International Corporate Governance Network
Boston Conference

30th September 2015

Regional Priorities for Global Governance Reform and Impact on US Capital Markets
Breakfast Panel 1: Audit committee transparency and investor stewardship regional perspectives on priorities for improvement - hosted by the Centre for Audit Quality

- Mauro Cunha, Chief Executive Officer, AMEC
- George Iguchi, Head of Corporate Governance, Nissay Asset Management
- Guy Jubb, Global Head of Governance and Stewardship, Standard Life Investments
- Anne Sheehan, Director of Corporate Governance, CalSTRS
- Chaired by Cindy Fornelli, Executive Director, Center for Audit Quality

Cindy Fornelli, Executive Director, Center for Audit Quality
At CAQ our mission is to increase investor confidence. Not only through the role that the auditors play, but working with key stakeholders, such as investors and audit committee members, regulators, academics, so this is a very important topic to us, and we think that strong audit committees make for enhanced audit quality. So, that’s our interest in the audit committee community, and of course, the investors are who the auditors serve. They’re the ultimate recipient and beneficiary of the work that auditors do. So that’s why it’s important to the CAQ.

Guy Jubb, Global Head of Governance and Stewardship, Standard Life Investments:
Audit committees have always been an important feature in the UK landscape, and I think it’s both appropriate and fitting to remark that it was Sir Adrian Cadbury, in his very important, Cadbury Committee Report, that was focusing on the financial aspects of corporate governance, that was the first development in the UK that required companies to have audit committees. Sir Adrian, sadly, as many of you will know, died last month and he left a great legacy in the work that he did.

And, it’s also important to bear in mind that actually, in the United States, audit committees have been around for many, many more years than actually had been the case in the United Kingdom. In 1978, the New York Stock Exchange required all listed companies to have audit committees. So there was a whole decade, or more, of greater experience in the United States, than there was actually in the United Kingdom.

Now, Sir Adrian’s report encouraged – sought to address the expectations gap of audits and audit committees, but it did not stray into the area of disclosure. That would have been one step too far for the UK in those days. But since then, things have gathered a huge momentum and our regulator, the Financial Reporting Council, through its UK governance code and importantly, it updates that governance code every two years, so it’s kept fresh; it isn’t something that just sits there and gets stale. They have set out, on a comply or explain basis, how UK audit committees, UK companies, should disclose certain items.

They look for the audit committee to disclose the significant issues that the audit committee has addressed over the last year. It expects audit committees to report as to how they have evaluated the effectiveness of external auditors. That’s quite an art. And they also require now, as we move in the United Kingdom and in a number of other jurisdictions into auditor rotation and mandatory audit tenders, how long the auditor has been in office. So we do have, in the United Kingdom, a framework now that – and have had for a number of years, that has enabled us, as shareholders, to get some insights as to what the audit committee has been doing.

To add to that, the Financial Reporting Council, the FRC, has something called the Financial Reporting Lab and in October 13, that body presented an informal best practice guidance as to how audit committees should put some of these areas into practice, and it provides audit committees, and investors with some useful insights.
Now, all these things in the United Kingdom are, as well as providing accountability, are also intended to encourage better engagement between investors and boards in general, but also with audit committees as well. And I have to observe that from my position, we are now (as well as engaging and having discussions, conversations with boards, about Chairmen, about their corporate governance in general) having one-on-one meetings with the Chairs of audit committees, and we tried to do that five, ten years ago and after five or ten minutes into such a meeting, it was actually very difficult to find anything to talk about, because the audit committees had nothing on the table for you to get your teeth into and equally, they were a little reticent, understandably, to be forthcoming. But things have changed and the audit committee reports that we now have, do provide an ability to have a meaningful conversation.

We can talk about how they've evaluated the external auditors, we can talk about how they've looked internal audit, that's another area that is often looked at and actually, that's often very insightful when evaluating corporate governance risk. But one cannot read all the audit committee reports when they come in. So, we probably read a significant fraction of how many reports come in, but there's also a significant fraction that we don't actually read and how often, after the event, you discover it's the ones that you didn't read, where actually the devil's in the detail.

So, it is challenging for investors, but we are being now given through the audit committees, these hooks for discussion and dialogue, to be able to understand what they're doing. As I perhaps draw to a close in terms of my introductory remarks, there are, perhaps, two other caveats to mention. One is to just question gently, how many other investors are reading these audit committee reports, as well. All of us in this room are converts to understanding that. But the Fund Managers sitting at their desks, do they read audit committee reports? I can probably count on one hand, with conviction, those who I think do so, so it's a fairly narrow community.

The second thing is, the degree to which these audit committee reports do actually present themselves a true and fair view. You get the edited highlights, but sometimes you can sense the red pen of the General Council has been at work and has, perhaps, put some of the best bits into the trash. And I think from here in the UK, it's going to be further improvements in audit committee reporting, are going to be sort of, incremental. They are going to be baby steps, but important baby steps that will enable us to move forward.

*Cindy Fornelli:*
Japan has just recently introduced the new provisions to the Corporate Governance Code that will strengthen audit committees with the equivalent of audit committees in Japan.

*George Iguchi, Head of Corporate Governance, Nissay Asset Management:*
Over the first two years in Japan, there were three initiatives to strengthen corporate governance. Our whole investor side introduction with stewardship code, as you know and for company side, the amendment of the Companies Act and also introduction of the Corporate Governance Code and I would like to focus on the Corporate Governance Code and the amendment of the Companies Act.

Firstly, the Companies Act has introduced a new type of the governance, from Code of Company with the Supervisory Committee, which includes the audit committee in the board. In Japan 98% of companies has the audit committee outside the board, and they monitor the
board from the outside. By this Act, audit committee is in the board and they are board members, so I think it would contribute to strengthen their corporate governance. There are 190 Japanese companies, now have adapted this form of the governance and it is said that that kind of the governance will spread from here. And the next step, Corporate Governance Code; that code seeks the gross oriented governance, but they also aim to strengthen the audit function.

It is often discussed who is the real customer of the external auditors, and this code clearly stipulates, the external auditors owe their responsibility to their shareholders and also, this code ask the company to set the establishment of their standard for selection of the auditor and also it demands at least one person, in which the committee has the appropriate expertise on their finance and accounting, so I think that will change the substance of the audit committee.

In this way, Japan is moving in a good direction toward strengthening corporate governance but I am thinking also that some points remain a challenge. I raise two points. First point is the internal audit. In Japan often the internal auditor position typically reports to our Executives, so I think they need to relax the independence of audit committee and that the other thing is that Guy mentioned, about the auditor report. In Japan the report is now the pass, fail model, so shareholders cannot have the substantial facts to judge the quality of the auditor committee, also external auditors, so additional information from the auditor report would enhance the transparency auditor committee and also the work of the external auditors.

And actually, I want to touch upon recent initiatives by Japanese Authorities, I will raise two very, very recent things. And one is the establishment of the committee for follow-up of the stewardship code and the Corporate Governance Code that has just started. And also, the other one is from the FSA, the Financial Service Agency, and the regulators and that is the review of the auditing and accounting practices in Japan. That is from the stewardship perspective. Japan is entering in the second phase of its corporate governance reform and I think this initiative would have the big impact on the Japanese corporate governance. And also, I think these initiatives will offer a good chance to bring a voice from the investors to Japanese corporate governance reform.

Cindy Fornelli:
So in the United States we don’t yet have a revised auditor’s report. We have the SEC asking, through a Concept Release, which is not regulation, about enhanced audit committee reporting. So give us your perspective, as a US investor, on the state of affairs between reporting by audit committees and auditors.

Anne Sheehan, Director of Corporate Governance, CalSTRS:
In the United States the SEC and the PCAOB are actively looking at the role of the auditor and then the role of the audit committee at the SEC. The SEC did send out a Concept Release, with numerous questions. For those of us who filed comments, we didn’t actually respond to each and every one of the 70 some questions and then sub-questions out there. But I think the goal, for the SEC, was could audit committees provide a little more information to investors? Is there a benefit to a little bit more information about how they carry out their job on our behalf? From the CalSTRS perspective and we did file a comment, we do think some additional information would be very helpful to US investors. And I think some of the issues, or some of the things that we’ve looked at what the FRC would be a little more substance, in terms of how the committee is carrying out their responsibilities.
Now, there have been a number of companies, in the US, that have voluntarily provided additional disclosure and I applaud them. You can tell the ones that just say, “We did everything according to the Charter,” and they have two or three sentences and not a lot of substance about it. There are companies who provide a lot more detail about how they carry it out, how they decide when they change auditors, what the process they go through to evaluate, that they want to keep the auditor, or change the auditor, the selection of the engagement partner, the issue of the tenure of the auditor, some companies have done a good job, but we do think some companies may need a little more prodding, in terms of the voluntary. At the rate we’re going, we may not get to all the publically listed companies at the rate we’re getting voluntary disclosure. So, we would encourage the SEC, as they look at the comments from investors, to choose a few things that the committees could provide a little more substance on.

One of the projects that we at CalSTRS did this past year, which helped us shed a lot of light on what committees are doing, is we sent letters to about seven, or eight companies who have had the same audit firm for over 100 years. Of course, they appointed an engagement partner so that’s good to hear, and then set up phone calls with them and chatted with them, the audit committee members, as well as some of their staff, and really walked through what they had disclosed, how they go through the process and gave them suggestions for how they could provide a little bit more information about how they do the evaluation. What criteria do they use? How they assess the fees that are charged, the non-audit fees, the audit fees and even those companies who have had long tenured auditors, told us that actually, they could improve their disclosure.

So, from our perspective, we think information about the tenure, it does not necessarily mean the quality of the auditor is bad, if the tenure is long, or if it is short, but it does help us inform, in terms of okay, as a committee, if you have a long tenured auditor, we want to make sure you're putting them through their paces, to make sure they’re doing the best job possible and that people are not getting, perhaps, complacent, about the role that they have to play on our behalf. And so shedding a little bit of light for us into that process is very helpful. Also, overseeing the fees, how they feel that the work on the non-audit side balances with the work on the audit side.

Many of the companies we engaged were very large companies, and so they have the other audit firms also doing some work for them, so they talked about the balance and we get that. We are, as a fund, our board has decided, we rotate auditors every seven years. So, for companies out there, I feel your pain when people bring this up. But I will say, a new auditor does look at things differently from the previous auditor and while it’s painful for us, as a fund, to have to go through this, it keeps us on our toes, in terms of looking at things differently.

So, I know I’ve seen a lot of the comment letters from companies, from CAQ and from others, in response to the Concept Release. I think there is a push for voluntary disclosure, but I think – and not for the SEC to be prescriptive on this issue, so perhaps there could be a balance there somewhere, of these are the sorts of things that investors would like, and not necessarily prescribe how they have to do it. So, and then looking at the issue of the engagement partner, and we can get into that, in terms of what PCAOB is doing. Our view on that is, it’s helpful to identify who that person is and how we can find them. It doesn't necessarily have to be in the committee report, where it's signed, it could be in a database that we can search, but somewhere, to be able to identify that information.
So that really is an overview of how we’re looking at the current state of play with regard to the SEC Concept Release.

Cindy Fornelli:
And Mauro, give us your perspectives, and I know that Brazil is in the process now of implementing changes to the corporate governance structures and going to require the audit committees and more investor stewardship. Tell us where things are in Brazil.

Mauro Cunha, Chief Executive, AMEC:
We’re always implementing change. Not always for the better, but at least we’re creative and yes, there’s been a lot of evolution in Brazil, even though lately we’ve been lacking some reform and Brazil showcases the dangers of us trying to export concepts globally and eventually they may end up defeating the purpose, or having unintended consequences. Audit committees are even younger in Brazil than in the UK experience, because it is not part of our Corporate Law. What we have in Brazil is something called Conselho Fiscal, which is not a board committee per se, it’s a separate entity, elected directly by shareholders, that has oversight responsibilities, but in a very different way from the audit committee.

It’s clearly just an advisory body and a watchdog for shareholders, which means that individual members have a very strong oversight power. They can request documents and investigate, to the extent that Directors usually cannot, since boards are collegiate bodies. But we did import the concept, especially through companies that listed ADRs in the late 90s and early 2000s. We then became impacted by Sarbanes-Oxley and here we start to see the effects of trying to export things without further thought.

To start with, when we look at Sarbanes-Oxley, it is full of exemptions, for foreign private issuers. So, you can eventually create an audit committee, but it doesn’t really need to be an audit committee. For example, you don’t need independent members, so it defeats the purpose. Also, in the case of Brazil, there was an agreement with the SEC that in some cases the Conselho Fiscal may act as an audit committee, which makes things even more complicated; the Corporate Governance Institute in Brazil spoke out against that.

So, what happened, is that these companies created audit committees, didn’t really know what they’re doing, they don’t really know what their role is, so they sit there, and they have a certain agenda that is usually built by the lawyers and they check the boxes and have some presentation on financial statements. Not very deep and they do not have a responsibility, because the audit committee doesn’t really decide anything in Brazil. They just analyse things and recommend how the board needs to act. This is a completely different structure, in terms of accountability and in terms of what this body can do.

Also, Brazilians tend to create, what we call jabuticabas. Jabuticabas, for those who don’t know, is a fruit that only exists in Brazil and we manage to do that in the audit committees as well, and in this case, it was the blasting of our Central Bank. They invented an audit committee, which has to be composed by at least one Director, meaning that the other members can all be Non-Directors and since you have the exemptions of Sarbanes-Oxley, they don’t even need to be independent. So, it is really a complete reversion of the intentions of an audit committee and it’s there.

The problem is, it would be better if we did not have these structures, than just having these, check the box things, because investors look at it, they say “Okay, there’s an audit
committee in this company, so it should have US levels of standards,” but it does not. And I cannot say about the reports, because they are basically non-existent, because of the exemptions again. So, what changed recently was in 2011, the CVM created a new – CVM is our capital market regulator, they created a new instruction, to introduce the Statutory Audit Committee. Which is a little bit closer and a little bit better than the standard one, it still reflects the jabuticabas of having at least one board member, and it at least introduces the need for an Annual Report, which not many companies do, because very few companies are electing to have a Statutory Audit Committee and the main reason to do so, is that, in Brazil, we do have auditor rotation for a long time now. The original rotation was five years, and the CVM allowed companies to postpone that to up to ten years, if they had the Statutory Audit Committee. So, companies are adopting this, just to have longer rotation periods. So, it is the wrong reason to pursue the creation of an audit committee. And again, this leads to unintended consequences.

It is important to mention that Brazil lives a reality, which is true in most countries that we have controlling shareholders and when that happens, the role of the oversight structures in corporate governance, needs to change. So, we cannot simply copy and paste from the US, or the UK experience and apply it in countries like Brazil, because again, we will be left over with institutions that will not fulfil the intended role. There’s another branch of discussions right now, which is the corporate governance of state owned companies. We all know what’s going on with some of them, and there are at least four, or five bills in congress, trying to revamp corporate governance for state owned companies and all of these bills, they are very prescriptive. And among other things they say “Oh, okay, the state owned company must have an audit committee,” so we’re going to be left with the same problem all over again.

When we look at a company like Petrobras, if you go over the checklist, it has everything. In 2013, Standard & Poor’s did a report on corporate governance of Brazilian companies. They ranked 300 companies and only seven had the top ranking and Petrobras was one of them, and that was May 2013 and I don’t have to tell you what happened since. So, if we apply that blanket rule to all state owned companies, in a country like Brazil, we’ll get more of the same. We’ll get bodies that will perform perfunctory work, checklists, it will not achieve anything, investors will not read the report, because they know they should not expect anything there and will just create not only a big waste of time, but the illusion that we’re doing something credible, in terms of corporate governance.

The experience in Petrobras shows that we also have a lot of work to do on the stewardship side of things and here, I speak on behalf of an investor association that my members have homework to do. Even in the cases where the audit committee scratches the surface to achieve something, I don’t think the investor community in our country is ready to react to that. I don’t want to overextend whatever happened in Petrobras and my personal experience there, but just to give you an idea, I actually voted against the approval financial statements at Petrobras, then they kicked me out of the audit committee and nothing happened. Nothing from the investor community, nothing from the regulatory side, nothing on – in relation to the relation of the audit committee and the auditors that were approving those financial statements, so I don’t think we are ready to rely on audit committees, in a country like Brazil, to improve corporate governance. There’s a lot of background work that needs to be done on stewardship and on really defining what the audit committee must do, before we’re going to achieve something.

Erik Breen, Chairman, ICGN:
Who sets the audit standards and how users, us investors, could be better involved in that process and I would be very curious if you could reflect on the importance of it and on what investors can do to improve that?

Guy Jubb:
In terms of audit standards and looking at it from an international perspective, the key driver of audit standards is something called the International Auditing and Assurance Standards Boards, the IAASB, which was doing good work, but it was fairly invisible work and it was extremely difficult, for investors to engage with it. It just didn’t connect with the investment community. It is a body which is based in New York. Its current Chairman, Arnold Schilder, from Holland, came in at a time when there is an age of greater enlightenment into the IAASB. This body is the one that sets the auditing standards globally, it is the one that has recently required, in terms of auditing standards, that auditors should prepare enhanced, more detailed, auditing reports, looking at key matters, that the auditor has addressed, and the importance of this for investors, is that many jurisdictions, internationally, require their auditors to adopt these international auditing standards. So, they are not an optional extra for companies, they are actually standards that have to be adopted. And the IAASB is looking at a number of other things on its radar, which are very much investor focused and they need the support of investors, to actually have their legitimacy reinforced, because they do get a lot of attention from the auditing firms, and they clearly are very legitimate stakeholders in this, with the corporations and others, and investors – we are overwhelmed, with consultations in generality these days. I think the IAASB and also the other aspects of accounting and auditing standards, investors need to find a better mechanism, and perhaps the ICGN can help here, to actually enable us to be more efficient, in actually getting investor views through, but in an authoritative way. There are things happening in the auditing standards world, which are good for investors, but I think it is very important that investors show their support for it, and if we can, we find a better way of having our views represented with authority and conviction.

Anne Sheehan:
I would agree on the whole, not just the auditing standards, but also FASB and the accounting standards go together in terms of what the information that we get, but I do think investors have a stronger role that they can play in this process. In reading some of the comment letters for the SEC, some of the comments from both companies is, “We’ve gone out and asked investors about what more do they need and we haven’t heard anything from them.” So, I do think investors have got to step up but when something goes wrong, we’re especially the ones who can pay the price in terms of lost shareholder value. And so, I think investors have got to do a better job about coalescing around this, and it is a lot of work, but to the extent whether ICGN can do it internationally, CII could do it in the United States, but a group should pay attention to this. There were only a handful of letters for the SEC from the investor community and many letters, both from the auditing firms and companies. And the audit committee Chairs, the SEC has got to weigh the investor letters. A lot of the comments were about “Oh, this makes it harder, we’re going to have liability, we’re going to have all these other issues, it’s being done voluntarily,” and I think investors have a more important role to play in this area and that we have probably not stepped up sufficiently to make the call for better, more information. I don’t want to overload them, because we read enough, but I do think we can play a bigger role in this.

Mauro Cunha:
We may be in a situation in which IFRS made things worse for investors, in certain situations, and that certainly may be the case in Brazil. Picture yourself in a country with defined control. So you have an owner that actually calls the shots anyway. You move from a national standard that is very prescriptive, with a lot of historical information and you’re moving to IFRS, that’s much more principle based and which has a lot of judgement when you publish financial statements. You have impairment exercises, you have all sorts of judgements that management needs to do, which involves assumptions and involves decisions, which are not always clear and very well disclosed. So, I’ve heard from one investor that balance sheets in Brazil, in many cases, are becoming like sell side reports. They are the management’s opinion about the value of those assets, or liabilities, and you don’t even know what the assumptions are. So, when you go back to the role of an audit committee in a situation like this, it becomes even more important.

If you have a dysfunctional structure that does not perform what is expected from it, investors are left in the worst of all worlds. You have a balance sheet that you don’t know what it is talking about, you have a structure that supposedly will have oversight over that, but does not, so even the auditors, in that scenario, which supposedly would see the audit committee as the owner of the relationship, they know that the audit committee will issue an opinion to a board, that is dominated by a controlling shareholder, who will make the ultimate decision. So, he’s actually serving the controlling shareholder.

I’ll give you one opinion that I’ve been through, in a given situation. I was questioning an elective accounting procedure and I asked the auditors whether that decision was a faithful representation of the economic reality of the company and the auditor came back to me and said, “It is not my job to say that,” and it was okay for him to say that to the audit committee, because he didn’t care about my opinion, he cared about what the controlling shareholder would decide and the controlling shareholder wanted a clean balance sheet. So, we may be creating a monster, in certain jurisdictions, by these combinations of factors.

Jamie Allen, Secretary General, Asian Corporate Governance Association:
Anne, you said that the SEC and the PCAOB were not getting much response for investors, on the consultation, this is a theme we hear again and again around the world and what’s the problem here, from your perspective? Audits are fundamentally important to investment, without them you couldn’t invest. Audit committees are the core committee of most boards, I think most people would agree with that, or at least, a linchpin committee. So, why aren’t investors all over this? Is it a lack of interest? Is there too many other issues to think about? Is it a lack of skills? What is the problem, because we see this in Asia, we see it all over the place?

Anne Sheehan:
I don’t know if there’s one specific thing. There are some investors that some of us do monitor what is going on and provide comments and have reached out to other investors. I think some of it, and it goes into a little bit about the discussion later today on perhaps the stewardship code. The culture in the investment community in this country is very dispersed, and so there’s not one group that represents everyone. I think the Council probably represents a certain, discreet group of investors, but there are many. There are so many other large investors and many have engaged with companies and communicate their issues differently, and perhaps not in a forum where a regulatory body is making those comments. I didn’t see some of the largest investors, in some of the companies in this country, weighing in on these comments. And so I think it’s an issue that we, the investor community have to say “Alright, you may want to not go on the public record, but how could
we get the benefit of your input into this process?” Even if you want to sit down and share one-on-one meetings with the SEC, or the PCAOB, or participate through some of the committees there, or even as observers, get their input. But I think it’s a challenge that the investment community does have to, sort of, hold a mirror up to itself and say “You yell and scream when something goes wrong, it’s like, where were you on the frontend, in terms of helping put together those standards?” because the corporate community would like the input of investors and the good companies are listening to their investors on this, but we’re not necessarily speaking with a common voice and so I think the regulators can say “Well there’s no commonality of message out there, so we’re not quite sure what to respond to.” Sometimes the squeaky wheel gets responded to in these instances, but I think we’re better if actually, a broad based message that a larger group of investors agree that information and that disclosure would be better, because the role the audit committee plays, we as investors depend on them so much to make sure that they are overseeing that process for us. So, it’s a conundrum.

Cindy Fornelli:
A thought occurred to me, because I whole heartedly agree with you that there are so many different types of investors and we reached out to investors to encourage them to write to the SEC, not to adopt our point of view and just for clarity the CAQ is in favour of voluntary disclosure, because we see more and more of that happening, particularly at the larger companies, but we didn’t have a point of view for investors, we just said, “Investors, please write in, the SEC needs to hear from you.”

This had a short period, it had a 60 day comment period, over the course of the summer, when a lot of people were gone and it’s a hard format for a large organisation, CalSTRS was able to write in, but a lot of companies, a lot of investors, don’t have the infrastructure to write a comment letter and get the approvals that you would need to get within the organisations. So maybe, going to the SEC, or other regulators and saying “We need a different mechanism, give us more time, or, you know, have an open forum where we can go and talk to you about it,” because they like transparency, but maybe there’s a different way to illicit investor feedback, so that you’re not having to write a comment letter over the summer and I think when you looked at the sub-questions, there were over 200 questions that the SEC asked. Who wants to do that? And you don’t have to answer all the questions, in fact, we didn’t answer a single question, ours was very principles based and policy based, but that’s still daunting. And then, if you have to go through a legal review and all of that, people I think just throw up their hands and say, if we’re large enough we can go directly to our audit committee and as you did with the letters, to the largest companies, that in which you invest, but there’s got to be a different way to get at regulators and maybe that’s what we should be focussed on. How to get those messages across in a different mechanism.

Mauro Cunha:
I think the answer is an association like us, investor associations, that will go to the membership and make it happen, because it’s not only that they don’t have the resources, the thing is, why? Why am I going to spend my summer answering 200 questions? What will I get from it? Investors are very pragmatic, even those that are keen to improve regulatory environment, so in the USA, us in Brazil, you in Asia, I mean, there’s this – we should be the conduits for that. I think it’s the only productive way.

Guy Jubb:
On the matter of audit committee reporting, and I know the CAQ has done some very good work in terms of guidelines, but several years ago a number of investors got together, CalPERS, APG, ourselves and developed something called some Global Disclosure Guidelines, and global includes the United States, as well as Europe and other jurisdictions. And these are written in a manner that is designed to be non-technical, because I think the technical aspect to Jamie’s question is actually one of the barriers people – and, it was mentioned, IFRS, I think there has been a total detachment. I don’t know how it is with the FASB, but they do consultations on documentations, the consultation documents are that thick, you don’t have the time, (in terms of efficiency) to go through it, but it’s full of acronyms, technical issues and even as an accountant, I lose the plot, and am I going to write a response about something I’ve lost the plot on? No, I am not.

John Seethoff, Vice President and Deputy General Counsel, Microsoft:
I'll be controversial. The structure of the industry and the structure of investors also inhibits it. From an asset manager side, if you have really good forensic accounting ability and you're playing a relative return quarter-to-quarter game, why do you want better reporting? You have a relative advantage over everyone else and the structure of the asset management industry does not reward real world economic growth, it rewards relative financial market outperformance on a quarter-to-quarter basis.

That’s as controversial as I want to get on that one, but on an asset owner and larger asset management firms, CalSTRS is an outlier. The reality is, most governance and ESG professionals are not comfortable part seeing a balance sheet or an income statement, that’s left to the Financial Analysts and the Portfolio Managers and so, the people who might care, theoretically, conceptually about this, we also have an issue specific to the US, which is split regulators, so you have to pay attention to the SEC and the PCAOB, and not just the FRC for instance, in the UK. The people who may know about it, and conceptually want to do something, don’t necessarily have the skill set to institute a comment letter, and the people who do, may not even know that there’s a comment letter pending, so that’s another issue.

So my suggestion is not just groups like the ICGN or CII, but what was really helpful, was when we do model comment letters and then circulate to our membership, steal from it, copy it, or just say you endorse it. Because part of the problem for the regulator, is yes you can get something from the ICGN that says we have 14 trillion dollars, but it’s one letter, and then you get 72 letters from audit committee Chairs, right, and it just makes it appear, even if those 72 have a market capitalisation of 200 billion, versus 14 trillion, it still makes it appear that investors don’t care. So, I think we have to overcome the structural problems in the industry and the way to do it, most easily is with model comment letters.

Anne Sheehan:
I agree, in terms of that and talking to the SEC over the years, they'll say, and not just on this Concept Release but on others, we need more letters from investors, because if you stack up the letters from the corporates and you stack up the letters from investors, it's very unbalanced. In terms of the impact that it can have, but I think, as the ones who really are the ultimate consumers of this information and depend on the information, that we can live and die by this, we do have an obligation to figure out a solution to this. And I think CII and others will say "Take our letter and take off the letterhead and"...

Cindy Fornelli:
But doing that in 60 days is hard to do, right?
John Seethoff:
Right, but I did one follow-up, which is not just CII, there are some service providers in the room, so, the service providers who deal with these issues, so the Property Advisors, or the Sustainability Raters, they could also circulate model letters to their clients as a service. Or at least say “We can help you develop your own,” because, if we just rely on the investing groups, it’s not going to happen.

Anne Sheehan:
The one thing about the SEC as well, it’s 60 days, but they’ll take letters any time.

Cindy Fornelli:
It’s not too late, you should definitely write in.

Anne Sheehan:
So they will take letters any time and I agree, the 60 days was entirely too short, especially when you look at all the sub-questions as well.

Jamie Allen:
What we’ve been doing in Asia, is we write our own submission as an association, and we do that with the input from our members, so it’s a group view. And then what we ask our members to do is, don’t write a model letter, just write your own letter and endorse the submission and add in whatever else you want. If you do that in Asia, then that will be counted as a separate submission, so it’ll be ACGA, plus however many investors write in. Even if the letter they only write in is one page, if we provide a template letter, what the regulators are now doing is actually counting those as one submission.

Cindy Fornelli:
There is a risk in the United States on that too. The SEC has when I worked there did discount form letters.

Jamie Allen:
I wasn’t saying form letters.

Cindy Fornelli:
So CII puts out a letter, then investors could just say – send their own letter, on their own letterhead and say, “What CII said,” ditto and then sign it. It really is a one paragraph letter. We now appreciate the opportunity to comment, we agree with CII. If you have a little bit more to say, say it, if not, that’s it. But then it would count as two letters, as opposed to one.

Anne Sheehan:
And some of the investors did do that on this Concept Release. They referenced the CII letter, so some of them have done that.
When the FRC was contemplating some of these changes and some enhanced disclosure, what did the audit community say, the audit committee members and the companies talk about, what the impact would be? Did they say it would be burdensome to them, that we should do voluntary only? I would just be curious as to see what that process is, because we’re a little bit behind you in that and so understanding the response from the business community.

Guy Jubb:
To provide context, I think there’s one important differentiator and that is that the United Kingdom, and a number of other jurisdictions, are by nature not as litigious, as is the case in the United States. And that all said, when I spoke at a memorial lecture in London, six years ago and speaking alongside me was the Chairman of PwC in the United Kingdom and I floated the idea that companies should have company specific audit reports, and I got a very strong pushback. It’ll never happen, it’ll never happen and Accountancy Age, which is one of the rag magazines, reported it as ‘Viva the Audit Revolution’ and to a certain extent that was where some of this started to come through. But that all said, when the FRC in the way that it tries to get consensus around these issues - we are a smaller community, so it was easier to do, but there were roundtables that were developed, but the FRC, to its credit and there’s one of their Directors, Non-Executive, Nick Land, he’s the Chair of the Audit, former partner of EY and is Chair of the Audit Committee at Vodafone, so he wears different hats. He provided very strong leadership to all the communities to come together, to bring about these changes. And so the debate really wasn’t about so much as to whether we should provide more information through audit committee reports, or auditor reports, but how should we do it and what we should provide. And we’ve reached a good place and we are finding that things are moving on. But we had to get over that first hurdle and obviously bringing the audit firms into the fold and making them comfortable was part of it. But litigation, I have to say, played its part.

Mauro Cunha:
In that, I am curious about all the jurisdictions here, in terms of the role of the whip, really, in relation to the audit committee members. How the regulators are making them liable and of course, I know the US is more litigious, but often the UK, Japan, because in our case, this is non-existent at this point. So I have a feeling that it is important that, for the audit committee to have teeth and to be relevant for investors, there need to be a sense of greater accountability. How is this playing out in each jurisdiction?

