



# BoardroomDirect

The monthly newsletter for [PwC's Center for Board Governance](#)—April 2015

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## Worth reading



### [Repertee: Mary Ann Cloyd and Suzanne M. Vautrinot](#)

Mary Ann Cloyd, PwC Center for Board Governance Leader, and Suzanne M. Vautrinot, a retired US Air Force major general and now director on several boards, discuss cybersecurity execution.  
-NACD Directorship

## NACD BoardVision

Watch a [video](#) of Cloyd and Vautrinot moderated by NACD Directorship Editor-in-Chief Judy Warner.

## Issue in focus archives

To read past BoardroomDirect Issue in focus articles, click [here](#).

## Contact us

For more information about this newsletter, contact [Gary Larkin](#).

## Inside America's Boardrooms



TK Kerstetter, CEO of Boardroom Resources LLC, kicks off his new online governance video show with Mary Ann Cloyd, PwC Center for Board Governance leader, talking about the recent rise in shareholder activism. To watch the episode, click [here](#).

## Issue in focus

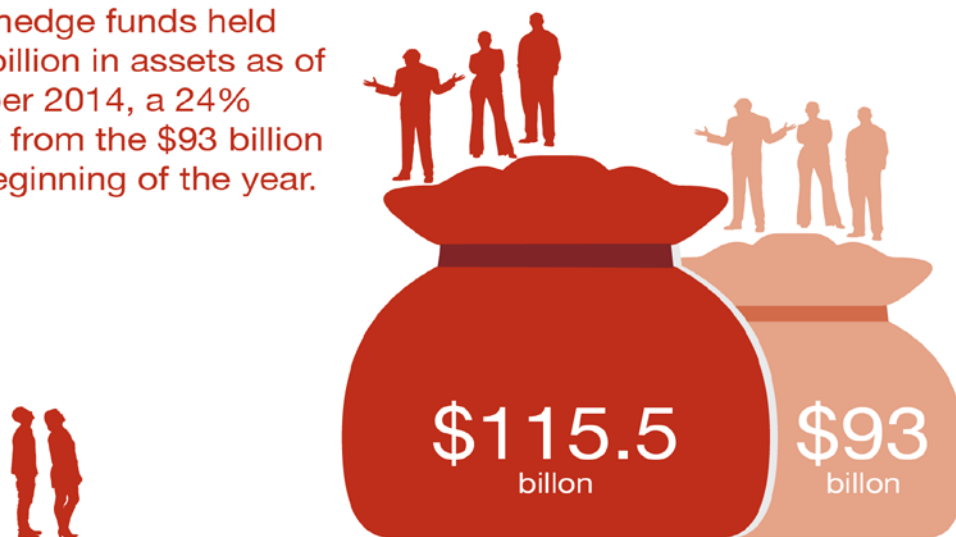
### Shareholder activism: Are you prepared to respond?

Activist investors are increasing in number and becoming more assertive in exercising their influence over companies in which they have a stake. Shareholder activism comes in different forms, ranging from say-on-pay votes, to shareholder proposals, to “vote no” campaigns (where some investors will urge other shareholders to withhold votes from one or more directors), to hedge fund activism.

Activism can build or progress. If a company is the target of a less aggressive form of activism one year, such as say-on-pay or shareholder proposals, and the activists’ issues are not resolved, it could lead to more aggressive activism in the following years. **[Read more in the PwC publication, [Shareholder activism: The who, what, when, & how.](#)]**

### Hedge fund activists are increasing their holdings

Activist hedge funds held \$115.5 billion in assets as of November 2014, a 24% increase from the \$93 billion at the beginning of the year.



Source: PwC, Shareholder activism - Who, what, when, and how?, 2015.  
David Benoit, “Activists Are on a Roll, With More to Come,” The Wall Street Journal, January 1, 2015.

Hedge fund activists may push a company to spin off underperforming or non-core parts of their businesses seek new executive management, operational efficiencies, or financial restructuring, engage in a proxy contest for full control of the board, or work to influence corporate strategy through one or two board seats. Some hedge fund activists target a company’s “capital allocation strategy” and push the company to change its acquisition strategy or return reserved cash to investors through stock buybacks or dividends. In order to drive these changes, activists

are generally engaging with at least some of a company's other major investors to get support for their proposals.

Directors have been taking notice of hedge funds and other activist shareholders, and they are talking about activism in the boardroom: Last year, 29% of directors said their board has interacted with an activist shareholder and held extensive board discussions about activism.<sup>1</sup> An additional 14% said they extensively discussed shareholder activism, though they hadn't had any interactions with an activist. Given the state of activism, we anticipate the level of boardroom discussion on this topic will continue, or even grow, this year.

### **What might make your company a target?**

About one in five S&P 500 companies was the target of a public activist campaign in 2014—and the number more than doubles when you consider the activity that never become public.<sup>2</sup> What are some common themes?

