“Mobilizing Ownership: Taking Corporate Governance to the Next Level”

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Canadian Coalition for Good Governance
Toronto, 18 June 2013
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Thanks chair, and to the CCGG for inviting me. I am honored to be here, especially as the CCGG annual meeting has become a rare place to step back from the daily skirmishes and consider big thoughts. It is also wonderful to be among so many friends.

I also can’t help but admire your welcoming an American to comment on corporate governance. In light of the disasters evident at US companies in recent years, this shows real courage on your part. Or to recast that in corporate governance terminology: you demonstrate a “high appetite for risk”.

I intend in these remarks to suggest some challenges our markets face in the near to medium future—and to offer a partial remedy for your consideration. But first, I believe it sometimes puts things into perspective to recall the lessons of those who come before us. Remember that old line from Star Trek about the Starship Enterprise? Its mission was to “boldly go where no one has gone before.” But then did you notice that whenever it arrived someplace the planet would be full of people already there? Similarly, corporate governance is not at all new, as much as we like to think it is. There were shareowner revolts in the mills of Toulouse some 800 years ago. And more than 400 years ago, in 1609, Isaac LeMaire became the first investor in the world’s first-ever stock company to complain of shoddy corporate governance.

The Dutch East India Company was his target. His concern was that management was paying out dividends only every decade or so—and in bags of nutmeg instead of cash. He would surely have joined the CCGG had it been around.

Intriguingly, LeMaire wasn't alone in dissent. At roughly the same time, Dutch citizens organized the first-ever share boycott over the Dutch East India Company's business practices in Southeast Asia. Management of the VOC tended to prefer strategies such as slaughter, conquest and slavery to enhance performance, an approach that didn't quite appeal to the ethics of some in 17th century Amsterdam. So if you think about it, controversy over what we now call "corporate governance" and even "corporate social responsibility"—together, "ESG"—has a very long pedigree. These issues turn out to have been hard-wired into the capital market from the very start. Moreover, the forces of entrenchment are powerful. Change is very, very hard to get right, which is all the more reason to appreciate what the CCGG has accomplished.

My own experience with Canadian corporate governance stretches back not quite to the era of Isaac LeMaire. But I recall coming to this great city and to Montreal back in 1988, 25 years ago, and opening conversations with the late Bill Allen, founder of Allenvest, later Fairvest, and now ISS Canada; Bill Davis of the United Church of Canada; Moira Hutchinson of the Taskforce on the Churches and Corporate Responsibility; and the fabled Stephen Jarislowsky. There was just a merry few at that time focused on what was the still-freshly-coined phrase "corporate governance." Many other greats have since come in their wake, of course—and many are in this room. You are the reason Canada has developed a solid and enviable record in ESG and performance. But I want to put your work in historic context. **CCGG is at the leading edge of a phenomenon that is indeed truly new in the 400 year history of corporate governance: you are trying to invent how *ownership* works when owners**

are neither tycoons, families or the state, as was universally true of old, but big, sprawling, modern financial institutions. How can an *institution*, sometimes representing millions of beneficiaries, act as an *owner*?

Today I want to profile some of the pressures and opportunities that I expect will sway that goal of reinventing and mobilizing institutional ownership. I hope you will forgive me if I concentrate on global trends rather than Canada alone. But I will use this background to build the case for a reform proposal that does squarely apply to North America.

