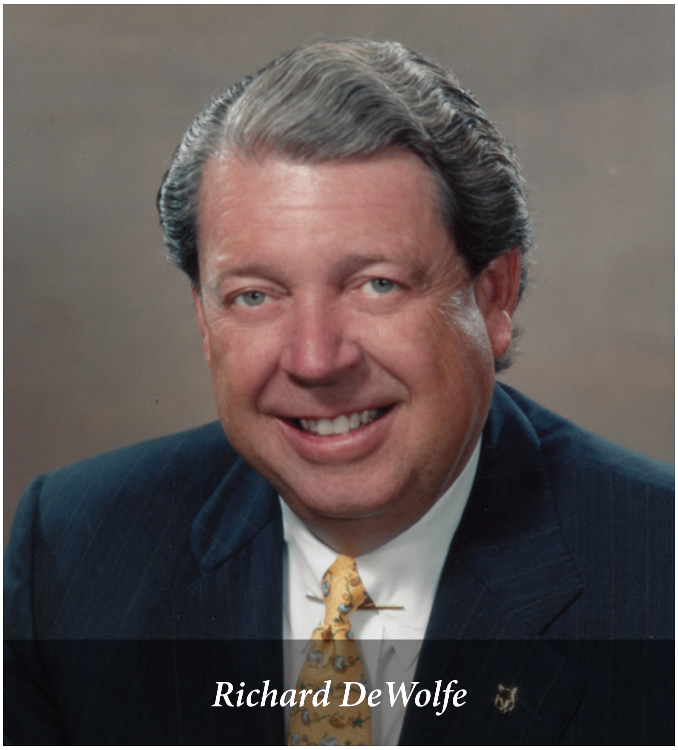
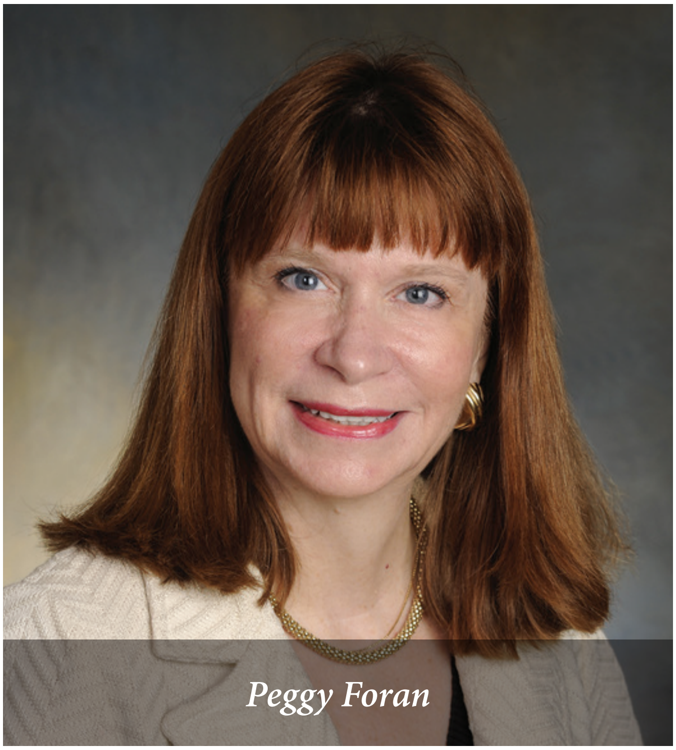


Richard DeWolfe



Peggy Foran

The Evolving Role of Directors in Shareholder Engagement: The Directors' Perspective

Shareholder engagement remains highly topical in boardrooms across North America. Issuers are recognizing the benefits of speaking directly with institutional shareholders on a broad range of topics beyond financial results – particularly in today's environment of increasingly influential proxy advisors and the ever-present spectre of activists.

The task of engaging with shareholders initially rested with investor relations and senior management. But recently, directors have become more involved in engagements, particularly on matters related to the board, the CEO and executive compensation.

To provide perspective on the director's role in engaging with shareholders, Hugessen Consulting Inc.'s *Steve Chan* and *Michelle Tan* spoke to two directors with extensive experience on the matter. ***Richard DeWolfe*** is chair of the board of Manulife Financial Corp., and ***Peggy Foran*** is chief governance officer of Prudential Financial Inc. and chair of the governance committee of Occidental Petroleum Corp.

Q: *The role of directors in shareholder engagement is obviously evolving – your views on who should lead engagements with shareholders?*

Richard: I prefer to engage the shareholders on behalf of the board without the presence of management, as this allows investors to express any concerns that they may have to the board directly - not filtered by management, not couched in language that management may find concerning or offensive. I have maintained a practice of having the head of investor relations accompany me for the purpose of listening and taking notes.

Peggy: I believe that as a starting point, the majority of engagements should be led by management, whether the corporate secretary or IR. If you talk with your top investors, most will say that it is not absolutely necessary to have a director involved in an engagement.

Obviously there are exceptions and certain topics that the board needs to be involved in, including executive compensation, CEO pay and succession – it's hard to talk to the CEO or someone who reports to the CEO about their own pay.

Q: *There are some who believe that directors should not be directly engaging with shareholders for a variety of reasons. Your thoughts?*

Richard: We can find 1001 excuses why directors shouldn't speak with shareholders. Directors are there to represent shareholders' interest, so it seems ridiculous that there wouldn't be an obligation on the part of the board to communicate with shareholders. One of the dangers of ignoring shareholders is to hasten the arrival of activists when a board erects a stone wall around its "obligations" and creates an artificial barrier to communication.

