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Considering a Shareholder Engagement Policy — The What, Why and How

Today, many shareholders may feel that the traditional investor communication and relations model is not adequate. Often, written communications are viewed as impersonal and outdated and shareholder meetings typically occur only annually and are rarely seen as leading to meaningful dialogue. Moreover, corporate governance is evolving and shareholders have more effective power to elect their own representatives to the board. For example, according to Institutional Shareholder Services Inc. ("ISS"), 2015 was the first year when a majority of all US companies have had some form of majority voting and annual elections.[1] Further, US companies are increasingly adopting proxy access bylaws that provide shareholders with another means of communicating potential dissatisfaction with the board or management.[2] In response to these changes, companies should consider establishing an effective two-way communication structure with shareholders.

Arguably, existing shareholder dissatisfaction with management and certain corporate governance practices (e.g., executive compensation) has given way to a rise in shareholder activism over the past several years. Additionally, companies may find themselves publicly subjected to shareholder activist demands, which demands have led some companies to divest underperforming businesses, increase share buyback programs or change board or company strategy and governance practices.[3] These changes, despite satisfying certain shareholders and activists at the time, are not always beneficial for the company and its shareholders in the long term. As the role of shareholders in company affairs becomes increasingly prominent and customary, companies will likely benefit from actively engaging their shareholders and adopting policies to ensure that the dialogue between them remains open and changes made to corporate strategy or governance satisfy the needs and expectations of both sides.

Establishing a shareholder engagement policy will assist with providing the company (including its board of directors and management) with formal guidelines to address interactions with shareholders, including shareholder activists. Further, such a policy will provide shareholders with formal guidance as to the methods and topics of engagement with the company. This article highlights the importance of shareholder engagement and presents a range of considerations and examples that will help company leadership design, implement and disclose an effective engagement policy.

Why Implement a Shareholder Engagement Policy?

What Is Shareholder Engagement?

Shareholder engagement refers to the methods in which shareholders can communicate their views, concerns and ideas to the board of directors and company management and, conversely, the ways that boards and management can communicate their perspectives to shareholders. It includes direct communication about corporate governance and other topics such as strategy, risk management or executive compensation, which may receive little attention during the usual conversations at the shareholders' annual meeting or other traditional means of shareholder engagement.[4] Engagement can take many forms, such as a shareholder vote or written consent, annual meeting, quarterly analyst/investor meetings, one-on-one meetings, an annual report, or a corporate social responsibilities report.

Regardless of the form in which engagement occurs, effective engagement benefits both companies and their shareholders. For shareholders, it facilitates a better understanding of the company; for companies, it offers a more complete picture of the diverse views of their shareholders.[5] This understanding may lead to enhanced management credibility and authority or increased shareholder goodwill and trust through improved transparency, which can have a positive impact when a company is facing a proxy fight or crisis arising from misunderstanding or lack of communication regarding corporate governance and other issues that are important to shareholders.[6] Shareholders can also serve as a source of advice since they may have a unique perspective on a company's performance or industry.

Current Issues Concerning Shareholder Engagement

As the possibility of management changes, alterations to corporate strategy, or purported shareholder-friendly moves such as a stock buyback or dividend issuance or increase are becoming more attractive to some investors, boards face heightened pressure to respond to investors who want to see these changes.

It has been reported that the most common board responses to shareholder pressure are the expansion of compensation explanations in the proxy statement, the revision of executive compensation plans, and the alteration or implementation of dividends and stock buybacks.[7] These changes can placate investors, but making these changes with that goal in mind may not be in a company's long-term interest.