George Iguchi:
In Japan the audit committee members are always step down from there and they have the extraordinary shareholder meetings and that they have the new audit members under litigation. Now they’re setup their committee to check whether there is a regulator or not, in the new audit committees and then there might be some litigation.

Guy Jubb:
One of the features in Japan, which I’ve only become recently aware of and George may be able to refute, or enlighten me, but I understand audit fees are actually very, very low in Japan, compared to it and the degree of differential is such that I was not aware of it and it was only recently brought to my attention, I do just wonder how audit committees and auditors can actually deliver the quality of audit, the really useful bit.
George Iguchi:
I heard the audit fees are very low in Japan, so it’s very severe situation, but I think that one solution is that we have the additional information from the auditor report and then the investors find quality auditors and because there is our shareholders to select external auditors ultimately, so I think that’s the one.

Cindy Fornelli:
I think people are looking into Europe to see what will happen with the mandatory firm rotation, what that impact will be on audit fees. I know that the US regulators have flagged it as a concern and yet they’ve not really done anything about this downward fee pressure and I personally worry that we’re at a place where it will negatively impact audit quality, this downward fee pressure and this is actually, something that I think audit committees need to do a better job of, is making sure that they’re the ones responsible for setting that fee and not letting management do it and then the audit committee endorse what management has put forth, and I don’t know if more disclosure on that would help.

Anne Sheehan:
I think you hit on a point, not just on the fee issue, but on others of the relationship of the audit committee and getting this is around the disclosure, with the auditor themselves, without management. I think that whole area, providing some insight for investors about that, because the concern without information, is that they are just depending on management and without knowing that, yes in fact, they meet with them on their own, these are some of the questions that we ask to make sure that they are, kicking the tyres and getting that information is very important.

Let me go back on the litigation issue because, absolutely, in this country, I think we take the prize for being too litigious but I don’t think the fear of that should completely stop any additional disclosure from the audit committees. The only parallel that I can give is after say on pay, various law firms around this country decided to sue companies on not enough disclosure. Now, I don’t know if you’ve read comp disclosure, but pages and pages and lack of disclosure about some compensation structures that I think is not a problem for investors pushing through some of it, and they have everything but the kitchen sink in there, in terms of metrics they use and this is how we do short-term, long-term, but...

Cindy Fornelli:
And yet you still don’t know exactly what the compensation structure is, but that’s a different issue.

Anne Sheehan:
But there was a law firm that were suing companies and saying that they were going to try and stop the annual meeting unless they got more disclosure, and CalSTRS actually filed an amicus on behalf of a company saying “We’re an investor, we feel that there is sufficient information.” So, that was one where I do think there is a role for investors to play, to help push back on this, because it doesn’t help for companies to be fearful of litigation on anything – any additional information they want to give, we’re asking for it. So, if in fact we’re going to stand by that I’m hopeful that it was helpful in that case, the company prevailed in that regard, but it shows that investors actually are going to put a stop to some of this. Now, we also file lawsuits where we feel shareholder litigation, when it’s in a tool –
it’s a tool in our tool belt, but I think investors have a role to play with some of these law firms, in saying okay, enough.

**Audience:**

I think that it’s also incumbent on the investors to make it clear to the audit committees what they want, regardless of what the SEC or other regulators may do. Because I found, in my communication with audit committee Chairs, the easy answer to anything around disclosure is “I never hear anything from the investors. They don’t really want this, it’s just a few lobbyists in Washington who are pushing for it.” And so it becomes a great excuse to do nothing and I think it’s partly because they don’t understand the role of the corporate governance teams in investors. So they understand what a Portfolio Manager does, they understand what an Analyst does and, by and large, those are the people that their company, as a whole, interacts with and that the audit committee would hear about, second hand, from management. They don’t interact with the corporate governance teams, they don’t necessarily know who those teams are and they don’t understand why it’s important. So, given that Guy said, “It’s a very small community of people who are going to read these reports” and, by and large, that is the corporate governance team, not the Portfolio Manager, then I think the teams are going to have to have more outreach, whether it’s one-on-one with companies that you’re interested in, or whether there’s just more general communication from ICGN and others to the board world, so that they could understand that you are important in the process and therefore, if you are asking for disclosure, investors are asking for disclosure, they’re just not hearing it right now.

**Guy Jubb:**

I’ve actually stepped back from using the word ‘engaging’ with audit committees. I actually go back to actually what Sir Adrian Cadbury had in mind, and that is of having conversations about these matters, between audit committees, because it actually makes the audit committee just feel a little bit more comfortable about having a conversation, as opposed to an engagement about these issues. And some of the conversations that we have are, in part, about the reporting, but more, this is the substantive issues which are the critical issues, and the sort of areas that we are starting to move into are, and the illustration I use is in relation to a shipbuilding company, as investors, and we are active investors, we manage our portfolios actively, if we look at a shipbuilding company, we’re actually as interested in the quality of the order book for the ships that are coming along, or not, as the case might be, as opposed to the historical information. So, the encouragement therefore goes to the audit committee, but they should get assurance from the auditor, about the quality of that order book and that should be reflected in the audit committee report, which then gives us that degree of assurance that an order, is an order, is an order. And that’s the sort of conversation we’re just starting to have, it’s an evolutionary point, but that’s the direction of travel.

**Mauro Cunha:**

We need to really understand the purpose of what the structure needs to do and investors need to have the tools to understand that and to convey that to companies. I think your point has a lot to do with integration of corporate governance and investments, because when these are far apart, you get the problem you described. So, stewardship, I think that the title and proposition of the panel are very relevant, because we’re talking not only about disclosure, but about stewardship and the purpose of the audit committee, this needs to be thought of and adapted to each jurisdiction.
George Iguchi:
In Japan also it’s very difficult to meet the audit committee members, so I think that at this stage it is very effective to have the impact during the framework of the audit committee, or the auditor report and now in Japan, we have interview with our second stage of the corporate governance reform and if it’s there, we’ll welcome the opinions of a voice from the investors, including the overseas investors.

Anne Sheehan:
Investors in this country need to do a better job of telling audit committees what information they want and communicating on a more regular basis, whether it is the corporate governance team, but representative some investors need to communicate more with audit committees what information they wanted would be helpful.

Guy Judd:
In addition to that, I add that investors and those who represent them, need to find a voice to their views, as well as actually letters that are submitted, in order that the volume – the volume of praise, as well as the volume of criticism, can be heard beyond this room.

Breakfast Panel 2: Political lobbying donations: what are the governance issues for directors and investors?
• Dan Bross, Senior Director of Corporate Citizenship, Microsoft
• Norman Eisen, Visiting Scholar, The Brookings Institute
• Peter Swabey, Policy and Research, Director, ICSA
• Chaired by George Dallas, Policy Director, ICGN

George Dallas, Policy Director, ICGN:
It is important for companies to be involved in the political process, particularly to the extent that they’re in a position, based on knowledge of technology, or markets, to help inform the policy process, in a way that’s good, maybe not only for the company, but in a broader context. But there’s also the potential for abuse, and this potential for abuse is particularly poignant where there’s a question of, not only lobbying, but also donations, when cash gets handed over. And so, we looked at this issue about four years ago after the Citizens United decision by the US Supreme Court opened the gates for corporate political donations in the US. We published a document that established a framework for looking at political lobbying and donations through the lens of legitimacy, and a principles based approach, needing to serve the interests of the company as a whole, and ultimately its investors. Transparency - what the company is doing in this space, what is the process, who are the decision makers? How are issues decided upon, relating to, either, lobbying and donations? Accountability, this is something particularly that we think Boards of Directors need to take a bit of ownership on and ensure that the company is doing things in a proper way. And then, responsibility in the context of providing an appropriate ethical and legal foundation for involvement in the political process. And the particularly sensitive issue is the issue of political donations, where ICGN, our own position as an investor body, is that we actually discourage political donations, as a matter of principle. It’s not as if it’s necessarily intrinsically corrupt or anything like that, but I think there are cases where it’s potentially a grey area and so, we officially discourage it, but we also recognise it’s a reality in many parts of the world, such as in the US in particular. So what we’re trying to do is establish, what is
an appropriate corporate governance framework that boards should be taking into consideration and investors as well?

It was interesting when we first put this document together some US corporate members of ICGN actually called this, the ICGN statement, radical and extreme, perhaps not fully appreciating how the political realities in this country differ from the rest of the world, which is an interesting response. But we need to explore this further and the coming election, in 2016, is certainly putting campaign finance in particular, in a very visible position.

Normal Eisen, Visiting Scholar, The Brookings Institute:
I will set the stage for our discussion by describing the somewhat anomalous position of the United States. When I went to the White House with President Obama to oversee what we hoped would be a massive Government reform effort, of recalibrating the special interest, which the President, first, as indeed, as a State Legislator and a Law Professor, and then as a Senator, and then as a Candidate, and finally, as the President Elect in 2008, thought that the special interest had gotten too much power in Washington, and the public interest was being suppressed by that. And the goal was our policy views, not unlike the one George articulated, that of course, there is a constitutionally protective place for speech, for corporate speech, as well as individual speech, a place for lobbying, but that the special interests needed to be rebalanced, we needed to recalibrate with the public interest. And over my two years in the White House and then almost four years as US Ambassador in Prague after that, I saw the United States plummeting in the global league tables of integrity, of government ethics and of corruption, because the Citizens United case had opened a floodgate of corporate money, pouring in unlimited amounts into the American political system.

In the White House, in my capacity as the Ethics Czar, I had responsibility for everything that had the word 'reform' in the title, except healthcare reform, and that was the only thing that could have made me less popular in Washington, was also to be in charge of healthcare reform. So the Campaign Finance Forum was one of my responsibilities, and I was keeping an eye on the Citizens United case. Citizens United claimed that a documentary they'd run, which was complained about, as outside spending. Doing this documentary, that effects and election was a violation of the Constitution. I was looking for a decision in the case from the Supreme Court, thinking that they were going to uphold the system, the constitutional balancing, and I got the notice in my inbox, the Supreme Court has ordered re-hearing in the Citizens United Case. And of course, the reason the Supreme Court – they'd already heard the case, it had been fully briefed and argued to the Supreme Court. It’s a very unusual event to have a re-hearing and a lightbulb went off, this was the end of the American Campaign Finance System as we knew it.

I was the first to tell the President, to inform the President that our lives had all changed and of course, the rest is history. We now have hundreds of millions of dollars that are sluicing through, unregulated, often dark money pools, coming from outside the traditional campaign finance structure, of parties and pacts.

The US system is a very intricate one. It sprung up following the Watergate scandal, the modern architecture of campaign finance regulations, sprung up in the 1970s with FECA the Federal Elections Campaign Act. And basically, what FECA did was place limits on what individuals can give, what political action committees, corporate pools, what they can give to campaigns, what parties can collect, what individuals can collect and FECA has evolved, legislatively. Also, through the regulatory oversight of the Federal Election Commission, FECA has evolved. The most notable evolution in FECA was BCRA, the Bipartisan
Campaign Reform Act, also known as McCain-Feingold. John McCain was a big proponent of BCRA, which, among other things, closed what we call the soft money loophole, where people figured out that under the statute, you could give unlimited amounts of money to political parties, for non-campaign activities. For example, for so-called party building.

So, Citizens United blew a hole through this very intricate and complex regulatory system and what has followed, in the United States, has been a series of additional decisions, from lower courts, for example, the DC Circuit, which is one of the Appellate Courts that is just below the Supreme Court. In the Speech Now Case, the DC Circuit allowed more generous and unregulated giving. In the White House, we failed to apply a transparency regime to all this giving, which the Supreme Court in Citizens United invited us to do. We came one vote short. It passed the House and 59 votes, we needed 60 in the Senate, one vote short. I’m reviewing all the greatest failures of the Obama Administration and my own career. So the disclosure regime collapsed and then most recently, in the McCutcheon Case, a 2014 case, the Supreme Court lifted aggregate limits.

There used to be limits on how much individuals could give for all of their federal and political giving that has been lifted as well. There’s still limits on how much you can give to an individual candidate. For example, I can only give $2,600 for a primary candidate in the Presidential Election, $2,600 in the general. McCutcheon lifted the overall limits and now – and the Congress has joined the act as well. They raised the giving limits, which used to be a little over $100,000 per person, per two year cycle, they’re giving limits now, if you include couples giving, are over a million dollars to parties and the parties are now soliciting million dollar cheques. So, those limits have been raised by Congress as well.

The result of this is, having described this situation to you, one: our campaign finance system in the United States is an intricate, complicated mess. Nobody can really understand it. The charts are like spaghetti charts. It’s like a calculus final, to try to understand what you can and cannot give. Two: there are these enormous amounts of money coming into the system, which are giving increasing amounts of power to the large givers, and the great danger is, the reason we had always limited corporate giving before Citizens United, was because corporations, unions, (but corporations more) have unlimited war chests and you literally could spend anything now, as long as it’s independent. You can’t actually co-ordinate with the candidate, but that is a distinction, virtually without a difference, perhaps we’ll get into that later. And my third, having described the present, I will describe the future. Another big scandal, like Watergate will inevitably result. It cannot be the case that these massive amounts of money are going to come into the system, without the people who are spending the money wanting something in exchange.

And so, I do think we will re-regulate on – I don’t know if this qualifies as an optimistic note, I think there will be another massive Watergate style scandal in the United States sooner or later, and that will result in the re-regulation, perhaps the Disclosure Act, or the Disclose Act will be resuscitated from the dead, we’ll get that additional vote we needed to pass it.

Dan Bross, Senior Director of Corporate Citizenship, Microsoft:
When my colleagues at Microsoft, from outside the United States, hear about everything Norm just described, they think we’ve all been drinking here or we’re on heavy drugs, and I’m talking about people who do Government affairs for Microsoft globally, who work in Brussels, or Paris, or London. They cannot believe the system that we are part of here in the United States. I wish Norm and the President would have been successful in realising the vision, and the dreams, and the hopes and the aspirations that they came into the White House with. Unfortunately, they were not. I also agree with Norm that there is going to be
another Chernobyl, tsunami at some point and we, as a country, are going to have to re-examine the craziness that is the current system of political giving, here in the United States. But the system, the current system is what it is.

So let me talk a bit about Microsoft and how we look at this issue, and the system in which we have to operate considering “These issues are really corporate governance issues.” So, back in about 2009, I and some of my colleagues started having conversations with some of you and your colleagues. Investors, shareholders, who were interested in the role of corporations in the political process, and you all had some very important questions. And we had a process and procedures in place, internally, but we didn’t share them with anybody and as a result of the dialogue and conversations and questions you had, we thought these are really valid issues that folks are raising. Why don’t we help explain how we engage and why we engage in this process? So, in about 2009 we developed what we call principles and policies for guiding Microsoft’s participation in a public policy process in the United States. And what these principles and policies do in three pages or so, is explain how we look at our responsibility to shareholders, for engaging in the public policy process globally, and we lay out a set of principles that touch on issues related to, obviously compliance, issues related to accountability and issues related to transparency and I can go through some of the specifics in each of those categories a little bit later, if you’re interested. But our participation in the political process is really premised on, and let me read from the introduction of this document, “we believe that corporate participation and political process is an important and essential means of enhancing shareholder value and is fundamental to free and democratic societies. Microsoft engages with Governments around the world on public policy issues, and I think this is really important, that are core to our business. We believe our engagement serves our business interests and also creates stronger, more informed public policies. Our engagement in the public policy process is grounded in and guided by our unwavering commitment to strong, corporate governance.”

We have this principle policy document on our website. We review it every year and we amend it and adjust it every year, and the most recent amendment to it was made just this past summer. We disclose, on a semi-annual basis, put it on our website. All of our corporate contributions and all of the contributions through MS-PAC, Microsoft Political Action Committee. We put that information on our website by candidate, designating the party of the candidate, designating where the candidate’s from and how much we gave, and as I said, we update that information every six months. We also post on our website, a list of all the trade associations that we belong to, through our Law and Corporate Affairs Department, here in the United States and trade associations where we contribute more than $25,000 a year in membership. That information is on the website and that information also includes how much each of those trade associate – what portion of the dues we are paying the trade association in membership dues, what portion of our money is being used for lobbying, on behalf of the trade association. We also disclose all of our lobbying reports on our website. So, for Microsoft, the issue on this topic is not should we engage, but how should we engage and we are firmly committed to issues relating to accountability, transparency and compliance.

In looking at the Citizens United decision and Justice Kennedy, he says “With the advent of the internet, prompt disclosure of expenditures can provide shareholders and citizens with the information needed to hold corporations and elected officials accountable for their positions and supporters. Shareholders can determine whether their corporation’s political speech advances the corporations interest in making profits and citizens can see whether elected officials are, “in the pocket” of so-called moneyed interest.” So, again, I think as investors, the US political system is what it is and we may wish it was different, we hope it
will be different, but it is what it is. So my advice to you, as investors, is you should hold your companies, in which you have holdings, accountable for disclosing their expenditures.

There is an index on all of this that comes out once a year, and it’s coming out next week for the 2015 version of the index. It’s called the CPA Zicklin Index and this year’s index will rank all S&P 500 companies, in terms of the amount of activity in this area that they disclose, so I think that is a document you may interested in taking a look at next week. So, let me stop there.

George Dallas:
In France, I think in the early 90s, the then Chairman, his name is La Floch, was convicted and sentenced to jail for, effectively bribing within the French state and that resulted in France abolishing political donations as a legal and regulatory response. So I think France has had its tsunami, or its Watergate already, and it resulted in donations being banned, and in other parts of the world, they tend to be legal, but they tend not to be actively used and again. In this context, this is where the US sticks out.

Peter Swabey, Policy and Research, Director, ICSA:
The central thing is around the definition of what a political donation actually is. Is it where you give some cash to a politician? Is it where you give some cash to a political party? Is it where you give some cash, or some services, to a body that has an alignment with a particular political party? So, there are a variety of ways of looking at that and one of the issues that we occasionally have with our European partners, is that not everybody looks at these things in the same way. So, in the UK, we have a particular model. The French political donations are banned completely. Now that’s not to say that something broadly similar, doesn’t go on, but it’s not a political donation. So you have to look at these things in a variety of ways but I’m sure there are different nuances within your own system.

Engagement in the political process is absolutely core to the business interests of companies. There has got to be a right way for companies to be able to do that. Not least because, in many cases in the UK and Europe, is that people from companies tend to know an awful lot more about the subjects at hand than the politicians do. In my view, the whole question of how political parties are funded, how politics generally is funded, is one of the major issues challenging every democracy in the world and every democracy in the world has got its own way of addressing that issue.

It was Churchill said that “Power tends to corrupt and absolute power corrupts absolutely.” He also said that “Democracy was the worst possible system of Government, apart from the alternatives.” So, I’ll just focus for a moment on the way that we tackle the situation in the UK. There are 28 other member states in the EU, they do things differently. For us, there has to be shareholder approval to make donations to a political party, well, that’s pretty straightforward and clear, or to incur political expenditure, and that’s rather less straightforward and clear, because that can include gifts, sponsorships, subscriptions, fees, any loan or service, other than on a commercial basis, etc. So what we have tended to find is that UK companies will get shareholder approval on a precautionary basis. Because you don’t quite know what is going to be interpreted as a political donation.

To give you an example, it can be expenditure, rather than an explicit donation. There is an exemption for anything that is done on behalf of trade unions, or on trade associations. But if a member of staff is a Local Councillor, and you give them paid time off to attend a Local Council meeting, which you might think is not an unreasonable thing to do, if they’re a
member of a political party, which they probably will be, that’s a political donation, technically. Now, it’s unlikely that many companies will actually be sued for that, because it’s fairly minor, but under UK Law, Directors are personally liable for any political expenditure the company incurs, which has not been approved by shareholders. So that, kind of, focuses their mind a little bit, and there is a tendency for those precautionary resolutions to be put through and roughly 50% of FTSE 350 companies put a political donations resolution of some sort through the system and seek shareholder approval. Now they’re not intending, in the vast majority of cases, to give money to the Conservative Party, or the Labour Party, but what they are intending to do is something which may be caught onto that fairly wide definition.

I said earlier on that each country, each democracy has its own way of looking at these things, so we have a model whereby political donations are fairly strictly regulated. However, we regularly in the UK press have issues about Cash for Questions, where a member of Parliament is paid, effectively to raise a question in Parliament and an MP can ask the Prime Minister a question, in Parliament, in public about anything they like and if you’re a company and you wanted an MP to ask a particular question, they’re not supposed to, but there have been examples where newspaper stings have caught them doing that. We also have the issue of Cash for Honours, which is where people, or companies want the Chief Executive to get a Knighthood from the Queen. And we’ve recently had some very interesting newspaper coverage of – as a result of David Cameron having not given political preferment to somebody who’d made a lot of donations, in a private capacity, to the Conservative Party, and has come out with revenge stories and there’s all sorts of unpleasantness in the newspapers about that. So, although there is a model, whereby political donations by companies are quite strictly regulated, actually, there are ways that people try to get around that, which bears out what Churchill said about power. I think it’s also something that applies in many other jurisdictions, many other member states worldwide. So, this is certainly an important issue, and it’s one that’s not at all easy to grapple with.

George Dallas:
Regarding Microsoft – I’ve looked at your website, it’s excellent disclosure, a clear policy framework and I think that the point is, if you’re going to be engaging in these activities, you need to do it right and I think that Microsoft is a good example. But I guess my question for you though, you were just saying, a few moments ago, yourself that you would’ve preferred that we didn’t have the regime that we have. I guess, the question then, why does Microsoft feel the need to actually donate money? I mean, there’s no obligation to do this, but – and you are disclosing what you’re doing, which is great, but what competitive disadvantages would you see for the company, if you were to cease donations?

Dan Bross:
We tried to answer that in the quote that I read from our policies and principles, where we believe we have an obligation, under our current system, to engage in the political process to advance policies that help increase profits to our shareholders and help advance our business principles.

One of the things is that to help shareholders and others appreciate what we mean by that, we publish a Public Policy Agenda every year, we put it on our website, so interested parties can take a look at the issues that we feel are fundamental to advancing shareholder value and advancing our business practices. So, that’s the principle answer to your question. The reality of the situation is, if a company like Microsoft or, name a company, were not to
engage in the political process, unless you had a complete ceasefire across the industry, you will have your competitors engaging in the political process, to help advance policies that could advantage them in the marketplace.

Let me also make a point. Your question though is really important, because when there is so much attention focussed on the role of money, which is an important conversation and an important focal point, but a corporation’s participation in the political process, is really multi-faceted. It’s lobbying and I think corporations have a legal responsibility, to disclose how much money they’re spending on lobbying and we disclose that. So, companies can participate the political process by lobbying, companies can participate in the political process by giving money, and I think there are disclosure requirements associated with that, and companies can participate in the political process by belonging to trade associations, who help influence policy. So, we’re trying to help our stakeholders understand how we engage in those three areas primarily.

George Dallas:
On the point of disclosure there has been a campaign to try to petition the SEC here, to establish more stringent rules on disclosure of political donations, which strikes me as a bit of a no brainer, but it’s a provocative issue and I think it doesn’t appear as if this is going to get traction.

Norman Eisen:
The Bebchuk led campaign has gotten the most comments of any repetition for an SEC rulemaking in the history of the US Securities and Exchange Commission; 1.3 million last time I checked. I predict, with equal confidence that this Securities and Exchange Commission will not, having not so far moved, will not move. It’s most recently been endorsed by Secretary Hilary Clinton, as part of her campaign platform on these reform issues, but I don’t think it’s going to move, for the same reason the IRS could also pass regulations that would better achieve disclosure and limits on non-profits, who can now deliver those huge, unregulated monies, but they haven’t done it either. The logic – both for a variety of institutional reasons, both of them feel that it’s a little bit outside their purview, outside their sweet spot. I think that’s wrong and I think ICGN has been a leader in adopting a balanced and moderate approach on this, in the guidelines on lobbying and political activity. So, the place where – among the regulatory agencies, the place where this movement, in the United States, should come from, is the Federal Election Commission, but the FEC has become a deadlocked organisation.

In order to prevent partisanship there are three Democrats and three Republicans at all times on the FEC, and there has been a asymmetrical agreement by the Republicans, although sometimes Democrats will join, not to move any reform. So they’ve frozen everything. The FEC has become a completely dysfunctional, and I don’t say that in a partisan way, because there are plenty in the Republican Party who would like to see change, but the FEC, the logical home of this, has become completely dysfunctional.

The White House also has not shown alacrity in this regard. There has been a long reported executive order in draft, regulating political giving by government contractors that could also deal with some of these problems. It’s been rumoured, in the press, that I drafted it before I left, when we were dealing in the wake of the failure, that one vote failure of the Disclose Act that I described to you and it’s been languishing there ever since. In fact, Secretary Clinton has said she would issue such an executive order, but it doesn’t seem to be moving through the vast bowels of the Federal Government at a very rapid rate, since I left over four years
ago. I won’t, of course, comment on whether those press rumours are true. So, the situation, the regulatory landscape is not very cheerful in the US, I’m afraid, to report.

**Audience:**
I dealt with a number of the disclosure issues internally. Is there any hope of a rational business voice here, because what we get from the internal discussion was, the burden on the business for internal disclosure, that wasn’t going to be used anyway. But what would be helpful in order to decide that you would petition, is the innovative voice of business talking about standardisation, the need for shareholder communications, in the way that would be effective, that would meet your business needs. Any hope of individual voices, or a coalition that could raise those issues, moving forward?

**Dan Bross:**
It’s a conversation that some of us, in the business community, have been having for a number of years. I hold out little hope for a grand coalition of companies coming together to advance that. But in terms of the SEC not moving forward, or the IRS, or any other federal agency, is of course their reluctance to move forward would have nothing to do with their fear of losing money through the appropriations process, out of Congress, where there are some in Congress who are not particularly supportive of the SEC rulemaking. So, I’m sure their opposition, or reluctance would have nothing to do with the appropriation process.

**Peter Swabey:**
I’d observe also, that that’s a global problem.

**Peter Swabey:**
Certainly in the UK we have significant issues with what has to go in companies’ Annual Reports. HSBC, for example, publishes an Annual Report and it’s colloquially known as the cat killer, because of what might happen if it went through the doormat or the front door and the cat was sitting underneath it. There was a report last year that a Royal Mail Postman would not carry more than ten of them in a sack, because they’re so big and heavy. So we’ve got a process that the Government’s been going through. They went through a thing called the Red Tape Challenge, which, as far as I could tell, resulted in more regulation. They’ve done a thing on annual reporting called Cutting the Clutter, which tends to mean that one or two very small disclosures are taken out and then somebody says “Hey, wouldn’t it be great if we introduced reporting on such and such?,” normally around remuneration, and you suddenly see that there’s an extra 20 or 30 pages mysteriously appearing in everybody’s Annual Report. So it is not an easy thing to solve, because there are always people who believe that the particular issue they’re interested in is, it’s absolutely critical and the best way of dealing with it is for companies to report it, rather than anything else. So, I think I fear I agree with Dan, that the chances of companies being able to come together and deal with that is fairly remote.

**Marianne Harper Gow, Director, Corporate Governance, Baillie Gifford**
So I’m another one with a foreign accent and I wondered if there’s a top five risk list of those that might cause the next Watergate or tsunami?

**Norman Eisen:**
And there is. There’s also, by the way, on the CPA, the Centre for Political Accountability, a Zicklin Index. There’s a top five hedge list, the companies that have done the most to hedge against the risks that come from the political activity that’s constitutionally protected for corporations in the United States, so Microsoft is in the top five year after year, I will predict. I think last year you were number three, tied for number three, so Microsoft is a model and many of the things we wanted in the Disclose Act.

When I started in the White House, the President and I, and the President was very involved in this, we really started with a rules based approach to how we were going to regulate, not just campaign finance, but every aspect of corruption and anti-corruption at large that you confront, which of course, is what your question about, which is on the supply side, the giving side, where do the risks stem? And there’s some interesting data coming out about this now. We started out with a very much of a rules based approach, so the first thing we did was – and we sat and wrote it together. We wrote a one page contract for every Government official Obama appointee to sign, that laid out the rules very cleanly and concisely on one page, with about 12 pages of fine print defining terms and explaining what they were. But people got the basic idea from that one page contract and we moved to and did more of disclosure in my time at the White House and counselling the President. We moved to more of a disclosure regime. So by the time we were dealing with Citizens United, we really were pushing the Disclose Act as less limits on behaviour and more transparency, and instantaneous transparency.

So, that leads me to the risk list. I think the greatest risk comes, not from public companies, and in fact, in the 2012 cycle, there was relatively little giving by public companies and public companies are increasingly moving because of all of you. Public companies, in part, because of all of you, and because of the ICGN statement, among other policy initiatives by the Institutional Investor Committee in the United States and globally, CII was also very active on this issue and I had the privilege of consulting from the White House a little bit with ICGN when you were thinking about this. So the institutional investor community has really started fostering best practices among publically traded companies, the companies you hold.

The danger comes from large individual givers and from privately held companies, if you’ve studied the issue on the United States, there are some very large individual givers and they’re giving some of these givers are even incorporating, because in this weird, complicated matrix of rules that I describe to you, that you need a PhD, or at least a Master’s Degree in Campaign Finance to understand. You can hide your identity by incorporating and putting money in a closed corporation and using that, the sole purpose of which is to give to a super PAC and then using that closed corporation to conceal your identity. So, I think you’re going to see some of the large individual players, who have large financial interests, who are reported as individually putting large sums of money in. Some of whom have a closely held corporations, non-public corporations and other business entities, that’s where the risk is, that’s where I would focus.

Can I finish answering that question with one other anecdote? The President didn’t just ask me to do this stuff because I had known him for so very long, but also because I founded a watchdog group, a progressive watchdog group in Washington. CREW, Citizens for Responsibility and Ethics in Washington, which recently celebrated its 15th anniversary. A pretty good one we represented, among others, Valerie Plame and Joe Wilson, when they became whistle blowers against the Bush Administration in the Iraq War. And we started out asking that exact question 15 years ago, and it’s the right question for institutional investors among the questions to ask in this area. Why? Because if you figure out where those risks are, then you can look at some of these large individual givers, do sit on boards, Chair boards, act as CEOs of public companies and there are associated risks that can flow and of
course, your portfolios are also not just limited to public companies, you have a variety of other investments.

We determined that the top risk was not on the supply side, but on the demand side in Congress, with Tom DeLay. In fact, we actually started publishing every year, the top ten most corrupt members of Congress and we went after Tom DeLay. We wrote the first ethics complaint against Tom DeLay and ended up to having the responsibility partnering with a brave representative member of the House of Representatives, to bring down Tom DeLay, because of this corrupt activity. So, it’s a very good question for individual and the group collectively, institutional investors to ask.

