Corporate Governance

April 2024

Topics

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Part I: New Paradigm of Corporate Governance

- Core Principles of Corporate Governance
- The New Paradigm

Core Principles of Corporate Governance

- Purpose of the corporation:
  - To conduct a lawful, ethical, profitable and sustainable business in order to enable its success and increase in value over the long term.
  - This requires consideration of the interests of all stakeholders who are critical to its success as determined by the corporation and its board of directors using their business judgment and with regular engagement with its shareholders, who are essential partners in supporting the corporation's pursuit of its purpose.
  - Fulfilling this purpose in this manner is fully consistent with the board's fiduciary duties, and the concomitant stewardship obligations of shareholders.
- Although the governance landscape has been heavily influenced by shareholder activists, a "new paradigm" has emerged, which aims to recalibrate the relationship between corporations and investors to resist short-termism and facilitate long-term value creation.
- The governance structure and policies that will best achieve this purpose are as varied as are companies themselves.
- A board should tailor its corporate governance decisions to the company it serves, bearing in mind factors such as the unique circumstances of the company and the culture and dynamics among the principal stakeholders.

The New Paradigm

Paradigm Components

- <u>Governance</u>
  - *Purpose and Strategy*. The board of directors and senior management should jointly articulate the company's purpose and oversee its long-term strategy, ensuring that the company pursues sustainable long-term value creation.
  - *Management and Oversight*. The board is responsible for overseeing the management of the company, monitoring company performance and preparing for senior management succession.
  - *Quality and Composition of the Board of Directors*. Directors should have integrity, competence and collegiality, devote the significant time and attention necessary to fulfill their duties and represent the interests of shareholders and other stakeholders. The board as a whole should include diverse backgrounds, experiences and expertise that are tailored to the company's needs.
  - *Compensation*. Executive and director compensation should be designed to align with the long-term strategy of the company and incentivize the generation of long-term value, while disincentivizing the myopic pursuit of short-term results.
  - *Corporate Citizenship*. Consideration should be given to the company's purpose and its stakeholders—including shareholders as well as employees, customers, suppliers, creditors and the community in which the company does business—in a manner that contributes to long-term sustainability and value creation.

The New Paradigm *(cont'd)*

Paradigm Components

- Engagement
  - *By the Company*. The board and senior management should engage with major shareholders on issues and concerns that affect the company's long-term value and be responsive to those issues and concerns.
  - *By Shareholders*. Asset managers and investors should be proactive in engaging in dialogue with a company as part of a long-term relationship and should communicate their preferences and expectations.
  - *Shareholder Proposals and Votes*. Boards should consider shareholder proposals and key shareholder concerns, but asset managers and investors should seek to engage privately before submitting a shareholder proposal.
  - *Interaction and Access*. Companies, asset managers, shareholders and other key stakeholders should provide each other with the access necessary to cultivate engagement and long-term relationships.

The New Paradigm *(cont'd)*

Paradigm Components

- Stewardship
  - *Beneficial Owners*. Asset managers are accountable to their investors—the beneficial owners whose money they invest—and they should use their power as shareholders to foster sustainable, long-term value creation for their investors and for the companies in which they invest.
  - *Voting*. Asset managers should actively vote on an informed basis consistent with the long-term interests of their investors, which aligns with the long-term success of the companies in which they invest.
  - *Investor Citizenship*. Asset managers and investors should consider value-relevant sustainability, citizenship and environmental, social and governance factors when developing investment strategies.