More than 20% of surveyed boards of public companies have been approached by an activist investor in the past year.[8] Yet, in 2015, 46% of these surveyed boards did not have a plan in place to respond to a challenge from an activist investor. Additionally, the boards of small-cap companies face shareholder or activist pressure more frequently than the boards of large companies. Only a minority of small-cap companies have established protocol for handling shareholder or activist pressure, despite 44% of directors of these small-cap companies indicating that a member of their board met with institutional investors in the past year.[9]

In their effort to improve corporate governance, certain institutional investors continue to push for greater engagement with companies, particularly with respect to direct engagement with board members. For example, several major institutional investors have written letters to investee companies highlighting the importance of shareholder engagement, including letters from The Vanguard Group Inc.'s[10] and BlackRock, Inc.'s[11] chief executive officers ("CEO"). These recent trends in corporate governance suggest that the relationships between investors and the companies in which they invest deserve more attention than many companies may give them. After all, the status of those relationships could have serious material consequences for both sides.

How Can a Shareholder Engagement Policy Help?

A shareholder engagement policy provides guidelines that, when adhered to, can facilitate effective communication between a company and its shareholders and may offer insight into both parties' perspectives and promote greater alignment. This insight and alignment can help to alleviate shareholder dissatisfaction and the consequent pressure a company may face to make decisions that placate its shareholders in the short term but might not be good in the long term. Frequent and direct shareholder engagement is more effective when implemented as a preventive measure rather than as a reaction to investor dissatisfaction or an activist attack.

Other benefits of an effective shareholder engagement policy may include:

- the avoidance of unexpected consequences of board decisions made without shareholder knowledge
- board-shareholder consideration about how the company's short-term performance may affect its longer-term goals
- opportunities for company management and directors to receive outside advice and fresh perspective
- better and more efficient use of company resources
- goodwill and trust between the company and its shareholders, developed through enhanced transparency
- company influence over proxy-voting decisions

Designing a Shareholder Engagement Policy

Elements to Consider

An effective shareholder engagement policy should facilitate two-way communication among company management, the board of directors and the company's shareholders. When designing a shareholder engagement policy, companies should consider:

- **Shareholders' primary concerns and their voting patterns relating thereto.** Companies should identify which types of investor they are seeking to engage, and use engagement with shareholders to obtain investors' perspectives on company policies and practices. The type and level of engagement may depend on whether the shareholder is a retail or institutional holder and whether the individual is an analyst, portfolio manager, governance professional or executive officer. The board and management should also continuously monitor significant shareholders for changes in share ownership and changes in position on issues regarding corporate governance and investor activism. Shareholder outreach can be a helpful way to identify the topics or policies about which shareholders are concerned and may assist the company in developing a responsive and preventive policy that addresses these concerns.[12] Some specific examples of topics to discuss with investors or to address within a shareholder engagement policy could include the following:
    - board composition and leadership
    - board involvement in strategy development and oversight
    - executive compensation philosophy and structure
    - process and philosophy surrounding executive and board member successions

  - financial oversight
  - risk management

- **The distinction between the board's role and management's responsibility regarding shareholder engagement.** A shareholder engagement policy should delineate the engagement role and responsibilities of directors and management. This delineation may be helpful for shareholders referencing the policy when they have questions or concerns about the company or a particular corporate governance practice and are not certain which group to engage. Generally, directors should address corporate governance matters, while financial performance and corporate strategy are more appropriate for management. Additionally, if the company chooses to engage with retail and institutional shareholders differently, the policy can describe the forms of engagement that are generally available to these different categories of shareholders.[13]

- **The personnel selected to represent the company during engagement.** Identifying the individuals in the policy who will represent the company during engagements can help ensure regulatory compliance, mitigate risks of misunderstanding or sharing inconsistent information and improve communication after the engagement. If desirable, these individuals may be selected based on the specific topics to be discussed, which may be determined based on experience, expertise or board role. Descriptions in the shareholder engagement policy of these individuals' role in the company and in shareholder engagement may help ensure the consistency of the information exchanged and allow the board, management and shareholders involved in the engagement to create a plan for how to proceed with the information if necessary.[14]

Certain challenges arising from shareholder engagement should be considered or addressed within the shareholder engagement policy as well. These challenges include:

- **The potential violation of Regulation Fair Disclosure ("Reg. FD").** Conversations with institutional or other shareholders could reveal material nonpublic information to those parties, potentially violating Reg. FD and resulting in prosecution, fines and public relations problems.[15] When designing a shareholder engagement policy, companies should address and provide for corresponding training on Reg. FD so that directors and management are aware of related issues and concerns and that counsel should be contacted in the event of a potential violation.