**Daniela Jaramillo, Sustainable Investment Specialist, Westpath Investment Management:**

I want to ask what do companies do to ensure consistency between their values and practices of them direct lobbying and what the trade associations or other member associations are doing and at the same time, how do they ensure that all the other type of donations that are done in a more concealed way are consistent with what they’re saying publically about policies?

**Dan Bross:**

We publish a Public Policy Agenda, which is, sort of the North Star, and the guide against which we’re making our decisions of how we’re going to engage in the political process. We have a committee internally to review contributions, requests for contributions and make determinations of which ones we’re going to support and which ones we’re not going to support. We publish that information, so people can understand our decisions and if there are questions or concerns, we try to be responsive and get back to people and answer those questions.

The trade association thing is a challenge, we belong to a lot of trade associations. The ones we disclose on our website are trade associations where we pay dues out of our Law and Corporate Affairs Department, where our dues are more than $25,000. But in our principles and policies and let me read this, and there’s some in the room that we have had conversations about this very topic over the years. “We review these memberships and trade associations annually to assess their business value and alignment with Microsoft's overall Public Policy Agenda. We work with many of these groups on narrowly tailored technology policy issues, relevant to specific business objectives and it is unrealistic to expect any group’s agenda to align with ours in all policy areas. Therefore, our engagement with a political group does not, and should not imply our endorsement, or the policy positions that a particular group take.” Now, the Chamber of Commerce takes some positions that we disagree with; other trade associations that we belong to take positions that we disagree with. When that happens, we voice our opposition to those groups on that particular issue and we have made public statements disassociating ourselves with the policy positions of certain trade associations on some specific issues. Having said that those same associations do have positions that we do agree with and help advance, we believe, our Public Policy Agenda and add shareholder value. It’s really, really challenging and of all of the issues that we cover in this general topic, the one I probably spend the most time on is this issue of trade associations. So, it’s a challenging issue.

I go back again to the point that I made earlier, in my mind it’s all about disclosure. I think companies have a responsibility to all of you and to other stakeholders to disclose this information. So, I don’t know why some companies are continuing to refuse to do so. I have
ideas of why they’re continuing to refuse to do so, but having said that the new Zicklin Index is coming out next week for 2015. There are going to be more companies in the top rank of that index in 2015 than there were in 2014, which is good news. Where there does seem to be a bit of a race to the top and there is nothing like competition within the corporate community to help change behaviour, so that if companies in a particular sector are showing leadership in disclosure, other companies in that sector are likely going to want to show that they also are leaders. So, again, this comes back to the important role that you all have to play in talking to companies about your belief, your philosophy, your hope that companies will disclose the donations and how they participate in the political process.

Stephen Davis, Associate Director and Senior Fellow, Harvard Law School Program on Corporate Governance:
I think that the points here is that not only is the source of corruption from the potential corruption from corporate contributions, but as a much broader group of people and the threat to shareholders and to the market as a whole is significant. And you’ve also set out that there seems to be strong, but not sufficient support so far in Congress and among the SEC and the regulators, for change. Even though we know, more or less, what change might look like through the SEC – the Bebchuk proposal and the Disclose Act. So what would push it over into an actual policy action and you mention that we’ve had 1.3 million letters in terms of the SEC, there’s an interesting social media campaign on this, if you look at #whereismaryjowhite. But it has done the trick, and my frustration is that institutional investors firms spend tens of millions and people of the United States, ordinary voting, ordinary citizens, but we’ve never really been very good at translating that representation into political actions. What would make that happen? Is that a consequence?

Norman Eisen:
The issue is going to drive the institutional investor community into that political activism. It’s important to understand that these are not isolated issues. I started out, when I made my remarks discussing the President’s larger ambition to rebalance special interests and public interest. Many of the things you care about, the environmental issues, the social issues, governance issues, the United States is one of the leading, perhaps the leading standard setter globally. Those standards are set by Congress and the regulators and the playing field is tilted, in all of those areas, so if you’re concerned about climate change, campaign finance reform is even more fundamental.

That said, just the reality now knowing, having represented institutional investors in my previous law firm life, and now having been welcomed to the institutional investor family, all these years in the White House as Ambassador. I remember coming to an ICGN meeting in San Francisco, with a large box of materials that ultimately turned into this very good statement, or supported the writing of this statement on political lobbying and donations, and I don’t think this is going to be the one. The thing that will push us that last five yards over the goal line is going to be the external scandal. I think the system is just too frozen and we’re looking for that external scandal, and it will come.

Here is two other very quick notes to the previous question. Here is a chart showing the S&P 100 Firms Voluntarily Disclosing Political Spending and you can see that it’s gone up year, year, year after year, so the public companies are disclosing. In terms of what institutional investors can get, the specific things that institutional investors can get their portfolio companies to do, working together, and this is achievable; it’s all laid out on pages 12 to 14 of the ICGN Statement. There’s five categories of things that you can work for. It’s balanced, it’s moderate, it represents a variety of stakeholders input and I think it’s working.
So Stephen, that’s the good news. Institutional investors are doing what they can, but the kind of political activism, I hope to be proven wrong, but I don’t think – there may be another issue that will push the institutional investor community into that next step of activism, but I wonder if it will be this one. I wish it were.

Dan Bross:
I agree, I think there’s going to be some scandal, like Watergate, or perhaps the election of Donald Trump as President. It could show the absurdity of our current political system. I do think the continued decline of voters in the United States going to the polls, goes down year after year. I talk to people and they are just disgusted by Washington, and I think part of it is the role of money in politics. When Citizens United was first issued back in 2010, the assumption was the corporate floodgates were going to open and all this corporate money was going to rush into the political system, and that just has not proven to be the case. The individual and the money from individuals have flooded the political system and there are some well-known names here in the United States that are flooding that system with money. The American people are with us on this, but it’s going to require a tipping point of another sort of scandal, to really have the Washington policymakers understand that they benefited from this system but the people have spoken and now we really need to take some action.

Peter Swabey:
We had a scandal with MP’s expenses, where they were claiming for some fairly unlikely things, including a house for the ducks on his duck pond and that was apparently urgently needed for doing his job and so on and so on. So that’s really focused minds in the UK on what the people we elect are taking out of the system and I think that’s the sort of thing that may well happen elsewhere.

George Dallas:
Microsoft is one of the progressive forces in this debate, and I would encourage this audience to go online and find the ICGN guidance. We’re talking about disclosure as being one of the main activities, and we certainly would support that, but the ICGN guidance goes one step further and says that “Shareholders should be able to vote on a company's political donation policy, particularly, preferably, through a company proposed resolution, or secondarily, through a shareholder resolution.” Do you ever see the day in which a progressive company may, not only say, we’re going to disclose, but we’re also going to ask our shareholders to support us in these activities?

Dan Bross:
I don’t think the conversation, or issue is that mature here in the United States. I think we have a long way to go to even get some of the companies, even in our sector, who are all about sharing information, are not sharing the kind of information that we believe they should be sharing in this particular area. So I think we have a long way to go to get there.

Audience:
I think the nature of giving in other markets is very different than in the US and be careful what you wish for. I mean, I represent a typical investor Plc, I don’t think we want the vote. I’m not sure we can exercise it. Our other investors are not going to know how to do that and our system may raise the abuse of this quota, you may well hope you aren’t accountable, but you have to render a decision on that spending. And I’m not sure that’s an
effective tool and I’m not sure if the tool allows institutional investors to even want to go there, so, in the end, essentially rubberstamps it and that’s the problem I have about giving.

Peter Swabey:
That certainly is a challenge with our model in that the resolution that the shareholders approve is extremely general. So it’s a general approval that the company can use, for example, up to a £100,000 in potential political expenditure during the year. Most companies, because of the definitions, then come back at the end of the year and say, “Well, we didn’t actually use any.” But it is that if you ask investors to approve specific donations, you’re creating an environment in which they have to demonstrate a far greater level of knowledge that I think anybody could reasonably expect.

Conference Welcome

Erik Breen, Chairman, ICGN:
Thank you everyone and a warm welcome to all of you here at our event in Boston. It’s hosted by CII and in fact we are already on day three of our programme here as we have had a two day ESG Course delivered on the days before. That was hosted by State Street Global Advisors and I must thank Stephen Davis for all his efforts in running the ESG Course for the ICGN.

ICGN was established 20 years ago in response to globalisation by some of the worlds’ largest and most influential investors, and actually, it was at the fringes of a CII meeting at the Watergate Hotel by then. They wanted to understand more about the jurisdiction they were sending their money and to collaborate more effectively. Today after 20 years, our members span 47 countries, with investors responsible for assets in excess of 26 trillion US dollars, and this includes around 30% of members from the US. Our mission is to inspire good governance practices worldwide and we do that through influencing policy, connecting people at events like this and through informing the governance debate on governance development.

Today we gather here with over 150 people and they are joining us from over a dozen different countries. We have a very strong programme for you today and we look forward to your active participation.

I’m delighted also to see so many familiar faces, so many of our ICGN members, who have been dedicated in attending our conferences over the many years. And it also includes a good number of our friends among the corporate community. BHP Billiton, Prudential, Pfizer, Microsoft, Pepsi, Chevron and of course we are very honoured to have Ellen Kullman, CEO of DuPont, who will join us for the joint ICGN CII keynote address.

I would like to thank CII, our host, for co-ordinating this event with us, with the Secretariat, and I wish them every success with their own event, which starts with joint sessions with ICGN later this afternoon and goes through to Friday. I would also like to thank our sponsors and without whom we could not have produced this event, and that includes also BHP Billiton, Broadridge, CAQ, MSCI and Sustainalytics. I’m also grateful to our speakers, who have committed much of their time and effort in preparing for today’s discussion and it is promising. I have already attended a breakfast panel, focusing on audit committees and it was thought provoking indeed and had good insights, one of those was that investors also need to step up their part in setting audit standards and also, in reaching out to regulators on audit matters. We can do a better job ourselves there.
For the coming years, we have set ICGN’s policy priorities and I would like to extend my thanks to all the committee members, the committee Chairs and George, for pulling this altogether into four policy priorities.

First, the priority for the ICGN over the coming years is to protect minority shareholder rights and we do that in the context of promoting long-term investment perspectives. This addresses the growing concerns around the rising tide of the debate about the introduction of differential voting rights, particularly in Europe, but also around the world, and it also addresses the role of investors, to properly incorporate long-term factors into their investment analysis and their decision making processes. We have a session on that today, hosted kindly by Sustainalytics.

Secondly, make successful stewardship reality. We cannot expect to have shareholder rights without having and acknowledging our shareholder responsibilities. Those are two sides of the same coin and it was already recognised by a person, no less than John D Rockefeller about a century ago.

Thirdly, culture and ethics and how this shapes investment thinking and behaviour. Many of you have probably just attended our breakfast session on political lobbying and on donation. In fact, we have a roundtable on a similar topic subject in London, in December and that will be jointly with IOSCO and all the regulatory bodies as well.

The fourth policy priority is promoting robust reporting, audit and metrics. The breakfast panel I just attended was kindly hosted by CAQ and that was on the role and transparency of audit committees. In addition, our own Policy Committee is currently focused on drafting our response to the IFRS Conceptual Framework and ICGN is a staunch reporter of integrated thinking and integrated reporting. So this concludes our four policy priorities.

The ICGN is your network, to voice your opinion and to influence public policy on all these matters and on important matters around the world. We reach policymakers and regulators around the world. The ICGN is your network to stay informed. Our ESG Course yesterday is a very good example of that and more resources and valuable information is accessible through our website and through our yearbook. Perhaps most relevant for you today is that the ICGN is your network to connect, and I wish you a very good conference and I wish you a very fruitful, inspiring and thoughtful connections throughout this day. And on that note, I would like to hand over to Kerrie. Thank you [applause].

Kerrie Waring:
Thank you, Erik, and it is wonderful to see so many ICGN members here and for those of you who are not ICGN members, please do come and talk to me, or Erik, or any other member here and we’d love to involve you as part of our network. So, this is a really special year for ICGN. It’s 20 years since we were established and I think it’s an opportune time to reflect on the core pillars of corporate governance. These original pillars defined 20 years ago, were defined by the great Ira Millstein, Adrian Cadbury, Bob Monks and they said, “There’s four core principles we need to think about, when we think about corporate governance.” The first thing they said was, “If companies want to have access to capital, they need to have transparency,” and this goes beyond the financial statements. If you really want to decarbonise your portfolios, you need access to carbon emission information. You need to understand long-term risks associated with water scarcity, demographics. We’ve got a session on this, hosted by BHP and also Sustainalytics are running a panel around how investors are integrating those risk factors into their long-term decision making.
Secondly, markets need to establish sound principles of accountability and that really does depend on which jurisdiction you’re sitting in. I think it’s fascinating to watch the developments around proxy access here in the USA and it’s wonderful to see such developments, but I do want to point out that the US is in fact an outlier in this regard. Almost every other developed economy has the very basic right that shareholders are able to appoint and dismiss Directors on the board. So, ICGN will continue to engage with the SEC and support any of your initiatives in the CII, in this really important matter.

The third principle was fairness and this is really about the equitable treatment of shareholders and, I guess this is probably an area where I think it’s fair to say, we’re actually in regression. As Erik’s just said, you know, there’s a huge discussion in Europe and around the world around the introduction of differential voting rights and ICGN is strongly against any mechanism that leads to voting control, disproportionate to a shareholder’s economic interest in a company. And particularly, this is acute in controlled companies, where voting rights can entrenched management and dilute accountability to minorities. That’s you who are the minority institutional investors in this regard. Jamie Allen is going to lead a panel talking about all of the regional initiatives that are taking place around this subject and it follows a keynote from Lucian Bebchuk.

The fourth, and perhaps most important principle that Adrian, Ira and Bob and others introduced us to, was the basic concept of responsibility. I’m not really talking here about corporate responsibility, I’m talking about investor responsibility and two years ago, we dropped the word ‘corporate’ from our Global Corporate Governance Principles. It was a bit radical at the time. It’s now the Global Governance Principles. Not only do we focus around the governance responsibilities of issuers, but also the governance responsibilities of investors. We’ve had a set of investor responsibilities since 2003, and it has been revised over the years. At the board meeting yesterday, we have agreed to publish a new set of principles, relying much on the work that’s already been done, but brilliantly and succinctly reproduced by George Dallas, our wonderful Policy Director. We’re going to be launching and consulting with members on an ICGN global stewardship code over the coming weeks and we’ll be looking for member approval for that in June.

Thank you all so much for being here. This is just such a treat to be here, ahead of the CII meeting taking place, who are good friends, who are our founding members, we’re very grateful for that support.

**Plenary 1: Global proxy season round-up and impact on US agenda**

*To what extent has global investment impacted the US proxy season? Has the wave of shareholder proposals on proxy access paved the way for stronger rights? Will this address board quality and competence on critical issues like climate risk, independence and diversity?*

- Louise Davidson, Chief Executive Officer, Australian Council for Superannuation Investors
- Paul Lee, Head of Corporate Governance, Aberdeen Asset Management
- Ann Mulé, Associate Director, John L. Weinberg Center for Corporate Governance, Lerner College of Business and Economics
- Zach Oleksiuk, Head of Americas, BlackRock
- Chaired by Darla Stuckey, President and Chief Executive Officer, Society of Corporate Secretaries and Governance Professionals
Darla Stuckey, President and Chief Executive Officer, Society of Corporate Secretaries and Governance Professionals:
We’re going to talk about board composition, what people want, what makes a good board, how activism works into that, how independence works into that. Then we’re going to talk a little bit about engagement. Then we’re going to get to proxy access.
Ann, why is Board composition important?

Ann Mulé, Associate Director, John L. Weinberg Center for Corporate Governance, Lerner College of Business and Economics:
We held a programme at the Weinberg Centre last October and we invited Bill McNabb, the Chairman and CEO of Vanguard, to speak to us about Vanguard’s views on corporate governance. He said that “The single most important factor in good corporate governance is board composition. Who the Directors are, what skill sets they bring to the table, and how they interact. These factors are crucial from a long-term value perspective.” And all the other protective governance measures, that we have, are really there in case we don’t get the right people in the room.

If you think about those protective, structural governance mechanisms for example, like majority voting, usually the harm has already happened. The company’s blown up, the scandal’s happened, shareholders have lost a lot of money, and it’s really only then that we say “Oh, well, let’s have a withhold campaign and hold those Directors accountable.” But, it’s more or less too late. It’s good prospectively, but the harm’s already occurred and so the importance of good board composition is paramount to ensure the directors can effectively oversee the evolving company strategy, evolving company risk profile and to oversee management.

Louise Davidson Chief Executive Officer, Australian Council for Superannuation Investors:
Just because you have the right skill sets in the board, doesn’t mean you have an effective board. The right skill set is a foundation but in addition to that, you have to have effective board processes and an open board culture.

Darla Stuckey:
I’ve long said that corporate governance is about getting the right people in the room and that includes the right managers, the right people presenting and they’ve got to have the right information. Paul, assuming that board composition is foundational, who should be on a board? What kind of experience are you looking for?

Paul Lee, Head of Corporate Governance, Aberdeen Asset Management:
I think what we’ve said is clearly right, that governance, fundamentally, is people and it’s about how those individuals interact and whether they form more than the sum of the part. In good boardrooms, there’s a kind of alchemy that goes on, that you have this whole range of raw materials that is forged together through discussion and debate and at the end of that, hopefully you get gold, sometimes you get something that’s rather less than gold. You have to meld a range of skills and a range of experiences, and I think one of the frustrations, looking at US boards, is that there seems to be this mind-set that the only people capable of going on boards, are people who have already been Chief Executives of major companies. You’re missing the range of perspectives and understandings that will really help a board see the company from the perspective of its employees, of its other stakeholders. It is
important that the board that thinks about the company in a broader context and you’ve only

got that if there is a range of experiences. This kind of diversity, in the broadest sense of the
term, will enable a board to be forged into a form of gold.

Zach Oleksiuk, Head of Americas, BlackRock:
I’m not sure if that in US public company boards there’s an under focus on adding only
CEOs, or a focus of adding ex-CEOs on boards. I don’t think that board members should
necessarily be added, because of a singular area of expertise or focus. Clearly, not every
individual can be all things and so you need the range of perspectives that’s already been
discussed here. And importantly, that’s relevant to where the company is going and the
oversight and advice that management needs, from the Board of Directors, to protect and
drive long-term value.

I think it’s really a balancing act. A board seat is a very valuable thing and they need to be
very careful about who they add, because they need an explicit perspective on the board,
versus where they can gain outside advice, without actually putting somebody on a board.
So clearly, an individual must, as a baseline, be able to contribute to the deliberation on
strategy and the oversight of the strategy and the deliberation, and the selection of the
leadership of the company, some of these very core, fundamental objectives of the Board of
Directors. That is a must, so, regardless of your expertise in cyber security, or financial
expertise, etc., you must be able to contribute substantively in those core areas.

Louise Davidson:
I think that one of the things that’s interesting about the gender diversity push, is that it has
started to lead to greater diversity in a broader sense in Australia. I think only 4% of the top
200 company CEOs are women, and so that is not providing a pipeline of women to go on
boards, therefore women are coming from other backgrounds. So it’s providing diversity in
background, and it’s also starting to provide some age diversity, because typically, a lot of
the women being appointed to boards are a little younger than the male cohort that they’re
joining.

I think the gender diversity push in Australia is starting to gain some real momentum, but it
came from a pretty low base. In the early 2000s, something like 80% of board appointments
were people who were already on a board in the same part of the index. So, it was a really
small and concentrated pool of the same people agreeing with each other. Do board
members need to like each other? My view would be, not necessarily, but they need to be
able to challenge each other and they need to be able to do it respectfully. If there’s too
much liking going on and too much going out for dinner, that could be a little cosy and not all
that constructive, in terms of challenge.

We’re campaigning for 30% of women on boards by the end of 2017. Half of our top 200
companies only have one, or zero women on their boards, so they’ve got some way to go.
We’re engaging strongly with them and we are starting to see a shift in attitude. I think it’s
going to change the way boards are comprised, in a much more significant way than just the
gender piece. There’s often a dichotomy established on the gender diversity debate
appointment on merit i.e. you can either have merit, or you can have women. I would argue
that if you were appointing on merit, we’d have 50% women already.

Paul Lee:
And there was a great quote from one of your Supreme Court Justices, talking about, we’ll only have equality when you have all nine members of the Supreme Court being women, because nobody raised an eyebrow when they were all men, so, why wouldn’t you have all nine being women? And, you know, I’m not sure that 50% should be the limit. We need to find the right people, the right people that can bring debate and discussion and value to boards.

Ann Mulé:
Using the skill sets paradigm for Board composition, really focusing on what skill sets do we need and then trying to fill the gaps, really goes a long way, in terms of broadening the pool, from a diversity perspective. For example with oil companies, obviously a big risk area is health environment and safety, and that’s why most oil companies have board level HES committees. It makes for a much richer discussion at that committee, if one or more of the Directors, preferably the Chairman, really knows a lot about health environment and safety. If the nominating committee, said “Oh, search firm, we want a Director with deep HES experience” here ours is lots of women and people of colour that have deep HES experience. So I think that the skill sets paradigm goes a long way.

Darla Stuckey:
There is also a school of thought in the US that says we’ve gone too far in independence, because we now have folks, opera singers is the famous example, on boards that don’t know anything about banks, or oil companies, or Burma. So, maybe we should have more folks from inside the corporation sitting on the board. Right now, I think most US companies have one or two, maybe a couple of companies have three, but it’s pretty much just the CEO and maybe one other person, maybe just the CEO. So I wanted to have a little bit of discussion around that, because the UK has a very different model, where Directors are considered independent only for, I guess, nine years, or up to nine years, and then they’re no longer independent, which helps refreshment. How does that work, Paul?

Paul Lee:
The UK model on Executive Directors is, essentially there are always two with a few exceptions. There are always two Executive Directors on nearly every board; The Chief Executive and the Finance Director. There’s strong encouragement to have at least one other Executive Director on a board in the UK and that drives that the suggestion is a different dynamic in the boardroom. There’s less funnelling of information and insight into the company through the single individual, who’s the Executive Director, and the board gets to probe and understand the business a bit more. And there is a marked difference between those individuals being full Directors, and just being in the room as guests.

Darla Stuckey:
I think if we’re going to look down the road five, or ten years, I do think we will see three insiders. Three is a good enough group that you can actually make a difference, and you can actually ask the really tough questions. And I know of Corporate Secretaries that know the company best, are the ones that can really handle the CEO, or Business Line Head, that wants to go off the rails and issue a product that’s not going to work, or do something that’s not going to work, and they can say “We tried this 20 years ago and it didn’t work, what’s different and what’s the exit strategy?”
Ann Mulé:
I think it’s really important that the outside independent Directors have the expertise. My one concern is, at the end of the day, all those insiders get their performance ratings from the CEO and so, they’re not independent and so, you have to weigh that. Although, I do think sometimes we used to invite a lot of the Senior Officers into the boardroom. They didn’t have the title as a board member, but they were there for much of the meeting, for much of the reason you’re saying.

Zach Oleksiuk:
Directors need to be relevant, right, and so that is a consideration, when you think about putting, a retired Executive, whether from they’re from the inside, or from another company, onto a board, the longer they’re out of the game, the greater potential that they may no longer bring the precisely relevant perspective that is needed.

So, on independence, and it’s clearly, pretty widely accepted that for the Directors who are meant to be the independent overseers of management, that they should not be subject to material conflicts of interest that would lead them to put their own interests, or management interests ahead of shareholder interests, and their fiduciary obligations. Outside Independent Directors need to know the right questions to ask, they need to know when they need to seek help from an outside advisor, they need to be thoughtfully engaged in how they’re getting the information they receive from management. Clearly, it’s management’s responsibility to provide that information, but a board needs to know that it’s getting the right information. This is not directly related to independence, but I think it’s really important that we recognise the amount of work that it takes for Directors to, essentially, get up to speed and learn a business, especially in large global complex businesses.

I hear from many Directors that it can take up to two to three years before those Directors are fully contributing in boardroom discussions and so I think, for shareholders, we should be asking companies, what are you doing to get Directors to be fully contributing? How are you being helped and examples would be having board meetings in different parts of the world, taking Directors around on site visits, giving Directors access to layers of management beyond the C-suite. So this is all, substantive processes that we’re looking for, that go beyond, is this Director independent, yes/no.

Darla Stuckey:
Boards do need a lot of orientation, they need education and it does take them a few years to get up to speed. When we think of the continuum, five to seven years, board members are really doing well then and really can contribute by the fifth, to sixth, to seventh, eighth year, so to think that we lose them after ten is difficult. I wanted to go back to the management, where they get their knowledge from, because at the University of Delaware, they’ve written a paper on, where they use this term, management knowledge captured board, so, the idea that the board is only getting their information from management and somehow that’s not necessarily good enough, or it could be tainted or conflicted, so Ann, tell us what you mean by that.

Ann Mulé:
As a result of all the corporate scandals in the 2000s, Congress and the regulators, really took the position that independence is the panacea. That if you have independent outside Directors on a board, that will be the cure-all and prevent these sorts of things from happening again, and to prevent a management captured board. Independence is critically
important but it's not enough. And now there are some boards where it's almost gone the other way, from a balance perspective, where you have a board, comprised of independent outside Directors, none of whom have industry expertise. None of whom know the underlying business at all, other than what they're going to learn through training, which is helpful.

But the only one who knows the business, is the inside CEO. So, the idea is that the inside CEo is capturing that board through his or her knowledge. And what's scary about it, is that a lot of times, outside directors don't even know the right questions to ask, because they don't know the industry really. The point is, it's just as dangerous when you have a management capture board, the Directors might know the questions to ask, but they're not asking them, because they're in the hip pocket of the CEO, while in the management knowledge capture board, the questions are still not getting asked, but for different reasons a lot of times, because again, perhaps they don't know the questions to ask.

It's almost like the Audit Committee Financial Expert, that's a case where I did agree with what was done, because it really by law and regulation, you have to have someone with a really deep accounting knowledge in the audit committee, and I know I found, from being in the audit committee, the questions were much tougher, the discussion was much more robust, and I think, ultimately, we ended up in a much better place, and so I'll use that analogy.

Paul Lee:
I'm vigorously agreeing, but just reflecting on Ann's comment about independence not being enough, which is clearly right. I think it's a debate that's going on very actively in Japan at the moment, where finally, after many years they have a Corporate Governance Code in Japan now. They are encouraged to have two Independent Non-Executive Directors. They don't really know what that means and they don't know what the Non-Executives are there for. So they're appointing independent individuals, but in a lot of cases, they're not necessarily individuals that are suited to add value to the board and add value to the business. The example that's been brought to my attention most vigorously is the karaoke business, one of whose independent Non-Executive's is a pop starlet. My concern there is that, we're in danger of the whole role of the Non-Exec in Japan being dismissed, because you've got a lot of individuals who are, yes, independent, but not going to be adding practical value to the board, and that's a real challenge and a real concern.

Zach Oleksiuk:
I certainly agree that having strong independent leadership within the board is vital, and in this market, I'm sure many in this room are familiar with the fact that that there are not many independent Chairmen. The more common independent leadership practice in the US is having a lead Independent Director, who does not lead the board meetings, but essentially co-ordinates the activities of the Independent Directors and increasingly serves as the voice of the board in this trend towards increasing shareholder Director Engagement in this market. And I support the ability for companies to choose the appropriate leadership structure for their board.

I think some important considerations, beyond what has really evolved as to be a check box approach to the role of the Lead Director. It's really about making sure you've got the right individual in that role; Somebody who has exhibited strong leadership, who will be able to challenge the management, both in board meetings and privately, but also work constructively with management. I also think it's really important that roles are made very
clear. I fully support the notion of having industry experience on the board, but we need to make sure that there is a clear delineation of responsibilities between the CEO and board leadership and so I see potential pitfalls if there is ambiguous leadership in the boardroom and within the company.

Louise Davidson:
The Australian situation is quite different to the US situation, where it is the norm in fact to have separation of CEO and Chair and the way I think about it is, so, what are the fundamental roles of the board? And one of them is the appointment and oversight of the CEO, and I just wonder how effectively that can happen, how much challenge there can be in that, if the CEO is also the Chair of the board? The second important role of the board is as the representative of the shareholders, and again, I just wonder, with that coming together of management and board positioning, I feel as though that capability is diluted as well.

Paul Lee:
I very strongly agree with what Louise has just said. If you come to my analogy of the alchemy of a board, the alchemist is the Chair and that individual, their role is to make the board work, to get the best out of each of the individuals, to draw them out, to get the diversity of skills discussed and debated and all those perspectives coming into play and in board discussions, is a very different skill from running a business, and why distract the individual from running a business, by this hugely different and difficult challenge of getting the best out of a boardroom discussion? I think you're just setting yourself up for problems. Is it a panacea to split the roles? Clearly not. We've had plenty of scandals, in all sorts of markets in the UK and Europe, elsewhere, where you've got a division of roles, but you've got a better chance of having that debate and that challenge more effectively if you've got the roles split.

Darla Stuckey:
In the US we're kind of unique, and I think what happens on a company by company basis, it becomes a bit of a personal referendum on the individual in that position at the time, and it's sometimes hard to get things separated and there are other procedures that you can do. You can split the roles when that person leaves and that's something that some US companies may do it, but this is a kind of slowly moving event.

Paul Lee:
I do find it interesting, as you rightly say, when these questions come up they tend to become a referendum on the individual, or be seen in that way, but there's no real need for that to be the case, but it's, frankly, the individual's ego that makes it the case, and that again, just emphasises the challenge of the two different roles, because, for a board to work properly, the Chairman's got to be, at least in part, without ego. They've got to be drawing everybody else out around the table, and not imposing their own individual view. We like our Chief Exec's to have a bit of ego, that helps drive the business forwards. It's not what you want in the boardroom.

James McRitchie, Corporate Governance (CorpGov.net):
Given the importance of the governance nominating committee, are those positions the most highly paid on the board, the Chair of those committees?
Darla Stuckey:
The audit committee Chair and the comp committee Chairs are paid additional fees, typically because there's twice as many audit committee meetings, as there are anything else, and when companies left the per meeting fees, and gave us set annual fee, they baked more in for audit committee Chairs and audit committee members. Also, for comp committee Chairs and members again, because comp, they basically have more work. It could be the case that nom and Gov committees are going to get.

Ann Mulé:
Well, I think it's a really good point, and I think the reason that they have historically not gotten as much, is because it wasn’t perceived as a committee where as much time was spent, and I assume that's what you were alluding to in your question. I think as investors and boards more and more focus on the absolute importance of this issue, and they need to spend more time on skill sets and really would like to see it where every year you have the new long range strategic plan approved and at that point, you're also, as a board, focusing on the more recent risk from the ERM, Enterprise Risk Management, 'cause you're getting ready to file your 10k, it would make logical sense, to have baked into the board calendar, you know, the next Governors’ Committee Meeting, let's look at that, let's update the skills matrix, what new skills do we need? Where do we have gaps, and then have a long range strategic plan for our Directors and skill sets? Now, I do know some companies have this, but I think a lot of companies do not, and I think it's so important that they should be, in my opinion, getting paid the most. But I don't think we’re there yet.

