Corporate Governance

Outlaws of the Roundtable? Adopting a Long-term Value Bylaw
Whoriskey, Cleary Gottlieb Steen & Hamilton LLP, reflects on the pledge by the CEOs of 150 major US public companies to act for all of their stakeholders, ie, customers, employees, suppliers, communities and even stockholders. Much commentary ensued. However, Whoriskey suggests that before we get too excited about whether these CEOs are grasping the mantle of government to act on behalf of the citizenry and other people who aren’t paying them, we need to question whether, as a matter of Delaware law, they can.

Analysis of the Business Roundtable Statement
Pierce, White & Case LLP discusses the Business Roundtable Statement on the Purpose of a Corporation. He says that to say that a corporation will act to further the interests of constituencies other than shareholders is legally incorrect. As the lawyer for Institutional Investors has noted, accountability to everyone means accountability to no one. To deviate from current legal standards could leave a board with no guiding decision-making principle.

Stakeholder Approach and Executive Compensation
Burchman and Emanuel, Semler Brossy Consulting Group, LLC, question what it means for boards and compensation committees that 181 CEOs from the Business Roundtable amended a long-standing statement of corporate purpose last month. Not surprisingly, the Business Roundtable’s statement sparked a host of editorials in the business press, some arguing that the group had made a grievous error.

Recruiting ESG Directors
Seiden, Seiden Krieger Executive Search, says that the pressure is now greater to populate boards with directors whose backgrounds satisfy ESG standards. Agitation for ESG boardroom reform is emanating from a variety of quarters and is taking on an even broader definition than originally. The Business Roundtable’s recent Statement on the Business of a Corporation would appear to align with such cohorts.
Principles of Purposeful Business: an Agenda for the Future of the Corporation in the 2020s

The British Academy released its first major report on the Future of the Corporation at the end of 2018. The Academy brought together evidence and examined the literature on corporate purpose, trust, ownership, governance, tax, technological disruption, law and regulation. The Academy’s second major report proposes a new formula for corporate purpose, ie, the purpose of business is to profitably solve problems of people and planet, and not profit from causing problems. The report presents eight principles for use in guiding lawmakers and business leaders, including the reform of company law.

Fiduciary Duty in the 21st Century

This final report from the UN Environment Programme and the Principles or Responsible Investment describes how the integration of ESG issues into investment practice and decision making is an increasingly standard part of the regulatory and legal requirements for institutional investors, along with requirements to consider the sustainability-related preferences of their clients and beneficiaries.

The Purposeful Company Study on Deferred Shares

This study shows that a quarter of the UK’s biggest companies are failing to adopt the right remuneration policies to reward executive performance. It concludes that at least 25% of British companies should be using schemes in order to pay fairer executive bonuses rather than sticking to the more popular but controversial long-term incentive plans.

Director Pay: Meeting Fee Trends

The National Association of Corporate Directors and Pearl Meyer address the reality that many boards encounter of a greater than expected workload on a recurring basis in the context of increasingly common meeting fee-free director pay programs. This raises the potential of alternative pay arrangements including increases in board and committee retainers consistent with market pay; one-time supplemental retainers or special committee fees for one-off circumstances; and a conditional meeting fee structure based upon a pre-established number of meetings.

Understanding the Impact of America’s Clampdown on Proxy Advisors

Freedman, Fein, and Robertson, Kingsdale Advisors, provide the background. In 2003, the SEC put forward a rule that required institutional investors to disclose their votes and provide an explanation as to why they voted the way they did. This paved the way for the rapid growth and influence of proxy advisors such as Institutional Shareholder Services, and Glass Lewis which quickly became a cost- and time-effective resource for funds seeking to rationalise their voting decisions. The SEC has once again shifted the paradigm by recently declaring that proxy voting advice provided by proxy advisory firms generally constitutes a ‘solicitation’ and issuing guidelines for investment advisors to follow when voting for their clients.

The Basis for ISS’ Lawsuit Against the SEC

Friedman, Institutional Shareholder Services, explains that Institutional Shareholder Services have filed a lawsuit against the US Securities and Exchange Commission (SEC) challenging the interpretation and guidance recently put forth by the Commission that applies the proxy solicitation rules to the provision of proxy advice. The lawsuit challenges the process by which the guidance was issued and, as important, the substance and legality of the SEC’s view on what constitutes a solicitation under The Securities Exchange Act (1934).

