Council of Institutional Investors
The Voice of Corporate Governance

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CII INVESTOR-COMPANY ROUNDTABLE

Effective Engagement

Introduction

Today, companies and their shareholders hold dialogues on a wide range of issues. Structured appropriately, engagement provides nuance, context and rationale in ways that cannot be conveyed through up or down proxy votes. In the past, large-cap companies generally met only with their biggest shareholders and only in extraordinary circumstances. Now, engagement occurs among market participants of all sizes in circumstances ranging from exceptional to routine.

To explore how market participants can get the most out of engagement, the Council of Institutional Investors (CII) on July 21, 2015, convened a roundtable of CII member representatives from institutional investors and public companies. The discussion focused on determining the most effective engagement practices for both types of representatives. Charles Elson, director of the University of Delaware's John L. Weinberg Center for Corporate Governance, moderated the roundtable, which was governed by Chatham House rules to promote candid discussion.

Participants agreed that company and shareholder views on engagement have evolved over the past several years. Most on both sides believed that dialogue is appropriate and useful. What is most needed now is agreement on ways to make engagement truly effective.

Ground Rules

Roundtable participants agreed that setting advance ground rules on who can attend, what topics are open for discussion and which discussion format will be used is helpful. To that end, some participants suggested outlining terms of engagement through a written policy or ad hoc agreement to provide a framework for dialogue and keep the discussion on track. The Shareholder-Director Exchange Protocol http://www.sdxprotocol.com/ is a good starting point for this they said. All agreed, however, that modifications could be made to any protocols or templates to allow for discussion of particular concerns. Participants stressed that no matter what engagement rules are set, federal regulations dictate that all material information must be disclosed to all investors at the same time. Engagement cannot violate Regulation FD.

Timing

Both companies and shareholders viewed engagement as a year-round exercise. They agreed that periodic engagement outside of the proxy season yields stronger long-term relationships and better outcomes. The extended timeframe also allows broader, long-term issues to be discussed, instead of just immediate concerns related to proxy votes.

Several participants stressed the importance of engaging months before a company's proxy statement is published. This allows time for board review, and, when warranted, adjustments to the proxy materials.

Perspectives on where shareholder proposals fit into the engagement process diverged. Some of the corporate participants said a shareholder proposal signifies a breakdown in the engagement process. By contrast, some of the investor participants said proposals are a valuable step in the process of coming to an agreement on an issue.

Some of the shareholder participants expressed concern about the volume of engagement requests they are receiving from companies. This is sometimes the result of companies adding quantitative measures to show investors they have robust engagement programs. Some participants said these measures can lead companies to focus on quantity over quality in engagement activities.

Both corporate and shareholder participants expressed concern about the pressure to engage. They said turning down an engagement invitation should not be viewed negatively, just as shareholders voting with management when warranted should not be considered a failure in stewardship.

Whom to Engage

Outreach on engagement is stretching wider and deeper, with companies extending invitations beyond their top holders and shareholders seeking contact with companies farther down in their portfolios. Companies that once only engaged with a handful of top shareholders now reach out for dialogue with their top 50 holders and some “strategically important” shareholders known for their activism. Shareholders are finding that they can have a greater impact on the governance practices at smaller companies that may not have adopted some of the basic reforms that larger companies already have implemented.

On the shareholder side of the dialogue, several participants said discussions should include both corporate governance/proxy voting staff and investment staff, such as portfolio managers. Shareholder participants were split on the value of having corporate directors involved. Some said they prefer to talk with companies’ managers about operational matters because managers are more likely to understand the finer points of an issue and are in a better position to implement changes. Others said meetings involving directors were more productive than those without board members. They also said companies should avoid surprise appearances by key figures such as the board chair or CEO. They said they prepare their remarks based on the audience expected and surprise appearances can be off putting.

Corporate participants said shareholders rarely ask to engage with directors. One corporate participant, who is an advocate of director involvement, said when board members participate they glean valuable information from the discussions and have an opportunity to hear perspectives that are different from management’s. Another corporate representative said that while managers on the financial side of the company rarely participated in engagements in the past, this is changing as the lines separating governance and finances are blurring.

One company representative explained that his company had established a steering committee comprised of senior executives who often participate in engagements. The committee, which regularly reports to the board’s governance committee, has a support staff that helps keeps track of emerging investor priorities.

Engagement Topics

All participants agreed that engagement topics should not be limited just to matters that are up for a vote on the proxy card. One corporate participant said his company’s top 10 shareholders use engagement as a way to gauge risk. At least one shareholder said discussions should be more tightly focused on governance issues that are material and relevant to how a company creates and protects value.

A great deal of discussion centered around engagement on strategy. Shareholders said understanding a company’s long-term strategy is critical to understanding how executive pay is tied to performance and how different governance mechanisms help achieve strategic goals. The corporate participants agreed

that strategy is a key component of any compensation discussion. Overall, all participants agreed that any topics related to explaining long-term corporate strategy should be open for discussion.

Preparation Matters

All participants agreed that while engagement during the proxy season often focuses on proxy voting matters and does not warrant a formal agenda or participant list, in all situations, both sides of the discussion must come to the table with a clear idea of the concerns or priorities that prompted the meeting.

Several participants agreed that the quality of a discussion improves when meetings are preceded by mutually agreed upon agendas and participant lists. This also helps ensure that the experts on the subject matter to be discussed attend the meeting. Both shareholder and corporate participants stressed the importance of having both an agenda and participant list any time board members and/or top executives are involved.

Company representatives noted the usefulness of entering a meeting knowing the investor's current, as well as past, equity positions. They said this helps them discern the extent of an investor's focus on long-term performance.

Both shareholder and corporate representatives agreed that companies should familiarize themselves with investors' proxy voting guidelines prior to any meetings. This provides insight into the investor's positions on the topics to be discussed and conveys the company's regard for its shareholders.

While all roundtable participants attested to the benefits of good preparation, they were skeptical about the value of requiring engagement participants to complete formal surveys before meetings.

Preparation can set the tone of the discussion. Some participants advised both parties to come to meetings, not with a list of demands, but with a roster of questions that make it clear where their priorities lie. They also recommended that both sides of the table be given equal time to speak, and expressed wariness about a "one-way push" masquerading as a two-way dialogue.

Roundtable Participants
Donna Anderson, T. Rowe Price
Chris Butner, Chevron
Dave Donlin, Target
JJ Fueser, Unite Here
Margaret Madden, Pfizer
Zach Oleksiuk, BlackRock
Mark Preisinger, Coca-Cola
TerriJo Saarela, State of Wisconsin Investment Board
Jacob Williams, Florida State Board of Administration

Facilitator
Charles Elson, John L. Weinberg Center for Corporate Governance at the University of Delaware

Observers
Amy Borrus, CII
Glenn Davis, CII
Rosemary Lally, CII
Gregory Toye, University of Delaware