

CORPORATE  
**BOARD MEMBER**<sup>®</sup>  
An NYSE Euronext Company

2012 SPECIAL SUPPLEMENT

# Legal Risks on the Radar



**The Corporate Board Member/FTI Consulting, Inc.,  
2012 Law and the Boardroom Study**

# Legal Risks On the Radar

**Figure 1**  
**Top 10 concerns for directors and general counsel:**

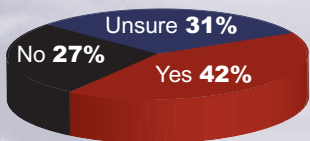
**Directors**

Data security	<b>48%</b>
Operational risk	<b>40%</b>
Company reputation	<b>40%</b>
M&A transactions	<b>37%</b>
Investor relations	<b>30%</b>
Executive compensation	<b>30%</b>
SEC/regulatory compliance	<b>28%</b>
Disaster recovery	<b>27%</b>
Internal controls	<b>26%</b>
Global business expansion	<b>26%</b>

**General Counsel**

Data security	<b>55%</b>
Operational risk	<b>47%</b>
Management of outside legal fees	<b>38%</b>
Company reputation	<b>35%</b>
Disaster recovery	<b>35%</b>
E-discovery	<b>33%</b>
FCPA	<b>30%</b>
Global business expansion	<b>29%</b>
Internal controls	<b>26%</b>
Executive compensation	<b>26%</b>

**Figure 2**  
**Directors who say their company has a crisis management plan in place to respond to a cyber attack.**



**Introduction**

Each year, Corporate Board Member and FTI Consulting, Inc. conduct research to gain insight on which current legal issues raise concern for public company directors and corporate general counsel and to analyze related legal and governance events and trends. In early 2012, the organizations gathered data by surveying 11,340 directors and 1,957 general counsel. Questions were asked of both groups to compare and contrast their perspectives; other queries were specifically targeted toward either directors or GCs. The 2012 Law and the Boardroom survey results that follow once again offer interesting insight into the thoughts and opinions of these two critical governance groups.

**Executive overview**

Several key themes emerged from the 2012 Law and the Boardroom study that reflect changes taking place within corporate America. During the past decade, for example, U.S. businesses have expanded globally and stepped up the use of online communication as well as web-based products and delivery channels. Thus, increasingly, corporate America is operating in a world where connectivity is high and there are few physical barriers. Accordingly, for the first time, data security was earmarked by the largest percentage of responding directors (48%) and general counsel (55%) as an issue of concern. The second most prevalent response for both directors and GCs centers on operational risk, which topped directors' list in 2011 and moved up several places for general counsel this year. Finally, on the risk/concern spectrum, directors and GCs flagged loss of reputation as an issue of critical concern in 2012.

A significant number of directors are also worried about risks related to mergers and acquisitions and their relationship with investors, while a significant number of general counsel

noted concern with the management of outside legal fees and disaster recovery. Also resonating this year are issues involving compliance and investigations (Figure 1).

In addition to this barometer, the 2012 Law and the Boardroom study delved into opinions relative to proxy access and other shareholder-related matters. In particular, the study homed in on respondents' opinions regarding the nomination of director slates and subsequent actions taken as a result of 2011 say-on-pay votes. Also, for the first time, the survey queried respondents about the use of corporate social media and the risks and policies surrounding it. And finally, because the board/management relationship is a critical factor in the performance of the company, we asked directors and GCs to rate each other in several key aspects of effectiveness, as well as how well they work in tandem with each other.

The following report, a supplement to *Corporate Board Member* magazine's third quarter 2012 issue, presents highlighted data and examines each of these topics in fuller detail.

**Cyber strategy and IT risk**

Today, there is arguably no more insidious threat to a public company than that of cyber risk; it's invisible, ever-changing, and pervasive—making it very difficult for boards to manage. On top of that, it's costly. *Corporate Board Member* magazine recently reported that the median annualized cost of cyber crime per company averaged \$5.9 million—a serious bottom-line expense. Thus, it comes as no surprise that this year, more than half (55%) of general counsel rated data security as a major concern and 48% of directors feel likewise. Interestingly, this level of concern has nearly doubled in the last four years: In 2008, only 25% of directors and 23% of GCs noted data security as an area of high concern.