Turning the tide to greater corporate accountability

EY has conducted in-depth research into how the top 30 asset managers and asset owners in the UK are reporting on and engaging with their investee companies. Their findings show that asset managers and owners are most focused on issues around the environment and corporate governance but have been less engaged on other areas such as audit, corporate reporting, trust
and reputation. The report says that stewardship, along with governance and reporting, is a critical component to enhanced corporate accountability and therefore to help build greater trust in business. Ball, Gourley and Perlberg, EY, discuss the findings.

On the board's agenda

Deloitte's 2019 Proxy Review on S&P 100 audit committee disclosures in the proxy statement reveals numerous noteworthy voluntary disclosure practices, many of which appear to be directly responsive to investor calls for greater transparency in particular areas. Notably, 58% of companies discussed the audit committee's role in cyber oversight. Of those, the majority delegate cyber risk responsibilities to the audit committee, while the balance disclosed shared responsibility between the audit committee and either the full board or another board committee.

SOX Compliance Benchmarking

According to Protiviti's Benchmarking SOX Costs, Hours and Controls, 45% of nearly 700 company survey respondents were required to issue a cybersecurity disclosure according to the SEC's disclosure guidance, and Sarbanes Oxley (SOX) compliance hours increased over 10% for more than half of companies required to make a disclosure. The report includes instructive benchmarking data on SOX compliance hours & costs, external audit fees, controls testing, auditor reliance and automation, key controls, the use of technology and other relevant practices and processes.

SEC's Clayton attacks lack of global commitment to combatting corruption

During his speech at the Economic Club of New York, Jay Clayton warned there was a continuing lack of global coordination and commitment to combat corruption around the world. Clayton said SEC and the Department of Justice have 'vigorously enforced' the Foreign Corrupt Practices Act bringing nearly 80 cases in the past five years involving alleged misconduct in more than 60 countries. However, he said many other countries, including those that have similar offshore anti-corruption laws on their books, do not enforce those laws.

UK Shareholder dissent hits 10 year low

The Minerva Analytics 2019 Voting Review identifies long-term trends in dissent, as well as examining resolution outcomes and shareholder proposals. The review concludes that shareholder dissent among investors in the top 350 UK companies stands at 2.95% on average for 2019, lower than 10 years ago.

Shareholder activism in the UK

Research by Law Business Research Ltd shows that shareholder activism continues to grow in prevalence and significance in the UK, in common with global trends. Shareholder activism comes in many forms, including engaging privately with a company on a particular governance issue, seeking to change some or all of a company's board of directors or publicly calling for a company to undergo a transformational change, eg, or merger or acquisition.

Understanding citizens' views on the regulation of corporate reporting, corporate governance and audit

This research was commissioned by the UK Financial Reporting Council. It was conducted by BritainThinks who held citizens' juries. Jurors identified a need for companies' reports to be more accessible to the public. Some jurors suggested implementing a rating system or ranking for annual reports to help identify which companies are producing the most straightforward, clearly written and well-structured reports. Jurors suggested setting stricter rules on the gender and black, Asian and minority ethnic balance of boards as well as reviewing recruitment processes. They also felt that it would be useful to ensure that there is an employee representative on boards. Jurors suggested a three year maximum tenure for non-executive directors to help retain their independence. For audit, jurors identified a need for making sure audit and ethical standards are being followed in order to prevent misconduct and drive high-quality work. Jurors felt that there
should be more focus on holding individuals to account for their actions. Jurors also suggested that audit firms and audit partners are changed more frequently.

**Fulfil your environmental, social and governance promises through performance and pay**

PeopleNetLtd provide valuable insights to assist companies with their quest for long-term success and global impact. Both responsible investors and investees acknowledge that they have to respond to the increasing demands from, mainly younger, consumers and employees as to where products are sourced, how they are manufactured, and how their financial savings are invested for later years. Some sceptics advocate that businesses only exist to make money for their owners and do not wish to risk compromising financial returns at the expense of societal impact. Divergent views within and across investment and advisory firms cause frustration and confusion for corporates who try to balance the conflicting financial, environmental, social, and regulatory demands placed upon them by their varied stakeholders. This report suggests putting responsible reward at the heart of business, sustainability and remuneration strategies.

