International Corporate Governance Network Annual Conference

3-5 June 2015

Lessons Learned, Unfinished Business and Priorities for Reform
Erik Breen, ICGN Chairman: Opening remarks

Welcome

It is my great pleasure to welcome you to the ICGN’s 20th anniversary Annual Conference here in London. We are very grateful to the City of London for their tremendous support they have provided as host and to the Conference Organizing Committee, particularly Richard Regan and Frank Curtiss as co-chairs, whose members have put together and engaging programme.

I would like to refer also to the many initiatives that have taken place this week: the ESG programme with 30 people in attendance hosted by FRC, the academic meeting jointly hosted by LBS and ECGI and the many ICGN Committee Meetings.

We are fortunate to have the support of a great cadre of sponsors, whom I hope you will get to meet during the conference. This includes EY, Goal Group, Lief Cabraser Heimann & Bernstein, Pomerantz, Stewarts Law, Broadridge, The Center For Audit Quality, KPMG, Mazars, MSCI, Nestlé, Schroders and Sustainalytics, Robbins Geller Rudman & Dowd and Lukoil for our connector meeting.

As you know, there are a range of reforms under consideration in Europe. The speakers in the programme are uniquely placed to debate these and highlight the key themes, trends and current practices the wonderful thing about ICGN is the international perspective our members bring to these discussions and the conference theme is ‘Lessons Learned, Unfinished Business and Priorities for Reform’.

Who are better placed than the 49 ICGN founders to speak about the lessons learned? I am very glad we found a selection of them prepared to speak to you about their lessons learned over the past 20 years and also to consider future priorities.

For unfinished business, I would like to pose a question to you. Do investors have the right to know that their votes are executed as instructed? Sadly, today’s practices still answers that question largely with a no.

The priorities for reforms. We largely support the EU Shareholder Rights Directive and the priorities for long term ownership, true stewardship and engagement. But let me be very clear. As adopted in the ICGN Global Governance Principles and approved by our membership, we are very much attached to the one share, one vote principle and disapprove of distorting this principle by adopting differential voting rights. A backward looking lengthy holding period is not equal to a forward looking long term commitment to the company and to true stewardship. Or as we say in investing, past performance is no guarantee for the future. And although the color of our conference bags may indicate otherwise, we do not wish to turn back time to the space ages of the eighties.

I sincerely hope you will enjoy today and the next two days of debate and networking. Thank you for your participation.
At this stage I would like to introduce Alderman Alan Yarrow. Alderman Alan Yarrow took office as the 687th Lord Mayor of the City of London and has a long standing career in the financial industry. He was appointed to the Kleinwort Benson Group Board in 1995. Alan left Dresdner Kleinwort in December 2009, after 37 years with the group, latterly as Group Vice Chairman and Chairman of the UK Bank.

Alan has served as Chairman of the London Investment Banking Association, a member of the Take-over Panel, Vice-Chairman of the Financial Services Authority Practitioner Panel, and Vice President of the British Bankers' Association. Alan, it is a great honour for us to be here at Guildhall and to have you here for your welcome address.

**Alderman Alan Yarrow, Rt Hon The Lord Mayor, City of London: Welcome address**

“The City’s standards of corporate governance are beyond world-class: we have made mistakes – sadly we will make more. It is how we recover as to how well the City will be judged.”

“The corporate sands beneath our feet aren’t just shifting – they are free-flowing.

Look at what’s happened to capital markets, which are key to a healthy climate for entrepreneurship and innovation. Recent years have seen huge changes. New and exciting products and services are emerging all the time. But fortunes have been lost as well as won. Reputations have waxed and waned.

Regulators wanted intermediaries with massive reserves of capital. Bigger than the brokers could ever hope to draw on. So intermediation was wrenched away from the brokers and into the banks, whose huge crash-mats of capital could absorb the shock of market volatility.

After the financial crisis, the tables were turned and the banks came under pressure. Capital requirements are more demanding than ever and they have to ring-fence a range of their retail-facing activities, de-risking at every turn. They have their inventory of stock severely limited. And they cannot lend as much.

That inventory was a shock-absorber. **Whilst we might feel more comfortable about the systemic stability of our larger banks – just like the soap in the bath – the risk hasn't disappeared, it has gone somewhere else.”**

“Unless global standards of professionalism are observed, we will not be able to access global flows – so capital will cost more. But if people take their professional obligations seriously, it will cost less. Because they have access to those larger pools of capital.

And I’m not just talking about practitioners – I mean the regulators as well. **Good regulation comes from professional regulators. Regulators who are well versed in best practice. Who have trained long and hard to**
get where they are and who understand that the market is a global market, tested constantly by global competition.

My view is that true professionalism has three ingredients. Knowledge, skills and behaviour. That last one is particularly important at the moment – when the spotlight is on a perceived culture of arrogance across the City. Think of those dreadful emails which make all of us squirm. Poor behaviour must be uprooted and disciplined because where it exists; it corrodes even the most stable of businesses. But there are ways to improve behaviour. Not least by leadership, good management and education, training and qualifications.”

Erik Breen, ICGN Chairman: Opening remarks continued:

Thank you very much Alan for your welcome address. It is with great honour that I may now introduce to you Baroness Neville-Rolfe. Baroness Neville-Rolfe is a British Conservative politician and Parliamentary Undersecretary of State for the Department for Business, Innovation and Skills and Minister for Intellectual Property. She previously worked at Tesco PLC (1997-2013), serving on the Board of Directors from 2006.

She was appointed a Life Peer in the House of Lords in 2013. Neville-Rolfe had many non-executive positions which she relinquished on appointment. Among others she sat on the board of Hermes Equity Ownership Services and on PwC's Advisory Board. She is a member of the London Business School's Governing Body. Baroness Neville-Rolfe, it is a great honour to introduce you.

Baroness Neville-Rolfe, DBE CMG, Parliamentary Under Secretary of State and Minister for Intellectual Property: Opening address

A political life, I have found, is a life full of surprises. I only became a party animal a couple of years ago after a career in the private sector as a board executive, as a non-executive director, and before that as a civil servant. I was surprised to become Minister last July and I am pleased to be back, as a Minister in the Business, Innovation and Skills (BIS) department, with responsibilities in the Department for Culture, Media and Sport.

I’ve gained some new responsibilities in BIS, and that includes corporate governance. In contrast with most of my other ministerial responsibilities, I’ve studied the subject relatively recently. When I became the company secretary at Tesco in 2003, I studied the ICSA qualification at night school; those exams included a paper on corporate governance. My knowledge of the rules on governance is much fresher than my recollection of politics, philosophy and economics, which I studied when at university.

I won’t assume that I am an expert in this area as a result of passing exams or from my experience as a director. Rather, in my first few months of this five-year government, I will be in listening mode. I’m very interested in what you and others recommend that the Government might do to improve matters. It might, however, be useful if I give a very brief indication of what I think good governance can contribute to society.
First, I suggest that the aim must be that the provisions on governance help and contribute towards an enterprise’s success. Some people seem to consider governance ought to act as a break or a handicap in any enterprise’s activities. That might be the case in specific circumstances, but I do not see that as the overall objective – quite the reverse.

Second, governance should encourage fairness. Fairness between owners and workers, or shareholders and employees, at all levels. This, of course, touches on the delicate subject of boardrooms and pay, and indeed, on equal pay for men and women.

Thirdly, governance has a presumption in favour of transparency. The main reason for opacity is often to hide potential embarrassment; the best way to avoid it is to be open about what is happening and what is intended. Openness encourages better decisions.

Fourthly, governance should be proportionate. Of 3.47 million UK companies, three million only have one or two shareholders; the rules should recognise facts like these.

Finally, I have a specific remit, described in BIS as ‘women on boards’. I see this aspect of my responsibilities as contributing to the other aims I’ve mentioned, notably commercial success and fairness. In my Tesco days, I was energetic in seeking to encourage the pipeline of female talent: that is, in my view, a more productive approach than imposing quotas.

Gathered together today are experts in corporate governance representing institutional investors from across the globe. You will understand the important role investors have to play, engaging with the companies in which you invest. This is vital if we are to have well-run, successful companies and a successful economy. I believe that these are issues of importance and look forward to the kind of analysis and dialogue that the ICGN seeks to promote. I hope we can move these thoughts and other matters forward, over the coming months and years.

**Plenary 1: Global governance reform: progression or regression?**

- Pierre Henri Leroy: President, Proxinvest
- Geoff Lindey: Formerly NAPF
- Anne Simpson: Senior Portfolio Manager, CalPERS
- Sarah Teslik: Sr. Vice President, Communications, Public Affairs and Governance, Apache Corporation
- Chaired by Sophie L'Helias: Senior Fellow, Governance at the Conference Board

**Sophie L'Helias, Senior Fellow, Governance at the Conference Board:**

Once upon a time in Washington DC, several people got together and decided that it was time for foreign investors to create a platform to engage. Four of those people, our Co-Founders, are with us today.

We'd like to offer you a little bit of perspective about where we were in 1995 and where we are today. What are the issues that were important then,
versus what are the issues that are important today, and what trends we see for the future?

**Sarah Teslik, Senior Vice President, Apache Corporation:**

When the Council for Institutional Investors (CII) started out 30 years ago, we thought it was exceptional if we could file a shareholder proposal and get 2% of the vote. Then, when we got 3% of the vote, we thought that that was huge progress. We never expected a company to do anything about the shareholder proposal that we filed. We didn’t expect them to return our calls. That was only 20 years ago: if you ask ‘is governance more powerful now’, there is no other answer but yes.

Back then, if you wanted to have influence over a company, you had to buy at least 15% of the shares. Most of us don’t have enough money in our wallets to buy 15% of the shares of any large company. Most large institutional investors did not use the vote. I accept some of you here, as the very largest, have been using the vote for a long time. Even when I joined Apache nine years ago, and visited our top 100 shareholders, virtually every one of them thought I was asking a compliance question when I asked them ‘How do you use the proxy vote?’. When I conveyed that I was not, the answer was ‘well, if we hold the stock, we vote for management’. That was virtually every shareholder just nine years ago. I think we often forget, how quickly times have changed.

The biggest change over the last 20 years has been the most unheralded and the most recent one. Now, virtually all of our large shareholders do vote for and against consistently. You no longer have to buy the shares; you just have to know the shareholders. It is much, much cheaper to know shareholders than it is to buy shares.

Just two years ago, it only took ValueAct 0.7% of the shares to get Microsoft to agree to put one of ValueAct’s 35-year-old employees on their board without a proxy fight – because they know the shareholders. That’s an unheralded revolution but it means that governance has, in the short period of the ICGN’s existence, gone from being a policy debate to a power debate.

**Anne Simpson, Senior Portfolio Manager, CalPERS:**

I was invited to the meeting 20 years ago to establish a new body to be called the ICGO, the International Corporate Governance Organisation. In the end, it became the International Corporate Governance Network, because there was a lot of sensitivity about who was in charge if it was an organisation. Why do we need to work together? It’s to understand what’s going on in each other’s markets in a collaborative way, through mutual understanding and support. That was the spirit of ICGN: it was a response to globalisation. Therefore, if your fiduciary duty was understood in your home market, you had to understand what was going on overseas.

This needed to be understood in all of the local markets, in order for us to be good fiduciaries in a global market. That was part of our very strongly felt fiduciary duty. This was about ownership, but across borders, and we could only do that if we became partners with each other in those local markets.
Sophie L’Helias:
Anne made a really interesting point about the globalisation of capital markets. It’s hard to imagine, our first meeting took place as CalPERS was starting to invest in France. The SEC had prevented US pension funds from investing abroad, so this was a very important time.

Pierre Henri Leroy:
CalPERS represented significant trade power. Indeed, when Bill Crist, the then chairman came to Paris three years later, the daily newspaper Libération, portrayed pension funds as Darth Vader!

The impression was that shareholders were nothing. It’s still the case in a lot of situations, but things have changed thanks to that mobilisation of investors. We designed a way to do things on a very friendly basis, to better understand the issues together.

For instance, the French would ignore the concept of ‘comply or explain’, which is actually a very good concept to avoid writing too much regulation. This came over to us in the following years, and that’s part of the success of the ICGN.

Geoff Lindey, formerly NAPF:
The reason I was at the meeting 20 years ago was because of global accountability. The free enterprise system is nothing if managements aren’t accountable to their owners. Within the different silos – US investors, UK investors and French investors – each one had a small ability to hold their management of their local companies to account. When we invested internationally, it was very difficult to get any leverage whatsoever when we were trying to get companies to change their ways. By bringing all the different parties together internationally, we get a unanimity of views amongst global investors so that the management of the multinational companies, can be held accountable.

Sophie L’Helias:
What would be the number one positive change that you believe that networking through the ICGN has brought you as an investor?

Anne Simpson:
What the ICGN has brought is an ability to exercise responsibility as an owner: just being big won’t do it. There’s a shared philosophy.

I want to pay homage to an important group, which included Ira Millstein, Adrian Cadbury and Michel Albert plus representatives from Germany and Japan, who were called upon before the OECD Principles thanks to Stephen Davis. The first thing they agreed upon is that every market needs access to capital: that was evident in the OECD countries.

Those gentlemen came up with four principles. In order to have access to capital, the first thing you need to offer is transparency. As a community, we’ve done an enormous amount to improve transparency of information. But we’ve got a lot more to do on transparency. That includes the work of the
International Financial Reporting Standards (IFRS) project and the development of an understanding that we need reporting on financial capital; but, as CalPERS’ investment beliefs would have it, also on human capital and on physical capital. That’s why we’re concerned with the sustainability agenda.

Their second principle was that every market needed to establish principles of accountability to get access to capital. That looks very different depending on where you are. In the US, we are celebrating because we have close to 50 major companies which are going to allow the owners to put forward candidates onto the ballot for consideration for the board. Even so, we’ve still got a lot to do in terms of making sure that boards are accountable to the owners and working through issues like controlling shareholders, rules and regulations which are there to frustrate that ownership responsibility.

Their third principle was fairness: this is where I don’t see progress. We’re regressing around the concept of one share, one vote. The Florida Law, with all respect, is a real problem. You should have influence to the extent that you have equity at risk, and that isn’t something which is respected in all markets.

The final principle is perhaps the most important: responsibility. If we consider the extent to which human wellbeing and security can be met through companies, it’s extraordinary. The scale and the influence of corporations globally is immense. There are also risks that come with that. We have to understand that we have scarce resources. We have to understand that there are externalities and consequences. If we’re going to have corporate responsibility, we need to have investor responsibility.

The ICGN Shareholder Responsibilities Committee has done tremendous work on this. The idea that rights confer responsibilities has been at the centre of ICGN’s work for a long time. We see that in the UK Stewardship Code, we see it in the Japanese Stewardship Code. But there’s a lot more to do – not just in terms of the responsibilities of asset owners, but also how that flows through the chain of intermediaries. What do we do about disclosure of votes? What do we do about conflicts of interest? How can we make sure that there’s alignment of interests?

Ultimately, the money we’re investing belongs to ordinary working people, who have put aside savings for their retirement. The issue is that the capital markets represent savings, but we haven’t completed the task of ensuring alignment of interest. We don’t have appropriate control at the level of owners. That’s the major unfinished business.

Geoff Lindey:

Remuneration policy is much more accountable than it was. In particular, the UK problem of rewards for failure is largely gone. Nothing can undermine the support for the free enterprise system amongst the population more than seeing people paid enormous amounts of money for doing a bad job.

When I was at the formation of ICGN 20 years ago, I think I was the only person there who was a full-time investor. I was employed by JP Morgan as an investment manager: I’m sure I was viewed with great suspicion by just
about everybody else who was there because it was felt that I was someone who was conflicted. I think that has changed to a large extent.

There are still a number of investment managers who don't take corporate governance seriously, but the overwhelming majority of them do it properly.

**Sophie L'Helias:**

It was very interesting when you joined the ICGN: you were with JP Morgan, now you’re a trustee of pension funds. Is governance part of the mission where you engage at the board level?

**Geoff Lindey:**

Absolutely. I don’t know what it’s like internationally. I’m a trustee of one UK pension fund, and I advise the Pensions Committee, the Investment Committee, of others. All of them have corporate governance on their agenda.

The reality that we have to face is that there is huge stress amongst trustees. There are member-nominated trustees who are employees of the company. There are also management people there who have got other full-time jobs. They come along and they’re facing the development of large deficits, real funding problems, major hedging problems, lots of regulation and the pension’s regulator.

They try to ‘fit in’ the corporate governance issue and hold accountable the people to whom they’ve delegated it. But in only one of the cases are they able to devote enough time to take it seriously. It’s becoming better installed as a part of the accountability chain. Still, the final link is very difficult – finding the investors have enough time on their agendas, at their board meetings, to take this seriously.

**Anne Simpson:**

CalPERS had $70 billion taken out of our assets by the financial crisis – the biggest corporate governance failure of all time. If we understand that governance is a way to manage the risks that we’re exposed to, then it was one of the major contributing factors to underfunding in pension funds.

Rather than rushing off and scrambling around trying to wonder how to make that money up in the short term, we need to step back and think about where value comes from. Where risk comes from. The trustees who serve, much like members of the jury system – citizen fiduciaries – they are people who need time for training and for support.

Even so, the great wisdom that trustees of funds bring is that they’re not in the day-to-day investment management business and should be able to step back and think about their fiduciary duty. If funds are not making the time to think about risk and reward for the long term, then they’re doing themselves a disservice.

**Geoff Lindey:**

Just to clarify, all the funds think very carefully about policy. I’m talking about the detail of individual votes on individual resolutions.
Anne Simpson:

Sure, but the board is responsible for the principles and the policy.

A groundbreaking development at CalPERS was the development of investment beliefs. These ten investment beliefs are now the framework for our decision making, and quite serious decisions have followed from those investment beliefs. Critical to that is a statement that being long term is both a responsibility and an advantage.

We have to have a voice with policymakers, with our own fund managers, and with companies. We have to re-orientate to the long term, because that’s where our investment returns will be protected; that’s where the wellbeing of the corporation and the CalPERS’ contribution to wider society lies.

Sophie L’Helias:

Sarah, with your experience at the CII you understand investors and your nine years at Apache means you’re one of the few people who has experience also on the corporate side, running a governance team. What would you recommend other issuers should look at to improve engagement?

Sarah Teslik:

We in the corporate community are told daily that we should engage more. It’s part of my job to reach out to at least our top two hundred shareholders. There are still many shareholders who will not meet with us at all. Indeed, there are some shareholders that used to meet who increasingly are putting up barriers because so many companies are asking to meet with them.

There is no substitute for having directors of the company meet with shareholders in person. It’s probably the single most important thing there is in governance. It’s not a policy, it’s a not a proxy process, it is the people who carry out the oversight, hearing directly from the people who are acting in their interests. It’s a visceral thing: it makes it seem real to the board members – shareholders are there and they matter.

If my life depended on creating better governance across the large companies in the US and most developed countries, I would find more reasons for directors to have individual meetings with shareholders where the communication goes both ways.

More than once, too, because the directors have to know that they will come back and see you in a couple of years, so that if you asked for X and X has not happened, they are the ones who will face the music.

Sophie L’Helias:

We’re seeing much more transparency, engagement and ultimately, improved accountability at board level. Pierre Henri, your big concern is that companies and their boards are more accountable to investors, but investors themselves also need to be more transparent and accountable.
Pierre Henri Leroy:

It goes back to what was said earlier by Geoff about him not being conflicted when he acted for JP Morgan. I strongly disagree with him. I think you’ve been utterly conflicted, but you’ve been fighting all you could against the absolutely structural conflict you were in. You’ve done a very good job, given the constraints.

We have been unable to get rid of all those conflict of interests. Instead, we have accepted to mitigate those conflicts of interests. My opinion is that we should seriously question the morals under which we operate. I think that’s the reason for most of the issues we have – why intermediaries are not working well, why votes are not confirmed, all those matters – but also the reason why asset management by banks has been so lousy over the years.

I’m very optimistic because the ICGN has been taking the right route. We’ve come back to the old state of having companies being a bit afraid about what we could do as investors. But I think we should also question, seriously, the overarching moral. That’s really an issue which has not been tackled within ICGN yet.

Sophie L’Helias:

Today, one of the big trends is the ‘ES’ of ESG – environmental and social issues. I’d like to ask each of you whether environmental and social concerns and interests are part of your governance programme? In addition, ICGN already has a training programme on ESG – which I highly recommend. Is this a direction that the ICGN should continue to expand in?

Sarah Teslik:

As an employee of a global oil and gas company, environmental and social issues are huge to us, to the board, to management. Some environmental and social issues are not ‘our’ issues. We have had to, on some occasions, communicate to shareholders that we are not a roving commission for the public good. We are not the United Nations.

But there are an awful lot of issues that are right in our fairway: indeed, many of them are actually leading indicators because so often things which seem to be niche at first are signalling issues that will become mainstream core financial issues 20 years from now.

Our programmes to try and identify creative thinkers are as elaborate as those pursued by any extractive industries company. We can point to many things that now make us money; that first cost us money. Ranging from being the first company to recycle water, using brackish water, using field gas instead of diesel, identifying our own chemicals and taking the chemical production in-house. We work with the Green Chemistry Council to produce green chemicals and work with the Environmental Defence Fund and agree to test methane emissions equipment which they are developing with our help. All of these are examples of things that now, in a downturn, make us money – that a few years ago cost us money because we had to develop them.

The challenge for many of us, as companies, is there are so many competing standards, checklists, principles and codes. You feel like there are mosquitos
flying around your head, with everyone wanting you to sign 20 different overlapping, slightly conflicting things – each one of which has one piece that doesn’t relate to your company.

It is much easier for us to do well on some of these issues if we can say, ‘Okay, we get it, this is where the best practice is, this is what we do’. I would also urge you to be careful of the checklist approach. Try to look underneath that to see what the company is actually doing. I have a great fear that there’s too much emphasis on, signing onto 20 different ‘best in the world’ documents with nothing behind that.

Yes, E and S is seeing its day – certainly in the extractive industries. It is often a leading indicator and it can be a terrific moneymaker. In our view, financial sustainability is inescapably tied to all other forms of sustainability. So it’s major business for us.

**Anne Simpson:**

What CalPERS has done is move away from just thinking about corporate governance. In fact, we’ve renamed the programme ‘Global Governance’ for two reasons.

One, to make clear we understand that we’re global citizens, but also because we understand that we have a very serious responsibility to hit those returns to produce the long-term risk-adjusted returns that we pay pensions with. We print this dollar, called the CalPERS Pension Buck, to show members that close to 70 cents on every dollar we pay out in pensions comes from investments. Not just today, not just next week, the next decade, for the best part of a century, because that’s where our liabilities lie.

I mentioned our investment beliefs: one of them states clearly that risk for CalPERS is multifaceted and can’t be captured through traditional measures like volatility and tracking error. We call out some examples – natural resource scarcity, water, climate change and demographics – there are shifts in the world and environment there that weren’t working and we need to be able to capture risk.

We also make a statement about value creation. It’s often called ESG, but we’re thinking of it as sustainability. We say long-term value creation comes from three forms of capital being well managed. One is financial capital.

However, human capital must be deployed with financial capital to create value. That gives us an interest in people as employees and as communities. It gives us an interest in labour practices and diversity and inclusion, in health and safety.

The third form of capital is what used to be called natural capital and this is why we are concerned about environmental issues.

That gets drawn together for us in three different ways. The first is we want those issues addressed in public policy, that’s why we’re calling for carbon pricing and we want subsidies to fossil fuel companies removed.

Secondly, we’re calling on this to be addressed by the companies that we invest in. We want boards that are competent on these issues, and we want
integrated reporting. We want it all connected in with the reports that we need to get.

The third is that most of CalPERS' money is internally invested, but about a quarter of the fund is externally managed, largely in the private asset classes. We want our managers to have integrated these risks and opportunities in a disciplined way, right through their own investment process. We've just gone to our board with a Manager Expectations project that sets out: the factors we want to be addressed; how this should be addressed in the selection of managers; the contracting with managers; and our monitoring of their performance. That's going to be a under review for a year's pilot, and we'll see what we learn.

It's hard for me to think about being a global, responsible fiduciary with such long term liabilities while ignoring environmental and human capital issues. I think that would be foolhardy. I think it would not be fulfilling fiduciary duty. But you need a framework, and really that's why the CalPERS board developed and adopted a set of investment beliefs because it integrates that thinking into our own approach.

**Geoff Lindey:**

I was at a trustee meeting this morning with a fund, which has spent a lot of time structuring a corporate governance framework. It has grappled a bit with environmental and social issues. It has decided to appoint consultants, structure a detailed policy and then appoint a manager to advise on it going forward. Most funds in the UK, generally, are taking this very seriously now.

For all these issues, you have to have some form of agreement, and this applies to the ICGN as well. Before I became chairman of the investment committee of the NAPF, one of my predecessors said to me, 'when you're developing policy with your board, remember every general has to be sure that his army is following him'.

There's no point in giving orders and fundamental principles if the people who are meant to be supporting you aren't following them. You have to have buy-in, which is why a meeting like this, and all the good work the ICGN does, is important. That goes for corporate governance as well as ESG.

**Sophie L'Helias:**

I find ESG very interesting, and I believe that the ICGN has played a very important role in bringing an investor community together and building relationships with investors. Everyone can reach out to everyone else and share information.

We started this organisation and wrote the first chapter in 1995. However it doesn't become an organisation without the people who run it. Therefore, I want to pay tribute to all the board members, the volunteers, the Executive Directors and the staff of the ICGN who have kept this wonderful network alive for the last 20 years. Hopefully, we'll be here for another 20 years to come.
Plenary 2: Financial market regulation: time for a holistic review?

- **James Bardrick**: Chief Executive, Citigroup Global Markets Ltd
- **Laurent Degabriel**: Head of Investment and Securities Division, European Securities and Markets Authority
- **Jane Diplock**: Director, Singapore Exchange Limited and Board Member, International Integrated Reporting Council
- **Jeroen Hooijer**: Head of Corporate Governance and Social Responsibility Unit, European Commission
- Chaired by **John Plender**: Senior Editorial Writer and Columnist

**John Plender, Senior Editorial Writer and Columnist**

The subject of this panel is financial market regulation. As you all know, there’s an awful lot of it around since the financial crisis and a considerable amount of scepticism about how effective that regulation will be. But, at the same time, there are some quite positive things going on. If you look at Europe, the proposal for capital markets union has the potential to strike a much better balance between bank finance and market funding. It’s a complicated landscape.

**Jeroen Hooijer, Head of Corporate Governance and Social Responsibility Unit, European Commission:**

We are not only working on the capital markets union, but there’s an earlier project called the Shareholder Rights Directive, which is currently being discussed in the European Parliament and also in the Council. We are trying to address a number of things, like more transparency about remuneration, more transparency around in the investment chain and more transparency around related party transactions.

I’m worried about the turn of the discussions at the moment in the European Parliament. We thought we were well on track but the whole discussion has been overshadowed by an announcement by the Green Party and the Socialist Party on country-by-country reporting. It is very important and nobody can be against more transparency in the fiscal area. However, it is not part of the Shareholder Rights Directive as such. The discussions are very difficult but if that is resolved, I think we can make a number of important steps forwards.

Regulation alone is not enough; you cannot and you should not try to regulate everything. Private sector initiatives are incredibly important. They also move much faster than regulation.

As far as the capital markets union work is concerned, it is early days. We need a level playing field in Europe among the different member states. We also need to work on cross-cutting policies to have a more open market, where offer and demand can meet each other, while thinking about accounting rules and corporate governance.

There is a lot to be done. However, nobody gets excited about the capital markets. My mother is not worried that the European capital market is not
functioning well. My mother is worried about the education of her grandchildren. I may be worried whether my pension will be payable in future.

How will this liberalised capital market union meet the needs of the people in Europe? What kind of companies do we want? How do we deal with ESG questions? How do we deal with sustainable companies with a long-term investment climate? Liberalising the market is one thing, but the kind of market we want is a very important question to answer.

We have focused on more transparency in the investment chain in the Shareholder Rights Directive. We have also introduced some transparency obligations for proxy advisors. However, there are many other players on the markets: advisors, credit rating agencies, brokers and so on. We should have a more holistic view of what all these people are doing. The Financial Stability Board has also made some remarks about the assessment of large asset managers. Are they so big that they are becoming a systemic issue? These are questions to address: we should not narrowly focus on corporate governance in the old sense.