Let me start with what some might consider heresy. Much of what has been called "shareholder activism" in the past 30 years turns out, in my view, to be a prelude. In the US, for instance, it largely involved an annual tide of non-binding resolutions on bits and pieces of a company's total identity. Corporate boards often fielded these proposals as time-consuming nuisances. And in other markets investors, despite enjoying significantly more rights, were mostly quiescent. **Today, thanks to a confluence of scandal, recession, law, regulation and social media, investors of almost any bulk have the means and motive to wield influence over the core governing power in a public company.**

Consider for now just one driver of this change: Politics. Politics is of greater importance today because private sector corporations increasingly affect citizens and national welfare. Think of Enron's fraud contributing to a broad collapse in market confidence; bank miscalculations leading to the global financial crisis; or private businesses now running services that were public until governments got too cash-strapped to keep them. Policymakers responded to public anxiety by crafting Sarbanes-Oxley, Dodd-Frank, and equivalent measures elsewhere. And there has been no apparent pause for breath. Signs abound of governments

continuing to intervene to move corporate governance goalposts. Who would have thought voters in market-friendly Switzerland ready to approve Europe's harshest curbs on executive compensation at corporations? Or a Conservative-led government in Britain making annual 'say on pay' votes binding? Or the European Commission imposing a 40% near-quota for women on corporate boards? Or an official US Republican party memorandum ("Growth and Opportunity Project") recommending that "We should speak out when CEOs receive tens of millions of dollars in retirement packages but middle-class workers have not had a meaningful rise in years"? Corporate behavior is under fire from surprising and unprecedented directions.

Executive compensation and board diversity are, of course, the two issues that today most grab headlines and the attention of politicians and investors. But they mask a more profound, less obvious, shift. **Let me put it this way: policymakers on both sides of the Atlantic have placed what I would call a Big Bet: that institutional investors have the self-interest to police markets and, if provided the right tools, will do so.**

That's a gamble that, on the surface, sounds appealing; it taps a market mechanism rather than relying solely on regulation and enforcement. In Europe, the EC's Action Plan contemplates the spread of stewardship codes, such as the one pioneered in Britain, to stimulate investor engagement with public companies. And in the US, the Dodd-Frank Act and SEC regulation boosted disclosure to investors and handed them further rights—such as 'say on pay'—with the express intent of pushing them to act. Hybrid majority vote reforms have also helped. Similar measures have been adopted or are underway in Canada as well as the Netherlands, South Africa and Australia.

OK. You'd think that with unprecedented shareowner power,

unleashed by the Big Bet, we would be living in a golden age of responsible or mindful investing. We're not. Not yet anyway. And the reason, I would contend, is that we are working with typewriter practices in a Blackberry world. We have a legacy culture and infrastructure unfit for new purpose. **Too many mainstream institutional investors outside the CCGG orbit are nowhere near configured to take on new ownership responsibilities.** Let me spotlight five such weaknesses.

1. For one, as you know, many funds have long followed super-diversification asset allocation strategies; they hold equity in thousands of public companies around the world—too many to follow each closely as owners without massive resources.
2. For another, institutions are inheritors of a bureaucratic culture derived from the long tradition of ownership without authority, which I call "empty ownership". Funds perhaps rationally treated governance monitoring as a matter of compliance unrelated to value. Because, frankly, why bother to do otherwise? And many still do. They silo ESG oversight separate from fund management and they under-resource, or wholly outsource, this function. No wonder Lord Myners famously described ESG analysts the "open toed sandal brigade" inhabiting the basements of investment houses. The discipline of trading and asset allocation is disconnected from the discipline of ownership.
3. Funds are opaque. Indeed, to be honest, few would meet minimal governance standards they ask of portfolio companies.
4. Conflicts of interest, as academic studies show, can suppress responsible ownership to the extent that it raises commercial risk—that is, if it endangers relationships with companies that give the funds business.
5. Most importantly, the citizens whose money is invested are systematically disenfranchised. Social media has made it

> massively easier to whip out an app on your smartphone to compare neighborhood restaurants or rate your university professors than to compare how financial agents are aligned with their interests.