Part II: Corporate Governance Landscape

- Trends in Corporate Governance Practices
- Rule 14a-8 Shareholder Proposals
- Board Structure
- Universal Proxy
- Officer Exculpation

General Trends in Corporate Governance Practices

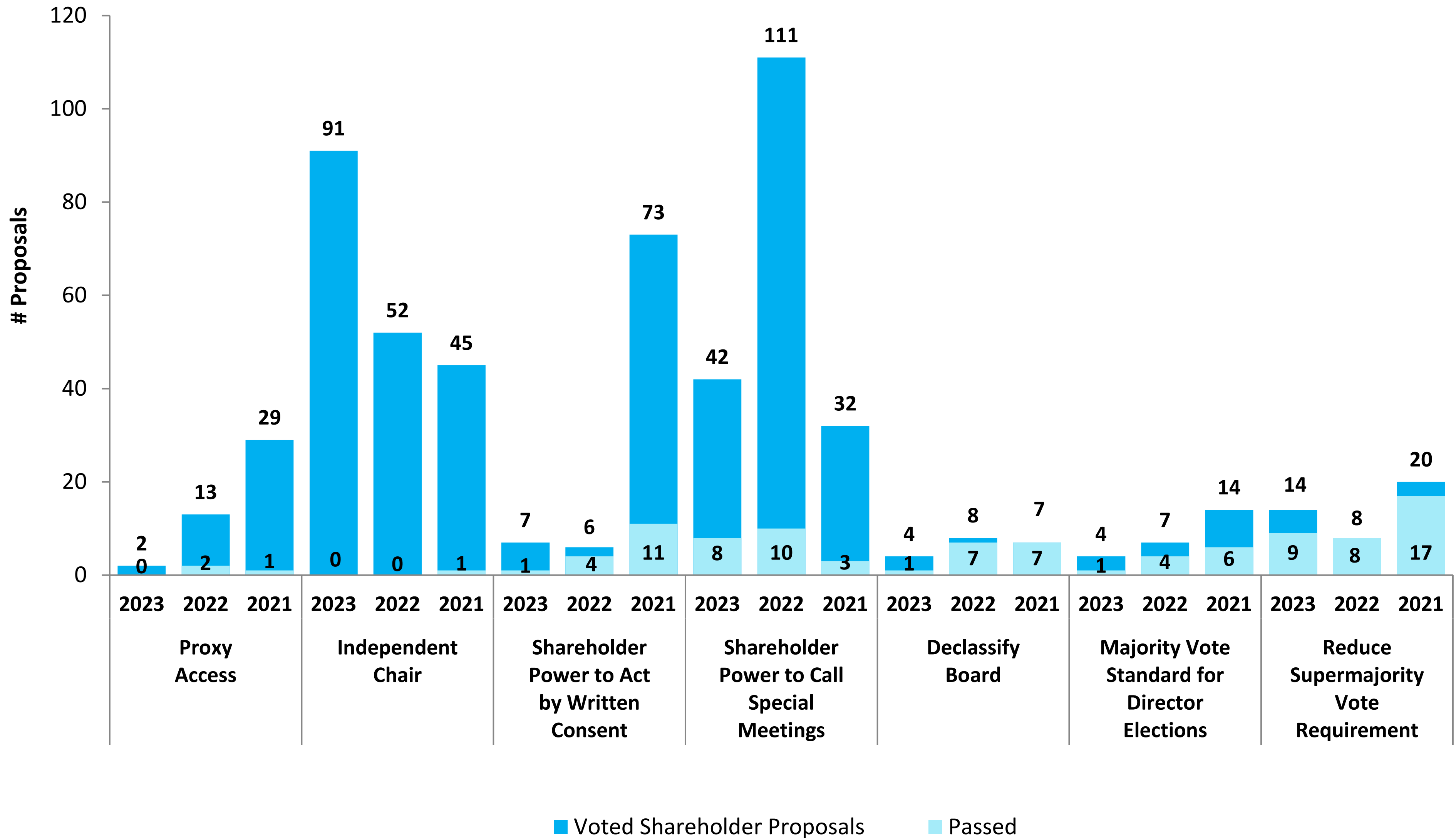
- Many long-salient corporate governance debates have been settled, with "best practices" (such as majority voting and proxy access) codified in rules and regulations or voluntarily adopted by a majority of S&P 500 companies.
- Yet the drive for "reform" to enhance shareholder rights and weaken takeover defenses persists.
  - Governance activists persist in advocating for more purported "best practices" (*e.g.*, mandatory removal of directors receiving sub-majority vote, hybrid vs. virtual-only shareholder meetings).
  - Drive to reach mid-sized and smaller companies has intensified.
  - Scrutiny of governance of newly public companies continues.
  - Domestic advocates are reaching globally to markets beyond the U.S.
- There is greater recognition that corporate governance is nuanced and less amenable to benchmarking and quantification, with an evolution from a check-the-box mentality to tackling questions such as:
  - How to craft a well-rounded board with relevant and diverse backgrounds, skills and experiences.
  - How to forge relationships with stakeholders that enhance the company's credibility.
- Companies and investors alike have sought to address these "next generation" governance issues in a way that facilitates comparability, objective assessment and accountability.
- Legislative initiatives have emerged, as dissatisfaction with corporations is near the top of the political agenda for the left and the right alike, even as surveys suggest that the public is increasing its expectations of corporations and may hold corporate leaders in high regard / deserving of trust.

