WHEN INVESTORS ASK TO SPEAK TO DIRECTORS

Preparation is vital to ensure successful board-shareholder engagement.

By Nicole Noutsios

It is no secret: proxy access and shareholder activism are grabbing the media spotlight, and more institutional investors are asking to speak to directors.

What does that mean for companies, their boards, and IR professionals? As the 2015 proxy season and other recent corporate governance developments have highlighted, companies need a thoughtful and proactive approach on how they structure engagement between their shareholders and their board of directors. And, since there is a broad spectrum of shareholder engagement that can occur, companies need to create a flexible and proactive framework for successful board-shareholder engagement.

The desire of shareholders to influence the board and the strategic decisions of companies is not a new development, although many companies traditionally have limited direct communications between investors and directors. In the past year, a number of fund managers have publicly called for greater board-shareholder engagement. Vanguard sent a letter to its portfolio companies asking them to create "shareholder liaison committees" and to "encourage boards to have a thoughtful process to communicate with shareholders." BlackRock, TIAA-CREF, State Street, and other institutions have urged companies to adopt a 10-point "Shareholder Director Exchange Protocol" to promote more effective engagement. Meanwhile, it appears that directors have become more willing to engage with investors. According to PricewaterhouseCoopers' 2014 Annual Corporate Directors Survey, 66

percent of respondents said they communicate with institutional investors.

Peggy Foran, the chief governance officer, vice president, and corporate secretary at Prudential Financial, who also serves on the board of Occidental Petroleum, observes that Say-on-Pay votes, activism, and proxy access are fueling an increase in engagement. "Companies are looking at the activism landscape and saying, if it happened to them, it can happen to us. So, over time, more companies will embrace direct board-shareholder interaction. Boards are starting to ask how to open up the dialogue so that they can promote better transparency on what is happening within the company and understand the shareholder ecosystem and perspective."

When and How Should Boards Communicate?

Given the increased frequency of board-shareholder engagement, companies should be proactive and evaluate their communications plans for potential shareholder dialogue, and create a customized protocol appropriate for each individual situation. Even with the increase in investor communications, the PricewaterhouseCoopers' survey found that "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."

The types and reasons for investor requests can vary. According to NIRI's 2013 Board-Shareholder Engagement survey, the most likely venues for direct interactions between board members and shareholders are annual meetings (49 percent) and through the proxy voting arms of institutional shareholders (11 percent). During proxy season, the most common topics on which directors interact with shareholders are corporate governance policies, including executive compensation and director nominations. Activist situations, which can also occur throughout the year, are becoming more commonplace and public.

If a company does decide to allow direct board-shareholder engagement, it must be mindful about when and how that engagement occurs. Additionally, the company's overall objectives need to be addressed. Given the broad spectrum of shareholder engagement that can occur, the initial priority should be a thoughtful examination of whether it is appropriate for a company's board members to interface with its shareholders, and who the most appropriate company contact is. Not all board members are ready for "prime time," so some companies limit which directors may speak directly to investors. Within the companies that do permit direct communication, 35 percent of NIRI survey respondents said they allow only certain directors to do so.

The first step in a successful board-shareholder engagement is for the investor relations officer to establish a communications protocol. The IRO should initially review every request prior to any interaction, and if the request needs to be escalated, it should involve other pre-determined members of the executive team – including the legal team and/or a senior executive. Often, it may be more appropriate for management, legal, or investor relations to try to address the reason for the request first before involving a board member.

While board-shareholder communication may be appropriate in select cases, direct access to any board member is not necessarily the best approach for every company. Directors with stronger capital markets expertise or greater industry expertise may serve as better company representatives than other board members. For investor inquiries related to Say-on-Pay, the chair of compensation committee may be the best representative, assuming the chair is conversant about the company's pay practices. Having a strong partnership and thoughtful discussion with executives, legal team, and external advisors can help determine the best course of action.

There are a variety of formats companies choose from to quickly and proactively address shareholder requests or concerns. While many companies designate only one representative from the board to speak for the company's interests, others may choose to create a special committee to address shareholder concerns. There are also situations where an IRO, legal counsel, or member of the management team will participate in the meeting or call with the board member and investor to provide additional perspective or oversight. The overarching goal in this situation is to provide company representatives who are knowledgeable, prepared, and can engage quickly if needed.