**China through an ESG lens**

MSCI reports that Chinese domestic investors and issuers are moving fast to incorporate environmental, social and governance considerations in their decision making, prodded by strong regulatory initiatives to promote these practices and disclosure. At the same time, economic and technological transformations in China are driving shortages of skilled talent, higher consumer expectations for product safety, increased climate awareness and raised expectations for shareholder rights.

**A Call by Investors on US Companies to Align Climate Lobbying with Paris Agreement**

Grady, Ceres, reports that institutional investors with a combined $6.5 trillion in assets-under-management announced they have written to 47 of the largest US publicly traded corporations to align their climate lobbying with the goals of the Paris Agreement, warning that lobbying activities that are inconsistent with meeting climate goals are an investment risk.

**Are Early Stage Investors Biased Against Women?**

Ewens, California Institute of Technology, and Townsend, University of California San Diego, say that it is well known that there is a significant gender gap in high-growth entrepreneurship. The persistence of this gap over time runs counter to more general labour market trends. Several potential explanations have been proposed, including gender differences in technical training or risk preferences. However, many have also speculated that part of the gender gap may, in fact, be due to a lower propensity for investors to fund female entrepreneurs seeking capital. This view largely stems from the fact that over 90% of venture capitalists are men. Ewens and Townsend examine whether female entrepreneurs are at a disadvantage in raising capital due to their gender and if so, why.

**2019 ISS Global Policy Survey Results**

Mishra, Institutional Investor Services, explores the survey results. Majorities of both investors (61%) and non-investors (55%) agreed with the view that board gender diversity is an essential attribute of effective board governance regardless of the company or its market; but investors and non-investors diverged on the question of measurement of director over-boarding. Concerning the US market, survey participants were asked to identify factors that suggest the need for an independent chair. Investor respondents cited poor responsiveness to shareholder concerns as the most commonly chosen factor that strongly suggested the need for an independent board chair.

**Business Judgment and the Courts**

The ruling that the UK executive acted unlawfully when proroguing parliament resonates with research about courts' treatment of directors' business judgment conducted by University of Leeds Law School, University of Liverpool Management School and Liverpool John Moores University School of Law. In finding that the decision of the executive to prorogue parliament was judicially,
the approach of the Supreme Court in relation to constitutional law bears similarities to the practice of the courts in the context of company law and litigation against company directors involving challenges to their business judgment. Notwithstanding assumptions that courts will defer to directors’ business judgment, the research shows that the business judgment of directors is not necessarily protected from judicial scrutiny or immune from findings of liability.

The Stewardship Implications of Passive Investing: Mobilizing Large Asset Managers as Stewards of Capital Markets

Cook and Sethi, Morningstar, note that a defining trend of global financial markets over the past 10 years has been growing investor preference for low-cost investment products with broad market exposure. The shift in assets from actively managed instruments to passive investing strategies is reshaping both the asset management industry and the structure of corporate shareholding. Because of the economies of scale in index investing, the asset management industry is becoming more concentrated and the largest players own and control a greater portion of the global securities market.

The Reverse Agency Problem in the Age of Compliance

Eckstein, Ono Academic College, and Parchomovsky, University of Pennsylvania, remind us that the agency problem, the idea that corporate directors and officers are motivated to prioritise their self-interest over the interest of their corporation, has had long-lasting impact on corporate law theory and practice. In recent years, however, as federal agencies have stepped up enforcement efforts against corporations, a new problem that is the mirror image of the agency problem has surface, ie, the reverse agency problem.

Financial Services

We’re Only Human: Culture and Change Management

Hennessy, Federal Reserve Bank of New York, made remarks at a Westminster Business Policy Forum about the bank’s approach to the reform of culture and conduct in financial services. The approach involves awareness, research, supervision and education. There is also a fundamental concentration on the problem of misconduct.

