INVESTOR STEWARDSHIP IN THE UNITED STATES

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By Mike McCauley

Mike McCauley reports on a significant new initiative that aims to provide a framework for governance and stewardship in the U.S.

The Investor Stewardship Group (ISG) is a collective of some of the largest institutional investors and global asset managers with a goal of establishing a core set of governance and stewardship principles for companies and investors.

At its launch, the sixteen founding members composed of U.S. and international institutional investors with large investments in the U.S. equity market was led by each member's senior corporate governance practitioners. Since its inception in late January 2017, membership in the ISG has grown significantly, with signatory assets increasing to over US $20 trillion in the first 3 months alone. Many stakeholders view the ISG as an unprecedented event and one that could be a turning point in the evolution of U.S. governance practice.

The ISG, as a private initiative wholly independent of any regulatory body, was formed to unite disparate investors to establish a framework of fundamental standards of investment stewardship and corporate governance for U.S. institutional investor and boardroom conduct. Its 'Framework for U.S. Stewardship and Governance' comprises both a set of six stewardship principles for institutional investors as well as six corporate governance principles for U.S. listed companies.

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The corporate governance principles are not intended to be overly prescriptive or all-encompassing in their scope, allowing flexibility in their application. The Framework borrows from other governance codes outside the U.S., which are typically structured on a "comply-or-explain" basis, thereby avoiding concerns over strict compliance and "one-size-fits-all" criticism. The Framework also serves to improvement alignment of U.S. corporate governance practices with those in other global markets. The ISG strongly encourages shareowner's elected representatives—company directors—to apply the corporate governance principles at the companies on whose boards they serve.

Although members of the ISG are supportive of the corporate governance principles, individual members of the group may and often do differ on specific standards regarding corporate governance practices that are expected of companies. The ISG members will evaluate companies' alignment with these principles, as well as any disclosure of alternative approaches that boards view being in the company's best interests.

Corporate Governance Framework for U.S. Listed Companies

Principle 1: Boards are accountable to shareholders.

Principle 2: Shareholders should be entitled to voting rights in proportion to their economic interest.

Principle 3: Boards should be responsive to shareholders and be proactive in order to understand their perspectives.

Principle 4: Boards should have a strong, independent leadership structure.

Principle 5: Boards should adopt structures and practices that enhance their effectiveness.

Principle 6: Boards should develop management incentive structures that are aligned with the long-term strategy of the company.

The ISG Corporate Governance Principles espouse the adoption of annual director elections, boards comprised of a majority of independent directors, majority voting standards used for uncontested board elections, equal voting capitalization with a one-share, one-vote structure, and clear explanations why the board has chosen to adopt or maintain a variety of anti-takeover devices.

The Framework also takes the view that directors need to make the substantial time commitment required to fulfill their responsibilities and duties to the company and its shareowners—when considering the nomination of both new and incumbent directors, nominating committees should assess a candidate's ability to dedicate sufficient time to the company in the context of their relevant outside commitments.

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In addition to the governance principles, the Stewardship Framework seeks to articulate a set of fundamental stewardship responsibilities for institutional investors. Listed companies should recognize that some of their largest investors now stand together behind these principles.

As guidance, the rationales and expectations that underpin each principle have been articulated. For example, for Stewardship Principle B-1 states, "Good corporate governance is essential to long-term value creation and risk mitigation by companies. Therefore, institutional investors should adopt and disclose guidelines and practices that help them oversee the corporate governance practices of their investment portfolio companies. These should include a description of their philosophy on including corporate governance factors in the investment process, as well as their proxy voting and engagement guidelines."

The ISG encourages institutional investors to be transparent in their proxy voting and engagement guidelines and to align them with the stewardship principles. These principles should not restrict investors from choosing to adopt more explicit and/or stronger stewardship practices.

It is important to emphasise that the Framework for U.S. Stewardship and Governance is not intended to replace or supersede any existing federal or state law and regulation, or any listing rules that apply to a company or an institutional investor. The Framework is also not intended to be static and will be evaluated and revised periodically, with input and consensus from its members, as expectations of corporate governance and investment stewardship continue to evolve in the U.S.

Stewardship Framework for Institutional Investors

Principle A:	Institutional investors are accountable to those whose money they invest.
Principle B:	Institutional investors should demonstrate how they evaluate corporate governance factors with respect to the companies in which they invest.
Principle C:	Institutional investors should disclose, in general terms, how they manage potential conflicts of interest that may arise in their proxy voting and engagement activities.
Principle D:	Institutional investors are responsible for proxy voting decisions and should monitor the relevant activities and policies of third parties that advise them on those decisions.
Principle E:	Institutional investors should address and attempt to resolve differences with companies in a constructive and pragmatic manner.
Principle F:	Institutional investors should work together, where appropriate, to encourage the adoption and implementation of the Corporate Governance and Stewardship principles.

The Framework advocates constructive dialogue and engagement, practices which have been a work in progress for both investors and issuers at times. The members believe that the ISG Framework is likely to foster a collaborative reconciliation between a company's strategy and its governance protocol.

The ISG Framework goes into effect January 1, 2018, deliberately timed to allow U.S. firms to review and adjust to ISG standards in advance of the 2018 proxy season. It is likely to have a major impact on how U.S. companies govern themselves, and also improve how asset managers and owners conduct their fiduciary activities on behalf of clients.

For information on becoming an ISG signatory and to view the Framework, please go to the ISG website at: ***www.isgframework.com***