

2011 SPECIAL SUPPLEMENT

# GETTING A GRIP ON GOVERNANCE



**RESULTS OF THE**  
**2011 Corporate Board Member/FTI Consulting Legal Study**

# Getting a Grip on Governance

Recent regulatory action, though well intentioned, is contributing to governance gridlock and increased liability, insiders say. Furthermore, our survey results indicate risks are escalating, particularly in the areas of operations, data security, and e-discovery.

Congress and the SEC have certainly given directors and general counsel much to consider in terms of the legal and regulatory challenges facing companies today. For starters, the 2,300-page Dodd-Frank Wall Street Reform and Consumer Protection Act holds much to digest, with its whistleblower provision drawing the most attention of late. Then there's the issue of proxy access and the pending lawsuit filed by two Washington, D.C.-based business groups. Beyond the headline-grabbing topics, however, there's still plenty to worry about in terms of previously identified risks and ongoing compliance requirements. To that end, Corporate Board Member and FTI Consulting surveyed 333 directors and 128 general counsel to find out which legal matters are top of mind.

## Doubts about Dodd-Frank

We began by asking directors and general counsel their feelings about the Dodd-Frank Act's whistleblower provision, which rewards employees who go directly to the SEC regarding alleged occurrences of fraud or company malfeasance. Perhaps not surprisingly, 94% of directors and an equal percentage of general counsel surveyed agree that this provision needs to be reevaluated (Figure 1).

One of the biggest concerns, again according to 94% of responding directors and a like percentage of general counsel participants, is that the provision gives employees the incentive to bypass established

whistleblower procedures in all cases, even those involving historically compliance-sensitive companies. As a result, many of the directors (83%) and general counsel (92%) surveyed believe the number of whistleblower incidents will rise. Furthermore, one-third of directors and 21% of general counsel in the study agree that the threat of employees going directly to the SEC will have most companies considering an increase in incentives offered to employees who identify and express their concerns internally.

"With the overwhelming majority of directors and general counsel agreeing that the whistleblower provision needs to be reevaluated, we see that companies are concerned with the future of their compliance programs," says Neal Hochberg, senior managing director and leader of FTI Consulting's forensic and litigation consulting practice. "In the regulatory environment that we are currently faced with, many directors and general counsel believe that this provision could lead to weakened internal compliance programs. As employees may be incentivized to go directly to the regulators, it will be critical to build solid internal programs."

As to the act itself, 83% of directors and a nearly equal percentage of general counsel who participated in the study indicated they do not believe Dodd-Frank will help create sound markets or benefit well-managed companies. Instead, 80% of responding directors and 72% of general

counsel participants agree that the ultimate impact of Dodd-Frank will be increased oversight, reduced earnings, and a less-attractive capital market environment for prospective public companies. However, just over one-third of directors and 37% of general counsel surveyed think that the Dodd-Frank Act, while not necessarily good for companies, will be important to investor confidence in the U.S. capital markets.

Past Corporate Board Member research has shown that directors believe the Sarbanes-Oxley Act ultimately contributed to their board being more effective. When asked if they think, in five years' time, opinion will reflect similarly on the Dodd-Frank regulation, only about a quarter of directors and a similar percentage of general counsel surveyed agree that it will be perceived positively in the future.

“As companies prepare for enforcement of the Dodd-Frank Act, the ultimate impact of the law is still to be determined. However, these findings demonstrate that directors and general counsel alike have responded negatively to the act, and they unfortunately do not envision that it will help investor confidence. This shows that much still needs to be done to help companies understand Dodd-Frank during this initial stage and the potential benefit to U.S. capital markets.”