Zach Oleksiuk:
I think underlying all of this discussion is that the nature of board service, and the time it takes to serve on a board, whether it’s the NGC, or the comp committee, audit committee, etc., is significantly different than it was five, ten, 15 years ago. Investors have a much heightened expectation of Directors, and Directors have, not only a whole new slew of regulatory matters to comply with, but also have to meet the expectations of investors and ultimately protect the value of the – seek to protect the value of the enterprise. And so, we do at BlackRock, pay keen attention to the number of boards that Directors serve on and we have seen the number of boards that Directors serve on coming down over the years, and I think we need to continue to see that trend, because I think, having served on at least one board is a good thing, I think it’s good to cross-pollinate ideas. I think that it’s reasonable to pay Directors more for the additional work that we are asking of them and I think that companies in turn, should set lower limits for the number of outside boards on which Directors will serve.

Darla Stuckey:
The last issue we have to touch on is the effect of activism on it, and Zach, I’m going to turn to you; Has it affected it? Is it the case that boards who are not targets of activism, nevertheless, are watching and trying to prevent activists by putting certain people on their board, or considering certain people on their board?

Zach Oleksiuk:
Activism is a key theme in the US market. It’s not limited to the US. I think we are seeing, as the case at Samsung recently and others, you’re seeing primarily US based activists,
targeting ex-US companies, but in any event, just for some context, in the US alone, over the past year or so, it’s estimated that there’s about 300 companies that have been targeted in some way by so-called hedge fund activists, who are reported to have, somewhere between 120 and 200 billion dollars of their assets under management. So if you look at the 20 trillion dollar value of the US equity market, it’s a small sliver, but it really, is having an outsize influence on boardroom and company behaviour for a couple of reasons.

In some instances it sounds right, activists are doing a much deeper dive than even your typical active equity investor. They’re very concentrated portfolios. They come to a board with a slew of ideas, whether it’s strategic ideas, change in leadership, buy back your shares, financial engineering, and some boards will push back and say, you know, these are just bad ideas, we’ve considered them and we’re not interested. I think good boards will listen to the ideas brought by activists, or any investor for that matter and will engage, more broadly with their shareholder base and really seek to understand the range of perspectives. Because activists do not, in my view, represent the shareholder voice, as many purports to represent and ultimately, a board needs to come to its own conclusion as to the right strategy for the company. But what we are seeing is an increasing trend towards settlements with activists in the US, whereby boards are inviting activists in and, in some instances, it may be ‘cause they just do not wish to fight. I don’t think that’s a good thing.

In other instances though, it may be because the board takes a good look at their composition and that leadership of the company, where the company’s going, says you know what, we need this, and good for them. So, I think ultimately, it’s about how the board communicates their deliberation and their ultimate decisions to shareholders. Beyond the 300 companies that have been targeted, there are likely thousands of companies now that have engaged outside advisors, to great expense, that are running fire drills, where they’re flying their Directors, from around the country, into corporate headquarters, to run a two or three day, what if we’re targeted by an activist? There could be some value in this exercise, but I do question whether that is the best exercise and use of Director’s time.

**Darla Stuckey:**
Not only that, there’s folks creating, sort of, dossiers that they’re selling to banks and Portfolio Managers and, sort of, a scorecard on whether you’re weak and a potential target for an activist and then, now they’re also selling into the boards, so that they can know if they have a certain score. I don’t know if it’s ubiquitous, but it does seem to be one way to change board composition. Zach, the settlement you referred to typically do they involve a new settlement meaning allowing someone from the activist firm on the board?

**Zach Oleksiuk:**
It depends, really. First of all, activist is a term that can mean many things, and there’s a wide range of, MOs, within the activist community, hedge fund activist community. Sometimes it’s the addition of a principle from the activist shop, sometimes it’s the addition of mutually agreed upon Independent Directors so it can be a good thing. As sure as we want to vote in every contested situation on the election of these Directors, because proxy contests are expensive, they are disruptive. I think they are damaging, at least in the near to mid-term, to shareholder value and, depending on the outcome, the long-term as well. So, it’s challenging.

**Louise Davidson:**
It would be very rare in Australia. There might be occasional examples of it, from a hedge fund perspective. There is a growing, what we call activist campaigns, tend to revolve around.

**Paul Lee:**
We’re certainly seeing a continuation of activism in the UK, less so in Europe. I think the shareholder rights in Europe are less conducive to this, but there certainly are activists busy in the UK market. Not all of them US based, quite a lot of them are, exporting the money that they’ve raised to another market, where they, sort of, see an analogy of the rights and influence that they can have. So, it’s definitely active. I often talk to boards who face these sorts of challenges and encourage them to think of the positives and to think of how they can learn, how they can challenge themselves. It brings another perspective into the room for them, and that can be useful. Sometimes it’s value destroying because it is a distraction, but often there is a kernel of truth in there and the mainstream investors, if I can differentiate between the activists and the rest of us, that the mainstream investors will only listen, and the activists will only have influence if the mainstream investors are listening. The mainstream investors will only be listening if the company is failing to deliver in some way, so it’s good for the board to step back and to ask itself the question, what can I learn in this circumstance?

**Ann Mulé:**
And I think the other thing, before we leave the topic of activism and the impact it has had on board composition is that, over the last couple of years, we’ve seen a number of activist fights where they really have focused on the board as another one of their tools and their toolkit, and really successfully have made the argument, look at the current board. The reason the company’s not doing all that well, is because the board’s not holding them accountable, because the board doesn’t have, for example, industry expertise. No one on the board has industry expertise. So, they’re not asking the right questions. And look at our slate, and they’ve been able to get Independent Directors, who are actually CEOs or former CEOs, who years ago wouldn’t have agreed to stand on a dissident slate, because they would view it as reputation tarnishing. Now, all of a sudden, since activism’s becoming more mainstream, you see these people agreeing to go on the dissident slates. So now they’re putting up slates that have these really excellent candidates, that have all the Director skill sets that are needed in order to turn the company around, or execute a strategic plan, and then, from a shareholder perspective, they’re, kind of, making it a little easy for the shareholders, if you will, to support the dissident slate. So, that’s another reason why boards need to be proactive themselves, because they’re leaving themselves wide open, also from a board composition perspective.

**Ric Marshall, Executive Director, MSCI:**
What about beta activism? You’ve focused entirely on alpha, where a specific company is targeted, presumably for reasons of improving performance. I’m thinking about proxy access, or broadly classification, where there are multiple targets, presumably with the idea of elevating standards across the entire market.

**Zach Oleksiuk:**
I think my reaction is that in this market, in the US in particular, we don’t have a well codified set of accountability mechanisms. You touched on proxy access. We view proxy access, first and foremost as an accountability mechanism. We view majority voting, the regular
election of Directors, all of these are accountability mechanisms. So, certainly, given that we don’t have well codified accountability mechanisms, one approach is through so-called beta activists, I assume you’re referring to shareholder proposal campaigns, etc.? Essentially, what we’ve seen this year with the private ordering of proxy access.

In my view, it’s necessary, because we don’t have these rights enshrined in this country, and to the extent that we do have meaningful accountability mechanisms at companies, shareholders will be judicious in their use of those accountability mechanisms. So, one thing that we haven’t touched on much in this panel, is the rise of engagement and the engagement dynamic in the US marketplace. In the past year, the BlackRock Corporate Governance Team in the US has engaged with nearly 700 issuers, and that’s about half of the inbound requests we get to engage. We do find that building mutual understanding over time on governance issues, and really, very importantly, how the chosen governance regime and governance structure in a company is meant to create value over time, I think can be quite beneficial to all involved, in driving value over the long-term, and then when boards don’t get it right, shareholders have those accountability mechanisms that you’ve referenced.

Louise Davidson: Yeah, I definitely agree that, from ACSI’s perspective, we find that that long-term constructive engagement is really, quite effective. But I think that the rise of the NGO campaigns, which are non-Government organisations, I assume that’s what you’re referring to here, targeting boards on particular issues. I think that that is really causing boards to focus and often they’re – the work they’re doing in these areas is quite effective, but they have really failed to explain to anyone what it is that they’re doing, and so it can be a good reminder to them to do that, and sometimes they just really need to focus more on that particular area, because it turns out it’s of interest to a whole lot of mainstream shareholders, as well as the activist ones.

Lucian Bebchuk, Friedman Professor of Law, Economics, and Finance, Director, Program on Corporate Governance, Harvard Law School:

Thanks a lot, George, for this kind introduction. I’m going to discuss controlling shareholders and the protection of investors and our programme is setting up a research project on this subject and doing so, is motivated by our belief that there has been insufficient attention by the corporate governance community around the world to this important subject, of core business controlling shareholders. A fair amount of attention, but still insufficient relative to its importance. So I’ll briefly talk about some of the research that we’ve already done and some of the research that is now in progress, or planned for the future.

Core business controlling shareholders are extremely important and especially for the ICGN audience, that brings together investors and others interested in governance from around the world. So a substantial fraction of the public traded companies in the US, and a large majority of public traded companies around the world are companies that have a controlling shareholder, I call them CS companies. In understanding the governance problems of such companies and what rules and arrangements are best for them, is therefore of great importance to ICGN members and unfortunately, most of the attention in the US or the Anglo American literature has been on widely held firms. And even so, many people think that one can extrapolate from this literature to companies with controlling shareholders, I’m going to suggest to you in a minute that this extrapolation isn’t really – I mean, often is impossible, and often might be misleading, so this literature is of limited relevance for people who are focused on companies with controlling shareholders.
To say in the next seven slides is based on a paper that Assaf Hamdani and I already published, titled The Elusive Quest for Global Governance Standards, and the key point that we were trying to make, is that the difference between CS companies and widely held companies, has not been adequately taken into account in the design and use of governance metrics, in the design and use of methodologies for approaching governance. And that’s because the governance arrangements that are beneficial for CS companies, might well, often are, either irrelevant or even counterproductive for the other type of companies and vice versa.

In particular, this means that the global metrics that have been extensively used by scholars, by advisors, by practitioners, for example, if you look at academics, or the Anti-Director and the Anti-Self-Dealing Index of De La Porta [inaudible – 07:05], or the quick score of ISS, those metrics, when you look at them closely, you see that they don’t really provide you with an effective tool for assessing governance around the world. And indeed, it’s not just that they didn’t do it right and one can find some metric to do it right, it’s really that any governance metric that you try to apply to both CS and widely held firms, is going to miss the mark, either for one type of companies, or for the other, or for both. And therefore, we shouldn’t really look for global governance standards, but really develop separate methodologies, which we’re trying to do in that paper, for assessing governance in CS firms and widely held firms.

Let me try to persuade you of the validity of these teases by going very quickly, if anyone is interested, you can look at the articles I’ve just mentioned, but looking at the number of issues, so take for example, contestability of control. So control is contestable in widely held France, but it’s locked by definition, in CS companies. If you look at most of the governance metrics, they pay a lot of attention to whether or not there are various anti-takeover provisions in place, whether or not you have appeal, or staggered boards and so forth, and those things might well be important for companies that are widely held, they are completely irrelevant for companies and for CS companies.

Take the nature of the agency problem. The fundamental agency problem in CS companies is protecting vis-a-vis of the controlling shareholder. In widely held companies you are concerned about managers. What does that imply? It implies that rules and provisions that increase the majority of the shareholders, which is something that many reformers in the US have been trying to get, I think that protect public investors. But in a CS company, if you give more power to the majority of the shareholders, you give even more power to the controlling shareholder vis-a-vis the board, and that might well be counterproductive.

Take a look at the existence of collective action programmes. So, if you have a widely held firm with shareholders distributed and perhaps even sometimes dispersed, then you have collective action problems that might impede the ability of a shareholder majority to exercise its powers. That’s the case in a widely held forum, but not in a CS company. This means that various rules, provisions, reforms that facilitate the ability of the majority of the shareholders to have, let’s say, a proxy access reform, might be beneficial for a widely held firm, but it’s generally irrelevant in a CS company.

There are other areas of corporate law that I could go over, but I think that what I’ve said might illustrate for you that it’s probably the case, that if you look at any area of corporate governance, and most legal rules in governance arrangement, you’ll see that they play out differently and different rules might be optimal and counterproductive in CS companies and widely held firms. So, from that and I should probably skip the slide, you can derive a very different methodology, a very different metric for assessing if you’re coming to a CS
company, you should look at it very differently than you look at the widely held firm, and you should have a very different perspective.

Now, the next point that I would like to make, that for assessing the large number of public traded companies that we see around the world, including in markets with most companies of that nature, it’s important, not only to recognise that CS companies are different than widely held firms, but also that CS companies can be usefully broken into subsets. They differ markedly and again, call for a different methods of assessment and different perspectives from investors and their advisors. And I’ll talk about two distinctions. Two ways of separating different types of CS companies. So one is, that CS companies, where you have a separation between cash flow rights and voting rights, that’s the subject of the next panel. Those are companies where control is logged in the hands of a controller that has just a minority of equity capital [inaudible – 12:43] label those controllers, controlling minority shareholders, because they have control, but they are really owners of a minority of the equity capital. Those companies are very different from companies where you have a controlling shareholder that has majority ownership and they pose especially large governance risks.

The reason for this is twofold. That if you look at companies where you have a controlling minority shareholder, then if you can trust them with widely held firms, the insiders are not subject to removal, to the discipline of the market for corporate control and therefore relative to those firms, agency problems are likely to be more severe. And if you compare them to companies where you have a controlling shareholder that has a majority of shares, when you have a controlling minority shareholder, that shareholder is not managing mostly his or her own money, which is the case for the majority shareholder, and therefore their financial incentives to do things in the alignment of interest, is much less good than a company that has a majority shareholder.

Indeed, in early paper, with [inaudible – 14:02] we show that when you have separation between cash flow rights and voting rights, then when the fraction of the equity capital that the controller earns goes down, and we know that there are many companies with separation, where the controller might own as little as 10% or 5% of equity capital. So, when the fraction goes down, the severity of agency problems not just increases, but it increases more than proportionately. It really grows almost exponentially. So, we have to worry about those situations and in current work with [inaudible – 14:45] we further identify within the set of companies with controlling shareholder, situations in which dual class structures are especially pernicious, when the separation of cash flow rights and voting rights is especially extreme, or when the time sees the passage – sees the IPO, is especially long.

Let me talk about – let me conclude by talking about yet another distinction that I think is important for people in this room when they approach a company with a controlling shareholder. The critical dimension that I would like to touch on now, is whether the controller owns substantial business assets outside the controlled public company. So many people in the literature are saying, what’s important for us is when you have controller and what is the fraction of the equity capital the controller has, let’s say 25%.

In a kind word with Assaf Hamdani and the limits of limiting controlling shareholder, what we show that it makes a huge difference whether there’s 25% owner, the controlled public companies really the main business asset, and they don’t have other assets, or whether this is just one asset and they have other companies, or privately owned businesses, where you could imagine various complications. And our claim that agency problems are likely to be much more substantial when you have business assets outside, than when you have a standalone CS company. So when you think about, say company with differential voting
rights, you might think differently about, say, Google, or Facebook, where that's really the main business asset the controller has.

Then another corporate, it might be in a similar line of business, but where the controller, let’s say Ali Baba were the controller, might have substantial business assets outside the publically traded company. And what we conclude, that when you have a lot of business assets outside, the potential for a transfer of value or the potential that the interest of public investors will be sacrificed, is much greater and moreover, it’s very difficult, even if one could adopt potentially any reforms one would want. It’s really difficult to limit the transfer of value and the deviation for value maximisation, without rules that are so intrusive and costly that they are really impractical and therefore, our conclusion is that we should really, investors, advisors, public officials, should really pay close attention to this distinction and should pay close attention to what business assets are controlled by their controller outside of the public firm.

So I say, that if you have already separation, it’s very important what you have outside and this also suggests that when you have not just small equity stake, which can result either for a dual class structure, or for pure middle structure, so imagine a pyramid with 5% equity stake and a standalone dual class structure with 5%, the pyramidal group poses much more significant governance risks, because of the fact that there are so many business assets outside any given publically traded firm.

Yeah, let me conclude with, and I would like you to do it to take away from this, is the importance of, not just paying attention to CS companies and to the governance problems, but the recognition that should a company, any scrutiny, any examination of such company, that they really markedly differ in their governance programmes from widely held firms, that investors, and their advisors should really abandon the attempt, which we all understand is very attractive, to find some yardstick, some metric that we can apply everywhere, some universal, global metric. And that’s a quest is not the right approach for investors to follow, rather we should really attempt to develop as well as we can, separate governance metrics for CS companies, than for widely held firms and for CS companies, we should also make adjustments, for those two key distinctions that I suggested to you, and this is an enterprise to which our programme and the research, as I’m describing, will seek to contribute in the coming years. Thank you very much [applause].

Unidentified Male Speaker:

Are you going to take questions?

Lucian Bebchuk:

I will do, but I’m not sure the organisers have time for this.

Unidentified Male Speaker:

Oh, okay.

Lucian Bebchuk:

No?
Kerrie Waring:

I think we can take a couple of questions, as long as you’re happy to take them [laughter].

Lucian Bebchuk:

I’ll stand here until I’m told to leave.

Unidentified Male Speaker:

As long as it’s not [inaudible – 20:58]. First of all, I appreciate we have lots of companies on our portfolio and customer index where either because of the voting structure, or [inaudible – 21:10] structure, who are stuck in there and were unable to move reform right there and protect our interests, and I know that the next panel will take this up as well. Maybe you, though, can explain a contradiction that I’ve never fully understood? So, in the US, in the Listing Standard requirements, the independence requirements are more lenient for controlled companies, which I think, under Listing Standards are just a 20% inside state, not a majority, than for others, and that seems to be completely upside down. Are you aware of that and can you explain how that got in there and why, am I missing something?

Lucian Bebchuk:

Yeah. You know, so I am aware of that and it’s the way which it’s got in, was that the exchange has accepted the idea that if you are a controlling shareholder and take the example, or if you’re a majority owner, you should be entitled, “to choose the majority of the board.” Now, as a practical matter, most of those companies actually do have a lot of Independent Directors, even though the controller is not required by the Listing Standards, and that is because under State Law, you get a lot of judicial difference if you have Independent Directors that approve compensation, save during transactions and the like.

In one of the research projects that we are doing, we actually take a view that goes further than it seems you would like to see. I mean, your concern is, we want to have Independent Directors when you have the controlling shareholder and your intuition is, if we have enough of them, I will feel sufficiently comfortable that we have investor protection. And our view is, look, if you have a controlling shareholder, and the controlling shareholder chooses Directors that are formally independent, so they have no material connection, but the controlling shareholder has complete control over their election and the replacement, then if you think about the lesson that many people in this room have drawn from the last 20 years about the election of Independent Directors in widely held firms, the lesson there was, look, even though the Directors are independent, we cannot fully count on them if we don’t have an election process in which public investors, who are supposed to be protected, have at least some say or inference. So this suggests that if you have a company with a controlling shareholder, and you have Independent Director, but the controlling shareholder has absolute power over election and removal, you are going to end up with Directors that perhaps cannot be fully expected to protect the interests of public investors.

So, in this paper that we are planning to issue this fall [inaudible – 24:13], is called Making Independent Directors Work and we will refer to controlled companies, is we advocate, in one way or another, arrangement that actually now exist, to some extent, in the UK, in Italy, in Israel, those are arrangements in which public investors, in a company with a controlling shareholder, have some input into the election of some Independent Directors. And there are a number of ways you can do it. You can give them a veto right over the approval of some Independent Directors. You can give them stronger rights. Indeed, for some
companies with dual class structures that went public on AMEX, a long time ago, they were required to give minority public investors some input into the election of Independent Directors. So that’s the direction, I think, where we need to go to fully protect public investors.

Kerrie Waring:

We can take one more question and then we need to move onto Jamie’s panel. Okay, two more questions and then [laughter]…

Unidentified Female Speaker:

Thank you, Lucian. So most of the companies, many of the companies that have a controlling shareholder are tech companies, and many of them claim that it’s the fact that they’re controlling that has allowed them to be so disruptive and this obviously influences their performance in the long run. Would we risk, by changing the rules of how controlling companies operate, will we be risking performance, or is this just like an excuse they have, to say that they want more power, the disruption and to ignore generation?

Lucian Bebchuk:

You know, obviously, things can differ from a situation to a situation. I tend to be undecided. I always think that we all understand the cost of separation, of dual class structure with extreme separation. The fact that you have entrenchment, the fact that you have distorted incentives. On the other side, people give arguments from, we have this genius who founded the company and it’s important to give them power for now, and what I would like to say, so obviously there is a trade-off. I, in this literature, tend to be on the side that says that overall, the balance of consideration weighs in favour of not allowing those structures. But I would say the following, that even if you accept the validity of those benefits and that you think that these are not justified, there is some piece, and a very critical piece of the existing arrangements we see in the US, that should be fully unacceptable to people who have those views.

There are two elements. One is, that when you look at those tech companies, say Google, or Facebook, and let’s suppose for a moment that the founder is this exceptional unique individual, and it’s extremely important to leave them control for now. That’s not the reason to give them perpetual control. Why? Because if Mark Zuckerberg is an amazing visionary now, you know, we all know the bitter song, how will you be when you’re 64 [laughter]? So, even if you fully accept that Mark Zuckerberg is a unique individual, we don’t have the same confidence at the age of 64. Mark Zuckerberg, or perhaps his heirs, would also be, kind of, especially unique, so the argument for having dual class structures, without bit in sunset provisions, which is what we have, say, with private equity, you give people absolute power over your money, but it’s for limited period of time, it’s for ten years, let’s say. So the argument for perpetual dual class structure is, I think, untenable and that most people who are willing to accept this argument, should be willing to accept dual class structures with some bit in sunset.

The other thing is, that we really have to distinguish between structures in which somebody say has 15% of the cash flow rights, and structures in which somebody has half a percent of the cash flow rights. And if you look at dual class structures in the US, many people lump them together, but there is a huge variation in this sense and the extreme separation situations, and there are very prominent examples of those, are especially pernicious, and even if you accept those other arguments, the case for them, I view it as untenable.
Kerrie Waring:

You can just take one more, brief question.

Unidentified Male Speaker:

And the question is, have you looked at whether the identity of the controlling shareholder makes a difference? And I’m thinking the difference between state owned controlled companies, for example, which is less of an issue in this market, but is an issue in other markets, between that and individuals, and actually, not just individuals, but perhaps family owned businesses, where you do have the continuity and the point about the perpetuity issue is perhaps different? And just thinking about a number of pieces of research that came out recently, showing that family owned companies in, under some conditions, outperform, especially in the aftermath of the credit crisis, where they were able to take long-term ideas, resist the temptation to overleverage and then be able to capitalise on the best price market, and actually do quite well.

Lucian Bebchuk:

Yeah, I think that – I understand there is a question of indigeneity and the like there. I think that in terms of my identifying two kind of situations, being especially pernicious. One’s where you have something that goes on for a very long period of time, in perpetuity in most situations. And the other, when you have substantial separation, so the family doesn’t own 25%, the family might own 1%. My view is, that as investors, you should be really very concerned about situations where you either have seen the goal for a long time, or you have a small percentage. And the reason is, one, you know, unfortunately, we all have to recognise that no matter how successful a person is, their children are not bound to be as talented as they are.

So, when you have a founder, and Colonel Sanders referred to the problem of the idiot son, or the idiot daughter, but you don’t need to go that far. The likelihood that you would necessarily have the second generation to be of the same unique talent. And secondly, when the separation is very large and the family owns a very small fraction, then the perverse incentives are very, very powerful. Because you have a situation which somebody’s having a local control, but having a small ownership stake, like many Managers in a widely held firm, accept that they don’t have any discipline for the market, unlike the Managers of the widely held firm. So they have neither the discipline of the market for corporate control, and nor the force of powerful financial incentives, and that’s a situation that not always, not in each and every case, but by and large, we have to be very worried about.

Thank you very much for your patience [applause].

Plenary 1: Global proxy season round-up and impact on US agenda

To what extent has global investment impacted the US proxy season? Has the wave of shareholder proposals on proxy access paved the way for stronger rights? Will this address board quality and competence on critical issues like climate risk, independence and diversity?

- Louise Davidson, Chief Executive Officer, Australian Council for Superannuation Investors
- Paul Lee, Head of Corporate Governance, Aberdeen Asset Management
Darla Stuckey, President and Chief Executive Officer, Society of Corporate Secretaries and Governance Professionals:
We’re going to talk about board composition, what people want, what makes a good board, how activism works into that, how independence works into that. Then we’re going to talk a little bit about engagement. Then we’re going to get to proxy access. Ann, why is Board composition important?

Ann Mulé, Associate Director, John L. Weinberg Center for Corporate Governance, Lerner College of Business and Economics:
We held a programme at the Weinberg Centre last October and we invited Bill McNabb, the Chairman and CEO of Vanguard, to speak to us about Vanguard’s views on corporate governance. He said that “The single most important factor in good corporate governance is board composition. Who the Directors are, what skill sets they bring to the table, and how they interact. These factors are crucial from a long-term value perspective.” And all the other protective governance measures, that we have, are really there in case we don’t get the right people in the room.

If you think about those protective, structural governance mechanisms for example, like majority voting, usually the harm has already happened. The company’s blown up, the scandal’s happened, shareholders have lost a lot of money, and it’s really only then that we say “Oh, well, let’s have a withhold campaign and hold those Directors accountable.” But, it’s more or less too late. It’s good prospectively, but the harm’s already occurred and so the importance of good board composition is paramount to ensure the directors can effectively oversee the evolving company strategy, evolving company risk profile and to oversee management.

Louise Davidson Chief Executive Officer, Australian Council for Superannuation Investors:
Just because you have the right skill sets in the board, doesn’t mean you have an effective board. The right skill set is a foundation but in addition to that, you have to have effective board processes and an open board culture.

Darla Stuckey:
I’ve long said that corporate governance is about getting the right people in the room and that includes the right managers, the right people presenting and they’ve got to have the right information. Paul, assuming that board composition is foundational, who should be on a board? What kind of experience are you looking for?

Paul Lee, Head of Corporate Governance, Aberdeen Asset Management:
I think what we’ve said is clearly right, that governance, fundamentally, is people and it’s about how those individuals interact and whether they form more than the sum of the part. In good boardrooms, there’s a kind of alchemy that goes on, that you have this whole range
of raw materials that is forged together through discussion and debate and at the end of that, hopefully you get gold, sometimes you get something that’s rather less than gold. You have to meld a range of skills and a range of experiences, and I think one of the frustrations, looking at US boards, is that there seems to be this mind-set that the only people capable of going on boards, are people who have already been Chief Executives of major companies. You’re missing the range of perspectives and understandings that will really help a board see the company from the perspective of its employees, of its other stakeholders. It is important that the board that thinks about the company in a broader context and you’ve only got that if there is a range of experiences. This kind of diversity, in the broadest sense of the term, will enable a board to be forged into a form of gold.

Zach Oleksiuk, Head of Americas, BlackRock:
I’m not sure if that in US public company boards there’s an under focus on adding only CEOs, or a focus of adding ex-CEOs on boards. I don’t think that board members should necessarily be added, because of a singular area of expertise or focus. Clearly, not every individual can be all things and so you need the range of perspectives that’s already been discussed here. And importantly, that’s relevant to where the company is going and the oversight and advice that management needs, from the Board of Directors, to protect and drive long-term value.

I think it’s really a balancing act. A board seat is a very valuable thing and they need to be very careful about who they add, because they need an explicit perspective on the board, versus where they can gain outside advice, without actually putting somebody on a board. So clearly, an individual must, as a baseline, be able to contribute to the deliberation on strategy and the oversight of the strategy and the deliberation, and the selection of the leadership of the company, some of these very core, fundamental objectives of the Board of Directors. That is a must, so, regardless of your expertise in cyber security, or financial expertise, etc., you must be able to contribute substantively in those core areas.

Louise Davidson:
I think that one of the things that’s interesting about the gender diversity push, is that it has started to lead to greater diversity in a broader sense in Australia. I think only 4% of the top 200 company CEOs are women, and so that is not providing a pipeline of women to go on boards, therefore women are coming from other backgrounds. So it’s providing diversity in background, and it’s also starting to provide some age diversity, because typically, a lot of the women being appointed to boards are a little younger than the male cohort that they’re joining.

I think the gender diversity push in Australia is starting to gain some real momentum, but it came from a pretty low base. In the early 2000s, something like 80% of board appointments were people who were already on a board in the same part of the index. So, it was a really small and concentrated pool of the same people agreeing with each other. Do board members need to like each other? My view would be, not necessarily, but they need to be able to challenge each other and they need to be able to do it respectfully. If there’s too much liking going on and too much going out for dinner, that could be a little cosy and not all that constructive, in terms of challenge.

We’re campaigning for 30% of women on boards by the end of 2017. Half of our top 200 companies only have one, or zero women on their boards, so they’ve got some way to go. We’re engaging strongly with them and we are starting to see a shift in attitude. I think it’s going to change the way boards are comprised, in a much more significant way than just the
gender piece. There’s often a dichotomy established on the gender diversity debate appointment on merit i.e. you can either have merit, or you can have women. I would argue that if you were appointing on merit, we’d have 50% women already.

Paul Lee:
And there was a great quote from one of your Supreme Court Justices, talking about, we’ll only have equality when you have all nine members of the Supreme Court being women, because nobody raised an eyebrow when they were all men, so, why wouldn’t you have all nine being women? And, you know, I’m not sure that 50% should be the limit. We need to find the right people, the right people that can bring debate and discussion and value to boards.

Ann Mulé:
Using the skill sets paradigm for Board composition, really focusing on what skill sets do we need and then trying to fill the gaps, really goes a long way, in terms of broadening the pool, from a diversity perspective. For example with oil companies, obviously a big risk area is health environment and safety, and that’s why most oil companies have board level HES committees. It makes for a much richer discussion at that committee, if one or more of the Directors, preferably the Chairman, really knows a lot about health environment and safety. If the nominating committee, said “Oh, search firm, we want a Director with deep HES experience” here ours is lots of women and people of colour that have deep HES experience. So I think that the skill sets paradigm goes a long way.

Darla Stuckey:
There is also a school of thought in the US that says we’ve gone too far in independence, because we now have folks, opera singers is the famous example, on boards that don’t know anything about banks, or oil companies, or Burma. So, maybe we should have more folks from inside the corporation sitting on the board. Right now, I think most US companies have one or two, maybe a couple of companies have three, but it’s pretty much just the CEO and maybe one other person, maybe just the CEO. So I wanted to have a little bit of discussion around that, because the UK has a very different model, where Directors are considered independent only for, I guess, nine years, or up to nine years, and then they’re no longer independent, which helps refreshment. How does that work, Paul?

