

European Audit Committee Leadership Network

March 2023

EACLN

SUMMARY of THEMES

Continuing professional development as a board member, investor activism, economic uncertainty, and the trade landscape

On 20-21 March 2023, the European Audit Committee Leadership Network (EACLN) convened in Rome to discuss:

- **Continuing Professional Development as a Board Member** (a members-only discussion)
- **Investor Activism** with Giorgio Furlani, CEO, AC Milan, and former Portfolio Manager at Elliott Management
- **Responding to Economic Uncertainty: Considerations for Companies and Boards in Difficult Markets** with Andrew Kenningham, Chief Europe Economist, Capital Economics
- **The European Trade Landscape and the U.S. Inflation Reduction Act** with Jacob Kirkegaard, Senior Fellow, German Marshall Fund

Below is a summary of each discussion.¹ A forthcoming *ViewPoints* will provide additional detail on economic uncertainty and the European trade landscape discussions.

Continuing professional development as a board member

In the wake of recent bank failures, there has been heightened scrutiny from the media and other stakeholders on the performance of boards of directors and their composition. Taking a board seat entails legal and reputational risk, and a substantial amount of work, especially in a crisis. This members-only discussion focused on how directors evaluate board opportunities as well as how they continue to educate themselves on key issues confronting their boards.

Considerations when joining a new board

There are several key factors that members agreed are important when considering whether to join a new board. Cultural considerations ranked highest but practical and operational points are also considered:

- **Meet people—individually and in groups—to get a sense of board culture.** Members stressed that meeting potential colleagues is one of the quickest ways to tell if the organization’s culture is a good fit. As a director put it, *“It’s all about the people, for me.”* One member highlighted the importance of meeting potential colleagues together: *“First, I met members of the board by themselves. Then, I met them again with the CEO and I saw*

how they behaved towards each other, and I declined,” adding: “It’s about the culture in the organization and how people interact with and treat each other.”

- **Get to know the chair.** The chair of the board plays a key role in creating culture in the boardroom. A chair who lacks critical competencies or who is poorly oriented to good governance can have a negative impact on culture and create heavier workloads for other board members. One member described how a new chair created more work for other members: *“He literally had no passion or understanding for what needed to happen in board meetings. The committees didn’t have a chance to go through detail, so committee chairs had to burden themselves to do more.”*
- **Assess the board’s scheduling process.** All members agreed that a well-organized board plans its meetings well in advance, with one recommending asking: *“Are committee meetings and board meetings, including their dates, planned on at least an annual basis? This can reflect the maturity of the company’s processes and be a major game changer for your peace of mind. I thought a company was very mature, but it was chaos because they didn’t do any planning.”* Another member noted that *“you should expect meetings to be planned for at least the next 2 years.”*
- **Understand the feedback process.** Even deeply experienced non-executives benefit from, and generally welcome, direct feedback, but directors say that it is often difficult to get. Members agreed that *“how”* feedback is delivered is influenced by company and board culture and is an important consideration. They recommended probing in two main areas:
 - **Is a structured feedback process in place?** Members agreed that board evaluations are helpful and recommended checking whether the board has an established process. One member described their company’s feedback process: *“We have an annual anonymous survey which includes 40 questions. Some are clearly related to the chair of the committee. It includes written answers where you can be more precise. It’s interesting and I’ve received very positive and encouraging feedback.”*
 - **Are evaluations performed in a constructive way?** Where a feedback process exists, members recommended checking that evaluations are done in a fair and professional way. One member recalled how *“the chairman asked us to force rank each other from best to worst. It was my first board meeting with them, so I was really shocked. He then put the results on the screen and soon after, the board members who ranked 9 and 10 were gone. And if you end up as number 8, you dare not say anything for a year. It created a lot of uncertainties. I would not recommend that!”*
- **Consider the company’s reputation.** Members noted that reputation is a reciprocal risk. As one put it, *“I risk my reputation when I join a board, so the board should also add to my reputation.”*