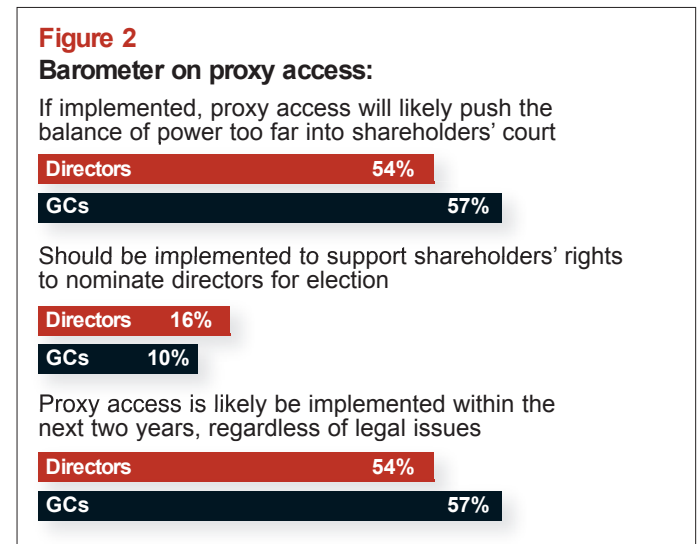
### Showdown on proxy access

The SEC's proposed proxy access rule would allow long-term shareholders to wield more power over director slates by recommending board nominees who would appear on company proxy statements. Last September, the U.S. Chamber of Commerce and the Business Roundtable sued the SEC to have the rule thrown out, saying the SEC was acting “arbitrarily and capriciously” in its treatment of state corporate laws. During oral arguments held in April, judges questioned the SEC's analysis of the rule's costs. A final ruling is expected this summer.

We asked respondents their thoughts on the possible effects of such a regulation (Figure 2). Just over half of the directors (54%) and general counsel (57%) surveyed agree that if implemented, proxy access would likely push the balance of power too far into shareholders' court. Furthermore, just 16% of responding directors and

**Figure 1**  
**The Dodd-Frank Act ...**

	Directors	GCs
Needs to be reevaluated	94%	94%
Gives employees incentive to bypass established whistleblower procedures	94%	95%
Will lead to an increase in whistleblower incidents	83%	92%
Will have most companies considering an increase in incentives	34%	21%
Will help create sound markets and benefit well-managed companies	17%	16%
Will ultimately lead to increased oversight, reduced earnings, and a less-attractive capital market environment	80%	72%
While not necessarily good for companies, will be important to investor confidence in U.S. markets	35%	37%
Will be perceived positively in five years' time	23%	26%



10% of general counsel participants think proxy access should be implemented to support shareholders' rights to nominate directors for election. However, a majority of respondents, 54% of directors and 57% of general counsel, believe that despite the current legal battle, proxy access will be implemented within the next two years.

## A renewed focus on liability

Given the close attention being paid to corporate accountability as a result of the economic meltdown and subsequent bailout, some governance observers predict we may see a greater effort to hold directors personally liable for serious violations or neglect of duties. When asked about the outcome should these predictions prove true, 61% of directors surveyed and 52% of responding general counsel indicated they would expect numerous qualified directors to either exit boards or choose not to serve in the future. Another 36% of directors and 45% of general counsel participants think such efforts would impact only a few “bad seeds” with most directors not being affected, similar to the Enron and WorldCom debacles (Figure 3).

Along those lines, directors were asked whether they feel confident that the advice they receive from inside counsel helps reduce their risk of liability. Seventy-four percent of those surveyed indicated confidence in their inside counsel in this area. This is a slight improvement from 2006, when about two-thirds of the directors surveyed believed that their general counsel’s advice would decrease their liability.

In an effort to find out how board members might be attempting to further limit their liability, directors were

asked whether they plan to include inside counsel in their committee meetings. Seventy-four percent of the audit committee members who responded said they anticipate regularly inviting general counsel to their committee meetings. This is a modest increase from the 68% who indicated the same in 2006.

Similarly, three-fourths of responding directors who sit on the nominating/governance committee anticipate having general counsel as a regular attendee at their meetings. This, too, is an increase from the 60% who gave this response in 2006. Furthermore, 80% of M&A committee participants plan to include general counsel in special committee meetings, while just over half (58%) of compensation committee members surveyed will be including general counsel in their committee meetings, an increase from the 45% answering likewise in 2006. Finally, 53% of responding directors on social responsibility committees plan to invite general counsel to their committee meetings.