It’s wonderful to talk about regulation and about codes, but at the end of the day they needs to be applied. Then you come to questions of culture ethics and integrity. It appears the G7 is considering whether more needs to be done about a code of conduct for the financial sector. This is a signal that some members of the G7 have realised that but the application of regulation needs to be looked at very carefully as well.

Jane Diplock, Director, Singapore Exchange and Board Member, IIRC:

There are a number of things about the global economic environment that are affecting the investment community.

Firstly, money has never been so cheap. I went to a speech by the Reserve Bank Governor of New Zealand recently, and he was saying he doesn’t think, in living memory, money has ever been so cheap. Interest rates are low, in some cases negative, in all major developed economies. Growth is sluggish and in some cases flat. The markets are vulnerable and skittish. Confidence is low. Have the markets actually factored in another significant correction, or are they reflecting the deep uncertainties about a possible Grexit?

Every time a new scandal occurs in financial markets, and particularly in the banking industry, it elicits a hard law regulatory response. The Fair and Efficient Markets Review that the Bank of England is currently undertaking will be reporting soon, but I don’t think it requires much imagination to predict that there will be some hard law regulatory responses to plug the obvious gaps in the regulatory landscape. The UBS employee who admitted there was no compliance around the setting of London Interbank Offer Rate (Libor) didn’t seem surprised, and why should he? There was no regulatory rule to apply to it. The setting of Libor depended on the world’s trust in the integrity of UK banks. That was sadly misplaced.

The various efforts of governments to keep plugging the gaps are laudable and necessary – but it’s not sufficient. We need new approaches to try and encourage the business community, particularly the financial community, to
shoulder the responsibilities they have to society, to encourage financial stability and economic growth. They are in a social compact with all of us. I think the concerns about your pension or the education of your children or the jobs they will get is part of that social compact. The shouldering of that responsibility, in some ways, is being displaced to the regulator.

Corporations – be they banks or other financial institutions – should be shouldering their own responsibilities in this social compact. The passing of more and more regulation is very good for one sector of the community – the legal profession. They make a motza out of it. However, it’s unlikely to stimulate business or economic growth: in some cases, it might do the opposite. Those of you who read the Financial Times this morning would have read about small banks in Switzerland who are finding compliance costs just impossible to manage, so they’re going out of business. The consolidation of those small banks might be a good thing. But you have to ask whether the ever-increasing compliance burden is helpful to the economic progress that we all hope for.

It can also create a form of regulatory fatigue, pushing the principle-based jurisdictions closer to the position of the more rule-based ones. It has the potential of limiting, rather than broadening, information to investors. Efforts have been made through stewardship codes to encourage shareholders to take some of this burden, and to hold companies to account for excessive remuneration policies and other corporate governance issues. But little effort so far has been exercised to encourage the business community itself to look to the sustainability of their business models, and to explain these add value over the long, medium and short term.

Overlaying this current economic framework is a time of massive discontinuity in the business models of many up-until-now successful enterprises. I was quite surprised to see that the stock price of Weight Watchers has slumped in the US. You would think that Weight Watchers would be a great stock to push in the midst of an obesity crisis. What has eaten its lunch? The Fitbit. The Fitbit provides a community where you can share your progress, you can factor in all of your calories, you can do everything that Weight Watchers did, but you don’t have to leave your house. It’s transformed and undercut that business model.

You can all think of many, many examples of this transformational change that’s occurring with the technological revolution. It’s affecting every aspect of commerce, including the financial banking system. If we look at Bitcoin, the intermediation of crowd-sourced funding and peer-to-peer lending, we’re seeing a transformation. Valuation becomes increasingly difficult as investors attempt to rely on the past quarter’s earnings when they don’t necessarily give any indication of next quarter’s earnings, let alone the sustainability of the enterprise. To rely merely on the financial risks and reports is to take a very narrow slice of an enterprise. How do the environmental, social and governance aspects of the enterprise affect the sustainability of the business model?

In a number of jurisdictions there’s been a nod to some aspects of the more holistic approach to the business model. The US Securities and Exchange Commission (SEC) requires disclosure of material sustainable issues.
Materiality is vitally important, but it’s a threshold that’s reached in a moment in time. The direction of travel of an issue which may become material is absent from the view of the investing public, and not necessary to address in current reporting.

Most disruptive technologies come over the horizon and attack the business model of the incumbent: without a holistic view of the model of the enterprise, it’s impossible for the investor to form a view of the likelihood of this happening. Core to the understanding of the true value of an enterprise, and its sustainability over the medium – short, medium and long-term – is the understanding of the value the business model adds to the enterprise over these various time horizons. Only then can the investor truly match their duration appetite, with the likely success of the enterprise.

Markets need investors with appetites of all duration: short-term investors seeking short-term yield and long-term investors which need patience and understanding of sustainable business models. Andrew Haldane at the Bank of England said ‘A patient market is a happy market.’ Patience is important in markets.

I’m leading on to integrated reporting. This is a vehicle that provides a holistic understanding of the value creation the business model provides. It’s a lens through which investors can assess the sustainability of the enterprise, and match it to their duration appetite. It encourages the integrated thinking that the enterprise needs to undertake to decide how the business model adds value over these time horizons. It also provides the discipline and rigour of analysis which enhances business management and requires analysis of the threats to the model.

The adoption of integrated reporting would increase transparency in all business sectors. The current model for corporate reporting does not encourage trust. It provides a spare, narrow, backward-looking financial assessment and ignores the social, governance, human and environmental issues, which in today’s world of transformational business models may well be crucial to the future viability of the enterprise.

A new way of communication and measurement is needed to enable competent valuation and assessment of future cash flows. The businesses of the 21st century need to be managed in a way which encourages the protection of the planet, which creates value, long and medium-term, which permits the enterprise to exist sustainably, and which encourages long-term investment to enable financial markets to respond with the stability needed for growth and prosperity.

As Albert Einstein said, ‘We can’t solve our problems with the same thinking we used when we created them’. It’s time for new thinking.

**James Bardrick, Chief Executive Officer, Citigroup Global Markets Ltd:**

I’m the chief executive of our investment banking entity outside the US and the chief executive of the European bank vehicle here in the region. I’m also the country head, and I mention those two jobs because one of them is clearly a senior governance role. I’m going to come back to this in terms of what’s
different, what we are doing differently around governance, and around my particular role and those of my colleagues.

I also want to mention the country head role because, within Citigroup and its 101 countries around the world, the role of the Citi country officer (CCO), is a longstanding and established one. However, I’ve changed the acronym to mean chief culture officer, because that’s the second element that I consider to be the most important part of my job. One is governance, and the other is culture. This stems somewhat from the financial crisis, but let’s be clear: this is an issue that has been building for most of my working career, and I’ve been in the industry for 29 years. Over that period of time, some things have gone very badly wrong.

What is a bank? What is a systemic, large financial institution for? What’s its purpose? Along the way, people either forgot or chose to forget that you have to be a safe anchor for the economic infrastructure and the society that you operate in. Indeed, it’s not sufficient to just be an anchor. A lot of regulation that has come in has been around prudential ways of trying to ensure that our anchor is better and will hold firm in the next inevitable storm.

That isn’t the limit of the responsibility. You’re not just the anchor – you also have a responsibility to be the driver and the conduit for economic development in your society. We’ve had a lot of regulation, a lot of law and a lot of change. Most of it is good, not all of it is perfect, not all of it is completely coherent and there’s a lot of work going on to deal with those things.

There are very problematic levels of growth and the real possibility of a major slowdown if the role and the purpose of banks and large financial institutions isn’t properly empowered in terms of becoming drivers of that process again. We see that clearly in the capital markets union agenda in Europe. I’ve been delighted in the times that I’ve been recently to Brussels, and just seeing how the tone has changed, how the alignment has changed in terms of really focusing on how we really get this to happen without damaging or taking away some of the good work that’s been put in place.

We can’t regulate for conduct, we can’t regulate for behaviour. We can regulate against the consequences of bad examples of these things, but how do we get the best and very constructive behaviours, actions and activities? How do we ensure that life isn’t fettered and life is better and the outcomes are better?

We can regulate for enormous transparency and enormous disclosure. If I get a prospectus which is 1,000 pages long and discloses everything that the legal profession and my internal people can come up with, I’m not sure it’s actually helpful in me getting to the right outcome and making good and sensible and fair and safe decisions.

Regulation can get to a certain point. Then something really important comes in, which is the bridge between a good bed of regulation and legislation. The bridge has two components. One is supremely improved governance: although a lot of work has been done in the last few years, there’s still a long way to go. The second is culture – these two are inter-related, because if the culture within the organisation isn’t correct institutionally and at a personal
level, then it doesn’t matter how good your governance is, or your planning, or your measurement, or your challenge or your recording: the outcomes won’t be right. If you don’t have the governance, you will not have the confidence, even internally, that you’re actually going in the right direction, allocating resources in the right way or making decisions in the right way.

It is my mission, as the Chief Culture Officer and as the Head of Governance in my organisation in this part of the world, to do something about that. So, what are we going to do about it?

On the culture front, we’ve introduced training. I see you all glazing over. Let me tell you a little bit about the training. The training is from the top, but it goes down into the organisation. We’ve trained 40,000 people: have we trained them in compliance? Have we done online training in ticking boxes? No, we’ve used real case studies, real examples, real situations and a lot of time and effort.

We start with a lens called ‘right, are we allowed to do this’? We examine internal regulations, external regulations, law, codes of conduct, anything that we have which actually prescribes how things should be. We ask if we are allowed to do it. We’ve had some major errors in that over the past. But people are normally pretty good at being compliant.

Even if you’ve got a lawyer’s letter saying you’re allowed to do it, even if internal council has signed it off, you now go to the next lens, called ‘good’. We want you to think about all the stakeholders. Have you properly thought through the consequences of the action on those stakeholders? Are there any which are unacceptable?

The final lens is the one that really matters and we call it ‘fitting’. It says, we have had a set of values for a long time. We have a strategy and an operating model. We have defined what we’re for as an organisation, who our customers are, what we’re meant to do with them and, importantly, what we’re not expecting to be particularly good at.

We’ve also defined the reputation that we would like to build over time, with all of our stakeholders, customers, regulators, host governments, society, employees, current and future. We measure the consequences of our decisions and our actions against that. In essence, it’s about building trustworthiness. On the culture side, that is the major pillar of what we’re doing.

Looking at governance, we’re moving away from a process which, throughout the industry, had perhaps become a little bit of an ‘after the event’ books and records affair. We have a board of directors, we have non-executives, we have a chairman. We have governance at every entity level with very specific responsibilities and a clear definition of our strategy and objectives.

Finally, we engage proactively because this is what the industry needs to do and what we, as an individual firm, need to do.
For the last few years, banks and major financial service institutions have been the problem. They remain a big problem. Libor, FX, we all know about the lack of trust. However they should be part of the solution.

Laurent Degabriel, Head of Investment and Securities Division, ESMA:

A lot of financial markets regulation has focused on transparency for both regulators and market participants, which is good. Not a lot has been done in terms of corporate governance. We are very optimistic about the outcome of the Shareholder Rights Directive. That will bring a lot of additional transparency. All that is very positive. Having tools for investors to take an active role will be also very important.

However, there are number of new drivers. There have been mentions of regulatory fatigue. A lot of new regulation has been made since 2008. Some of the regulation has not been implemented, especially in its most innovative parts. If you look at the Markets in Financial Instruments Directive (MiFID) II, for instance, it looks at new tools for regulators like product governance, which goes deeper into the culture of the organisation. It’s the right time to digest all of those regulations.

Secondly, the landscape of financial market regulation has changed. We are now in a different environment. The objective now is to stimulate economic growth, stimulate job creation. That demands a different set of measures.

The capital market union will play a key role, but nothing will be possible through the capital market union if investor confidence is not restored. Investors, especially retail investors, have suffered quite a lot over the last few years, and we need to bear it in mind that trust need to be restored. That will take time.

The other thing which we need to factor in is the role of technology. It’s disrupting business models; it’s also disrupting the way we do regulation.

As far as ESMA is concerned, the mandate that we have on corporate governance is a bit narrow. We are very interested in those areas and we have the feeling that we can play a key role on a number of items. One of them could be information dissemination. We have a setup a number of registers on prospectuses, and there could be other things that we could do as a ‘central hub’ for information on corporate governance. We will be very happy to further develop that role.

We’re already quite active on proxy advisors, and we have been encouraging the industry to come up with a code of best practice. They came up with that code in March last year. We are reviewing the impact of that code. We’re going to issue a call for evidence very soon on that issue of proxy advising and would really encourage you to reply to that call.

There are other two things that we are doing – or one thing that we are doing and one that we could contemplate doing. The first is work on disclosure and comparability of information on directors’ remuneration. We would also be interested to do some further work on the voting chain. We need to make the
life of shareholders easier, especially across borders, if we want to create more integrated financial markets.

**John Plender:**

Perhaps we could explore the issue of rebuilding trust. We've had successive financial crises – the early 90s, dotcom, late 90s, 2008, the huge financial crisis – and with each of these things, we get more and harder regulation. We’re now locked into what is, in effect, a low trust financial system. Is talking about rebuilding trust unrealistic?

**Jane Diplock:**

That nexus, between trust in markets or confidence in markets and increased regulation, clearly is not a natural ‘one equals one’ relationship. We have a necessary ‘plugging of the gaps’. We’re trying constantly to think, okay, we haven’t perhaps covered this area, so we’d better regulate in that area. The soft regulation, which is what corporate governance codes have been, and where integrated reporting is coming from, tries to encourage businesses through more concise transparency.

I totally agree that the 1,000-page prospectus is turgid and incomprehensible. One of the great reliefs of not being a regulator is that I don’t have to read those damn things unless I want to invest. Part of the integrated reporting movement is to try and pare that down.

I’m optimistic that the integrated reporting model will encourage management to take a much more holistic approach. Certainly in some of the companies that have done this in South Africa and Brazil, where it’s mandated on an ‘if not, why not’ basis, have found significant governance pluses out of it. As we all know, what gets measured gets managed. If you have to articulate your governance model and how you think it adds value to your business, you really try to make it add value to your business because you’re going to have to communicate that. It’s a virtuous circle.

**John Plender:**

Laurent, you pointed out that there’s been so much regulation that we need to take stock and digest. Can you see a way back to a more trust-based system?

**Laurent Degabriel:**

I’m not sure; I would oppose ‘trust versus regulation’. Those two things contribute to one another. I don’t think we can establish trust with less regulation. At the same time, we cannot say that regulation will build trust by itself. It has to be a combination of both.

The foundations need to be there. When you talk about the prudential side, transparency needs to be there, and there needs to be strict rules about that, to allow shareholders, investors, to find out what they want to know about the company they are investing in, and about the product they are investing in.
At the same time, regulation will not be able to achieve everything. We have seen a lot of new regulation and there are still scandals. Trust in financial institutions will only come on top of the positive effects of regulation and if corporate culture changes.

I personally think that it’s too early to impose more regulation. Change has come from inside of financial institutions.

Transparency in itself is not a panacea either. We have to bear in mind that it’s about better information rather than more information. The temptation has been to give out a lot of information to investors or shareholders. We have to have a critical eye on transparency and make sure that we, as regulators, are demanding the right information, and that issuers are providing the right information to interested parties.

John Plender:

James, what are the lessons we’ve learnt, when you look at, for example, JP Morgan and the London Whale? How long is culture change going to take and how can you convince us that it is even doable?

James Bardrick:

Let’s be clear, some of the things that continue to come out around behaviour and culture didn’t end with the financial crisis. I can’t look anyone in the eye and say that they’re not continuing to go on, not only in the industry, but even in parts of my own firm. We are changing the culture and we have consistent standards which we enforce. At the end of the day, it’s the outcomes that matter, and seeing results will take time.

John Plender:

Jeroen, you made the point that there had been an excessive regulatory focus on securities. I wonder if you could expand on that?

Also, if one looks at the liberalising measures that have been taken in Europe and in the US in relation to trying to increase competition between exchanges and trading platforms, there has been a degree of fragmentation and a loss of transparency there. Is that something that you can envisage reversing in the foreseeable future?

Jeroen Hooijer:

A number of you probably think ‘those guys in Brussels have been behind their computers designing all these legislative instruments without having been in touch with the real world’.

All these instruments were designed with the input of your administrations, your stakeholders, all the Parliaments and the European Parliament. I remember when I joined what was Internal Markets at the time, the code word was ‘light touch’. Light touch regulation that was the thing we got from London and we believed in it. Now, we know what it brought us. We should not forget this.
If I look back six years ago to October/November 2008, we were afraid of a major meltdown of our economy. These lessons are forgotten: that’s why this whole regulatory system was put in place, and we did this consciously. The regulation has an objective, a purpose. A number of these things are still being implemented.

We have this very sophisticated system of regulations and obligations and so on, but we should not forget why we’re doing it. What is the underlying objective? You also have the social component, the environmental component, the better world we all would like to see happening.

I’d also like to make a point about culture. The Commission has also had its scandals as a public organisation. Scandals about potential corruption – people handle a lot of money. We have gone through an enormous training process, and I want to share that with you. I had a Swedish Director General a few years ago, who was very open about transparency and very interested in this kind of phenomenon. In the beginning, we all said, ‘yeah, we know, we have listened to our little voice, we know what culture is, we will do the right thing’. I was sceptical about it.

Anyway, we went to ethics training. We were presented with guidelines, and we did questionnaires and surveys, and I thought ‘okay, I’m going to do this honestly’. I’m not going to write down what is politically correct. I replied with what I would really do in that case. I only had six right out of ten. I don’t think I’m a very unethical guy, I try to do the right things, and still a number of borderline cases were there which were not so easy to address. It made me realise how important it is to pay attention to culture, to ethics, to integrity, to doing the right thing. It requires constant maintenance. It’s not a question of ticking the boxes: I’ve been there. It requires something permanent in an organisation. There is this wonderful expression: ‘culture is served for breakfast and is eaten before lunch’. It is very, very difficult.

**John Plender:**

Laurent, if you go back to the financial crisis, a great deal of what went wrong – particularly in relation to a lot of the off-balance sheet risks that were run, the structure of products and so forth – were to do with regulatory arbitrage and banks trying to get round the Basel capital regime. Isn’t there a risk that with these 40-plus regulatory initiatives, we will spawn a new round of regulatory arbitrage – and the only way you can really address that problem is to retreat from globalisation?

**Laurent Degabriel:**

What the wave of regulation has tried to address since then is the fact that various sectors are either not regulated or not fully regulated. I think it’s the case for rating agencies, it’s the case for the investment funds. It’s also to bring more transparency on some of the transactions, derivatives, bonds, which were over-the-counter transactions, and that should be taken care of by MiFID II.

If the changes are successful in changing the corporate culture, that regulatory arbitrage should not exist anymore. I think we still have to be
mindful of that risk though. Look at the whole debate about shadow banking: the fact that by having too many requirements on banks, we could see financing being provided by other players, even asset managers.

I’m not sure we can transfer some of the prudential requirements that we impose on banks to asset managers. It could justify a new regulation, but I think we need to be really take into consideration the characteristics of those players and avoid the temptation to ‘transfer out’ some of the regulations from the banking world.

**Jane Diplock:**

It’s easy, in 2015, to forget the near-death experience of the global financial market in 2008. Had the markets actually failed, the implications would have been horrendous. While we might debate about the extent of the regulatory response and the nature of specific parts of it, I don’t believe that there’s any getting away from globalisation, any more than there might be any part of the world saying we’re not going to be influenced by climate change.

The things that are not global, of course, are the national regulatory frameworks. IOSCO’s worked very hard to try and provide some standards and principles to enable more congruence of global regulatory frameworks. The European Union and the question of the capital markets union is another step. This is quite a long journey, and I don’t think we can possibly hope to eliminate all arbitrage in the near term.

Every aspect has to be looked at: because of the current economic circumstances, you see the growth of the asset management business, and you have to ask ‘is it systemic’? I see that debate is very playing out right now.

**John Plender:**

It’s time to invite the audience to ask questions.

**Anita Skipper, Corporate Governance Advisor, Aviva Investors:**

Jeroen, you were saying the holistic view is important, but in fact it’s the whole chain in the investment market. You were talking about brokers, investment consultants and so on – will you be promoting this holistic approach on the capital markets union? If so, can we help you do this because we believe that that’s the right way to go?

Jane, disclosure from companies on culture and ESG issues is very slow in happening. I know you’re not at IOSCO any longer, but do you support IOSCO saying that stock exchanges should make it part of their listing rules that companies should inform their investors on things like this?

James, if you believe in culture and long-termism for future sustainability of economies, would you recommend that your sell side analysts cover these issues when they’re doing their research for investors?
**Jeroen Hooijer:**

First of all, as far as the change is concerned in the Shareholder Rights Directive, we are already trying to address this for the main players. Institutional investors should be far more open about their long-term policy. We also want the asset managers to be more open as far as their policy is concerned, about how they comply with their instructions, about the mandates that they get. They should also pass that back to the big investors, the pensioners, or the insurance firms behind it.

There are many more players in the chain – proxy advisors, brokers, advisors and so on. It would be interesting to address that, but we are now in the consultation process with the capital markets union so we have to see what comes out of that. It’s difficult for me to say whether this will be one of the prime actions or not.

**John Plender:**

Jane, on Anita’s point, it’s just very striking that if you look at the objectives and principles of IOSCO, they’re all about fair and efficient markets. There’s virtually nothing on corporate governance.

**Jane Diplock:**

I think that it’s partly a historical matter. The initial 30 principles were really looking at the technical aspects of the capital markets and bedding in broad principles. Corporate governance has grown up as a parallel series of frameworks, supported by various institutions and also by domestic Institutes of Directors and others. There’s not been an absolute interlinkage.

The Sustainable Stock Exchanges Initiative is well worth supporting, but I see this as a step towards integrated reporting. You really can’t do an integrated report unless you’ve thought very carefully about sustainability, your ESG obligations and so on.

On IOSCO versus corporate governance, it hasn’t been an issue that has been taken on because it’s been seen to be dealt with by other parties.

**James Bardrick:**

One of the biggest efforts we’ve made as an organisation recently is the publication of global macro research around several topics, which range from the impact of women in the workforce, to climate change, to automation and its impact on productivity and employment. We think we have a lot of information and we know that our clients like to understand that, and see it.

At a second level, we’re encouraging everyone in our organisation to be more holistic in their thinking. When you really think about the things that are going to make someone successful as a company or less successful, is it just down to the next three months earnings-per-share forecast? Or are there other things that need to be taken into account which will either drive success, or make the qualitative analysis of that company better? That’s absolutely a focus of what we’re doing.
At a third level, we’ve still got a lot of people who don’t like paying for this stuff, and just want to know what the number’s going to be in three months’ time. I suspect you’ve got a longer term outlook. We think from the other side of the market, which is the investor side, there could be more longer-term thinking too.

**Peter Butler, Founder Partner Emeritus, GO Investment Partners LLP:**

I spent 20 years as a company director. It seems to me that we’re in need of some enabling legislation on directors’ rights, rather than shareholders’ rights. There’s a problem of trust between company directors and institutional investors, which is a result of the lack of transparency in the ownership chain. Because there’s a political move around the world to get institutional investors to hold directors to account, isn’t it only fair that those directors should know who their decision makers are? This information just isn’t easily available on a register. Is there a need, for some enabling legislation so that directors can get better access to the people that politicians are asking to hold them to account?

**Jeroen Hooijer:**

This is also an issue for companies who ask, ‘Who are my shareholders? Who are my investors?’ Even in this time of transparency and digitalisation, it’s not always so easy to know who has built up a certain share in a company. Listed companies can have millions of shareholders, but sometimes there can be countries or companies have built up 5% or 10% and you’re not aware of it.

We try to address this in the Shareholder Rights Directive, so that a company has the ability to ask ‘who are my main shareholders?’ above a certain percentage of shares. Having said that, it is technically hard to do.

I think we are getting there by creating the obligation, but the problem is that it is still subject to negotiation and it is costly. Who will pay for it? We could see the watering down of such a system.

**Sandra Carlisle, Head of Responsible Investment, Newton Investment Management:**

I’m hearing a lot about trust, transparency, legislation and regulation. However, the one word I’m not hearing is value. Jane mentioned Fitbit, and I suspect the reason why customers are buying Fitbit is they perceive it delivers better value to them than going to Weight Watchers. How do those of us who are in the financial system acting on behalf of investors deliver that value? In a world where we’re perceived as delivering more value, do you think the regulator would respond differently?

**James Bardrick:**

I had meant to specifically talk about value in the same context as trustworthiness, in terms of the customer relationship.
If we look at our strategies and our operating models, and what our responsibility is, we’ve all got to look at the value proposition. Technology is changing life: market behaviour is changing, globalisation has changed many things, and regulation has changed the customer behaviour and requirements as well.

If a major element of what we do is to be an anchor and driver of the economic system on the one hand, but the other element is to be the provider of a valuable and trustworthy relationship with your customers, then that has to be defined, explicit and dynamic. That requires investment, relationships and development. One of the things that we must be very careful of as we deal with rebuilding trustworthiness is that we mustn’t stop thinking about what is it that we do with our customers that is valuable and therefore makes them want to use us and work with us?

Otherwise, we’ll find that the finance equivalent of Fitbit will come along and do it differently, which will then set off another series of regulatory and stability issues as well. I think we have a responsibility to continue innovating and delivering better quality experience and better value, but also to ensure that that part of the industry which is responsible for sustainability and the economic activity remains at the centre and doesn’t create a further systemic risk.

Plenary 3: Inside the boardroom black-box

- Annell Bay: Board Director, Apache Corporation and Hunting PLC
- Gilles Hilary: INSEAD Professor of Accounting and Control and The Mubadala Chaired Professor in Corporate Governance and Strategy
- Wendy Lane: Director, Willis Group Holdings
- Simon Walker: Director General, Institute of Directors
- Chaired by Holly Gregory: Partner, Sidley Austin LLP and Chair of the American Bar Association’s Committee on Corporate Governance

Holly Gregory, Partner, Sidley Austin LLP and Chair of the American Bar Association’s Committee on Corporate Governance:

Boards function these days in a challenging environment. It’s not only challenging from a business perspective, but boards also face a lot of scrutiny. Everyone is interested in what boards decide and every newspaper you read is filled with stories about boards of directors.

Yet, boards function in a very confidential environment, so there’s not much of a window into how boards make decisions. I thought that that’s what we could talk about today with this panel.

Wendy Lane, Director, Willis Group Holdings:

The biggest issue we face is the short-termism versus long-termism issue. Clearly, there is a rise in short-termism, at least in the US. The rise of hedge funds, activists being very noisy and even long-term shareholders.

The biggest help that directors can have when they think about this issue is to ask ‘who do I represent’? I personally represent the long-term best interests of
a company. That’s a true north for me. A great example is DuPont, where Nelson Peltz was calling for value creation – cut costs, spin off divisions, maybe split up the company, repurchase shares. The DuPont board listened to that, reviewed their strategy and R&D programme and they found out where there was convergence with the activists’ point of view. Ellen Kullman is a fantastic CEO, she and the directors communicated really clearly what their policy was, what their strategy was and better yet, they listened. What ultimately won the day was that the board listened.

I was on the board of LabCorp for 18 years – that’s the second largest clinical diagnostic lab in the world. During 2008–2013, we were generating enormous cash. All we heard from shareholders was, you’ve got to repurchase, lever up, release cash... But we saw long term that the healthcare industry in the US was changing dramatically. United Healthcare was a huge customer of ours already and it was going to be a multiple factor of that. Personalised medicine is coming in: how do you prepare for that?

We kept looking at adjacent spaces and all of a sudden Covance, a clinical research lab, came along and we bought it. That was a huge purchase. It was very bold, we conducted key communications, listened to shareholders, answered their concerns... and the price went up.

We hear shareholders and we hear what their concerns are. If you know what your long term responsibility is, you can balance all those things pretty well.

**Annell Bay, Board Director, Apache Corporation and Hunting PLC:**

In the energy industry, you cannot have sustainable short-term, quarter-over-quarter, successful business results. You have to have capital investment for infrastructure. That’s certainly going to factor in if you’re looking at one specific parameter, particularly return on capital. If you’re just looking at that, you definitely need to look at a longer-term view.

Having said that, if you have consistently poor results, quarter after quarter, something’s got to change. What are you doing to change the outcome? What have you laid out that’s going to show the shareholders that you have some changes in effect that are going to be better and make the long term successful?

