

Board Governance Series

What Every Director Should Know about Conflict Minerals

PwC

Comp Committees 101: Covering the Basics

Meridian Compensation Partners, LLC

Dealing with Cyber Risk at the Board Level

BoardVantage

Dear Corporate Director:

Think of the Board Governance Series as a director's tool kit. Whichever committee you are serving on, we have the tools you need to do your best. In this Volume 22 edition, we bring you three conversations that includes tips and tools from foremost board experts.

First, we examine how the Securities and Exchange Commission's final rules on conflict minerals will impact the boardroom. Mary Ann Cloyd, PwC's Center for Board Governance, reviews the SEC's final rules on this section of the Dodd-Frank Wall Street Reform and Consumer Protection Act, explains which materials qualify as "conflict minerals," and reviews the three-step process that boards will need to complete in order to comply with the SEC's rules.

Next, we turn to the hot topic of the times: cyber risk. Again and again, we hear board members saying this is a major concern at their companies. Joe Ruck, BoardVantage, lays out the board's role in protecting against cyber threats, from anticipation and management of cyber risk to complying with the SEC's guidance on cyber risk disclosure. He also gives some advice for not-so-tech-savvy directors on how to get up to speed and what kinds of questions directors should be asking to manage on this topic.

Finally, Mary Ann Polk, Meridian Compensation Partners, provides compensation committee members with a back-to-basics guide featuring three tips for new directors. As the committee with the "greatest potential for controversy," Polk emphasizes the questions that comp committee members should be able to answer and who compensation committees should spend time with to orient themselves in the complexities of compensation.

Whatever board skill you want to enhance, the Board Governance Series can help you prepare. These three new tools accompany an entire series of educational videos available on our website, www.boardmember.com, with additional links to our series partners' resources and websites as well.



A handwritten signature in black ink, appearing to read "TK Kerstetter". The signature is fluid and cursive, with a large, sweeping flourish at the end.

TK KERSTETTER
President
Corporate Board Member
An NYSE Euronext Company

Board Governance Series

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What Every Director Should Know about Conflict Minerals

Mary Ann Cloyd

Leader, PwC Center for Board Governance
PwC

The SEC's final rules on disclosure and reporting requirements for conflict minerals adopted a three-step process that companies need to complete. This article walks directors through that process to ensure compliance is being managed for this new regulatory issue.

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Comp Committees 101: Covering the Basics

Mary Ann Polk

Partner
Meridian Compensation Partners, LLC

Between say on pay and resulting litigation and an overall focus on pay packages and governance, the comp committee is the hottest seat on the board right now. Here are some tips and refreshers on duties for compensation committee members.

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Dealing with Cyber Risk at the Board Level

Joe Ruck

President and CEO
BoardVantage

Increased reports of cyber attacks have led the SEC to encourage companies to disclose attacks. This interview sheds some light on this guidance and discusses the board's role in overseeing cyber risk management.



What Every Director Should Know about Conflict Minerals

On August 22, the SEC finalized rules around disclosure and reporting requirements for conflict minerals. Would you talk a little bit about the origin of these new rules?

The Conflict Mineral Rules were part of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act. The SEC, as you said, recently issued the final rules, which we've been waiting for since then. This congressional mandate responds to concerns about the exploitation and trade of conflict minerals in the DRC (Democratic Republic of the Congo) and the surrounding countries. The concerns are that profits from the mining and sale of these minerals are supporting the violence and some of the really bad things that are happening in that country. The rules require disclosures for companies that use these minerals, and the final rules tell us what those minerals are: gold, and then what we refer to as the three Ts—tin, tungsten, and tantalum.



Mary Ann Cloyd
Leader, PwC Center for Board Governance
PwC

What types of companies will be affected by the new rule?