Continuing to learn as a board member

As expectations and responsibilities for non-executives continue to grow, directors look for ways to stay informed on new risks, regulations, and emerging trends. But it can be difficult to find time for learning, which for many EACLN members is mainly self-driven. One member said, Continuing professional development as a board member, investor activism, economic uncertainty, and the trade landscape

“There’s difficulty to keep up from an audit chair perspective, especially with sustainability regulations and ESG.” Staying updated is critical, a member explained: *“If there wasn’t a minimum education on sustainability issues and regulations in the audit committee, the non-financial report would have been approved with no due diligence on structure.”* Takeaways from the session are as follows:

- **The board chair plays a key role in education.** Members agreed that the board chair is responsible for getting director education onto the board agenda. One member said, *“Every month we have an education session on pertinent topics and company-relevant subject matter; at least two a year are on ESG. In addition, our board meetings are combined with site visits to help increase understanding of the underlying business. In my experience, if the chair doesn’t understand that education is important, it’s hard work.”*
- **Audit committee chairs can promote education on issues that aren’t on the full board’s priority list.** When boards are not getting updates on particular issues—cybersecurity, for example—audit chairs can invite board members to committee-specific learning sessions. One member said, *“In our case, we needed an education session on ESG, and the board chair was positive about it but not active, so as audit committee chair, I managed to have education sessions with the audit committee, and then opened our meeting to the rest of the board. They felt the pressure, and within 3 months, they had education sessions planned on ESG and other matters too.”*
- **Make time for education sessions from the auditor.** EY’s Marie-Laure Delarue, Global Vice Chair-Assurance, described how education sessions led by the external auditor can be valuable. She said, *“These education sessions for audit committees that auditors can provide, it’s all about finding enough time in the board agenda. If you’re interested in having this, my advice is to make sure the secretariat of the board is addressing this need.”*

Investor activism

Following a slowdown in shareholder activism during the COVID-19 pandemic, 2022 saw a resurgence of activist campaigns in Europe. Whether they have been on the boards of companies that have been targets of activists or not, all EACLN members reported that they monitor the activist landscape. In this session, members spoke with Giorgio Furlani, recently named CEO of football club AC Milan, and a former portfolio manager at Elliott Management, on how to avoid being targeted by an activist investor and how to respond to a campaign. Mr. Furlani also highlighted the similarities between business in sports leadership, particularly related to acquiring and retaining talent, the importance of mental health, and the increased prevalence of data analytics.

How to avoid becoming an activist target

Mr. Furlani identified the easiest way to elude activist campaigns: *“Simply perform well.”* He added, *“The basis of every activist campaign is underperformance and undervaluation. If your stock price is underperforming your peers, you will stand out. Undervaluation just means there’s upside; underperformance and undervaluation tend to coincide, but not always.”* He provided the following advice for board members:

Continuing professional development as a board member, investor activism, economic uncertainty, and the trade landscape

- **View the company through an activist lens.** Getting into the mind frame of an activist can help identify a company’s vulnerabilities and allow the opportunity to proactively address them. Mr. Furlani recommends examining the company’s capital allocation and determining whether the strategic focus is appropriate: *“If you have too many businesses that are unrelated, it’s easy for an investor to come and say, ‘sell them.’ If you open the Finance 101 textbook it says do one thing, not 100 things.”*
- **Make sure the board has appropriate experience and diverse competencies.** Board composition—including a lack of diverse experience and skills—can attract activist attention. Mr. Furlani explained, *“Sometimes boards are stale, and it’s been the same people for decades. Sometimes they are full of the same kind of people with the same expertise. Sometimes there is not enough sector expertise to know what’s going on and to appropriately challenge management.”*
- **Ensure that strong governance is in place.** Mr. Furlani highlighted the importance of good governance adding that, as the parameters of governance have expanded to include ESG, strong governance now includes good ESG practices: *“Now that governance has expanded to ESG, not doing well on E, S, or G can affect stock price, and ESG issues tend to help activists gain support from other investors.”* He acknowledged that this can be challenging for companies and boards, since ESG is front and center for many governance and proxy voting investors, but less so for fundamental analysts and portfolio managers: *“The portfolio manager that owns your stock and has recommended your stock is not the person that casts the proxy vote. The team that casts the proxy vote tends to be more focused on ESG and less on valuation, stock prices, or performance. Strong governance is often the easiest way to get votes from shareholders.”*