**Simon Walker, Director General, Institute of Directors:**

The level of distrust in business is at an all-time high, and for very good reasons. My last job, before I came to this one, was running the Private Equity & Venture Capital Association. A problem that private equity had was that it really did operate in a black box. When KKR bought Boots, it couldn’t just buy it and say ‘now this is a private company and you can all go away’, for several reasons. First of all, because the public at large feels it has a stake in Boots as well. Secondly, because you’re destroying the brand value of a great name if you operate that way. Companies always operate better, if they’re not treated with suspicion by their customers, regulators, employees and potential employees.
Gilles Hilary, INSEAD Professor of Accounting and Control and The Mubadala Chaired Professor in Corporate Governance and Strategy:

We have touched on different points about trust, complexity or short-termism. I think it relates, to a large extent, to a single dimension. Maybe one way to think about it is to take an example. OW Bunker was the second or third largest Danish companies; it had its IPO last year in March. When you looked at the board of this company, you had the best people in Denmark on that board. Fast forward to November, it took three days for the company to enter liquidation. What happened?

Essentially, the board spent too much time focusing on risk management and not enough time on uncertainty management. Risk situations where you know the threat, but you just don’t know the outcome, are okay. Uncertainty situations are where the threat and the probability are not well known. Often this is not a dimension that people focus on. People don’t like to deal with uncertainty. People like to focus on things that they can measure and that can lead to the short-term aspect.

Gilles Hilary:

The approximate cause of the bankruptcy was bad hedging and bad credit policy. But that was not the root cause. The root cause was, essentially, whatever characterises a bad culture. There was a drive towards short-termism, there was a drive towards reporting the right numbers and that put pressure on a lot of people.

Holly Gregory:

Wendy, you’ve been involved in a company that had some struggles. Was it a culture problem or was it a culture problem in management?

Wendy Lane:

Holly is referring to the Tyco situation. It was culture, and I always talk about tone at the top. There were two sets of employment agreements with Dennis Kozlowski, the CEO. There was one that we, the board, had with him, and then there was one in the drawer. We had the General Counsel signing off against the CFO and the CEO. Guess what? They all had the same bonus plan: whatever the CEO got, the CFO would get half of his bonus and the General Counsel would get a third. None of us knew there was this corruption. Then they would corrupt the layer by paying them special bonuses – flying them to Bermuda or Bahamas or wherever. We didn’t know any of this. It went very, very deep.

When it all hit the fan, ultimately we got a new CEO and they cleaned house. Within the Finance Department, they probably cleaned three layers down and probably another three layers in the HR Department. The culture was pretty bad.
Holly Gregory:

Simon, how does boardroom culture impact decision making? Why is it important? What are the cultural hallmarks that you would expect to see for an effective board?

Simon Walker:

I think it ends up permeating the whole organisation. It starts with the chairman, who needs to demonstrate the highest standards of integrity and probity and set clear expectations about the company’s culture, values and behaviour.

But it goes to the board and then needs to permeate the company as a whole. One of the things we saw after the financial crisis in this country, was how that had not applied, particularly in the large banks. Barclays Bank commissioned Anthony Salz, a very well-known lawyer here, to report on the culture at Barclays. It was a brave thing to do, and made quite horrifying reading, because it suggested that profound cultural problems had gone right through the organisation. You often have that situation where boards are not attentive enough to the minor flaws or apparent inconsistencies that actually suggest far deeper problems within an organisation. It’s a constant attentiveness to the little lapses that are what make a good board really work.

Simon Walker:

A lot of the problems in this country came from having only the same voices, having people who knew each other, played golf with each other, related to each other, had dinner with each other all the time and thought the same way.

The problems of groupthink, as companies were making takeover bids or mergers that were actually deeply questionable and should’ve been questioned, but weren’t because groupthink had taken over. Questioning, doubting and arguing needs to be very actively encouraged and on the basis of full information.

Wendy Lane:

One of the big issues inside the boardroom is trust. You have to trust each other, trust the CEO and they have to trust you.

On one of my boards, we’ve started having a devil’s advocate. If everybody gets into group thinking, we will actually appoint somebody, to take the opposing view and present those things. Trust and balance are big issues in creating a great culture.

Annell Bay:

Trust is very key, but also respect for the other board members. I would say it really does start with the personality or the character of the chairman of the board, and the tenure that is set with that.

Secondly, the effectiveness of the CEO is critical. Once you look at those two items, how do those two work together? Are they clear on what their roles
are? Because the chairman is not the CEO and does not need to be managing the company, he’s got a different role. Do they work well together and do they trust each other?

I was talking to someone and they told me that they have someone with certain expertise on their board, and his comment was, ‘When I talk about my area of expertise, I expect you not to argue with me and I won’t do the same with you’. Well, that’s a real disservice to that board because no one on the board is stupid. Everybody sees things differently and that’s the whole reason to have a diversity of skillsets, to be able to ask those questions.

Holly Gregory:

When you think about it, the board makes a decision as a group, and yet, that encouragement of diverse viewpoints, as well as encouraging reliance on one another, has to be natural and come about because of trust.

Gilles Hilary:

One of the important issues at the moment is managing diversity. When you’ve got a very homogenous group, then people are going to think alike and you’re going to miss things. At the same time, you mentioned trust is very important, and we know that one of the biggest impediments of trust is difference. So, you have a harder time trusting people who don’t look like you or who don’t come from the same background.

Boards are becoming more international now, you’re getting Asians on Western boards, you’re getting Westerners on Asian boards. How you can manage the diversity, avoid the groupthink, without destroying the trust, particularly in times of crisis?

There are techniques that can help— you were mentioning devil’s advocates. Another thing that I’ve seen working fairly efficiently when you have experts is to ask the person who doesn’t know much to do the presentation about the topic. That’s a representation of whether the board understand the issues, and then the expert can wade in and say, ‘oh no, I think you missed that point’.

Holly Gregory:

We know we want this environment where there’s trust, but there’s also a real challenge, there’s rigour in the discussion, that there’s debate, and, at the end of it all, there is commitment to whatever the group view comes to be.

What are some of the individual director behaviours – not board structures and board processes – that help support and help evidence this culture that we’re seeking?

Annell Bay:

The CEO and the chairman set the culture, but every member of the board is a part of that culture. One thing is a constant refreshment of the board. If you refresh the board, you are bringing new people in who are going to change
the culture of the board. Fresh eyes, someone new has the right to say, ‘Well, I don’t understand that, why are we doing that?’

The next question is where that refreshment comes from. Who are you bringing on? What skillsets are needed and what diversity of skillsets – particularly in industry areas.

Another key element, particularly on the debate and the challenge, is where you get your information. If all the information is coming from executive management, and that’s all you have, can you hire some outside consultants come in or spend some time separately putting together some information that you can present?

At Apache, we have access to the employees and the staff to delve further into opportunities and issues and the technical work. On the first day of our board meeting, that night, we have a board dinner with the board of directors and executive management, but they also invite a host of younger staff from the company.

I’m by no means trying to say that CEO and executive management is trying to sugar coat or cover something up, but there’s limited time and certain things are presented. This is a way to not only get to know the rest of the staff, but also to see the concerns that they’re thinking about and what they see? I think those are key elements of individual behaviours.

Holly Gregory:

What do we expect of individuals by way of behaviours in the boardroom? I ask this because I spend a lot of time with good boards, but I spend a lot of time, also, helping boards that are in trouble. Often, it’s because of behaviours in the boardroom. If you had rules for individual directors, what would they be?

Wendy Lane:

Respect is number one. You can’t be trashing the other board members or the CEO. There are ways to respectfully disagree. You can say, ‘help me understand’ or, ‘how does this fit with X’? You don’t have to say, ‘you’re dead wrong’.

One of the other things that really matters, is that you represent the long term interests of the company. You don’t represent a constituent. Even if you’re an activist shareholder, you represent the long term, best interests of the company.

You can’t get into power struggles. There are ego struggles and there are power struggles, but you have to really set all that aside. That’s another really important consideration of creating a great board culture.

Holly Gregory:

Annell, you were saying that there’s a process by which there’s encouragement to have connections with members of the management
outside of the boardroom setting. Are there rules of behaviour and an understanding of what you do and don’t do in that kind of relationship?

**Annell Bay:**

There is an understanding. Has anyone sat down and said to me ‘these are the do’s and don’ts’? No, I don’t think anyone would say that to the board members.

It goes back to individual behaviours, what we do and how we interact with people. It really is respect and that’s not being on my iPhone, not interrupting, not switching subjects.

Working with an effective board is no different than working with an effective leadership team, and you have to spend time with each other outside of the work you're doing. The dinners are important, a lunch is important. Maybe you’re in town and you can get together one-on-one with another board member just for coffee or tea. You’re not making decisions, but you’re trying to understand something or get to know them better. Because then it’s easier, then it’s not personal in the boardroom.

**Simon Walker:**

I think the breadth and diversity of the people making up the board is a vital ingredient and sometimes that will involve more challenging situations. In the UK, particularly, the principle is that if you’ve been CEO or a finance director of any FTSE 350 company, you can probably be put as a non-executive director on any board. Consequently, there is a very set pattern of the make-up of FTSE 100 boards. That’s a problem because it narrows things.

There has been a lot of attention paid to gender diversity, but less on other kinds of diversity. In particular, the one I’d single out is age diversity. There are only four directors of FTSE 100 companies who are under 40. That seems very short-sighted of British business as a whole.

**Gilles Hilary:**

I think there a couple of important aspects of board behaviour. One is the discussion, the debates and the right to disagree. One also has to realise that what happens in the boardroom needs to stay in the boardroom. Because one of the issues is that you get on a board because you’re very successful, and then you sometimes have the feeling that you’re legitimate because of your prior experience.

Maybe you’re part of the family that created the organisation, and that gives you the right to speak for the company. Sometimes you’re going to be in the minority and sometimes people take it outside the boardroom. The notion of disagreement needs to be fostered, but it’s a majesty position and stays within the system.

In terms of diversity other than gender diversity, we looked at the leadership teams of airline companies right after September 11. We found the companies that had a more diverse executive teams in terms of functional diversities –
whether you had PhD graduates with high school dropouts, engineers with accountants – did much better in time of uncertainty.

Wendy Lane:

Sometimes boards don’t agree with the CEO or there’s a touchy issue like, succession or compensation. One of the best things that happened in the US, in terms of Sarbanes-Oxley, was executive sessions. They’ve really helped us be able to say what we think, even if it’s contrary to positions that the CEO has taken. If you have a great chair, they can take the news on in a very respectful fashion.

Holly Gregory:

What are the signs, inside the boardroom, that you might have culture problems developing?

Gilles Hilary:

The quality of the discussion is obviously going to be very important. If you’re able to express an honest opinion in the board, that’s going to be fairly crucial for the rest of the discussion. When you see people staying silent for a long period of time or getting into outbursts, then that’s obviously problematic.

One thing that is becoming more complicated is that you have people coming from different cultures, and you don’t behave in the same way, in the same situations. The ability to read a diverse cultural group is going to be very important.

Holly Gregory:

Wendy, I wanted to ask you about this issue because you sit on an Irish board, a Finnish board, a US board and a Saudi board. Are the boardroom cultures different or is it pretty much the same?

Wendy Lane:

I’d just like to go back about how you can tell whether the culture’s turning toxic. There are two kinds of tell-tale signs that I’ve observed in other companies. One is a director who’s census-taking inside the boardroom, going around and collecting votes for his or her point of view. Second, sometimes you get a director who will go out and take a census of investors and how they feel. Those are two kind of toxic culture signals.

Getting back to the cultures of the boardrooms, the degree of formality is very different. In America, you don’t interrupt anybody, but you don’t have to wait to be called on. For instance, if you don’t understand something as slides come up, you can say, ‘wait, wait, let’s stay on that slide, I don’t understand this’.

In Finland, typically, the chairman calls on you. Before I got on the board, it used to be that that you’d have to hold questions to the end. Finland’s much more formal and the chairman controls the agenda. The Irish company’s actually split between London and the US, and it has a culture where there is
an equal responsibility between the CEO and the chair. It’s the true European/UK model where you pay the chairman a lot of money and they have a lot of responsibility. There’s much more of a division of power than there is Finland or in the United States.

The Saudi Arabian company is private so I can’t speak for their public companies, but basically the CEO is the chair. They speak first and your comments have to be much more indicative of support than disagreement. If you disagree, you tend to disagree behind the scenes.

Holly Gregory:

We talked about behavioural indicators of a potential problem in board culture. I’ve got a board where we have somebody who has created great private relations with lots of the managers, and will often, in a boardroom say, ‘well, I’ve polled the managers and they think X’. The rest of the directors go crazy, because how do you counter that? It’s like he has a private font of information. You don’t know if it’s real, you don’t know if it’s not real. It can be really problematic.

The other one that I see a lot is when we have factions – a group that always agree with one another and another group that takes a different view. What does a board do when behavioural problems develop?

Annell Bay:

It’s actually no different than when executive leadership deals with an employee. Of course, an employee working for you is slightly different than a fellow board member. But you have to address it. I’m thinking of the boards I’m on, and if I could see this rogue behaviour or this perceived differential access, that would need to be discussed with them privately. You’ve got to address it, that’s got to stop.

Holly Gregory:

Do you view that as a role of the chair to police that?

Annell Bay:

I would say you would go to the chair and talk to them, and depending on how that goes, ask who the best person is because you are going to continue to work with this person. You discreetly go to the chair and say, ‘this isn’t acceptable, this has got to stop and how are we going to do it?’

Gilles Hilary:

There are often five steps that are suggested. First, talk authentically and be honest about the problem.

The second step would be continuing communication because often what happens is people stop talking to each other. Being able to maintain the dialogue is going to be important.
Third, understand where people are coming from – put yourself in the other person's shoes.

Fourth, try to separate the issues from the person.

Fifth, take ownership. Realise that this is not somebody else's problem – once you’re on the board, this is your problem. You might argue this is more of the chairman’s problem, but at the end of the day, you are on the board.

**Holly Gregory:**

Simon, do you have any insights on this? Do you help directors understand, and boards, how to deal with really problematic behaviours?

**Simon Walker:**

I think it’s fundamentally down to the chair of the board to try and address the issues.

**Holly Gregory:**

What if the chair’s the problem?

**Simon Walker:**

Then there’s a senior independent director who can be addressed as well. One of the interesting things we’ve seen is the relative longevity of chairs in companies. Last year at our convention, the chairman of BP talked about how he would be presiding over three CEOs at that company, over an eight-to-ten year period.

The chair does have an important cultural role. Resolving those kinds of problems seems, to me, absolutely crucial. But it is something that needs to be addressed, as soon as it happens, because it will always get worse. Difficult though it is to address it now, it'll always be more difficult in X months’ time.

**Wendy Lane:**

If the problem’s the chair and it’s not a one-off problem, that one thing that can be tried – and we’ve done it – is make sure that there’s an outside assessment of the board. Most of us carry out self-assessments and are actually fairly critical of ourselves. But if there’s a chair that’s a problem, you can say, ‘well, we haven’t had an outside assessment for a really long time, I think this would be a really good idea to do that’. And you can say that right out there in the boardroom. Anybody that feels the way you do, will probably agree.

**Simon Walker:**

The greater problem we’ve seen here is relatively weak chairs, unable to cope with CEOs. We saw a lot of that in the financial crisis here.
**Gilles Hilary:**

We do a fair amount of training for Directors at INSEAD, and one thing we often do is the 360-degree appraisal. That’s typically something that is well received.

**Holly Gregory:**

And when you do the 360, do you have management review the directors?

**Gilles Hilary:**

It varies, but yes, that’s fairly common.

**Holly Gregory:**

I do a fair amount of board evaluation and I always want to try to figure out why I’m being brought in. It’s often because there is some sense of dysfunction and they want a little bit of board therapy session. Sometimes, you just need to get the board in a room after finding out what are the behaviours that are troubling people, and then putting it on the table. Those cultural cracks, those fissures, get deeper when there’s a crisis. This is crisis preparedness, making sure we’ve got the whole organisation working well.

I want to turn to some of the board practices that support effective culture and behaviour. And one of the reasons I try to focus on behaviour first is, in settings like this, we often talk about board best practices. I thought it was important to try to step back and say, what are we trying to accomplish from those practices? And, to me, it’s this boardroom culture. Annell, can you give us the top three board practices that you think help support the kind of culture that we’re talking about for effective decision making?

**Annell Bay:**

Well, it’s got to start with the refreshment of the board. Because of that refreshment, then you’re able to continue to have a healthy culture because you’re bringing in some fresh ideas, some new ways of doing things, some ability to question, rather than group think and group agreement.

**Holly Gregory:**

What’s the best way to encourage that refreshment? Is it ‘age in term’ limits or is it something else?

**Annell Bay:**

It’s looking at a skill gap, and asking what is missing. You might lay it out differently: industry, experience and expertise is definitely important, but is there something else out there? Are you doing something new in your business that we need to have somebody else with a different expertise on the board?
Then, where are you going to go search for those board members? You can’t necessarily go to the usual suspects, all the headhunting firms and then the friends of the CEO and the friends of the directors. I really think you’ve got to seek out different people: maybe you go to a different recruiting firm that and ask them to target an industry and/or people with this experience.

Wendy Lane:

This whole ‘age in term’ limits issue is very big in the United States. Having sat on a couple of boards and watching others, in terms of board construction and refreshment, it’s good to have one-third old-timers, one-third in the middle and one-third newbies. You can get that by natural turnover or review of skills.

Interesting things happen at either end of that spectrum... as you point out, the average tenure is something like ten years. I don’t think the tenure and term limits are necessarily indicative of how good the board is.

So, if you have all new members it’s bad, if you have all old members, it’s bad. If you get this bell curve, and you watch the bell curve to make sure that that happens, you get the refreshment and the experience that you need.

Gilles Hilary:

I would argue that you want people who’ve failed, because you’re going to learn from their experience.

Wendy Lane:

If you want to learn where your IT system’s got holes, you hire a hacker, right?

Gilles Hilary:

That’s exactly right.

Holly Gregory:

It’s very interesting that you say that because there are investors who talk about failed directors. They would consider somebody who served on a board at a time of a great scandal to be a failed director and they would object to them going on other boards. But some of those people might be the best director you could have on a board because they saw what went wrong, and they have really good insights into what could help keep the company out of trouble. They have a different view of what red and yellow flags are.

Gilles Hilary:

You do have to be careful that person was not involved in the issue. Because then you have another problem, which is bad practice contamination. FINRA, the organisation that regulates brokers in the US, has started to look here at brokers who move from a failed organisation to another one, even though they didn’t have any problem. The thought is, they may risk contaminating the culture. So, you have to be careful, at the same time, to get the information
from people who failed, but not to contaminate the culture by bringing practices that were probably not optimal.

**Holly Gregory:**

It has always struck me as strange that the pace of business change is remarkably rapid, but the pace of board turnover is very, very slow. It seems to me, if a business is changing fast, you’ve got to be looking every year whether the skillsets and the experiences on the board keeping up with whatever direction it’s going.

Age limits and term limits seem false in two ways. They’re going to get rid of directors who still have a real value at times, but on the other side, they’re also going to set an expectation of service that probably isn’t right. What I’m struggling with is how you get a culture in a board of having that real rigorous decision at every re-nomination point, to say, ‘is this the best director we can have? Is this the best board’? If it’s an annual election, everybody should be contestable and put through some kind of screening. Do you think boards have that kind of rigour in their re-nomination decision?

**Wendy Lane:**

I think it’s your position until you screw up. So you might not have the best, but you don’t have to have the absolute best, you can have one that’s very, very good.

If you have a board of ten people, chances are there’s somebody that’s weaker. In today’s world, it’s really difficult to keep somebody that’s not strong enough. One of my boards is wrestling with the issue, and it’s difficult to ask somebody to leave the board, but I think that that’s going to happen.

**Holly Gregory:**

That’s part of the culture that really needs to change. I’ve got a board right now where there are two people on it who can be a little bit bullying, and who became really problematic in a time of crisis. The rest of the board decided we’re going to tell them that it’s time for them to go. When the two directors pushed back a little bit, the board capitulated and re-nominated them. Now their behaviours are worse, because these two directors are angry at the rest of the board.

It’s not fun, because it’s a trust environment. It’s hard to vote people off the island, but directors are there to make some hard decisions.

**Wendy Lane:**

If you have a strong chairman, they can coach along somebody that’s weaker and say, ‘Look, you’re at risk, unless you do X, Y and Z’. If their skillset is truly antiquated, there’s probably nothing they can do.
Holly Gregory:

But is it right to say ‘you’re at risk unless you do that’, instead of saying, we’re going to let you go and not re-nominate you?

Wendy Lane:

I don’t think you should let it get to that point. If you see somebody that’s weak and struggling you ought to say ‘Look, you’ve got your seat for this year, but these are the things you need to work on’.

It’s better to try to work with somebody and coach them along than to axe them right away, as I think you’ve got to give them a chance. A lot of people are really smart on these boards and they’ve got a lot of experience – maybe they’re just not showing it. But if you give them that year and they’re still unnoticed, the decision is a lot easier.

Annell Bay:

Some of those conversations need to be private. You don’t need to embarrass somebody in any kind of public setting. That is the value of the annual vote for the directors. I know some companies don’t want to do that, but it actually strengthens the board itself, to be able to tell board members, it’s not the right chemistry anymore.

Gilles Hilary:

It’s also a tricky one, because you want to make sure that the person that is not voted out of the board; is not someone who is just thinking differently on the board. It’s always difficult to distinguish between true performance and lack of it, but the problem is, if you always look for someone who is the most easy to work with, you’re also going to foster this culture of groupthink. Separate the person and the issue.

Annell Bay:

That may go back to what you suggested, which is the 360-degree feedback and the board evaluation. That also helps present to that board member that it’s not just the chairman or it’s not one board member telling you this.

Holly Gregory:

Around 15 years ago, executive compensation decisions were viewed as almost a surrogate for whether a board was effective because it was one of the only decisions that there was a fair degree of disclosure around

Simon, are compensation decisions a place where there are pressures for the short term that are taking us out of alignment with the long term interests of the company? If so, are there things boards should be doing about that?
Simon Walker:

Performance-related pay can obviously be a great driver of success, but pay for top executives has become so divided from performance that it can’t be justified.

Large companies in this country need to look very closely at the role that excessive pay is playing in fuelling this anti-business backlash from the public and from politicians, because I think it could spread into legislation.

Andrew Smithers, one of our leading economists, has written quite compellingly about the damage it is doing because it is actually militating against long-term investment. That could explain why productivity in this country has deteriorated so much, over the last few years.

Holly Gregory:

It’s interesting that you’re saying that your directors agree, that your constituents at the Institute of Directors, agree that compensation is out of whack, and yet they’re the ones who make the compensation decisions.

Simon Walker:

Not all of them. We represent businesses of all sizes, and a lot of them are shocked at what they see as real excess in the hundred biggest companies in this country. When you see a major British company calling an EGM to overturn its pay policies so it can pay someone a £25 million signing-on fee, and the company then gets taken over, so he could walk away six months later with £25 million, how are people meant to react to that?

Holly Gregory:

It goes right to that point of the trust that we’re trying to build in businesses. I’d like to give Wendy, Annell and Gilles an opportunity to talk about how you think we can get better alignment between the interests of shareholders in the long term, and the actions of the board.

Annell Bay:

How do you get better alignment? More disclosure – at the end of the day, the shareholders have a huge portfolio and they may not be able to meet with everybody.

You cannot sustainably have quarter-over-quarter short-term business results, but you absolutely have to finally deliver business results. You explain your short-term gaps so you get to that long term and you get to that capability. Is the board disclosing enough? Are the directors willing to go out and speak to the shareholders, go to the conferences as well? If you’re able to do that, there is longer term trust and there’s a better understanding.
Wendy Lane:

One of the keys is having a true chairman that is equal to the CEO. The way that outside investors can tell whether you’ve got a good chairman is to find out what their reputation is. You just send out your feelers into your own community, and the research community, and they’ll tell you what kind of person this is.

Gilles Hilary:

The core issue is trust. To illustrate that, we have done a study. We looked at US firms that are located in part of the US where people trust their neighbours more. And what we find is the compensation is flatter in those counties. The likelihood of being fired if you’re the CEO is lower, particularly if the shareholder returns are lower – you’re given a second chance. At the same time, the performance of the firm tends to be higher, you don’t have as much of an investment, the returns are higher, and the valuations are also higher. At the heart of it all is basically trust.

Holly Gregory:

I want to turn to the audience for questions.

Florian Schilling, Managing Partner, Board Consultants International:

I would urge caution about the disclosure of board evaluation results. My experience has been that the process is only effective if the interview partners in a board review can rely absolutely that confidential information will not be disclosed. There’s a very fine line in keeping the relevant information within the board, within the company, and disclosing only that part that is not confidential.

You asked about what are effective processes, tools and behaviours to improve the effectiveness of a board. I agree with everything that’s been said and might add two practices that I have found particularly effective.

First of all, a board should sit down and discuss its role definition. Annell compared a board to a leadership team. I believe there’s a huge difference because leadership teams usually have a common purpose, a common goal. Boards, to a surprising degree, quite often don’t. In many board reviews I’ve done, I’ve found a wide variety of different role definitions within one and the same board. Very few boards have ever sat down, as a group, and talked about what they are there for.

My second recommendation would be for boards to carry out a regular post-mortem analysis – it’s one of the most effective tools. If you have been on a board for a long time, look back at decisions you took a couple of years ago that didn’t turn out well. Ask why those decisions were taken. The board that does that regularly can learn enormously from it and is very likely to become more effective.
Stilpon Nestor, Managing Director, Nestor Advisors:

My question has to do with what the codes ask companies to do in this country in the context of the board evaluation, which I understand is less of a practice in the US. It has now become a statutory obligation for the financial sector. This is an area where there’s a lot of pain in boards. I wanted to ask for your views and your opinions as regards this part of the evaluation process.

Wendy Lane:

In terms of individual assessments, I think everybody knows that assessing skillsets in the banking sector is very important. To have nobody on your board that understands derivatives or to have them assume that they do is dangerous.

The one thing you have to be careful with on boards – especially if you do a 360 review – is that you don’t run a popularity contest, because that makes people retreat into their holes and not be willing to take that devil’s advocate position. The individual director situation has to be handled very carefully and it has to be totally anonymous. You should not be able to tell who said what.

Holly Gregory:

I always want to talk first with the board about why we are doing an evaluation. There are lots of different ways to do it, but we need to have our goal in mind when we figure out what the process is and how we’re going to use it.

Some of the healthiest individual director evaluations are when the director assesses themselves against the set of standards that are provided by the board. All the other directors also assess them and the individual is given back a document that has a peer composite view next to his or her own self-evaluation, so that they can see where the disconnects are. Your peers may think more highly of you, in some respects, than you rate yourself and vice versa.

Wendy Lane:

One of the other interesting aspects of board evaluations is if you ask the question about what your role is as a board. If you also ask, on those evaluations, what you think the board or the committee’s goals are for the year, that can be a very interesting conversation.

Holly Gregory:

For this question, I’d like to suggest ‘what are the most important issues facing this company in the next 18 to 24 months’? I ask it for two reasons. It’s very interesting to get the viewpoints, and there may be views there to share with the board that they hadn’t thought about. Even more than that, that question alone tells me the most about how aligned the board is, around how they think about the company.
Hiroshi Komori, Associate General Manager, Sumitomo Mitsui Trust Bank:

I attended the CII conference in April this year, in Washington DC. I was surprised that CII invited Pershing Square and that many attendees welcomed such a fund, because Pershing Square seems to be a longer term holding activist in the US. Do you see differences among the US activists in terms of length of shareholding of each company? Also, would you like to meet with longer-term activist people, even though they are activists?

Annell Bay:

I’d have to say, at least in my experience, I’ve been on the board of Apache for a year and on the board of Hunting for about eight months. The activists that I’m aware of and have looked into are all short-term.

Am I interested in hearing what they have to say and what they’re discussing? I think that’s important to listen to what they have to say. Do I think they also have a different goal than the rest of your shareholders? Yes, it’s my perception they do, they do have short-term goals, and they want to chop up and do some things and then potentially make their money and leave and then go off.

Wendy Lane:

Ralph Whitworth took a position in Tyco and ValueAct has taken a position in both Willis and in MSCI, and I had opposed them being on the board because I thought they’re going to have this short term point of view – they’re going to represent their constituency and whatnot.