It will affect manufacturing companies that use these minerals in the production of their products, whether the company manufactures or contracts to manufacture. It applies to public issuers. The SEC, in fact, in releasing these rules, estimates that they will apply to 6,000 public companies. There is no exception for foreign private issuers, small companies, or emerging-growth companies. The other important thing to know is that although the law is geared toward public companies, the impact could be even broader because there are private companies in the supply chain that are furnishing

these minerals are only a catalyst, that is an exemption to the final rule. But the rules do apply where—and I believe those are the words they used—“some [minerals are] still included in the final product.” So that’s step one. Do the rules apply to you at all? If the answer is no, you are done.

Step two, in the event that these minerals are included, the company must determine if these minerals that have been used in your product originated from the DRC or adjoining countries. If the answer is yes, then step three is that the company must conduct due diligence on the source and chain of custody to determine if the minerals are “DRC conflict free”

Although the law is geared toward public companies, the impact could be even broader because there are private companies in the supply chain that are furnishing product to these public companies.

product to these public companies. The SEC estimates suppliers affected by this could potentially be as many as 280,000 companies.

The final rules adopted a three-step process that companies need to complete. Would you walk us through those three steps?

Step one is to determine whether or not any of these minerals are necessary to the functionality or production of their product. So if

or “not DRC conflict free.” Where did they come from; did they come from these countries; if so, where in these countries, what mines? Here companies will really have to dig into the weeds.

Mary Ann, that process sounds like it could be very time consuming. Considering the process, what’s the timeline for reporting?

We did get clarity around that. There is uniformity in the timing of

the reporting, as all companies will make these reports on a calendar-year basis. The first effective year is calendar year 2013. The reports are due on May 31 of the year following, so the first reports will actually be due on May 31, 2014. The rules also clarify that the reporting will be done on a new Form SD. There is a two-year delay for companies that cannot determine the country of origin (and for very small companies, potentially a four-year delay).

And the good news for companies is that this doesn't have to roll out with their annual report.

Yes, it does not have to roll out with the annual report. It is, as I said, a separate filing on a separate form, with everybody filing on a calendar-year basis.

And most important to board members, what types of questions should they be asking management about conflict minerals?

I think that is a really good question. So to step back and put myself in the boardroom, I think my first questions to management would be, "These new rules are in place, but do they apply to us? What process has the company gone through to determine whether they do or do not apply to us?" The next questions I would ask are, assuming they do apply, "What are we going to do? What is our process for due diligence to determine the country of origin to be in complete compliance with the disclosures

that will be required on the Form SD?" And then I think my final question, if I were a board member, would be, "How much is this going to cost us?" The SEC gave a \$3 billion to \$4 billion estimate of cost to comply, so I would want to know how much of that my company is going to be paying.

And I've heard people say that the cost will be sharply higher than that.

Time will tell.

Well, regardless of the cost, time is ticking away until implementation, so board members definitely need to get up to speed on this.

They do. We have seen with many companies, and certainly with many boards, that this has not been top of mind. I think this could be because Dodd-Frank was signed back in 2010, and it has taken over two years to get these final rules in place. I think a lot of people have not, as I said, had this top of mind, but it is here today.

Comp Committees 101: Covering the Basics

Thank you for being here to share some tips for new compensation committee members, which is helpful because, between say on pay and resulting litigation and an overall focus on pay packages and governance, the comp committee is the hottest seat on the board right now. In fact, it really has become a contentious area for board members.

Absolutely. We believe everyone would agree that serving on a compensation committee today is not for the faint of heart. Over the past few years—particularly since the proxy disclosure rules were revamped—this committee has become very high profile, even more so than the audit committee. It has the greatest potential for controversy, in part because there is no single rule book to follow for compensation issues. The technical, regulatory, and other requirements continue to increase exponentially. In addition, there are various constituencies who want to have a voice—if not also a vote—in the process, including shareholder advisory groups, social activists, the media, government, and others.



Mary Ann Polk
Partner
Meridian Compensation Partners, LLC

With that daunting background, what can new compensation committee members do to make sure they get up to speed as soon as possible?

To be an effective committee member requires a high degree of knowledge and expertise. Although we could come up with a long list of tips, we have limited today's comments to three broad statements that we believe will serve new committee members especially well.