For example, when Atmel announced the retirement of its CEO, several investors wanted to provide feedback to the board about the CEO selection process. Peter Schuman, senior director, investor relations at Atmel, worked with his management team to determine the most effective spokesperson from the board to engage with select shareholders. The team determined that the chairman was the most appropriate member of the board to speak with key investors.

Preparation for Engagement

Before a board member engages with a shareholder, the company should have a clear and cohesive communication plan in place, as well as an educated and prepared director. While constructive dialogue between the board and investors can be insightful for both sides, large and long-term negative ramifications may result if not executed properly. This holds especially true in the case of activism; campaigns can have a range of outcomes and parts of a director's conversation can be taken out of context and end up in print, negatively affecting shareholders' perceptions of the company.

Strong and advanced preparation also is paramount in ensuring a positive outcome during board-shareholder communications. In some cases, board members may not be up-to-date about the company if board meetings are only held on a quarterly basis. Therefore, it is likely that select board members may not have as strong a grasp about the company's story and disclosure history as the company's day-to-day IR or communications representatives. All board members who plan to speak to investors should have Regulation FD training to help prevent inadvertent disclosures of material, non-public information. The PricewaterhouseCoopers' survey found that "despite increased director-shareholder communications ... directors also continue to be worried about violating Regulation FD" – 89 percent said they are at least "somewhat concerned."

It is imperative that advance preparations are made so the parameters of what will and will not be discussed are clearly understood and agreed upon by the company's representatives. If the company decides to allocate board time to speak with a shareholder, the board member should be armed with not only talking points and disclosure history, but also the shareholder's key concerns and perspective about the company.

Clear and consistent communications, coupled with an approved cohesive and coordinated plan, are necessary when multiple representatives are communicating with investors. For example, if the topic is related to proxy season, the designated board member(s) should be briefed about whether or not the company spoke with this investor about a specific topic in the past, and whether

A YEAR-ROUND STRATEGY FOR PROXY SEASON

MANY COMPANIES HAVE DEVELOPED ACTIVE YEAR-ROUND GOVERNANCE OUTREACH programs to help guarantee a successful proxy season. Advanced planning with your management team and directors on the company's expected proxy ballot items can greatly impact a company's relationship with investors, as well as ensure a successful proxy season.

Here are some guidelines to consider, well in advance of your shareholder meeting.

Advance planning can have a large impact. Six to nine months before your shareholder meeting, begin your company's proxy planning and shareholder outreach. Engage your general counsel, management team, and board to proactively discuss key issues, such as Say-on-Pay, that may impact the company in proxy season.

Prepare well in advance of your shareholder meeting to ensure a positive outcome. Before engaging your shareholders, make sure your team has a communication plan and established goals. Spokespersons should be armed with not only talking points and disclosure history, but also the shareholders' key concerns and perspective about the company. For example, the company's representatives should be briefed about whether or not the company communicated with this investor on a specific governance topic in the past and whether or not the board implemented any of the investor's suggestions.

Start investor outreach well in advance of your shareholder meeting. Reach out early to your top shareholders to obtain feedback about your compensation program, as well as other potential governance issues. If the dialogue is started well before the busy spring proxy season, governance experts, such as a proxy solicitation firm, can offer your company broad perspective about key issues that may impact your company. Early engagement allows for an interactive conversation that will help drive the board's discussion regarding the company's future proxy proposals.

Have a strong knowledge of your investors and how they vote. Many companies use a proxy solicitation firm to analyze proxy voting data to determine whether their investors closely follow their institution's voting guidelines or if they have the ability to have an independent perspective on your proxy proposals. In some cases, the proxy compliance department will have greater impact than your institutional contact. Before you allocate management or board time, it is important that the company has a clear understanding of who the decision makers are at each buy-side firm.

Incorporate feedback into your planning. When reaching out to the company's key influencers, determine what each buy-side firm's policies are and potential "hot buttons" to consider. If you receive insightful investor feedback about the company's anticipated proxy proposals, you should consider incorporating this input into your proxy planning.

Continue outreach later in your proxy process. Reach out a second time to investors as the company sets the record date for the annual meeting. Identify your top influencers and target your discussions to be focused on the preliminary proxy filing. Depending on your proxy proposals, certain issues may require you to enlist a specific board committee member to assist with engagement.

