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Discussion Paper

Opening Remarks by Roger Fergusons Jr.

Roger W. Ferguson Jr., President and Chief Executive Officer, TIAA-CREF:

It really is a pleasure for me to be here with all of you today. I was speaking to some folks who've had a longer experience with ICGN who reminded me of the old days when we could host this in rooms that would only fit 50, 75 or 100 people, and now we have 400, 500 people registered. So we are really proud to be associated with ICGN and to be hosting this conference. More than that, I'd say we are proud to stand with all of you, and working to raise global corporate governance standards around the world. We share your conviction that good corporate governance is absolutely essential for a number of reasons. For the health of companies, for the strength of investor returns, and representing a large institutional investment that's quite important to me, personally. For the stability of markets, which again, we care about, and for the strength and competitiveness of national economies. And I'd go further and say, of the global economy itself.

I'd like to make three points to try to bring out the importance of this meeting at this time and in this place. First, we are in times of improving economic conditions, at least here in the US, which can give us much hope of brighter days ahead following the worst downturn since the depression. Yet, even as we are enjoying the beginnings of a recovery, we cannot forget the role that questionable governance played in instigating the financial crisis. So, obviously, as we think about this from a macroeconomic standpoint, there's much more work to be done in improving governance in the financial services sector.

The second point I'm going to make is that it's vital that this happens now, because the world needs a strong and trusted financial services sector. The industry has a key role to play in helping individuals navigate through some of the long-term economic challenges that we face, particularly those resulting from the global trend of ageing populations. In pushing for better governance in the financial services industry and the industries overall, institutional investors like TIAA-CREF and many others represented here today have a unique role to play, given our client base and our long-term focus.

And my third and final point is that we must recognise, however, that shareholders are not monolithic. There may be different issues that each confronts, and therefore, different avenues for reaching good governance. And, frankly, that's okay. It's the destination of better corporate governance that matters, and each of us and each of the institutions we're involved with will have to find the path that seems most appropriate to get to that outcome.

So now, having told you what I'm going to tell you let me now tell you. It's been about five years since the darkest days of the crisis, which obviously wreaked economic chaos and imposed enormous costs on societies and individuals around the globe. The global economy is still healing from the trauma. Some areas are doing so more quickly than others. Still, I would say we are finally starting to see some light at the end of the tunnel.

Focusing on the US economy first, TIAA-CREF is, I would use the word cautiously optimistic about the economic outlook through 2013 and beyond. That does not mean that we think it will be smooth sailing from here on out. Indeed, in just the past few weeks, we've seen a great deal of volatility in markets, the result of fears about the federal reserves winding down or tapering, as the phrase is, its monetary easing programme. The Fed has begun articulating the framework of an exit plan precisely because it expects to see an improvement in the economy.

We must remember that economic growth and financial market behaviour don't always act in sync with each other in the short-term, at least. Obviously, we hope that over long-term, markets really do reflect underlying economic trends. Time will tell, in this case, whether or not the markets' reaction to the Feds' hint of the beginning of a tapering was an overreaction or just the beginning of an appropriate and, ultimately, a smooth adjustment. In any event, our forecast calls for a second quarter GDP growth to be approximately 1.7, 1.8%, similar to the revised first quarter growth. But, importantly, we expect to see GDP growth improve in the third and the fourth quarters. We believe that there will be a gradual improvement in labour markets during the second half of the year, moderate increases in wages, slightly stronger increases in consumer spending, as well as something that's very important, a pick-up in spending on business inventory starting later this summer. Put all those things together, and these are the ingredients that we need for an obviously and visibly stronger second half of the year than the relatively weak growth of the first half of the year.

On the global front, China and Japan continue to grapple with economic challenges, as does Europe. But these challenges do not at this stage seem to represent the kind of threat that markets feared last year, when it seemed that Europe, Japan, maybe even China might derail any signs of economic recovery. TIAA-CREF therefore believes that the economy's improvement will not be derailed. May be delayed, may be a little volatile, but will not be derailed by things like continued market volatility or stumbles in housing or job growth. We don't believe, ultimately, that the economy will be knocked off track.

We are confident, instead, that the initial stages of the recovery are behind us and we are focusing on the expansion portion of the cycle. In the context of corporate governance, though, it's not time to pop open any champagne bottles. We believe there's still much work to be done to address some of the issues that helped usher in the crisis and the subsequent economic downturn. The financial services industry has made some progress on this front of corporate governance, but not nearly enough. It needs better governance at all levels.

That point has been underscored by the Group of 30, which is an international forum of public and private sector financial leaders of which I am a member. Last year, the Group of 30 announced the results of an extensive survey that we completed on the governance at 36 of the world's largest and most complex financial services firms. We outlined specific steps that Boards, management, regulators and long-term shareholders should take to restore confidence and to ensure the strength and stability of the financial system. We urged Boards to take a long-term view that encourages long-term value creation in the interest of shareholders, and to ensure that firms are prudent in their decision-making. We urged management to model the right kind of behaviour and to support a culture that promotes long-term thinking, discipline, accountability and prudent risk-taking, and we urged regulators to take a broader view of their roles, one that includes understanding the overall business strategy, the people and culture of the firms that they oversee and regulate.

We urge shareholders, finally, to use their influence to keep companies honest about performance and focused on improving governance. And we emphasise that governance is an on going process, not a fixed set of guidelines, not a static set of rules, and that in the end, what matters most is how people actually behave, which is driven by the company's values and by its culture. So, we advise companies to focus on what we described as the software of governance: culture, people, leadership and values, as much as hardware, the structures, the process, etc. Given the continuing scandals of the years since the crisis, it's quite clear that financial firms need to undertake, if anything, reengage themselves to a serious and wide-ranging effort to ensure that they have the right software in place, and it's vital that this happens.