The first tip is this: "Be realistic about the learning curve." It is simply going to take some time for new committee members to become

sufficiently familiar with the company's programs and the related issues that will be factors in the many decisions that will be made while they serve on the committee. New committee members have typically served on the board for at least a year, if not longer. This means they have been exposed to the company's programs and philosophy and key decisions about senior executive pay at a fairly high level. However, as a member of the committee, he or she will need to develop a much more detailed level of knowledge and expertise about

the programs than he or she likely will have as they start out.

What are some of the ways new comp committee members can gain the knowledge they'll need to serve effectively on the compensation committee?

That question leads straight to our second tip, which is, "Take advantage of the resources that will be available to you." One of the ways many companies orient their new compensation committee members is to provide a resource guide or a briefing book. They also conduct one-on-one orientation sessions with those who are involved in the decision-making process.

Serving on a compensation committee today is not for the faint of heart. ... It has the greatest potential for controversy, in part because there is no single rule book to follow for compensation issues.

Let's consider the resource guide first. This is a briefing book that includes key background information and reference materials, both on committee operations, as well as on company programs. In brief, the committee operations section will generally include a copy of the committee's charter, as well as a detailed annual calendar. The charter, of course, outlines the duties and responsibilities of the committee. The annual calendar serves as a practical guide for understanding what topics will be discussed at each committee

meeting and what decisions in particular will be required at a specific meeting.

The next major section includes summaries of key program elements, including pay philosophy, competitive objectives, the committee's approved peer group and benchmarking approach, and summaries of key design features (such as salary administration, annual and long-term incentives), and any benefits and perquisites that might be provided. These summaries generally include not only the current program design, but also provide historical context so the new committee member can understand how the programs have evolved.

Additional sections may include copies of other compensation analyses, such as tally sheets, pay and performance comparisons, legal and regulatory updates and market trends, shareholder advisory group voting recommendation reports, and various legal documents (e.g., equity plan documents, award agreements, etc.). These all provide valuable background for the new committee member.

That sounds extremely thorough and like quite a bit of homework, though I suspect the time spent is well worthwhile. What about the orientation sessions you mentioned?

Orientation sessions involve one-on-one or group discussions with the various parties involved,

including the compensation committee chair, the head of human resources, the internal legal group, and also the committee's outside independent consultant.

The committee chair can provide a valuable framework for the new committee member in terms of helping him or her understand more quickly what topics might be sensitive and delicate and also in providing institutional knowledge.

The head of human resources spends time orienting the new committee member about the overall compensation programs and human resources function at the company and providing some level of detail on each of the components. This is an important discussion to have because it can be helpful for the new committee member to understand how pay programs align across the organization.

The legal session might be one of the driest there is, but it's nonetheless valuable, because it provides an overview of the legal and regulatory requirements that a new committee member needs to be aware of.

And then, finally, the discussion with the outside committee consultant can help establish the governance parameters for that relationship and perhaps provide a broader perspective on the topics that cannot be gained elsewhere.

Mary Ann, what is your third and final tip for compensation committee members?

Our third and final tip is "Challenge yourself." The new committee member should consider setting some goals in terms of what he or she should be able to describe about the company's programs within a reasonable timeframe. For example, what are the key elements of our program? Who are our peers? How do our incentive plans work? What performance measures do we use and why, and how do they align with our business goals? For example, if we have a growth strategy, how do we measure and reward for that? Are our programs sufficiently transparent? That is, can our shareholders understand how our programs work simply by reading our CD&A and, more important, do they support the decisions that we've made through their say-on-pay votes? Are our programs balanced between executives and shareholders, or are they tilted too much in one direction versus another?

If new committee members can answer questions like these within their first six months to a year of committee service, that will be a noteworthy accomplishment.

Dealing with Cyber Risk at the Board Level

Increased reports of cyber attacks have led the SEC to encourage companies to disclose attacks. Can you shed some light on the SEC's guidance?

