



On March 29, 2018, NIRI Los Angeles and the National Association of Corporate Directors (NACD) Southern California Chapter hosted a joint luncheon featuring Melody Hobson, President of Ariel Investments and Chairman of Ariel Investment Trust, at the California Club in downtown Los Angeles. Moderating the conversation was Jennifer DiGrazia, Senior Vice President Investor Relations at Ariel Investments, board member for Communities In Schools Los Angeles, and a member of NIRI.

Ariel Investment Philosophy

Melody began the discussion highlighting that she is a strong believer in always seeking to ask the right questions. This belief compliments the cornerstone tenants of Ariel's core investment philosophy, guided by three key principles: Patience, Focus and Independent Thinking. She explained:

- *Patience* - Ariel takes a disciplined, long-term approach to investments, i.e., 'Time arbitrage'. Look past the noise for opportunities and avoid 'what have you done for me lately' thinking which leads boards to look for/settle on short-term answers. Ask yourself "Would we do this if we were a private company?" If yes, then do it.
- *Focus* - What do we do best, what is our niche? Focus on core competencies and strengths, ask questions acknowledging that there is no one right answer. Consider the team environment and culture in the Board room and at the company – "Would I want my child to work here?"
- *Independent Thinking* - Be willing to be different. Intuition is often right; observations are often wrong. "Deep Survival" by Laurence Gonzales is required reading for Melody's direct reports as it crystalizes many truths. Melody said that the book taught her:
 1. Rigid = Dangerous. Example: military rigid leader. Hold ideas lightly in the board room. In adversity, asses change.
 2. Beginner's Mind: 10 yr. old knows enough to be dangerous whereas a 5 yr. old drinks the water/sleeps. Younger age = higher survival. When does expertise trump being open minded? Be open – as a Board member we don't know everything...we can't know everything.
 3. Survivors Rescue Themselves: not rescued by someone else. Example scenario of plane crash - who lives, who dies and why, showed that those who waited to be rescued died and the one person who set out to 'follow the water' to find help lived. Companies often think that 'some external event/circumstance will save us.'

Board Composition

As an experienced Chairman of the Board and Chairs of various committees, Melody has been an advocate for board diversity. Among her favorite books is "The Difference: How the Power of Diversity

Creates Better Groups, Firms, Schools and Societies” by Scott E. Page, a mathematician’s formula for diversity.

She discussed two themes that stood out for her in this book:

1. Hard problems are solved best by diverse intellects.
2. A good Board should hear every voice at the table.

“Is Everyone in the Room?” - Consider recent headlines and whether outcomes would have been different had all perspectives been in the room. Tough to say, but thought provoking.

Additionally, as a newly appointed Board member at JP Morgan, Melody observed a practice she’d never seen before as a board member. When a new strategy/initiative/policy is proposed to the Board they draft a faux press release – written as if the subject were a tremendous success. Surprisingly, this method turned out to be a successful way to hold people accountable and to serve as a road map to measure against.

Finally, sharing her thoughts on separation of Chair and CEO, it depends on the company. Not one size fits all.

Expectations & Board Dynamics

With numerous priorities and expectations, Melody explained that the board should understand the direction and strategy of the company, but it is impossible to know everything. “The Board functions best not when it’s making decisions, but when it is asking questions.” Her goal in each meeting is to ask one original question or bring one original thought.

Management Evaluation & Compensation

Executive compensation may be the board responsibility most scrutinized by investors, the media and other stakeholders. Melody shared that management teams should seek metrics for outcomes that align with shareholders; you get what you incent – what are we incenting?

It is important to have a long term strategic direction that you are constantly assessing yourself against.

Communicating with Stakeholders

The need for shareholder engagement is more important than ever, and Melody shared that Ariel evaluates that issue on a case-by-case basis. They assume that company executives are not hiding/misleading/distracting/deceiving, however, she will sometimes plant a ‘verbal virus’ such as, “I wouldn’t be surprised if revenues were down significantly next quarter,” for an unexpected outcome to gauge the reaction of the executive.

Active vs. Passive Investors

With an ever increasing focus on the growing market share of index and ETF investing, Melody discussed the implications of passive investors that are “locked” in a position. For passive investors, the only time they have an opportunity to voice an opinion is during proxy season. For the first time, Environmental and Social took priority over Governance. Interestingly, they typically vote the last proxy. Also, if a passive investor can’t sell, it could possibly lead to activism. Takeaway – a passive investor

does not mean they are not active behind the scenes. It is important to have relationships in place with passive teams just as you would active teams.

Q&A

Concluding the robust discussion, Melody took a few more minutes to address a few questions from the audience consisting of the following topics:

- Stock buy backs?
 - Not always the best use of capital. Great CEOs are great allocators of capital. What is the best use of capital. Buy back if your stock is at the right valuation and there are no other alternative uses of capital that could present greater returns.
- What lengths should a Board member go, ex: Enron and Wells Fargo, to sense a problem?
 - It is impossible to know everything. Board is not running daily business.
 - Ask questions.
- What are your recommendations for board material composition?
 - Less is more – get to the point when providing board materials. State up front – this is the takeaway/this is why we're talking about this.
 - Include investor sentiment levels as well as asset classes that are your top and bottom shareholders.
 - Default to common sense. You should be able to explain the investment thesis to a six year old.
 - She dislikes acronyms – nomenclature creates its own barrier. Simplify.
- NY Pension and Black Rock say they are voting against Boards without female representation. Does this help the cause to diversify Boards?
 - It all helps – not just women – ethnic diversity. Ariel seeks to know the philosophy and expectations of a non-diverse company and will vote accordingly. This does not happen overnight, it takes time to compose a diverse board and it really depends on the situation.
 - “One size doesn't fit all at a specific moment in time.”

In conclusion, we were delighted and truly appreciate the time Melody and Jennifer took out of their schedules to speak with us. Beyond her work at Ariel, Melody has become a nationally recognized voice on financial literacy and investor education. To learn more about her philanthropic contributions, please refer to the website links below.

If you missed this event, we hope to see you May 14 for our luncheon event featuring a panel focused on “The Changing Landscape on the Buy-side.” Check www.nirila.org for more details and our full schedule of program events.

Community Outreach:

- After School Matters <http://www.afterschoolmatters.org/>

Investor Education:

- Ariel/Hewitt Study: 401(K) Plans in Living Color <https://www.arielinvestments.com/401k-Study-2012/>

Mentioned readings:

- “Deep Survival” by Laurence Gonzales <https://www.amazon.com/Deep-Survival-Who-Lives-Dies/dp/0393326152>
- “The Difference: How the Power of Diversity Creates Better Groups, Firms, Schools, and Societies” by Scott E. Page <https://www.amazon.com/Difference-Diversity-Creates-Schools-Societies/dp/0691138540>