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Activists Have Sudden Outbreak Of Dialogue

By Stephen Davis and Jon Lukomnik, *Compliance Week Columnists* — February 13, 2007

Here's a surprise start to the 2007 proxy season: An unprecedented level of dialogue among the institutional investor and corporate communities has broken out.

No one can quite pinpoint the cause. Is it an unanticipated consequence of the globalization of capital markets, simply the beginning of another proxy season, or the beginning of a "grand bargain" wherein investors and corporations will allow investors more ability to affect corporate agendas in return for less regulation? Whatever the reason, signs of dialogue are everywhere.

Moreover, the goals appear audacious. By engaging and seeking consensus, the participants seek to shape market practice around the contentious issue of executive compensation. As might be expected, debates between shareholders and executives are vigorous, but they're also respectful. They're laser-focused on suggesting market-based solutions and best practices. And, right now, that focus is illuminating an idea imported from the British, Australian, and Dutch markets: "Say on pay," the ability of shareowners to have an advisory vote on executive compensation.

First, there are the investor-only groups. While such groups have long been a feature of the American corporate-governance landscape, the new wrinkle is the ad hoc and somewhat sudden appearance of a group of major investors coalescing around a single issue, and often with the participation of major foreign funds.

One coalition, coordinated by Walden Asset Management and the American Federation of State, County and Municipal Employees, has filed resolutions calling for advisory votes of confidence on executive compensation at 44 American companies. Joining such activist stalwarts as New York City's pension funds was Hermes, the leading European activist fund, located in the United Kingdom.

Perhaps more surprising, however, was the international group that wrote to Securities and Exchange Commission Chairman Christopher Cox. These 13 institutions were heavyweights, with some $1.5 trillion under management. They asked that the SEC establish a requirement for say on pay at all listed American companies "whether through direct regulatory action or stock exchange listing standards." Notably, the 13 institutions included only one U.S. entity, the State of Connecticut's retirement system. Other signatories came from all three countries that have advisory voting, and included mainstream asset managers (F&C and Morley) and large insurance companies (Standard Life and Co-Operative Insurance), as well as British, Dutch, and Australian pension funds. Most significantly, it also included a corporate-pension plan: Shell Pensions Management Ltd.

The second important manifestation of the new dialogue dynamic is the ad hoc groups designed specifically to cross the traditional investor-corporate divide. Remember the coalition that filed the 44 say-on-pay resolutions? The two key investors behind that effort, Walden and AFSCME, are likely to be joined by a band of leading corporations to plan a joint working group to examine the potential problems of implementing say-on-pay advisory votes in the United States.

Or consider the unlikely coalition now quietly recruiting a working group on executive compensation more generally. How unlikely? Well, it's led by the Business Roundtable—the target of vituperation from various shareowner activists in the past—and the United Brotherhood of Carpenters, the union that led the movement towards majority voting in corporate elections. That's an unusual pair of bedfellows, indeed.

Although the number and ambitions of such ad hoc groups are new, dialogue itself is not. Gary Lutin, an investment banker, has led the Shareholder Forum for seven years now, stemming from a talk at the New York Society of Security Analysts, where he realized how rarely various parts of the capital markets actually talked to each other. "Until recently, we picked one company as a case example," he says, citing both Amazon and CA as companies which served as subjects in the past for investors, analysts, and corporate officials to study together. "It became oriented to getting the different representative decision-makers in the room to find common interest, instead of traditional 'Whoever screams louder gets points for their agendas.' Now what we're trying to do is apply the same general thing, where we get all the relevant decision-maker perspectives in the room to discuss common shared objectives."

Those executive-compensation objectives began with a review of option policies, broadened to equity-based compensation in general, and now may focus on what facts investors actually need to analyze and judge compensation adequately. Notably, the forum has "10 or so companies representing a range of corporate perspectives," as well as investors, according to Lutin.

Keith Johnson of Reinhart Institutional Investor Services in Wisconsin is another veteran of collaboration and dialogue. Johnson, former general counsel to the State of Wisconsin Investment Board, serves as the convener of the International Roundtable on Executive Remuneration. It has no membership, no set meeting schedule, and doesn't make any decisions. Yet it still influences trillions of dollars. "If there are funds that want to get together to talk about things, if there are funds that want to convene it, and other funds which want to talk about it, they will get together," Johnson says.

The first roundtable, in September 2005, featured corporate directors and investors. "I think everyone found it more valuable than they anticipated. One of the ideas of the roundtable was to share information and perspective." Ideas from that roundtable and others have found their way into SEC comment letters, among other venues, Johnson says. The roundtable may have another meeting next month to discuss—you guessed it—say on pay, which is clearly emerging as the executive-compensation topic of the day.

What's a reader of Compliance Week to make of all this?

1. International investors increasingly affect the corporate-governance landscape in the United States. They have not only provided the idea for say on pay; they're now actively lobbying to bring the practice to American businesses.
2. Stay abreast of what the ad hoc groups are doing. Their moves are often leading indicators of tomorrow's agenda. Many, like the Shareholder Forum, host Web sites or put out press releases (see box at right for details).

3. Feel free to ask to crash the party, particularly for those groups seeking investor-corporation dialogue. These are, after all, ad hoc groups with fluid memberships. But be prepared to listen as well as talk. And realize that by volunteering to join the club, you've also agreed to live by the club rules. That said, ad hoc groups tend to jealously guard each participant's freedom to act independently; these are rules that rarely chafe.

What will you get in return? The opportunity to affect national corporate-governance policies that directly affect your company, while getting to know many of your institutional investors, including, more and more, your cross-border investors. That's a pretty good bargain.

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