Bear in mind that I'm not even talking here about other inherited, horse-and-buggy aspects of the market that also impede prudent ownership. Law, for instance, falls well short on fiduciary duty: it is still legally ok for a fund to assert that climate change is unrelated to value. Regulation is out of date. In the US, the Department of Labor, which oversees pension funds, is notoriously poor at enforcement, and the SEC is tied in political knots. To give one quick example, it's been *two years now* and the Commission has still not named an Investor Advocate, as called for in Dodd-Frank. And "investor advocacy" is the SEC's core mission! Neither the DOL nor the SEC is configured to look after the retirement savings vehicles of today. Moreover, the proxy plumbing we rely on—which CCGG well knows was designed in an era when the vote was mostly for show—is nobody's idea of a system that is clear, coherent, fair and efficient. Just look at the controversy we just saw at JPMorgan Chase, where Broadridge was caught in a battle between the firm and regulators about how much information to disclose to investors about proxy votes as they came in.

Put this all together and we come to a sobering conclusion. The dawn of consequential institutional ownership has put intense strain on the antiquated infrastructure that now defines investor capacity. The package of plumbing, leadership, skills, strategies and resources investors need to activate constructive stewardship is very different from the package suited for waging skirmishes at the periphery of corporate influence. Funds in this room have adapted to meaningful ownership despite those obstacles. But among many other mainstream funds, adaptation is coming only slowly, or not at all. On the other hand, savvy and nimble hedge

funds and other investors have quickly seized the new opportunities for influence as a route to value—and, by the way, they seem to be making good money at it. **But let's be blunt: by operating with a market infrastructure that in many ways is obsolete, we are tolerating an unsafe and underpowered capitalism compared to what we should have.**

So—is the Big Bet misplaced? That's the debate today. Shareowner empowerment has triggered a powerful reaction. Some prominent advisors to corporations have argued for an urgent restoration of director primacy, a rollback of investor authority and, in particular, in what I consider a largely 'shoot-the-messenger' chorus, sharp new curbs on proxy voting firms. **These critics contend that expanding shareowner rights has become an experiment gone very badly wrong, since it has placed boards at the mercy of too many institutions that either agitate for short term results or who, lacking internal ownership capacity, roboticaly follow one-size-fits-all advice of proxy advisors.**

My view is different. Criticism of institutional investors may of course have merit, for reasons I have noted. But retracting hard-won rights and re-elevating agents is not the only option. I would suggest another agenda, one founded on the bedrock of free enterprise. **We have to make ownership meaningful. We've spent years on reform of governance of public corporations. Now we need to turn those energies to mobilizing prudent ownership among institutional investors.** If we don't, I believe, investors risk losing the battle over their 'license to operate' and policymakers will increasingly curb, rather than enhance, the shareowners' role in the marketplace.

A full agenda to catalyze prudent ownership would surely have to include an update of laws on fiduciary duty, as Ed Waitzer and others have urged and as the UK's Law Commission is now

exploring. It would involve modernizing regulation. And it would require revisiting whether the way we structure retirement savings itself is right. Good research suggests that defined contribution plans, as now framed, leak *way* too much money from savers to agents while weakening ownership behavior. Those are each big issues requiring what I'd call "an owner's manual" for capitalism, a book I'm co-writing with Jon Lukomnik and David Pitt-Watson. But these solutions also rely on a whole lot of actors outside the market. Today I would like to offer a challenge for an achievable, Do-It-Yourself remedy investors can apply with no politicians necessary.

It is time for stewardship principles for North America. I don't mean a copycat of stewardship codes in Britain, South Africa and elsewhere. These are welcome, breakthrough documents. But they almost entirely address the role of investors as owners. We need to be more ambitious if we are truly to affirm investors' license to operate as asset owners—to assure policymakers and stakeholders that the Big Bet is still worth taking. **Stewardship principles in North America must address the *accountability* of funds *as well as* their behavior as holders of assets.** Institutions must be able to convince skeptics that they are not just *built to last*, but *built to align*—with the interests of those who provide them capital.