Due Diligence for Responsible Corporate Lending and Securities Underwriting

This new report provides a common global framework for financial institutions to identify, respond to and publicly communicate on environmental and social risks associated with their clients. The report helps banks and other financial institutions implement the due diligence recommendations of the OECD Guidelines for Multinational Enterprises in the context of their corporate lending and underwriting activities.

FCA letter to remuneration committee chairs

The FCA has written to Level 1 firms (deposit takers and investment firms with total assets exceeding £50bn) with findings which cover accountability, post-event risk adjustments and diversity and inclusion. The letter also explains the FCA’s approach to assessing the remuneration policies and practices of Level 1 firms in 2019/2020, and sets out key remuneration elements of the FCA’s ongoing work on transforming culture in financial services.

What if Libra disrupted the financial system?

Facebook’s cryptocurrency project Libra promises to connect everybody to the global, digital world of banking. The introduction of a privately governed currency could fundamentally challenge the current EU financial framework, conflict with EU law and tax requirements, and violate consumer rights. The European Parliamentary Research Service published a briefing which assesses what could happen in Libra disrupted the financial system.
A structural model of interbank network formation and contagion

The interbank network, in which banks compete with each other to supply and demand differentiated financial products, fulfils an important function but may also result in risk propagation. Coen and Coen from the Bank of England examine this trade-off by setting out a model in which banks form interbank network links endogenously, taking into account the effect of links on default risk.

Modernizing Bank Merger Review

Kress, University of Michigan thinks that the biggest irony of the 2008 financial crisis is that the market crash was both initially triggered and ultimately alleviated by massive bank mergers. A wave of mergers by Bank of America, Citigroup, JPMorgan, and Wells Fargo in the late 1990s created the ‘too big to fail’ banks that became so central to the crisis. Less than a decade later, the federal government orchestrated multibillion dollar emergency acquisitions by several of these firms to stem the panic.

Inflection point: seven transformative shifts in US retail banking

McKinsey’s view is that since the global crisis, US banks have made a return to stable ground and greater liquidity. Now, however, several transformative forces are accelerating the evolution of US banking and promising to make the business more challenging in the next ten years.

Sustainability

UK behind in efforts to meet Sustainable Development Goals

The UK Government’s Voluntary National Review outlines its progress towards the SDGs, showed it only received a satisfactory rating in one of the eleven areas on which it was assessed. The review, conducted by the UK Stakeholders for Sustainable Development, used a scorecard system to rate the UK government’s progress in achieving the SDGs, which must be met by 2030.

TCFD: Strengthening the foundations of sustainable finance

The Governor of the Bank of England says that the financial sector must help the transition to ‘net zero’ (a neutral carbon footprint). Businesses need to keep improving their disclosure of climate risks. To support that aim, he says the Task Force on Climate-related Financial Disclosures should: spread knowledge on how to measure and use information on strategic resilience more widely; and consider how asset owners should disclose how well their portfolios are placed for the transition to net zero.

Voting matters: are asset managers using their proxy votes for climate action

ShareAction has released a report which shows that European asset managers vote more in favour of climate friendly resolutions than those from the US. UBS (90%) tops the rankings whilst Aviva (86.9%) is the highest UK firm.

Auditing

Shared and joint audits: are two auditors better than one?

This ICAEW report acknowledges that the audit market for larger listed companies in many jurisdictions, including the UK, is dominated by the Big Four. Governments and regulators are considering whether to mandate shared or joint audits in an attempt to increase audit quality, competition and choice. This report defines shared and joint audits, explains the experience of shared and joint and outlines the big issues of cost and liability.
How to audit change
Change and transformation will fail where there is a lack of assurance over how they are being managed. ICAEW’s internal audit guidance, How to audit change, provides valuable guidance to help project managers successfully deliver change by adopting good assurance practices throughout a project's lifecycle.

What audit committees are reporting to shareholders in 2019
EY’s report reveals dramatic improvements in voluntary disclosure based on an analysis of Fortune 100 proxy statements filed since 2012. The key takeaways are: 64% of companies disclosed the factors considered by the audit committee when assessing the external auditor’s qualifications and work quality (up from 16% in 2012); and 80% of companies disclosed that the audit committee was involved in the selection of the lead audit partner (compared to 0% in 2012).

