



CORPORATE ACCOUNTABILITY

REPORT

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Board Communication

Companies Need to Revamp Communications To Better Suit Diverse Investor Constituencies

■ **Practice Tip:** *In light of the current institutional voting system, public companies need to make sure they have effective and distinct channels of communication with institutional investment decision makers and with voters.*

All public companies and members of the corporate governance community need to comprehend the diverse nature and needs of institutional shareholders in order to better communicate with these groups, corporate governance attorneys and a governance institute director told BNA in recent interviews.

It is important that companies realize that a vast majority of institutional investors have delegated voting decisions to a separate internal voting function, Charles Nathan, a partner with Latham & Watkins LLP in New York, told BNA May 5. "Some have even outsourced voting authority to third-party proxy advisory firms," he said.

While this is not a new topic, it is nonetheless an important issue to remind companies about, Nathan said. "There exists a lot of confusing rulemaking and literature that does not recognize the separate institutional investing and voting constituencies," he said.

Shareholder activism has become increasingly mainstream in recent years, Paul DeNicola, director of the Conference Board Governance Center and Directors' Institute, told BNA May 12.

"In the current proxy season, activist investors have been filing unprecedented numbers of shareholder proposals," DeNicola said. As a result, companies are increasingly concerned about understanding what their investor base is looking for, he said.

In structuring engagement with investors and proxy advisors, companies must be mindful of the restrictions

imposed by Securities and Exchange Commission's Regulation Fair Disclosure, Claudia Allen, of Neal, Gerber & Eisenberg in Chicago, told BNA in an April 28 e-mail.

"The SEC is expected to issue a concept release on proxy mechanics in the next few months, and one of the issues which the release may address (and solicit comments on) is the role of proxy advisory firms," Allen said.

Companies Still Struggle With Larger Investors. According to Nathan, many companies continue to struggle with recognizing that the two investing bodies do not in fact behave as a unified whole. "Regulators and corporate governance groups are also facing similar difficulties," he said.

"A lack of comprehension about the unique characteristics of institutional investors and voters among companies, regulators, and governance groups makes it difficult for parties to generate effective dialogue," Nathan said.

The first major step that companies need to take is in changing their mindsets about institutional sharehold-

Keys to Institutional Investor Communication.

Charles Nathan, a partner with Latham & Watkins LLP in New York, told BNA May 5 that companies should take the following actions to make sure they are communicating effectively with investment decision makers and voting managers:

- Refer to institutional investors or voters as separate constituencies for all purposes;
- Recognize that the two constituencies are interested in and respond uniquely to different issues; and
- Engage in separate, constructive dialogues with investor and voter constituencies.

ers, Nathan said. “We need to stop referring to institutional investors as a single entity for all purposes,” he said.

For example, regulators such as the SEC should be specific about which group they are referring to—investment decision makers or voting decision makers, Nathan said.

Also, public companies and their affiliates should more clearly distinguish the groups in everyday activities as well, Nathan said.

Split Dialogues With Investors and Voters Are Key. All companies also need to consider engaging in separate and effective dialogues with each institutional shareholder constituency, Nathan said.

“It is no longer sufficient for companies and regulators to communicate solely with investment decision makers,” Nathan said.

“Basically, this entails establishing individual yet parallel channels of communication and specialists to work with voting decision makers at institutional investment firms and their proxy advisers,” Nathan said.

According to Nathan, the corporate governance community needs to understand that it is not necessary to communicate with a company’s operating and financial management functions because voting decision makers are not involved with measuring those areas of a company.

In terms of engagement with investors, “some public companies seek to reach out to their largest shareholders before the proxy season to get a better sense of the executive compensation and other governance issues with which these investors may be concerned,” Allen said.

“This strategy recognizes the practical reality that institutional investors may have investments in hundreds or thousands of companies, and that during the proxy season, the individuals in charge of voting decisions are pressed for time,” Allen said.

Some Companies Opt to Meet With Investors. Also, according to Allen, reaching out before the proxy season gives a company a better opportunity for determining who at an institutional investor is responsible for voting decisions related to the company.

“Such contacts and dialogue can serve as an early warning system for a board, by allowing the board to get a better sense of what its shareholders are thinking,” Allen said.

Companies use a variety of formats for engaging with shareholders on governance issues, Allen said. One of the issues that is growing in popularity due to shareholder demands is whether members of the board should participate in meetings with large shareholders, and if so, which members of the board would be appropriate, she said.

Because RiskMetrics Group makes voting recommendations which are consulted or used by many insti-

tutional investors, some companies also seek to meet with RiskMetrics to establish a dialogue before the proxy season, Allen said.

In that regard, RiskMetrics has recommended that introductory and informational meetings should take place outside of proxy season, Allen said.

“A consistent criticism of RiskMetrics is that a number of its proxy voting guidelines do not take into account the specific situation of a company—instead using one-size-fits-all criteria,” Allen said. “Some critics question whether some of the governance practices advocated by RiskMetrics can be empirically shown to create long-term shareholder wealth,” she said.

Boom in Shareholder Activism Calls for Refocusing. Companies and their boards need to monitor trade activities, obtaining insights from large investors, and consistently conduct perception studies to better comprehend their shareholders, DeNicola said.

The Conference Board Governance Center April 8 issued a report containing a set of resources for board members and their advisers on engaging with and responding to shareholders. “We produced this report in response to Governance Center members’ requests for education and guidance on addressing shareholder activism,” DeNicola said.

“The report clearly emphasizes that companies must understand who their shareholders are,” DeNicola said.

Furthermore, board members should be receiving regular reports on key shareholder issues from company executives, DeNicola said. “Boards should be able to distinguish the different types of shareholders as well as what investor strategies are,” he said.

“This may involve compiling investor profiles, or learning about different fund structures and their investment tactics,” DeNicola said. “It is also important to establish and maintain a good relationship with other industry professionals in the corporate governance field. Enhancing disclosure on these communications is key as well,” he said.

After the company undergoes these initial steps, it should move on to assess the gaps and vulnerabilities left in its strategies, DeNicola said. It would be wise for a company to continue to assess its strategic goals and keep abreast of the newest governance standards, he said.

“Companies need to remain open-minded about change. They should try to understand the rationale of shareholder activist requests and meet with concerned investors when appropriate,” DeNicola said.

BY TINA CHI

The Latham Watkins publication is available at http://www.lw.com/upload/pubContent/_pdf/pub3446_1.pdf.

The Conference Board’s publication is available upon request at <http://www.conference-board.org/publications/describe.cfm?id=1755>.