Rule 14a-8 Shareholder Proposals

- In 2020, the SEC adopted amendments to the eligibility requirements for shareholder proposals under Rule 14a-8. The amendments:
  - replace current $2,000 or 1% for one-year holding requirement with a tiered approach to ownership;
  - require that the proponent state their availability, from 10 to 30 days following submission of the proposal, to meet with the issuer;
  - add information requirements for proposals submitted by shareholder representatives and clarify the existing one-proposal-per-shareholder rule; and
  - raise the resubmission thresholds required to exclude proposals
- In 2021, the SEC Staff issued Legal Bulletin 14L, which provides that shareholder proposals raising issues of broad social or ethical concern related to a company's business may not be excluded on "ordinary business" grounds, even if the relevant business falls below the economic thresholds in Rule 14a-8(i)(5)
  - The Staff framed the change as a "return to [its] longstanding approach"
  - The guidance facilitated a pronounced uptick in proposals regarding environmental and social topics
- The Staff may determine to respond orally, instead of in writing, to some no-action requests from companies seeking to exclude Rule 14a-8 shareholder proposals
  - Even if the Staff declines to take a view on any particular exclusion request, the company may have a valid basis to exclude the proposal under Rule 14a-8
  - Parties may seek formal, binding adjudication on the merits of the issue in court
- ISS and Glass Lewis each have policies regarding shareholder proposals and recommendation considerations when companies have excluded shareholder proposals

Rule 14a-8 Shareholder Proposals *(cont'd)*

Shareholder Proposal Trends



Board Structure

Widespread Elimination of Classified Boards

- Percentage of domestic S&P 500 companies with classified boards (where, generally, one-third of directors are elected each year for three-year terms) has sharply declined.
  - Approximately 11% as of year-end 2023 (vs. 60% of all S&P 500 companies in 2000).
- Declassification proposal activity has waned in light of sustained success in this arena by activist campaigns—*e.g.*, Lucian Bebchuk's Harvard Law School Shareholder Rights Project.
- As revised for 2024, the ISS policy on problematic governance structures for newly public companies provides for negative recommendations in the event that the company or board adopted a classified board structure prior to or in connection with the company's public offering.
  - Sunset provisions that are "reasonable" are deemed mitigating.

Source: FactSet; ISS.

Board Structure *(cont'd)*

Separation of Chair and CEO

- 59% of S&P 500 companies separate the CEO & chair roles; 39% have an independent chair.
  - 65% of S&P 500 boards have an independent lead or presiding director.
- Required disclosure in annual meeting proxy statement of whether CEO and chair are combined or separate, and, if combined, whether there is a lead independent director and what is its role. Also must disclose rationale for leadership structure.
- ISS recommends generally voting for shareholder proposals requiring an independent chair, but such proposals rarely receive majority support.
  - In 2023, shareholders at 88 companies voted on shareholder-initiated proposals to require an independent chair—proposals averaged 29.7% shareholder support and none passed. 44 proposals voted on in 2022 averaged 29.2% shareholder support; none passed.
  - Notwithstanding lagging support for these proposals, supporters can apply pressure through a substantial, sub-majority vote.