ValueAct has turned out to be a long-term shareholder. They’ve held Willis shares since 2007. Yes, they have short-term goals and they’ve got a term to their fund, which is basically seven years, so we’re passed that point already.

I think there are two different classes of activists. If an activist is credible, I would engage with them and listen to what they have to say because I think it’s a very interesting thing for a board to ask itself, at least annually in their strategic planning, ‘if I were an activist in this company, what would I do with it to create value? If I were to create this company de novo, how would I create it’?

Unidentified Male Speaker:

What do you think of the role of due diligence policy, a conflict of interest policy, as well as a code of ethics in building trust?

Holly Gregory:

I would agree that they’re fundamental within a company to have a really good articulation of what’s expected by way of ethics, business conduct and compliance. You can’t be a good company these days if you don’t work hard
at articulating that down through the ranks and making sure that the board is a driver of it.

**Afternoon Keynote - Robert Monks, Chairman, ValueEdge Advisors:**

My friends, a little over 70 years ago, a million Londoners took to the streets of this great city to celebrate the end of World War II in Europe. For people of my generation, those of us old enough to remember what became known in the US as VE Day, nothing can ever compare to the horror of those war years. To even attempt to do so is banal, yet there is much about the task, facing us today, that puts me in mind of the challenges and high stakes of that long ago.

Then, the rich self-rule traditions born and nurtured at Runnymede, at Valley Forge and the barricades of Paris, and elsewhere, hung in the balance. Hitler’s Germany held many evils, but among them were a contempt for democracy, the appropriation of sweeping executive powers, the intimidation of press and public, coupled with grandiose visions and a wayward moral compass.

Unaccountable corporate power, I contend, has brought us perilously close to a similar situation in America today. This, of course, is not the way things were meant to be. Just as the American political system is legitimated by a belief in the sanctity of the ballot, so the American corporate system, which vests control largely in the hands of privately appointed managers, is legitimated on three major bases.

The first is a belief that the shareholders, as the owners of the corporation, have the ultimate right to control it. The second is a belief that corporate managers are accountable for their performance. The third is a belief that placing control of the factors of production and distribution, in the hands of privately appointed corporate managers, who are accountable for performance and who act in the interests of the ultimate owners, achieves the most efficient utilisation of economic resources – better than that achievable under alternate systems. In both instances, if you dilute or strip away the foundational beliefs, the legitimacy begins to crumble. I'll talk later about the political system, but about the corporate system, there can be little doubt. Why that is so, I will be detailing in the time allotted to me today.

But first, let me say this. I’m here today more as Winston Churchill than as Jeremiah. On 10 November 1942, two and a half years before he announced the Germans surrendered to his countrymen, Churchill delivered yet another memorable speech, at the Lord Mayor’s Day Luncheon at London’s Mansion House. Rommel had been defeated in the African desert, America had joined the fray, Germany was not yet on its heels, but as happens so often in sports contests, the momentum had shifted in a subtle, subterranean way.

‘This is not the end,’ Churchill cautioned, ‘it is not even the beginning of the end, but it is perhaps, the end of the beginning.’

He was dead on right. I’ve titled this speech, ‘The end of the beginning’, in Winston Churchill’s honour and more importantly, in yours.
All of you here today have good reason to be proud of what you have accomplished over the last 20 years against an implacable foe. In the simplest terms, you have made corporate governance a legitimate subject for discussion. You have defined the issues and generated increasingly sophisticated codes of conduct to inform global enterprise. Beyond that, the great institutions have educated themselves as to how they can best discharge their responsibilities as stewards, and how they can act responsibly as activist shareholders, and how they can hold management to account.

Peter Butler at Hermes was a model for us all. We witnessed that skilful and persistent activists are welcomed to the best corporate boards, even as chairmen. Think of Ralph Whitworth at Hewlett Packard. Clearly, we’re ready to advance, but equally clearly, we have a long way to go. We have barely begun the process of persuading managements that their best interests lie in encouraging a system of involved and effective ownership. Until we can achieve this objective, full success will elude our efforts. Our reality checks are not geographic progress, but institutional ones. How far we have to go can most persistently be understood through the lens of executive compensation. The persistent and unending increases, disconnected from any objective measure, are an ugly and ill-recognised part of our culture and a major contributor to broader economic and social problems of inequality.

We need go no further to witness that the commitment of western countries to provide employer finance pensions has been destroyed with little notice. There are today, virtually no companies offering genuine pensions, in the sense that a return is guaranteed by their employer or the government. Managements posted immediate profit from abolishing the so-called defined contribution plans, while transferring risk of loss from those most able to overcome it, to those least able to – employees themselves.

Worse, by far, too many CEOs and their top lieutenants have simultaneously feathered their own nests with executive pensions, generous beyond all measure and far beyond any real need. This huge transfer of wealth stands on its head the old and vital balance between management and worker compensation, with potentially dire social consequences. Corporate language and priorities have captured the American republic. The allocation of government resources is directed by the imperatives of short-term profit maximisation and by a vocabulary of cost-benefit, rather than of concern for flesh and blood citizens. While we watched, CEOs have acquired autocratic control of the levers of corporate power, which in turn has given them accelerating political power. They are accountable to no one, as they direct lobbying and the legal corruption of sponsoring political conventions, inaugurations, congressional self-monuments, not to mention the bread and butter of political campaigns.

More alarming still, these lobbying efforts are increasingly off the book. One might take heart in the fact that the number of registered lobbyists in Washington DC, has actually declined in recent years, until one realises that the amount spent on lobbying has grown dramatically, thanks to whatever expanding network of stealth lobbyists is taking advantage of ever weakening lobbying regulations. This has been nowhere more true than in finance, insurance and the real estate sector, which has spent somewhere between $450 million and $1 billion annually on lobbying, ever since the finance-driven
crisis of 2008. Not coincidentally, one suspects, not a single high-ranking executive of any major finance firm has yet been prosecuted for malfeasances that rocked the entire global financial structure. But that is the subject of another speech.

Suffice it for now to note, that while ownership has awakened to the challenge, CEO accountability remains largely a myth. Yet, American shareholders can neither nominate, remove, nor communicate with directors. The tendency is for the largest corporations to become drones in the sense of having no effective owners. That is, no owners with more than 10% of the total. What’s more, ownership increasingly is represented by index and algorithm selection, in which human decisions, as to purchase and sale, have no relevance. As one might expect, drone corporations, on the whole, pay fewer taxes, incur larger criminal fines, reward their CEOs with higher compensation and externalise more liabilities onto society, than do corporations that have effective owners.

The latter point, indecently, includes externalising onto shareholders’ fines. Sometimes in the billions of dollars imposed in civil actions, undertaken as the direct result of management malfeasances. 80 years ago, Adolf A Berle warned that granting management free reign brought with it, ‘the corresponding danger of a corporate oligarchy, coupled with a probability of an era of corporate plundering’. Today, this corporate capture has found its fullest expression in the decision of the United States Supreme Court in Citizens United, that a Supreme Court Justice could write the opinion, as Anthony Kennedy did, that little evidence of abuse that cannot be corrected by shareholders through the process of corporate democracy, shows how far we have sunk into a never, never land of convenient truths and rosy shibboleths.

Instead of corporate governance, we’ve devised a kind of shadow play kabuki, in which the various constituents act out their assigned roles, culminating in the kabuki festival we know as the annual meeting. Even shareholder activism, rather than undermining the legitimacy of the current system, serves illegitimating function at these yearly events, by maintaining the illusion that reform for the better is possible and that shareholders have power.

The endless proposals asking for actions to be subject to shareholder consent, have not progressed from the classic judgement of the great scholar, Melvin Aron Eisenberg, who said that it was a delusion to think that shareholders meaningfully are involved, when they’re asked for a legal consent. The same can be true of shareholder access to the company board for the nominations to the board of directors. Here’s the drôle de guerre in all its glory: words like nominate, elect, invoke, are used for a process that virtually always results in the election of those individuals whose names are on the proxy, credited and distributed at shareholder expense, but selected entirely by the incumbents.

Similarly, words and phrases like trustee and fiduciary obligation, are promiscuously elicited to describe the functional responsibility of the CEO and board members, under circumstances in which their pervasive conflicts of interest are manifest. It is almost as if we dumbly recite the words in denial of the certainty that they will have no effect. When George Orwell spoke of
political speak, it’s equally true of corporate speak, they’re largely the defence of the indefensible.

‘A mass of Latin words, falling upon the facts like soft snow, blurring the outline and covering up all the details.’

The great enemy of clear language is insincerity. By this time you must be wondering what is this all about? Where is he taking us? We now have been confronted with the reality that all manner of professionals are conducting serious discussions about corporate governance and arriving at conclusions based on plainly erroneous understandings of key concepts. Is this just an accident? Is everybody being careless? Is this equilibrium of misunderstanding excepted because it provides something of value to the principally interested parties? Institutional shareholders can claim to their beneficiaries that they’re monitoring trust assets. Corporate directors can solemnly aver they’re subject to excruciating oversight, all of which justifies their otherwise incomprehensibly large fees. And corporate managers can assign professional advisors to play whatever role in this kabuki drama, all the while unthreatened, in their virtually absolute control of corporate assets and direction.

You have to ask, is there an organising mind that profits from this confusion and engenders its continuance? Is the corporate governance industry a high profile smokescreen that enables the present composition of corporate power, hegemony of the CEO? Answering these questions is the legacy of this speech. All I will say now is, it didn’t get there by chance, and it won’t be changed by a simple laying on of hands.

The inescapable fact is that corporations cannot be effectively monitored or controlled by elements external to the corporation. Simply, corporations can lobby more effectively, can hire better lawyers to control the process of converting laws into public policy. And now, thanks to Citizens United, can commit almost limitless corporate funds, to turning the political process in their favour.

As the great Louis Brandeis once put it, ‘we believe that no method of regulation ever has been or can be devised to remove the menace inherent in private monopoly and overweening commercial power’. That’s about 100 years ago. The only internal component of the corporate system, with power, motivation and interest, sufficient to act as an effective monitor is the ownership. Here though, we do have some models to build on.

War has produced unlikely heroes: the meek private who storms an empty bunker. I don’t put Carl Icahn in that category – meek he is not – and self-interest enters freely into his calculations. But Carl has shown, repeatedly, that a single activist, using his own long-term money, can generate long and short-term results. In doing so, he’s offered both compelling evidence that responsible, active involvement is the key to superlative investment performance and has shown the way for a generation of imitators, like him, capable of being part of the problem as well as of the solution.

Owners with skin in the game. That, my friends, is the magic formula, and that is the challenge for the rest of us. How do we organise the trillions of dollars
under management, so as to emerge with activists, capable of and willing to hold management to account? How can we corral Carl Icahn's energies to more holistic ends?

Let me begin to answer that, with a fundamental truth. Ownership needs to expand its agenda for the future. In the globalised world of commerce, effective and legitimate corporate functioning, will require leadership from the business community and co-operation from governments. The future agenda must deal with at least the following items. First, corporations must have a legal domicile, importantly connected with their operations. Domicile shopping, for the least effective governance regime, must stop.

Second, all constituencies need to cooperate on developing a system of integrated accounting, so that corporations stop having incentive to pursue socially destructive practices and shareholders and customers stop being enablers of personal conduct that they deplore. Thirdly, all publicly traded companies must have real owners. Obviously, defining the requisite characteristics will require much flexibility as there is no shoe that fits every foot. What is critical, is that there exist within the corporate framework, an energy capable of acting as steward, or even fiduciary for the shareholders, capable of dealing with such issues as the permissible level of environmental impact and involvement in politics.

Let me leave you with two thoughts that harken back to World War II, with which I began this talk. Both thoughts would be hyperbolic, were I not convinced that the social and economic fabric of my country were at such risk. The first is a riff on the famous, ‘first they came for’ formulation by the German Theologian Martin Niemöller, who survived seven years in concentration camps.

First, the CEOs paid themselves royally, second they took control of the Government. I said nothing because I wasn’t a CEO; I said nothing because I rarely vote. Then they ended pensions, captured Governments, corrupted international institutions and suborned the judiciary. Finally, they came for the owners, me.

Lastly, on a more upbeat note, and a return to where I began, this abridgement from Winston Churchill’s 42, ‘end of the beginning’ speech.

‘Henceforth, those who oppose us will meet equally well-armed and perhaps better armed troops. Henceforth, they will have to face, in many theatres, that superiority which they have so often used without mercy against others.’

The stakes are high. One reads today of daily attacks on government by and for the people. Holding corporate account, power to account, may well be the best, even the only opportunity to return a civil society, based on human values. The tide, I believe, is turning in our favour. Corporate hegemony is unnoticed; management excesses will no longer go unchallenged. The fight that remains will be a long one, but I leave the struggle to you, with great confidence.
Plenary 4: The changing face of ownership in a new world order

- Donna Anderson, Vice President and Head of Global Corporate Governance, T. Rowe Price Group, Inc
- Michael Garland, Assistant Comptroller for ESG, New York City Comptroller Mark Fawcett, Chief Investment Officer, NEST
- Ron Lind, Board Member, CalPERS
- Chaired by Kathleen Carney, Managing Director, Teneo

Kathleen Carney, Managing Director, Teneo:

Today, institutional investors are becoming more active, either through their own internal proxy voting process or engagement efforts, and/or through hiring to manage their assets. The lines between traditionally passive index funds and active institutions are blurring. Is that a good thing? Are these activities aligning the interests of the beneficiaries whose money they manage, with the companies they’re invested in?

CalPERS recently decided to eliminate hedge fund strategies: Ron, could you could give us some thoughts behind why and how this aligns with CalPERS’ investment philosophy or beliefs?

Ron Lind, Board Member, CalPERS:

At CalPERS, we’ve long been leaders around the issues under discussion at this conference, because with size comes responsibility.

We were impacted by the financial crisis and the new world order that it created. In response to that, we developed investment beliefs that give a foundation and clarity to the work we do. Those were developed through a long collaborative process with our staff and our board and with stakeholders. We measure our performance against those beliefs.

Having said that there’s still tension around these beliefs. It turns out our investment staff are a little more comfortable with some of the beliefs than with others. They instinctively get the beliefs around asset liability management, liquidity, risk and reward, and so on. They’re less comfortable with beliefs around our responsibilities for being long-term investors. Particularly, our investment belief around the need to manage three forms of capital: human, physical and financial.

A proposal came to us at the last board meeting around tiering these beliefs – taking the ones that the staff members are more comfortable – and call them the core beliefs – and then have the other beliefs be aspirational or key beliefs. That was not met with a lot of excitement from the board – it’s pretty clear what would happen if we did that. Once you bifurcate, there’s going to be focus on one set of beliefs, to the detriment of the others.

Now it’s time to move forward in this grand process around the next step, which is expanding our sustainability agenda throughout all of our asset classes and our manager expectations. The actions of the people that invest our money should be reflective of our investment beliefs. Our goal is to implement our sustainability agenda throughout the lifecycle of our
relationships with internal and external managers. It’s an evolutionary, not a revolutionary process.

When we do something at CalPERS, it always creates headlines. When this got rolled out to us and we talked about it at our last meeting, the headline the next day was, ‘CalPERS issues ESG ultimatum to managers’. That was a little bit overstated – we’re working through this process. We’ve taken an inventory of our current internal practices around sustainability. We’ve looked to best practices through other organisations, including the ICGN and the PRI. One thing I’ve learned since I’ve been at CalPERS is we don’t do anything quickly. We deliberate and we look for best practices. We take inventories; we get the opinions of stakeholders. But we’re moving forward with this.

With our internal managers it’s pretty easy. We’ve formed a cross-asset team amongst the staff, and the portfolio managers are going to be discussing with us as part of their regular reporting to the board, how they’re implementing this, what some of the challenges are and what the expectations are. They’re not starting from scratch: as an example, our private equity team would ask the ESG questions as part of their due diligence. But we have to go beyond the question-asking: that leads to our expectations of the external managers. We’re going to build our sustainability agenda into the selection process and into the contracting process. We want to make sure, as part of that contract, we have the implementation of the work around the sustainability issues that we care so much about and that drive our long term value creation and, just as importantly, a reporting structure.

On hedge funds, we were not trying to make some sort of global statement that hedge funds are the investment of the devil. But, when we matched up the hedge fund space versus our investment beliefs around costs matter, eliminating complexity, risk versus reward and transparency, it was pretty clear to us that it was a mismatch. The good thing about this being driven by the investment beliefs is that this was not a decision that was driven by the board. We got to the finish line with the staff at the same time.

Kathleen Carney:

The board comes up with a set of beliefs around how money should be managed and what the goals are, and then it’s your job to decide where to allocate the assets and what to invest in. I assume maybe you invest in hedge fund strategies and some others: could you talk about how you think about it?

Mark Fawcett, Chief Investment Officer, NEST:

Yes. First, a 30-second introduction to NEST. We’ve been set up by the Government to help employers automatically enrol millions of members into a pension scheme, so that pretty well everyone in the UK will be saving in a pension scheme. We’ve currently got just over two million members, we service 18,000 employers and we’ve got slightly under half a billion pounds of assets under management. We’re growing very fast. Our youngest member is 18 years old, and one of our investment beliefs is we should take into account member characteristics when we’re choosing our investments. If you’re 18 years old, you have a very long-term time horizon for pension saving. We remind ourselves of that frequently.
I’ve worked in asset management for well over 25 years, and the tendency in the world is to become shorter and shorter-term. It’s really easy to get sucked into thinking about things in the short term, and we have to remind ourselves that our members need us to be for the long term. We have eight investment beliefs and we worked with the board to derive those beliefs. I don’t think we have the problem that maybe CalPERS has: everyone buys into our investment beliefs, both the board and the investment team, and that really helps drive our decisions.

There are two beliefs I would highlight. One is about active versus passive management. We talk about it in terms of index management: for many asset classes, that is the most cost-effective and efficient way to invest. When you’re investing passively, you don’t have the choice to sell. Therefore, how management responds and behaves is extremely important to us. We’re a defined contribution (DC) scheme – many investors here will be from defined benefit schemes and it’s pretty clear, certainly in the UK, defined benefit trustees and executives really care about responsible investment and active ownership. It’s not at all clear whether that’s true in the DC space.

I wouldn’t say NEST is unique, but we’re certainly bit of an outlier because we really do care about long-term investment and responsible investment. That brings me to the second of the beliefs I’d like to highlight, which is we believe integrating ESG factors into our assessment of risk is really important, particularly for that 18-year-old, but right through the age spectrum. We’re preaching to the converted here – everyone here is here because they believe that corporate governance needs to get better and we want to unify on that. In the outside world, do they know we’re here, do they know we’re meeting and do they care? One of the issues for us is, if a world increasingly goes DC, this could get worse rather than better.

Kathleen Carney:

Once the money’s invested and you’ve got a set of portfolio companies, it’s your job to make sure that the company’s performing and being responsive, whether that’s through voting or engagement effort or shareholder proposals. Mike, is proxy access the last resort for coming up with alignment between what you do and the company is?

Michael Garland, Assistant Comptroller for ESG, New York City Comptroller:

Bob Monks set the stage well about alignment and I share his critique about some of the engagement work over the years. I also come from New York City. We have a system of five funds that collectively have $160 billion in assets, a long history of collaboration. A prior comptroller of the city co-founded CII, co-founded Ceres and one of the things we’re very active doing is shareholder proposals on a very broad set of issues. At the margins, we’ve changed behaviour, we’ve increased transparency, but to really align interests, it’s all about the board – whether you’re talking about core corporate governance or material, environmental or social risks. The problems are probably most acute with the system in the US, for two reasons.
We have a plurality voting system for directors, so you can be a director who owns one share and if you vote for yourself, and every other shareholder votes against you, you’re re-elected anyway unless there’s a proxy contest. So we now find ourselves with dozens of zombie directors – I think CII has a list of close to 80 – who are unelected but still serving. In some cases, the directors submitted their resignations and the nominating committee of their boards summarily rejected those resignations.

I sat in on the Shareholder Rights Committee meeting a couple of days ago and there was a significant discussion of proxy access, which was really encouraging. In the US, we’re one of the only developed markets that doesn’t have proxy access. We have a right, under state law, to nominate directors, but you have to have your own proxy card, it costs millions of dollars. If you want to take or influence control, you should do that. But, if you’re a substantial, long-term investor and you want to nominate some genuinely independent directors to fill a skills gap or hold an incumbent board accountable, you really don’t have a mechanism.

In the wake of Enron, the SEC proposed a rule that would grant this right to all shareholders and there was a swift backlash from the business community. The US Chamber of Commerce threatened to sue the SEC, and the rule never went anywhere. Then we had the financial crisis and the SEC, once again, proposed a universal rule in 2009. In 2010, in the Dodd-Frank Act, the US Congress affirmed that the SEC had the authority to do that, in order to inoculate the SEC against litigation from the business community, but the Business Roundtable and the Chamber of Commerce sued the SEC anyway. I should mention the SEC approved its rule, it was enacted, the business community sued and the court vacated the rule. So, for about a month, we had universal access in the US.

What survived through that process was that we were granted, for the first time, the right to ask for proxy access company by company – essentially to file shareholder proposals on the topic. 2012 was the first year one could do that and so, from 2012 to 2014, there were a handful of proposals, including by New York City. We were all waiting for the SEC to reissue its rule, and we’re still waiting. What we’ve seen, in the last six months, was the frustration that that’s not likely to happen. Proxy access is too important in addressing some of the fundamental concerns that I know a number of us have been discussing here today. Do we have the right board to address climate change risk? Diversity? Executive compensation?

Last November, New York City filed 75 proxy access proposals across the US market, focused on companies that extract and burn carbon, board diversity laggards and executive pay laggards. We stepped that with a coalition of large public pension funds, CalPERS, CalSTRS, New York State and some others. What happened, over the past several months, is really quite remarkable. I think it shows the appetite among the global institutional investors for a meaningful say in the director process.

Initially, a company went to the SEC to exclude the proposal by putting forward their own proposal as Whole Foods that said ‘we’re going to put a proposal forward that says a 9% shareholder who’s held for five years can nominate a director’. Whole Foods doesn’t have a 9% shareholder. The SEC,
under what is called SEC Rule 14a-8(i) (9), said ‘that’s a conflicting proposal with the shareholder proposal, and so we’re going to allow you to exclude the shareholder proposal from the proxy’. Within weeks, dozens of companies tried the same thing: it was absolutely clear they were trying to game the system in order to deny investors the right to vote on what we considered a meaningful access proposal.

What was interesting was Whole Foods was on our proposals by a small, individual shareholder, not well resourced, and he ended up getting some help. He did a very effective appeal and what you saw was the institutional investor community rally, and the CII convened calls and weighed in with the SEC. Remarkably, the chair of the SEC pulled that Whole Foods decision. She reversed course, setting the stage for our proposals to go to a vote.

Then we had another round of pushback where we thought companies were going to go to court. The VRT essentially threatened the companies and encouraged companies to go to court to exclude our proposals. Again, the Council convened calls: we had T. Rowe Price and a very large constellation of investors come together and strategise, collectively, about how we were going to respond. The message that we took to the market, publically, was if you exclude a proposal, even lawfully – because the State Court allows you to do that – that’s acting in bad faith and we’re going to hold the board accountable.

All of a sudden, the landscape in the US shifted quite dramatically. The more responsive companies started coming to the table voluntarily, and we negotiated withdrawals of our proposal at Abercrombie & Fitch and Staples, and GE agreed to implement proxy access. Apache supported it, the board recommended in favour of our proposal – essentially embracing it. Prudential Financial is the first – and right now, the only – company that has agreed to enact meaningful proxy access, using the thresholds put forward by the SEC, without receiving a shareholder proposal. I think what had happened in the first round was all these over-zealous attorneys who were giving bad advice and charging a lot of money for it to their issuers.

We’re three-quarters of the way through proxy season. I think we’ve received majority support on 33 of our 53 proposals that went to a vote through yesterday. Roughly two out of three are passing and that holds for the proposals put forward by other investors. We still want a universal rule, but I think it’s time that we take the things that really matter into the boardroom and have some mechanism to both hold boards accountable and to deal with board quality issues.

**Kathleen Carney:**

I do think the tides have shifted and there is something to be said for collaboration. I still think there’s something to be said for whether proxy access the can be used, even at 3%. If you can get enough institutions together to get to that level – assuming, a special interest or an activist wouldn’t use the rule per se. Maybe it is a mechanism in the background that holds board members accountable.
Having said that, Donna, would you say the tide has shifted or do you feel companies are maybe taking a step back and are digging in their heels in a bit, with proxy access and more activity from their institutions?

Donna Anderson, Vice President and Head of Global Corporate Governance, T. Rowe Price Group, Inc:

My own involvement in corporate governance is a little bit shorter than the ICGN’s history. If I get through the next couple of weeks, I’ll have survived my 18th proxy season. If I think about it over that timeframe, I get a little bit more optimistic about the state of shareholder rights today versus in the 90s. Over the last few years, however, I am concerned.

I’m concerned that the pace of shareholder rights in a lot of markets, and in particular the US, has been pretty fast from the corporate perspective since the financial crisis. Boards are tired of the ‘apology tour’ and they want to move on now. They feel really constrained by this new and misunderstood voice of the shareholder. Activism, in particular, in our market is one big contributor to that. There is a deep sense of ‘we’re fed up and we’re not going to take it anymore’ from a lot of companies.

It’s partly fuelled, at least in the US market, by what I would call the ‘haves’ and the ‘have nots’. I can’t tell you how many companies we speak with, especially biotech and tech, who say ‘we are competing with people, we are competing with other companies for talent’. They describe it as a war on talent. The run up in those stocks have created a situation where everybody has really valuable currency, and everybody can recruit easily from other firms.

There’s a non-level playing field between the companies that are controlled and those that are not: those with dual class structures can put in things like evergreen plans and they never have to go to their shareholders for approval of their use of equity. Things like that are perpetuating the system of the companies that don’t have those non-shareholder friendly structures feeling constrained by that on a competitive basis. That is fuelling a genuine frustration that shareholders are running amok.

The other thing I think that I’m picking up on is that they can’t figure out what we want because we don’t all agree. As a community, materiality is something we’re not doing a great job on. We’re not consistent in our messages to companies, we’re not all focused on the same drivers of the business. We’re not even all that up to speed on really knowing the companies – we tend to look at things on an issues basis and we apply that same issue to all the companies in the portfolio. That is causing a level of frustration with the companies that we, as active managers, are picking up on a lot. We, as a community, need to look in the mirror in the coming years and work on priorities.

Kathleen Carney:

Certainly there’s engagement between investors, and engagement between the investors and boards and management of the companies they’re invested
in. Ron, how do you view CalPERS’ role as the largest pension in the US in terms of collaborating with other investors either in the US or abroad?

**Ron Lind:**

As I said earlier, with size comes responsibility. We take our leadership role seriously, but collaboration is important as well. We do a lot of work with Mike in New York, with our sister fund 'across the river', CalSTRS, and other larger funds, as well as work with our important stakeholders.

We’ve seen this interesting synergy in the US that has developed around our work on governance issues, along with these developing social issues like income and inequality, the Fight for $15 and particularly with companies that have reputational risk, retail companies like Walmart or McDonalds or whatever.

It’s not just collaboration amongst funds and amongst investors, but with other groups that have interests that are aligned with ours.

**Mark Fawcett:**

I’d like to pick up on the collaboration point. We’re part of a group of large pension funds where our assets are small but we’re prospectively very large, and we work with other pension funds on key issues. To some extent, we punch above our weight.

Because we’re set up by the Government, we get audiences with companies we probably wouldn’t typically get. This collaboration is really important: I know there are initiatives and it’s beginning to happen across borders, but our biggest investment is in the US. We would love to work more closely with US investors on key issues.

In the UK, we complain about the state of corporate governance sometimes, but things are relatively good relative to other jurisdictions. I’m sure members of the audience have different experiences of that, but we’re probably happier with corporate governance in the UK than in the US. We struggle with some of the issues that US investors face.

**Donna Anderson:**

When I engage with UK companies, I find it’s the other side of the coin. There’s nothing that shocks me. I mean, you all get offended about some of these pay packages, and I see that every other Wednesday in the US market. The UK remuneration committee chairmen love me because there is nothing you can do that shocks us anymore.

**Michael Garland:**

I think investors struggle with collaborating on company-specific and issue-specific work.