The payoff, if we get this right, is threefold. (1) We could gain policy goodwill to stave off pressure to roll back shareowner rights. (2) We could get investors sending more constructive signals to public corporate boards. And (3), as Keith Ambachtsheer has shown in research, better-governed funds tend to generate and safeguard more wealth for citizen-savers. Stewardship Principles alone would be no panacea; but they would set a higher bar of expectations among owners.

Let me offer some reassurance. We don't need to conjure

principles from whole cloth. In fact, a state-of-the-art global template will be ready for market prime time in just a few days. The updated International Corporate Governance Network (ICGN) *Statement of Principles for Institutional Investor Responsibilities* is due for a vote in New York a week from tomorrow. It includes 6 principles on internal governance and 6 on institutions' external role as investors. That's a good balance. Carol Hansell is an ICGN board governor so she can give you all the information you need on that. Another model—an "EU Capital Stewardship Pact"—is being developed by a multi-stakeholder group for launch in Brussels this October. And Australia's prudential regulator has released in recent months a series of internal governance standards for funds. These texts can serve as a baseline resource.

What might North American Stewardship Principles include? I would make 4 proposals, all based on the types of disclosures we now ask of corporations. For context, think of 1994 guidelines in Peter Dey's seminal *Where Were the Directors?* report. You can call this counterpart "Where Were the Investors?".

First, principles could urge institutions to disclose their own accountability features, in plain language. How do governance arrangements ensure alignment with the interests of beneficiaries? Who serves as fiduciaries, what are their skill sets, and how can beneficiaries contact them? How are regular independent assessments of internal governance used? What two-way communications link the institution to beneficiaries? (Ontario Teachers under Claude Lamoureux pioneered this in Canada). How are conflicts of interest and ethics guidelines policed?

Second, North American Stewardship Principles could urge institutions to explain how pay for portfolio managers aligns with beneficiaries' interests. If a fund says it acts long-term while advisors and portfolio managers are evaluated and compensated

for the short-term, it should explain why.

Third, principles could ask institutions to disclose how they deploy ownership tools to protect assets. I'm not just talking here about the narrow-gauge measure of how asset managers vote shares, but by how or whether they integrate ESG risk into asset allocation, use engagement, or act collectively with other investors. Does the job description for the institution's CEO or CIO include skills in ownership? Is governance monitoring treated as a compliance function or part of portfolio management? What ownership resources exist in-house? If ownership responsibilities are outsourced, how are policies set and agents regularly monitored?

Finally, principles could ask institutions to disclose that they abide by a fiduciary standard that balances the real timelines of beneficiaries. For many, this would mean exchanging a blanket obligation to always pursue immediate value for a "duty of impartiality"—that is, the need to combine patient capital for younger savers with the obligation to make short-term payouts to retirees. Equally, fiduciary guidelines should permit institutions to consider extra-financial risks such as ESG factors in investment decision-making.

These four measures would make it possible for citizens who provide capital to more easily compare—even through a smartphone app—the quality and alignment of their savings arrangements. Such best-practice guidance could also catalyze institutions to pay more robust attention both to internal accountability and to the use of ownership in search of value. And at the end of the day such principles would take us further along that path CCGG is paving to define how ownership can work for the age of the institutional investor.

What steps then do we need to move North American

Stewardship Principles forward? Mainly, we need a core group of champions to begin. Some work along these lines, for the US, got underway a year ago under the auspices of the Millstein Center, then at the Yale School of Management. Catherine Jackson and PGGM were and are key players in that. Participants saw a benefit to wrapping stewardship guidance into an overall corporate governance code for companies. But frankly, doing that involves a parade of players, much resistance and lots of time. It may be practical to get going now on the investor piece. **Some 404 years after Isaac LeMaire invented shareowner engagement, now is the moment for a DIY effort to unlock the full value potential of ownership by institutions.** Let's apply the extraordinary progress CCGG has achieved in the world of the public corporation to the world of institutional investors. Let's get started.

Thank you for your kind attention.