Source: Spencer Stuart U.S. Board Index.

Board Structure *(cont'd)*

Board Composition and Refreshment

- Increasing focus on board composition and refreshment—as well as on associated disclosure—especially as to gender, racial and ethnic diversity, age, tenure, independence and expertise:
  - Institutional investor calls for greater board diversity (*e.g.*, BlackRock's call for companies to have at least two women directors and at least one director who identifies as an underrepresented group).
  - Policies tying director tenure to independence (*e.g.*, CalPERS).
  - Mandatory retirement ages (disclosed by 69% of S&P 500 boards) and, to a lesser extent, term limits (5%).
  - Tightened proxy advisory firm policies on director "overboarding."
  - Closer attention to related board practices, including onboarding, continued education, evaluation, succession planning/leadership rotation.
  - Demands for board refreshment as a response to (perceived) mismanagement/poor performance (may be accompanied by calls for implementation of proxy access or other governance changes).

Source: Spencer Stuart U.S. Board Index.

Board Structure *(cont'd)*

Focus on Gender and Racial and Ethnic Diversity

- As the push for gender diversity on U.S. boards has taken root, and as racial equity has emerged as a societal priority, industry participants' diversity focus is expanding to racial and ethnic diversity and into leadership positions inside and outside of the boardroom.
- Nasdaq listed companies must have, or explain why they do not have, at least two directors who are diverse, including (i) at least one diverse director who self-identifies as female; and (ii) at least one diverse director who self-identifies as an underrepresented minority or LGBTQ+.
- Forthcoming SEC rules anticipated to be finalized in 2024 expected to enhance requirements regarding disclosure about board diversity.
- Proxy advisors have also developed and tightened policies on board gender diversity.
    - ISS will provide for adverse recommendations for the nominating committee chair (or other directors case-by-case) at Russell 3000/S&P 1500 companies with no women on the board, considering mitigating factors.
    - Glass Lewis will generally recommend voting against the nominating committee chair of a board that is not at least 30% gender diverse at Russell 3000 companies.
- Legislative initiatives are focused on board diversity disclosure and mandated quotas for women and racially diverse individuals on boards.
    - *E.g.*, California AB 979 (Underrepresented Communities on Boards) and SB 826 (Board Gender Diversity), both of which are subject to ongoing legal challenges.

Universal Proxy

- As a result of the "universal proxy" rules, which went into effect on September 1, 2022, in a contested proxy fight, both the company and the dissident must use a proxy card that lists the names of **all** director candidates, regardless of who nominated the candidates.
- Universal proxy provides a dissident an easier path to target particular directors for replacement.
  - As a result, companies must focus on board composition and clearly articulate the unique skillsets and experience each individual director brings to the board.
  - Enhanced focus on individual director qualifications may make it more challenging for boards to maintain collegiality and cohesion and speak with one voice in a proxy fight.
- The long-term effect of the new universal proxy rules remains to be seen, but the rules did not bring the wave of activism that many predicted in the 2023 proxy season (the first proxy season when the rules were in effect).
- The universal proxy card appears to have made at least partial victory easier for activists, as the change allows shareholders to "mix and match" their votes for individual directors from both the company and dissident slates, rather than being forced to vote from one card.
- Proxy advisor voting recommendations during the first proxy season of universal proxy were generally consistent with historical practices, suggesting that the rules have not materially impacted proxy advisory firms' analysis or recommendations.