Paul Lee:
The UK model on Executive Directors is, essentially there are always two with a few exceptions. There are always two Executive Directors on nearly every board; The Chief Executive and the Finance Director. There’s strong encouragement to have at least one other Executive Director on a board in the UK and that drives that the suggestion is a different dynamic in the boardroom. There’s less funnelling of information and insight into the company through the single individual, who’s the Executive Director, and the board gets to probe and understand the business a bit more. And there is a marked difference between those individuals being full Directors, and just being in the room as guests.

Darla Stuckey:
I think if we’re going to look down the road five, or ten years, I do think we will see three insiders. Three is a good enough group that you can actually make a difference, and you can actually ask the really tough questions. And I know of Corporate Secretaries that know the
company best, are the ones that can really handle the CEO, or Business Line Head, that wants to go off the rails and issue a product that’s not going to work, or do something that’s not going to work, and they can say “We tried this 20 years ago and it didn’t work, what’s different and what’s the exit strategy?

Ann Mulé:
I think it’s really important that the outside independent Directors have the expertise. My one concern is, at the end of the day, all those insiders get their performance ratings from the CEO and so, they’re not independent and so, you have to weigh that. Although, I do think sometimes we used to invite a lot of the Senior Officers into the boardroom. They didn’t have the title as a board member, but they were there for much of the meeting, for much of the reason you’re saying.

Zach Oleksiuk:
Directors need to be relevant, right, and so that is a consideration, when you think about putting, a retired Executive, whether from they’re from the inside, or from another company, onto a board, the longer they’re out of the game, the greater potential that they may no longer bring the precisely relevant perspective that is needed.

So, on independence, and it’s clearly, pretty widely accepted that for the Directors who are meant to be the independent overseers of management, that they should not be subject to material conflicts of interest that would lead them to put their own interests, or management interests ahead of shareholder interests, and their fiduciary obligations. Outside Independent Directors need to know the right questions to ask, they need to know when they need to seek help from an outside advisor, they need to be thoughtfully engaged in how they’re getting the information they receive from management. Clearly, it’s management’s responsibility to provide that information, but a board needs to know that it’s getting the right information. This is not directly related to independence, but I think it’s really important that we recognise the amount of work that it takes for Directors to, essentially, get up to speed and learn a business, especially in large global complex businesses.

I hear from many Directors that it can take up to two to three years before those Directors are fully contributing in boardroom discussions and so I think, for shareholders, we should be asking companies, what are you doing to get Directors to be fully contributing? How are you being helped and examples would be having board meetings in different parts of the world, taking Directors around on site visits, giving Directors access to layers of management beyond the C-suite. So this is all, substantive processes that we’re looking for, that go beyond, is this Director independent, yes/no.

Darla Stuckey:
Boards do need a lot of orientation, they need education and it does take them a few years to get up to speed. When we think of the continuum, five to seven years, board members are really doing well then and really can contribute by the fifth, to sixth, to seventh, eighth year, so to think that we lose them after ten is difficult. I wanted to go back to the management, where they get their knowledge from, because at the University of Delaware, they’ve written a paper on, where they use this term, management knowledge captured board, so, the idea that the board is only getting their information from management and somehow that’s not necessarily good enough, or it could be tainted or conflicted, so Ann, tell us what you mean by that.
Ann Mulé:
As a result of all the corporate scandals in the 2000s, Congress and the regulators, really took the position that independence is the panacea. That if you have independent outside Directors on a board, that will be the cure-all and prevent these sorts of things from happening again, and to prevent a management captured board. Independence is critically important but it’s not enough. And now there are some boards where it’s almost gone the other way, from a balance perspective, where you have a board, comprised of independent outside Directors, none of whom have industry expertise. None of whom know the underlying business at all, other than what they’re going to learn through training, which is helpful.

But the only one who knows the business, is the inside CEO. So, the idea is that the inside CEO is capturing that board through his or her knowledge. And what’s scary about it, is that a lot of times, outside directors don’t even know the right questions to ask, because they don’t know the industry really. The point is, it’s just as dangerous when you have a management capture board, the Directors might know the questions to ask, but they’re not asking them, because they’re in the hip pocket of the CEO, while in the management knowledge capture board, the questions are still not getting asked, but for different reasons a lot of times, because again, perhaps they don’t know the questions to ask.

It’s almost like the Audit Committee Financial Expert, that’s a case where I did agree with what was done, because it really by law and regulation, you have to have someone with a really deep accounting knowledge in the audit committee, and I know I found, from being in the audit committee, the questions were much tougher, the discussion was much more robust, and I think, ultimately, we ended up in a much better place, and so I’ll use that analogy.

Paul Lee:
I’m vigorously agreeing, but just reflecting on Ann’s comment about independence not being enough, which is clearly right. I think it’s a debate that’s going on very actively in Japan at the moment, where finally, after many years they have a Corporate Governance Code in Japan now. They are encouraged to have two Independent Non-Executive Directors. They don’t really know what that means and they don’t know what the Non-Executives are there for. So they’re appointing independent individuals, but in a lot of cases, they’re not necessarily individuals that are suited to add value to the board and add value to the business. The example that’s been brought to my attention most vigorously is the karaoke business, one of whose independent Non-Executive’s is a pop starlet. My concern there is that, we’re in danger of the whole role of the Non-Exec in Japan being dismissed, because you’ve got a lot of individuals who are, yes, independent, but not going to be adding practical value to the board, and that’s a real challenge and a real concern.

Zach Oleksiuk:
I certainly agree that having strong independent leadership within the board is vital, and in this market, I’m sure many in this room are familiar with the fact that that there are not many independent Chairmen. The more common independent leadership practice in the US is having a lead Independent Director, who does not lead the board meetings, but essentially co-ordinates the activities of the Independent Directors and increasingly serves as the voice of the board in this trend towards increasing shareholder Director Engagement in this market. And I support the ability for companies to choose the appropriate leadership structure for their board.
I think some important considerations, beyond what has really evolved as to be a check box approach to the role of the Lead Director. It’s really about making sure you’ve got the right individual in that role; Somebody who has exhibited strong leadership, who will be able to challenge the management, both in board meetings and privately, but also work constructively with management. I also think it’s really important that roles are made very clear. I fully support the notion of having industry experience on the board, but we need to make sure that there is a clear delineation of responsibilities between the CEO and board leadership and so I see potential pitfalls if there is ambiguous leadership in the boardroom and within the company.

Louise Davidson:
The Australian situation is quite different to the US situation, where it is the norm in fact to have separation of CEO and Chair and the way I think about it is, so, what are the fundamental roles of the board? And one of them is the appointment and oversight of the CEO, and I just wonder how effectively that can happen, how much challenge there can be in that, if the CEO is also the Chair of the board? The second important role of the board is as the representative of the shareholders, and again, I just wonder, with that coming together of management and board positioning, I feel as though that capability is diluted as well.

Paul Lee:
I very strongly agree with what Louise has just said. If you come to my analogy of the alchemy of a board, the alchemist is the Chair and that individual, their role is to make the board work, to get the best out of each of the individuals, to draw them out, to get the diversity of skills discussed and debated and all those perspectives coming into play and in board discussions, is a very different skill from running a business, and why distract the individual from running a business, by this hugely different and difficult challenge of getting the best out of a boardroom discussion? I think you’re just setting yourself up for problems. Is it a panacea to split the roles? Clearly not. We’ve had plenty of scandals, in all sorts of markets in the UK and Europe, elsewhere, where you’ve got a division of roles, but you’ve got a better chance of having that debate and that challenge more effectively if you’ve got the roles split.

Darla Stuckey:
In the US we’re kind of unique, and I think what happens on a company by company basis, it becomes a bit of a personal referendum on the individual in that position at the time, and it’s sometimes hard to get things separated and there are other procedures that you can do. You can split the roles when that person leaves and that’s something that some US companies may do it, but this is a kind of slowly moving event.

Paul Lee:
I do find it interesting, as you rightly say, when these questions come up they tend to become a referendum on the individual, or be seen in that way, but there’s no real need for that to be the case, but it’s, frankly, the individual’s ego that makes it the case, and that again, just emphasises the challenge of the two different roles, because, for a board to work properly, the Chairman’s got to be, at least in part, without ego. They’ve got to be drawing everybody else out around the table, and not imposing their own individual view. We like our
Chief Exec’s to have a bit of ego, that helps drive the business forwards. It’s not what you want in the boardroom.

**James McRitchie, Corporate Governance (CorpGov.net):**
Given the importance of the governance nominating committee, are those positions the most highly paid on the board, the Chair of those committees?

**Darla Stuckey:**
The audit committee Chair and the comp committee Chairs are paid additional fees, typically because there’s twice as many audit committee meetings, as there are anything else, and when companies left the per meeting fees, and gave us set annual fee, they baked more in for audit committee Chairs and audit committee members. Also, for comp committee Chairs and members again, because comp, they basically have more work. It could be the case that nom and Gov committees are going to get.

**Ann Mulé:**
Well, I think it’s a really good point, and I think the reason that they have historically not gotten as much, is because it wasn’t perceived as a committee where as much time was spent, and I assume that’s what you were alluding to in your question. I think as investors and boards more and more focus on the absolute importance of this issue, and they need to spend more time on skill sets and really would like to see it where every year you have the new long range strategic plan approved and at that point, you’re also, as a board, focusing on the more recent risk from the ERM, Enterprise Risk Management, ‘cause you’re getting ready to file your 10k, it would make logical sense, to have baked into the board calendar, you know, the next Governors’ Committee Meeting, let’s look at that, let’s update the skills matrix, what new skills do we need? Where do we have gaps, and then have a long range strategic plan for our Directors and skill sets? Now, I do know some companies have this, but I think a lot of companies do not, and I think it’s so important that they should be, in my opinion, getting paid the most. But I don’t think we’re there yet.

**Zach Oleksiuk:**
I think underlying all of this discussion is that the nature of board service, and the time it takes to serve on a board, whether it’s the NGC, or the comp committee, audit committee, etc., is significantly different than it was five, ten, 15 years ago. Investors have a much heightened expectation of Directors, and Directors have, not only a whole new slew of regulatory matters to comply with, but also have to meet the expectations of investors and ultimately protect the value of the – seek to protect the value of the enterprise. And so, we do at BlackRock, pay keen attention to the number of boards that Directors serve on and we have seen the number of boards that Directors serve on coming down over the years, and I think we need to continue to see that trend, because I think, having served on at least one board is a good thing, I think it’s good to cross-pollinate ideas. I think that it’s reasonable to pay Directors more for the additional work that we are asking of them and I think that companies in turn, should set lower limits for the number of outside boards on which Directors will serve.

**Darla Stuckey:**
The last issue we have to touch on is the effect of activism on it, and Zach, I’m going to turn to you; Has it affected it? Is it the case that boards who are not targets of activism,
nevertheless, are watching and trying to prevent activists by putting certain people on their board, or considering certain people on their board?

**Zach Oleksiuk:**
Activism is a key theme in the US market. It’s not limited to the US. I think we are seeing, as the case at Samsung recently and others, you’re seeing primarily US based activists, targeting ex-US companies, but in any event, just for some context, in the US alone, over the past year or so, it’s estimated that there’s about 300 companies that have been targeted in some way by so-called hedge fund activists, who are reported to have, somewhere between 120 and 200 billion dollars of their assets under management. So if you look at the 20 trillion dollar value of the US equity market, it’s a small sliver, but it really, is having an outsized influence on boardroom and company behaviour for a couple of reasons.

In some instances it sounds right, activists are doing a much deeper dive than even your typical active equity investor. They’re very concentrated portfolios. They come to a board with a slew of ideas, whether it’s strategic ideas, change in leadership, buy back your shares, financial engineering, and some boards will push back and say, you know, these are just bad ideas, we’ve considered them and we’re not interested. I think good boards will listen to the ideas brought by activists, or any investor for that matter and will engage, more broadly with their shareholder base and really seek to understand the range of perspectives. Because activists do not, in my view, represent the shareholder voice, as many purports to represent and ultimately, a board needs to come to its own conclusion as to the right strategy for the company. But what we are seeing is an increasing trend towards settlements with activists in the US, whereby boards are inviting activists in and, in some instances, it may be because they just do not wish to fight. I don’t think that’s a good thing.

In other instances though, it may be because the board takes a good look at their composition and that leadership of the company, where the company’s going, says you know what, we need this, and good for them. So, I think ultimately, it’s about how the board communicates their deliberation and their ultimate decisions to shareholders. Beyond the 300 companies that have been targeted, there are likely thousands of companies now that have engaged outside advisors, to great expense, that are running fire drills, where they’re flying their Directors, from around the country, into corporate headquarters, to run a two or three day, what if we’re targeted by an activist? There could be some value in this exercise, but I do question whether that is the best exercise and use of Director’s time.

**Darla Stuckey:**
Not only that, there’s folks creating, sort of, dossiers that they’re selling to banks and Portfolio Managers and, sort of, a scorecard on whether you’re weak and a potential target for an activist and then, now they’re also selling into the boards, so that they can know if they have a certain score. I don’t know if it’s ubiquitous, but it does seem to be one way to change board composition. Zach, the settlement you referred to typically do they involve a new settlement meaning allowing someone from the activist firm on the board?

**Zach Oleksiuk:**
It depends, really. First of all, activist is a term that can mean many things, and there’s a wide range of, MOs, within the activist community, hedge fund activist community. Sometimes it’s the addition of a principle from the activist shop, sometimes it’s the addition of mutually agreed upon Independent Directors so it can be a good thing. As sure as we want to vote in every contested situation on the election of these Directors, because proxy
contests are expensive, they are disruptive. I think they are damaging, at least in the near to mid-tem, to shareholder value and, depending on the outcome, the long-term as well. So, it’s challenging.

Louise Davidson:
It would be very rare in Australia. There might be occasional examples of it, from a hedge fund perspective. There is a growing, what we call activist campaigns, tend to revolve around.

Paul Lee:
We’re certainly seeing a continuation of activism in the UK, less so in Europe. I think the shareholder rights in Europe are less conducive to this, but there certainly are activists busy in the UK market. Not all of them US based, quite a lot of them are, exporting the money that they’ve raised to another market, where they, sort of, see an analogy of the rights and influence that they can have. So, it’s definitely active. I often talk to boards who face these sorts of challenges and encourage them to think of the positives and to think of how they can learn, how they can challenge themselves. It brings another perspective into the room for them, and that can be useful. Sometimes it’s value destroying because it is a distraction, but often there is a kernel of truth in there and the mainstream investors, if I can differentiate between the activists and the rest of us, that the mainstream investors will only listen, and the activists will only have influence if the mainstream investors are listening. The mainstream investors will only be listening if the company is failing to deliver in some way, so it’s good for the board to step back and to ask itself the question, what can I learn in this circumstance?

Ann Mulé:
And I think the other thing, before we leave the topic of activism and the impact it has had on board composition is that, over the last couple of years, we’ve seen a number of activist fights where they really have focused on the board as another one of their tools and their toolkit, and really successfully have made the argument, look at the current board. The reason the company’s not doing all that well, is because the board’s not holding them accountable, because the board doesn’t have, for example, industry expertise. No one on the board has industry expertise. So, they’re not asking the right questions. And look at our slate, and they’ve been able to get Independent Directors, who are actually CEOs or former CEOs, who years ago wouldn’t have agreed to stand on a dissident slate, because they would view it as reputation tarnishing. Now, all of a sudden, since activism’s becoming more mainstream, you see these people agreeing to go on the dissident slates. So now they’re putting up slates that have these really excellent candidates, that have all the Director skill sets that are needed in order to turn the company around, or execute a strategic plan, and then, from a shareholder perspective, they’re, kind of, making it a little easy for the shareholders, if you will, to support the dissident slate. So, that’s another reason why boards need to be proactive themselves, because they’re leaving themselves wide open, also from a board composition perspective.

Ric Marshall, Executive Director, MSCI:
What about beta activism? You’ve focused entirely on alpha, where a specific company is targeted, presumably for reasons of improving performance. I’m thinking about proxy access, or broadly classification, where there are multiple targets, presumably with the idea of elevating standards across the entire market.
Zach Oleksiuk:
I think my reaction is that in this market, in the US in particular, we don't have a well codified set of accountability mechanisms. You touched on proxy access. We view proxy access, first and foremost as an accountability mechanism. We view majority voting, the regular election of Directors, all of these are accountability mechanisms. So, certainly, given that we don't have well codified accountability mechanisms, one approach is through so-called beta activists, I assume you're referring to shareholder proposal campaigns, etc.? Essentially, what we've seen this year with the private ordering of proxy access.

In my view, it's necessary, because we don't have these rights enshrined in this country, and to the extent that we do have meaningful accountability mechanisms at companies, shareholders will be judicious in their use of those accountability mechanisms. So, one thing that we haven't touched on much in this panel, is the rise of engagement and the engagement dynamic in the US marketplace. In the past year, the BlackRock Corporate Governance Team in the US has engaged with nearly 700 issuers, and that's about half of the inbound requests we get to engage. We do find that building mutual understanding over time on governance issues, and really, very importantly, how the chosen governance regime and governance structure in a company is meant to create value over time, I think can be quite beneficial to all involved, in driving value over the long-term, and then when boards don't get it right, shareholders have those accountability mechanisms that you've referenced.

Louise Davidson:
Yeah, I definitely agree that, from ACSI’s perspective, we find that that long-term constructive engagement is really, quite effective. But I think that the rise of the NGO campaigns, which are non-Government organisations, I assume that’s what you’re referring to here, targeting boards on particular issues. I think that that is really causing boards to focus and often they’re – the work they’re doing in these areas is quite effective, but they have really failed to explain to anyone what it is that they’re doing, and so it can be a good reminder to them to do that, and sometimes they just really need to focus more on that particular area, because it turns out it’s of interest to a whole lot of mainstream shareholders, as well as the activist ones.

**Hosted Workshops - Assessing risk of climate change to long term investment and company operations hosted by BHP Billiton**

The global challenges of climate change are well understood and companies need to take serious and integrated action to mitigate their risks. This session will examine what companies and investors are doing in practice now and how they are interpreting and managing climate risk for the future.

• **Sally Fisk**, Senior Corporate Counsel, Pfizer
• **Michael Garland**, Assistant Comptroller for ESG, New York City Comptroller
• **Andrew Logan**, Director of Oil & Gas Programs, Ceres
• **Robert Walker**, Vice President, Ethical Funds & ESG Services, NEI Investments
• Chairied by **Tony Cudmore**, Chief Public Affairs Officer, BHP Billiton

**Tony Cudmore, Chief Public Affairs Officer, BHP Billiton:**
BHP Billiton is the world’s largest resource company, primarily now in the commodities of coal, metallurgical and thermal. So metallurgical for steelmaking and thermal for energy,
iron ore, copper and oil and gas. And today, we're going to have, I think a very interesting panel to talk about assessing the risk of climate change to long-term investment and company operations, particularly from the point of view of questions around disclosure. So, I'll introduce the panel very quickly and then I'll make a few opening comments and then ask each of my co-panellists to make some comments.

From BHP Billiton's perspective, I'd just like to talk a little bit about disclosure, and particularly about a document that we just released yesterday on the question of how we manage climate risk. But it's certainly true to say that from BHP Billiton’s perspective, we've long acknowledged the risk of climate change and long thought about this as a strategic issue that the company has to be engaged in, both in terms of its own operations and in its broader advocacy. We have a robust annual corporate planning process that underpins the development and delivery of our overall strategy, including the question of how we address climate risk. Just yesterday, in London, my counterpart on the Group Management Committee, Dean Dalla Valle, who's our Chief Commercial Officer, released a new document, which I know Geof Stapledon's in the room somewhere and has a few copies of, is this document which we're calling our Climate Change Portfolio Analysis, which has been developed to really respond, we hope, to a lot of the questions from investors about how a carbon constrained world would impact our business and our portfolio. And so, for the first time in that document, we’ve introduced for external consumption, as it were, our internal carbon price range and we’ve talked in more granular terms than we have in the past, about how climate risk might affect our portfolio. And we do believe that more disclosure is really important in this area, as I'm sure we all agree, not just in terms of informing investors, which is critically important, but also policymakers, regulators and broader stakeholders.

So the report is focused on the impact of a transition to a two degree world and highlights our diversified portfolio mix and how we would manage that portfolio in both, if you like, an orderly and a more accelerated transition to a two degree world. Just a couple of points out of that report that might be of interest, is the report finds that in a more carbon constrained future, there’s likelihood of upside for some of our commodities, so uranium, and high quality metallurgical coal. As I mentioned, metallurgical coal is an essential ingredient in steel production, as opposed to thermal coal, which is, as we know, an input to power generation. And also, then, we believe there’d be upside for iron ore, because our iron ore commodities, our resources are high quality and therefore more efficiently produced, ultimately, in the production of steel. We'd also expect copper to offer continued opportunity for growth, because it's an input into renewable energy infrastructure, as would natural gas. We do believe these commodities are robust and would mitigate potential negative impacts on other commodities.

I would say that that portfolio analysis is part of a broader integrated approach that BHP Billiton has to managing climate risk, which also encompasses efforts at mitigating our own emissions, supporting work on adaptation, social and environmental, as well as investing in low emissions technology. I’m happy to talk about that later and Geof can certainly add detail as well, but in the interests of time, I'll perhaps leave that for Q&A, or subsequent discussion.

The last thing I would like to say though, is that the document that we’ve just produced is a board level document. It has been endorsed by the Sustainability Committee of our Board. It reflects the fact that the Board of BHP Billiton takes climate change very seriously, sees it as an inherently strategic issue and one that is critical to the future management of our portfolio and our company, and ultimately, in the value that we can offer to shareholders.
Robert Walker, Vice President, Ethical Funds & ESG Services, NEI Investments:

Good afternoon. Starting with NEI Ethical Funds is a bit of an odd place to start, I suppose, because we’re not an investor like most people in this room, in the sense that environmental and social issues have long been central to how we assess our investment risks. But also, in terms of expressing the values of our unit holders, that has been something that we’ve held central to our mandate as a fund company going back to 1986, when we were first launched. So we’ve been around for a long time in this space, and having that mandate and that statement of principles around ethics and the environment in our prospectus, has given us some leeway in terms of how we address climate issues that some investors might not have had. So we began to look at climate risk as early as 2001, when the IPCC Report came out in that year. I think that was the third report in 2001. And I think at that time the conclusion reached in that process, was that human induced climate change was either likely, or very likely and that was good enough for us, at that stage to start working on this issue. I think now we’re down to almost dead certainty, or something towards words of that nature.

So, we did get into assessing climate change and the need to address climate change pretty early. Part of what we do at NEI Ethical Funds is we do screen our investments and we began to look at energy issues and climate issues as part of that screening process, but always with the preference for engagement first. There was always an effort there to address these risks after engagement, but over time it has meant that, at this stage, we are underweight in energy quite severely. And we did stop investing in coal companies, thermal coal companies about five years ago, and that decision came from a blanket screen on coal, we were looking for coal companies that would take active steps on climate risk, either through using, or looking at working on carbon sequestration and taking aggressive positions on climate change, in terms of advocating for a price on carbon. We couldn’t find any candidates that fit our strains in the community context, and that took us out of coal completely, a few years ago.

As I mentioned, we have been underweight in energy as well, oil and gas and a part of our calculation there has been again an expression of concern about those companies that have helped muddy the waters on climate science, and that took us out of a few companies, most notably in Canada, Talisman Energy, back in the day. The CEO there, Jim Buckee was quite famous, or infamous for denying climate science. There were other CEOs we knew weren’t too enthusiastic about the field. Gwyn Morgan at EnCana would be another one, but Gwyn was a little smarter. He, kind of, kept his mouth shut when it came to these things, but Jim Buckee was quite aggressive. So we were out of Talisman and that was one reason, there were others that led us away from that company. So we’ve long had screening against some fossil fuel companies as part of our effort to address climate risk.

But as I mentioned, we’ve also been big on engagement and engaging those companies we felt that have been capable of change, in fact, in many cases demonstrated change. The poster child for this in Canada would be Suncor Energy, quite frankly. It almost always comes back to Suncor when we’re asked for leaders in this space, an oil sands company, so controversial obviously, but an integrated company, doing a lot of good work, has a renewable energy portfolio and has been a leader on a number of initiatives designed to address climate risk. But across the sector we have been looking for disclosure for many, many years. NEI was the first Canadian member of the Carbon Disclosure Project. We have been advocating for carbon pricing scenarios more than gas companies. So as it made allocation decisions for decades to come, we’ve asked that they bill a price of carbon.
into their planning. Most large oil and gas companies in Canada now do this. Not just because of us, but I think we have been an important voice in that space.

We’ve also advocated for increased expenditure on research and development, not just on climate issues, but also other issues around Tailings Ponds for example, in North East Alberta. Those numbers have improved over the years, but of course, those budgets are under a risk at a time when commodity prices are as low as they are now. We’ve also asked companies to support a price on carbon publically, and I think this is a situation where in Canada, it’s quite a bit different than what we have – what we see here in the US. Most, again, most large oil and gas companies have supported a price on carbon since about 2010. We don’t have this block in our political system. The block to a price on carbon lies someplace else and that’s become – that effort to get companies to cry out on climate change has become more energetic, no pun intended, this year, in the run-up to Paris and we have seen Steve Williams, the CEO of Suncor, speak to the press quite aggressively on a need for a price on carbon.

Part of the background to this as well has been a change in government in Canada. Natural resources are governed by the provinces, not the Federal Government and we now – part of our effort, over the years, has been to engage those Governments in a dialogue on a price on carbon. And we’re in a situation now, where we have four provinces, the four biggest provinces: British Columbia, Quebec, Ontario and now miraculously, Alberta, now either with a price on carbon in place, or heading in that direction. So, in some ways, the Government in Ottawa has become less relevant in this conversation, as the provinces are taking action and putting in place, what we think, are very useful strategies to address climate risk, in a way that goes across the economy.

We’re working that the window of opportunity in Alberta has just recently opened. There was a change of Government back in May, when a party that had been in power for 44 years, was swept from office and replaced by the new Democratic Party, with a strong environmental agenda. So, that’s a very useful thing to have happened and we’ve been going up, and an inappropriate metaphor of ‘Pedal to the Metal’ on that Government since that change. They – Rachel Notley, the new Premier does want to go to Paris with a feather in her cap, a new climate strategy. We’re getting close to the Government. There is a Climate Panel has been formed and we’ve been helping to organise investors in Canada and outside Canada to express support, or for meaningful action on climate change and this is part of our big public policy and issue at NEI. So I’ll stop there.

Andrew Logan, Director of Oil & Gas Programs, Ceres:
So we’re based here in Boston and we worked with investment companies to build sustainability leadership on issues like climate change and water. We also direct the investment network on climate risk, for INCR, which again, many of you are members. We’re a network of investors, about 110 investor members, about 14 trillion dollars in assets, which, as its name suggests, is focused on, you know, managing and understanding the impacts of climate change on investor portfolios. And for the last two years or so, one of the major focus areas of our work on climate change has been the issue of stranded assets and in carbon asset risk. So we’ve been working with our partners at the AGCC in London and IGCC in Australia, to organise really a global investor engagement with the fossil fuel sector, on carbon asset risk. We’re pushing for improved disclosure, improved governance and, you know, in the end, change is a natural business practice, in terms of how companies actually allocate capital if they’re going to survive and thrive in a carbon constrained future.
You know, and our basic concern, and the reason that investors are engaging on this, is that we fear that industry, or certainly some companies, are preparing for a future which we don’t think is likely to come to fruition. I think a lot of oil and gas companies, coal companies, are assuming that the future is going to look at lot like the past. High prices, high demand for fossil fuels, kind of, going out as far as the eye can see and I think, you know, our concern is that argument is sort of logically impossible, right, so either the world will take strong action on climate change, which, kind of by necessity, has to result in decreased demand for fossil fuels, or, if the world doesn’t take action and we kind of head toward unmanaged climate change, we know that that has, you know, profound and profoundly negative implications for the economy as a whole, which, it will also dent demand for fossil fuels.

You know, yesterday Marc Carney, who is the Governor of the Bank of England, gave a tremendous speech. He’s also Chair of the Financial Stability Board. A tremendous speech in which he talked about climate change as the single biggest financial risk the world faces going forward, that it poses real risk for global financial stability and that fossil fuel stranded assets are likely to be substantial and that investors should take – should pay attention and take action and I think, you know, when we see comments like that coming, not from Greenpeace, but from The Bank of England, I think we know that something fundamental has changed in the context and in the conversation.

You know, as I said, when we look at stranded assets and carbon asset risk, we see this really as, kind of, a demand risk, commodity price risk issue. Kind of, less about climate policy per se, and more about all the factors from technology, to fuel switching, to clean air regulations, but also including the Global Climate Policy, that we think has the potential to bring down demand going forward in a way undercuts the economics that the industry is currently built on.

The industry has changed over the last year, but I think we still have an oil and gas industry that’s largely built for a 100 dollar barrel world, a 90 dollar barrel world, and, you know, I don’t think it’s clear that that world is ever going to come back. So I think the question we think about is, what does a high cost industry do in a low demand, low price, carbon constrained world, and that’s where our global investor engagement around this issue has focused on.

So, maybe just wrapping up, you know, what are investors doing around this issue? As I said, we’ve been working with a group of around 7,500 investors globally, engaging with 55 or so companies. We call for a test stress test against a variety of future scenarios, including lower demand scenarios and a two degree scenario, disclose the results of that stress test to investors and make sure your company is prepared for managing those risks going forward. That means having a climate competent board, as we’ll here from Mike, his work on that, and it means really thinking hard about what these risks mean for your actual day-to-day business and how you allocate capital.

Again we saw, a very good example of how this can go wrong this week, when we saw Shell having to write off roughly seven billion dollars, for their failed efforts in the Arctic. So it’s a very real and very ripe issue, unfortunately, for investors. So I think, those are the asks that we’ve been pointing to industry and we’ve seen a real progress in the first couple of years. You know, we’ve seen you all do your stress test, which is great. We’ve seen Konica do something similar, we’ve seen BP and Shell and Statoil, the boards of those companies actually come out and publicly endorse, share the proposals at those companies, on carbon asset risk and climate risk, which is really unprecedented on this issue. We’ve seen New York City and CalPERS have great success on the proxy access front and we’re raising the
profile of climate competency, as an issue that boards need to tackle. So, lots more we can
discuss on the detail front, but I'll just leave it there and pass off to Mike.

