AN INVESTOR'S PERSPECTIVE ON CORPORATE GOVERNANCE

Presentation for the symposium:
Corporate governance developments in Greece and the European Union and the role of investors – 11 October 2018 – Athens

Richard Schreuder, CFA
Member CFA Institute Corporate Disclosure Policy Committee
Senior Portfolio Manager at Saemor Capital

Disclaimer: this presentation does not constitute investment advice. This presentation does not reflect opinions of organisations Richard Schreuder is affiliated with.

Content

- Definitions of corporate governance
- A condensed historical perspective
- Insights from pioneers in security analysis and investing
- Essential corporate governance standards
- Intermezzo
- Concluding remarks

Definitions of corporate governance

- *"The system by which companies are directed and controlled. More specifically it is the framework by which the various stakeholder interests are balanced."* – Cadbury Report, 1992
- *"The relationships among the management, board of directors, controlling shareholders, minority shareholders and other stakeholders."* - IFC
- *"Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined."* - OECD.

A condensed historical perspective

- Corporate scandals and contested takeovers in 1980s-2005 were a catalyst for new laws and codes addressing corporate governance.
- These codes and laws focused on board independence, audit quality, shareholders' rights and risk containment ('narrow' definition of governance). Strengthened monitoring by the board.

Cadbury report (1992):

- Separation of chief executive (CEO) and chair of the board.
- Boards should have at least three non-executive directors (NED), two of whom should be wholly independent.
- Board audit committees made up of NEDs.

Sarbanes-Oxley (2002):

- CEO certification of financial statements.
- Improved audit and audit committee regulation.
- Corporate loans to executives are prohibited.

Dodd-Frank (2010), Subtitle G

A condensed historical perspective

- Environmental, Social and Governance (ESG) investing is currently asserting itself. ‘End investors’ (e.g. pension funds) are propelling the asset management industry in that direction.
- Coincides or follows concerns within society about income inequality, job security, the environment, suppliers (e.g. in food and clothing industries), etc.
- Environmental and Social issues, to a degree, make their way onto the board agenda and become intertwined with Governance. Some new disclosures will be encouraged or even required.

The scope of corporate governance is becoming broader:
- wider range of topics that should be addressed;
- bigger variety of stakeholders than management and shareholders.

Insights from pioneers in security analysis and investing

"Ever since 1934 we have argued in our writings for a more intelligent and <u>energetic attitude by shareholders</u> toward their managements. We have asked them to take a generous attitude toward those who are demonstrably doing a good job. We have asked them also to demand clear and satisfying explanations when the results appear to be worse than they should be, and to <u>support movements to improve</u> or remove clearly unproductive managements."
- Benjamin Graham

"What needs to be reported is data … that helps the financially literate readers answer three key questions: (1) Approximately how much is this company worth? (2) What is the likelihood it can meet its future obligations? and (3) How good a job are its managers doing, <u>given the hand the have been dealt</u>." – Warren Buffett

"Shareholders should demand of their managements either a normal <u>payout of earnings</u> …or else a clear-cut demonstration that the <u>reinvested profits</u> have produced a satisfactory increase in per-share earnings." – Benjamin Graham

Essential corporate governance standards

Separate chairman and CEO:

- Clear delineation of responsibilities.
- Ex-CEOs should not become chairman.
- Tenure limits.

Shareholder rights

- Equal voting rights; no restrictions
- Takeover defenses not at discretion of management.
- Pre-emptive rights to prevent dilution in capital raising.
- AGM and EGM: notice period, agendas; disclosure of voting results.

Board of directors:

- Majority of members should be independent.
- Disclosure of expertise and experience.
- Written selection procedures.
- Should meet regularly and predictably.
- Agendas, minutes, clear lines of reporting.
- Members should receive training.
- Tenure limits.
- Commitment to diversity.
- Should be ESG aware.

Essential corporate governance standards

Audit committee:

- Ideally non-executive board members only, with majority & chair non-exec as second-best option.
- Written terms of reference.
- Detailed review of financial statements prior to recommendation to board for approval.
- Audit plans and review of internal controls.
- Disclosure of audit fees.

Remuneration committee:

- Majority and chairman should be independent directors.

Remuneration:

- Aligned with shareholders.
- Long-term orientation.
- Remuneration policy should be set by board.
- Performance reviews by remuneration committee.
- Transparent and described in detail in annual report.
- Disclosure of variable pay, deferred pay, pensions and long-term incentives.
- Disclosure of bonus cap as percentage of salary.