I’ve been involved in a lot of collaborative initiatives over the years. What felt qualitatively different and very effective about the proxy access collaboration
is that we were taking on an issue where the voting support was largely there from the beginning. We had to align ourselves to respond to various things that were thrown at us around competing proposals. It played to the comfort zones of different kinds of institutions.

I come from a public fund in a city that has a history of being very vocal and public. We’re comfortable being public, where we believe that’s in our interest. Some other funds in the coalition are also very public about their position. We had some investment managers on calls, including calls with proxy advisors, to communicate that we were all aligned. T. Rowe Price was very active in a very different way, but a very helpful way. TIAA-CREF was both on those calls and then they communicated, quite publically to 100 of their largest companies. BlackRock – which is not part of a coalition – showed up at the investor advisory committee at the SEC and presented in support of proxy access, supporting private ordering and favouring the 3% thresholds that are in our proposal.

I think there’s a lesson in there about collaboration, of figuring out what’s the most effective way to work with institutions beyond just their voting support, in order to try and move an important agenda.

Kathleen Carney:

We’ve seen, I think in the last year or two, the number of shareholder proposals around E&S increasing. Ron is E&S becoming a big part of how you view the investment process, sustainability issues?

Ron Lind:

Well, that struggle between the long term and the short term is right in the wheelhouse of the investment beliefs. Our primary investment belief is that we are a long-term investor and the belief says that there’s not only an advantage to that, but a responsibility in that.

Kathleen Carney:

E&S was part of the underlying factors for some of the companies that you decided to submit the proxy access proposal to. Is that the most effective way of dealing with E&S issues?

Michael Garland:

If you think it is a fundamental risk. You want to make sure that the board is focused and you have the right board. We’re not going to be nominating directors wholesale – this isn’t an easy right to use – but it is a mechanism to have a discussion with the board, both about an issuer and about the composition of the board.

Thirty-three of our 75 proposals were the most carbon-intensive companies in our portfolio. The next step is to look at those boards and ask if they have people there that have diverse, informed perspectives. A climate-competent board so that there’s a lively discussion about alternatives and understanding
and challenging that information when information is coming solely from management. The other part about climate change is that we know it’s a risk across our portfolio. We don’t fully understand it. It’s hard to price, it’s hard to quantify, and we certainly know those risks are most acute in companies tied to carbon. We’re not in a position to prescribe the solution, but it’s certainly the responsibility of those boards to manage those companies for the long term.

If you think about a fossil fuel company, you have to start making your investments today to begin to shift away from carbon intensive industries. I think it was Ian Dunlop at BHP who said ‘investments today lock in emissions for decades to come.’ The management driving the ship has at most, a three-year or five-year time horizon. If you’re making an investment that may save the company ten or 20 years down the road, the current management’s not going to be paid for that. Where’s the incentive? Nor are they going to be held accountable if their decisions that are more focused on the short-term and end up blowing up further down the road because they’re long gone.

Mark Fawcett:

One of the issues we have is that trustees don’t necessarily understand their fiduciary duty. They feel that ESG issues and particularly E&S conflict with that fiduciary duty.

People confuse ESG with ethical investing, values investing and all that sort of ‘fluffy bunny rabbits’ stuff. I’m a trustee on a FTSE 100 company pension fund, and when I first started talking about ESG issues, I got exactly that reaction.

That is finally beginning to change. Yesterday, we had a DC investment committee meeting at this organisation. For the first time, our main equity management brought in their head of ESG and responsible investment. We had 45 minutes and everyone was engaged. The sponsor company also had a representative come into the room. So that feels like it’s beginning to change.

Donna Anderson:

We have a big DC business and institutional clients around the world. For every client we have like a CalPERS, who is deeply engaged, there are probably ten other clients who wouldn’t even take a meeting with me if I showed up in their office.

They’re not engaged in these issues. Maybe if one of their trustees has a personal interest, they may throw a couple of questions in the RFP, but there is no follow-up. I don’t think it’s just a matter of evangelising. The interests of active managers, for one thing, are quite different than the passive holdings in this area. What’s material in a 50-year time horizon may not be in five.

One of the things we really struggle on with our clients who are dedicated and focused on ESG, is that the category – let’s say environmental issues – is very broad. Dealing with a particular safety issue, a particular spill, a particular containment of an incident is one thing, and we endeavour to engage with
companies on those. But climate, for us, all belongs in the same bucket. I think we would all be better off with a more company-specific approach.

Ron Lind:

There’s an interesting challenge that we sometimes have at CalPERS around these issues.

We operate in a very open, political environment and we have many stakeholders that come to us and in particular around the climate change issue. Recently, a lot of stakeholders are coming to our meetings and advocating for divestment, whether it’s total fossil fuel divestment, coal divestment or sometimes country divestment. Of course, our position in CalPERS is that we don’t divest. That’s the opposite of what we want to do: because of the amount of assets that we hold, we think we could be a lot more effective by engaging than we can in divesting.

Sometimes, the government forces us to divest around tobacco and firearms and so on. More recently, we’ve had the Leader of the Senate introduce a bill that would mandate our divestment from certain forms of fossil fuel, primarily coal. We’ve been able to negotiate with him around narrowing the scope – finally coming down to CalPERS taking an unprecedented step where instead of opposing his bill, we’re neutral on it. The whole divestment movement, sort of undermines what we think is a much more effective role, which is engaging these companies to make change, both short-term and long-term.

Kathleen Carney:

There are some who would say engagement’s just not getting anything done. Either the investor calls the company wanting a meeting and it doesn’t happen, or directors want to be proactive, and investors say ‘I don’t have time to talk to you, everything’s fine’. Are there times when engagement just isn’t enough, at least in the US?

Donna Anderson:

I think it’s a mistake to assume that the companies who face a serious activist campaign are the same population of companies that are doing engagement. It’s probably not, because that’s how they’ve gotten in that mess in the first place.

I know this sounds like a broken record because active management is part of our religion but we are very company-specific about it. Even so, I have some concerns about where we’re headed with this whole ‘engagement for its own sake’ movement. We do have an approach where if we are large investors in any active strategy and the company wants to engage with us, we absolutely will. We also make our own outbound requests when we have serious and material concerns.

The ratio of hot air to meaningful change or meaningful kind of traction is increasing. There’s more repetition year over year; more, checking of boxes; more IR involvement which really cranks up the hot air component of the dialogue. I’m a little worried about where we’re headed with that, long term.
We actually discourage a lot of companies from bringing their boards into it too much. In the US, dialogue with shareholders and board members is still relatively new. The honest truth is they are not that good at it yet. Most of the time, it does not go well for the company, I'll put it that way. It certainly brings new insights to us, but it it's not in the company’s interest to have directors involved. We just all need to be a little careful about that. Our approach to it is that we will ask for director involvement if it’s really material, really relevant and directly going to impact our investment decision over the foreseeable future.

**Mark Fawcett:**

I echo some of those thoughts. We obviously like to talk to directors, but there's a risk that engagement is just a way of prolonging and prevaricating in the conversation.

Companies need to understand that shareholders will vote against them and they will take potentially high profile, controversial positions. There aren't enough of us doing it and you get positions where a 35% in favour shareholder solution is considered success on an issue that should lead to a shareholder win. People in this room are galvanised and are probably reasonably united. There are too many people out there that Donna can’t meet, who just don’t care about these issues. That’s why we’re in a situation where Bob can stand up and say there’s so far for us to go, we’ve only just started.

**Michael Garland:**

I want to provide a slightly different perspective on the board.

I do think that there’s too much meaningless engagement. The biggest impact of ‘say on pay’ in the US is a proliferation of engagement. Sometimes it’s defensive once they have a negative recommendation on their pay, and sometimes it’s more forward-looking.

This may be a distinction between a long-term owner – more than 80% of our public equity is index first – and an active owner, but I think it’s fundamentally important on some issues that the board, or a member of the board or the relevant committee, is part of a dialogue. Not on every issue – with lots of issues it’s more important to engage with management or start with management. But there are some key issues that really only the board is best positioned to discuss. When you walk into an engagement with a director, there is an expectation of knowledge – particularly if they’re setting the pay, talking some detail. However, it isn’t the same level of detail as, say, when you speak to Exxon about climate change and you get these spectacularly smart management people burying you in information that you can’t challenge. I think director engagement is important and the fact that so few companies in the US are comfortable with it is tremendously problematic.

I take your point that a lot of them aren’t that good at it, but I hear from issuers and their lawyers that they are encouraging boards to put forward their ‘camera-ready’ directors. I find that concept hugely problematic. Shareholders aren’t stupid. I don’t care if someone’s not polished; this is a window into how
the board works and how they think. Don’t give us your most camera-ready person; give us the director who we can talk to us about what we want to talk about.

**Ron Lind:**

I want to defend the whole engagement process. At CalPERS, we developed this focus list where we identify companies that we think can be more successful and create more long-term value through engagement. We do that engagement, we put our money where our mouth is, we up our investments into those companies, we engage.

Then, each year, we’re able to publish the results and show that there’s an improvement in the return prior versus the return after our engagement. Then we track it over longer periods of time and show continued or more improvement. We think it works and it’s a big part of what we do. It’s not the ultimate answer, but it’s just one more piece in the governance work that we do.

**Kathleen Carney:**

Are there any questions from the audience?

**Tracey Rembert, Senior Manager of Investor Engagement, Ceres:**

Where do you see the relationship between investors and proxy advisors going in the next couple of years? What do you see as trends in that space? Are we going to get a greater diversity of proxy advisory services? Do you feel like they’re going to play a smaller or larger role?

**Donna Anderson:**

I would put the war on proxy advisors on the list of bad signs I’m seeing out there about the pressure that’s building on the company side.

We all know about the intemperate remarks made last week by a prominent chairman, but I think a lot of companies feel that way, they just wouldn’t say it so bluntly. They do believe, if you use the advice of outside services, you’re a lazy investor. That was no surprise to me. Over the years, companies have advocated that we should have more competition, we should have a third service; we should have this and that. There have been a lot of solutions offered.

I don’t know that there’s a great market for additional insight, but because of the pension clients and the more engaged asset owners, there is definitely demand coming upstream to the asset managers to be more engaged in these issues and to demonstrate that you’re using your brain at voting time and not just outsourcing.

**Michael Garland:**

It’s a red herring. It’s about a change in voting practices. Fifteen years ago, investors routinely rubberstamped management, and that’s no longer the case.
for a whole series of reasons. I think the disclosure of mutual fund votes changed the pattern of voting in that industry.

Issuers are trying to put the genie back in the bottle. I think we’d be better served if there were more proxy advisors than fewer, but the economics of the industry just don’t support them. So, the reality is, there are a very small number of advisors, they’re influential but their influence is way exaggerated. Investors are not lemmings.

Mind you, the people who buy the research are not the ones complaining. We buy it. We couldn’t do what we do without it. We have our own guidelines, we don’t look at the recommendations. We use both Glass Lewis and ISS, among other advisors.

Sometimes there may be quality issues, but I don’t think we need more regulation. It’s a punching bag for trying to change votes and that genie is out of the bottle.

Mark Fawcett:

This is a bizarre argument. You use external research services in all walks of life, why should this be any different? We’ve got one and a half people on active responsible investment. At NEST, we chose very carefully who our proxy advisor was and they do a great job for us.

JN Gupta, Managing Director, Stakeholders Empowerment Services Private Limited:

I run a not-for-profit proxy advisory company. We find that when we recommend certain things for shareholders for consideration, there is a conflict of interest that comes to the asset managers. When we are discussing with asset managers, they say ‘look, this company is giving me such a good return, why should I follow your advice about the remuneration of the managing director’? In that case, the managing director and his wife were drawing remuneration which was more than the total remuneration of 2,000 employees.

The asset managers says ‘look, I have to serve my investors, they have appointed me for returns, and I’m getting a good return from this company, why should we take care of this’?

Donna Anderson:

I can definitely relate because in T. Rowe Price, fund managers vote their own shares. My role in the process is to make a recommendation from a subject matter expert perspective and to work with the analyst who knows the company the best. The fund managers can agree or disagree with us.

I have heard exactly what you’re saying over the years. ‘Well, I hate to vote against this situation because we’ve made a lot of money too, so why shouldn’t they make a lot of money?’ Or, ‘it’ll impact the relationship’. There
are definitely cases where it’s a very tough call from the investment perspective to create disruption.

When we have enough situations where we can see that that setup is okay in the short term, but in the long term its going to backfire, we do try to take a longer term perspective. We might give them a year’s warning: we ask for change and then follow up with an ‘against’ vote the following year.

Everybody has seen situations like you’re describing blow up on them. Fund managers are really good at pattern recognition. When they know they’ve seen the movie before, they will change behaviour and try to create a different ending.

**Guy Jubb, Standard Life Investments, Speech**

Mr Chairman, Ladies and Gentlemen

We are all indebted to the foresight and vision, the unwavering commitment and the courage of our founding fathers. They provided us with a firm foundation on which they and their successors have built on and after 20 years we have inherited a legacy that is rich – rich in its diversity, rich in its purpose and principles and rich its momentum. We salute you. The ICGN is now a dynamic network that connects us around the world, the ICGN is building for the future by providing educational programmes and scholarships for those working in difficult environments, and the ICGN is a cradle for change – and change for good.

The journey has certainly had its twists and turns but the ICGN today gives us much to celebrate and much to nurture. The ICGN is now established as the number one source of investor views on a wide range of governance policy issues – and we are all indebted to the unsung heros and heroines who give so much of their time to serve on policy and other committees. These committees have delivered a rich portfolio of letters, statements and guidance which enjoy a level of respect that is second to none.

But 20 years is only a short time in the history of corporate governance and our journey – the ICGN's journey - has only just begun. Today, as well as reflecting and celebrating the achievements of the past, we have a responsibility to look to the future with renewed vision and courage – institutional and individual.

At Standard Life Investments our investment philosophy is based on ‘Focus on Change’ and I can guarantee that over the next 20 years there will be no shortage of change for the ICGN to focus on. Investment portfolios will become even more and more diversified, as will corporate boards. Society and politicians are starting to recognise the power that investors have to influence how companies and their boards behave – values and business practices were never more important.

Shareholders are getting more rights – here in the UK the binding vote on executive pay policies is one such, and the European Shareholder Rights Directive is another – and with rights come responsibilities, which the ICGN
and its members must embrace if we are to keep our licence to invest – our licence to invest to make the world a better and more prosperous place.

Change is a constant and change has consequences. I am very confident that the ICGN is extremely well positioned to respond to change and its consequences. It has enormous potential to serve its members – and importantly the public interest – by influencing the direction and detail of public policy, as stewardship codes are developed around the globe, as corporate reporting goes digital, as integrated reporting goes mainstream, and as the complexities and short-comings of executive pay become ever more evident.

I could go on – and I haven’t even mentioned my favourite subjects of accounting and auditing - but even I know that this is not the right time or the right place to prattle about prudence or converse about the conceptual framework.

But I do know it is the right time to ask you to charge your glasses as we approach the Toast, and as you do so I ask you to celebrate – to celebrate the ICGN’s founders and their vision, to celebrate the ICGN’s progress over the last 20 years and the momentum we now have, and to celebrate the ICGN’s potential to make a difference in the future and make the world a better place for us, for our children and for our children’s children.

Mr Chairman, Ladies and Gentlemen, please be upstanding – and join me in toasting ‘The ICGN – Past, Present and Future’.

**Plenary 5: Global capital market reform: pipe dream or achievable reality?**

- Evan Harvey, Director of Corporate Responsibility, Nasdaq
- Edward Mason, Head of Responsible Investment, Church Commissioners
- Corien Wortmann-Kool, Chair, ABP Pensionfund
- Alderman Alan Yarrow, Rt Hon The Lord Mayor, City of London
- Chaired by Nick Robbins, Co-Director, UNEP Inquiry into Sustainable Financial Systems

**Nick Robbins, Co-Director, UNEP Inquiry Sustainable Financial Systems:**

The United Nations Environment Programme is currently undertaking an enquiry in many different countries around the world looking at how the financial system can be better aligned to long-term sustainable value creation. The question of investor engagement in system governance is becoming one of the new agendas.

Clearly, there are many issues in the wake of the financial crisis and concerns about unintended consequences. Here in Europe, we have the capital markets union and how that can mobilise long-term capital. At the international level, we have a new set of sustainable development goals coming this year. At the end of the year, we will have a new climate change agreement. In the enquiry, we’ve set out a number of steps in which
policymakers can help mobilise long-term capital in terms of risk and prudential policy, capital markets reform, transparency and then financial culture and capability.

Firstly, I’d like to ask Alderman Alan Yarrow, the Lord Mayor of London, for his initial thoughts about why this issue is so important and how we can take steps to make the policy framework work for long-term value creation.

**Alderman Alan Yarrow, Rt Hon The Lord Mayor, City of London:**

Sustainability is not an aim in its own right, but it’s a way to maximise profits and benefit society. It’s probably fair to say that in the excitement of the Noughties, people forgot how the financial markets were going to be viewed by the vast majority of the people living in the world.

We were overtaken by greed; we had a number of failures, and not just failures of management. There were failures of regulators, there were failures all over the place. Until we recognise those failures took place and go through the process of disciplining those who misbehaved, we’re going to find it increasingly difficult to make more progress.

Most of you involved in compliance and law recognise the fact that only about 17% of market flows were regulated effectively. The equity market itself is a fully regulated market, with insider trading rules, reporting rules and sustainability. Everything is covered as far as I’m concerned – it always has been a very tightly regulated market.

I challenged the European regulators in the early 2000s, and said ‘Why, do you spend your whole time regulating equities? Why don’t you spend more time looking at foreign exchange, looking at the bond markets and so on?’ They said ‘Ah, it comes down to ownership. It’s all about who actually owns the equity that’s important’. Well, can I just say how wrong they were?

The reality is that misbehaviour was taking place largely in those markets that weren’t properly regulated. I’m not saying for one second that regulators are going to make all the difference. If you go into a shop and steal something and there’s not a camera there, theft is still theft. Now we’re focusing on people’s behaviour, whether they’ve got any real interest in behaving properly and looking after the end investor.

There’s no doubt that the client became a secondary feature in people’s minds. That was a problem, a mistake and a lack of good management. People shouldn’t hide behind that fact. We had inappropriate regulation and management itself was not doing its job properly.

Current regulation is insufficient, too expensive, too ungainly and always playing catch-up. We’ve got the situation where you’ve got prescriptive regulation in the US – where you have the ‘it’s legal, therefore it must be right’ attitude. We all know in our heart of hearts that just because something’s legal doesn’t mean it’s right.

We in the UK have a different interpretation. We tried principle-based regulation and that failed, but it didn’t fail completely. We’re now sliding back
into the default position of prescription that is, in my mind, is a retreat into the wrong place.

Individuals need to have a far better idea about judgement, how they behave, the impact on their customer base and on the reputation of the company they’re working for.

Education, training and qualification is critical. Why is there a reluctance to allow professionalism to come into these markets? It’s extraordinary. I’ve spoken to Mark Carney, the Governor of the Bank of England, and he’s supportive of our view.

Professionalism reduces the need for regulation. What we’ve got at the moment is too much regulation. Regulation should step in only when markets can’t sort themselves out. Markets should self-repair. Every market participant, recognises that appropriate regulation is necessary, but they also need to be involved in the formation of that regulation.

When we had the self-regulatory organisations (SROs), they were responsible for the behaviour of their members. They didn’t fail completely, but an awful lot of what was good with an SRO is still good about an SRO. My suggestion is that regulators have to get more involved with the practitioner and the practitioner more involved with the regulator, so the regulations that come through aren’t so far behind the curve.

We’re already two years ahead of the regulator in most products. It takes them a long time to catch up. That’s not a healthy position to be in if people are going to take advantage of that position, because markets need to be clean. Clean markets are there because the people who participate in them want them to be clean, because that is how you keep the cost of equity and the cost of capital as low as possible.

**Nick Robbins:**

Corien, you’re the Chair of ABP, but you also have a background in the European Parliament. What are your thoughts on why this agenda is so important for ABP and your beneficiaries?

**Corien Wortmann-Kool, Chair, ABP Pension Funds:**

The issues of corporate governance and responsible investments are key to our investment portfolio. As a long-term investor, we have a lot of opportunities to invest in infrastructure and in real estate. Whether it’s about equities or other assets, we try to use our power or our influence as an investor to contribute to sustainable goals.

Of course, our primary goal is to ensure adequate pension benefits. We want to generate that revenue in a responsible and a sustainable way throughout our portfolio. ESG is now one of our investment beliefs, but we are currently also reviewing our sustainable investment policies.

I’m been in this role for five months, and previously I served for ten years in the European Parliament – most recently as Vice President of the EPP Group.
on Financial and Economic Affairs. I have been involved in many of these pieces of legislation that you are currently complaining about.

The first point I would like to make is that it's not very inspiring to complain about legislation. I'm the first to acknowledge that improvements are needed in many parts. What we try to do, given the current regulatory and supervisory environment, is to look for what we can do because we are convinced that we can step up our ambition today.

An important goal is dealing with climate change. As a long-term investor, we can do a lot more in real estate around issues like energy efficiency, which are extremely important. Public opinion tries to force us to step out of fossil fuels. We are not going to do that because fossil fuels will be part of our energy supply for decades to come. We try to use our influence and our investment strategy to push the energy sector in stepping up their ambition, the speed of the transformation to a low carbon economy, and their efforts in that area.

In one year, we have doubled our high sustainability investments from €16 to 30 billion and lowered our CO2 emissions by 10%. In three years’ time, we want to double our investments in renewable energy. There is a lot of potential out there and we are going to look for that actively.

As a long-term investor, a stable regulatory and policy environment is key. Subsidies on fossil fuels – and even subsidies on renewables – make for a very fragmented energy market in Europe and throughout the world. That’s bad for us because we want stable, long-term revenues on our investments. Reform of the European emission trading system and, even better, a worldwide CO2 price is an important issue. We’ve seen five big European energy companies pleading for a worldwide energy price.

Nick Robbins:

I'd like to look across the Atlantic and welcome Evan Harvey, Director of Corporate Responsibility at Nasdaq.

It’s interesting that much of the innovation on sustainability in the exchange world has been coming from emerging economies – Bovespa and Johannesburg in particular. However, Nasdaq has been active too.

Evan, what is your perspective of why you’re doing it – particularly this question of how we get the policy arena and securities regulation lined up so it’s supporting long-term sustainable behaviour on your markets?

Evan Harvey, Director of Corporate Responsibility, Nasdaq:

The exchange industry has been both a leader and a laggard when it comes to this. Some exchanges have done tremendous things in terms of compelling better ESG data from listed companies, as well as building and sustaining capital products that reward green investment behaviour.

Then you have a number of exchanges, largely the larger equities-based, IPO-competitive exchanges, that have been absent on this issue for a long
time. Nasdaq stepped into that void four or five years ago to try and form a coalition between exchanges to drive the industry forward. We think that we have a unique amount of leverage in our position. We have this quasi-regulatory relationship with most of the public companies on the planet. When you’re talking about our groups of exchanges that band together in something like the Trade Association for the World Federation of Exchanges, it’s an overwhelming majority of global GDP. If we can drive some consensus, change and shared thinking around this topic at that level, the scale justifies itself.

Why is it so important for the policy, legal and regulatory frameworks governing capital markets to promote long-term capital sustainable value creation?

First, it’s because voluntary measures, opt-in measures and benighted self-interest measures only go so far. You’re only going to get so much compliance, no matter how good the business case is.

Policymakers and regulators are designed to look at long-term trends. If we left this entirely up to companies, we would get too mired in short-term drivers and short-term interests because that is the state that we have right now. There are a lot of legitimate issues that are driven through the short term and the quarterly cycle of earnings that companies have to go through. There are also a lot of illegitimate issues and a lot of issues that were just subterfuge and kabuki.

One of the main reasons why policy, legal and regulatory frameworks should be put in place and why those bodies should be in charge of it is because some imperatives are just beyond market control. I take issue with the Lord Mayor’s comment about markets being completely self-correcting. Sometimes they are and sometimes they aren’t. Traditional constraints are not always capable of dealing with global issues that cross borders and cross markets, like climate change. I’ve seen first-hand that the old ways don’t always work.

The Johannesburg Stock Exchange was a real leader in the space in 2010. Coming out of the King Code, it mandated not only better environmental reporting from its 450 or so companies, but integrated reporting, which is a pretty substantive request for companies to provide. It’s been a tremendous good but there’s also been a downside.

It instantly put better ESG data into the system. It instantly made that market one of the largest and most complete providers of ESG data for investors. It instantly put them at the top of a lot of lists in terms of market disclosure rates among exchanges. The downside is there are a lot of issues with the integrated reporting format that companies use. The regulation itself was a little bit vague. There was a ‘comply or explain’ aspect to it that a lot of companies took to mean ‘I will just explain very well why I don’t have to do this’. They had to issue subsequent regulation or guidance on why they should report on some metrics.

Exchanges are wrestling with this very question and hope to answer it very quickly. What process for getting information out of public companies works the best? Is it a listing rule that we can put into place tomorrow? Is it making
the business case over and over again, proving the value to companies and showing them the way forward? Or is it some mix of the two? So far, it’s been a mix of the two, but we’re still trying to figure that out.

**Nick Robbins:**

Edward, you’ve been very busy over the last two years on various parts of the Church Commissioners’ responsible investment agenda, and its new climate change policy has just come out. It would be very interesting to hear about how the work and your investment beliefs are driving what you’re doing internally, but also what that means in terms of policy engagement.

**Edward Mason, Head of Responsible Investment, Church Commissioners:**

The Church Commissioners runs the Church of England’s endowment; it’s a £6.7 billion fund. I feel like the tiddler of the asset owners on the panel, but we like to think we get some of our influence from other sources as well.

In terms of how we integrate sustainability into what we do, the first is that we restrict our capital to certain areas that we want to be unsustainable: those are areas like indiscriminate weaponry, tobacco and most recently the highest carbon fossil fuels like oil sands and thermal coal.

Another key part of it is active ownership: how we vote our shares and how we engage with companies. We’ve integrated sustainability into that: for example, in voting, we require companies to reward long-term performance more than short-term performance in executive remuneration. We require them to have environmental and social, non-financial factors recognised in their remuneration schemes, as well as financial factors, or we will vote against.

On engagement, we’re piloting more forceful forms of stewardship and engagement. You’ve particularly seen that in the BP and Shell shareholder resolutions, of which we were co-filers. Robust engagement, particularly in the fossil fuel sector as Corien was saying, is absolutely vital to forward-looking sustainability.

We also promote research and growing intellectual capital on sustainability issues. We were partners in the Mercer study on climate change and asset allocation that was published yesterday. If you haven’t had a chance to look at that, or weren’t aware of it, I would encourage you to do that. It’s a very thoughtful and detailed piece of work on climate change and what it means for investors.

Finally, there is public policy. Public policy has become an increasingly important part of our approach to sustainability. That’s largely because of climate change becoming ever larger on our agenda. Climate change is the biggest market failure that there is, the failure of markets to take the externalities of carbon emissions into account. So, I very much agree with the Lord Mayor in terms of the role of regulation, that it is to ensure that markets work effectively, and markets are not working effectively on this issue.
because carbon isn’t priced. This is a classic area where we need public policy.

I agree with the Lord Mayor on the role of individuals, and I think as a church and as church investors, this is very much part of our philosophy and part of our engagement that people matter and how people behave matter – that’s at companies and investors as well.

The last observation I would make is that we need investors to step up to the table more on public policy. Everyone else is at the table: corporates are at the table in a big way, NGOs are at the table, politicians are reflecting their kind of immediate priorities for their parties and electorates. Investors need to be there because we have a real interest in the long-term sustainability of the economy.

**Nick Robbins:**

Alan, the City of London is a major voice in terms of financial policy. How do you make sure that it’s a credible voice and not seen to be looking after the self-interest of institutions?

**Alan Yarrow:**

The fundamental thing is that you need a belief that the markets have to be efficient and fair and clean. If you don’t start from that belief, you might as well not be participating.

We have a dichotomy all the time in the City. In fund management, the long term is made up of a number of connections of short-term issues. The fact is that there are still situations where people profess that they’re long-term investors, but they still report quarterly. The two are in direct conflict, especially if you’re constantly put up against a bunch of trustees saying, ‘Yes, but we’re investing long term, but, by the way, your performance last quarter was lousy’.