How to respond in an activist situation

If a company becomes a target of an activist investor, Mr. Furlani advised:

- **Do not defend—listen and engage.** Mr. Furlani said, *“The most useful frame of mind to have if targeted by an activist is not to be defensive. It’s better to engage. The shareholder has identified issues; they might be right, they might be wrong, but the first thing they want is to engage.”* And he emphasized the importance of listening as part of engaging: *“Listen at first. It’s fundamentally free advice from people who’ve spent hundreds of hours on how to create value at a company.”* A member concurred, describing how an activist added value: *“The company had some weaknesses and the activist identified them very professionally and made management address two or three points, and I was impressed. They needed some pressure; it was a good step forward. I’m a fan of activists, they usually give a good push.”*
- **Determine if there is a quick win.** Activist campaigns cost money, time, and effort. Mr. Furlani explained that sometimes there can be an easy ‘win’ that benefits both parties. *“Sometimes it’s a simple governance win, sometimes it’s capital allocation, sometimes it’s communication,”* he said. *“If activists stick around for a long time, you have costs, it’s a slog ... quick wins are best if you can find them.”*

- **Don't ignore activists—they'll start acting more aggressively.** Communication is a crucial element at every stage of engaging an activist, even if the company has achieved a quick win. Mr. Furlani recommends continuing engagement with activists and warns against disregarding them after a success: *"I talked about quick wins, but don't think it's going to go away. Don't ignore them as they'll react more aggressively and unfriendly."*
- **Secure expert advisors.** *"You might have an advisor who's an expert in a particular area, but he doesn't know how to deal with these situations,"* said Mr. Furlani. He recommends hiring advisors—especially bankers and lawyers—who have expertise in activism. Shareholder activism response lawyers, in particular, can support the company and board on some of the detailed mechanics of activist campaigns.

Responding to economic uncertainty: considerations for companies and boards in difficult markets

2022 saw ongoing geopolitical conflict, persistent high inflation and rising interest rates, record-breaking energy prices, and labor challenges. With the volatile environment showing no signs of steadying, and adding bank failures to the mix in 2023, members met with economist Andrew Kenningham to discuss the economic outlook and how audit committees and boards are responding. Broader themes discussed were:

- **Europe's economy has been more resilient than expected ...** Headlines in the final months of 2022 warned that Europe was heading for a recession and a tough winter, but unseasonably warm weather and government stimulus spending have helped keep Europe's economy afloat. Mr. Kenningham said, *"It was thought that the Eurozone would suffer a huge recession in Q4 2022 and Q1 2023 because of the scale of the energy price shocks. In historical terms, the price was comparable to the additional costs of oil in 1974 and 1979, and on those occasions, it resulted in a recession. However, things worked out better than feared, it was almost a 'good' experience over winter."* He added, *"What surprised people was both the scale of government support throughout Europe and that the private sector was more flexible than assumed. Companies reduced energy consumption quite effectively."*
- **... but there are contractions on the horizon.** Although Europe has fared better than expected, Mr. Kenningham estimates that energy prices and rising interest rates mean that a downturn is likely over the next six months. He said, *"We're now more optimistic about the energy outlook ... gas is still double the price of historic levels, but it's not at a level that's particularly worrying, which is really positive. However, with rising interest rates related to the energy shock, we think growth will slow and cause the economy to contract slightly, with small contractions in Q2 and Q3."*

Members concurred, with most indicating that they expect a mild economic downturn in the near term. Top concerns include inflation, interest rates, hedge exposures, and geopolitics. As one audit chair noted, this combination of risks requires a widening risk aperture and agility: *"As a director, we're seeing things related to international supply chains and trade relationships, that are more than a black swan. In my experience, even if we're extending*

risk maps, new and compounding risks are still popping up. We try now to be very agile, if you see things coming, don't wait and see, but think through earlier what it could be and how to react."