We encourage all board members to actively act as observers in any and all investor presentations, to listen and understand the concerns of shareholders. However, we recognize that not all directors are the best communicators in the sense of being able to articulate the issues or to answer questions from shareholders. There should be a few directors who are designated spokespersons for the board and responsible for leading the discussions. This is one of the skills boards should be considering as they recruit for directors.

Peggy: I go back to what I initially said: a lot of this can and should be done by management. There are some instances and there are some subjects that are harder to do without a director. Also, there will be some investors that want to talk to board members so I think that to categorically say 'never' is probably wrong. So I think boards have to keep an open mind and I also agree that if you're not prepared then it can be a real negative. Every one of the institutional investors I know has stories of directors that have just been horrible. At the same time, a good director that shows oversight, independence, and knowledge of the issue, and is a good communicator is a real plus. A real negative is having a meeting where the director does not do a good job and at that point it would be better to not have a director present at all.

Q: *Given that smaller shareholders tend to rely more heavily on the proxy advisors, is it the best use of time to engage with them or is there a better alternative?*

Peggy: Engagement is not just meetings, be it management or board members – you engage through your proxy statement, your website and letters, and I think people underestimate the effect that these venues can have. At Prudential, we have a letter to our shareholders from our board as well as the lead director, in addition to a video from the lead director that we embedded in the proxy statement that is also on our website. That video has gotten an unbelievable number of hits. For some of the smaller shareholders that may not have time or resources to engage, receiving a letter with the video link to say 'we can't engage with everyone, we just wanted you to see this and if you have any feedback, let us know" can also be very powerful.

Q: *What are your thoughts on engaging with the proxy advisors?*

Richard: We undertook engagement with the proxy advisors this year for the first time and I thought it was really helpful. First of all, we found them very responsive; we wanted to address concerns that they had raised about our proxy and it gave us an opportunity to better understand how their judgments are formed. It gives you an opportunity to discuss your point of view on those things. And I think it would be helpful if more companies did engage them so that they were not simply making these judgments, or publishing opinions, without an opportunity to discuss how that advice was formulated.

Q: *Any advice for boards who expect to receive a negative say-on-pay recommendation from a proxy advisor? Can engagement with shareholders and/or proxy advisors help mitigate this?*

Richard: What I would say is that you can't formulate your pay for performance on the basis of what you think the proxy advisor is going to say. You have to design your compensation systems on the basis of the economics of your business and what you believe will fairly reward management while maintaining the best interest of the shareholders.

If you know that your approach is likely to result in a 'no,' it makes sense to engage key shareholders in advance. My suggestion is that it's easier to explain your position up front rather than falling back and being criticized and then having your explanation seem like an excuse.

Peggy: Don't underestimate your disclosure. Proxy advisors and shareholders read proxy statements very closely. It's like a test – even though you may fail on the multiple choice, if you have a good story then you probably are going to get extra credit on the essays.

It is much better to make the extra effort and do a great job telling your story in the proxy, and perhaps reinforce that with a meeting with investors and proxy advisors, than have to use a meeting to try filling in the gaps in your proxy. To me a good offence is better than a good defense, so figure out what your investors and the proxy advisors look at and address that in the proxy statement.

People like to hate the proxy advisors but they are just doing their job. If you really are unique, you need to tell that unique story – you need to light the candle instead of cursing the darkness. If you are going to fail on the quantitative tests then tell that really good story, and that story is a board story – one the board believes in.

Q: *Is shareholder engagement an effective tool in dealing with activist shareholders?*

Richard: Director-led shareholder engagement allows boards to get ahead of being the subject of an attack by an activist. If a board knows the expectations of shareholders in advance, you're on far safer ground than if you decide to hide in the board room and ignore shareholder expectations.

Q: *We are several years into shareholder engagement – how would you describe your general experience with it?*

Richard: Going back probably 10 years ago when this really became a question for the board, my view was that having engagement was better than not having any engagement. However, you can't just say "well, we are going to have an engagement program" and then everyone goes off and does it. It needs to be carefully planned and orchestrated to ensure that you are talking to the right people, covering the right bases, keeping track of the subjects of interest and ultimately using that as a way of guiding management in terms of meeting shareholders' expectations. At the end of the day, it's really using the board to keep management apprised of expectations of shareholders and vice versa so people aren't surprised - and like everything in life, the only surprise people like is a birthday present.

Peggy: I started doing this years ago when I was at Pfizer; starting with a meeting with the lead director and chairs of the committees with our top 30 investors. We invited them to Pfizer for an afternoon event and cocktails. This was in 2007, and one law firm called it 'a governance run amuck'. Now look where we are today.

If you talk with the major institutional shareholders they will tell you that a rapidly increasing number of their engagements involve board members. So you see engagement evolving. People shouldn't go crazy, but there are certainly companies and instances where it makes a lot of sense.

STEVE CHAN and MICHELLE TAN are principals with Hugessen Consulting, an executive compensation consulting firm dedicated to supporting directors and boards.

THE SHAREHOLDER PERSPECTIVE

"There are situations where we want to understand the role of the board in important decisions or developments. Engagement with board directors in those situations is a key part of our assessment. It can provide the assurance we are seeking that an unconventional, or perhaps even controversial approach, does indeed serve the long-term interests of shareholders, such as our clients, and thus should be supported."

Michelle Edkins, Managing Director & Global Head of Corporate Governance & Responsible Investment, BlackRock Inc.

"We have found meetings with independent directors to be generally very constructive, as it allows us to touch upon topics such as management remuneration in a candid manner and allows the directors to hear a perspective different from that of management."

Marie Giguère, Executive Vice-President, Legal Affairs and Secretariat, Caisse de dépôt et placement du Québec