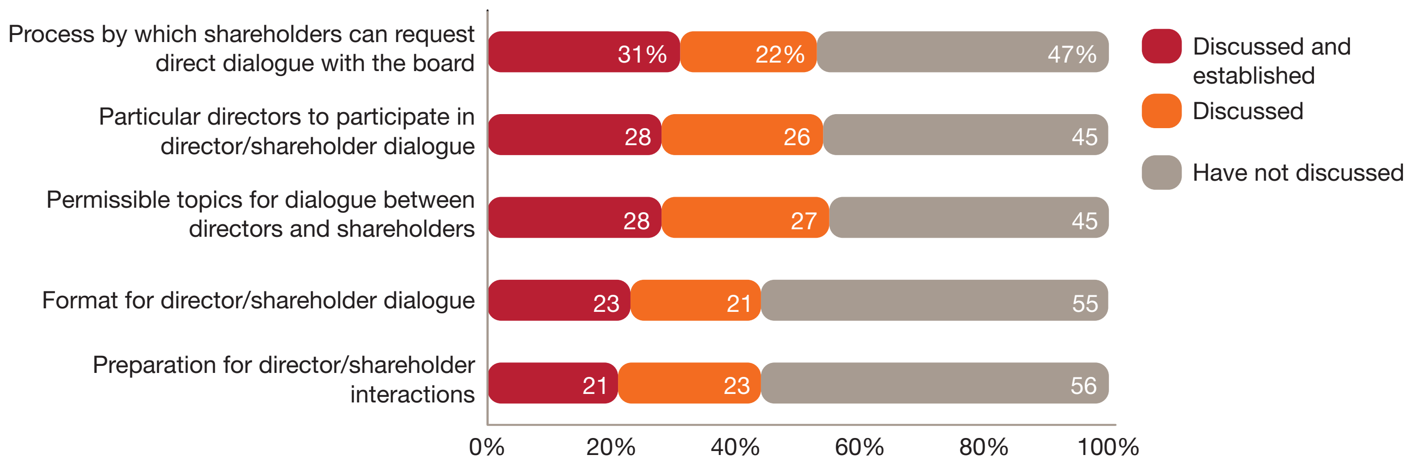


More communication protocols needed

Recently, an influential working group of institutional investors and directors sent a letter to every Lead Director and Corporate Secretary in the Russell 1000 asking them to consider adopting a formal policy on director-shareholder engagement.[11] There have also been other groups that have brought directors and investors together to discuss the issue of engagement, and subsequently issued suggested leading practices. Among the recommendations, a common suggestion is for boards to develop policies and protocols for shareholder dialogue. Despite this fact, only about one-quarter of directors reports their board has discussed and established a format for such dialogue.

Further, more than half of directors have not held discussions about company protocols and practices in preparation for director-shareholder interactions. Almost half of directors have also not discussed company protocols and practices regarding the process by which shareholders can request direct dialogue with the board, the particular director(s) who would participate in such a dialogue, and the permissible topics for discussion. A greater percentage of mega-cap company directors have discussed and established director communication protocols and practices. This may be partially because shareholder requests were made of them sooner or because they have greater internal resources.

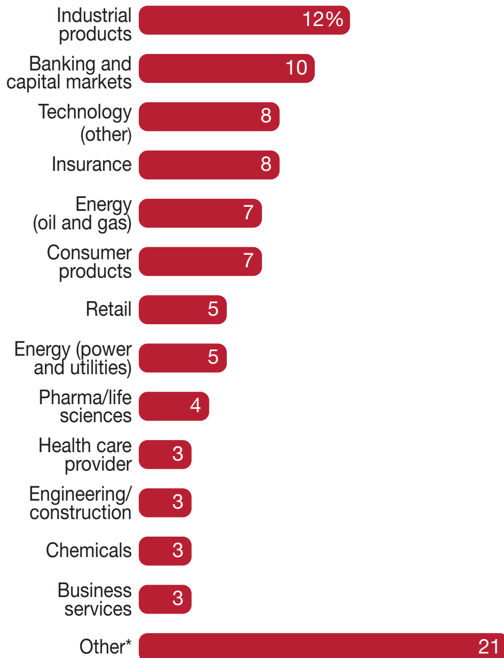
Has your board discussed or established company protocols/practices for:



11 See the Shareholder-Director Exchange (SDX) Protocol, available at www.sdxprotocol.com

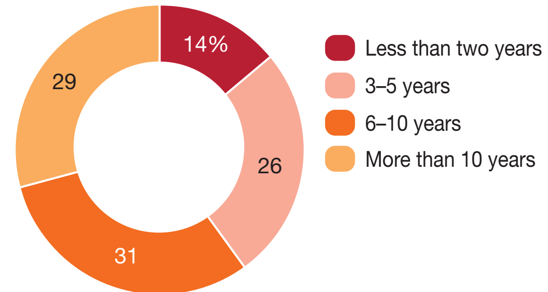
Demographics of survey participants

Which of the following best describes the company?

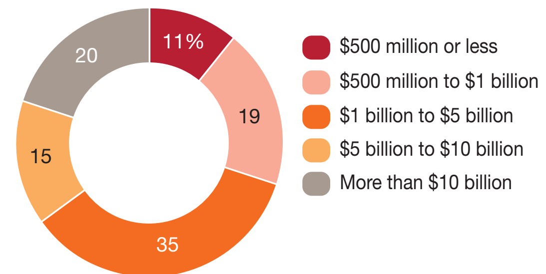


*Other includes the sum of the following industries with no individual response receiving over 2%: transportation/logistics; software/internet solutions; semiconductor; hospitality/leisure; government contracting; communications; automotive; asset management; mining; healthcare payer; forest, paper, and packaging; entertainment/media; and agribusiness.

How long have you served on this board?



What are the annual revenues of the company?



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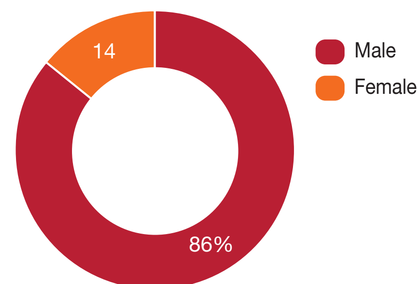

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