- **The labor market is tighter than anticipated, and supply is still an issue.** Members expressed concerns over labor shortages, with one saying, *"I'm really concerned about the supply of labor. I'd express it as a touchy subject. It seems like people's attitude towards work changed in the pandemic."* Mr. Kenningham agreed with these observations: *"The labor market is much tighter than anyone anticipated given the economic activity levels. In some countries this seems to be a partial legacy of the pandemic related government benefits."*

Members discussed the disconnect between traditional office-based, forty-hour work weeks, with younger generations' and others' attitudes since the pandemic. *"We're in a period of transition where companies are trying to recruit people into the old ways of working,"* said one member. *"But I think younger people are ahead of us—they realize it doesn't work and want to be a part of a new way of working. We're trying to recruit into professions that maybe shouldn't exist how they exist today."*

- **Globalization is being reshaped, not rolled back.** COVID-19 exposed the vulnerabilities of single source supply chains and added to deepening tensions between the US and China that have contributed to global realignment. Mr. Kenningham described how these forces are reshaping globalization: *"Apart from extreme geopolitical scenarios, it's not likely that this will affect most streams of business. It'll have a very big impact on a minority of industries, clearly the tech sector. It'll be a rewriting of globalization rather than a rolling back of globalization—for example, the iPhone being constructed in India rather than China."*

The European trade landscape and the U.S. Inflation Reduction Act

The international trade landscape has become increasingly complex, including from the implementation of domestic subsidies and other incentives by developed nations in the effort to combat climate change. The US Inflation Reduction Act (IRA) was enacted 16 August 2022 and at \$369 billion, is the US' largest investment in clean energy solutions to date. The legislation is primarily focused on rewarding investment in green energy, products, and services, including \$270 billion in estimated tax incentives. But its goal of increasing domestic industrial productivity has sparked global concerns, including complaints that parts of the IRA are not compatible with World Trade Organization (WTO) rules.

Europe's Carbon Border Adjustment Mechanism (CBAM), proposed by the European Commission and due to begin its initial phase in October 2023, is aimed at achieving climate neutrality by 2050. It requires European Union (EU) importers to purchase certificates equivalent to the amount of emissions generated in the production of the goods. The two approaches, the carrot (tax credits) and the stick (carbon costs) are an important consideration

for global companies. Members were joined by Jacob Kirkegaard to discuss the global trade landscape, including the effects of the IRA and CBAM.

- **The effect of the IRA will be large.** The Inflation Reduction Act is the third piece of US legislation passed since late 2021 that aims to improve US economic competitiveness. It has raised concerns for European policymakers and companies. One member described the IRA as *“more like the ‘Importation’ Reduction Act.”* In Mr. Kirkegaard’s view, the economic effect of the IRA will be large and the costs to US taxpayers will far exceed the \$369 billion estimate from the Congressional Budget Office. But it will also have far-reaching geopolitical implications: exacerbating US-China polarization and challenging the legitimacy of the WTO. Mr. Kirkegaard and members discussed several concerns related to the IRA:
 - **It will create massive stimulation for green investment in the US.** Mr. Kirkegaard believes that the IRA could cause European businesses to relocate to the US: *“In my opinion, the IRA is going to be a massive stimulus for investment in the US that could reach \$1 trillion over more than a decade; it will be market-developing, if you like. It offers very big business opportunities for European firms to locate production in the US, which is obviously the intent of the bill.”*
 - **It goes against WTO rules.** *“Looking at the IRA, ‘friendly’ isn’t the first word that comes to mind,”* one member said. *“The focus is purely relocation. I understand why, but it’s not compliant with the WTO. Does it mean those rules don’t matter anymore?”* Mr. Kirkegaard explained that the IRA challenges the WTO’s enforcement ability and weakens its legitimacy: *“The Biden administration has continued the amputation of the WTO. He resisted appointment of new judges to the appeal court. This means that when countries complain to the WTO over these explicitly protectionist measures in the IRA, they can complain but the WTO no longer has a functioning dispute settlement mechanism. It has no enforcement mechanism anymore, no way to discipline countries who want to break the rules for domestic political reasons.”*
 - **Europe will have to further align with the US—and against China—to mitigate the effects of the IRA.** In Mr. Kirkegaard’s view, the political effects of the IRA *“cannot be underestimated”* and will be a driver in the increasing polarization between the US and China. He explained, *“There might be ways the US and Europe can come to agreements to mitigate some effects of the IRA, but I’m confident that the political price for the EU for doing so will be to more explicitly confront China.”*
 - **CBAM could be a more effective policy but is politically contentious and needs updating.** *“The problem is when you mapped out who’d be most affected by the original CBAM proposal that came out in 2021, it was Russia, Ukraine, Turkey, and China. They account for two-thirds of the total trade impact of CBAM,”* Mr. Kirkegaard said, which *“creates risk of retaliation.”* In his view, the CBAM has potential to be more successful than the IRA, but it needs updating: *“I’d argue Europe’s approach is a more effective policy than the US’, but the CBAM proposed in 2021 is already outdated due to the war in Ukraine and sanctions on Russia. This means they will have to think of a very*