Audit firm transparency reports not visible enough and ineffective
Transparency reporting by accountancy firms performing audits is currently ineffective, with a lack of awareness amongst investors and audit committee chairs that the reports even exist and many being used as a marketing exercise, according to a review from the Financial Reporting Council.

Audit committees in Europe
Building on the joint ICAEW and Deloitte 2017 report, a new report expands examination of the evolving roles and changing perceptions of audit committees to a further six EU countries: Belgium, Cyprus, Greece, Malta, The Netherlands and Belgium. The new report highlights both the differences and commonalities facing audit committees operating across a range of sectors, in entities of varying size and structure, and in countries with differing corporate governance traditions. In addition to assessing ways of working and areas of impact, the report takes a closer look at how audit committees are dealing with evolutions in corporate reporting and corporate governance frameworks as well responding to far reaching changes resulting from the accelerating technological transformation of business and society. The authors welcome comments on the reports.

Reporting

EU Enforcers must monitor closely new reporting standards
ESMA has published the priorities that European enforcers should consider when examining the 2019 annual financial reports of listed companies, including issues relating to IFRS 16, IFRS 9 and IFRS 15 ESMA also stresses the importance of ensuring ‘material, complete, balanced and accessible information on non-financial matters, including environmental matters and climate change’ as well as potential issues associated with interest rate benchmarks transition.

Smaller Listed and AIM Quoted Companies. A Practical Guide for Audit Committees on improving Financial Reporting
ICAEW’s Practical Guide for Audit Committees on Improving Financial Reporting is intended to offer practical advice on how smaller quoted companies can improve the quality of their financial reporting and suggested questions for audit committees to ask themselves and those associated with the financial reporting process, including the board, chief financial officer, finance team and external auditors.
Capital Markets

Financial Contracting with the Crowd
The prospect of allowing the general public the chance to invest in private companies for the first time in eighty years understandably spooked the powers that be. First Congress and then the SEC in turn layered requirement after requirement on crowdfunding companies seeking to raise money from the public capital markets. The result, unfortunately, is a burdensome compilation of regulations that is widely regarded as not being worth the effort, especially when companies can raise at most only $1.07 million for their troubles. Rodrigues, University of Georgia, looks at two radically different settings as models for investor protection.

Corporate Control Across the World
Aminadav and Papaioannou, London Business School, think that understanding the driving forces and consequences of the various types of corporate control are core inquiries of corporate finance. While most economics and legal theory distinguishes between widely-held corporations with dispersed ownership and controlled firms where a dominant shareholder exerts control, in fact corporate structures can be more complex. Pyramids that allow shareholders to influence decisions over their cash-flow rights and cross-holdings of equity in business groups are pervasive. Moreover, ownership and control are often hidden behind shell companies incorporated in offshore centres. Equity blocks which entail some controlling right are commonplace, even in companies that most would coin as widely-held.

Tax

Taxes on polluting fuels are too low to encourage a shift to low-carbon alternatives
In Taxing Energy Use 2019 the OECD shows that for 44 countries accounting for over 80% of energy emissions, taxes on polluting sources of energy are not set anywhere near the levels needed to reduce the risks and impacts of climate change and air pollution. 70% of energy-related CO₂ emissions from advanced and emerging economies are entirely untaxed, offering little incentive to move to cleaner energy.

Disputing Tax

The UK Treasury Committee published this report and the Government has now responded to it. In its report, the committee included some comments on the role of tax advisers in marketing tax avoidance schemes, and said that professional bodies have a role to develop standards for professional conduct in relation to tax. Although tax advice is not regulated and not all tax advisers are necessarily members of professional bodies, clear standards of conduct endorsed by influential professional bodies provide the public with a valuable benchmark against which to judge the conduct of any tax adviser, professionally qualified or not. The committee recommended that HMRC works with the professional bodies to consider whether their standards are sufficiently clear about conduct relating to all stages at which their members may be called upon to provide advice on tax avoidance, including stages leading up to settlement of a tax dispute. ICAEW has had some initial discussions with HMRC and these discussions will continue after the general election.