Michael Garland, Assistant Comptroller for ESG, New York City Comptroller:
So as a representative of New York City, I feel compelled to mention two things. New York
City is among the most – has among the lowest emissions, the most green places on the
planet, on a per capita basis, because of our density, you know, we don’t drive to the corner
market to get the newspaper, or heat individual homes out in the middle of nowhere, and we
also, and I was unprepared, so I don’t have the number, but our – the miles of coastline we
have are staggering. I mean, it’s hundreds of miles, if not larger, and I don’t have that at
hand, and we certainly saw the impact on the city of climate change, or likely of climate
change in Hurricane Katrina.

New York City is an active participant and member of Ceres and we appreciate their work,
and I just want to share a little bit of our perspective, because we do see climate change as
a fundamental risk across our portfolio, and both because we’re a universal owner, so we’re
very much tied to the economy and we are truly a long-term owner. And, you know, those
risks are difficult to quantify, they’re hard to understand, I think it’s fair to say though, they’re
probably most acute when it comes to the energy sector and very active in working to
increase disclosure, so we better understand those risks. In our case, it’s where we better
understand, it’s a tool to engage, we have large index, so it isn’t for picking one company
over another, or selling a company. But ultimately, whether or not we have the capacity to
even understand those numbers in-depth, just like any fundamental risk to a business,
ultimately, we do rely on the board to manage risk.

I think the risks around responding to climate change are particularly challenging for a board,
in part because the time horizons involved and I think there is an inherent conflict with
management, this time horizon, you know, at best, has maybe three to five years. Particularly
in the energy industry, you make investments today for projects, whose pay off
may be significantly far down the road, or you’re walking in a strategy. So you’re making
decisions today around strategy and capital allocation, with longer-term consequences, or
benefits and if the pay off an investment is significantly down the road, you may not get the
benefit as an executive today for making that decision. And if you fail to make an investment
that it will have significant pay off down the road, you’re not going to be around – or with
significant consequences, you’re not going to be held accountable. And so, just as we’re
concerned and when you look at the banking sector and they’re running off directors on the
risk committee or the audit committee who understood the complex financial products their
banks were selling we’re also looking and trying to better understand what are the core
competencies on a board of an energy company. And I think this is really an extension of a
panel earlier today, with Ann Mulé and others about, you know, the risk of knowledge
captured boards.

And so, when New York City launched their Boardroom Accountability Project last year, and
which we’re seeking to try and rollout proxy access, essentially across the market and
across our portfolio in the US, we started with three areas of focus. So, the energy
companies, I think we filed at roughly more than 30 of our most energy intensive – excuse
me, carbon intensive energy companies, we also filed the companies, where we had
concerns about lack of diversity on their board, and then companies with CEO compensation
concerns. And so it is linked – it is, I think, and trying to put the pieces in place so we can
engage boards more substantively about what is the right mix of skills and experience, the
right Directors in the boardroom, and I want to be clear, because this, sort of, came up on
the panel this morning, it isn’t about an expert and, you know, oh, we need an expert in this, or an expert in that, it’s a set of competencies that collectively the board has.

I think the expectation is that any individual director doesn’t need all those competencies, but should not be a single issue Director either, you want people who are adding value in the boardroom. Along those lines, New York City is a signatory to a petition at the SEC, led by North Carolina Treasurer, Janet Cowell that requests that the SEC require companies to disclose a skills and experience matrix in their proxy. Right now, you can read the bios of directors and you may get a sense of what they bring to the Board. And it’s very hard to get a picture of the board in totality is it international, regulatory expertise, technological expertise, risk management, safety? And what the petition says is, the board should be permitted to define the dimensions, they think are most important and how their directors fit in, and it’s obviously, probably going to be craft – you know, we don’t suffer from any illusions. If boards will likely craft the matrix to make their current board look exactly – to have exactly what they need, but I think it’s an important starting point. The partition also asks for a couple of mandatory dimensions of disclosure around race and gender, but largely, it’s left up to the board to define the dimensions.

Sally Fisk, Senior Corporate Counsel, Pfizer:
I think we come to this from a somewhat different perspective than the oil and gas industry, being a biopharmaceutical company and just by way of a little bit of background. We have 65 manufacturing sites worldwide. Our 2014 revenue is $54 billion. We have more than 97,000 colleagues around the world and we sell products in more than 175 markets, but unlike some of the other panellists our main assets are not carbon assets and our products are medicines.

That said, I thought I would give you just a brief overview of our energy and climate change programme, of how we have approached it, in terms of mitigation, risk assessment and disclosure. And Pfizer recognised the, kind of, importance of climate change on our operations, as well as on public health, going back to about 2001 when we established our Energy and Climate Change Programme. And at that time, the focus of the programme was really around energy efficiency, and improving our energy efficiency so that we could reduce our greenhouse gas emissions.

We’ve had two successful greenhouse gas reduction goals, which have enabled us to reduce our absolute emissions about 50%, from a 2000 baseline, to 2014. We currently have our third generation greenhouse gas reduction goal, which is another absolute goal, to get us another 20% reduced emissions, from a 2012 baseline, by 2020. When we set that goal, we took a, kind of, different approach than we had in the past, which had been, you know, establishing a goal that we felt reasonably certain we could achieve, and in setting the third goal, we recognised that the science had evolved somewhat since 2001, and it made all the sense in the world to make sure we were on a trajectory, to enable a two degree – no more than two degree centigrade rise in temperature by 2050, as recommended by the IPCC. So, on looking at their reports, we determined that meant about a 60 to 80% reduction by 2050, from 2000 levels. For a company like Pfizer, to set a firm goal out to 2050, all of the folks on that team would be, hopefully, retired by then, so it made much more sense to set a near term target. So our target is 2020, but when it was presented to the Executive Leadership Team for approval, it was with the understanding that the vision is out to 2050. But again, it, sort of, echoes some of the issues discussed by the other panellists, in terms of like, the long-term strategy, versus near term goals.
So, we've realised our carbon reduction goals, mostly through concrete energy efficiency projects, and also through renewable and cleaner energy technologies. We’ve done over 3,000 renewable – energy efficiency projects to realise these gains, as well as, I think we have 116 megawatts of cleaner energy capacity in our portfolio. But that's, sort of, on the mitigation side. As our programme evolved, we realised that climate change is more than just an opportunity to reduce our own greenhouse gas emissions, but there's also the need to assess the other risks that are attendant with this issue. And we see those risks around three primary areas. Regulatory drivers, so changes in regulations that could increase our, either capital or operational expenses.

We also see physical risks, from climate change, to our 65 manufacturing sites and our network of thousands of key suppliers that really makes up our supply chain, and ensuring that those locations are assessing whether they're at higher risk from storms, or other severe weather events, sea level rise and understanding what potential impacts that has on our supply chains, as well as just on the assets that are there, and the risk to those assets. And third, climate change also presents reputational risks, particularly for a company in the pharmaceutical industry. We are very sensitive to our reputation and ensuring that we are clear with our stakeholders and our shareholders, in terms of what our position on climate change is.

And to that end, we published our Climate Change Position Paper, I think the first version of it was in 2012 or 2011 and we updated it in 2014, and that, kind of, sets out Pfizer's view on the policy landscape and our own actions, vis-a-vis climate change. We also published a document that we call, Our Making the Link document, which recognises the link between climate change and human health. The WHO has articulated the various ways climate change could potentially impact public health, more recently Lancet Commission and American Medical Association and others have reinforced, and seconded the research that was done in that area. So, those three areas are where we see the risks: regulatory, physical and reputational. We assess those risks through our operational risk evaluation process, which is a multidisciplinary process, run through our Global Environmental Group, with key partners involved and the outcomes reported up through our corporate governance chain, into our Executive Leadership Committee and key components of our Executive Leadership Committee.

But one thing I just did want to mention, in terms of reporting. We report out risks on climate change and our 10k, and we started doing that in – for fiscal year 2009, after the Ceres petition prompted the SEC to issue guidance that climate risks need to be disclosed along with other risks to a company. So while they’re not material to our company, at this time, we want to make sure that investors are clear that we do consider them in the framework of our other environmental risks that could be presented to the company. So if you read our 10k, you’ll find climate change noted in a couple of key places. But we also have been disclosing our performance and on the issue of climate change in our CDP Report since 2007 and finally, we report key performance indicators around climate, as well as other sustainability metrics in our annual report, and on our website.

Tony Cudmore:
Thanks, Sally. I’m going to put a small plug in, I should have mentioned. In addition to releasing our climate portfolio analysis this week, last week we released our FY15 report. So I used to work in the US and I’m used to calendar years. I’ve now got to think again about fiscal years and different terms, when our June to July 2014/15 Annual Report was released last week, and as was our sustainability report, which also contains quite detailed analysis and an overview of our views on climate risk. So, we have strategic reporting
requirements now under UK reporting legislation, which we have, and a detailed discussion in there and again, Geof can certainly talk further about that later. But you know, for us, obviously, climate is a significant risk on both the operational side and the market side.

But, because I’m from Australia, I’m going to use a slight cricketing analogy here and I’m going to open the batting, I’m going to ask one question, maybe Andrew, or really anyone on the panel might care to answer and then I’d really welcome questions from the floor. But just thinking about some of the perspectives we’ve heard, from both the private sector, as it were, the public sector, from Mike’s point of view and from the, sort of, investor analyst sector.

One of the things that I think is interesting, is we all talk about climate risk, we all talk about the prospects for stranded assets and so forth, but I guess my question – thinking about a future carbon strained world, how much do you think, and Andrew, I might ask this to you initially. How much of that future carbon constraint, as you see it, is driven by Government policy, one? Secondly, by expectations of Government policy, if that makes sense? And thirdly, by the market reacting to more intrinsic commercial risks associated with climate change. You talked quite a bit about the economic implications of unabated CO2 emissions, so could you?

Andrew Logan:
I guess my sense is it’s the reverse order that you laid that out. So I guess we see policies being incredibly critical and the, kind of, the ultimate solution, you know, if we want to actually avoid the worst impacts of climate change and keep it to a manageable level, I think it’s going to be a while before we get that, kind of, very strong global policy. It’ll take a while for it to really have a bite I think in the near term. And there’s lots of other research out there that, kind of, think underscores this. You take research from Barclays and HSBC recently around what might impact oil demand going forward and it really is more on the technology and innovation side. So it’s things like improve fuel efficiency and in transportation in China. It’s fuel switching in the petrochemical sector, this whole sales switch away from oil.

I mean, all these kind of things really actually add up. I think what we found over the last year is the price of oil has come down, what, like 60% if we look at the IEA data, it’s like a one or 2% imbalance between supply and demand. I think we’re seeing that small changes in demand have huge impacts on price. So I think you don’t have to imagine the world going off of oil or anything in the next 30 or 40 years, to really be worried about the price of that commodity going forward and planning for a demand in price, are much different. Obviously, policy will come and I think expectations of policy, at this point, are having more of an impact than the policy itself.

Michael Garland:
I’m not as optimistic. I think absent dramatic political will and I think all of those things are important. Technological change in the market, but even in the regulatory arena, so an investor like us, and it would be great to be investing in the solutions to climate change, but we need a change in the incentive structure, where there’s stable incentives, those investments need our risk return profile. It’s very difficult to do and I think for lots of reasons there’s not global consensus. I think some of the short sighted lobbying activity by companies, who may think it’s in their short-term interest to block reform and I applaud companies that have publically recognised the need for strong policy action. So I think there are a lot of things going on, but I think there’s a critical need for a global political will and policy change. And absent that, we have unmitigated climate risk and it’s a whole other set of risks and so energy companies are – have to deal with the two degree scenario but the
largest energy producers in the US have a lot of refining capacity on the Gulf of Mexico, so you talked about the physical risks of climate change they're quite susceptible to those physical risks as well.

Andrew Logan:
Yeah, just to be clear, I wasn't saying, or maybe I wasn't clear about this, that technology's not the answer on its own. My sense is you've get policies critical to solve the problem, but until we get a policy there’s lots of things going on, on the technology side that will bring demand down and I think, the worst cases we get, we get to no policy, or we get it where there’s, kind of, horrible, muddled middle where climate change is still running rampant, but the price of oil is low, and so, kind of, everyone’s in a bad place.

Robert Walker:
Well, just to observe I think it’s government policy versus a technological revolution, and I think there are jurisdictions where government policy very often does support a technological revolution. We are seeing a lot of, I think, a lot more aggressive public policy action in Europe, in France and Germany where they do have very active energy transition strategies underway, where a whole of suite of policy instruments are being brought to bear, not just to put a price on carbon, but to support the technology that we need. I’d love to leave it all up to Elon Musk, but I don’t think it’s going to be enough [laughter].

Sally Fisk:
From our experience, I mentioned all the projects we’ve been able to do and while those have been able to meet our own internal financial return requirements, having price stability and predictability going forward, can really help a company plan for the long-term and make projects that might otherwise not meet our internal financial requirements, far more favourable, if there is a more clear financial signal on carbon.

Tony Cudmore:
Great, thank you very much. So we’d love to have some questions from the floor if – there’s a gentleman over here to the – to your right. Thanks.

Doug Cogan, MSCI:
Just a point of clarification from you Tony and then a broader question, and I’ll get them both out now. So, the first is just what you were saying initially is you were looking at your own commodity portfolio, your thoughts on metallurgical and thermal coal, ’cause I didn’t quite capture that. And then the broader question for the group is, from the company representatives, we’ve heard this idea of what you are budgeting in terms of analysis of your commodities, or in Pfizer’s case, what you might need to do to reach a two degree scenario, with carbon reductions within your own energy portfolio? So, turning it then to the investors on the panel, is there a carbon budgeting exercise that you’re going through as well? I mean, Bob talked a little bit about how you’re reducing your underweight energy, so you’re obviously doing that in some form, but to what extent you’re actually trying to measure that result, and in terms of carbon footprint? And I guess to, kind of, crystallise that question, a year ago at this time there was a lot of fanfare around the Montreal Carbon Pledge to have investors come out and set a baseline for their emissions. In the US there’s been relatively little uptake for that. I think there was just two playing sponsors: UC Regents and CalPERS that have done that. So if there’s any – you can speak specifically to the pledge, or just
more generally to the IBF setting up a baseline or a budget for your portfolio. But if you could start.

**Tony Cudmore:**
Sure, and glad to clarify. So we certainly make a distinction in our portfolio between thermal coal and metallurgical coal. Our view, in that two degree world scenario, is that thermal – there’s a more significant impact on thermal coal than there is on met coal and that’s, I think, for a fairly clear reason we do assume, in a two degree world, that there will be a moderating effect on future steel production, but that steel will still be intrinsically important through economic growth and development. That’s probably a statement of the obvious, but there may be more of a transition to recycling. But if there is an ongoing demand for steel, which we can fairly safely assume, you’re going to need metallurgical coal, because it’s essentially, at this point at least, unsubstitutable in the steelmaking process.

It’s a different story, obviously, thermal coal is quite substitutable for energy production. So we would see a greater impact on thermal, relatively moderate impact on iron ore, and met coal, a positive impact on copper, because copper, as I said, is essentially required for a renewable energy infrastructure. We’re a significant uranium producer but it’s not a significant part of our portfolio, if that makes sense, relatively speaking, but we would see likely upside there, and probably likely upside, at least in the new term, on natural gas. Does that clarify? I might hand it to the team to talk on the investor side.

**Michael Garland:**
We’re about covered for climate assessments, we’re looking at it. We are talking to a consultant and for quite some time. We’ve ongoing concerns about methodology and accuracy and the question that we have, we have a sub-advisory model and so the question we have from our business model perspective is, if we get a number, what do we do with it? Do we then integrate that into our screens, or do we integrate it to our engagement programme? We’re not sure yet. So we’re still working all that out, but at this stage, we haven’t done that, taken that step.

**Robert Walker:**
Yeah and we’re aware of the Montreal Pledge, we’re not a signatory and although there’s been some discussion internally, there’s no plan at this point to take that step.

**Michael Garland:**
I’ll add to that. We are, as I’ve said, underweight energy, so we know we’re likely below any benchmark that might be out there. We’re also very much interested in neurotechnologies, a bit of challenge in doing that from a risk return perspective, but there are models out there now that are under consideration to advance those solutions, as opposed to working on a footprint, which is, in any sense, a look backwards as opposed to a look ahead.

**Richard Ferlauto, Senior Advisor, 50/50 Climate Project:**
Tony, I guess this is mostly for you, is that your 2% carbon constraints review I understand was mostly a board driven process. Could you unpack that a little bit, about the role of the board, in setting the strategic review of that and then, more broadly for you and the other people on the panel who want to comment is that, as investors we’re looking for an increase in carbon competency on boards. How could you help us evaluate whether a board actually
has those competencies, or how we turn a path to develop those competencies, in terms of board refreshment, recruitment of new directors, developing internal educational support, so that the board has got the ability to deal in this brand new scenario that you've indicated?

Tony Cudmore:
So, our board, and obviously I'm not on the board, so I can only speak about the board. In terms of the production of the document and the scenarios and so forth, the board absolutely play an intrinsic role there and I think, Andrew you might have mentioned the comment around the tension between the Executives, or maybe Michael it was you, Executives and boards and the various timeframes and how are Executives rewarded and so forth? I can't speak for other companies. I would say, I think in our organisation, because, apart from onshore US oil and gas, where the payback period is relatively short-term, most of our other commodities are long-term plays, and they do require long-term bets, as it were, and so, I don't quite see, at least at BHP Billiton, from at least certainly a remuneration perspective, a sort of, a clear link between, sort of, short-term profitability and long-term decision making, but that might be a little different elsewhere, so I can't speak more generically.

I go to every board meeting, so I can at least observe, if not participate. Climate risk is one of the most debated topics at the board, both at the general board level and on the sustainability committee of the board, so we have a sustainability committee that's comprised of a number of directors, some from oil and gas, in the past, some from mining. There is a, I think, a clear literacy and an understanding of the strategic dimensions of climate change and a clear expectation of management, that these issues are thought about in periods of decades, not in periods of handfuls of years and from what I've seen, it has been an incredibly positive discipline on management.

The carbon portfolio analysis that we released yesterday, was a board level document, so while the foreword to the document is authored, so it's a management document as it were, it's the Chief Commercial Officer who has responsibility for our Environment Policy, which is no accident by the way and BHP Billiton is the owner of that document but it did go to the sustainability committee for endorsement. I can tell you it was the subject of very robust assistance and input and guidance, and I don't mean that cynically at all. It was a really robust debate between the board and management on the production of that document and the finished product represents, very much, the view of the board.

I don't know if that answers your question, but speaking for BHP Billiton, certainly this literally is a strategic question for us, because ultimately, it's a question of our future viability, so I think it's relatively binary for the company and I certainly know our directors see that.

Robert Massie, Somerville Retirement Board:
I have a question about your opinion on a topic that is debated pretty much everywhere. Among some of the other things I'm doing, I find myself now on the Somerville Massachusetts Retirement Board, which has 238 billion dollars, for a city of 7,000 people, and we've all noticed the decline in oil stocks and general deflation of the value across fossil fuels. The argument that is emerging in the board is whether those downturns, particularly for coal suggest a structural decline, at least in the US. There aren't many, many people defending the idea that coal's going to come rushing back. But the question mark is hanging over oil and the asset managers that Somerville has, I'm new to the board, the asset managers, first of all, seem really ignorant on the whole issue, which is, I suppose in some ways, depressingly not surprising. But to the extent that they've been queried, or some of the members of the board say, "Well, oil's down, it'll go back up, you know, we'll just hang
onto the stock” and so forth, whereas Andrew painted a portrait of secular and fundamental decline where low prices are not going to necessarily stimulate demand and where we’re looking at a major structural transition in the economy, one way or the other. So, I think that’s a key point now and it connects to fiduciary duty. It is your fiduciary duty to wait around and wait for oil to come back, or is it to recognise that this is a serious problem that needs to be addressed as soon as possible? So, the question is, how do you see this? Do you see this as in structural decline, where are we on that broad assessment of where the oil industry, in particular’s at?

Tony Cudmore:
Well, I think it’s a very interesting question as to whether or not we’re in structural decline, or whether there’s some other variables at work that have seen this significant change in price recently. I know there’s a lot of debate about the strategy of Saudi Arabia to drive onshore US shale production out of the market. If that’s the case, well, we’ll see. I mean, you know, you can see objectively the recounts and so forth are falling, thus we can presume that liquids production is falling, but these things don’t happen overnight, so there’s clearly a lag between the supply side response and on the US side, so we’ll see.

I think it’s a question about whether or not there’s a broader term structural issue here. I mean, if you look at the US alone, I mean, many people may not realise that gasoline demand, I think, is either at or pretty much peaked and now falling in the United States. Now, I’m not sure ten or 15 years ago people would have thought that would be the case and that’s driven, in a large part, by fuel efficiency improvements, smaller vehicles. It’s going to be interesting to see, and I haven’t looked at the data recently, what’s happened to US light vehicle demand, but I bet with lower gas prices, people are buying at a margin, at least more issue of these again. I’d have to see, so I don’t know. I think we can assume around the world as efficiency technologies, to your point Andrew, take hold, that’s going to have a moderating impact on oil and gas demand, this is what it would otherwise be.

In fact, in our report, there’s a chart that shows there is still need for action to disconnect economic growth from energy demand, because the absence of some change there, we’re not going to hit 450 parts per million. I’m not trying to, sort of, bridge back to you unnecessarily Andrew, other than to say, I think the question of where the market goes, what consumer behaviour and technology does and where policy intersects, to hit that intersecting point, I think is a really interesting question.
So I guess, I’m not sure I can answer your question on structural decline, but I think you can see the market in many ways responding to incentives for efficiency as technology evolves and it’s happening quite rapidly, actually.

Michael Garland:
I appreciate the question, and take it in a slightly different direction, because that is a fundamental question we’re all thinking about and so, from the perspective of an institution that’s 80% indexed, then it becomes a question for a board of a company that is trying to look out for the long-term and saying, is our business model, you know, has the market fundamentally changed, or is this just the cycle and it gives me the opportunity to talk about a study that I had meant to bring up, but didn’t really have the opportunity. But it came out of Oxford. The study, which came out in July, is named Cognitive Biases and Stranded Assets, detecting psychological vulnerabilities within international oil companies. And what they did, is they looked at ten of the largest majors in the world – they basically set the stage by saying that there’s this trend toward CAPEX density, so more capital and fewer large projects and that as that happens, you have a greater risk of cognitive biases.
It’s the risk of stranding an asset or making the wrong decision and they list 20 different cognitive biases. One of which is optimism bias, and this comes into where we are, and that’s defined as the tendency to distort the perceived likelihood of favourable or positive outcomes, by judging them to be more probable, than less favourable or positive ones and if this should cause negative scenarios to be overly discounted. So they take this set of concerns about cognitive bias and then they look at diversity on the boards of these companies. Diversity defined by gender, nationality, age, experience, industry I think, there were about five dimensions, and they conclude that, actually, the US major, Chevron and Exxon had the least diversity of perspective in the boardroom and therefore, the most susceptible to climate change. I think it’s on a scale of zero to one and BP came out, sort of in the middle and actually looking pretty good. ConocoPhillips was not as bad as Chevron or Exxon, who had few, if any non-US directors and they credit the likelihood that BP’s board seemed to be more diverse across various dimensions to possibly a reconstituting of the board, more thoughtfully in the wake of the Deepwater Horizon.

Fiona Reynolds, Managing Director, Principles for Responsible Investment:
I just wanted to add about your question about the Montreal Carbon Pledge. I’m Fiona Reynolds from the PRI, since this was a PRI initiative. So, we’ve got 96 signatories to it, over five trillion. I think Bob talked about the fact that some of the – there’s queries about the data and I think there are issues around the data, but I think a lot of our signatories have been able to use it as a way, at least, to get started to think about what risks that they’ve got and what steps are they going to take. But my question was to Tony. One of the other pieces of work that we’re doing is a collective collaborative engagement, with a whole lot of signatories, that is around political lobbying and climate change, and that came up on the panel. And so we see – we put out an expectations for companies about how we expect them to deal with these issues, but you do see a number of companies who, on the one hand, say the right things about climate change, on the other hand, through trade associations or others, are funding organisations not, you know, to lobby against a carbon price and things like that. You’re Australian, minerals counts on Australia’s very out there and anti-climate change, it’s put its new coal campaign out. What’s your stance on these issues and how are you disclosing them?

Tony Cudmore:
Well, our stance on these issues on – insofar as the MCA is concerned, is that we – so we’re probably the biggest member of the MCA, but the MCA doesn’t speak for us. We don’t seek to impose our views on every other member of the MCA. So, you’re right, they’ve got a new campaign on coal. I would note that the campaign, we can debate whether it’s optimistic or not, has a significant dimension around efforts to reduce the CO2 intensity of coal, but I’m happy we can, in the issue of time, perhaps we can take it offline, or we can do it right now.

On your second question on political lobbying, we try and be as transparent as we can be. I mean, we certainly comply with all, obviously, laws and regulations on lobbying disclosure, including here in the United States. We are participating right now, you probably know Transparency International is doing a whole project on political activities and we’re working with them to put our point of view forward. But in the end, I would say, and I can say this absolutely with 100% confidence, anything we say to government in any capacity, would be completely consistent with what we would say externally. We would make no distinction between those views.

Well, thank you very much everyone.
Integrating environmental, social and governance factors into investment considerations hosted by Sustainalytics

- Donna Anderson, VP & Head Global Corporate Governance, T. Rowe Price Group, Inc
- Peter Coffin, President, Breckenridge Capital
- Clare Payn, International ESG Manager, Legal & General Investment Management
- David Shammai, Senior Corporate Governance Specialist, APG Asset Management
- Chaired by Michael Jantzi, Chief Executive Officer, Sustainalytics

Michael Jantzi, Chief Executive Officer, Sustainalytics:
The practice of looking at environmental, social and governance factors as part of investment decision making, is something that is happening globally. It's not a one-size fits all proposition. There is a variety of approaches to ESG integration. It’s happening across asset classes. It’s integrated into different investment styles and philosophies and yet, amid the sea of diversity, when it comes to ESG integration, there is one consistent theme, that brings all of these individuals to the table to talk about ESG integration, and that is materiality. The fact of the matter is that those who use ESG factors to inform their investment decision making process are doing it, because they believe it helps them identify risks and opportunities that otherwise might go unnoticed. They believe that it helps them make more informed investment decisions that can lead to a better outcome, on the shareholder value side, over the long-term.

Donna Anderson, VP & Head Global Corporate Governance, T. Rowe Price Group Inc:
My firm has a deeply rooted conviction from hard experience that corporate governance is absolutely an investment consideration, it’s material. It should be part of the research process, it should involve resources and training. The evidence of that is our Fund Managers who vote their own proxies. I can give them advice, I have policies, I have recommendations, jointly with our Analysts, but ultimately, the investor who knows the company the best, is charged with the responsibility of voting in their clients’ own interest. So, we have this deeply rooted process in governance that goes way back. But I think today’s scope of what we are wanting to talk about is expanding that beyond purely ‘G’ or governance into longer term issues, or issues of a different nature. And so, where we started with that is again, we have this deep investment, over the years, in a fundamental Analyst Team. My firm is deeply committed on actively managed strategies. Virtually all of our assets are under management, which are about 750 billion US, are an actively managed strategy.

We believe in fundamental research, original independent research and getting close to the companies. We have staff of about 350 analysts that are throughout our investment offices around the world and they have deep expertise in their industries and geographies, and are good investors, but they’re also very territorial about their companies. They are ultimately responsible for taking these factors into account, weighting them appropriately and factoring them into their investment recommendations. But they need help to do that.

So we have a booster programme. I’m an ESG Specialist to provide in-depth research and screening on various bases. We also have an expert in emerging markets and an expert in fixed income. They are the designated ESG subject matter expert in their areas. They are
advocating for ESG and starting conversations which can centralise that dialogue and keep it at the forefront of people's mind's who might not identify some of these issues.

**Michael Jantzi:**
And you talked about ‘G’ being so deeply rooted culturally in the firm for a longer period of time, how was it that that thought process has expanded to the ‘E’ and the ‘S’? Was it a gradual journey? Was there an event or two that triggered that?

**Donna Anderson:**
So it starts with some experience where you realise there was an expected event, or there was a mistreatment of our interest and then you're looking for patterns. We do that, for instance, with Directors and we have Directors in the portfolio who exhibit behaviour that we cannot justify as in our interest. We track those Directors wherever else they show up in the portfolio and generally don’t support them there. So pattern recognition is all what it’s about. And the same thing’s happening with ‘E’ and ‘S’, you find a good, relevant, material investment centred, appropriate, case to take up as a cause and then the lightbulb goes on and they start to look for those patterns elsewhere in the portfolio.

**Michael Jantzi:**
I want to turn to you, Clare. An asset management perspective, but with L&G, it’s a different approach to ESG integration? What were the drivers there?

**Clare Payn, International ESG Manager, Legal & General Investment Management:**
To give a little bit of background on L&G, we have a trillion dollars of assets under management and 40% of that is in equities and of this, 95% is actually in index funds. This means that within equities there isn’t a huge amount of mandate for ESG integration, and this isn’t actually integration into active funds. The rest of our assets are broken down as 60% fixed income and of this, 50% is actually active. So, we have a lot of fixed income active assets and a result of this, the integration work is mainly done with the Fixed Income Managers.

We’ve pursued this from client demand. Clients are asking for more ESG integration and some of that was already in the process that the team leads. But some of our clients have really been asking for demonstrable evidence that ESG is integrated into our fundamental analysis and especially those with long-term mandates. So we realised that we needed to align what we do with what clients were asking for. We decided to create a more systematic way of addressing ESG risks in credit funds and together with the Analysts and Fund Managers we looked at some of the material risks that sit in different sectors, in terms of ESG.

We broke the universe down into 22 broad sectors and we picked up the kind of things that could go wrong for a company and developed indicators around these issues, to let us see if companies are managing these sufficiently. We decided to do it this way, because our investable universe is so huge and this was a good way to start and allowed us to more easily develop identifiable flags in the portfolio. So the development of this proprietary tool allows us to benchmark companies against each other, in terms of ESG performance. But crucially, the tool allows us to customise everything, in terms of how material we think the risks actually are and it draws data and it’s something that we’ve built internally. It draws
data from six external providers: ISS, RepRisk, Sustainalytics, Bloomberg, GMI and Maplecroft.

The scores are based on relativity to peer group universe, of all issuers that are covered for ESG data by Bloomberg, in the industry classification benchmark grouping. The top score we have for a company is ten, and the bottom is one. There’s an overall score, which sits against the peer score, then there is a breakdown into ‘E’ and ‘S’ and ‘G’ categories, again, against peers. This then breaks down into more granular level detail. All these granular ESG categories can be weighted by the user, which is quite crucial. There’s also a controversy section, that spots consistent bad news and this is top negative ESG news where that’s captured. There is a country section as well that captures person, environmental, social and political risks, for each country that is relevant to the company.