Select the most appropriate representatives. If you need to set up a governance road show, you should send a knowledgeable board member and ensure that he or she is adequately prepared. For Say-on-Pay matters, other internal participants also may include the IRO, the chief governance officer, and the HR officer who oversees compensation and understands your executive pay practices. Your team members should also be aware of key speaking points and past shareholder concerns.

or not the company implemented any of the investor's suggestions. When dealing with proxy fight activism, many companies schedule multiple preparation sessions and heavily engage outside lawyers, communications consultants, and proxy solicitors. Preparation will help avoid the possibility of an unprepared director inadvertently violating Regulation FD or sending messages that conflict with what management has been sharing with Wall Street. Extensive preparation is critical to achieving the most optimal outcome and company alignment on key issues.

The Role of IROs in Facilitating Engagement

As board-shareholder engagement becomes more prevalent, boards have developed an increasing need to be continuously informed of Wall Street's perspective and the drivers of the company's valuation. The board should never be surprised by adverse shareholder sentiment or a negative perception of the company. IROs are in a unique position to provide their boards with strategic perspective on the most pressing investor issues facing the company and industry, as well as the interplay among executive compensation, board compensation, and corporate governance trends. When informed about the most relevant company issues, concerns, and changes in the governance landscape, boards can better understand shareholder views and be more proactive and strategic if needed for shareholder engagement.

"I think IROs can add value to the board by focusing on the right issues that impact the company on Wall Street," says Stephanie Wakefield, vice president, IR, at Informatica, who has experienced a high-profile activist campaign. "For example, it is hard to provide appropriate context for a conversation with an activist if there isn't a solid understanding by your board members about the company's investor base and key investor issues before an activist emerges. To me, providing regular updates of the top holders, shifts in the base, questions that were being asked, and providing investor perspective on the company, is important. The last thing you want to do is have your board surprised by an activist situation or other investor relations related issue."

In addition to regular correspondence, many IROs provide quarterly overviews to the board, typically around the earnings cycle. A number of considerations when providing materials might include: Who are the top shareholders and how are their holdings changing over time? Is there anything that might be concerning about the company's shareholder mix? How do key influencers feel about the company's long-term growth drivers? Are there any areas where the key shareholders and sell-side analysts believe the company needs to improve? What are the key messages and how do they relate to the corporate strategy? Has the company's peer group been impacted by activism? If so, who is involved?

To provide a basic overview of the company's shareholder base and key concerns, many IROs send quarterly background materials, such as shareholder reports, analyst notes, and a summary of current Wall Street feedback and key concerns. If a perception study was recently completed, a high-level summary is often included to provide a third-party perspective. In preparation for proxy season, many IROs are providing customized reports about possible key issues and action plans as early as nine months prior to the shareholder meeting. In addition to written materials, many IROs are also presenting to the board on an ongoing basis and bringing Wall Street's perspective and sentiments on important issues that face the company and industry.

Jim Tolonen, former CFO of five public companies over 30 years, and a current board member and audit committee chair of MobileIron and Imperva, believes IROs can add a tremendous amount of value to boards if they provide strategic insight to not only the company's investor relations efforts, but also to corporate governance issues and other developments that may impact the board. "I think an insightful investor relations perspective can be extremely beneficial for boards to become more educated about how to deliver shareholder value. From a tactical perspective, I like to see background materials that outline the company's investor relations efforts at a high-level, such as shareholder outreach," he said. "However, what adds more value is the dialogue an IRO can bring on a strategic level, such as: What are the key messages and how do they relate to the company's strategy? What is the candid feedback from Wall Street that can assist the board on enhancing shareholder value? What are the key issues the board may face in proxy season and what should we be thinking about six to nine months in advance of our shareholder meeting?"

There is a strong need for companies to look forward and anticipate market trends and governance developments. As board-shareholder engagement becomes more prevalent, companies will benefit from having a communications policy about how to promptly address serious investor inquires. Companies and boards need to be thoughtful about understanding their shareholder base and the ever-changing sentiment of Wall Street and commit to strategic engagement. This presents an opportunity for investor relations officers to think proactively and to add significant value by educating the board about activism, corporate governance, and other key issues that may impact the company. IRU

***Nicole Noutsios** is the founder of NMN Advisors, Inc.; Oakland, Calif.; nicole@nmnadvisors.com.*