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2017 Institutional Investor Survey

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Editor's note: John C. Wilcox is Chairman of Morrow Sodali. This post is based on a Morrow Sodali publication by Mr. Wilcox.

There is an increased emphasis being placed on Environmental, Social and Governance (ESG) considerations by the investment community. ESG considerations' shift into the mainstream is being propelled by regulatory changes and the proliferation of data substantiating that ESG integration can help increase risk-adjusted investment returns. Despite the current political uncertainty around the world, it appears that investors are determined to continue their push for progressive governance changes through increased engagement with individual companies. Asset owners are also continuing to demand from their asset managers whether they are executing responsibilities in line with the owners' investment objectives. Consequently, large institutional investors and pension funds are pushing for more aligned approaches to corporate governance across borders to support long-term value creation.

Ira Millstein announced to the world many years ago, that "corporate governance is not rocket science." Even with today's challenges, most companies are well equipped to deal with shareholder and governance concerns. Drawing on the resources and skills they have developed in public relations, market research, customer satisfaction and investor relations, companies can conduct effective outreach programs and manage the expectations of their shareholders. A change of attitude may be necessary for some companies to understand that it is in their interest to treat shareholders as a sounding board rather than as opponents. CEOs must be tasked with providing leadership and for setting the tone at the top. Boards should articulate a convincing strategic rationale for their governance decisions and most importantly, company management must initiate communication and engage with shareholders on governance matters, rather than waiting for activists to put them on the defensive.

Corporate boards are required to demonstrate that they are improving the integration of governance frameworks within their business strategy, sustainable economic performance and long-term value creation. The good news for companies is that shareholders give more attention to customized governance arrangements. Companies should emphasize the "one size fits all" approach is ineffective, does not benefit the company or shareholders however, the board must show willingness to articulate performance measures and business goals with sufficient detail and specificity. To do so, board members themselves should work harder to understand the business fundamentals of the companies they oversee and to articulate the strategic rationale for their governance policies and decisions.

The corporate governance landscape is rapidly changing and companies and investors must do more to improve trust in business and promote strong global economies. The proliferation of

stewardship codes is a positive movement which heightens the pace of change for boards with an increase in demand for continuous improvement and transparency in 2017. Our annual survey focused on the core themes of governance to ensure that the investor insights are applicable to listed companies around the world. The results highlight some important takeaways on issues such as ESG Factors and Shareholder Engagement, Board Dynamics, Executive Pay and Shareholder Activism.

We very much appreciate the input of those investors who participated in our 2017 Institutional Investor Survey.

Methodology and Key Findings

The survey was conducted over a two-month period through an online questionnaire from December 2016 to January

2017. Responses were received from a diverse mix of investors representing $24 trillion Assets Under Management (AUM) with 78% being asset managers and the remaining 22% being asset owners/pension funds. As for the geographic breakdown—50% UK; 28% US; 18% Europe ex-UK; and 4% Asia.

As we continue to experience a greater convergence of global corporate governance practices, Morrow Sodali focused on four key broad themes that are globally applicable: (1) ESG and Shareholder Engagement; (2) Board Dynamics; (3) Executive Pay; and (4) Shareholder Activism.

Below are some of the key findings from the survey:

1. All survey participants (representing $24 trillion AUM) confirmed that they will communicate with activists. Although investors will evaluate each case individually, they are now more willing to lend an ear to activists' arguments. Close to 60 percent of respondents (representing $11 trillion AUM) said that they will listen to the activist only if approached with the remaining 40 percent suggesting that they will not only listen to activists reaching out to them but will also be willing to reach out to them if not contacted.
2. Poor financial performance is the key driver for traditional investor support for activist campaigns. We focused our survey to identify what other contributing factors lead traditional investors to support activist proposals. To this end, 60 percent of respondents (representing $10 trillion AUM) viewed poor governance practices as the most important contributing factor in leading them to support activist claims/proposals. This was followed by companies not acting on previous shareholder dissent. Both of these factors suggest that it is important for companies to continuously review their governance practices and disclosures as well as identify key areas for improvements through effective communication and dialogue.
3. Pay-for-performance will continue to be a perennial topic of conversation, as suggested by investors representing $10 trillion AUM, followed by board diversity and board refreshment tying in third place. A new key engagement driver in 2017 appears to be Climate Change, which topped the list with half of the respondents (representing $7 trillion AUM). This result is not surprising considering the Paris Climate deal and the aggressive targets that investors have set to reduce their portfolios' carbon footprint.

4. All investors participating in the survey confirmed that they will vote against the compensation/remuneration committee chairs or members in the case of chronic poor pay practices in 2017. This was one of only two survey questions where all investors agreed, reiterating that investors will pay more and more attention to how compensation committee members discharge their responsibilities in 2017.
5. Investors representing $19 trillion AUM, or close to three-quarters of the respondents, viewed board members as their preferred counterpart when engaging with companies, followed by senior executives. To cater to this demand from investors, boards should seek assistance from their Investor Relations teams. In addition to market data and investor relations reports, the board should receive regular briefings on investors' engagement profiles and ESG policies.
6. The disclosure of the "Board Skills Matrix" was viewed as a key disclosure item by investors representing $18 trillion AUM when voting on director elections. The board skills matrix is not only useful for investors to determine whether the board comprises the necessary skills and expertise to deliver long-term value, but it is also useful for companies when looking for a new board member. Whilst the topic of diversity initially started with a focus on gender, the discussion has now evolved to an overarching belief that there should be a diversity of skills and thought.
7. The annual board evaluation has rapidly evolved beyond a mere compliance exercise and companies are increasingly warming to the idea of carrying out an external evaluation. Investors representing $19 trillion AUM viewed the disclosure of findings and recommendations of the evaluation exercise to be more important than the process used or the identity of the external provider undertaking the exercise.
8. Nearly three-quarters of respondents (representing $14 trillion AUM) view the disclosure on ESG factors to be very important. Most notably, however, is that only 2 percent of respondents viewed the disclosure of ESG information as not at all important. The results suggest that companies need to pay attention to the disclosure of their ESG performance on factors that are the most material within the industry they operate in as well as how effectively ESG risk factors are managed.

The complete publication is available here.