different design as the EU carbon price is around €90/ton and EU businesses want a level playing field.”

- **China is being forced to evolve.** The slowing Chinese economy remains a concern for members, who worry about how this economic slowdown and geopolitical tensions will affect global trade. One member said, *“Dependency on China as a market for certain European countries’ exports has become so big. Considering potential geopolitical crises and tensions in Taiwan, the risk of losing that market is quite large for some companies, much larger than the Russian exit has been.”* Other China-related considerations include:
 - **The Chinese economic model has dim growth prospects.** In Mr. Kirkegaard’s view, China’s economy will not bounce back to historic growth levels. He described the domestic economy as *“suffering from extraordinarily deep structural problems and a dramatically declining population”* and estimated that, *“It will be an economy that suffers due to lack of domestic demand. They’ll never grow at 5% again, but more likely at 2%.”*
 - **China’s heavy reliance on external demand will make them a more problematic trading partner ...** Mr. Kirkegaard explained that China’s slowing economy will have political implications in Europe: *“They will heavily rely on external demand and trade surpluses that will make them a more problematic trading partner politically going forward—especially for Europe. This is because Trump’s tariffs—which Biden has enforced—will remain in place and cause the trade balance between Europe and China to deteriorate. Larger trade deficits with China will have political implications in Europe.”*
 - **... but Europe is an important piece on the US-China chessboard.** However, Mr. Kirkegaard noted, the US-China rivalry could ultimately be advantageous for Europe: *“Europe’s in a fortuitous position in that it’s arguably the most important chess piece on the board. If you’re China, for example, and in perpetual rivalry with the US, avoiding Europe sliding into the orbit of the US may be the most important diplomatic or geopolitical goal you have to achieve. Future US administrations’ actions against the EU might also be similarly tempered.”*

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Appendix 1: Meeting participants

The following members participated in all or part of the meeting:



Carolyn Dittmeier
Chair of Statutory
Auditors, Generali



Dagmar Kollmann
Audit Committee Chair,
Deutsche Telekom



Pilar Lopez
Audit Committee Chair,
Inditex



Benoît Maes
Audit Committee Chair,
Bouygues



David Meline
Audit Committee Chair,
ABB



Marie-José Nadeau
Audit Committee Chair,
ENGIE



Karyn Ovelmen
Audit Committee Chair,
ArcelorMittal



Erhard Schipporeit
Audit Committee Chair,
RWE



**Carla Smits-
Nusteling**
Audit Committee Chair,
Nokia



**Maria van der
Hoeven**
Audit Committee Chair,
TotalEnergies

EY was represented in all or part of the meeting by the following:



**Marie-Laure
Delarue**
Global Vice Chair,
Assurance, EY



Jean-Yves Jégourel
Country Managing
Partner Germany, EY

Endnotes

¹ *Summary of Themes* reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments are not attributed to individuals or corporations. Quotations in italics are drawn directly from members and guests in connection with the meeting but may be edited for clarity.