Companies where management appears to be either unable or unwilling to address issues that seem apparent to the market, investors, or analysts are ripe for activism. In addition, poor financial and stock performance, a weak pipeline of new products, a lack of innovation, the absence of a clear strategy, and turnover in leadership are also frequent red flags.

Hedge fund activists often focus on whether a company's business line or sector is significantly underperforming in its market. They may target profitable companies with low market-to-book value, a well-regarded brand, and sound operating cash flows and return on assets. If a company's cash reserves exceed historic norms and those of its peers, the company may be a target, particularly when it's unclear why it has a large cash reserve. And board composition practices can also draw an activist's attention—for example, if the company has a classified board or a long average director tenure and few new board members

An activist campaign can come at a very high cost. In addition to the out-of-pocket legal and advisory fees for a proxy battle, the management distraction, emotional impact, and potential business disruption can take a toll. Relationships with suppliers, customers, and even employees can also be damaged.

### **Preparation is key**

Viewing a company through the eyes of an activist can help management and boards anticipate, prepare for, and respond to an activist campaign. A first step is to critically assess the company's businesses as an activist would—looking for underperforming components. Some companies proactively examine their portfolios and capabilities to determine what fits both strategically and financially.

Companies that can articulate their strategy and demonstrate that it is grounded in a well-considered assessment of both their asset portfolios and their capabilities may be more likely to minimize the risk of becoming an activist's target. Companies will want to tell a compelling story about their vision for success to shareholders. **[Read more in another PwC publication, [Shareholder Activism: Strategies for mitigating risk and responding effectively.](#)]**

Companies should also understand their shareholder base and have a tailored engagement plan in place.

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<sup>1</sup> PwC, *2014 Annual Corporate Directors Survey*, October 2014.

<sup>2</sup> Brendan Sheehan, "Trends in Shareholder Activism," *Global Governance Advisors*, October 2014.

## **Responding when an activist comes knocking**

Companies and their boards will need to consider how to respond based on the facts and circumstances. Generally, an effective response plan will objectively consider the activist's ideas to identify if there are areas around which to build consensus. Finding a way to work with an activist may avoid the potentially high costs of a proxy contest.

"One of the first areas of focus for boards and the management team is to engage. Sit down, have a discussion, hear out the activist, understand what's on their mind, and then see if you can find common ground. We find engaging and listening is important," Tim Ryan, PwC's Vice Chairman and Markets, Strategy and Stakeholders Leader said in a recent interview with [Wall Street Journal Live's MoneyBeat](#).

It is important to recognize that the pressure from shareholder activists is not likely to go away any time soon, and companies of all sizes and in all industries need to be on alert. A well-articulated strategy, supported by a proactive assessment of the company's existing portfolio, is critical. By telling a clear story and openly communicating with shareholders and investors, companies may minimize the risk of becoming a target of activists.

## **Issues in brief**

### **Update on 2015 proxy access proposals**

With proxy access, shareholders who meet certain criteria can include a slate of directors to challenge sitting directors on the company's proxy rather than filing their own. In 2014, there were only 17 such proposals filed, with 13 going to a vote and five receiving majority support.

As of this writing in the 2015 proxy season, 64 companies have taken some type of action on proxy access bylaw proposals, according to the proxy solicitation firm Morrow & Co. A total of 107 companies have received proxy access shareholder proposals this year.

According to [ProxyMonitor.org](#), which tracks the Fortune 250, as of April 14, 2015 one of three proxy access shareholder proposals that has been voted on received majority support.

[Morrow also reports](#) that 36 companies included a shareholder proxy access proposal in the proxy statement, though the companies recommended voting *against* the proposal. Two companies included such proposals and recommended voting *for* them.

The remaining 26 companies have taken the following actions:

- Five companies adopted their own bylaw.
- Eight adopted a bylaw in response to a shareholder proposal.
- Seven agreed to adopt a bylaw at some point in response to a shareholder proposal.
- Five companies are including both a management and shareholder proposal on the ballot with three being advisory and two binding.
- One company included a management proposal in the proxy statement while excluding the shareholder proposal.

Of those 26 companies, 12 included a 3% ownership stake and 3-year holding period as a threshold for filing a proxy access proposal, while 10 included a 5%/3-year-holding period threshold. About two-thirds of those companies opted for a 20% cap on the number of proxy access directors on the board.

Seventy-five of the proxy access proposals came from the New York City Pension Funds led by City Comptroller Scott M. Stringer. Illinois State Board of Investment and The Philadelphia Public Employees Retirement System joined Stringer in that campaign.

## **BlackRock and Vanguard address corporate governance matters**

In a [letter](#) to independent directors of its largest portfolio holdings, Vanguard Group, which oversees \$3 trillion in client assets, stated: “We want to see our clients’ investments grow over the long term, and good governance is a key to helping companies maximize their returns to shareholders. We have no interest in telling companies how to run their businesses, but we have valuable governance insights to share with the board of directors.”

