

Specialist Directors

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The Argument in a Nutshell

- Board composition is changing – adding specific, ESG-expert directors
 - Hand collecting data to assess the scope and magnitude of the change
- Change is not necessarily good for corporate governance or for ESG
 - Interviewing gov & nom. committees to highlight potential drawbacks
- Carries policy implications for regulators, judges
 - Scope of legal intervention; disclosure; assessing liability

Background

Boards Matter; Expertise Matters for Boards

- Boards matter
 - Monitoring
 - Resource provision
- What determines board effectiveness?
 - Incentives (independence)
 - Structure (subcommittees)
 - Ability (expertise) [our focus]

Background

Boards Play an Increased Role in ESG

- Incentives: link executive-pay to ESG criteria
- Structure: assign responsibility to ESG issues to subcommittees
- Ability: pressures to increase board competence on ESG by adding ESG-expert directors. Coming from multiple sources:

Background

1st Conduit: Disclosure Rules

E. Disclosure Regarding the Board of Directors' Cybersecurity Expertise

Cybersecurity is already among the top priorities of many boards of directors⁸² and cybersecurity incidents and other risks are considered one of the largest threats to companies.⁸³ Accordingly, investors may find disclosure of whether any board members have cybersecurity expertise to be important as they consider their investment in the registrant as well as their votes on the election of directors of the registrant.

We propose to amend Item 407 of Regulation S-K by adding paragraph (j) to require disclosure about the cybersecurity expertise of members of the board of directors of the registrant, if any. If any member of the board has cybersecurity expertise, the registrant would have to disclose the name(s) of any such director(s), and provide such detail as necessary to fully

Background

2nd Conduit: SH Involvement



Background

3rd Conduit: Court Settlements






Our story thus far: indications that board expertise is changing in response to increased societal and regulatory demands

The question becomes: to what extent? Cross-sectional variation?

Methodology

- Hand collected data from all proxy statements of S&P 500 firms in 2016, 2019, 2022; sampled 100 firms out of S&P 600

	Hoffman	Johnston	List	Nadella	Peterson	Pritzker	Rodriguez	Scharf	Stanton	Thompson	Walmsley	Warrior
Qualifications and Expertise												
 Financial		✓	✓				✓	✓	✓	✓		
 Global Business		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
 Leadership	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
 Mergers and Acquisitions	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
 Sales and Marketing			✓		✓			✓		✓	✓	
 Technology	✓			✓	✓			✓	✓	✓		✓
Tenure and Independence												
Tenure	2017	2017	2014	2014	2015	2017	Nominee	2014	2014	2012	2019	2015
Independent	✓	✓	✓		✓	✓	✓	✓	✓	✓	✓	✓
Demographics												
Age	54	60	58	54	62	62	57	56	66	72	52	60
Gender Identity	M	M	W	M	W	W	M	M	M	M	W	W
Asian				✓								✓
Black / African American										✓		
Hispanic / Latinx							✓					
White	✓	✓	✓		✓	✓		✓	✓		✓	
Born Outside U.S.				✓			✓				✓	✓

Findings #1

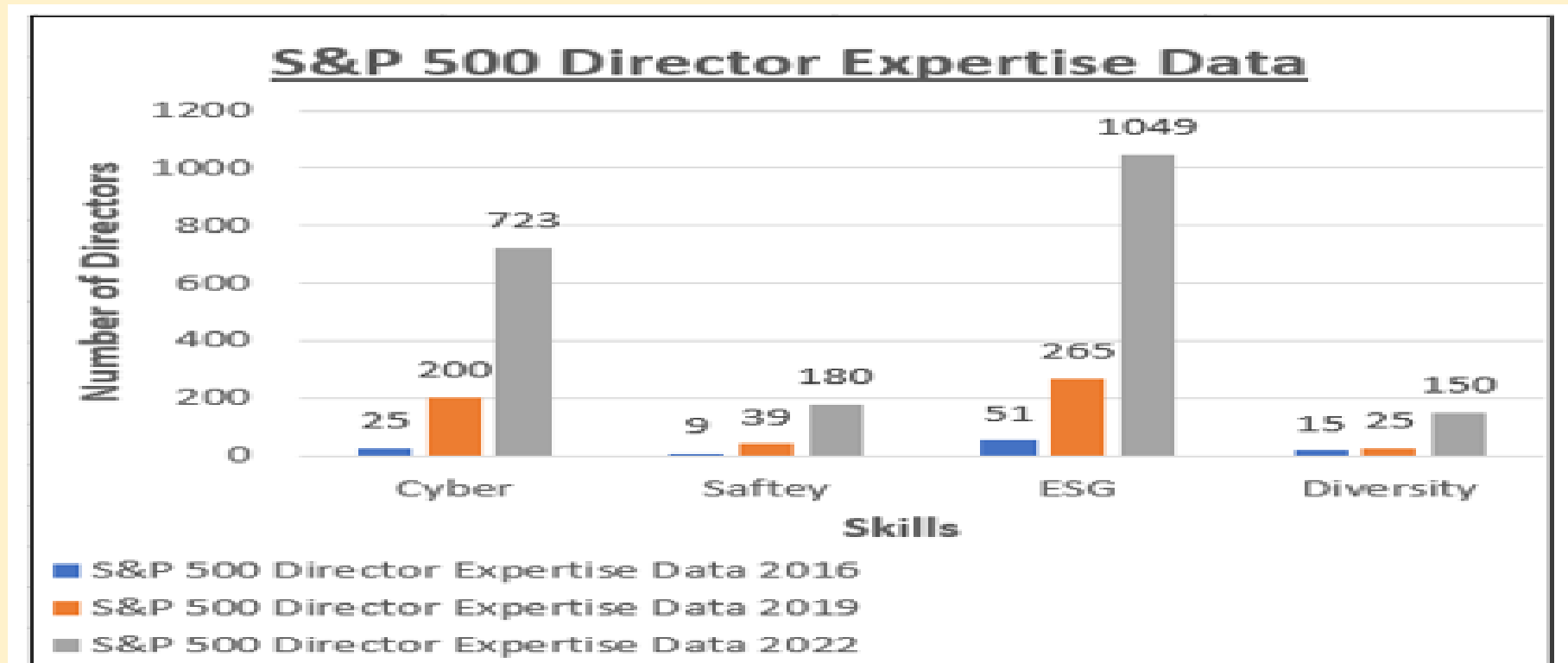
Companies Emphasize Expertise Disclosure