Last October the SEC released guidance that provides direction in regard to reporting the risks and consequences of cyber attacks. The guidance doesn't specify any new requirements or make changes to existing rules. Instead, it is a reminder that cyber risk should be considered along the same lines of other significant risk factors that need to be reported by public companies. Keep in mind that cyber risk is relatively new. So what the SEC seems to be saying is that cyber risk should be reported similarly to any other risk that would influence an investment. One additional point is that the guidance stresses the disclosure does not need to be detailed to the extent it might harm security efforts.



Joe Ruck
President and CEO
BoardVantage

How would you describe the board's role in protecting against cyber threats?

At the 2011 [Corporate Board Member West Coast Summit] conference in Scottsdale, there was a panel discussion on cyber threats. It was obvious from the exchange that it was perceived by many directors as a serious and growing threat. At the same time, it was obvious that many directors struggle to define their role in protecting against those threats. But if you think of the board's role as governance, and if governance includes the management and anticipation of risk, it does fall squarely within the board's charter. I think this unease reflects the underlying challenge directors face, in that

It would be unwise to ignore [IT] risks because the cost of a security breach is daunting. It can run the gamut from loss of confidential information to brand damage to a privacy breach, including the privacy of your customers or worse—all of which are very costly.

technology and IT security are not traditional areas of strength for most boards. In other words, it's not a natural extension of their existing practices and charters. Nevertheless, it would be unwise to ignore these risks because the cost of a security breach is daunting. It can run the gamut from loss of confidential information to brand damage to a privacy breach, including the

privacy of your customers, or worse—all of which are very costly.

So let me suggest that the first step for boards is to accept that responsibility and take an active role. The second step is to build expertise commensurate with the exposure and the risk profile of their particular businesses.

What would you recommend board members do to brush up on information technology? Who could they talk to within the company to get a better level of IT knowledge?

Today, informal standards are developing around what it means to be digitally literate. It means things like knowing how to download apps

from iTunes, use text messaging, or make a dinner reservation with Open Table. There is only one way to learn about those things, and that's through usage, so if they haven't already done so, directors should get very familiar with smart phones and tablets. These devices are designed for consumers, so they're intuitive and straightforward to use. That experience will be relevant because

it creates firsthand exposure to key technology use patterns with which consumers are engaging with businesses in many industries today.

So that's a good starting point, but that's not enough. It's also important for directors to develop a grasp of IT risk, especially in light of the many disruptive trends sweeping the technology landscape. What I have in mind here is social media, mobility, cloud technology, revolutionary new payment systems, and things of that nature. Driven by constant innovation, all these fields are rapidly evolving.

Not only should directors make sure they are conversant by actively using the technologies themselves, but if they want to stay current, it will require that they identify the relevant trends that affect their business and then follow the salient developments in the media sources that cover those topics. Traditional papers like the *New York Times*, the *Wall Street Journal*, and *Business Week* do a good job, but to stay on top of the issues, follow websites and blogs like *The Business Insider* and *Tech Crunch*. They all cover topics from a business perspective, which is what you as a board member are interested in, so you can begin to understand how the trends might impact the businesses of the boards you sit on.

What are some good questions that a board member, regardless of his or her industry, should ask management about cyber risk?

In many companies, management will already be focused on cyber risk, so you may as well start with tapping into that existing expertise. You can certainly ask some very specific questions like, "What's our mobile security strategy? How do we prevent information leakage? How do we deal with hosted cloud services that are not under IT's control?" With a little forethought, you could probably add two dozen more to that list. But keep in mind that for any given threat, different companies may be affected in different ways. Therefore the best place to start is at a high level—request a list of exposures prioritized by severity from the CIO. And once you have that in hand, you can begin to drill down into specifics.

How frequently should the board have informational sessions about cyber risk, and would this be something for the entire board or for a particular committee?

When you think about it, it's difficult to run a big bank, energy company, or retail without IT. So for organizations like that, I imagine that IT is a strategic asset and they already have a calendar of presentations, but for those companies that don't, I would suggest that they have a regular session with the CIO. And although there are no hard-and-fast rules for public companies, a minimum of once a quarter seems prudent because the landscape is changing so fast. Anything less than that and you run the risk of being out of touch with the pace of change.

Series Host



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Series Contributors



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