

Major Institutional Investors Adopt Corporate Governance Framework

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A group of major investors has endorsed a corporate governance framework to go into effect on January 1, 2018. The Investor Stewardship Group (ISG) currently comprises BlackRock, CalSTRS, Florida State Board of Administration (SBA), GIC Private Limited (Singapore's Sovereign Wealth Fund), Legal and General Investment Management, MFS Investment Management, MN Netherlands, PGGM, Royal Bank of Canada (Asset Management), State Street Global Advisors, TIAA Investments, T. Rowe Price Associates, Inc., ValueAct Capital, Vanguard, Washington State Investment Board, and Wellington Management.

The ISG was formed to enable investors who sign on to “speak with one voice,” resulting in a framework consisting of a set of six corporate governance principles and six stewardship principles for institutional investors. They note that ISG is the only investor-led effort in the world to develop a structure for both corporate governance and investment stewardship for a specific market. While ISG indicates that the corporate governance framework is not intended to be prescriptive, all founding members, which include at least one or more of the major investors of most companies, are encouraging boards to voluntarily adopt the corporate governance practices. The [corporate governance principles](#) take key positions on certain board practices, including that:

Boards are accountable to shareholders.

- Directors' performance is evaluated through the company's overall long-term performance, financial and otherwise.
- Requiring directors to stand for election annually helps increase their accountability to shareholders.
- Directors who fail to receive a majority of the votes cast in an uncontested election should tender their resignation. The board should accept the resignation or provide a timely, robust, written rationale for not accepting the resignation.
- Companies should adopt proxy access.
- Boards should explain to shareholders why the anti-takeover measures they adopted are in the best long-term interest of the company.
- Directors should encourage companies to disclose sufficient information about their corporate governance and board practices.

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

- Companies should adopt a one-share, one-vote standard.
- Boards of companies that already have dual or multiple class share structures should review these structures on a regular basis or as company circumstances change, and establish mechanisms to end or phase out controlling structures at the appropriate time, while minimizing costs to shareholders.

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

- Boards should implement shareholder proposals that receive “significant” support, or explain their actions.
- Boards should understand the reasons for and respond to significant shareholder opposition to management proposals.

- Appropriate independent directors should be available to engage in dialogue with shareholders.
- Shareholders expect responsive boards to work for their benefit and in the best interest of the company. It is reasonable for shareholders to oppose the re-election of directors when they have persistently failed to respond to feedback from their shareholders.

Boards should have a strong, independent leadership structure.

- Independent leadership of the board is essential to good governance and is necessary to oversee a company's strategy, assess management's performance, ensure board and board committee effectiveness and provide a voice independent from management that is accountable directly to investors and other stakeholders.
- Some investor signatories believe that independent board leadership requires an independent chairperson, while others believe that a credible independent lead director also achieves this objective.
- The role of the independent board leader should be clearly defined and sufficiently robust to ensure effective and constructive leadership.
- For companies with an executive chair, the responsibilities of the independent board leader and the executive chair should be agreed upon by the board, clearly established in writing and disclosed to shareholders. Further, boards should periodically review the structure and explain how the division of responsibilities between the two roles is intended to maintain the integrity of the oversight function of the board.

Boards should adopt structures and practices that enhance their effectiveness.

- Boards should be composed of directors having a mix of direct industry expertise and experience and skills relevant to the company's current and future strategy. Boards embody and encourage diversity, including diversity of thought and background.
- A majority of directors on the board should be independent.
- Boards should establish committees to which they delegate certain tasks to fulfill their oversight responsibilities.
- Directors need to make the substantial time commitment required to fulfill their responsibilities and duties to the company and its shareholders. The nominating committee should assess directors' ability to dedicate sufficient time to the company in the context of his or her relevant outside commitments.
- Attending board and committee meetings is a prerequisite for a director; attendance is integral to a director's oversight responsibilities. Directors should aim to attend all board meetings, including the annual meeting, and poor attendance should be explained to shareholders.
- Boards should ensure that individual directors can obtain information regarding any aspect of the business or activities undertaken or proposed by management. Directors should seek access to information from a variety of sources relevant to their role as a director (including, for example, outside auditors and mid-level management) and not rely solely on information provided to them by executive management.
- Boards should disclose mechanisms to ensure that there is appropriate board refreshment, including a regular and robust evaluation process, as well as an evaluation of policies relating to term limits and/or retirement ages.

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

- The board or its compensation committee should identify short and long-term performance goals that underpin the company's long-term strategy and incorporate them into the management incentive plans and serve as significant drivers of incentive awards.
- A change in the company's long-term strategy should necessitate a re-evaluation of management incentive structures in order to determine whether they continue to incentivize management to achieve the goals of the new strategy.

The six stewardship framework for institutional investors include:

- Institutional investors are accountable to those whose money they invest.
- Institutional investors should demonstrate how they evaluate corporate governance factors with respect to the companies in which they invest.
- Institutional investors should disclose, in general terms, how they manage potential conflicts of interest that may arise in their proxy voting and engagement activities.

- 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.
- Institutional investors should address and attempt to resolve differences with companies in a constructive and pragmatic manner.
- Institutional investors should work together, where appropriate, to encourage the adoption and implementation of the Corporate Governance and Stewardship principles.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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