- Companies are putting heavier emphasis on board expertise
 - E.g., prevalence of “skill matrices” jumped from 14% to 66%
- Companies are disclosing more on specific, ESG-type expertise
 - Adding rows to skill matrices: from 46% to 59%; from 40% to 83%

Findings #2

Companies Add Expert Directors

- E.g., from 25 “cyber” directors in 2016, to 723 in 2022



Findings #3

Different Reporting vs. Different Expertise

- E.g., cyber breakdown: 570 cyber experts added from 2019 to 2022:
 - 348: new disclosure (~): their company added a “cyber” row
 - 23: different disclosure: had a “cyber” row, but they didn’t check it
 - 199: new directors
 - How many cyber directors mention cyber in bio? Less than 40%

Findings #4

Quality of Disclosure is Questionable

- Two companies reporting different expertise for same director
- Single company reporting different expertise for same director
- No criteria of what counts as “expertise” in new types

Findings #5

Differences Between Large- and Small-Cap

- E.g., “Ideal skills” section: increase for large, decrease for small
- E.g., “poaching”: diverse experts increase for large, decrease for small

Our story thus far: Companies react to pressures by disclosing more about and adding more ESG-expert directors

Now the question becomes: is it a good thing?

The Advantages of Adding Specific Expertise

- Monitoring:
 - Raises awareness; breaks groupthink; informs discussions
- Resource provision:
 - Channels of communications with stakeholder groups; legitimacy

Drawback #1

Limited Supply = Worse Directors/Dynamics?

- At the individual-level:
 - Less expertise on other matters?
 - Less bandwidth (e.g., cyber experts as “hot commodity”)?
 - Less motivation (“keeping a ledger”)?
- At the group level:
 - Different priors and backgrounds could interfere with group dynamics

Drawback #2

Authority Bias

- Tendency to overvalue ideas and opinions of perceived authority
 - We see it in deals (e.g., *Southern Peru*); and financial reporting (e.g., *Enron*)
- Applied here:
 - Director underwhelmed by scope and complexity of ESG responsibilities
 - “Many companies created a board seat for a cybersecurity expert, with the onus landing on that person to know all and see all.”

Drawback #3

Board Packing

- How do we inject expertise? Adding or turning over?
- Additions may raise the size above optimal level: communication slower, coordination harder, motivation reduced
- A tradeoff that is company-specific; but changes aren't organic

Drawback #4

Board Diversity

- Demand-side pressures for ESG expertise coupled with limited supply = can hinder efforts to increase gender/minority diversity
- Problem is pronounced in S&P 600 firms; in certain ESG dimensions (e.g., cyber)

Drawback #5

Board Washing

- Companies may overly tout director ESG expertise to buffer reputational pressures
- Unstandardized disclosure – increases risk

Our story thus far: Adding specific expertise not necessarily desirable.
Context-specific, empirical question

The question becomes: what should policymakers do about it, if at all?

Implication #1

Lessons for Regulators

- Rethink desirability of legal intervention
- If anything, focus on disclosure

Implication #2

Lessons for Courts

- Assessing board behavior:
 - Individually or collectively?
 - *Caremark vs. Park*?
 - Securities ESG fraud?

- Settlement approvals: appointing ESG experts as part of the “give”