Officer Exculpation

- In August 2022, the Delaware legislature amended §102(b)(7) of the Delaware General Corporation Law to allow shareholders to adopt a provision in the charter eliminating personal monetary liability of officers on largely the same basis as directors for breach of the duty of care.
- The statute is limited in application to due care claims:
  - Claims for injunctive relief for breaches of the duty of care by officers can still proceed.
  - Officers would still be subject to possible due care liability in a claim brought against them by the company directly (*i.e.*, a suit authorized by the board), or in a derivative suit that meets the requirements of demand excusal under Delaware law.
- Covered officers eligible for such exculpation include: the president, chief executive officer, chief operating officer, chief financial officer, chief legal officer, controller, treasurer or chief accounting officer, the company's most highly compensated executive officers as identified in its SEC filings, and certain other officers who have (or are deemed to have) consented to be identified as an officer and to service of process.

Officer Exculpation *(cont'd)*

- Officer "exculpation" does not self-effectuate. Companies must adopt such provisions in their charter:
  - Companies that are already publicly traded must amend their charter. Given such amendments typically require shareholder approval, companies should consider submitting a board-sponsored proposal for vote by their shareholders at the annual meeting.
- Key items needed for the charter amendment to be put to a shareholder vote include:
  - Updates to the proxy card to reflect management-sponsored charter amendment proposal;
  - Updates to the proxy statement mechanics and Q&A to address the amendment proposal;
  - Text for the proxy proposal insert, including supporting statement and the proposed charter amendment; and
  - Text for the Board's recommendation, ideally supported by a recommendation of the Nominating, Governance and Social Responsibility Committee in favor of the charter amendment proposal.
- If officer exculpation requires a charter amendment, a preliminary proxy filing subject to SEC clearance is required, and proxy advisory firms will issue recommendations with respect to the charter amendment proposal.

Part III: More on the Role of Directors

- Directors' Key Responsibilities in Light of Increasing Focus on ESG and Stakeholder Governance
- Shareholder Engagement
- Risk Management
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Directors’ Key Responsibilities in Light of Increasing Scrutiny of ESG and Stakeholder Governance

- The term “ESG” has steadily faded from the investor and corporate lexicon over the past year in the wake of cultural and political clashes over its meaning and purpose.
  - “Anti-ESG” legislation adopted by several states.
  - Institutional investors have gone quiet on ESG amid public criticism and congressional subpoenas.
  - BlackRock publicly disavowed the term “ESG” for becoming too politicized.
  - Precipitous drop of use of “ESG” in earnings calls.
- All of this likely signals ESG’s evolution rather than its demise.
  - Without the hype and polarizing effect of the ESG mantle, companies and investors may have more flexibility to take a surgical approach to issues such as climate, sustainability, human capital and DEI, and pursue tailored strategies rooted in the creation of long-term sustainable value.
  - Despite the recent outflow in sustainable funds, record sums are being invested into renewable energy / infrastructure.
  - Accelerating capabilities of AI will pose new ethical, social and regulatory dilemmas.
  - Regulators globally have continued to impose demands for disclosure and accountability on sustainability, human capital and environmental risks.

Directors' Key Responsibilities in Light of Increasing Scrutiny of ESG and Stakeholder Governance *(cont'd)*

- As boards and management teams navigate toward a post-ESG era, the following are some key principles and practical considerations:
  - *Prioritize issues of highest value to the business*. ESG is not a monolithic concept but rather a composite of disparate matters not all equally important to a business. Boards and management teams should periodically assess whether resources are being allocated to address matters that are most likely to have a material impact on the operations and financial results of the business.
  - *Focus on responsive actions to risks (and opportunities)*. Boards and management teams must develop and disclose strategies to address business risks and opportunities, including pending and forthcoming SEC rules on climate, human capital and board diversity, and International Sustainability Standards Board global baseline reporting standards. Investor and regulatory expectations of board and management action and accountability on underlying issues have not abated.
  - *Seek to balance, not equalize, stakeholder priorities*. Many individual issues shoehorned under the ESG umbrella will remain important to a range of stakeholders. It is the responsibility of boards and management teams to balance, not equalize, stakeholder priorities, all in the service of the pursuit and achievement of superior performance and long-term value creation. How a business responds to stakeholder interests should be commensurate with the magnitude of the stakeholder's impact on the business and the anticipated time horizon of the impact.