There is of course engagement on companies held in passive funds, whether in equities or bonds, but in active fixed income, the big difference is between investment grade and high yield funds, that’s where things differ for us. A high yield fund is the portfolio of smaller companies which don’t disclose much information around ESG, yet ESG risks are a much bigger issue, as they can significantly impact the credit worthiness of the bond, and this team already has a good process in place to assess ESG risks, because if one thing goes wrong in ESG, then this can really affect the bottom line. So, it’s the Investment Grade Fixed Income Team that we mainly do the work with and the quality development, the conversation that we have with our Portfolio Managers, is more important than the quantity development, which is the system we’ve actually built. The flagging system, because that doesn’t actually tell us everything.

We also have some client mandates that are clearly more suited to ESG integration than others. For a short-term investment horizon, we don’t need to worry quite as much about ESG risks as these won’t materialise, whereas for long-term funds, we have a Buyer Maintained Fund, where we buy bonds and hold these to maturity, so there’s very little turnover in the actual fund. So, looking over 30 years, ESG risks become much more material, as they are more likely to play out in the holding period.

**Peter Coffin, President, Breckenridge Capital:**

Today we manage about 22 billion, most of which is still domestic and Local Government, municipal bond portfolios. But that has something to do with a revolution as we grew and expanded into corporates, then we applied much the same approach in our research or endeavoured to apply a lot of the same thinking and philosophy in our research on the municipalities side, or the corporate side, where of course, on muni’s, while disclosure’s come a long way, there is still it’s credit to credit and it’s know your borrower. There are no big sweeping quantitative judgements that can be made analytically.

I would also argue that municipalities tend to be community oriented. But the time horizon is longer. So, in any event, as we moved into corporates, we first identified securities that had greater risk, inherently. Municipals are much more monopolistic, so we had to worry about competition in the corporate world, and so there are riskier credits and importantly more idiosyncratic, or event risk. So ESG grew out of that. Just a sincere investment case that we wanted a deeper, broader, more holistic forward looking view of the companies in which we were investing.

Turning to investment grade fixed income, I think ESG is beyond compelling, in terms of its role in our research. It is essential and irresponsible not to fully integrate ESG. That doesn’t mean we have figured it out, in terms of materiality and relevance, but we are on this journey
and so when you believe that, it becomes something that you want every Analyst, regardless of their particular sector, or industry responsibility, to be engaged in. So our approach at Breckenridge is to have every Analyst, in every research report that they’re writing, to include an assessment on environmental social governance factors. Sustainability, and then we’ve built our frameworks and had some great partners in doing that. Bloomberg, Sustainalytics and MSCI go to SSphere and look at their rankings, and brand logic and Newsweek and it's not all internal, but more and more of it's internal and it's important.

Regarding fixed income, we have a responsibility, because we’re trying to price risk, and avoid under-price, or unpriced risks. That’s obvious and in the investment spectrum, everybody’s looking at risk relative of return, but fixed income more oriented towards the risk side, equity’s probably more the return side. I also think we have the luxury in fixed income of being a little less beholden to the markets. And the frustration is that the markets are slow to recognise, or validate a lot of risks that we know exist over the long-term. And it is ultimately, the long-term that also makes fixed income a good spot for ESG, as Clare said, a lot of these bonds that we’re buying have a duration that extends well beyond the immediate future. And so, it’s incumbent on us to take that into account, which we do.

David Shammai, Senior Corporate Governance Specialist, APG Asset Management:
We’re an asset management firm, representing or managing the assets of six very large pension funds in The Netherlands, in total representing an overall of four and half million pensioners, which is about 40% of the Dutch market. We’re part of APG Group, which is owned by our largest client, which is where we get the asset owner mind set. Good governance and incorporation of environmental and sustainability consideration, is something that we do as part of the investment considerations. I can think about three reasons why you’d care about these considerations. One is because you truly believe that it's essential in order to risk return and performance of the asset class, of our investment. The second is because, as a global investor, we have over 400 billion under management in 50 markets. We have a responsibility to contribute to the integrity of the markets and that will benefit us as well. And the third reason, which is less a direct investment reason, or rationale, it’s that we think we should be acting responsibly, that will protect our reputation and the reputation of our clients. I think it's quite crucial to make that distinction and pretty much build it into your concept and the process of integration, because why you're doing something will tell you how to go about doing it. For example, if your consideration is about optimising risk return, you may think that your understanding of risk is such that you think, actually you want to buy more, or to increase your weighting on particular stock, but it doesn’t show good performance of governance. But if you do it for ethical and reputational responsibilities, you’ll always act in one way. So it's quite important to have that as part of the way you think about it.

I think there are three sets of challenges or areas that need to be tackled. One is the tools and that’s bringing the ESG information into the investment side of the house and perhaps just also to add that 80% of our assets are managed in-house and we’re mostly an active manager. So, information and knowing companies is very much part of how we manage our assets and therefore, we need to bring the data and various tools and dashboards, etc., that are available.

The second one, in terms of sets of challenges and things to think about, it’s the integration of the thought, integration in terms of working together and that was also discussed and sounds quite familiar. So, we have that and the classic example of course is voting and governance, because that's a lot more established, but now you need to push that boundary of working together with Portfolio Managers on ‘E’ and ‘S’ issues. So, it will come to them
fairly instinctively that issues around carbon emissions and other health and safety, etc., are integral and are strategically important to the portfolio, but why should the information come from the sustainability and governance team?

The third set of challenges and things to think about is conceptually, what are you doing? And that is something because we are committed to integration of ESG across all our asset classes, and we have a diverse portfolio, it's really very much focusing on asset classes every time, whether it's equity and within equity there are different ways of pushing it in the different strategies. To give as an example, we had a concentrated effort around our quantitative trading strategies last year and again, all the data is instrumental but data is scarce. And then, you're asking about asset classes that are outside capital markets, so that's real estate for us. About 10% of our assets are invested in real estate, both listed and unlisted and it's an asset class that has quite a strong impact on carbon emissions and sustainability and that's something that's one of the things that we looked at. And more recently, we've launched initiative on measuring the impact of infrastructure investments and through that was some monitoring it.

Chuck Canfield, International Finance Corporation:
When we talk about 'E', 'S' and 'G', I work on the 'G' side and I have colleagues that work on the 'E' and 'S' side, and I'm just wondering, how do you really holistically look at 'E', 'S' and 'G', because what I find is it's either heavy on the 'E' and 'S' side, or heavy on the 'G' side? Do you look at it separately, or is there a better way of doing it?

Clare Payn:
I'm a traditionally governance background and as much as we're an ESG Team, in the system that we've created, the flagging system with material issues, we can weight what we think is important to a company. It might be slightly market specific, but if governance isn't where you want it to be in terms of what the board looks like, then the 'E' and 'S' issues aren't going to follow.

Peter Coffin:
It does depend on the industry, or sector, or company and some extracted industries are looking more at environmental issues, whereas in banking or finance you might focus more on social. At Breckenridge, the view is set at the top and often a lot of what's reflected in relative performance on 'E' and 'S', have much to do with the 'G'. So, our approach is to weight things, based on industries and then all factors are added up for a score. A perfect example is Walmart which has made great strides on its environmental practices, but has work to do on the social, in terms of labour practices and so, we haven't gotten over that hump, in terms of making an investment.

Donna Anderson:
We need to acknowledge that most of the issue of separation of 'E' and 'S' is relegation of 'E' and 'S' issues, to a lesser place than the whole portfolio is self-imposed, and it is propagated by our own communities resistance to getting a grip on materiality. I have two examples; one was a big software company that was in a huge transition. The CEO had already, under duress, announced that he was retiring and there was an open search in place for the new one, and major strategic questions, lurking on the side lines. And I went to this ESG conference, and someone from CSR and an investor was specifically highlighting why this company was such a great investment, because they had a really good way of
dealing with this censorship privacy issue in this one Asian market. And not saying it’s not a real issue. He said, “This is the reason to own this company, they’re really good at managing this one Government relationship, and censorship,” and I was the only person in the room, who thought that was a crazy thing to say. This is a company whose existence is in question and to say that you should buy them because they manage this one risk. Well, that is why ESG is not fully integrated when you talk to Portfolio Managers with a fundamental outlook.

The other example is Mylan. They were in the middle of a love triangle with these two other companies, and major strategic questions were involved. And it’s still unclear how these parties are going to come together, but they have major stuff going on and we were approached by an ESG oriented client of ours to engage the company on an issue of safety or label abuse of one of their products. We collectively as the investment community have got to stop, staying in this echo chamber. All of us should go to more investment conferences and you might hear an ESG theme pop up, like Mylan, that’s a governance thing, but you are not going to hear 100% of the time, this is the stuff that matters and until we get some balance in that way, we’re always going to be separated, ‘E’ and ‘S’ is going to be separated from real investment issues.

David Shammai:
In my view, there are two ways of looking at it and which way you look at it, depends on what the purpose you’re doing it. One way is to say, there’s no ethical dimension to governance, it’s about efficient allocation of capital and it’s about minimising long-term risks. We don’t like deviation from one share, one vote, not because we think there is some sort of ethical dimension attached to it, but because we think it will lead to long-term risks, etc., or just not put entire interest as minority shareholders. Looking at it like that, governance does stand out, because ‘E’ and ‘S’ do have a very strong ethical dimension.

The other way of looking at it, is to say ‘E’, ‘S’ and ‘G’ are all proxies to a certain level of risk and then you can come up with an index, or with a score that will be a composite of a number of sources, and covering all that. I think both ways are valid, and it really depends why you’re doing it. If you’re looking to protect your reputation and your concern is about the integrity of the market, you’ll be really putting ‘E’ and ‘S’ on the frontline and then you’ll be using governance as a way to assess your likelihood of success, because it’s how easy it would be to engage on these things. If on the other hand, what you’re looking to do is just to introduce an ESG input into an investment strategy, then I think you’d be looking at all these three things, because all of them are valid inputs to assessing long-term risks.

Michael Jantzi:
I think that both ESG and the ‘G’ communities are in a state of evolution and that evolution is bringing us closer together. I absolutely agree with the historic comparative of ESG was values driven, but ESG has been mainstreaming and that’s been focused on materiality and looking at risks and opportunities that will drive long-term shareholder value.

I would argue, from an outsider perspective, that traditionally, ‘G’ has been driven by compliance. Or when you’re looking at ‘G’, you’re evaluating a decision against a policy, or a particular event, a resolution at an AGM. I think that governance is now also shifting to looking at whether or not the company is structured in a way that’s going to drive long-term shareholder value, as opposed to whether this policy is being followed or whether it’s a yes or no vote. I do think that ES and ‘G’ communities are now increasingly focusing on that shareholder value over the long-term. So, there’s a journey happening on both sides, that’s bringing us close together and that’s going to continue evolving. ICGN is embracing that.
That we’re having this session here at an ICGN Conference, I think is highlighting that fact, at least to a certain extent.

**Daniela Jaramillo, Westpath Investment Management:**
I’m curious to see what the panel thinks of where should ESG Specialist Analysts sit? Should they be on the corporate governance? Should they be sitting and working together with a Portfolio Manager? And I’m asking as an asset owner, because we’re now in the process of evaluating ESG integration across our External Managers and should we be penalising an Asset Manager because they don’t have an ESG Team, or maybe older Analysts have expertise, but how do I know that they are actually doing it in a systematic way?

**David Shammai:**
Although mostly we’re managing our assets in-house, we also have External Managers and we developed a framework for assessing their performance by the External Managers Team, but specifically of how to incorporate ESG performance in the assessment of the External Managers, and we do that before we take on any new External Managers and also, as an annual exercise of assessing their performance. Making the distinction between the very large Asset Managers, the small niche ones, that have different capabilities and different approach to this and really try to think about what are the things that are important for us, in how they are factoring ESG and what questions to ask them, and what’s a good answer and what’s bad, and very systematically assessing their performance.

**Clare Payn:**
We’re not separated from our Portfolio Managers in terms of conversations. The conversations that we have, whether on the equity side or the bond side, with our Portfolio Managers is constant. We might have a meeting where our Portfolio Manager on the active equity side, in the London office, will be sitting at the table with us, where a company – whether it’s the Chairman of the company comes in, or the CEO of a company and the Governance Team and the Portfolio Manager and that’s the way we integrate the conversations. The tool that we’ve developed is owned by us, we own the scores, we’ve got to understand the scoring behind what we’re giving companies, but at the end of the day, Portfolio Managers will understand from us the risks around why we’ve given that company that score and they will see that tool as a valuable start of a conversation of where do the material risks lie? So we’re separate, but integrated.

**Peter Coffin:**
There are two things that I’ve heard people say. One, that when asked where they hoped sustainable investing would be five, ten years from now, the response from this individual was that he hoped there would be no such thing as sustainable investment, that it would be just investing, and that, of course, would mean the full integration into the investment process. But somebody else said, in a cautionary note that his greatest fear was that ten years from now there would be full integration of the ESG, but nothing really would have changed. And that latter scenario would make the case that there needs to be somebody who’s really accountable for ESG.

Our own situation in Breckenridge is very unique and fortunate and we made the decision that we believed that these factors were relevant and material, to the point that we ourselves said, we want to become a certified B Corp, and we changed our Corporate Charter to be a
Benefit Corporation. Every member of the Investment Team, especially the research, must take full account and we’re doing that.

**Donna Anderson:**
Our view is separation, building up a separate parallel ESG Team only perpetuates this issue of remaining in an echo chamber, out of touch with the drivers of short and long-term performance. To the question of, how do we document? Because we’ve assigned this responsibility to the Analysts themselves, we have an initiation template. Everybody who initiates on a new stock or recommends the purchase of a new bond, has to do a ten point evaluation of the investment and one of those is a full ESG analysis. Another example is, we have partnered with Sustainalytics. We import the data that we’ve selected, that we find most indicative of a conversation, into our own RMS platform, our own research platform that we built. On our journey, it became clear right away that if you just hand an Analyst a password to an outside site and say “you can go over there if you want ESG research,” you get nowhere. So, for us, we said, “Well, let’s bring the data and the reports into the environment where they live and work all day long anyway.” So I would say there are other signs of process that are not related to headcount, dedicated to ESG.

**David Shammai:**
The ESG Team is part reporting into the CEO and it works for us, because we’re an active house and I cannot see how it will work in any other way. I think in any other way, it would be difficult for us to be as effective as we are. I don’t think it takes away from the responsibility of the Portfolio Managers to incorporate, because they’re the frontline for these, that’s where their industry experience lies. But if you’re looking at External Managers, then you have to consider exactly the type of organisation and the type of investment strategy that they offer you, to evaluate whether the answer that they gave you about how they incorporate the issue, whether that makes sense or not.

**Audience:**
You talk about the challenges to integration and the thing that is always very apparent is that while we all claim to say or think we know what ESG risks are, we’re very good at identifying ESG risks, we’re not very good at measuring the risk. Do you think that the governance and ES community could do better, in terms of measuring the actual risk, because what gets quantified gets noticed?

**Donna Anderson:**
My view is we’re not there yet. We don’t have the dataset and I think these factors are really highly correlated with each other, so as a fundamentally oriented investor, our objective is to just expand the range of considerations that an Analyst is already taking into account. There are things that are natural for them to look at and then the goal here is to expand that universe. But to try to say this board outperforms because it has an independent Chairman better than another one, we’ve never found that we could separate and isolate those factors, because the idea of governance, with a lower case ‘g’, governance of a company dictates a lot more of your ‘E’ and ‘S’ strategy and the risks, than any single isolated factor, so we’ve never been able to quantify it.

**Michael Jantzi:**
Peter, you talked about specifically, very definitely focused on the risk side of the equation and the fixed income side, over the long-term.

**Peter Coffin:**
I think we do a better job assessing risk than we give ourselves credit for. So take Volkswagen, the point I want to make there is they almost got away with it. There was clearly a risk there that was never validated or recognised by the market, and might very well not have been. And I think that's commonplace. I would argue that there are lots of risks out there or uncertainties. Keynes was very distinct about risk versus uncertainty and ESG, I think, extends into the realm of uncertainty, which means you may not be able to quantify every plotted line and bell curve, but, you can make judgements and that's our job, as Investment Managers. So, I would suggest that the work Breckenridge is doing and why we are far from the point where we've figured it out, but we're on this journey. I do think these risks and costs are material and relevant, even though, in a large part, the market doesn't validate that for us. I think our job, as investors, is to look beyond short-term market opinion and I think we're on the right track.

**Keith Johnson, Attorney, Reinhart Boerner Van Deuren S.C.**
I'm curious if any of the panellists have taken a look at the Sustainable Accounting Standards Board and their attempt to identify, on an industry by industry basis, what are material factors? Have you found that useful?

**David Shammai:**
We did work at developing our own templates to assess materiality of issues, and ES issues according in different sectors and we looked at what SASB produced. Where we ended is of course not something that's identical to that, because it's something that's a reflection to us, especially if you look at materiality, in terms of public concerns, etc., then one needs to take into account, one's own clients and other specific circumstances. But in terms of relevancy of certain factors to sectors, then I think there's a lot of good stuff there.

**Peter Coffin:**
I would definitely concur, and we've worked pretty closely with SASB ourselves. We don't look at SASB's frameworks as the definitive final guide for materiality. A lot of other firms have done some outstanding work in developing their own frameworks and we value all of it.

**Michael Jantzi:**
There may be people in the audience who are looking to explore ESG integration, are there steps that you can initially take to engage with your colleagues, educate your colleagues, that people here, in a practical, tangible way, could take back to their day jobs to just take the first steps in this direction?

**David Shammai:**
It's the point about why you're doing it and you need to be very clear, especially when you speak to investment side, Portfolio Managers, who are thinking very analytically and very much in terms of impact of a company. If you're going to try to oversell the impact of human right risks on performance, but actually it's an ethical and it's a reputational issue, I think you'll be losing credibility, so you need to really be very clear about why you're doing it. Also
the point about try to quantify – looking at data that's out there and trying to evidence stuff, there’s quite a lot of academic research out there that shows the link. Mainly governance, but also, increasingly, ‘E’ and ‘S’, impact on price etc., so I think that’s also a good direction to start with.

Clare Payn:
To recognise it's not a one size fits all, there's lots of different ways that we can do this and certainly for us, the flagging system that has been developed internally, that will be on Bloomberg screens, internally, for Portfolio Managers to look at, it'll be our own scores on there. It's just a starting point. We haven’t got it completely sussed, but we think it's a good foundation to where we want to go and I think you've got to be confident in looking at risk sectors, whereas it really comes down to materiality and focus, and unfortunately, that is a bit of a judgement call. It's all about materiality and focus, because it's such a huge issue, it can be intimidating.

Peter Coffin:
I do think the fixed income side is compelling, because it does help us do a better job. There’s a compelling investment case from getting a better assessment of risk, and again, fixed income because you derive a return and an individual portfolio from cash flow, from coupons, in principle, that is earned independent of the market. You can look beyond short-term market. So I think it's a good entry point. But as a practical matter, what I’ve been most impressed with is adding insight and value in our research process, has been our own engagement with companies. And you wouldn’t think a Fixed Income Manager had much place, we don’t get a vote, can’t file a proxy, but we get to talk to managements and we learn a lot from them and they learn a lot from us, and they understand that we, as an important part of the capital markets, we think some of these issues are relevant and if you want managements to pay attention to them, then you’ve got to get the markets too. So, engaging, I think is a good step.

Donna Anderson:
I think we found leveraging the dynamics that are already present in your culture can help. By and large, investment shops are competitive people, they’re type A type personalities, they’re always looking for an edge, they’re always looking to outperform their peers and their benchmark and if you deliver something that’s of value to one of them, and other people are not using that particular source, or that particular insight, it’s viral. If one person identifies value, it will catch on because they talk to each other and nobody wants to be missing out. So, in our case, you can take moments like Volkswagen or you can take a theme like water and agriculture - here is a specific miss priced cost in the system and here’s how it affects your portfolio. You start with one and as word spreads that there is a free resource to be availed, a free new source of insight. Analyst should be reading on ESG, I find that word spreads and they will, organically buy-in and much, much more effective than just going around twisting arms or writing memos.

Plenary 3: The case for governance best practice codes in a US context
Over a dozen Stewardship Codes are now established - or in the process - around the world. Should there be a stewardship code in the USA? What are the benefits of having a code –
and disadvantages? What can be learned from those in jurisdictions where a code already exists?

- Peggy Foran, Chief Governance Officer, VP and Corporate Secretary, Prudential Financial, Inc
- Guy Jubb, Global Head of Governance and Stewardship, Standard Life Investments
- Ric Marshall, Executive Director ESG Research, MSCI
- Anne Sheehan, Director of Corporate Governance, CalSTRS
- Chaired by Dr. Stephen Davis, Associate Director and Senior Fellow, Harvard Law School Program on Corporate Governance

Dr Stephen Davis, Associate Director and Senior Fellow, Harvard Law School Program on Corporate Governance:

I would make this case, that in 2015 we have seen the rise of engagement between boards
and shareholders to a degree in the United States that we’ve really not seen before. And so,
you have this fact on the ground of Corporate Directors, engaging with real owners,
institutional investors and talking about how to frame the practices of corporate governance
within a specific company. It’s something remarkable and I’m sure we can expect this’ll be
carrying on in the future.

But when we think about market practices and not single company practices, we are still in a
different age. We’re in an age when the default of what the rules are and the frameworks
are for the market as a whole, is law, or is regulation, and both of those are blunt
instruments. Sometimes, because of the state of regulation, it can be dysfunctional, random
and arbitrary, and very often, law and regulation is not really attuned to the way either
business works, or the way the investment world works. And if it isn’t law and regulation that
we default to, it’s the Proxy Advisors, who are our default standard setters. And I’m not
disparaging them, it’s just a way of life that we don’t have a way in which players in the
marketplace, actors with skin in the game, can come
together, as they do now on a company
by company level, but at a market wide level, to figure out what are the practices of
corporate governance that makes sense.

Now, the United States is, in some respects, unique in not having a channel for discussion.
Since the Cadbury Report was issued in 1992, there have been about 90 markets that have
developed comply or explain corporate governance codes. Which essentially represent
agreements among major market parties, about what are the best practices. It’s not law,
and it’s not regulation, and it can be changed as market conditions change. It’s comply or
explain, rather than penalise, if you don’t meet the letter of the regulation. In addition to
those corporate governance standards, we now have stewardship codes, which began in the
UK, but now are in nine markets. The latest one being Japan, and that’s as of just quite
recently. So, those kinds of soft standards, have developed now worldwide and the question
before us today is, is the time ripe for us to consider a corporate governance code, and
maybe also a stewardship code, maybe together, in the United States? What benefits are
there, or what are the experiences of having those, as opposed to not having them?

Guy Jubb, Global Head of Governance and Stewardship, Standard Life Investments:

In terms of the benefits of codes in the UK we have two primary codes. The UK Corporate
Governance Code and the UK Stewardship Code, and the benefit that comes from a code
based approach, an approach based on principles, on a comply or explain basis, is that it
enables flexibility, but flexibility with accountability. If you have flexibility without
accountability, you’re on a road to nowhere and you need the two to come together, to
enable the checks and the balances, and at the end of the day, corporate governance is all about checks and balances. You need the two codes to come together to enable boards to operate, but operate in the best interests of the shareholders, and for investors to hold boards to account, but to do so in a way that is transparent, insofar as that they are required under the stewardship code to explain how they have applied the seven principles that are put to them, to do so in a way that is in the best interests of their clients, or their beneficiaries, if they are asset owners. So flexibility is very, very important.

Stephen referred to codes as being soft standards, but I would suggest that codes of themselves are not soft standards. They require thoughtful approach by both companies, by boards and by investors as to how they are applied, and to make codes really work, you need to have a little bit of regulatory underpin to enable that to happen. So, in the UK, when Sir Adrian Cadbury produced his report, he suggested that the London Stock Exchange should actually require companies to adopt that code and the Stock Exchange required that, so it became a requirement for listing, that all companies had to comply with the substance of the code and provide a comply or explain approach.

First, I think that one can adopt, and it’s too easy to adopt, a culture of compliance. Companies in particular will tend to find it easier to comply with the provisions of a code, and therefore avoid a difficult AGM, even when they would feel in their hearts it would be better to do something that was not in compliance with the code, and provide an explanation, but doing that invokes, the wrath of Proxy Advisors and, consequently, shareholders and boards just feel it’s not worth the candle.

The second issue about codes, is that over time they can grow like topsy. The Cadbury Code was well under ten pages when it was first published. You could get your head around it and boards could apply the principles thoughtfully. Now, the UK Governance Code is running to over 30 pages, and there is a point where, perhaps, a code of principles, somewhere along the lines, becomes a code of rules. I’m not suggesting we’re necessarily there at the moment in the UK, but it is a danger that one has to be mindful of, if one is going down the code route.

And finally, in terms of the shortcomings of codes, we have found ourselves, and since the financial crisis, experiencing, both in the UK, but elsewhere as portfolios of global investors become more diversified geographically, there has been a dilution of domestic stewardship. This means that in terms of the conversations that take place between boards and their shareholders, the engagement that takes place, it becomes more difficult sometimes for boards to get shareholders who are willing, because they are spread around the world to engage in the quality of dialogue that is intended, and equally, the views of the shareholders actually becomes more diverse, rather than otherwise, and that can actually make it quite difficult for companies to take decisions.

So, globalisation, in terms of the field of codes, is an emerging issue, which could dilute the effectiveness of codes.

Peggy Foran, Chief Governance Officer, VP and Corporate Secretary, Prudential Financial, Inc:
I think it’s unlikely, unless something else happens, there’s a scandal, unless there’s a strategy involved in this. We have a 50 state model, with a federal overlay and the federal overlay. That has been our model, and it’s been a particularly good model.
There are notable best practices out there from a number of organisations. There’s a Business Roundtable Best Practice that I know was updated mid-2000 and it may have been updated again. There’s Aspen principles, there’s NACD, so there’s notable practices out there that people look at and they follow, CII, as best practices.

I remember when I was Advisor, I put our top 30 shareholders in the room with the board, and there was controversy surrounding that because it was the first meeting really to have investors talk to board members. But one of the things that was very interesting to the board, is really they see the diversity in the room, that not all investors thought alike, and to really, for a principle, in order to get people to agree to various principles would be very hard.

Now, there are certain things that companies could agree to. There’s probably 20 high levels, but in any event, I think part of getting something like this out, is to have the dialogue and to have the agreement, and to come to the conclusion of what the best practices are. Recognising that there will be instances where, if you’re not necessarily four scores on that, that you will disclose it. I do see benefits, but given our system and the overlay, I see a tremendous amount of redundancy.

**Stephen Davis:**

Peggy is saying we’ve come some way along that road of creating a code, but we don’t recognise it as such, because actually, we have got lots of different initiatives. No single authoritative code as might exist in another market. So we have different people applying different standards, but not a single one. I think your argument would be that if it would happen in the United States, the trigger might be a scandal.

**Peggy Foran:**

Well, that’s what I’ve been on a couple of the taskforces that have looked at this and my advice to investors that really would like a code, is to draft one right now, put it in your drawer, the next time there is a major scandal and people are going all over the place with Dodd Frank and Sarbanes-Oxley and legislation, take it out. Because I think the business community would be very willing to have something like that, instead of the type of legislation that they’re used to. So I think it’s a compromise.

But the interesting thing now, if you look at a lot of the better proxy statements, you see companies trying to put charts that say, this is what we do, this is what we don’t do, and interestingly, it seems like these are the basic things you as investors, we think this is what you would want and we do them. There are some things that you would not like and we don’t do them. So, I think in many ways, companies would like something a little more definitive, as you would see with a code, but I think, there’s too many people that have skin in this game, because of the state and the federal.

**Stephen Davis:**

Okay, so that sounds like a bit of an invitation to, you said the investor community, but maybe a broader group to get something ready for when a scandal might erupt. But let me ask Anne, if we were to think about an authoritative code, what would it look like?

**Anne Sheehan, Director of Corporate Governance, CalSTRS:**

I think it would probably reflect best practices, that have emerged and that where there is some consensus around. It could have some aspirational aspects to it also, so that
everyone may not be there yet, but it would be a nice place to get, if we could, and they could do it on their own path and in their own way.

I think one thing that was interesting that Peggy said, that actually matched with the answer to the question about the market developing something and investors, or the other players, putting it in the drawer, because I think the answer to the first question was, some sort of market solution. I’m a big believer in us taking control of our own destiny, I’m not trying to leave it up to the SEC, or some of the others. It’s not their role in this country. We don’t see the regulators and it has been said, we have such a large market, with 50 states, there are so many companies, so many investors as well as dispersed ownership. So trying to corral all those cats, and herding cats is not an easy process, so that’s why I say, I think some of code, or guidelines and best practices. I think amongst investors, and I don’t want to speak for all investors obviously, but there are some best practices and some voting patterns that you can see that have emerged over the years that people are accepting. I think majority vote is much more accepted this day and age. I think a lot of investors have concerns about certain aspects of poison pills.

I think the jury is still out on proxy access, but I think this past year, and these next couple of years, we’ll see where that becomes an accepted standard. There are some that many investors could agree on. I think the issue is, you’ve got the Corporate Governance Code, this is what investors like and this is what we expect of our companies. I think the stewardship code is a little different aspect, and that is, what are the expectations that people have for investors, in terms of how we carry on our business as investors? How do we engage with companies? How do we put out what our guidelines are? All of those types of issues. They could be in one document, but I think they have perhaps different audiences, depending on who you’re talking to.

Peggy Foran:
This takes a long time. Aspen had an initiative, it was eight years ago, and it took a long time with investors, public pension funds in some companies, and interestingly, they could not get full agreement.

Stephen Davis:
I wonder whether given the evolution of the market, since that period, and certainly in the last year or so, where you have investors playing a very different role than they used to play and companies doing engagement in a way that they didn’t do before, even at the board level. That I just wonder whether that’s an opening, because otherwise, the default again, for a standard setting is law or is the Proxy Advisor. So, I’m just wondering, is there – might there be more of an appetite for that now?

Peggy Foran:
There might, but I think you have to get the right people to the table. You know, who would represent whom, type of thing. Do you get the NACD, do you get the BRT, do you get Aspen, do you get the society? But my sense is that would give you an outline that could be used and put in the top drawer. And at some point might be very useful.

Anne Sheehan:
I think I would agree that things have changed and since the financial crisis, and there have been some evolution within the corporate governance world. I think the SDX, the
Shareholder Director Exchange, is a model that investors, companies and other Advisors came together to develop something. So, we have moved, perhaps not as far as they have in other jurisdictions.