Likewise, when general counsel were asked if they believe inside counsel should regularly attend certain committee meetings, more than 90% said they should be invited to audit committee, nominating/governance committee, special M&A committee, and compensation committee meetings. Eighty-three percent of general counsel in the study believe they should be a regular attendee at social responsibility committee meetings.

**Figure 3**

**Experts have predicted we may see a greater effort to hold directors personally liable for serious violations or neglect of duties. Should these predictions prove true, what are the possible outcomes?**

Numerous qualified directors will either exit boards or choose not to serve in the future



Such efforts would only impact a few “bad seeds”



This would be a very positive step to make sure directors stay focused on their duties and prevent financial crisis



## Key risks on the rise

Beyond board liability, we were interested to discover how survey participants rate companywide risks (Figure 4). This year, directors identified operational risk as the biggest threat, with 50% saying they are worried about this issue, compared to just 33% who indicated this concern last year. Similarly, data security was selected by 46% of responding directors, a significant increase from 2008 when 25% of directors surveyed said they were worried about data protection. Meanwhile, 43% of directors in the study indicated they are concerned about managing their company’s reputation. This is a substantial increase from the 18% of directors who responded similarly in 2007.

Rounding out the top concerns for directors are governance and compliance, mergers and acquisitions,

business continuity/disaster recovery risk, liquidity, and executive compensation, which was mentioned by 33% of directors. Looking at the last five years this question has been asked, the level of concern for the latter peaked in 2008, when 45% of director respondents indicated they were worried about executive compensation.

When general counsel participating in the study were asked to rate their level of concern on the same list of issues, 56% chose electronic discovery for litigation and investigation. This represents a marked increase since 2007, when 36% of general counsel surveyed had the same worry. Similarly, managing outside legal fees was selected by 54% of responding general counsel, compared with 36% of GCs surveyed in 2007 who said they found this issue worrisome. Likewise, 51% of responding general counsel selected data security as an issue about which they are concerned. Worry over data security has increased substantially since 2008, when only 23% of GC respondents were bothered by this issue.

Other key concerns for inside counsel include governance and compliance, operational risk, managing the company reputation, and the Foreign Corrupt Practices Act, which at 34% shows a significant increase from 2008, when only 15% of GC respondents were worried about FCPA. General counsel were also asked to rate executive officers and board members on their ability to manage the company's risk. Forty-two percent answered that their company's risk is being managed very well, while 37% indicated their management and board are managing the company's risk well and 17% said that their company's risk is adequately managed. Only 4% indicated their risk management program needs improvement, a significant decrease from 2006 when 9% indicated their program needed improvement.

### Reactions to the regulatory environment

It's no secret that the current regulatory environment is a lot tougher than it used to be. General counsel study participants were asked whether, compared to the past, there has been a change in their fear of possible action against the company from regulatory agencies. Fifty-six percent of general counsel answered that their fear of regulatory action has increased. Another 42% indicated their concern has stayed the same, with only 2% answering that their fear of such

**Figure 4**  
**Top 10 Concerns for Directors and General Counsel**

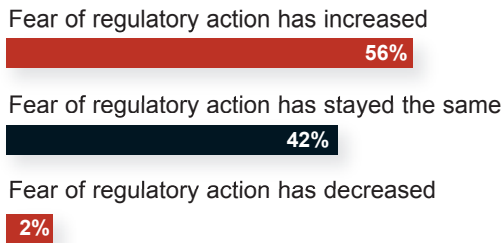
<b>Directors</b>	<b>% with major concern</b>
Operational risk	50%
Data security	46%
Managing company reputation	43%
Governance/compliance	38%
M&A	36%
Business continuity/disaster risk	33%
Liquidity	33%
Executive compensation	33%
Managing outside legal fees	32%
Electronic discovery for litigation/investigation	31%
<b>General Counsel</b>	<b>% with major concern</b>
Electronic discovery for litigation/investigation	56%
Managing outside legal fees	54%
Data security	51%
Governance/compliance	41%
Operational risk	40%
FCPA	34%
Managing company reputation	33%
Intellectual property	29%
Executive compensation	28%
M&A	27%