Directors' Key Responsibilities in Light of Increasing Scrutiny of ESG and Stakeholder Governance *(cont'd)*

- *Expect and prepare for criticism*. Businesses of all profiles will likely continue to face public pressure on ESG issues. Accordingly, boards and management teams should prepare for public pressure and scrutiny, including by proactively engaging with stakeholders, maintaining a record of thoughtful board oversight, adopting well-reasoned policies that can be demonstrably linked to better performance and long-term value creation, communication policies and practices effectively, and ensuring that company leadership is fully prepared to face public scrutiny when it arises.

- *Stay close to investors*. While the largest U.S. investors may have steered away from prescriptive mandates on environmental and social issues, "dry powder" is estimated to be $6 trillion. Consequently, efforts should be made to communicate to the markets the steps the company is taking to enhance business performance, including to address specific ESG issues as relevant. The fact that institutional investors' stewardship teams may be shying away from "ESG" is not necessarily a green light to move material social and environmental issues to the back burner.

Shareholder Engagement

- Engagement is no longer limited to the "proxy season," and traditional governance outreach has evolved to address financial, strategic and social responsibility matters. Engagement is increasingly a board-level issue with limited direct participation by independent directors, as appropriate and necessary.
- No "one-size-fits-all" structure for shareholder engagement. Companies may consider a range of approaches to facilitate the development of meaningful long-term relationships, such as:
  - Ensuring general board-level oversight of company's investor relations and engagement efforts (board updated regularly at meetings).
  - Being open to providing major institutional investors with director access if requested.
  - Coordinating director attendance alongside management at investor visits.
  - Designating the chair/lead independent director as a primary liaison for director-level shareholder communication (with other directors involved as the subject matter warrants).
- The policies and arrangements best suited to any given company will depend on factors such as directors' preferences, nature of existing relationships with shareholders, expressed preferences of shareholders and structure / staffing of existing shareholder relations programs.
- In the case of an activist attack or other contested situation, the company's approach should be supplemented by an intensive campaign with participation of directors.
- Advance preparation, including regarding Regulation FD compliance / communication plans, is critical.
- Proactive, productive and effective engagement can strengthen a company's relationship with its largest institutional investors.

Risk Management

- The risk oversight function of the board has never been more critical and challenging.
  - Tighter monetary policies, deepening geopolitical tensions, widening domestic political polarization, labor shortages, severe weather events, growing challenges tied to nature and biodiversity loss, and the uncertainties surrounding generative AI are among the varied risks that companies have had to contend with in recent years.
  - These risks are likely to persist and even intensify—against the backdrop of an election year in the United States, ongoing conflict in Ukraine and the Middle East, and China's sluggish post-pandemic recovery.
  - Burgeoning financial and climate risks continue to present a challenge to companies.
  - Cybersecurity risk continues to increase in scale and scope.
  - Geopolitical rivalry between China and the United States remains unabated.
- All of this underscores the corporate imperative to continually reassess risk profile and exposure, and to adapt policies and processes accordingly.
  - The recently published *Boeing Report* is a bellwether for and reminder of the importance of the board's risk oversight role.

Risk Management *(cont'd)*

- Managing corporate risk is not just the business and operational responsibility of a company's management team—it is a governance and strategic issue that is squarely within the board's oversight responsibility.
  - Courts and regulators are increasingly scrutinizing board-level risk oversight mechanisms, as well as the adequacy of public disclosures and the quality of board responses when crises erupt.
  - Recent *Caremark* decisions from the Delaware Court of Chancery continue to set a very high bar for claims of oversight failure, but have also allowed some claims to proceed beyond the motion to dismiss stage where the allegations show a bad-faith failure to appreciate and oversee core risks to the company's business.
  - Pressure from institutional and activist investors, state law enforcement authorities, and federal administrative agencies also continues to mount.
- Boards cannot and should not be involved in day-to-day risk management.
  - However, every board's oversight role should include active engagement in monitoring key corporate risk factors, including through appropriate use of board committees.
  - These board-level monitoring efforts should be documented through minutes and other corporate records.