The letter, which was sent by Vanguard Chair and CEO F. William McNabb III, calls for better shareholder engagement by boards and sets out principles the asset manager considers good corporate governance, including:

- Boards should be substantially independent of management and have independent leadership (i.e., chair or lead director).
- Management should be accountable to the board and directors should be accountable to shareholders.
- Shareholder voting rights should be consistent with economic interests (i.e., no special share classes for added voting power).
- Anti-takeover devices such as classified boards or poison pills should be minimized.
- Executive pay should be tied to creating long-term shareholder value.

Also, Vanguard suggested that companies create a “shareholder liaison committee” to promote better communication between shareholders and boards. “We’ve also seen boards successfully assign engagement expectations to existing committees,” the letter stated. “Ultimately, it’s more about the behavior than the framework. We’re indifferent as to how the board chooses to engage. What’s important to us is *that* it engages.”

BlackRock, Inc., which manages more than \$4 trillion in assets, recently updated its [voting policies](#). The asset manager emphasizes the importance of corporate governance and the rights of shareholders to vote on corporate governance matters.

“We expect boards to consider and disclose how the corporate governance structures adopted upon initial public offering are in shareholders’ best long-term interests,” according to its updated policies. “We also expect boards to conduct a regular review of corporate governance and control structures, such that boards might evolve foundational corporate governance structures as company circumstances change, without undue costs and disruption to shareholders.”

The policies also address shareholder voting rights on corporate governance matters, such as changes to governance mechanisms and amendments to the charter and bylaws. “We may vote against certain directors where changes to governing documents are not put to a shareholder vote within a reasonable period of time, in particular if those changes have the potential to impact shareholder rights,” according to the policies.

Regarding board composition, BlackRock stated that when a nominating/governance committee considers director candidates, it should take into consideration the diversity of experience and expertise of the current directors. “We encourage boards to disclose their views on the

consideration given towards board diversity, including but not limited to, diversity of gender, race, age, experience, and skills...” the policies state.

## **Pension funds asking for board diversity disclosure**

Nine large public pension funds with more than \$1.12 trillion in assets have [called](#) on the SEC to strengthen requirements of board diversity disclosure.

In a joint [rulemaking petition](#), the funds urged the SEC to adopt a rule requiring disclosure of board nominees’ gender, race, and ethnic diversity, as well as their mix of skills, experiences and attributes. They want companies to indicate in a chart or matrix each nominee’s gender, race and ethnicity. This would amend the 2010 SEC rule that called for the disclosure of skills, experiences and attributes.

The proposal emphasizes the missed opportunities when governing boards lack diversity, which could lead to “groupthink” or lack of differing views. The letter cites a 2011 International Monetary Fund report stating a “high degree of groupthink” contributed to the IMF’s failure to correctly identify the risks leading up to the worldwide financial crisis.

“As large institutional investors, we have a real interest in electing a slate of board nominees who are well-positioned to help carry out a company’s business strategy and meet our long-term investment needs,” the group said.

The funds calling for the disclosure include CalSTRS, CalPERS, Connecticut Retirement Plans and Trust Fund, New York City Pension Funds, New York State Common Retirement Fund, Illinois State Board of Investment, Ohio Public Employees Retirement System, North Carolina Department of the State Treasurer, and Washington State Investment Board.

## **Audit committee issues**

### **One-year deferral in the works for new revenue standard**

On April 29, 2015, the FASB issued a proposal to defer the effective date of the new revenue standard by one year. Entities will still be allowed to adopt one year earlier (the original adoption date) if they choose. A day earlier, the IASB voted to issue a similar proposal that would defer the effective date by one year. Early adoption will still be permitted.

The FASB and IASB determined that a deferral is necessary to provide adequate time for many companies to effectively implement the new revenue standard.

Comments on the FASB’s proposed deferral are due May 29, after which the FASB will vote on whether to defer the standard. The IASB will issue an exposure draft on their proposed deferral in the near term.

For public entities using US GAAP, the FASB’s proposed deferral would result in the revenue standard being effective for fiscal years (and interim periods within those fiscal years) beginning after December 15, 2017. For calendar year-end public entities, this means the 2018 interim and annual financial statements.



Similar to public entities, the FASB will also propose a one year deferral of the effective date for nonpublic entities. Nonpublic entities would be required to apply the revenue standard for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019.

For more information on the FASB's revenue recognition deferral, read PwC's [In the loop: New revenue guidance – where does it stand?](#)

## **Resources, webcasts, and events**

**The Quarter close – Directors edition, Q1, 2015:** This edition includes insight into the accounting implications of declining oil and gas prices and the Affordable Care Act. To read the publication, click [here](#).

**Center for Board Governance Webcast archive:** In a February 19 webcast, Mary Ann Cloyd, Leader of PwC's Center for Board Governance; Mike Gallagher, Managing Partner of Assurance Quality, PwC; and Wayne Carnall, Partner, SEC Services, PwC and former Chief Accountant of the SEC's Division of Corporate Finance; discussed the SEC's active agenda, the FASB's standard-setting activities, and the PCAOB's key priorities. To listen to the webcast archive, click [here](#).

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