How are companies coping with this challenge? The survey asked general counsel to rate how well their board was managing cyber/IT risk, and while the majority of GCs gave a positive response to the question, one-third (33%) believe their board is not effective at managing cyber risk— noteworthy as being one of the least-effective ratings among 13 risk management areas surveyed.

In a related area, the survey measured disaster planning and business continuity preparedness in the event of a cyber attack. When asked if their company had instituted a plan that would manage a cyber breach or attack should one occur, less than half (42%) of directors said their company has a formal, written crisis management plan for that purpose; just over a quarter (27%) said their company has no such written plan, and nearly another third (31%) were uncertain (Figure 2).

While these findings may raise a flag related to companies having formal, written policies in place, the majority of respondents have a comfort level with their ability to respond to a cyber attack. Seventy-seven (77%) of directors and general counsel believe their company is prepared to detect a cyber breach should one occur. Corporate Board Member President TK Kerstetter says the disconnect between having written plans and the perception of preparedness is cause for concern, and certainly an area to monitor in the years ahead.

“I hate to say this, but I think it is going to take several well-publicized security breaches before a supermajority of corporate boards finally embrace the fact that doing business today without a prudent crisis plan in place is a formula for disaster. Cyber risk and social media developments only increase the odds that it will happen to your organization—so boards should take steps to protect their company’s reputation,” says Kerstetter.

### **Operational risk**

Concern about operational risk garnered the second-highest percentage of responses from both directors (40%) and general counsel (47%)—not surprising, given the myriad ways in which operational matters affect corporate performance. Yet, it is important to note that the mere presence of risk should not warrant undue concern. Rather, what is important is a board’s ability to leverage such risk toward the proper offsetting reward, a task that requires directors to be given meaningful analytics and maintain effective communication with management and the general counsel. To gauge board performance in this area, the survey asked GCs to rate their board: the majority of general counsel surveyed (59%) believe their board is effective at managing operational risk, while another third (33%) responded with a neutral rating to the board’s effectiveness in this area.

According to Neal Hochberg, Senior Managing Director and Global Leader of the FTI Consulting Forensic & Litigation Consulting practice, operational risk is squarely in the purview of the board and requires sophisticated analysis to help the board make meaningful decisions. “Boards increasingly are concerned about operational risk in the context of emerging markets, where rising economic prosperity offers opportunities to expand operations and grow market share yet also poses heightened governance risk,” Hochberg notes. “To make informed decisions about these market opportunities, corporations increasingly are conducting proactive market risk assessments that identify and prioritize the risks that first need to be evaluated.”

### **Compliance**

In the post–Dodd-Frank Act regulatory environment, the responsibility for boards to oversee legal and regulatory matters is much greater. This year, the

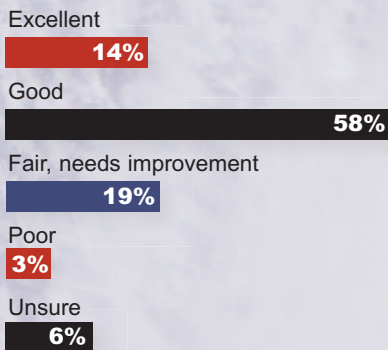
survey gathered respondents’ opinions regarding preparedness and concern about several key compliance issues, foremost among them, the Foreign Corrupt Practices Act.

Enacted in 1977, the threat of FCPA ramifications has loomed for several decades over U.S. companies doing business in foreign countries. While once affecting just a few multinational players, today FCPA touches a vast number of U.S. concerns. Board members have thus become increasingly attuned to the risk of noncompliance, especially after the 2008 case of Siemens AG, which was hit with a whopping \$1.6 billion FCPA penalty after bribes to foreign officials were confirmed.

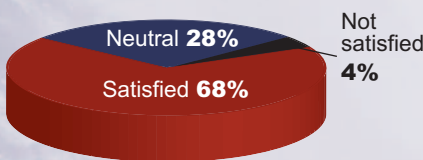
Among directors and general counsel surveyed, most appear fairly comfortable with their oversight of FCPA compliance; only 18% of directors and a 30% of GCs noted significant concern in this area. Accordingly, it did not appear on the list of top 10 concerns for directors, and ranked seventh on the GCs’ list. When asked how they would characterize the FCPA compliance education level of the company’s employees, 72% of directors described this level as either excellent (14%) or good (58%) (Figure 3). The majority of general counsel also characterized employees’ FCPA education level as excellent (18%) or good (43%).

