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CLIENT MEMORANDUM

Group of CEOs Issues Principles of Corporate Governance for Public Companies

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On July 21, 2016, a group comprised of the chief executive officers of some of America's largest publicly owned corporations, as well as the chief executive officers of several major asset managers, an activist investor and a pension plan issued an open letter accompanied by a list of recommended corporate governance principles.[1] The group included Warren Buffett of Berkshire Hathaway, Jamie Dimon of JPMorgan Chase, Mary Barra of the General Motors Company, Jeff Immelt of General Electric, Lowell McAdam of Verizon Communications, and Larry Fink of BlackRock, among others. It has been reported that the chief executive officers of at least two major asset managers (Fidelity Investments and Wellington Management Company) dropped out of the group during the process of preparing the principles.

In presenting its set of recommended corporate governance principles, the group noted that good governance must be more than a catchphrase or fad and the belief that American public companies must take a long-term approach to the management and governance of their businesses. The principles set forth a number of recommendations and guidelines as to the roles and responsibilities of boards, companies and shareholders. The group issued the principles in the hope of, at a minimum, serving as a catalyst for thoughtful discussion on corporate governance.

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[1] The open letter and corporate governance principles can be found at www.governanceprinciples.org.

The series of principles addressed eight specific areas of corporate governance:

- Composition and Internal Governance of Boards of Directors
- Boards of Directors' Responsibilities
- Shareholder Rights
- Public Reporting
- Board Leadership
- Management Succession Planning
- Management Compensation
- Asset Managers' Role in Corporate Governance

The principles outlined in the nine-page report aim to provide a framework for sound, long-term-oriented governance of public companies. The authors noted, however, that due to the disparities among businesses of different sizes and in different industries, certain principles may be inapplicable to, or applied differently by, certain companies. Some of these principles are described below:

- While a subset of directors should have professional experiences related to the company's business, directors should possess diverse skills, backgrounds and experiences to cultivate a productive exchange of insights and ideas.
- Directors should be business savvy.
- Boards should be large enough to allow for the desired amount of diversity but small enough to promote open dialogue among directors.
- As directors need to commit substantial time and energy to their roles, the board should carefully consider a director's service on multiple boards and other commitments.
- As to the nomination of directors, long-term shareholders should recommend potential directors if they know the individuals well and believe they would be additive to the board.
- In order to align directors' interests with the long-term interests of the company, companies should consider paying a substantial portion (for some companies, up to as much as 50% or more) of director compensation in stock, performance stock units or similar equity-like instruments. Companies should also consider instituting a requirement that directors hold a significant portion of their equity for the duration of their tenure.
- Companies should conduct a thorough and robust orientation program for new directors, including background on the industry in which the company operates and its important legal and regulatory issues.

- Boards should consider rotating directors through board leadership roles to prevent stagnation and introduce fresh ideas while balancing the benefits of rotation against those of continuity, experience and expertise.
- Communication of the board's thinking to company shareholders is critical, though there are multiple ways to achieve this, including by designating certain directors to reach out to shareholders in coordination with management. Directors who communicate directly with shareholders ideally will be experienced in such matters. Directors should only speak with the media if authorized by the board.
- The CEO should actively engage on corporate governance with shareholders.
- A board should be continually educated on the company and its industry.
- The full board should have input into setting the board agenda.
- At each meeting, the board should meet in executive session without management present.
- Directors should have unobstructed access to management, including those working under the CEO.
- Many public companies have recently reviewed their proxy access procedures, with larger capitalization companies allowing shareholders (or a group of up to 20 shareholders) who have continuously held at least 3% of the company's outstanding shares for a period of at least three years to include nominees for a minimum of 20% of the company's board seats on the company's proxy statement. A higher ownership threshold (5%) has been adopted by many smaller capitalization companies (under $2 billion).
- Dual class voting is not a best practice. If a company does have dual class voting, which is often employed to protect the company from short-term behavior, the company should consider having specific "sunset" provisions, which eliminate dual class voting after a certain period of time or upon the occurrence of certain events.
- Companies should not feel obligated to provide earnings guidance and should consider whether providing earnings guidance will do more harm than good. Companies that do provide earnings guidance should avoid inflated projections, which can be harmful to the company in the long term.
- If the board's independent directors decide to combine the role of chair and CEO, it is crucial to have a strong lead independent director.
- Senior management bench strength can be evaluated by the board and shareholders through an assessment of key company employees; direct exposure to those employees should be provided to assist in that assessment.
- Companies should inform shareholders of the board's process for management succession planning.
- In the context of compensation, management benchmarks and performance measurements should be disclosed to allow shareholders to assess the rigor of the company's goals and the goal-setting process.

- In order to align management's interests with the long-term interests of the company, management compensation should have both current and long-term components. To the same end, companies should consider paying a substantial portion (for some companies, up to as much as 50% or more) of management compensation in stock, performance stock units or similar equity-like instruments.
- Companies should be explicit in their explanation of management compensation plans to shareholders.
- As significant owners of many public companies, asset managers should actively engage, as appropriate and based on the issues, with management and/or the board, both to convey the asset manager's point of view and to understand the company's perspective.

Given the involvement of a number of well-regarded CEOs in the drafting of the principles, we expect that they will receive serious attention from the business and hedge fund community.

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