We’ve got to grow up and look at things objectively: look for long-term, sustainable issues and stick to a long-term sustainable reporting process. The reality is, there isn’t sufficient interest in the stewardship of companies by private investors. There has to be proper interest in the stewardship of companies by institutional investors, and that’s not just getting some agency to do all the voting for you. It’s about taking an interest in the issues that face that company.

**Nick Robbins:**

Evan, you tossed up a few different ways of getting consistent and comprehensive sustainability disclosure across exchanges. I’ve been working on this issue for 20 years, and I can sometimes feel a little bit fatigued that we haven’t made more progress. What do you think we can do, over the next six months to a year, to start getting a more comprehensive approach in the exchange world?
Evan Harvey:

I think the exchanges themselves are going to come out with guidance that’s going to help.

We have to start working with the regulators too. There’s only so far this conversation will go unless the regulators get involved. Exchanges and companies working in their own self-interests are not going to get us all the way there.

Nick Robbins:

That balance between market principles, market standards and the regulatory frameworks is a very interesting theme. It’s odd to have exchanges saying the regulators could do more, but we’ll pick up on that a bit later.

One of the things that have come up quite a lot is not just corporate disclosure, but disclosure by institutional investors. Two weeks ago in Paris, the French Assemblée passed a law requiring institutional investors in France to report on their carbon footprint and for banks in France to think about climate change in terms of stress tests and so on.

Edward, do you think that we’re going to need to have some form of regulatory framework for institutional investors to ensure that they are being transparent on the full range of ESG issues?

Edward Mason:

I’m still trying to digest that move by the French Government, because it was quite unexpected.

We very much support carbon disclosure by companies and UK moves to make that compulsory. My hesitation is that it might lead to a ‘tick box’ approach where people are doing it because they have to. We’ve seen some quite interesting moves where people are doing it because they want to and because their beneficiaries are creating demand for it.

A couple of very interesting points have come up in this discussion: the point about pension funds and short-term thinking is very important. In the UK, pension funds are required to have triennial evaluations, to mark their assets to market and also measure their liabilities against current short-term bond yields. That is potentially quite unhelpful for pension funds.

Nick Robbins:

Corien, there is now a requirement in the Netherlands for pension funds to report annually on many of these aspects. Could you talk about that? Perhaps you could also pick up your point about European legislation and capital requirements?
Corien Wortmann-Kool:

We publish a quite extensive report on our responsible investment because we want to be very transparent not only on what we achieve, but also on the dilemmas we face. It’s an area we enter very easily – we get political pressure to do things or to get out of certain investment. But we want to be clear that we act according to objective guidelines because otherwise, we will be ‘playing ball’ due to public pressure.

At certain stages, we do step up. We publish an extensive list of all the companies we engage with. We don’t publish the issues that it’s about – or only very general information – but we say where we don’t see sufficient progress. For example, we went to the AGM of Shell to publically speak out on the proposed drilling in the North Pole area. That got a lot of public and media attention. There you can step up: that’s not only about being big or small, but about acting together as institutional investors, and sometimes with NGOs.

Also, we publish our CO2 footprint: listed companies should do that too, but national legislation is not the road to go because then we get a very splintered landscape. I prefer international guidelines because that would work better. Even European-level would not be sufficient for me on that issue.

On short-termism in the pension sector, and speaking for the Dutch pension funds, it’s actually the national legislation was doing that. It’s a real big problem for us, especially in this time of financial downturn with regard to interest rates. We don’t get a lot of support because we are then seen as a financial institution more than being a pension fund.

Nick Robbins:

Any questions from the audience?

Erik Breen, Chairman, ICGN:

As investors, we encourage companies to create long-term value and we ask them to use integrated reporting. Do investors need to apply the integrated reporting framework?

Peter Montagnon, Institute of Business Ethics:

There seemed to be two strands to this debate that are coming across in the discussion. One is the point about ESG, and the other is about the sustainability of the capital markets themselves. In order to do all this, we have to have capital markets that are configured in a way that they can deliver long-term capital from savers to those who can use them productively.

We seem to have got to a stage where the regulation that’s followed the financial crisis has really inhibited the development of bank lending. If you talk to people in the Commission about capital markets union, they’re looking to the capital markets to replace the lending that was done by the banks. Then, they begin to worry about the systemic risk of the new lenders, the shadow
bankers: that brings in the asset managers, and they begin to worry that asset managers are systemic.

Having killed off the banks, do you think that the authorities are now about to kill off asset managers because they’ve decided they’re systemic, and if so, what should we do about it? How can the asset management industry demonstrate that it plays a safe and useful role in the capital markets and contribute to the building of sustainable capital markets that can deliver everything else that we’ve been talking about?

Christianna Wood, Independent:

My question is for Evan. My observation in engaging exchanges throughout time is that they rarely want to raise the level of disclosure. What is going to be different this time, on this subject of sustainability? They’re all willing to say they want to be sustainable, but I wonder if they’re really willing to do anything. What’s going to happen to make exchanges raise the level of disclosure and walk the walk?

Alan Yarrow:

Peter, it’s a very good question and we don’t know what the answer is, ultimately. But the reality is that – we hope – the banks are no longer systemic. It’s like the soap in the bath – you don’t know where the soap is, but you know it’s there. Similarly, the risk is still there, it’s just not in the banking sector as we know it at the moment. Has it gone to the fund management business? I don’t know: it’s possibly gone to peer-to-peer lending, it might have gone to crowd funding: there are all sorts of other instruments which are coming in from the challenge of banks, to try and fill a vacuum. But there’s one thing that’s absolutely clear and that is that we’ve lost the shock absorbers in the financial system. In other words, liquidity has disappeared. Those shock absorbers have a direct impact on the cost of capital.

The more volatile the market, the bigger the premium affected if people are going to charge the use of capital. I think we’re beginning to see the lack of liquidity in the markets. We have got to look very hard as to how we can replace the distribution of risk and how we actually are living with the unintended consequences of trying to make our banks safer. We used to have a broking industry of some size, which knew exactly who the buyers and sellers were, and introduced liquidity by being intermediaries in the system. That broking layer has largely disappeared. People got lazy, they’d just go over to one of the investment banks to go and get their line of stock because the bankers had the inventory. They no longer have the inventory, either in bonds or in equity, and we haven’t replaced it. So the unintended consequence of making our banking system safer has meant the risk has gone somewhere and volatility’s going to go up.

The cost of equity’s going to go up, which means the whole concept of capital union is going to be more difficult to deliver. These are things we’d have to cope with every day: this is the evolving market, this is what’s exciting about being involved in financial systems – you have to adapt very quickly. I don’t know what the answer is, but I do think we need to think quite hard about how
we improve liquidity of markets when it comes under pressure. When these interest rates start to go up, we’re going to see a very, very difficult market.

**Nick Robbins:**

My experience, certainly at if we’re talking about the world, is that it’s seen to be a particularly European problem. Other parts of the world look at the European banking system as being a little bit less solid, perhaps. Corien, you’ve been on both sides. What do you think about this question of the systemic implications and the unintended consequences?

**Corien Wortmann-Kool:**

I was indeed involved in the capital requirements for bank legislation, but also on the banking union. I would argue against the suggestion that the capital requirement killed off banks. I think we are still in a period of adaptation. Capital requirements are important for the stability of the financial sector and in particular, the banking sector.

Many countries in Europe were or are too dependent on bank lending. More diversification is healthy for our financial system. There are other areas that we, as an investor, are closely linked to. They have to play their part as well. When you put everything into the basket of ‘shadow banking’, it might be as if everything takes place in the dark, but that’s not the case.

We have a lot of regulation for financial markets, we even have our Alternative Investment Fund Managers Directive (AIFMD) for hedge funds and private equity. A lot has been regulated in order to announce transparency and to increase better supervision. If one thing is clear, it’s that we are just at the beginning of building up the banking union, but we definitely also need a capital market union.

**Nick Robbins:**

If I could just touch on this question of capital markets union with Corien and Alan. This is probably the biggest piece of financial reform around. What are the top priorities and opportunities that you see?

**Corien Wortmann-Kool:**

It’s about putting the right incentives to enhance long-term investments. It’s about, harmonising the sectorisations, because harmonisation can help to make this market work effectively again. That can also help banks because, through sectorisation, assets can be taken off the balance sheets of banks. I would argue in that direction for covered bond markets too. With the capital markets union and the energy union, legislation in that area is well connected and gives the right incentives to each other.

**Alan Yarrow:**

There’s no doubt that if you just look to see how countries came out of the last recession, it was those countries that had a mature alternative capital market, other than banking, that came out the fastest. There’s no doubt that Europe in
general relies too much on banking. Therefore, we’ve got to find a way to get money into industry and into business. A capital markets union is, without doubt, a very important change in the approach. May it be through private equity or through private placement, whatever it is, we’ve got to get moving quickly because, effectively, Europe is starving of capital in certain places.

Young companies need capital. We also need to tackle the extraordinary ability of big companies to use small companies as a way of financing their working capital. The SME sector suffers from being used as the financiers of working capital for big companies and that is genuinely unacceptable.

**Nick Robbins:**

How many institutional investors have been engaging with listed companies on their treatment of SMEs in terms of working capital? Maybe that’d be a good area for long-term strategic engagement.

Evan, you said there was some guidance was going to be coming out from the World Federation of Exchanges about how we are going to ‘walk the talk’?

**Evan Harvey:**

I think that the scepticism about the exchanges’ willingness to do this is well founded. I don’t think that there’s much of a track record there apart from the notable examples of exchanges that I mentioned earlier – Brazil, South Africa, Singapore to some extent – coming up with their arbitrary rules.

There are some particular factors that drive rule creation in those markets. It’s a small market generally and there’s not a lot of IPO competition so there are some things that have happened in those markets where an arbitrary rule has been more palatable. But most exchanges are spectacularly unwilling to just drop more regulation on companies.

They’re trying to find this ideal mix between relevant and material information from companies and what’s a burden. We don’t want to bury companies, especially premarket companies and fresh companies, in a lot of regulation that doesn’t really have a lot of material import. There’s probably room here for a ‘grand bargain’ where we can trade the better long-term insight that we get through ESG and other factors for some of the short-term stuff that’s just part of the churn and doesn’t really have as much material value. Some people have been talking about a trade-off in this way: how can we make the total burden of compliance and reporting on companies equal, but add more on the ESG side and take some away from the financial side that is not as telling?

IOSCO could help lead. IOSCO could drive consensus among securities regulators like Nasdaq and other people have been trying to do in the exchange industry. First and foremost, what IOSCO could do is just publically address the issue more. It has been fairly mute on this through the years. It has a dozen different committees on a variety of different topics in our industry, and sustainability is not among them.
PRI and Ceres have sent a letter to IOSCO asking for a number of things related to ESG information in the markets – dialogue and engagement with different parties, a creation of a rule set or maybe a task force, some sort of official statement but primarily urging IOSCO to become part of the public conversation. As I mentioned earlier, the SEC has not really been part of it either, but we’re thinking that IOSCO probably offers the most opportunity to scale the effort.

**Nick Robbins:**

Obviously most exchanges now are listed companies themselves, and that business model has changed from being owned by participants to being owned by shareholders. How much encouragement are you getting in this area by your owners, as well as the market participants?

**Evan Harvey:**

Not much. The encouragement tends to come from institutional investors. It tends to come from individual shareholders and other market participants. There hasn’t been a huge driver from our particular owners as a public company to get into this area. This is one of those areas where the boundary between being a public company listed on an exchange and also having this semi-regulatory role with thousands of other listed companies gets a little bit murky.

**Nick Robbins:**

On the question of integrated reporting, is that something that all investors should be doing?

**Edward Mason:**

Integrated reporting is very important for sustainability and hopefully it’s where we’re going with corporate reporting in particular. We’re some way off finding the ways of doing that. I’m not sure whether institutional investors will be at the vanguard of it in their own reporting. We produce a responsible investment review as part of our annual report: that’s a new thing, so it’s something that we are growing. But many, many asset owners are very small and poorly resourced, particularly in the UK. I think it’s quite tricky for them to start doing really innovative things like integrated reporting. The future is for it to kind of come more into company reporting, for accountancy standards to be established on it, and then it will more naturally flow into the investment arena.

On Peter Montagnon’s points about asset managers and withdrawal of bank lending, I too agree that Europe is too dependent on bank lending and that institutional investors have a role to play in kind of directly providing capital in other ways. We very quickly went into private credit after the financial crisis. I think that’s a positive thing.

On the question of whether asset managers are systemic, I think it depends in what context you apply the word systemic. You can debate whether they’re systemic in financial risk. But I don’t think you can debate whether they are systemic in terms of sustainability. This is something Professor Kay very
much picked out in his report. Many people felt that perhaps he didn’t put
enough emphasis on asset owners and the role of asset owners in long-
termism and sustainability, but he was spot on that the big asset managers
are huge players and they’re big on shareholder registers. How they behave
affects the sustainability of our economic system.

Evan Harvey:

It’s important to keep integrated reporting in context. Integrated reporting is
done by a small minority of companies and an even smaller minority of
investors. Integrated reporting is a very specific, sophisticated framework that
requires you to balance ESG concerns and financial concerns in the same
narrative. It is a difficult format to master.

We’re still at the point where we don’t have basic ESG data in the system;
integrated reporting is two steps down the road because most public
companies are not reporting on a lot of very basic ESG data. I know we don’t
want to rely on a ‘tick the box’ kind of methodology, but we haven’t really
ticked the box yet that will enable us to move onto this more sophisticated
narrative of how ESG affects your business story.

Corien Wortmann-Kool:

It looks like a defensive approach to say ‘well, it’s far away’. For us,
developing our report on sustainable investment is a journey and it’s not
perfect. I had a press conference on that last week: I got a lot of questions
and some not-so-nice articles in newspapers because we also disclosed what
we’re not doing well. But, it helps transparency and discussion, and it really
helps credibility. So, I think we should be offensive on this.

Nick Robbins:

More questions from the floor, please.

Tracey Rembert, Senior Manager of Investor Engagement, Ceres:

What are the top two things for each of you that really need to be changed to
get the markets thinking much more holistically long-term?

Peter Crow, Managing Director, Quarry Group:

Many of the commentators yesterday were speaking in terms of trust,
whereas much of the commentary this morning has spoken more in terms of
structural matters, such as reporting the sustainability agenda. I’m very keen
to understand what the panel’s got to say around desirable behaviours in the
boardroom to pursue this agenda.

Unidentified Male Speaker:

Andy Haldane at the Bank of England has a wonderful paper which says
investors always over-discount the future in terms of cash flows – they value
cash flows 16 years out as if they’re eight years out. Citicorp came out with a
paper yesterday that said investors in the US much prefer share buybacks than investing for the future. They didn’t link it, but I will: it makes perfect sense that if we over-discount the future, we over-value present share buybacks. It strikes me that that mental disconnect between the supposedly rational investor, able to appropriately discount the future, undercuts everything that people of the panel are trying to do. How do we more fundamentally value future cash flows and sustainability in a way that doesn’t over-value present short-termism?

**Nick Robbins:**

We have been talking about refinements to the system, better reporting, CMU and so on. But this question of time horizons is absolutely at the heart of everything that investors do when we’re looking forward. How do we actually get proper discount rates? I’d also like to extend the question of desirable behaviours from the corporate boards, but onto the boards of institutional investors as well.

**Corien Wortmann-Kool:**

A lot is about practising what you preach. What are we doing ourselves about culture, integrity and enhancing sustainability? Are we really doing whatever we can?

Taken as a whole, my priority would be the climate and energy policy and the changes needed there. We need this CO2 price on a worldwide scale to enhance and step up our investments as long-term investors and get the right risk-return profile.

**Edward Mason:**

I absolutely agree that the key is carbon pricing. That would set a tone for pricing externalities and getting markets to work in a more sustainable way. It would also feed into things like integrated reporting because if it’s financially material, it’s got to be right there in the financial account. Listing standards are another potentially interesting area, but perhaps Evan might want to pick that up.

Behaviour in the boardroom is very much our territory and something that we work on a lot in our engagement. It is a real problem: there have been studies of whether boards would make investments that would pay off in the long term, but would involve them missing their quarterly earning targets. By and large, they don’t do it. One of the things that we encourage boards to do is to think in terms of business purpose, because that can anchor the company in a longer-term perspective.

Coming to the last question on the value of future cash flows, it’s about a cultural and behavioural shift. There is a cultural reason for investors behaving in a short-term way. It’s not logical: we know that, in terms of active asset management, high conviction asset management does better taking a long-term view. There are cultural problems there in terms of herding and fear of underperforming your peers in the short term.
Nick Robbins:

Evan, you’ve been quite honest about how some of the exchanges haven’t been leaping forward on this agenda. What are your thoughts on the future?

Evan Harvey:

On a macro level, carbon pricing solves a very particular problem. Listing standards, or listing guidance as we like to say, solves another kind of problem – not the future per se, but it gets us to a point in the future that is better than where we are right now.

Engagement with the board is absolutely essential. Boards that are checked in on this topic tend to represent higher-performing companies. Those companies have all kinds of lines, dotted or otherwise, so you can draw between their performance and financial performance. I think that boards that have one or two specialists in this area who care about this tend to bring it to the fore and make it part of the agenda, and boards that do not tend to isolate it.

We need to de-marginalise ESG. This has to become part of our standard workflow when we talk about company reporting and company performance management. We never get analyst questions about ESG per se, but that depends on the language that people use on the quarterly calls. The more CFOs are called to task for not performing on ESG issues, the more we’ll see a ripple effect throughout the company.

Alan Yarrow:

What I find fascinating about the conversations here is that big companies don’t need banks. They’ve either got access to capital markets already or they don’t need banks. Ninety-nine per cent of the companies in this country are SMEs – they’re not the big companies. The SMEs are the ones who can’t get the bank finance.

If we’re talking about sustainability of the economy and going forward, the SME is the area where the real sustainability is, because that is where most people are employed. That’s where behaviour of big companies is absolutely critical. Equally, these small companies desperately need cash and they can’t go to the banks. We have to get better at asking how big companies treat their suppliers.
Plenary 6: The board of the future: will it be fit for purpose?

- Olivia Kirtley, President, IFAC
- Karina Litvack, Independent Non-Executive Director, Eni SpA
- Barbara J Lundberg, Director, Axcelis Technologies
- Chaired by Conor Kehoe, Director, McKinsey

Conor Kehoe, Director, McKinsey:

Where is director and non-executive director responsibility going? After the banking crisis, there was a lot of similarity between the post-mortems that happened in the UK, in Brussels and in Washington DC. One question that everyone seemed to ask was ‘where were the directors’? The second question was ‘Where were the shareholders’?

Do you think expectations of directors will change over the next 10 or 20 years? Is it already happening?

Olivia Kirtley, President, IFAC:

There’s certainly a change in the expectation of directors, particularly from the regulators. However, I would also say ‘where were the regulators’? You can say ‘Where were the directors’?, but there are many others that play a vital role and we all need to do our part.

There is much more engagement between directors and regulators in the financial services industry in particular. I have a lot of one-on-ones as chair of an audit committee. I have much more engagement with the regulators than I did before. Before, it was me reaching out to them – now they’re reaching out to directors and asking us to have direct dialogue with them.

The more we share information, the more I understand what the regulators are thinking and what they’re saying. It helps me do a better job and vice versa. There’s greater expectation on the part of shareholders and investors, as there should be. Over time, I have seen that directors’ expectations of themselves have increased. That’s a healthy thing.

Conor Kehoe:

When I saw these questions coming up about banking, with demands for more director engagement and investor involvement, the obvious next step was, ‘Well, if it’s good enough for banks, it should be good enough for everybody’.

That occurred in the UK when Sir David Walker reported and the governance code for all companies was revised in accordance with his views. Barbara, have you noticed that spreading to industry more generally as you’re on a semiconductor board in the United States?

Barbara Lundberg, Director, Axcelis Technologies:

I think that it’s moving to a more active and accountable role for the board. They’re being asked to really get involved in strategy. Performance improvement is being driven by activist investors. We’re going much more to a
private equity model: to me, a private equity investor is an activist with a longer-term perspective. However, a private equity person usually buys the right to govern, and an activist is not necessarily buying the right to govern. This is creating a real problem in terms of a board nomination process, in terms of really knowledgeable selection of directors.

Conor Kehoe:

There’s a trend towards more engagement, whether banking or non-banking. I wonder how this has spread out geographically. Italy is a big economy, but any time I’ve gone to Milan, you seem to be able to meet many of the actors in the same restaurant. Are these notions penetrating communities, even in big economies, that seem to be smaller or more cohesive than the dispersed community we have in London and the US?

Karina Litvack, Independent Non-Executive Director, Eni SpA:

The first thing I should point out is that the board on which I serve is a very large one and has a very specific way of composing itself, as opposed to the very large number of smaller companies that make up the Italian Stock Exchange. They are governed in a completely different way.

My experience is very different from what you have just described. The board is not chosen in the way you guys are chosen. Two-thirds of the board is chosen by the Prime Minister’s office or the Treasury, and the remaining third by the institutional shareholders. From day one, it’s an arranged marriage of a group of people who are then going to have to work together for three years and make it work.

The remit is perceived in a very different way from what you’ve just described. For one thing there isn’t anything like the same expectation on the part of board members to be connected directly to investors or to regulators. The relationship with the regulators is handled by management, and that’s the end of it.

Conor Kehoe:

How many days a year should a plain, vanilla non-exec – one that’s not chairing the board or chairing a major committee of the board – spend on the job to do a good job?

In the UK, Sir David Walker suggested that non-executive directors of major financial institutions should spend 35 days a year on the job. It caused an uproar – so much so that his final report had the words, ‘sufficient time’ instead of 35 days a year. Interestingly, if you asked around in London at the time, the norm was about 40 days. Recently, Sir David said he believes it’s more like 50 days a year for a significant financial institution. So, what do you feel?

Olivia Kirtley:

There’s not a single day that I don’t spend some time either reading to know what’s going on in the industry and so on. The number of days that I actually
spend in a meeting is more like 20. I always say I’m on 24/7, 365 days a year. That has to be your expectation and you have to have a margin in order to be that, because different things will arise at different points in time.

**Conor Kehoe:**

Let me move again to general industry, because we survey board members across the globe. We’ve just completed a survey – we asked them, what level of impact they’re having – high medium or low? NEDs in high-impact boards generally say they’re doing about 40 days a year and the low-impact board members say they’re doing about 20 days a year. It feels like that 40 days is where people at least feel they’re having an impact.

We also talked to two groups in more depth who were sitting on private equity boards and listed companies in London. We asked them how they spent their time. It was 20 days a year on their listed company board, 54 days a year on their private equity board. The listed company board agenda was about compliance and succession. The private equity board agenda was about strategy and performance management, and the economists were relieved to find that these men and women were responding to incentives. Their main incentive on the plc boards was to protect their reputations. Their main incentive on their private equity boards was to create wealth. Does this resonate at all with you?

**Barbara Lundberg:**

It’s value and creation.

**Conor Kehoe:**

What about the time spent? What does it take to be an effective board member in a non-financial institution?

**Barbara Lundberg:**

It really depends on the company and the situation that they’re going through at a time. I think Olivia’s right – being on call is something important because you’re never sure when something is going to happen. I would subscribe that the 50–60 days, at least, for private equity boards is probably pretty true.

**Conor Kehoe:**

Karina, you were describing a situation in Italy which is slightly different, where more is done by the management. As board members get more engaged, often there’s quite a shift needed for management to accept this.

I’ve noticed that managers from the listed sector who move to being owned by private equity companies go through some emotional turmoil for a couple of years. Are you finding that the demands on your time are growing or is it still, more or less, a supervisory role? How much time are you spending at this point?
Karina Litvack:

I’m spending a lot more than what you’ve quoted. It’s not just me, it’s all of us on that board.

It’s not a surprise because it was something that was laid out to me, when I was nominated. I was told to set aside a much bigger number than that. It does raise questions in my mind about what constitutes ‘too much’ in terms of one’s ability as a board director to add value but also maintain the necessary distance. There’s an element of reflecting on how much is too much. The standard practice on the board on which I am on is for everybody not only to put a lot more days than what we’ve just described, but also insofar as many of my fellow directors serve on a number of other boards, this one comes first. If there’s a conflict, if there’s an extra meeting, this one comes first. Which raises questions, in my mind, of about how the other boards are getting the right commitment.

Conor Kehoe:

How much time is spent on it? When I’ve asked people this question before, they might have up to 20 days in meetings or preparing for meetings, but they’re spending time visiting sites, or visiting competitors’ restaurants and things like that. Is that the type of activity you’re spending time on or is yours more ‘in the office’?

Karina Litvack:

In our case it’s a lot of scheduled and unscheduled meetings – additional meetings that are called for various reasons like a corporate action, a big discussion on the dividend or a particular judicial investigation. In addition, we’re a brand new board so there’s a huge appetite for induction.

We’re all asking to go and visit key locations. It’s a complex business and we all need to get to grips with it – not a single member of that board is from the industry.

Olivia Kirtley:

I think you have to be careful. The board’s job is oversight. The amount of time you spend depends greatly on the quality of management, the board’s relationship with management, and how much management leverages the value of the board. The expectation needs to be measured and balanced because you want them to remain independent and in an oversight role.

Directors in many countries, in the banking industry in particular, have an office at the company. The risk is that you get so involved in certain issues that you lose your objectivity and your oversight role. There is a line that you want to make sure that you’re not crossing – of spending so much time engaged with management and the issues that you have the risk of becoming part of it.
Conor Kehoe:

If you contrast your public company experience with private equity, do you retain independence when you’re working that intensely in the private equity world?

Barbara Lundberg:

Independence is a principle of how you approach it. At the end of the day, while you may be involved, you really have to support management or not support management. If you can’t support management, then you have to make a change. You’re there as an advisor – an independent evaluator, even. In my opinion, you really need to get into the development of the strategy and form your own opinion as an independent voice.

Conor Kehoe:

There’s a good piece of work by the London School of Economics and the University of California, Los Angeles (UCLA) looking at the US banking industry, the relationship between independent directors and the need for a bailout.

They found that US banks with more independent directors were more likely to need a bailout. They looked at the root causes as well and it turned out independent directors didn’t understand banking. They were therefore more susceptible to short-term messages from Wall Street, which they brought into the boardroom and led to sub-optimal decisions. It wasn’t a problem with independents; it was a problem with induction: taking people from outside the industry, and not giving them enough knowledge to be effective.

Barbara Lundberg:

You cannot be uninformed. It’s your duty as a director to be informed. If you don’t understand the industry, it’s your job to find the answer – not just rely on management or data input studies. You’ve got to do your homework.

Conor Kehoe:

Here’s a question for the audience. What is the most important role of a non-executive when it comes to setting strategy? Should he or she review and comment on the management’s proposed strategy, or do they get engaged in debating strategic alternatives and ensuring that resources are deployed in accordance with strategy?

Seventy-four per cent of you believe that non-executives should be engaged in a debate between true alternatives. One per cent say it’s all the management’s role. I rather suspect that if I were to survey boards, I’d find the truth was the other way around, that 74% of them thoughtfully comment on management strategy, but are not engaged in that vigorous debate between alternatives. What do you, as board members, think?
Olivia Kirtley:

I think good, engaged boards definitely talk strategy every meeting. In formulating or reviewing the proposed new strategy, boards will engage early and often in that conversation so that the management can go away and make sure that they’re responding to the thoughts and the input from the directors, before they come forward with a proposed strategy.

If management’s not providing that opportunity, then boards need to ask for that. Maybe that’s why you have the opinion that it would be the other way around, because management often thinks that the board expects them to come forth with the strategy and let them comment on it so they may view it as a weakness of going to their board and asking for that input in advance.

Karina Litvack:

A lot of times people think they’re engaged in debating strategy, but in actual fact they’re commenting on it. What does the management really want from its board? Does it perceive the board as a resource or as just somebody that they are answerable to and that they have to satisfy?

Barbara Lundberg:

I think boards are expected to have a responsibility for risk management review. I don’t think you can possibly have a point of view on that: unless you’re really part of the development of the strategy, you’re not leading it, but I think part of it.

Conor Kehoe:

How can directors be assured that they are fully informed on these corporate risks? What channels of information are available? Being engaged in strategy obviously gives you a very good sense of what the strategic risks are, but there are many other risks.

Barbara Lundberg:

You approach it like doing due diligence. Private equity does it all the time. You listen to the people on Wall Street, you listen to your shareholders, but you also find third-party verification in market research or research reports or things like that. If you don’t feel like you have all the information in the boardroom with the management, you can ask for more access to information. It’s the board’s responsibility not to wait for management to give them all the answers.