Risk Management *(cont'd)*

- Tone at the top and corporate culture is key to effective risk management.
  - The board and relevant committees should work with management to set the appropriate "tone at the top" by fostering a corporate culture that meets the board's expectations and aligns with the company's strategy, and to ensure that a strong compliance culture is embedded at all organizational levels.
  - The board's vision for the corporation should include its commitment to risk oversight, ethics, good corporate citizenship, and avoiding compliance failures, and this commitment should be communicated effectively throughout the organization.
  - Growing scrutiny over DEI initiatives and practices has added pressure on boards to set the appropriate tone at the top.
  - The board should work with management to consider developing a crisis response plan that includes the input of human resources, legal counsel, and other external advisors in addition to senior management with direct oversight over risk reporting and management.
  - The use, scope, and design of preventative corporate policies, including training and educational programming related to conduct and reporting expectations, should also be carefully considered, as should potential implications, enforcement, and remedies in the event of a violation once such policies are adopted.
  - Disclosure of board-level participation in these deliberations also may be key to demonstrating to internal and external audiences the seriousness of these policies.
- Boards should also adopt a program of regular director training.

Risk Management *(cont'd)*

- Sources of risk oversight obligations:
  - A board's risk oversight responsibilities derive from state law fiduciary duties, federal and state laws and regulations, stock exchange listing requirements and evolving best practices.
  - Delaware courts have taken the lead in formulating the national legal standards for directors' duties for risk management (*e.g.*, *Caremark, Blue Bell*, *Clovis*, *Shabbouei*, *Hughes* and *Boeing* cases).
- The SEC requires disclosures regarding risk oversight and risk factors.
  - To the extent that risks arising from compensation policies are reasonably likely to have a "material adverse effect" on a company, SEC proxy rules also require the company to discuss how its compensation policies and practices relate to risk management and risk-taking incentives.
- DOJ guidance on design of effective compliance programs.
- NYSE governance standards impose risk-oversight obligations on listed company audit committees.
- Major institutional shareholders and proxy advisory firms consider risk-oversight matters in evaluating director elections and shareholder proposals, and routinely engage companies on risk-related topics.
- Various industry-specific regulators and private organizations publish suggested best practices for board oversight of risk management (*e.g.*, COSO).

Risk Management *(cont'd)*

- Actions that boards and committees should consider as part of their risk management oversight include:
  - Reviewing with management the categories of risk the company faces, including any risk concentrations and risk interrelationships, as well as the likelihood of occurrence, the potential impact of those risks, mitigating measures, reporting and monitoring, and action plans to be employed if a given risk materializes;
  - Reviewing with management the company's risk appetite and risk tolerance, its tools for measuring company-wide risks and assessing risk limits, and whether the company's business strategy is consistent with the agreed-upon risk appetite and tolerance, taking into account feedback from management and stakeholders;
  - Reviewing with management the primary elements comprising the company's risk culture, including establishing a "tone at the top" that reflects the company's core values and the expectation that employees act with integrity and promptly escalate instances of noncompliance, and steps to ensure effective communication of and compliance with the company's risk management strategy throughout the enterprise and through appropriate public disclosures;
  - Reviewing the company's director, executive, and employee compensation structure and incentive programs to ensure they are appropriate in light of the company's articulated risk appetite and that these programs are creating incentives to encourage, reward, and reinforce desired corporate behavior;

Risk Management *(cont'd)*

- Reviewing with committees and management the board's expectations as to each group's respective responsibilities for risk oversight and management to ensure a shared understanding as to roles and accountability, including the quality, format, and cadence of management's risk reporting to the board and/or appropriate committees;
- Reviewing and reassessing the allocation of board and committee oversight responsibilities with respect to the different categories of new and evolving risks the company faces, including consideration of whether to form ad hoc or subcommittees, where appropriate, to address particular risks; and
- Reviewing the skills and professional experiences that would best serve the board in overseeing the company's risk management program, to assess whether the current board's mix of skills and professional experiences may benefit from supplementation (including through use of outside advisors), and to identify selection priorities to be used as part of the board recruitment and refreshment process.