action has decreased. Interestingly, this barometer reading has both dipped and hiked in the last few years: In 2005, 63% of GCs surveyed said their concerns in this area had increased; in 2007 the percentage indicating the same decreased to 29%; and this year that percentage has increased once again (Figure 5).

Meanwhile, it's easy to see why FCPA rated fairly high on GCs' list of key concerns, as just 36% of responding general counsel serving companies subject to FCPA believe their board and management have done a good job with FCPA training and compliance. Another 63%

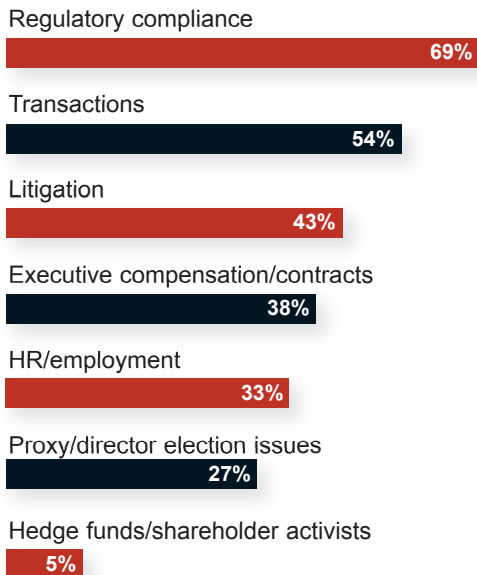
**Figure 5**

**Percentage of general counsel who say there has been a change in their fear of possible action against the company from regulatory agencies:**



**Figure 6**

**Percentage of general counsel who believe there will be a significant increase in their workload over the next 12 months for each of the following:**



Transactions were selected by 54% of general counsel respondents as an area that will add to the legal department's workload, while litigation was selected by 43% and 38% chose executive compensation/contracts. The latter percentage has increased significantly from the 5% of general counsel respondents in 2009 who selected executive compensation/contracts as an area where they anticipated increased workload (Figure 6).

"Clearly, regulatory compliance is top of mind for the general counsel, with the majority feeling strongly that it will be the single biggest contributor to their workload through the rest of this year and leading into 2012."

### **Moving forward**

As more companies continue to emerge from the recession and credit crisis, our research indicates that most corporate professionals are cautiously optimistic. Deal activity is picking up, and companies are starting to invest in growth opportunities again. That said, shareholders and regulators will be watching these moves closely. As a result, directors and general counsel must work together with management to provide more transparent accountability while fostering profitability, mitigating risk, and maintaining a high ethical standard in an increasingly litigious environment. There's much for them to get their arms around, but a confident, measured approach bolstered by an internal system of checks and balances will make a good governance plan even better.

indicated their board and management have done a satisfactory job, but believe there is room for improvement.

Finally, the majority (69%) of responding general counsel see regulatory compliance as the function adding the most workload to their internal legal department over the next 12 months, which is a significant increase from 2009 when 37% of GCs surveyed indicated the same.



FTI Consulting, Inc. is a global business advisory firm dedicated to helping organizations protect and enhance enterprise value in an increasingly complex legal, regulatory, and economic environment. With more than 3,700 employees located in 22 countries, FTI Consulting professionals work closely with clients to anticipate, illuminate, and overcome complex business challenges in areas such as investigations, litigation, mergers and acquisitions, regulatory issues, reputation management, and restructuring. The company generated \$1.4 billion in revenues during fiscal year 2010. More information can be found at [www.fticonsulting.com](http://www.fticonsulting.com).

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