Conor Kehoe:

Should it all come from management or should you have an independent source? Should you commission your owners?
Barbara Lundberg:

You might. It’s a working relationship, so it’s not that you’re doing something against management or behind the management.

Olivia Kirtley:

There are many ways to get information. I'll use the example of cybersecurity: one of the things that our board has asked for is for a law firm come in and meet with the board to talk about defending people who have cybersecurity breaches and what they should have done, in hindsight. That’s a way that a board can get information. You have to be alert and aware of what the issues are, and you have to seek information accordingly.

The board has to be in control of what information they receive, rather than just sitting there and waiting to see what management might provide to them. The real key is you getting the information in the format and answering the questions that you want to have answered as opposed to the information they’re providing you. Quite frankly, the other way around can be very well intended. They’re trying to guess what the board wants. But I’ll always ask the question ‘If you were sitting on this side of the table, what would you want to know’? That’s what I expect them to give me.

Conor Kehoe:

Karina, what about when they flood you with information? It’s all in there somewhere, as long as you’ve got time to read 1,000 pages. Have you ever found a way of shoving that back?

Karina Litvack:

That is definitely a concern. I’ve been a big proponent of introducing the Anglo-American thing of ‘tell me the conclusion first’.

The other thing I often think about is the risk of becoming caught in the vision that the company has of itself. I’m always surprised to read about the company in the press or hear views from the analyst community its critical stakeholders. You get a very different picture of the company. Keeping the antenna out for conflicting views on the company and bringing that perspective into the boardroom is necessary and useful.

One thing I’ve seen a number of companies do is to consult external stakeholders, including investors and a whole range of other parties. It could be trade unions and their employee representatives; it can be journalists and various pressure groups and so forth. It’s a way of widening the range of information coming in. That can then be understood and processed to get a sense of how your company is perceived.

Olivia Kirtley:

Don’t ever underestimate the value and power of the board committees. It’s really important who serves on each of those committees and who chairs each of those committees. Board leadership takes many forms, but so much
information is gleaned through the committee process because you can’t do everything at full board level. As investors, as shareholders, you look at the board construct in a holistic way of ‘Who’s on the board’? I’m always a lot more interested in who serves on the committees and who chairs those committees because that’s where so much of the work is done.

**Conor Kehoe:**

I’d like to move onto to your relationship with investors.

There’s some wonderful work by Harvard, where they got the transcripts of speeches made by CEOs to the investor community and counted the short-term words and the long-term words. ‘Weak’ is a short-term word, ‘Quarter’ is a short-term word. They constructed a short-term index, where the more short-term words used put you further out on the index. They then correlated this index with the shareholder register and they were able to show that the more short-term words you used, the more likely you were to have churn in your shareholder register. Their hypothesis was that, if you spoke about the short term, you would attract short-term investors who would then put you under pressure for more short-term news.

We discovered something similar at McKinsey during our work on long termism. We asked CEOs why they behaved in a short-term way – such as foregoing projects if it was going to affect quarterly earnings. They said it’s because the board tells them to. When we asked the boards, the boards said it’s because investors tell us to. Are boards too attentive to the shrill voices of short-term investors?

**Barbara Lundberg:**

The environment we’re in dictates a lot of that now. You’ve got activist investors who are looking for shorter term results. That doesn’t have to be a bad thing; companies can decide that their priority is going to include performance improvement.

If you look at your analysis of private equity boards and public boards, public boards don’t have the capability of focusing on performance improvement. You may get management to focus or bring resources in to do that. I think strategy is the long-term view, so you’ve got to be able to do both. People do measure short-term performance. Private equity people do it intensively.

**Olivia Kirtley:**

I’m very fortunate to be part of boards where the CEO and the board are likeminded in that we look to the long term. During the financial crisis, we spent into the headwinds in order to position ourselves for the longer term.

You have short-term investors and you have long-term investors, but you have to do what’s right for the company over the long term. It does take more courage because you have to do more explaining because, in the US in particular, there’s much more short-termism.
At one point in time, I was part of a company that was half owned by Americans and half owned by Germans. It was a very uncomfortable position because the Americans want to know what you're doing this quarter, and the Germans want to know where you're going to be in five years. You have to do what's right for the company. We, as board members, are also owners: we have an ownership requirement. Hopefully, that makes us think more like an investor and we try to align our actions accordingly.

**Conor Kehoe:**

You really need to have that understanding of what the long term for the company is—which, as Barbara was saying, is the strategy. That allows you to deal with, but perhaps not succumb to, shrill voices of short-term. Does that make sense to you?

**Karina Litvack:**

It does, but let's not forget there are different ownership structures in different companies. The one that I'm involved in—indeed, most of the companies in that market—are controlled. In our case, we have a 30% government stake and the rest is very dispersed. Many other companies in Italy have a controlling shareholder of some sort, even if it's under 50%. That completely changes things.

Then you have a chorus of voices, with one party that has a particular vision that may or may not converge with the market. As the company, you are obligated to reconcile all the voices. Companies have little choice but to respond to the demands for information. We have the so-called 'mainstream message', and then we have the 'tailored message' for the governance and sustainability audiences, and for retail investors… it becomes a series of attempts to satisfy the expectations of each of these constituencies.

**Conor Kehoe:**

There's one highly respected owner representative in California. When I was talking to her recently, she said "Nothing frustrates me more than being sent to the vice president of HR, when actually I want to speak to the chair of the remuneration committee." Are the demands on you as non-executive directors to interact with investors growing and what does it mean? Does it make management uncomfortable?

**Barbara Lundberg:**

I think it’s going to grow as a requirement. In the past, it was unusual for board members to be interacting with investors. But I think that’s going to increase.

**Olivia Kirtley:**

We, the boards, resisted it more in the past, and I think it's a fait accompli now. In the US, many of the board structures have a common chairman and CEO, unlike in the UK. However, the lead director has taken on much more
prominence and the chair’s certain committees have taken up much more prominence.

We are seeing a lot more willingness to engage. We’re still trying to find the comfort zone of how you do that within the construct of regulation – you have to trust that director not to go off the reservation when it comes to information. I think that we are going to continue to see more ways for investors to engage directly with directors in a somewhat controlled environment though.

One of the things that has changed over the last several years, particularly since the financial crisis, is that regulators are requesting one-on-one meetings with directors. That has created a comfort level for directors engaging directly with someone other than management.

**Conor Kehoe:**

I’d like to know about the group dynamic of boards. I hear varying reports. I hear some people saying to me, ‘I love going to that board’. ‘We’re all good friends’, whereas Sir David Walker told me ‘A good board’s an uncomfortable place. People feel challenged, it’s not a place where people go for a love-in’.

There are two contrasting pictures. In your experience, what does it feel like? What’s the team dynamic of a good board?

**Barbara Lundberg:**

The best boards like each other, respect each other, work well together and don’t mind challenging each other.

When you’re going on a board, you really want to make sure that you fit. And the worst thing would be to be on a board where you’re uncomfortable. Now, if your discomfort means being challenged, that’s okay. But the human interaction going well and professionally is absolutely required for an outstanding board.

**Olivia Kirtley:**

I don’t think that a great board is one where you feel uncomfortable. I think there’s mutual respect. I think that a great board is where you feel very comfortable taking the contrary view. It is a place where you go in and you can speak your mind. You don’t have to agree with everyone – if you’re all agreeing all the time, it’s probably not a very well-functioning board to begin with.

I really look forward to board meetings, because I highly respect the people sitting round the table. I know that there will be insightful points of view. I really do respect those points of view, and it challenges me to think about things in a way that I never would have otherwise.

**Conor Kehoe:**

To do David justice, he’s talking about the discomfort of challenge. If challenge disappears, it gets too comfortable.
Olivia Kirtley:

There’s a thing called credible challenge, which the regulators like to use a whole lot. That’s part of the job. If you aren’t offering credible challenge, then you probably haven’t had enough discussion about the topic to begin with. That challenge and debate is what really makes a great board. If they’re just there to approve what you’re presenting, then the company’s not getting value out of the board.

Conor Kehoe:

Karina, how does it feel on your boards? Do you challenge to the point where, you know, there’s real vigour in the debate or is it more nuanced?

Karina Litvack:

Getting that exact point of balance between friendly, mutually trusting challenge and discomfort is difficult. It’s inevitable, particularly in situations such as the one that exists in Italy – especially if there’s going to be more proxy access – there’s going to be more of these arranged marriages where intelligent professionals have to find a way to work together.

That’s just the way it’s going to be. You have to devote a tremendous amount of effort to building trust. I spent a lot of time just having breakfast, lunch, dinner and coffee just to build the basis to be able to say ‘I’m not sure I agree with that’ in a way that is not going to be perceived as ‘I’m calling into question your fundamental integrity and competence’.

When you have the luxury of composing a board through a bottom-up process, you already have a head start in achieving that level of common values and purpose. When you’re bringing together a group of people who’ve never met, you have to build it. You can’t compromise on having moments of discomfort, as long as it doesn’t tip into outright conflict.

Olivia Kirtley:

A very insightful question for investors to ask board members is ‘How much challenge is there in the boardroom’? It all goes back to the CEO: the CEO has to be comfortable in their own skin, welcoming to debate and challenge, and feeling that that is of great value to them.

Conor Kehoe:

Are there any questions from the floor?

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

We are in an interesting moment in Europe in particular. Because of policymaking, and in some cases private ordering, boards are moving rapidly to a more diverse situation. In some cases, we have law requiring gender diversity. In the US, the turnover is very low in board members and there’s little prospect of policy guidance on this. We probably are seeing a much
slower change in North America and in effect seeing a gender gap arising between the two sides of the Atlantic.

My question is not whether quotas are good or bad, but how are they changing boards? Do you think that boards will behave differently in Europe as they undergo this process, as compared to boards in the United States?

**Barbara Lundberg:**

The UK has clearly taken the lead with the Davies Report and the work that Helena Morrissey has done with the 30% Club. The 30% Club does not advocate quotas, they try to get support from existing chairmen – I think the chairmen in the UK have gone overboard in trying to support it.

One of the points that amazes me is that there’s actual research supporting diversity. There’s a study with quite a lot of data points which statistically proved that boards do better when you have women on them.

There are differences in terms of not being afraid of challenging – I think there’s a more effective board when that happens. I think we’re going, in the US, to see a push on the whole discussion of turnover. You’re going to see real pressure. Then, you really need to set objectives that you want a certain number of the replacements to be female. If you don’t have that objective, I don’t think it happens very effectively.

**Conor Kehoe:**

In Norway, where there’s a rule of 50% on boards, there’s a group called the Golden Skirts. Because there aren’t that many candidates, there are a relatively small number of women who are on many boards. Now, the males are feeling excluded because they’re a small cabal unto themselves. Is there a danger we could go too far?

**Barbara Lundberg:**

There’s a woman named Elin Hurvenes who runs something called Professional Board Forum. She has them twice a year in the UK, and I think Germany will have its first one this month. They bring board chairmen around a table – say three board chairmen and really outstanding senior managers, and then the rest will be women. You have a test case study and that’s allowed people to see that these women are really qualified. The women that are going are people that Elin said yes, they deserved to be on boards. Her success record is pretty good at getting the numbers up.

**Conor Kehoe:**

Will we diverge from the US practice? Will it make a difference?

**Olivia Kirtley:**

We’re making progress in the US. If you look at the new board members over this past year, more than 30% of them were female. The difference that I’ve seen is when you’re looking for new board members. In the past, it’s often
been only me that offered the diverse candidate, even though everyone said diversity is at the top of our list. But instead they brought in names of people they knew and were highly qualified. They’d still be such a great addition to the board that you couldn’t turn them down. I think we’re seeing a change there.

I’ve also had the experience of us really expanding the board’s size by one or two, in order to go ahead and on-board those candidates. The people in this room could have such a huge impact on boards’ attitudes toward achieving the diversity by asking ‘Where you are on this and what are you really doing’?

We need search firms to not recirculate the same names. We need more diversity of thought, more diversity of background, more diversity of other areas. Not everyone needs to have been a CEO, even though that’s a very valuable attribute on boards and you need your fair share.

**Megumi Terayama, Deputy General Manager, Nikko Financial Intelligence:**

In Japan, non-executive directors are relatively unusual, so there is a limited talent pool right now. How many companies do you think a non-executive director can serve simultaneously?

**Olivia Kirtley:**

It depends on what their responsibilities are on their various boards. If they’re chairing significant committees, that’s very time consuming.

Most companies will say that if you serve on more than X number of boards, you have to have the permission of the company to serve on more. It also depends on what their other duties are. CEOs often serve as a non-exec on another company’s board, but if they have a ‘more than 100%’ job as a CEO and they’re trying to serve as a non-exec, I would say it will be difficult to serve on more than one board as a non-exec.

I don’t think there’s one size fits all. It is difficult with reporting requirements to serve on many boards and be involved because there’s such a short window of time for your filings with securities authorities. Once you get over, say, three boards, then you would have to take a very serious look at whether you have time to do that.

**Conor Kehoe:**

The norms in the UK that have been published say one non-executive board seat if you’re a senior officer in a major company. If you’re not a senior officer — in other words, a professional non-exec — four is the limit. It’s not a hard rule, but those are the norms that have been set.

**Florian Schilling, Managing Partner, Board Consultants International:**

Sometimes I wonder if we’re asking a bit too much of boards. Let me provide two examples. One is the question of independence. I have the impression that, particularly in the US, independence of board members is seen almost
as a kind of panacea. If you get independence right, kind of everything else automatically falls into place.

What I observe in European boards is not usually a lack of independence – instead the major deficiency is lack of understanding of the business and the ability to form your own judgment about what the company is doing. If you push independence to the limit, you're going to lose on the side of business understanding. I'm a bit concerned that we're pushing that limit.

My second point relates to the board discussing different strategic alternatives and making sure the resources are there. I haven't observed a board that would really have been able to do that. A board that is able to see different strategic alternatives before the decision has been taken is already way above the norm. If we're asking for things that boards realistically cannot do today, we're asking them to run before they can walk. I'm concerned that we're probably getting a bit too carried away in what we're really expecting from boards.

Rita Benoy-Bushon, Chief Executive Officer, Minority Shareholder Watchdog Group:

I'd like to know how the board evaluates performance and dynamics, as well as how often you do it? Also, when you need to make the uncomfortable decision of asking a board member to leave, how do you do it and who does it? How do you evaluate that the person needs to go? Finally, do you have any protocol on tenure limits in your companies?

Conor Kehoe:

Here in the UK, the exhortation is to do a board review every year, and to have it externally facilitated every third year. In the US, board reviews are sometimes undertaken by lawyers, to protect from discovery. Karina, how does it work? Have you encountered it as yet?

Karina Litvack:

I was very impressed with the way we handled it. If it's done well, you have in-depth questions that are tailored to the board itself, giving constructive comment on what's good and what's not good and what could be changed and so forth.

It's an enormously useful exercise. When it's done properly, it needs to do is be both an exercise in the collective performance of the board as a whole, but also looking into each individual with a 360-degree approach. I'm only one year into a three-year term, so I don't know what's going to happen in the successive years and whether we'll do this each year with an external facilitator, which was the case this time. But, I think it's incredibly valuable, albeit only as valuable as the quality of input of the board members.
Barbara Lundberg:

The board that I’m on holds an annual assessment of each member and the board in full, asking what can be improved. It’s conducted by the head of the nominating and governance committee.

There was a question about tenure. It’s a very, very difficult question to deal with because there nothing really in the US. Because of our activist investor, we had three board members who were over 75. We decided that there would be a policy that at 75, people have to step down. I’m not sure that I advocate that, but I think people will be wrestling with that as an issue of entrenched boards. I think independence has something to do with tenure. When you’ve been on a board for many years, you do lose objectivity.

Olivia Kirtley:

In the UK you’re not considered independent after nine years. Our process is similar to what you describe. It is orchestrated and conducted by the governance and nominating committee. A lot of the time people look at the governance committee as being sort of the ‘throwaway’ committee. It doesn’t have the same demands as the remuneration or the audit committee or the risk committee. However, the governance committee is extremely important if you want to achieve board renewal and have the courage to escort people off the board.

As far as how we actually do it, it’s usually the head of the governance committee, or the lead director, and they just have an adult conversation with the board members. We do the annual evaluation, we do the evaluation of the full board of the committees, and of individual directors by asking ‘How do you think they could contribute more’? We do it both in writing and then we have a verbal follow-up with the head of the governance committee.

External evaluation can be not so useful because they don’t necessarily understand the dynamics of the board and some of the questions they ask aren’t necessarily very relevant to your particular board. If you’re going to have an outside third party evaluation, then you need to understand the dynamics and do your homework before you actually conduct the evaluation, if you want that board to get value of that evaluation.

In terms of how you handle someone that needs to go off the board, we have a couple of tools. Any time that you change positions in any way, you have to offer your resignation. That gives the board an opportunity to relook at it. That should not be the only tool you use: you have to do an honest evaluation. It’s just like an employee. They’re taking up a seat, it’s a very valuable seat, and if they’re not bringing value to the board, then you need to find someone else to fill that seat.

Conor Kehoe:

Here in the UK, we also have the more drastic sanction that board members have to be re-elected every year by the shareholders.
Olivia Kirtley:

That’s the norm in the US now too. Most companies have gone to annual elections.

Anita Skipper, Corporate Governance Advisor, Aviva Investors

This is a very general question about what it feels like to be on a board. Do you spend sleepless nights thinking about it? Are you very comfortable and are you confident that your board has covered everything? How do you deal with moments when you feel you’re not in control?

Olivia Kirtley:

The year that I headed up the audit committee, it was conducting an internal investigation that went on for a year. I dealt with the Department of Justice and the SEC and others. I did not have my best sleep.

You sleep a lot better if the board does their job with appointing a good CEO and management, and with succession planning and so on. You just can expect, any day, that there’s going to be a piece of news or an event where you’re not as comfortable. You just have to be prepared to either be comfortable or uncomfortable and you have to just face whatever it is because that’s your job. You are there to represent the shareholders and then do the best that you can every single day.

Karina Litvack:

In my case, where it’s a relatively young board that’s been working together for exactly a year, it should be more on the substance because that’s what we’re there to do. But, because all of us have to be working to create a board that works well, there’s a chunk of it which is about making sure we get that right.

Part of what complicates things for me is that we are operating under at least two legal regimes, not to mention all the countries in which we have operations. We’re listed in the US and we’re listed in Italy, and there are very different sets of expectations that we, as board members, have to fulfil. I’m not a lawyer, therefore I always say to myself, ‘What is the common sense way to look at this question?’ The filter I use is what investors are going to say to me three to five years from now for the way that I handled this particular issue.

I try to project myself into the future, because sometimes when you’re in the thick of it, it’s hard to get that perspective and see where how it’s going to play out over time.

Ian Woods, Head of ESG Research, AMP Capital:

One of the issues that directors in Australia are dealing with is the level of personal liability they take on as a director. They are arguing that amount of personal liability is actually creating poor outcomes for investors – you’re not getting enough people who want to be directors, for example, or directors on boards settle class actions as opposed to maybe fighting them, or they just
become risk averse because they feel there’s this liability on them. From your experience, what sort of a legal test makes sense to check whether a director has fulfilled their responsibility, given the fact there’s no certainty about the world and you do have to take on risk?

**Barbara Lundberg:**

I believe, very strongly, that you should be protecting directors and officers with insurance for using their best judgment and taking risks that are required. I think we get a little crazy when we start talking about criminal liability for recklessness.

You need to trust and respect people that they’re professional. I don’t think you can ever protect yourself from somebody who intends to do something wrong. If there’s goodwill there, then you need to protect people: you run a risk of losing the best people, if you create a situation where there’s personal liability.

**Karina Litvack:**

I’m a lot less scared about coming under investigation than I am about focusing so much on protecting ourselves from a liability that we then shrink down to just doing what we have to do to comply.

It’s important for us to think proactively about what’s right for the business and to make sure that we’re defending the interests of the shareholders as well as our own personal interests. That’s the one thing that slightly concerns me when the discussion turns to director liability, because it causes people to shrink back and get defensive in a way that undermines our ability to do our job well.

**Olivia Kirtley:**

You want the best and brightest to make themselves available. In the US, the SEC has gone after a couple of directors within the last year, but Mary Jo White is very, very careful and was very clear in explaining how blatant the behaviour was. It wasn’t a judgment call or cases where they barely went over the line – it can be demonstrated they ignored the information they received time after time after time. That’s the attitude that has to be there.

There has to be a safe environment for competent people who are doing their homework and who are using their judgment. There can always be ‘Monday morning quarterbacking’, but you have to have an environment where people can feel safe if you want to have high quality directors make themselves available.
Afternoon Keynote

Martin Wolf CBE, Financial Times

OPPORTUNIST SHAREHOLDERS SHOULD EMBRACE COMMITMENT

Limited-liability, privately-owned joint-stock companies are the core institutions of modern capitalism. These entities are largely responsible for organising the production and distribution of goods and services across the globe. Their role is both cause and consequence of the revolution in the scale and diversity of economic activity over the past two centuries.

So how should we think about these hugely important entities? To answer this question, I will address four narrower ones.

- Why do companies exist?
- What is the purpose of companies?
- What should be the goal of companies?
- Who should control companies?

Why do companies exist?

Why do we have limited liability companies? The answer is that if one wants to organise production and sales of complex products and services, a (semi)-permanent institution may outperform an array of small businesses that have to deal with one another through markets. As the late Ronald Coase taught us, companies exist because, hierarchy – “command and control” – frequently beats markets. Companies exist because markets have limits where complex, long-term planning is required.

The advantages of companies derive from the costs of creating and monitoring a vast set of detailed contracts under irreducible and inescapable uncertainty. Organising many vital economic activities require the scale of an army and the longevity of a tortoise.

A life insurer is of limited use if one cannot be sure that it will meet its obligations 80 years hence. A maker of jet engines is of little use if it will be unable to service and replace its engines over their lifetimes. A car manufacturer is likely to be of little use if it is unable to use what it has learned from today’s models in making tomorrow’s.

The raison d’etre of the company - its ability to commit for the long term - means that it is built upon relational, or implicit, contracts, contracts that, by their very nature, cannot be fully specified.

Why do we have to rely on implicit contracts? Long-term commitments could in theory be managed instead by trying to specify every eventuality. But this would be inconceivably complex and costly. It would also come up against the deeper problem of uncertainty. We have little idea of what might happen in the next few months, let alone the next few decades. In other words, companies are a partial solution to the reality of what economists call “incomplete markets”.


A company's implicit contracts say, more or less, that the company will purchase one's services for a more or less indefinite period, the company will look after one, and, in return, one will do what the company tells one to do. The genius of the limited liability joint-stock company then was to achieve vital economic ends by importing the hierarchical structures of older institutional forms – civil bureaucracies or armies – within the market economy.

In order to make these entities work, one needs vast amounts of capital. In the beginning, that money is mostly provided by shareholders. They would not provide it without the benefits of limited liability, partly because they know they cannot control management effectively. Thereafter, it mostly comes from retained earnings and borrowing.

In return for providing risk capital, shareholders are entitled to the stream of corporate profits, whether these are paid out (as dividends or share buy-backs) or are retained and reinvested by the company. If things go well, shareholders have a profitable investment. But, under limited liability, if things go badly, they lose no more than their investment.

What is the purpose of companies?

Let me turn to my second question. What is the purpose of companies? The answer is that it is an institution intended to generate economic value. That is its social purpose. It is the function of any and all companies, subject to an important proviso: the company should not seek to add economic value by inflicting negative externalities, such as environmental degradation.

Society has given the corporate form important privileges. In return, society has a right not only to expect obedience to the law, but decency: even if it were not illegal, dumping toxic waste or rigging one's affairs so as to pay minimal taxes to the jurisdictions that provide the profits is indecent. It is freeloading.

A company should, in sum, add value to those who engage with it. It does so by organising its assets – skills, knowledge, values, traditions and loyalties – into an effective and flexible whole. It is succeeding if it prospers in a competitive market. It fails if it does not.

What should be the goal of companies?

Now, turn to the third question: what should be the goal of companies? Unfortunately, we have accepted a simplistic answer to this question: "maximisation of shareholder value ".

An obvious difficulty is that if companies are allowed to make the maximisation of shareholder value their sole goal, they can (and will) argue that they are not just allowed, but even obliged, to do whatever they can expect to get away with. But these are the values of a psychopath. They would destroy the trust on which civilised society is built.

A company aiming solely at maximising shareholder value might conclude it would be its duty to cheat its customers, abuse its staff, or pollute the air and water if it is allowed to do so (or at last not prevented from doing so). Such a
company might use its resources to obstruct an appropriate regulatory response to such (mis)behaviour. The only check on such behaviour would be loss of reputation. But that is a slender reed. If we believed this is how companies think, many potentially valuable transactions would never be made.

Shareholder value maximisation is at the least a radically incomplete goal. Ethical restraints must be internalised, even if they are against the interests of shareholders, for the good of society as a whole.

Who should control companies?

Now turn to the last and most significant question: who should control companies? The economic argument for shareholder control is that, while all other stakeholders are protected by contract, shareholders are not. They therefore bear the residual risk. This being so, they need to control the company in order to protect their interests.

A practical argument against such shareholder control is that shareholders are unable to exercise it effectively. The main difficulties here are the combination of asymmetric information (generally, shareholders are ignorant outsiders) with conflicts of interest (generally, shareholders of public limited companies are agents, not principals, and too often they are closer to the management of companies than to their principals) and collective action problems (generally, individual shareholders own a very small share of the company, which means that their efforts at improving governance are shared very widely).

Thus, no less a figure than Adam Smith, founder of modern economics, argued: “Negligence and profusion . . . must always prevail, more or less, in the management of the affairs of such a company.” His concern here was over the “agency problem”. Indeed, it is clear that management, often in place for a short time, may well loot companies for their own benefit, with malignant consequences for the company and the economy, as Adam Smith feared.

This agency problem is likely to become even worse under shareholder value maximisation. In principle, this should mean the maximisation of the present value of the company’s earnings to infinity. In practice, when dealing with inescapably ill-informed shareholders, managers find it all this all too easy to manipulate the share price, at the expense of the longer-term future of the corporation.

Yet a still more important argument against shareholder control does exist. While shareholders do indeed bear risks in their role as insurers of solvency, they are not the only stakeholders to do so. A host of others are also exposed to risks against which they cannot be protected by contract – indeed, that is the whole point of the company. Among such groups are long-term workers, long-term suppliers and the jurisdictions in which companies operate. All are likely to suffer long-term damage if a company – particularly a large company – fails. Was Detroit vulnerable to the failure of General Motors? Yes, it was. Were long-term suppliers to General Motors vulnerable its failure? Yes, they were. Were long-term employees and pensioners of General Motors
vulnerable to its failure? Again, yes, they were. It is simply false to argue that shareholders and shareholders alone bear the residual risks of companies.

Moreover, shareholders, unlike the others, and particularly unlike employees, can readily hedge their risks by diversifying their portfolios. A worker cannot normally work for many companies at the same time and, other than in exceptional circumstances (professional sports, for example) nobody may own tradable shares in other people, except via taxation.

The doctrines of shareholder value maximisation and shareholder control allows us to pretend that the creation of limited liability companies has not changed the market economy in any fundamental way. But, as Colin Mayer of Oxford's Saïd Business School argues in his book, *Firm Commitment*, this misses the true purpose of the company – the creation of economic value in the long run. To deliver on those purposes, he argues, companies must sustain long-term commitments. But such commitments will only endure if it is costly for parties to be opportunistic. Moreover, it is often in the interests of all parties to bind themselves not to behave in an opportunistic way. But, with the control rights of shareholders on sale to the highest bidder, such commitments cannot be made. Those who make the promises might disappear long before they can deliver.

If people are to make long-term commitments, trust is the only alternative. But a company whose goal is whatever seems profitable today can be trusted only to renege on implicit contracts. It is sure to act opportunistically. If its managers did not want to do so, they would be replaced. This is because, as Prof Mayer argues: "The corporation is a rent extraction vehicle for the shortest-term shareholders." Aligning managerial rewards to shareholder returns reinforces the opportunism.

In practice, many capitalist economies do mitigate the risks of a market in corporate control. This is true of continental Europe, notably Germany. But it is also true in the US, where the idea that management should be protected against shareholders is accepted in practice, if not in theory. The country that has taken the idea of shareholder control furthest is probably the UK.