But I think one of the issues, is no one wants to, give their proxy to someone else when it comes right down to it. But I think one of the benefits of even having the discussion, or trying, is going through the process to see where the agreement is, on some of these issues. It may be that there’s agreement on 80%, but on the 20% perhaps not. That process alone can be beneficial to the discussion, and if nothing else, it helps us see how the other side is seeing these things and from our perspective, we always learn when we sit down with companies. We have our view going into the engagement, and we come away being educated on how they see it through their eyes. So I think that process alone is very good and beneficial to the players, if they’re willing to sit down. I also think the old adage that ‘perfect is the enemy of good’, would come into play in this type of discussion, because you would have people who feel very strongly about certain issues, and they insist it has to be in that. People have to come in with an open mind about what could be done as a starting point.

**Stephen Davis:**
Ric, why do you think the United States is so unique, in a sense that it has not, at this point, developed a national code? What are the reasons that we could look to for explaining that?

**Ric Marshall, Executive Director ESG Research, MSCI:**
I’d like to take this back in time about 25 years ago, when I first started looking at these questions for myself. Certainly a gathering of this type and this particular group of people, would not have occurred at that time. We wouldn’t be looking at this discussion at all. The opportunities that have been opened up, by virtue of the increasing engagement and so on, that makes this discussion even possible in this country, is relatively new. So I think it might be worth looking at how we got here. When I go back 25 years, if you had asked me, what is the single most salient feature of US corporate governance? I probably would have said at the time, that it was the extraordinary degree of power, welded by the CEOs of widely held companies.

We have been looking at the distinction between widely held companies and controlled companies. The sort of power that, in the rest of the world, only occurs when there is a controlling shareholder, and the controlling shareholder is represented by the CEO, often is the CEO. But in this country, we saw the rise of that at the management level and embodied by the CEO, and as a consequence of that, we ended up with certain kinds of governance problems that were relatively unique to this country. Such as the extraordinary levels of CEO pay that occurred over the course of the late 80s, 90s and earlier in this last decade and I think it’s worth reflecting on what lay beneath that.

Probably, most importantly, the fact that the US economy was doing so well, was dominating the world for so long, that US CEO’s perhaps felt they were on top of the world. We had a prevailing economic and legal theory that said that the bottom line was everything. We weren’t looking at lifetime employment, we weren’t looking at social impacts, environmental impacts; we weren’t looking at anything but the bottom line. The CEO had a very clear job and the board had a very clear job, and that was to maximise profits. It’s the extraordinary patchwork quilt of case law that we have, which is really what currently dominates corporate behaviour in this country. We have this obsession with litigation, as a means of resolving a lot of these conflicts and problems, and so as a result, we’ve ended up with this system.
that's very complex, with a lot of obstacles and I think they have their roots, and this historical pattern of development.

If you look at the corporate governance characteristics of any market, you can really only understand it by going back and looking at the history of how the particular practice is developed in that market. You cannot understand the Japanese corporate governance system, without understanding how Japanese boards evolved over the last 40 or 50 years. And I think the same thing is true here in the United States. We are dealing with these legacy issues, and they need to come out, they need to be talked about and they need to be dealt with.

Guy Jubb:
I think focus on change is actually where we should be on this, and it's the dynamics of change. When I was here ten years ago talking about corporate engagement, and in the UK we've done corporate engagement, really since the Cadbury Code came into being. It's evolved. But the question was, ten years ago, why should we engage? Now, the question is, how should we engage? Not only how we should engage, but how we should engage better. We have found, in the United Kingdom, that the codes that we use, they're living codes, they're not ones which are stuck in stone, they're ones which are reviewed every two years by the Financial Reporting Council, who is the owner of the codes. They're reviewed in consultation with companies, with Boards of Directors, with investors and others and other stakeholders. Every two years a number of changes are made to improve the codes, to make them better. This does give rise to the growth in the size of the code, so there is some downside to it. But these are living codes and the codes, if they were to be adopted in the United States, I would strongly encourage them to have that degree of refreshment built into them from day one.

Peggy Foran:
I could see a group of us getting together right now and figuring out the ten top best practices. I think you could probably find an agreement on that. But when you start getting into that middle ground, it's going to be harder.

Stephen Davis:
The approach that I'm hearing is a at some stage group of corporates, and a group of investors, and others, would come together with some common ground, asking where are the current cracks that intersect, but really not expecting that to take hold until the next crisis, or panic. Now that's very, very different from other markets, where codes, or best practices, have really been, in part, driven by Governments. In fact, even as I mentioned the latest one, Japan that was really driven by the Abe Government. Not authored by it, but driven by it. Is there any prospect of any Government entity driving a code in the United States?

Ric Marshall:
One thing that we certainly agreed on, is that the standing rule for counsel and at corporations, for many years, was that Directors shouldn't speak with shareholders, because there was liability attached to that, and that's part of that litigation history. Well, that's broken down. Sometimes it takes that enforcement, and we saw that with say on pay. There was engagement and the discussion was expanding, and that helped to break it open. It would be good to have a sponsoring body that could bring these groups together.
Stephen Davis:
Are there US bodies, the CII, the NACD, are there some established bodies that we could look to as potential drivers of this?

Anne Sheehan:
There are certainly bodies that you could look to. Whether they want to take the lead on doing something like this is a different issue, but there are established bodies who represent many of the interests that would be addressed in such a code.

Anne Sheehan:
The SDX was a grassroots effort of a number of companies, investors, advisors, law firms and others, who felt it was beneficial to come together and put out some standards and some principles about engagement. I think there is a model for that can work organically, and you have to recognise and acknowledge the culture in this country, we’re not going to do it out of the Government, and I’m not sure we should. I’m not sure that’s the role of the Securities and Exchange Commission (SEC). We have to figure out what the role to play is for the Government; the SEC is already overburdened with a list of things that they’re going to do, and adding this to that list, I’m not sure would really benefit investors in the long run.

So who else could step into the breach and step up and do this? And it could be investors with corporations, and some of the Advisors coming up and using the SDX as a model. The investors were a little ahead of the proxy advisory firms, in terms of who sets the standards, which was heartening to see. Because I do think the proxy advisory firms, while they have become the de facto standard centres, they do reflect much of what the investor clients tell them, in terms of what we’re looking for in our voting practices. Sometimes it’s easier for some companies to yell at the advisory firms, than to call me up, or some of the other investors and yell directly at us. So, I think the investors have to own how they have played into de facto setting the standards, and letting people know what their voting practices and policies are.

Peggy Foran:
It’s important, from a corporate perspective, to recognise this is not just governance standards, but we’re talking about a stewardship code, that with power, comes obligation, so I think that would make it easier. But I also think, you really have to go to those courageous leaders out there that you think would get followship. People who can really command groups, who have courage and are open minded. We would need to clearly articulate what are the benefits for doing this; what’s the problem you’re trying to solve and how this will help that problem.

Richard Bennett, President and CEO, ValueEdge Advisors:
I have a couple of thoughts, one is, what is the point? What problem are we trying to solve? The notion of putting something in a top drawer so that after the next panic it’s absolutely horrifying that we would find something we’ve been trying to create that would solve a problem after it’s occurred. Isn’t that a total dereliction of duty, for us as leaders of the capital markets? If we’re going to do this, with the point is to clean up after the next crisis, maybe the point should be what can we get to that will happen to flag the possibility that that crisis will occur?
I think that Government is not the solution. As responsible leaders in the capital market, we really ought to decide what the problem is that such a code would solve and then set about solving it. I think the notion of a prophylactic against the next crisis, is exactly the right goal to have in mind as we group these people together and get them to do something important.

**Marianne Harper Gow, Director, Corporate Governance, Baillie Gifford:**
As a foreigner, I think the thing that would make the most difference quickly, would be access to the board, and being able to engage with the board.

**Mauro Cunha, Chief Executive Officer, AMEC:**
My comment is, there may be a role for Government and we’re feeling that in Brazil as we try to turn the Corporate Governance Codes, into a comply or explain mechanism. You get investors on one side and companies on the other side, they don’t agree and, forgive me, ‘cause it could be an oxymoron, but you could have the Government get in as an honest broker to settle this, and really try to set these standards. My question is, given the experience in the UK, how do you ensure that the entity, only in the code, will not be captured? We have a lot of experience with self-regulation and a number of times they become irrelevant because of capture. How do we avoid that?

**Manuel Isaza, Associate Director - Governance & Sustainable Investment, BMO Global Asset Management EMEA:**
There were a number of references made to history and how that has played a role, and then the point about waiting for the next crisis. In the US particularly, that history has shown that after a crisis the solution has come from the regulator. It probably hasn’t been the most ideal solution in many cases. A point was made that for these codes to work, there needs to be a little bit of a regulatory underpin, where could that regulatory underpin be in the US?

**Paul Lee, Head of Corporate Governance, Aberdeen Asset Management:**
I think if we believe that Corporate Governance Codes prevent crisis, the UK is actually a marvellous example that shows that that’s not true. The UK had just as much of a financial crisis as the US did and its banks behaved exactly the same way US banks did, and it made no difference that there was a separate Chairman and CEO, and it made no difference that there was a Corporate Governance Code, so, I don’t think those things are linked, and that’s not a good reason to have the code.

If we go down the road of trying to put a voluntary code together and I suspect that’s the only way it can work in the US, there will need to be a sponsoring body. We haven’t heard much about the Stock Exchanges. In some countries in Europe, it is the Stock Exchange that sponsors the Corporate Governance Code. That is a possible opportunity, but there does need to be a sponsor, and the sponsor is going to have to be a space where people can come together and have the conversation, and it is going to take resources, both money and people to make it happen.

**Peter Webster, CEO, Eiris:**
Clearly something that’s on the move – previously we were dismissing out of hand the possibility of there being a stewardship code in the US so the ground is shifting in this area. Today it sounds as though you solved the problem, actually. Peggy has ten things you think
could be agreed now, Guy has pointed out that if the code could be refreshed every couple of years you could go with Anne’s idea of not making perfect the enemy of the good it is, so that you start with what you can agree now and in two years’ time you add the things that turned out to be more difficult. So it sounds like you’ve almost fixed it. So my question is just what is next?

Anne Sheehan:
You have the workings of something. There’s agreement on a large number of best practices and what we see are governance standards, and I think many companies would also agree to those. I also think, from the stewardship side, many investors have their processes in place as to what their guidelines are, how they engage when they escalate. I think one of the issues, in this country, is when do investors work as a group and collaborate? Some are less comfortable with that in this market. Transparency about our processes some of us. So there are elements that are out there that are reflected in what codes and exist in other. But I think having one Government entity in the Stock Exchange with their job is to list as many companies as possible and so, while ideally and historically, perhaps the exchanges would have been a good place and they still have some best practices. I sit on the NASDAQ Listing Council and in terms of what their role is, to get as many listings as possible. Yes, they do set standards. Yes, there could be a place that brings it together, but you’d have to just know what you’re getting into in terms of that and there are many companies are staying private. So there’s all sorts of issues there.

But I do think that we have come further than we were, in this country, in terms of these things, and the issue is tying the pieces together. We don’t want to have to wait for the crisis. There is going to be a crisis at some point and I think some of this at least gets the discussion in front of us as to what our expectations are as players in the capital markets, or what we hope the best practices are as players in the capital markets, knowing that as long as human nature is involved, you’re going to have issues that are going to come up.

Ric Marshall:
A good focus is, what’s the point? I spend a fair amount of time with a completely different group of stakeholders, which is the Director and Officer Liability Insurance Underwriters, and the Directors that they serve. This is a very risk averse, and they’re very concerned about the role of the Director and the fiduciary responsibility of the Director, and the liability of the Directors. And I think the group that we’ve not talked about enough here today, is the Directors.

We get questions all the time about how we rate a company and how we interpret something that appears in a US proxy, and the implied question is, what should we do? What should the standard be? And I think more than any other group, it’s not corporate management, it’s the Corporate Boards, it’s the actual Directors, particularly as we begin to expand the skill pool and diversify our boards. These individuals are really looking for this kind of clarity and a code would benefit Directors more than any other group, including investors, in my view.

Guy Jubb:
The code did not prevent the financial crisis. But what the crisis did do, it provoked a significant degree of reflection, reflection by boards, reflection by investors. Much of that reflection was embodied in a report by Sir David Walker, who did a very detailed, but very thoughtful investigation into the governance of banks and other financial institutions. But he didn’t stop there. It was that report which actually gave rise to the recommendation that
there should be a stewardship code for investors. It was a recognition that investors needed
to raise their game, and in the business of governance and stewardship, crises will arise but
they do generate some improvements, hopefully for the future, but there is no guarantee
around any of this. On the issue of regulatory capture, thus far in the United Kingdom, the
Financial Reporting Council is accountable to the Government, to the Department of
Business and Innovation and Science, but it has its own Board of Directors who prepare
their own report, develop their own strategy. The Government has a right of veto over who
is the Chairman of the FRC and in certain situations, one could envisage capture could
occur, but there one could also envisage that the UK might be a much less attractive place
for companies to list and raise capital.

Peggy Foran:
I think we can all agree here on ten things. We probably can agree on five to seven bad
things. So let’s define the trades’ bad apples. I think we probably could get buy-in by a
number of groups, at least to start a process, that we have something and then can see
where it might go from there.

Stephen Davis:
I think that we wound up, really coming to a view that in the United States, a code, if there is
one, would not be something that emerges out of the public sector. It would have to be out
of the private sector and in fact, it may not be the creature of established institutions. It could
be instead, the product of some courageous leaders, from the business and the investor
community. We are meant to be long-term investors, long-term capital players and so we
need to think about and anticipate that there will be crises.

Joint ICGN-CII Afternoon Keynote: Ellen J Kullman, Chair and Chief Executive Officer,
DuPont:
Last week, I was participating in a global event. This one was a US, China business
roundtable of sorts in Seattle, where there were 30 CEOs that were asked, 15 from the
United States and 15 from China, to come together and to speak with President Xi Jinping
and discuss the state of Chinese, US business relationships. So, he always, of course, as
the President of China, starts out and gave his comments to us and it was one of the most
straightforward and direct conversations I’ve heard and dealing at that level with the
Chinese, in my seven years as CEO. He assured us the doors to the Chinese market would
remain open, encouraged us to come in even greater numbers, with research and
development, with headquarters, as he saw things changing in China for the positive, and
spoke openly about the tensions in cyber security and IP Rights, about protectionism. You
know, he talked about the deepening China and US business relationship as being vitally
important for both countries, as well as for the prosperity of the world. And then he listened
and the 30 of us spoke individually and gave feedback, around what was working, about
what wasn’t working, our US Secretary of Commerce was very direct in her remarks as well.
But as I sat there and listened, and thought about the exchange, I think it really hit me as
saying something very deep about leadership today. And that is, leaders of all types must
actively engage with all stakeholders. It’s an interconnected, transparent world, where isolation, diplomatic, economic or cultural, is not an option.

So, it gets at the definition, I think, of good governance today. Management teams and boards must have a broad worldview, a clear strategy, a mission, a purpose and most importantly, a willingness to embrace change. We must clearly define our long-term strategy, which now requires a commitment to not only the business results, but to sustainable practices throughout our value chains. Our ability, as leaders, to deal with such issues as energy conservation, waste reduction, resource scarcity, will be vital to measuring our success.

We must also thoughtfully engage with all of our stakeholders, shareholders, customers, government officials, regulators, employees. And we need to see the world through their eyes, and we need to look objectively at ourselves, our management teams, at our performance, at our boards, and the impact we have, not only on business, but on the environment and on the communities in which we operate. We need to truly understand the expectations of our stakeholders, and then we need to meet them consistently, over time. And this will allow us to build relationships based on credibility and trust, which is foundational for building growth and value. This philosophy of open engagement applies to board members specifically. I’m a big believer in the importance of direct board engagement with shareholders. Not only does it result in improved transparency, but like the US, China roundtable, it promotes mutual understanding. There’s great value in Director, shareholder conversations on such topics as board composition, leadership, strategic direction, compensation, capital allocation, management performance and environment and social issues, and that’s just naming a few. Just like management boards should have a clear understanding of shareholder expectation.

We also encourage our board members to pierce through the layers of our operations. In today’s world, it isn’t enough for any Director to show up at a board meeting and read a few documents. Such passive oversight has no role in modern commerce. Board members must go beyond the soundbites and grapple with the facts and the details of our business. Senior management of public companies must foster this dynamic by being open, transparent and willing to facilitate this kind of collaboration.

The guidance of the DuPont Board has been vital to me. I want our Directors to poke and to prod, to ask the tough questions. Most importantly, to provide their ideas and their insights. It’s the role of management to set the company strategy and present it to the board, where we rely on our Directors to challenge it, to test it and leverage their expertise and experiences to analyse and help us shape it. Finally, the board holds us accountable for execution and for delivering on those results. Critical engagement not only makes it possible to fully tap into their expertise, but it also prepares them to represent our strategy for value creation externally. We think this mindset and level of engagement reflects the next generation of board governance, and I know you do too. We think this trend will continue to grow.
While we must consider the views of all of our stakeholders to be prepared to make real changes, as leaders we must also ensure that those changes are consistent with our values and our mission. At DuPont, our approach to doing business is guided by our core values of safety and health, environmental stewardship, respect for people and highest ethical standards. At the pace of business transformation and technology accelerates, these core values do not change. In today’s environment, business models are fundamentally dynamic. Our philosophy of open and objective engagement is the only way for our leaders to stay ahead of change and disruption. Tomorrow’s winners will be the companies that conduct continuous evaluation and fundamentally embrace reinvention. DuPont’s 200 and plus year history of continuous change fits this model. We don’t just respond to industry trends, we look ahead to anticipate future needs and in turn, use our science and our engineering capabilities to develop products that have created entirely new growth markets. We have never hesitated to pursue new commercially promising area of science, or acquire companies that strengthen our position in faster growth, higher margin businesses, nor have we hesitated to exit a business, no matter how firmly it’s been associated with the company’s identity. Black powder in the first 100 years, textile fibres and coatings, and most recently, performance chemicals, and these are just a few examples of the businesses that we’ve exited, after determining that they no longer fit strategically with our model of long-term value creation.

Over the past six years, we’ve transformed DuPont to ensure our core science and engineering capabilities are focused on commercial opportunities, where we can provide our customers with sustainable, renewable solutions, to some of the world’s biggest challenges. Between now and 2050 the world’s population is said to climb to nine billion, while the middleclass will expand dramatically, creating a new age of resource scarcity. DuPont’s science and focus on creating solutions that address real challenges, helping provide plentiful healthier food, renewably sourced materials, ample energy and better infrastructure and transportation. The world’s leading positions that we’re building, are leveraging in three strategic focus areas: agriculture and nutrition, bio based industrials and advanced materials, and this makes us uniquely positioned to address market needs that address the challenges and create value for our shareholders.

Within our focus portfolio, we’re applying DuPont’s science to find solutions for needs as diverse as creating more nutritious food that can be grown on less land, under a range of environmental conditions, developing renewable energy sources and creating advanced materials for an increasingly urban world. Think of cars that are half the weight, but twice as strong, and run on fuels made from plant material left behind after harvest. As both Governments in a rising middle class and developing markets demand innovative products at an accelerating pace, we’re expanding our global innovation delivery system, connecting our science and innovation with the intimate knowledge of local markets and a deep understanding of customers’ needs and expectations.

For example, you need to understand the requirements of a farmer in Africa, in order to produce seeds designed for their unique agronomic conditions. And as a result of our deep engagement with local customers, we’ve developed a maize hybrid that’s helped farmers in Malawi overcome such challenges as draught and pests. That foothold with farmers and our
knowledge of the entire food value chain can then lead to additional opportunities to serve other local markets with innovative products. At the same time, we know that our environmental ecosystem, they’re precious and we understand our responsibility to protect them.

Our goal is to drive sustainable growth, creating shareholder and societal value, while reducing the environmental impact of our value chains. As we operate our 200 plus DuPont production facilities around the world, we’ve significantly reduced our environmental footprint. Since 2004 we’ve reduced greenhouse gas emissions by 19% and cut total water consumption by 8.4%, and in an August report, CDP cited DuPont as the comfortable leader in the chemical industry, as best positioned for the future in developing green products, enhancing efficiency and addressing regulatory change across sectors specific to environmental metrics.

We have set first in industry sustainability goals for sales from products made with renewable resources, products that help customers reduce their own greenhouse gas emissions and for a percentage of our R&D spend, dedicated to developing more sustainable products. In 2014 products that created energy efficiency, or significantly reduced greenhouse gas emissions, generated $2.5 billion in revenue. We’re also helping customers succeed, by developing innovative products lines that reduced end use environmental impacts, and we’ve commercialised a new version of our Tyvek Housewrap, which improves the energy efficiency of the buildings as well. We’ve partnered with Procter & Gamble to build a new enzyme technology that provides superior cleaning power when washing clothes at energy saving cold temperatures, and we’re continuing to help our agricultural customers apply crop protection products, in a way that’s smarter and safer. We know that a successful approach to sustainability requires us also to embed our values into our supply chain, and an important tool to help us accomplish this is our Supplier Code of Conduct, which sets out our expectations that our partners will embrace and share DuPont’s commitment to sustainability. This commitment to environmental sustainability is not new for DuPont. We’ve been a thought leader on sustainability for more than 20 years. We were among the first companies to appoint a Chief Sustainability Officer, and that’s a role that reports directly to our Environmental Policy Committee of the Board of Directors. And I think it’s been since 1993 that we’ve had a past Administrator of the US Environmental Protection Agency as a member of our board. Our most recent member is Lee Thomas, a former Administrator, who’s been a director with us since 2011. So sustainability has clearly become part of the DNA of DuPont, and it’s also a topic of keen in – a keen interest across our key stakeholders. We’re engaged more often and more directly with customers, investors, suppliers, employees and other thought leaders about the progress of our work in sustainability, and how sustainability can provide a competitive advantage in the marketplace, while we drive value for our shareholders.

Our successful execution of the priorities and goals I’ve described, along with our commitment to a 360 degree engagement with all of our stakeholders, will make us even stronger, better enable us to withstand the, macro industry challenges that the world currently faces. Like all large global companies, we’re operating in a volatile environment. Local markets are even more competitive, world economies are even more connected,
concerns about China’s economy are fuelling uncertainty, while Brazil and Russia are experiencing economic distress. And as we navigate this volatility, we’ve been listening to our shareholders and factoring their diverse views into our approach, and as we go forward, our management and our board members will continue to meet with investors to understand their concerns and explain how we’re addressing these challenges.

The support and guidance of our world class board members has been vital to navigating this complex, fast moving global environment. In times of market and economic turbulence, their involvement and engagement is critical. I believe it’s never been more important to surround myself with people who will guide me, who will challenge me and who’ll make me better, and I believe that all CEOs can leverage their boards in this way.

All boards must include a clear set of skills and experience that are of value to the company they serve and, for DuPont, that means a balance of significant experience in global strategy, portfolio transformation, commercially focussed research and development, cost control and efficient operations, as well as regulatory and financial experience. We’re constantly managing the composition of our board to ensure that we have a proper diversity in the broadest sense, and of course, I’m talking about gender diversity, but I’m also talking about diversity of competency. Given our global footprint, with more than 60% of our revenues coming from outside the US, another kind of diversity, and what we call passport diversity, is also essential. We need global management experience and global cultural perspectives. As our strategy and portfolio have evolved, so has our board and we’ve added six new members since 2011.

I know that shareholders I’ve visited, over the past several months, place a high value on the strategy of renewal. They understand the value of bringing in fresh perspectives, and the importance of entering the boardroom with an open mind. In keeping with the leadership principles I’ve outlined at the beginning of the remarks, we’ll continue to communicate regularly with our investors and to make sure that our board and management team are aware of our shareholders expectations. And as I look to the future, I couldn’t be more excited about the next generation DuPont. I believe we have the right strategy, the right board and the right commitment to building a sustainable value for all of our stakeholders. We know our stakeholders have high expectations for us, and we’re ready to meet these expectations by driving continued productivity and leveraging a robust pipeline to address global trends. And while I know we all have more work to do, our work is never ending, our progress to date gives me confidence that we’re up to the challenge and that we fully intend to deliver. So I thank you today for your attention. It’s been a pleasure to address you, and now I’ll join Anne for some Q&A [applause].

Anne Simpson:
Thank you. The first thing I’d like to ask you, all of us were following both sides of this recent proxy fight, you knew where CalPERS was and knew where other funds were, and you won, and this was an issue of great importance to say “Okay, well, if you’re clear in your long-term and you have a great board, and you communicate, you can actually win the support of the majority of the owners,” but then we saw the share price fall. So what’s going on there? Is it
that the long-term is in conflict with the short-term, or how do you get through short-term volatility with a long-term plan?

**Ellen J Kullman:**
Of course it’s a concern. Of course we’re now 50% in agriculture. Agriculture is in the middle of a downturn with very low commodity prices and the shocks that we’re seeing around corn and soy, based on decisions made by whether it’s China, or Brazil, and the instability that are in those countries. I believe that you have to have and maintain a long-term view, but it has to make sense in the short-term as well, it’s an ‘and’ equation, not an ‘or’ equation.

When we were going through the global financial crisis, we understood there were decisions we had to make, we needed to be very productive and we needed to make sure that we were managing our cash well and managing our costs very well in these turbulent times, but we kept our focus on the research and development, that would continue to deliver for our customers. At the end of the day, when the markets are volatile, what I keep telling my teams is you’ve got to focus on beating the competition, you’ve got to focus on winning in the marketplace, and in the end, if we’re successful and we communicate that well with shareholders, that’s a very positive thing. So, we are in the middle of turbulent times and currency volatility this year certainly has not benefitted any US based manufacturer, from that standpoint, but that’s where transparency and engagement come in to continue to tell our story. Because I think, from the long-term, our pipelines are very strong, but in the short-term, we’re going to have to be more productive because the times are volatile.

**Anne Simpson:**
So, do you think shareholders are part of the problem for companies, in being long-term?

**Ellen J Kullman:**
I think there’s a lot of pressures on companies today, in a lot of different directions, whether it’s government or regulatory is certainly increasing. Whether it’s returns and funds looking for returns, I think we just have to take that all in and listen to it, and chart the best course we can.

**Anne Simpson:**
So, the other notable feature, is this whole theme of diversity, and certainly, for CalPERS, we say, a high quality board is independent, it’s competent and it’s diverse, and we see so little movement – we all know this phrase, it comes from the UK’s Sir Derek Higgs, he said, “There’s nothing wrong with the British boardroom, other than it being male, pale and stale.” So, the tenure’s increasing, we’re not seeing diversity, we’re just not getting the traction we expected, so what are your thoughts about this? You’re on another board, United Technologies, you’re a scientist, an engineer by training. What do we need to do and where do shareholders fit in with that, what’s next?
Ellen J Kullman:
This is the debate I think that we’ve all been having for a while, I mean 25% of our board is women, and obviously I’m one of them. So, that’s obviously a step up for us, because we had a woman CEO. But I’m a member of the 30% club and believe that the US has to get there and we talk about things, we have an age limit that is 72, as part of our governance. Should there be term limits? I think that’s what we have to get into; a well-functioning board and a board that’s very engaged. It’s hard to tap somebody on the shoulder and say “You’ve been a great board member, you’ve been here X number of years, we need to renew,” that’s a very difficult thing to have. I think that that’s what makes it hard for boards, is because we’d like to be principle based and if we have a principle that says you age out at a certain age, we want to maintain that principle. But I do think that we need to be more supportive and I’m on the Catalyst Board of Directors and I work with several of my senior women in getting them on boards, and I think that we have to be more supportive of our own people, women, taking on a board. They’re going to be working full-time, but taking on a board, and I know some companies struggle with that, and I think that we have to be part of the solution, and that’s something that we can all work on together.

Anne Simpson:
I think this issue about tenure and retirement ages is really important, because there are companies like you which have a retirement age and J P Morgan’s just an example that comes to mind where each year the anniversary and the farewell party’s organised, but then it’s “Oh, we’ll put it off for another year, and another year, and another year.” So, what we’re all thinking about on the shareholder side is, what do we need to do, to back up the Directors – there needs to be change?

Ellen J Kullman:
To date, we have not deviated from our policy, so we’ve held a line and we’ve had those conversations and sometimes they’re uncomfortable, but I do think that that’s something that we just have to do more. And for instance, when I became the CEO, almost seven years ago, and we looked out, we saw that there were going to be at least four retirements in the next five to six years, and that’s a lot for a board and so we started the process. My lead director and I, started the process and started looking at what skills we needed and all of that. And then, so we’ve run a continuous process of looking for board members, understanding and creating that and then with the additional change with spinning the chemicals business, that two of our board members wanted to go with the new company, and that gave us the total of six new board members since 2011. And so, we’ve had that opportunity. That’s unusual, as I look forward to the next six years: how do we think about that going forward, and what are the skills and the mix that we need to have?

Anne Simpson:
So, what does DuPont think about proxy access? What do you think about the idea of the Independent Chair? You have a combined role, you have a lead Independent Director, where is the board in thinking about the governance agenda? How does that help or hinder what you’re trying to get done for the company?

Ellen J Kullman:
Proxy access is an active discussion that we’re having. Certainly there’s been some more definition on that, and a lot more activity on it in the last year. There’s still some questions that we have and want to see how they play out - what defines ownership?

There’s a couple of more questions like that, but I think that’s part of the Governance Committee and their active engagement about that. We’ve actually had separated Chair and CEO and combined Chair and CEO, it depends what’s going on in the company, and our board has used that very flexibly, and believe it’s one of the options they want to have, because there are times, in their estimation, where it’s made sense to have it separate and there are times when it makes sense to have it together. And so, they believe that should be part of their process in looking at it and they have done it differently. I was not the Chairman when I started and I took on that role later, and so I do think that’s part of the active discussion we’re having, and that’s informed a lot by what’s happening, what’s been written, and we’re all reading the same papers that are out there, and I think the world’s changing. And I think transparency and engagement is a good thing.

Anne Simpson:
So, the company, 200 years old and this all rings true for CalPERS, board members are here, our liabilities run to the best part of a century, so we hope we’re still investing in DuPont in a century, but what in the 200 years ahead is the most important thing for the board to focus on, and where do shareholders fit into that? What do we need to be doing better?

Ellen J Kullman:
We’d look at it two ways; what needs to stay the same and what needs to change? What needs to stay the same is our core values, our ethics, our respect for people, safety in the environment and we need – people, companies need to have something they can count on, no matter where they are in the world, no matter what the environment is, we don’t deviate from those core values. But then, what does deviate? The opportunity deviates. Science creates interesting opportunities that we couldn’t even imagine ten years ago now, and so how forward thinking are we going to be on those investments? I think we’ve learned, over 212 years, that if you hang onto something too long, you can destroy value, not create value, and that you have to be able to redefine yourself and to create a relevant company for the environment, and it’s a continuous process that includes the board, includes our shareholders, and the dialogue we have with shareholders about portfolio and what belongs together? How do we create value with it being together or not? Is a very active part of our
process and I think that's why we've continued to renew and that's created a very exciting future for us in areas of agriculture, nutrition, bio based industrials and advanced materials.