- **Sharing inconsistent information.** Since investor meetings held outside of the annual meeting are not always based on a scripted agenda, relaying the same message every time various members of management sit down with a different investor or group of investors can be difficult. The inconsistency has the potential to escalate when the conversation evolves or strays from the agenda and different questions and responses are shared and discussed. The board and management might benefit from a shareholder engagement policy that outlines procedures that allow for consistent responses while not unnecessarily restricting dialogue. As noted above, the policy may also detail the board or management personnel responsible for communication in specified areas.

If a company already has an existing shareholder engagement policy, its board and management should evaluate its efficacy and the shareholders' satisfaction with it and consider whether improvements can or should be made.

Implementing a Shareholder Engagement Policy

How?

Companies hoping to implement a shareholder engagement policy should identify the appropriate internal stakeholders and assemble a group or a committee, potentially comprised of company executives, management or members of the board of directors, to lead the effort.[16] Ensuring that this committee is diverse in its knowledge of shareholder concerns is an important element to consider during the implementation of a shareholder engagement policy. For example, people from the investor relations, human resources and legal departments might have better knowledge and authority to answer questions that will likely arise during meetings. Similarly, if a company has experienced poor say-on-pay votes in recent years, the compensation committee chairman's participation may be beneficial.

Analyzing which investors a company seeks to engage and then developing an outreach strategy to connect with those investors is one way to begin implementing a shareholder engagement policy. Proactively reaching out to the company's largest institutional investors can help management identify specific elements that the engagement policy should include. Large institutional investors, particularly value investors with a longer-term investment horizon, are more likely than index or fund investors[17] to confront companies on specific issues (e.g., executive compensation), but a broad range of topics is also appropriate for discussion. The main goal is that the opportunity for conversation is available and that guidelines exist to help it remain available and effective. Opening a dialogue early through a shareholder engagement policy can help keep shareholder dissatisfaction at bay. In addition, continued dialogue is important to developing and maintaining good investor relations.[18]

Many successful companies' policies combine several methods of shareholder engagement that allow for many avenues of communication. These methods might incorporate mass shareholder outreach, targeted shareholder outreach or individual conversations.[19] Some popular avenues of engagement to incorporate in the policy may include:

- virtual meetings
- shareholder surveys
- electronic shareholder forums
- governance roadshows
- conference calls
- webcasts
- podcasts
- corporate websites/blogs
- social media

Virtual technology deserves consideration as a potentially valuable part of an effective shareholder engagement policy. The Council for Institutional Investors' policy states: "Companies incorporating virtual technology into their shareowner meeting should use it as a tool for broadening, not limiting, shareowner meeting participation. With this objective in mind, a virtual option, if used, should facilitate the opportunity for remote attendees to participate in the meeting to the same degree as in-person attendees."[20] Virtual shareholder meetings may promote attendance, boost participation and save company and shareholder money, and thus should be considered when implementing the policy. Furthermore, a virtual shareholder meeting platform can enable an electronic display of submitted questions so investors can vote on questions they want management to answer, which may provide a clear list of priorities that allows meetings to stay on track and ensures that the issues important to shareholders are addressed.[21] A company should consider incorporating these engagement platforms and virtual options into a shareholder engagement policy.

Disclosing the Shareholder Engagement Policy

What and Where?

When the shareholder engagement policy has been approved, the company should publish it on its website and in its proxy statement.[22] The disclosure of the policy should ideally provide information about the processes the company has put in place to facilitate shareholder engagement. Contact information, such as email addresses for board members or the committee in charge of engagement or corporate governance, should be readily available for shareholders wishing to engage with the company. The means of disclosure should also detail the board's and management's roles in the engagement process as well as the procedure for the discussions.