Prof Mayer argues that: "The defect of existing economic models of the corporation is in not recognising its distinguishing feature - the fact that it is a separate legal entity. The significance of this stems from the fact that it is thereby capable of sustaining arrangements that are distinct from those that its owners, its shareholders, are able to achieve."

It is, in other words, in the shareholders' interests not to control companies completely. They need to be able to tie their hands. Mayer's suggested solution is what he calls a "trust company", one with explicit values and a board designed to oversee them. He justifies such a radical switch with his scepticism about the feasibility and effectiveness of regulation.

Less radical would be to encourage companies to consider divergent structures of control. One might be to vest voting rights in shares whose ownership can be transferred only after a holding period of years, not hours. In that way, control would be married to commitment. One could also vest limited control rights in some groups of workers. This is not to argue that
committed long-term ownership is always preferable. Family control, for example, has both weaknesses and strengths.

We have to recognise the trade-offs in managing and governing these complex, long-lived institutions. We should let 100 governance flowers bloom. Different models of control and governance are likely to work best for different sorts of companies. But the canonical academic model of the past few decades is unlikely always, or even frequently, to be the best.

Conclusion

In the words of the great H. L. Mencken, “To every complex problem there is an answer that is clear, simple and wrong.” The governance of corporations is an extremely complex problem, because of their nature: they are in the market economy, but not of it. Shareholder value maximisation and shareholder control are clear and relatively simple answers to that problem. Unfortunately, they are also wrong.

Plenary 7: Share ownership in a global context – is stewardship working?

- Stephen Haddrill, CEO, Financial Reporting Council
- Rakhi Kumar, Head of Governance, State Street Global Advisors
- Lynn Stout, Professor of Corporate & Business Law, Cornell University Law School, USA
- Motoyuki Yufu, Director, Corporate Accounting and Disclosure Division, Japan Financial Services Agency
- Chaired by Peter Montagnon, Senior Associate, Institute of Business Ethics

Peter Montagnon, Senior Associate, Institute of Business Ethics:

Is stewardship working?

It is quite extraordinary how the world has changed since the financial crisis. Before the financial crisis, the word ‘stewardship’ was barely uttered. Now, we’ve got a much greater awareness and we’ve thought about the role – or at least the potential role – of shareholders.

We’ve had the stewardship code in the UK and we’ve seen stewardship codes develop in a number of other jurisdictions. We’ve seen a much greater awareness among asset owners, particularly long-term asset owners, of their role. But has it really made a difference? We’ve talked the talk, but have we walked the walk? If we still have some walking to do, how do we set about it?

I’ll begin with Stephen Haddrill from the Financial Reporting Council (FRC). The UK Stewardship Code’s been in place for around five years, but we still have crises at companies like Tesco. What evidence is there that it’s made a difference?
Stephen Haddrill, CEO, Financial Reporting Council:

To some extent, one has to go back to our original intention, which was the promotion of the long-term success of companies in such a way that investors prosper.

We are obviously concerned about risk absorption, we are concerned about the socialisation of the fruits of growth coming through to shareholders. We set out the aims of the code as being to: create a critical mass of investors to engage with companies; to improve the quality of that engagement; and to help clients of asset managers differentiate between them, to know whether they were going to be involved in engagement or not, and what their policy was in that regard. We also hoped that it would underpin the ‘comply or explain’ basis of the Corporate Governance Code, so that one could have some assurance that someone was paying attention to the explanations.

We recognised from the outset that there was a degree of pushing water uphill in the stewardship context. We knew fully well that many shareholders do not aspire to be long-term, and nothing we said in a code or even in the law is going to change that.

We recognised that there was a limit to what you could expect of asset managers if the asset owners were not placing any requirements on them in this regard in their mandates and didn’t want to pay for it. We also recognised that not every asset manager was able to take on this task. It wasn’t really a code designed to revolutionise that: it was an attempt to make things somewhat better than they were now.

How are we doing? I rely on the annual survey that the Investment Management Association (IMA) conducts. This year it had nearly 230 respondents from amongst its members and it showed some positive things. The quantity of engagement has certainly increased, and that’s been backed by more resource in the investment in the asset management houses. Quality is very hard to measure, but 90% of those who responded to the survey said they were satisfied with the engagement and what followed from it. If investors are satisfied, is it really for me to say that the quality isn’t there?

The IMA didn’t ask companies the same question: maybe there would’ve been a different answer if they had. It was interesting that investors said they’d engaged on remuneration, but also performance, strategy, culture, the board and leadership – all the things you would hope that they were in fact engaging on. If they’re satisfied with engagement over that range of issues, I think things have definitely improved.

On the less positive side, there is a decrease in companies being notified of an intention to vote against. I’m not quite sure why that should be. At the FRC, we’re quite keen that companies do get notified and that there is an opportunity to engage. Maybe if engagement is increasing, they feel that notification is not necessary.

More worryingly, there is a drop in the number of mandates referring to stewardship. That does concern us, and it comes back to that point I was making about pushing water uphill. In the FRC’s own analysis of the reports
that asset managers give on what they’ve been doing, the quality of reporting is quite variable against the requirements of the code for reporting. Therefore, whether people who are trying to distinguish between asset managers have a reliable source of information is perhaps a bit questionable.

I don’t think we can address this question just in terms of whether the Stewardship Code is doing its bit, because the Stewardship Code operates in a wide environment. The Corporate Governance Code needs to work well, but the framework for corporate reporting also needs to deliver what investors need. The changes in corporate reporting over the last five years in the UK have been very much in the right direction – the concept of a strategic report and the linking of other parts of the report, including remuneration and so on, back to the strategy of the business. All that should give investors a much better insight into what the company is trying to achieve and how well it’s doing that.

That should empower those other shareholders who don’t want to engage, but want to express their view by perhaps selling the stock or in other ways. I think we should make sure that when we look at the quality of stewardship, we look at the ability of shareholders to reach sensible decisions about the companies that they have invested in.

**Peter Montagnon:**

Lynn, there is a lot being raised about the possibilities and the role of shareholders. Do they want to engage? Are there enough long-term shareholders prepared to put their back into the work, or are we condemned to much more of the short-term approach??

**Lynn Stout, Distinguished Professor, Cornell Law School:**

If we are rational about the current system and the incentives it creates for institutional investors, there is reason to be deeply sceptical about the long-term benefits of institutional investor engagement.

Being rational about the matter, we have to acknowledge that most institutional investors are A) very diversified, and B) although they have long-term objectives, there is no constraint on their ability to hold only short term. They have long-term objectives, but they have the possibility of holding for a very short period and selling in a liquid market.

When you take those two factors and put them together, you get the following reality. If you are a portfolio manager, and you have reason to believe that one of the companies in your portfolio is not being well run, what is the rational thing for you to do? What is in the best interest of your beneficiaries? The rational thing to do, that also is consistent with your fiduciary duty to your beneficiaries, is to sell that position quickly and quietly. What is not rational is to take an active role in trying to promote an improvement at the company. I submit to you, as someone who’s served on a mutual fund trusteeship for more than a decade, it’s not in the interests of your beneficiaries.

Nevertheless, as I’m sure everyone in this room is well aware, there is an enormous amount of pressure coming from outside for institutions to be ‘good
stewards’. A Stewardship Code is only one example of the enormous pressure that’s being put upon institutional investors from outside forces to suit up in your armour, mount your steed and go off to rescue the entire investing population. But it’s not rational to do that.

If we look at the incentives, you would expect a lot of institutions to try and create the appearance of being actively engaged in improving corporate governance without necessarily investing a lot of resources. It’s not in the interests of the beneficiaries of your fund to invest a lot of resources in rescuing the investor world at large. We predict we would see a lot of herd behaviour. You would expect that in trying to decide what the governance campaign _du jour_ is, you would imitate what other institutions are doing, or worse – and this really is scary – you would listen to professors. Worse still, you might listen to ISS, because that is the cheapest, easiest way to appear to be a knight in shining armour, without having to actually waste fund resources.

You can make an argument that the history of institutional engagement looks a lot like what I’ve just described. The first herd behaviour was everyone thinking that stock option-based compensation was going to solve the problem.

Remember when ISS thought that paying executives in stock options was a great idea? The next herd behaviour was de-staggering corporate boards. Remember when ISS, and other parties, thought that de-staggering corporate boards was a great idea? Now there’s empirical research out that suggests that doesn’t actually help.

Then, separating the chair and the CEO position was the fad _du jour_, and the empirical data now suggests that while separating those positions makes poorly performing firms do better, it also makes well-performing firms do worse. Now, the latest fad is focusing on executive compensation and pay for performance.

I don’t want to suggest that institutional investors can’t perform a very positive role. I think they can, just not necessarily under the current incentive structure we have. If we want to talk about possible solutions, I understand there was a discussion of time-weighted voting. I’m not against time-weighted voting, but I think there are even better solutions. One of them might be time-weighted dividends. Instead of giving long-term investors more work to do, I’d like to give them a nice big, fat carrot and reward them relative to short-term investors.

**Peter Montagnon:**

Motoyuki Yufu, I’d be interested to know if the development of that Stewardship Code, has actually added to the awareness in the Japanese corporate world of the importance of the role of shareholders and changed the view in which shareholders are seen in any way?
Motoyuki Yufu, Director for Corporate Accounting and Disclosure Division, Japan Financial Services Agency:

In Japan, shareholders have little to do with the corporation. In Japan, shareholders are well-respected, but the companies try to keep a respectful distance between them and the shareholders. They don’t want shareholders to be involved in the decision making or the business judgment, *per se*.

There is a big difference between Japan, the UK, and US. In case of Japan, we still need to strengthen the power of shareholders. Japan’s Stewardship Code was developed in February last year. A council of experts was established in order to draft the content of the code, and I had the opportunity to serve as secretariat for the council. The ICGN kindly welcomed the code, and subsequently, held a meeting in Tokyo in March last year if I remember correctly.

I remember one panellist made the comment that now that Japan has the Stewardship Code, why don’t you have a Corporate Governance Code? As you can easily imagine, the business circle in Japan was reluctant to do so. Even so, the FSA and the Tokyo Stock Exchange, made the decision to develop the Corporate Governance Code within a few months. I asked that panellist to join the Council to draft the Corporate Governance Code, which came into effect this week.

People familiar with the situation in Japan often ask me, ‘why such a dramatic change within two years’? There are three reasons. First, the corporate governance revolution is supported by the current administration and the economic policy known as Abenomics. The administration enjoys a relatively high rate of approval and they have provided strong political leadership in improving the corporate governance framework.

Second, the Corporate Governance Code and the Stewardship Code placed a great emphasis on long-term growth. In Japan, it’s been more than 15 years since the discussion on corporate governance started, but little progress had been made. I think this is partly because of the overall emphasis on monitoring organisational issues. These issues are very important – I wouldn’t deny that – but the Code puts more emphasis on the role of the board, and the board contributes to increasing long-term corporate values.

Thirdly, the change was inevitable. Fifteen years of discussion over corporate governance in Japan had not made big achievements, but it doesn’t mean the efforts were totally in vain.

In terms of stewardship, a recent survey asked investor relations officers in listed companies whether they had seen any changes in the attitude of the institutional investors since the development of the Stewardship Code. One-third said yes, there had been a change. One-third said no. The rest didn’t know the answer.
Peter Montagnon:

Rakhi, I’d like to come to you. You’ve got a large number of companies in your portfolio, how can you possibly be a good steward to all of them? Aren’t you just going to follow the fads that Lynn’s talking about?

Rakhi Kumar, Head of Governance, State Street Global Advisors, Boston:

Size is an advantage when it comes to accessibility to management and the fact that you can have good engagement. Having said that, that’s also our biggest challenge.

We are required to take a risk-based approach to designing a stewardship programme. The stewardship programme has two elements to it: the engagement element and a proxy voting element. If you think of companies in the index in the shape of a bell curve, you are designing a programme that identifies the outliers. You learn from the positive and the negative engagements, and you overlay your risk that the company is within your portfolio. You have to have an absolute holdings risk as well as a relative position – that’s how you get to the small and midcap companies. For the mid, or most of the companies that are in the middle of that bell curve, you have to design robust proxy voting policies that can be implemented to address the stewardship element or provide that stewardship element.

The reason we don’t follow a herd mentality is because we take a geographic approach. Stewardship cannot be practiced the same way in different geographies. It has to reflect the culture that sets up the governance of the corporate governance structure of corporations. That’s what our stewardship programme is designed to do. While we have a strong philosophy on proxy voting, we have six market guidelines for different markets. We also have our stewardship programmes which are adjusted based on client interest as well as stewardship elements.

As a passive manager, you cannot be a passive investor – you have to be an active investor because you cannot sell. I don’t have the option to get out of the stock.

Peter Montagnon:

But it’s resource-intensive, isn’t it? Most of your clients are investing with you because it’s cheap to invest with you, so how do you get round that?

Rakhi Kumar:

That’s a very important point to make. There is a cost: you have to do it in a cost-efficient way. Just as every passive investor or index investor knows that they’re going to be invested in companies that may underperform, there has to be some level of comfort that you are going to be invested in companies that may not have the best governance. That is why I mentioned the bell curve. While you’re trying to identify the outliers in a cost effective manner, and focus your engagement with them, you also want to recognise that you have to find some comfort with not being perfect to some extent.
**Peter Montagnon:**

If I can paraphrase slightly, Lynn was saying this is an all an elaborate con. You’re being gullied by the people out there into thinking they’re all beavering away, but actually it’s a load of fashions, fads and pretence. Is it?

Or do we have to be realistic about what we can expect and what we’ve got is better than what we had? How much do we really believe that these organisations have got their heart and soul behind this?

**Stephen Haddrill:**

I entirely agree with the proposition that it’s better than it was rather than taking a view that we’ve reached some nirvana. We clearly haven’t and we’re never going to because, as Lynn says, there are all sorts of constraints and commercial realities.

The other side of it is that we talk to companies. They feel the dialogue is rewarding and it’s benefiting them. A lot of them aren’t quite so keen on it when they’re under pressure, but even that’s a good thing. I’ve listened to the corporate side too. If we only heard from the investment houses through the voices of the corporate governance engagers, I would be a little bit nervous because that’s what they’re hired to do. We get together the chief investment officers and the CEOs of the big houses on a regular basis and I do feel that they have that commitment.

**Peter Montagnon:**

From what Rakhi said about the bell curve, you can talk to the big companies but there are also the smaller companies who are never going to quite make it onto her engagement horizon because they’re just too small. Do you talk to those companies, and if so how do they feel about stewardship?

**Stephen Haddrill:**

We published a report just a few days ago because we’d been talking to them about the quality of their corporate reporting. It’s often not that good. The CFOs say they don’t prioritise it because their investors say that they’re not interested in the report and they don’t hear from their investors very much anyway.

We talked to a lot of investors about that. They said a corporate report is fundamentally important to them because there’s not much analyst material and because they’re not so confident in the governance of the business. Investors might not be talking, but that doesn’t mean to say they’re not taking an interest. Governance is more than just what the code says: it is that process of reporting and auditing and other things as well.

**Peter Montagnon:**

Lynn, you talked about how this was more form than substance. What’s the answer? Somebody’s got to hold these companies to account, and aren’t the shareholders the people who could and should be doing this?
If we believe what you say, there is an ownership vacuum out there, and that’s not acceptable either. What do we do about accountability?

**Lynn Stout:**

I actually think it’s worse than it being a vacuum. The way institutional intervention is structured now, it may actually be being destructive.

You’re probably aware of the data: public companies are disappearing; the life expectancy of large companies is being shrunk dramatically; and returns from owning public equity are down. All this embracing of shareholder engagement is not translating at any macro sense into better returns. The key is something that you’ve heard a lot about at this meeting: as long as institutions can and don’t bear any cost from selling in the short term, they’re not going to support long-term investment. They’re also going to support the Dan Loebs, the Bill Ackmans and the Carl Icahns who come along and have some strategy for pumping up the share price in the short term through things like leveraging and cutting R&D and spinning off assets that probably harm long-term return.

We need to find a way to reward institutions for holding long-term and to discourage them from holding short-term. There are a million ways to skin that particular cat: you can use the tax code, you can have time-weighted voting and you can have time-weighted dividends.

It all starts with recognising there might be a problem. I’ve been talking about this since 1998, and I must say I’m more encouraged now than I’ve been in a long time, because I see the tone of the conversation shifting.

**Peter Montagnon:**

There’s a lot of food for thought there and lots of questions to come from the audience.

**Peter Butler, Founder Partner Emeritus, GO Investment Partners LLP:**

Engagement and activism is difficult. It needs a lot of resource to be done well. Therefore, although I disagree with a lot of the things that you’ve said, I think the conclusion is absolutely right. If we want stewardship to work, we have to give extra resource to the long-term shareholders.

Why can’t we get a proper debate going about how we overcome the advantages or disadvantages of each of the methods of doing this? Unless there’s a will to change, it won’t happen and stewardship will just be a box-ticking exercise which may or may not add value.

**Peter Montagnon:**

If I can add a spin to that question, a lot of this is about the business model of the asset management firms, isn’t it? That’s what’s got to change: we haven’t seen a willingness to do that.
Stephen Haddrill:

I hope that we are seeing a debate. There’s certainly a debate in the UK around the effectiveness of the Stewardship Code and some of the things Lynn’s suggesting. I rather like the idea of long-term dividends. These are things that we should consider. Where we have not succeeded as much as I’d hope we would is in the engagement of the owners. We have to put more effort into that because it started to take off but plateaued.

Peter Montagnon:

Motoyuki, I wonder how much this discussion resonates with you coming from Japan, where the corporate view has always been longer-term. Do you think that there is more inherent long-termism in the way that the Japanese financial community approaches companies?

Motoyuki Yufu:

The CEOs of companies continue to complain about the short-termism of investors, even in Japan. However, the structure protocol in Japan encourages institutional investors to take a longer-term perspective. The Stewardship Code requires the institutional investors to have a longer time horizon. I’m not sure how well it will work.

Coming back to the incentive for the long-term holding of shares, that shouldn’t be implemented in a way that hampers the interest of short-term investors.

Peter Montagnon:

Rakhi, can I also ask you about this question of extra dividends. Would that really make a difference to the resources you were prepared to put into engagement? Or would you just sit on your hands, collect the extra dividend and let somebody else do the work?

Rakhi Kumar:

You’re assuming that the companies will be around to pay the extra dividend in the long term.

Our clients value us on our cost. If you are going to ask us questions on the request for proposal (RFP) side, you have to start evaluating us on the effectiveness of our stewardship and outcomes. How are we evaluating the efficiency of a stewardship programme? You mentioned votes against; that may be how it is done – number of engagements, votes against.

However, I may not have to use my vote. For a steward of my size. I use my vote as a sign for failed engagement. We need to really start focusing on an outcomes-based measurement instead of asking ‘How did you vote on this one particular ballot item, and what was your percentage against’?

It’s different in the UK. I meet with a lot of clients in the UK as well as in other parts of Europe, and they keep me on my toes. The asset owners in Europe
are different than the asset owners in the US. Having said that, there are asset owners like large pension funds in the US who do keep us on our toes, but there are not enough of them who challenge us to do a lot more.

**Unidentified Male Speaker:**

In the field of democracy, a wiser person than I commented, many years ago, that democracy was the worst method of choosing the government of a country, except for all the others. I think much the same applies to the method of choosing the governance of a company. The only exception is if you have a benevolent dictator like Warren Buffet, but you don’t get that very often.

**Jean-Aymon Massie, Directeur de publication, La Lettre trimestrielle de l’AFGE, AFGE (Association Française de Gouvernement d’Entreprise):**

Why is it so difficult for the shareholder to engage directly in dialogue with the board members outside the roadshow?

**Unidentified Female Speaker:**

What would be the extra incentive required to restructure? How many extra basis points would you require to do your stewardship activities?

**Rakhi Kumar:**

It depends; I don’t have it on a map. I think we do a good stewardship programme right now, but if you want me to engage with all 9,000 companies I’m invested in, and if you think that’s not engagement for engagement’s sake, then I guess it’d be a lot more than just one basis point.

**Peter Montagnon:**

Stephen, the question about why is it difficult to approach directors outside the roadshows, I’m not sure that’s true in the UK, is it?

**Stephen Haddrill:**

I don’t think so.

**Peter Montagnon:**

Presumably there should be dialogue between the directors, the non-executive directors and the shareholders?

**Stephen Haddrill:**

One of the things that people felt they needed in the past was an agenda for the discussion, that they would get better access if they could give notice of some good points to make. I think that’s improving with more reporting around strategy. Even the audit report has got better from that point of view. The door is often open.
Peter Montagnon:

Going back to the point about the benevolent dictator, one of the things we haven’t really talked about is the controlling shareholder ownership structure. There are a lot of instances where controlling shareholders have been good. Lynn, should we be doing something more to promote incentivised, benevolent controlling shareholders, rather than trying to re-engineer the dispersed marketplace?

Lynn Stout:

Democracy works in the political sphere, because you can’t vote and then go to another country and become a citizen of another country. Voters are long-term investors in their own nation. Does democracy work when you can cast your vote, sell your shares and get out?

We are seeing a very interesting pattern in the US in that its corporate sector is starting to look a lot like Europe. We’re seeing more companies that are refusing to go public; we’re seeing private companies exercising a bigger role. The few companies that do go public increasingly do so with dual-class share structures. Google, Facebook, LinkedIn, all the private equity funds that have gone public, have done so with a dual-class structure. It may have a lot of advantages in terms of improving corporate performance. Interestingly enough, the data suggests that companies with a controlling shareholder also take better care of their stakeholders.

Alison Schneider, Senior Manager, Responsible Investment, AIMCo:

Lynn, you mentioned that it’s easy for us to just dump investments. It’s not quite that easy. Often we can’t even get out of the investment, even if we wanted to do, so we’re faced with engaging to make a difference. We use strategies that look for companies that are undervalued and don’t have good corporate governance, engage with them and try to improve them. Where does that fit into your theory?

Amra Balic, Managing Director, BlackRock:

Lynn, you made a point about active managers who can consciously buy and sell stock. Their fiduciary duty to their clients is to walk away if the company’s doing well. I’m struggling to put that together with your latest statement that solution for long-term holding is to give double voting rights, or even higher dividends, assuming that the company can pay dividends – which is often not the case.

Jon Lukomnik, Managing Partner/Executive Director, Sinclair Capital/IRRC Institute:

Just a factual correction, dual class shares in the US, according to our last study, performed worse than single class shares. They have a higher beta and they performed worse over time. Controlled companies with single class shares do perform better and have lower volatilities. When you mentioned Facebook and Google, that’s great, but you leave out Zynga and all the
failures. I would say the argument for dual class shares is unproven. It may be time period specific.

**Lynn Stout:**

Even for a passive fund, engagement is a public good and will be underprovided – that’s Econ 101. I’m just talking about logic, I’m not trying to name names.

As for dual class, there were 11 studies when I looked at this: we’ll put yours in as the 12th. Some found that dual class firms did worse, some found that they did better. There was no clear result: that makes sense because corporate governance is endogenous. You would expect to see poorly performing firms opting into that governance structure as well. The problem is if you look at the entire literature, the results are all over the map. I think this is one of those cases.

**Peter Montagnon:**

Stephen, I’ll just come back to you quickly. There’s been a lot of debate in Europe in the context of the Shareholder Rights Directive about whether member states should require companies to offer incentives to long-term shareholders. Where does the FRC in the UK stand on that? What do you think is going to happen?

**Stephen Haddrill:**

I don’t think there’s going to be much change in where we stand at the moment in the UK. I think the consequences haven’t been fully thought through. You change the balance between rights and return at your peril.

**Erik Breen, ICGN Chairman: Closing remarks**

It has truly been a great couple of days. As chair, I have humbly received many compliments for the secretariat, from you the ICGN members, speakers and conference participants.

I am very proud of our team and all those who contributed to making this a great conference. Please join me in thanking them all. I also wish to extend thanks to our program committee; in particular co-chairs Richard Regnan and Frank Curtiss, our speakers, the Lord Major; the Minister, our host the City of London and all our sponsors, without whom this conference would not have been possible. Lastly a special thanks to you; the attendees, this is your conference, your network and you’ve made this a lively and interactive experience.

We can look back on a very successful 20th anniversary conference. We received the welcome address from the Lord Mayor followed by an invitation for dialogue with the Minister who is in listening mode.

From the founders, we learned about our history and governance 20 years ago. We have progressed beyond the right to send faxes and see 3% support for a shareholder resolution as progress. We could have been named IC GO,
but the N for network captures the essence better. Today, we still embrace the core principles of transparency, accountability, fairness and responsibility. The relevance of those core principles has only grown over time, and so has ICGN as your network to influence, connect and inform.

Yesterday's breakfast session hosted a thoughtful debate on the case for and against differential voting rights, on Florange, being more than a French town in the Moezel, on consequences and alternative remedies, with long term, true stewardship and dialogue coming out on top.

The next panel questioned if and how a capital market union will address the worries of our mothers and contribute to the futures of our sons and daughters. More regulation to fix past failures is to be expected, although 70% of the audience believes fully effective regulation is a pipe dream. Cultural change and a more holistic lens is necessary, yet difficult to accomplish.

The board room black box was opened. Panel and audience agreed that board room culture balanced with individual expertise and effectiveness are the two most important attributes of effective boards. Culture should be based on trust, respect and balance; allowing even inviting opposing views.

Lunch options covered legal redress as corporate governance element and integration of environmental, social and governance into investment decisions, with insightful examples from practitioners.

In the next panel, we heard how investment beliefs are put into practice, leading to concrete decisions on asset classes and on how contracts with managers are designed. Panellists shared how they are still battling collaboratively to gain further, meaningful proxy access, lacking a universal rule, in the US shocks.

We heard about challenges and opportunities in controlled companies in emerging markets and how the battle for necessary change continues. We learned about opportunities the new UK audit report standard holds for investors and we had workshops on investor expectations on human rights and on cyber resilience.

Importantly, one of the workshops was devoted to driving accountability across the voting chain and in this respect I wish to repeat the question that ICGN's Shareholder Rights Committee is so fiercely aiming to answer; with a yes in practice. ‘Do shareholders have a right to know that their votes are executed as instructed?’

In the evening we enjoyed a lovely gala dinner and jazz party. Although Moneypenny was spotted, unfortunately, our very special guest for the evening could not make it to our party as he was rumoured to have been involved in a car accident in a Jaguar nearby...

The opening panel this morning addressed sustainable capital market reform. Individual behaviour - for executives and investors alike - is key, regardless of being regulated and watched. Prescription only is a retreat. Principles allude to awareness, self judgement and self control. Instead of complaining about
new regulations, we are encouraged to engage with the regulator about what effective change is.

Company engagement and long term thinking are once again confirmed as vital elements to sustainable capital market reform. Europe, being very dependent on banks, is in need of a capital markets union as an alternative way to provide much needed capital to young companies.

We heard about whether boards are fit for times to come. Time commitment to board responsibility indeed has grown. In fact, the question was discussed whether there could be too much time focused on ‘independence’ and how time commitment conflicts between multiple board positions.

Lunch options included a panel on how to create long term, sustainable success and what boards and investors need to do. Besides pro-active engagement, investors also have to respond to more outreach by companies towards investors.

In another panel looking beyond the financial statements, it became clear there is no one size fits all and there is wide variety and amount of qualitative and quantitative reporting.

Martin Wolf spoke about the defecting economic corporation. He gave thought provoking arguments that it is not in the best interest of shareholders to seek control over corporations and seek shareholder maximisation as a wrong answer to the complexity of the governance question. Instead, he held it to us that trust is the only alternative for long term commitment.

The final panel gave a global overview of the developments of stewardship in several jurisdictions around the world.

Bob Monks gave an inspiring speech emphasising the need for real owners and true stewardship. Holding corporate boards to account may well be the only option to return to a civil society based on human values and Bob made the distinct connection to the remembrance of liberation. This resonated with me personally having cycled back in a Dutch-German remembrance tour last month the route my grandfather took 70 years ago from Dachau back to a home where those very values were to be restored.

I wish to say farewell to you and wish you all a safe journey home. We have a continuous battle to restore human values in corporate governance, to stand up for the right individual cases, while acknowledging our collective mission to inspire and promote good practices around the world. Something that is bigger than ourselves. And please know that you are not alone but part of your network, the ICGN.

Thank you.