Tax Policy Reforms: OECD and Selected Partner Economies
The fourth edition of this annual report provides comparative information on tax reforms across countries and tracks tax policy developments over time. The report covers the latest tax policy reforms in all OECD countries, as well as in Argentina, Indonesia and South Africa. Monitoring tax policy reforms and understanding the context in which they were undertaken are crucial to informing tax policy discussions and to supporting governments in the assessment and design of tax reforms.
Combating Tax Crimes More Effectively in APEX Economies

APEC Finance Ministers developed the Cebu Action Plan, a roadmap for a more sustainable financial future, calling on all APEC Economies to build their capacity to address financial crimes. To support these efforts, the OECD has developed this report which describes the range of OECD legal instruments, policy tools, and capacity building initiatives available to enhance the fight against tax crime in the Asia-Pacific region, drawing on examples and successful practices in APEC Economies.

Selected ICAEW CEO blogs since 16 September 2019

07/10/19 Preparing businesses for Brexit
13/11/19 A revised Stewardship Code
18/11/19 It’s More Than a Vote

Related work across ICAEW

Moscow Exchange Conference: Corporate Governance in Russia

On 13 November, Elizabeth Richards participated in a panel session covering responsible business conduct, alongside representatives from the OECD centre for responsible business conduct, the OECD centre for competencies and analysis of OECD standards, Norilsky Nickel, ALROSA and Bank of Russia. The session included an explanation of the OECD Guidelines for Multinational Enterprises including the work of National Contact Points. Some companies find it challenging to monitor their supply chains. There was general agreement that the agency problem is reducing because large investors can work together if they wish to do so, and that corporate governance and responsible business are consolidating into one discipline.

Helping members prepare for Brexit (HELP)

On 4 October, ICAEW was successfully awarded significant funding from the UK government’s Brexit readiness fund. The funds enabled two activities: mailing a postcard (A5, no plastic to minimise carbon) to all practices and all members in SME businesses (total 33,000); and an email was also sent to all ICAEW members. The ICAEW checklist of ten key questions for business has been trending on Google.

Understanding how geopolitics drives M&A

The Corporate Finance Faculty continues to support members to understand the growing importance of geopolitics for M&A activity. Keynote speaker at the Cass Business School Mergers and Acquisitions Research Centre conference was David Petrie. He spoke about the impact of geopolitics on M&A, the subject of a corporate finance faculty hosted event at Chatham House in May. He commented that corporate advisors find themselves in a febrile environment because US foreign policy frequently changes. The days of being able to do international deals solely on the basis of corporate strategy are probably gone. Sterling’s slide is making some UK companies even more attractive to overseas bidders while at the same time businesses are attempting to mitigate uncertainty, eg, by seeking to protect their supply chains.

Supporting UK business finance

ICAEW has been included in the UK government’s new Business Finance Council, which has been set up to boost funding for the country’s SMEs. Andrea Leadsom, Secretary of State for Business, Energy & Industrial Strategy, co-chaired the first meeting of the council on 9 October. She invited David Petrie to represent ICAEW, alongside heads of business banking at major lenders, including Lloyds, Barclays, HSBC, Santander, RBS and CYBG. Keith Morgan, chief executive of the British Business Bank and member of the Corporate Finance Faculty’s board is also on the council. At its first meeting the council adopted an SME Finance Charter.
Finance for the Future Awards recognise organisations responding to climate change

With the future health of our planet and society at stake, it is vital that the finance and accounting community across business, investment and academia play their part to transform our economy. The Finance for the Future Awards recognise those individuals and organisations, large and small, who are seeking to respond. The 2019 winners were announced in October, they are: Tesco, ABN AMRO, Globalance, SteamaCo, Imperial College Business School, Ecology Building Society, Stora Enso and SSE.

Digital transformation in finance functions

New thought leadership from the Tech faculty Digital transformation in finance functions: ASEAN and UK perspectives, examines how finance functions are adapting to new technologies. Written by Kirstin Gillon, with the Institute of Singapore Chartered Accountants, it shares the practical experience and insights of ICAEW and ISCA members in the UK and across in the ASEAN region. The report was launched at an event in Singapore, with over 150 finance professionals attending.