The medium in which the company wishes to disclose its engagement policy is generally unrestricted. However, despite the lack of restriction, disclosure has an important part to play in publicizing corporate governance matters and should be considered in the shareholder engagement policy. Providing accessibility to a company's policies and perspectives on corporate governance can make the company a more transparent issuer that has the shareholders' interests in mind. If the company has tangible results or examples of the positive change that the shareholder engagement policy has helped to effect, those should be publicized as well.

Effective and productive disclosure of a company's shareholder engagement policy should provide shareholders with knowledge of the specific opportunities and avenues for direct communication that allow shareholders to voice their concerns. Effective disclosure may also reduce the risk that a shareholder whose request has been turned down may view the company's decision to decline engagement as company disregard for shareholder concerns, a personal bias or an indication of a lack of board independence. Reducing this risk has the potential to strengthen shareholder confidence and goodwill.

Best Practices

Proxy statements should include detailed information about a company's shareholder engagement policy. For example, a proxy statement might list the specific ways in which the board receives feedback from investors, and it may explain how the company has incorporated that feedback in the past. It could also emphasize the board's role in the engagement process and share the company's procedure for evaluating both the votes and the independent feedback it received relating to corporate governance issues.[23] In addition, companies may want to consider preparing a shareholder engagement report, a tool that can highlight key company and governance data, including the shareholder engagement policy.[24] Alternative (or additional) mediums for disclosing the engagement policy can include a company's Annual or Corporate Governance Report.

Another suggested method of disclosure is to provide a summary of a company's shareholder engagement policy on its website. The webpage could also provide a link that leads shareholders to feedback forms or a link that shareholders and other members of the public can use to find information about contacting the board of directors by letter or email.

Other important aspects of the disclosure of the shareholder engagement policy are that it is clear, concise, well organized and easy to comprehend. Poorly written materials are less likely to be read or understood by shareholders, and shareholders may feel that the company is not being forthright in its effort to effectively communicate with them if the disclosure is not readily available or coherent.[25]

Final Thoughts

A shareholder engagement policy may be an effective, preventive measure against the consequences of shareholder dissatisfaction. Confidence is built upon the open communication that an established shareholder engagement policy can help provide. That increased confidence can lead to more productive shareholder meetings, changes that benefit the company as a whole and the achievement of long-term goals. Designing, implementing and disclosing a shareholder engagement policy may protect a company against the consequences of shareholders' discontent and can engender trust and goodwill on both sides. A shareholder engagement policy is a tool that may establish common ground and lead a company and its shareholders into a new relationship built on respect, trust and effective communication.

How Chapman Can Help

Chapman and Cutler attorneys provide corporate and business counseling to a wide range of clients, both publicly and privately held entities, with a focus on financial services institutions, utilities, investment advisors, insurance companies, manufacturers, distributors, wholesalers, retailers, contractors, transportation companies, professional service providers, pension funds and not-for-profit entities. Chapman and Cutler maintains a dedicated Corporate Counseling Practice Group with the necessary skills and experience to counsel on the issues presented in this corporate governance update. If you would like to discuss any of the issues contained in this update or other legal, regulatory, compliance or corporate governance-related issues facing your organization, please contact an attorney in our Corporate Counseling Practice Group.

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1 *Prevalence of Independent Chairs Continues to Climb*, ISS (March 16, 2015).

2 It has been recently reported that 259 public US companies provide proxy access rights to their shareholders, including 185 S&P 500 companies (or 37% of the index), of which 94% were instituted since the beginning of 2015. *2016 Proxy Season Review*, THE ADVISOR, Shirley Wescott (July 2016).

3 *10Minutes on hedge fund activism*, PricewaterhouseCoopers ("PwC") (2016).