So while there are no immediate red flags in this data, the day-to-day oversight on compliance matters falls to the general counsel to watch for triggers and assess whether mitigation is necessary. Most boards feel the GC has this well in hand: 68% of directors reported satisfaction in their GC’s ability to handle FCPA compliance matters; 28% were neutral in their response (Figure 4). But while GCs shoulder a great deal of this burden, boards also have the responsibility to

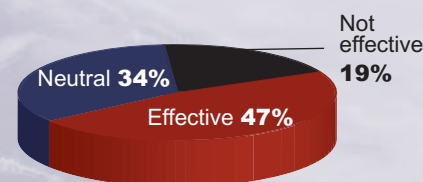
**Figure 3**  
**How directors characterize the education level of employees regarding FCPA compliance:**



**Figure 4**  
**How satisfied are you with the GC's handling of FCPA?**



**Figure 5**  
**How effective is the board at managing FCPA risk?**



ask questions to uncover issues that might signal regulatory risk. Interestingly, the survey found that less than half of general counsel (47%) believe their board is effective at managing FCPA risk in this regard, 34% are neutral as to their board's effectiveness, and the remaining 19% reported their board is ineffective at managing FCPA risk (Figure 5).

In other compliance-related findings, the survey found less than half (47%) of directors are worried about government investigations, which is a bit surprising, given the increased vigor of securities law enforcement since 2008. Finally, the survey inquired about directors' concern over whistleblower incidents—another outgrowth of Dodd-Frank. Only 9% of directors noted whistleblower incidents as a high concern and 81% are satisfied with their general counsel's handling of their whistleblower policies. The vast majority (91%) of companies have instituted an in-house whistleblower hotline, with the majority of directors (84%) and GCs (80%) believing such a hotline is useful in helping the company mitigate risk (Figure 6).

"With 91% of surveyed companies implementing whistleblower hotlines, it confirms that companies operating in today's regulatory environment are taking a proactive stance to mitigate fraud and protect the enterprise," says Hochberg of FTI Consulting. "Given the SEC's new whistleblower bounty incentives, now more than ever, companies must adopt standard practices to respond to hotline reports, acting upon a report quickly and confidentially through an independent internal investigation with the aim of establishing employee confidence in the hotline and the internal culture of compliance throughout the organization."

The above compliance issues are all relevant to U.S. public companies that operate in a world that is rapidly expanding beyond traditional geopolitical borders and is much more complex than ever before. With FCPA in particular, the international

marketplace now touches just about every major domestic corporation in one way or another—be it through global distribution of products and services, overseas supply chains, outsourcing, or even cloud management of human resources. As a result, the Law and the Boardroom study will continue to track FCPA and other compliance trends to help boards and general counsel better prepare to manage these challenges that remain on the forefront of boards' and GCs' risk concerns.

"Anticorruption compliance is a highly challenging governance area, and it may be that the respondents feel the risk of an isolated violation is continually present," Hochberg notes. "But, increasingly, companies are implementing robust internal controls; enhancing their corporate compliance and ethics policies; conducting risk assessments and third-party due diligence; and, equally as important, training employees at every level of the operation and in all geographies about the governing legal statutes and applicable corporate compliance policies—setting the tone at the top."

**Corporate reputation risk and business continuity**

A company's reputation may be built over years, but unfortunately, can dive bomb quite rapidly. News related to compensation, fraud, labor disputes, product recalls—even an executive's personal crisis—can translate within minutes to negative cable news headlines and thousands of hits in the Twittersphere.

It's no surprise, therefore, that corporate reputation risk issue garnered the third-highest prevalence of responses by directors (40%) and the fourth-highest by general counsel (35%) among those who noted it as a major concern. Furthermore, an analysis of historical Law and the Boardroom data shows this level of concern has increased compared to 2007 results, when only 18% of directors and 25% of GCs indicated concern about loss of reputation.