Board and Cybersecurity

- As businesses of all profiles become ever more dependent on technology and data management, cybersecurity risks have become increasingly salient. Indeed, failure to adequately identify, control, and mitigate cyber risk can be devastating.
  - The events of recent years, which led the Biden administration to issue multiple Executive Orders declaring cyber threats a "top priority and essential to national and economic security," and to promulgate in 2023 a "National Cybersecurity Strategy," underscore this need.
  - The risk of targeted attacks from criminal groups and state-sponsored malefactors has increased with the spread of remote or hybrid work arrangements, the embrace of cloud-based operations, the continued growth of virtual commerce, the proliferation of the Internet of Things, and the rapid development of AI tools.
- It is imperative that companies diligently consider cybersecurity risks, mitigate vulnerabilities, engage in active and multi-layered defense, leverage law enforcement resources and third-party specialists identified in advance, plan for a robust and rapid incident response, and consider securing appropriate insurance coverage.
- In September 2023, the SEC adopted its final cybersecurity-related disclosure rules for public companies, which became effective in December 2023 and require registrants to disclose on the new Item 1.05 of Form 8-K any cybersecurity incident within four business days after the registrant determines the incident to be material.

Board and Cybersecurity *(cont'd)*

  - Registrants are also required to disclose in their annual report on Form 10-K, pursuant to the new Regulation S-K Item 106, their processes for assessing, identifying, and managing material risks from cybersecurity threats, the material impacts of cybersecurity threats and previous cybersecurity incidents, the board's oversight of risks posed by cybersecurity threats, and management's role and expertise in assessing and managing material risks posed by cybersecurity threats.
  - The SEC has also taken numerous enforcement actions with respect to cybersecurity controls and the safeguarding of customer information, as have other agencies including the DOJ and FTC.
  - The SEC's November 2023 enforcement action against SolarWinds relating to allegedly known cybersecurity risks and vulnerabilities underscores growing scrutiny over cybersecurity internal controls, reporting and disclosures.
- The board's responsibility in this increasingly critical domain is to ensure that management is thinking about and addressing cybersecurity risk in line with the company's risk profile and organizational goals and strategy.
- Importance of effective internal controls and incident preparedness protocols.

Board and AI

- AI offers potentially transformative benefits for businesses of all profiles, but also poses outsized risks.
- Practical recommendations for boards:
  - Take affirmative steps to become and remain reasonably informed about developments in AI and machine learning that could affect strategy, risks or compliance obligations.
  - Exercise business judgment in balancing the potential benefits of AI, such as growth, cost savings and increased efficiencies, with long-term risks and responsibility to stakeholders. Regularly assess risks and benefits as AI continues to progress.
  - Tailor oversight to the organization's priorities and the relevance of AI to the business, ensuring there is adequate monitoring of risks, compliance and unintended impacts.
  - Consult guidelines like the NIST AI Risk Management Framework, IEEE guidelines, etc. to shape company-specific policies, especially around transparency, bias, privacy, and job disruption.
  - Monitor the legal and regulatory landscape, including the implementation of the Biden administration 2023 Executive Order, which encompasses a broad array of government agencies, potentially affecting almost every public company.

Board and AI *(cont'd)*

- Consider periodic audits of data, models, algorithms and governance practices, using internal or third-party evaluations, to validate that AI is developed and used safely, ethically, and in line with laws and compliance policies.
- Promote transparency and communication with stakeholders on AI use and governance.
- Remain alert to novel litigation risks, including IP infringement (including ability to exclude others from using AI-developed IP), exposure of inappropriate content or private data, misleading information or recommendations that cause harm, and consult legal counsel on emerging case law and regulatory guidance.