4 *Defining Engagement: An Update on the Evolving Relationship Between Shareholders, Directors and Executives*, Marc Goldstein (April 10, 2014).

5 *Shareholder Engagement: Maximizing the Shareholder Relationship*, EXECUTIVE COMPENSATION INSIGHTS, Tarun Mehta (2013).

6 *Directors Briefing – Shareholder Engagement*, Andrew J. MacDougall and Robert Adamson (2011).

7 The 2015-2016 National Association of Corporate Directors ("NACD") Public Company Survey noted that the expansion of compensation explanations in the proxy statement (36%), the revision of executive compensation plans (28%) and the alteration or implementation of dividends and stock buybacks (18%) are the most common board responses to shareholder pressure. *Highlights: 2015-2016 NACD Public Company Governance Survey*, NACD (September 2015).

8 *Id.*

9 *Id.*

10 Vanguard CEO F. William NcNabb's letter to the boards of directors of the Vanguard funds' largest portfolio holdings proposed the creation of "shareholder liaison committees" to give shareholders greater access to board members and indicated that meetings with directors would allow investors to express their opinions and allow discussion about important long-term issues. *Text of a letter sent by F. William McNabb III, Vanguard's Chairman and CEO, to the independent leaders of the boards of directors of the Vanguard funds' largest portfolio holdings*, F. William McNabb (February 27, 2015).

11 BlackRock CEO Larry Fink's letter to his firm's largest portfolio companies encourages them to take a long-term approach to creating value. BlackRock views the use of engagement with those companies as an effective mechanism to promote such value. *Text of letter sent to Chairmen/CEOs asking them to focus on delivering long-term value*, Laurence D. Fink (March 31, 2015).

12 *Shareholder activism: Who, what, when, and how?*, PwC (March 2015).

13 *Directors Briefing – Shareholder Engagement*, *supra* note 6.

14 *ICD Guidance for Director-Shareholder Engagement*, Institute of Corporate Directors (2016).

15 Reg. FD is a disclosure rule that addresses selective disclosure of company information. Generally, the regulation provides that when a company, or person acting on its behalf, discloses material nonpublic information to certain enumerated persons (in general, securities market professions and holders of the company's securities who may well trade on the basis of the information), it must make public disclosure of that information. The timing of the required public disclosure depends on whether the selective disclosure was intentional or non-intentional (for an intentional selective disclosure, the company must make public disclosure simultaneously; for a non-intentional disclosure, the company must make a public disclosure promptly). Under the regulation, the required public disclosure may be made by filing or furnishing a Form 8-K or by another method or combination of methods that is reasonably designed to effect broad, non-exclusionary distribution of the information to the public. *SEC Final Rule: Selective Disclosure and Insider Trading*, Release Nos. 33-7881, 34-43154; File No. S7-31-99 (August 15, 2000).

16 *Director-Investor Communication Is Coming. Here's How to Do It*, Stephen Davis and Jon Lukomnik (July 7, 2015).

17 *Global Trends in Board-Shareholder Engagement*, DIRECTOR NOTES, The Conference Board, James Kim and Jason D. Schloetzer (October 2013).

18 *Principles of Corporate Governance*, Business Roundtable (August 2016).

19 *Shareholder Engagement: Maximizing the Shareholder Relationship*, *supra* note 5.

20 *Adopting a Virtual Approach to the Annual Meeting*, Judy Warner (January/February 2012).

21 *Id.*

22 *The Investor-Savvy Board*, Anthony Goodman (July 15, 2016).

23 See General Electric Company's 2016 proxy statement as an example of effective disclosure describing shareholder engagement and feedback received from investors. SEC Schedule 14A filed on March 14, 2016.

24 *Preparing for Investor Meetings Has Never Been Easier or More Accurate: Equilar launches Shareholder Engagement Report*, Equilar (August 3, 2016).

25 *Directors Briefing – Shareholder Engagement*, *supra* note 6.

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