Tangential to these findings are data gathered on director and GC concerns related to disaster recovery and business continuity preparedness. Thirty-five percent of general counsel indicated business continuity/disaster recovery risk is an area of concern; 27% of directors consider it a high-level concern. Like reputation risk, worry over business continuity/disaster recovery risk has crept upward. In 2010 when the question was first asked, only 15% of GCs reported significant concern, and just 16% of directors noted likewise.

### Proxy issues

During the past year, corporate governance observers witnessed much anxiety surrounding proposed rules on shareholders' access to the proxy. In 2011, the U.S. Court of Appeals, D.C. Circuit, vacated SEC Rule 14a-11, saying the agency had adopted the rule without adequately assessing its economic effects. While SEC Chairman Mary Schapiro has since stated that shareholder access to company proxy materials is no longer on the commission's immediate agenda, it is important to note that changes facilitating private ordering in proxy access were not impacted by the court's decision.

These developments led to several Law and the Boardroom questions on proxy access, private ordering, and the manner in which companies manage their communication with shareholders. Interestingly, 54% of directors and 51% of general counsel feel comfortable letting members of their board address shareholders face to face and answer their questions; however, 46% of directors and 49% of GCs don't think it's a good idea (Figure 7). Respondents were also asked their opinion on the practice of holding a fifth analyst call, an additional conference call in which board members discuss issues and answer shareholder questions. The majority of general counsel (93%) and directors (89%) agreed that holding a fifth analyst call isn't a good idea. However, Corporate Board Member's Kerstetter says he doesn't see this issue fading away.

"Companies have been consistent about their distaste for adding an additional call that focuses on governance issues and includes board members on the call. But one should not feel too confident that this will deter shareholders," Kerstetter warns. "We expect more pressure from shareholder groups asking to speak directly with board leadership and committee chairs. Therefore, directors should discuss their company's plan to improve its shareholder communications prior to the next proxy season."

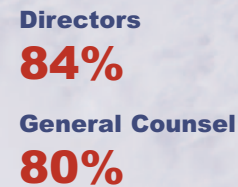
Overall, there does not appear to be significant concern with regard to management of shareholder communications from either directors or general counsel. The majority (54%) of general counsel believe their board is effectively managing shareholder communications (with another 38% neutral), and fully 89% of directors said they are satisfied with their GC's handling of SEC-mandated proxy disclosures.

### Executive compensation

Few governance issues in recent history have risen to the level of contention and controversy that has accompanied executive compensation since 2008. Whether the sticking point is the level of pay, the management/employee pay ratio, satisfaction with peer group analyses, information contained in the CD&A, or numerous other matters—executive compensation is a challenge for virtually every public company board. Even the merit of performance-based compensation—once considered the gold standard—has tarnished. Thus, the responsibility of the board to develop long-term incentive plans that pass muster with shareholders and governance watchdogs, while legitimately rewarding and retaining key personnel, has become the holy grail.

Despite all the distractions this multitude of issues creates, one aspect has clearly emerged: More than ever, there is a need for transparent and effective communications around all information related to compensation.

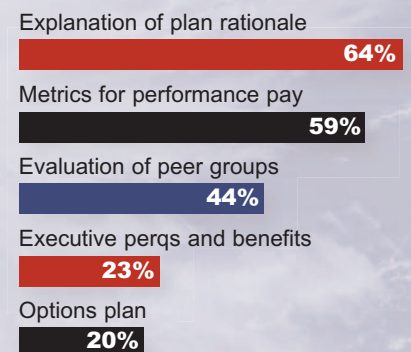
**Figure 6**  
Percentage who believe a whistleblower hotline mitigates risk:



**Figure 7**  
Are you comfortable having the board address shareholders face to face and answer their questions?

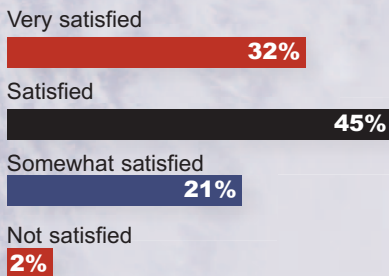


**Figure 8**  
Ways in which boards have discussed improving communication to shareholders regarding executive compensation:

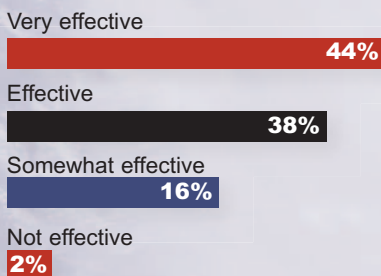




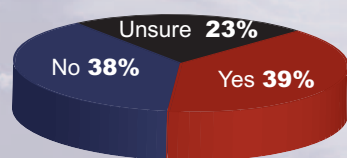
**Figure 9**  
**How satisfied are you with your general counsel's handling of executive compensation? (Directors' ratings)**



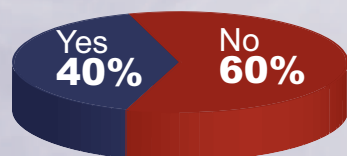
**Figure 10**  
**How effective are boards at managing executive compensation? (General counsel ratings)**



**Figure 11**  
**Does your company have a social media policy?**



**Figure 12**  
**Does your board have a good handle on the risks associated with corporate social media?**



To address this, the survey asked whether boards had discussed making changes since 2011 that would improve communications with shareholders regarding executive compensation. The largest percentages of directors said their boards have focused more on explanation of overall plan rationale (64%), metrics for performance pay (59%), and evaluation of peer groups (44%). Only 23% talked about improvements regarding executive perquisites and benefits, and even fewer (20%) discussed an options plan (Figure 8).

The survey asked directors to rate how much assistance the board received from its general counsel on executive compensation matters. Most directors (77%) are satisfied/very satisfied with their general counsel's handling of executive compensation issues, and while that leaves about a quarter of directors who do have concerns, the percentage of those who are very concerned has declined since 2009 (Figure 9). Conversely, GCs gave their boards mostly high marks: Most (82%) agreed that their board is effective at managing executive compensation (Figure 10).

It's interesting to note that the survey data indicates that general counsel might be ready to offer more assistance with compensation decisions than they are today. Sixteen percent of GCs said they are regularly excluded from committee meetings where they believe they could contribute; of those, 88% said it is the compensation committee discussions from which they are excluded.

### Social media

The 2012 Law and the Boardroom survey also investigated the growing use of corporate social media as a communications and marketing strategy. In its first year to track this data, the survey found only 39% of directors said their company has a social media policy; 38% said their company does not have such a policy; and 23% of directors are unsure if their company has such a policy in place (Figure 11). Directors and general

counsel also were asked if they feel their board has a good handle on the risks associated with corporate social media. Given that this is a relatively new risk area for many companies, it is not surprising that the majority of directors (60%) believe their board does not fully understand the risks surrounding social media (Figure 12).

### Looking Ahead

Looking ahead, directors were asked what type of information their board most needs to be as effective as possible in 2012. The five areas receiving the largest percentages of director responses were strategic planning (88%), executive compensation plans (48%), board/ management relations (41%), enterprise risk management (36%), and investor relations (33%).

These findings verify that such topics remain steadfastly in corporate boards' domain and will likely contribute to their chief concerns in the years ahead. Yet, each year new concerns do continue to emerge, and it is always enlightening for Corporate Board Member and FTI Consulting to tap into the mindset of directors and general counsel in order to illuminate which new topics and risk areas will become more prominent in U.S. boardrooms. We offer many thanks to all the directors and GCs who took the time to participate in the 2012 Law and the Boardroom survey, and hope the thought leadership and the survey data presented here offers valuable insights for your board in the year ahead.



FTI Consulting, Inc. is a global business advisory firm dedicated to helping organizations protect and enhance enterprise value in an increasingly complex legal, regulatory and economic environment. With more than 3,800 employees located in 24 countries, FTI Consulting professionals work closely with clients to anticipate, illuminate and overcome complex business challenges in areas such as investigations, litigation, mergers and acquisitions, regulatory issues, reputation management, strategic communications and restructuring. The company generated \$1.56 billion in revenues during fiscal year 2011. More information can be found at [www.fticonsulting.com](http://www.fticonsulting.com).

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