Essential corporate governance standards

Strategic business plan, investment framework and acquisition strategy:

- Reviewed at AGM.
- Additional capital raising subject to shareholder approval.

Additional disclosures:

- MD&A should discuss relevant KPIs, competitive position and risks.
- Corporate & Social Responsibility report.
- Other ESG disclosures.

The corporate culture should foster good corporate governance.

- *"The principles on which the Code is based are those of openness, integrity and accountability. They go together."* – Cadbury Report.

Accountability eventually requires the willingness of shareholders to act as owners. (Benjamin Graham, Cadbury Report)

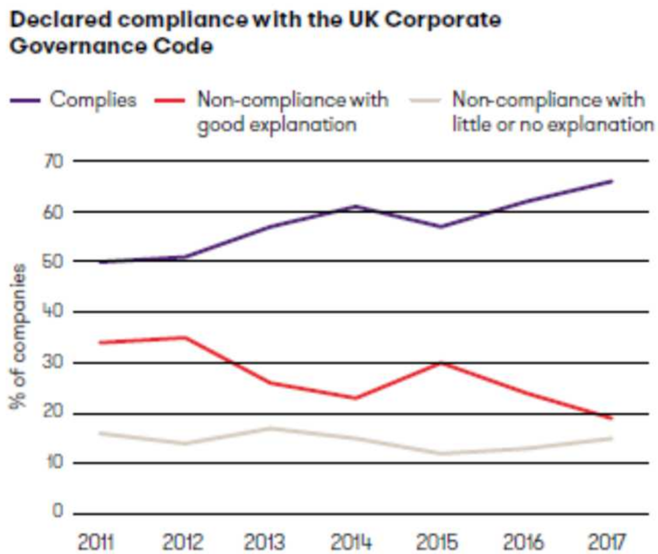
Intermezzo – Quantitative ESG Data Disclosure Rates

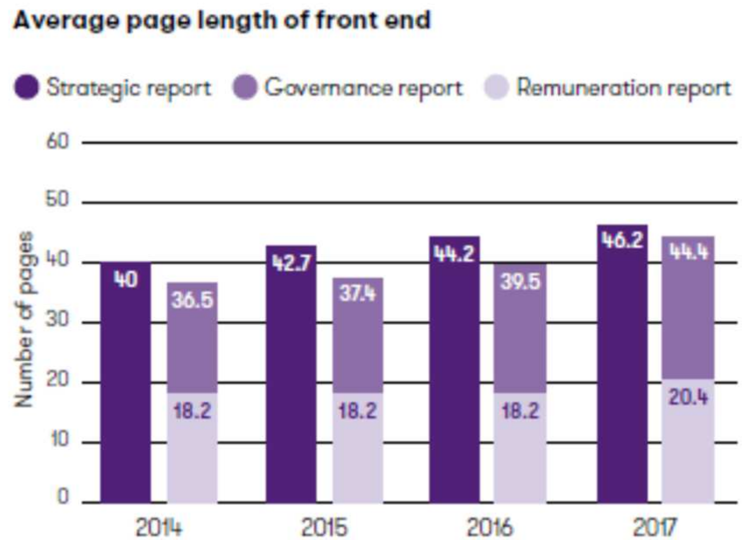
Global League ESG Disclosure: Average quantitative ESG data disclosure rate by country

Rank	Country	Average ESG Disclosure	Average Environmental Disclosure	Average Social Disclosure	Average Governance Disclosure	Companies Researched
1	Greece	69%	70%	75%	58%	5
2	Finland	67%	77%	68%	31%	13
3	Portugal	60%	60%	71%	22%	5
4	Spain	60%	63%	70%	25%	29
5	Italy	59%	62%	68%	29%	27

Source: *FTSE4Good 15 Year Anniversary Report* (2016). Based on corporate reports accessed between April 2015 and March 2016.
NB: table contains ESG disclosure rates, not EGS scores.

Intermezzo – UK 'comply or explain' and report length





Note: the remuneration report is part of the governance report

Source for both exhibits: *Grant Thornton Corporate Governance Review 2017.* This report looks at constituents of the FTSE 350 Index.

Concluding remarks

- Corporate governance requires active engagement by executive management, non-executive directors and shareholders.
- Formalised process that includes setting of goals, auditing, openness in communication and accountability.
- Key responsibilities should be separated.
- Environmental and Social topics have become part of the Governance agenda. Some investors will focus on traditional aspects of governance first.
- Revised EU Shareholder Rights Directive (SRDii).
- Proper governance benefits shareholders (end investors), management & board and most likely also employees and other stakeholders.