Big investors should follow code of conduct, advocate says

Globe and Mail
By Janet McFarland
June 18, 2013

The world's largest investment funds – including pension plans and mutual funds – should adopt a code of conduct to ensure they will wield their growing power appropriately in a new "age of the institutional investor," according to Stephen Davis, a leading governance advocate.

The Harvard University professor spoke Tuesday at the annual meeting of the Canadian Coalition for Good Governance (CCGG), telling Canada's largest institutional investors that governments have increasingly shifted power to major investors in the hope they will police the capital markets.

The problem with this "big bet," he said, is that most funds are not equipped to do so.

"We have to make ownership meaningful," Mr. Davis said. "We've spent years on reform of governance of public corporations. Now we need to turn those energies to mobilizing prudent ownership among institutional investors."

Mr. Davis, who is associate director of Harvard Law School's programs on Corporate Governance and Institutional Investors, said investors have seen their power grow with a host of new policies such as the introduction of say-on-pay votes to approve executive compensation and majority voting policies to allow them to more easily remove directors. Regulators prefer these solutions because they tap into market forces to regulate companies rather than relying on government intervention, he said.

The problem is that many institutional investors "are nowhere near configured to take on the new ownership responsibilities," he argues, with large institutional investors often holding shares in thousands of companies they cannot closely follow. Many funds "under-resource" or entirely outsource their proxy voting and other aspects of their oversight of environmental, social and governance practices, he said, which means they provide little careful oversight of the companies they own.

They are also often "opaque" about their practices, don't adhere to the governance standards they espouse for companies they own, and are rife with conflicts of interest.

"By operating with a market infrastructure that in many ways is obsolete, we are tolerating an unsafe and underpowered capitalism compared to what we should have," he said.

The solution, Mr. Davis argues, is to create "stewardship principles" for North America – a code of conduct that major investors would voluntarily adopt.

He recommends such policies should include a requirement for funds to reveal their own governance and accountability details, an explanation of how they pay portfolio managers, and

disclosure of their broad approach to managing the shares they own – not just their proxy voting record, but more broadly their approach to managing assets and engaging with the companies they own.

Codes of conduct for large investors already exist in Britain and other countries, and a new global code is poised to be released within days by the International Corporate Governance Network, a global organization of institutional investors. The CCGG, which represents most of Canada's largest institutional investors with combined assets of more than $2-trillion, has also proposed a code of conduct for its own members that calls on investment funds to develop policies for monitoring companies and publicizing how they vote their shares.

Mr. Davis said many of Canada's largest funds are ahead of their global peers and have "adapted to meaningful ownership," but many other mainstream funds have done little. He said many existing stewardship codes need to be "more ambitious" and need to address not just voting behaviour but also broader issues of accountability of institutional investors.