This takes me to my second major point. We need a healthy industry to help people address the challenges that we face in the years and decades to come, particularly as a result of the great demographic trend that's sweeping across the globe, one that we at TIAA-CREF know well, which is, obviously, population ageing. Ageing is happening because of two factors. First, people are living longer, which is a net positive thing. And second, fertility rates are declining. The upshot is that there are fewer and fewer people working and they are supporting more and more people who are retired and not working. This is an unsustainable imbalance that presents significant fiscal challenges in almost every country of the globe. Most notably, it threatens the long-term health and stability of programmes that are designed to support the elderly in retirement.

Here in the US, Social Security, Medicare and Medicaid already account for roughly 40% of all federal spending and 10% of our nation's GDP. Knowing that those numbers are large and knowing that they're unsustainable, at least the growth is unsustainable, average Americans worry about whether the programmes will be there to provide support in their old age. The programmes clearly will come under increased pressure as the elderly dependency ratio, the number of elderly people per 100 workers, rises.

In the US, all of this is happening at a time when the private sector has mostly jettisoned pensions, and when the public sector faces a crisis of unfunded liabilities. To add to this problem, Americans are saving far too little for retirement. For an individual, the impact of these three factors is that planning for financial security throughout their lives falls more and more heavily on their own shoulders. Unfortunately, just as the risk for financial security is being shifted from companies or the Government to individuals, we know that, at least in the US, the majority of adults are simply not sufficiently financially literate to take care of these issues. At a time of increasing complexity, individuals are being called on to manage their own financial affairs in a way that results in lifetime financial security, yet they are woefully unprepared to handle this.

More than ever, people need help in achieving financial wellbeing throughout their lives, and especially in retirement. They need sound advice, but advice that is given in the context of what's best for the customer, not what's best for the firm's bottom line. So, we clearly need a strong and healthy financial services industry, an industry that can be trusted to do the right thing for clients. Yet, against the backdrop of the crisis and continuing scandals, financial services has become one of the least trusted industries in the world. In fact, this year, for the third consecutive year, banks and financial services firms placed last in the annual global rankings of trust in industries that was published by the Edelman Public Relations Firm.

One way that firms can turn the situation around is by focusing on and, indeed, raising their corporate governance standards. Another is by embracing the industry's potential to be a force for positive social change. Indeed, the Yale Economist Robert Shiller argues that finance has a larger social role and purpose, and that, in fact, it is one of the most powerful tools we have for solving common problems and increasing society's wellbeing. In his book Finance and the Good Society, which was published last year, Shiller says that finance is not about making money, per se, but quote, "Financing is really creating the architecture for reaching a goal. The goals served by finance originate with us." And that's an important point to keep in mind. If you think about it in terms of the lives of average people, the financial services industry makes possible everything from college loans to 30 year mortgages to life insurance to annuities, to create guaranteed income for retirement. And we should think about the industry in terms of the lives of those average folks that we serve. As our clients, their interest should come first.

Within the industry, institutional investors have a clear role to play in championing good governance. We invest trillions of dollars on behalf of the average American. In doing so, we help them to realise their hopes and dreams, as Shiller suggests, and to achieve their plans for the future. So, we can never forget that we're acting on their behalf. We have to take the lead on corporate governance, therefore, because our clients are counting on us to do so.

Institutional investors are also an important voice because we have a long-term focus. Therefore, we must promote a long-term perspective throughout the industry, because it is in the best interests of the people that we serve. As what is called universal owners, we institutional investors are part of the constituency whose interests are most tightly aligned with stable and growing markets and well-governed institutions. As providers of capital, we are among those who are most likely to lose if markets deteriorate, if asset prices fall, or scandals and failure of corporate governance leads to uncertainties about the underlying value and honesty of corporate America. It's therefore critical that institutional investors participate as active owners of their portfolio companies, using their influence and their leverage to promote good corporate governance and effective functioning markets.

Now, that brings me to my third and final point. So, while we are all committed to raising the standards of good governance, we should recognise that there is rarely just one path to get there. Shareholders are not monolithic. We work under a big tent. We may agree on the outcome while we don't always agree and we don't always have to agree on the pathways. For example, TIAA-CREF takes a quiet approach to advocating on behalf of clients and participants, just as other institutional investors take a louder, more public approach. Our brand of involvement and activism has been far-reaching. We've opposed abusive and anti-takeover provisions and addressed issues such as automotive safety and human rights issues. We've also influenced companies to adopt best in class governance practices and disclosure for director elections, board structure and compensation. But we do not dictate practices to companies or prescribe what issues they should focus on. We prefer to engage privately with companies to ensure that their policies and their practices are in the best interest of our participants.

This strategy of quiet diplomacy reflects our belief and our past experience that informed dialogue with Board members and Senior Executives, rather than public confrontation, will more likely lead to a mutually productive outcome. This approach may not make headlines, but we believe that it can contribute to superior, long-term results. Still, we respect that others who are in our business, others who are pension firms, others who invest hundreds of billions of dollars on behalf of average Americans, may take a different approach, and we believe it's okay for them to have a different approach. And, in line with the theme of this conference, it's also good to question the accepted orthodoxy. Debate and dialogue can lead to better and more effective ways to achieve success. The important thing is to keep driving toward the ultimate goal, which we all understand to be better corporate governance standards.