# Governance Briefing

## CORPORATE GOVERNANCE COMMITTEE (10 05 2021)

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**For Information:**

Updates on UK, US, EU and other international developments.

This paper provides an update on publications since the last Corporate Governance Committee meeting on 09 February 2021.

### Corporate Governance

**COVID-19 and Comparative Corporate Governance**
Gelter of Fordham University and Puaschunder of Columbia University and The New School confirm that corporate governance is at a critical juncture. They speculate as to whether COVID-19 will have a lasting effect on corporate governance around the world. How will large corporations be run and controlled differently? Will the interaction between firms and their shareholders and other stakeholders change due to a different balance of powers between interest and the political environment? While corporate governance tends to evolve gradually during times of peace, prosperity and growth, the authors provide historical examples which prove that it takes leaps during periods of severe social and economic disruptions.

**Incentive Design Changes in Response to COVID-19**
This database of Russell 3000 remuneration disclosures is published by the Conference Board, who are collaborating with Semler Brossy and ESGAUGE. The data is divided into base salary reductions and incentive plan changes, and there are hyperlinks to the underlying SEC filings.

**Hampton-Alexander Review - FTSE 350 Women Leaders**
A 5 year summary report confirms ten successes: exceeded 33% target for women on boards and many more women in leadership roles; progress achieved through entirely voluntary and business-led approach; stronger supply than ever of experienced women leaders; opened up new career path and opportunities for senior women; gained deep insights into workplace barriers and how to fix them; a fringe, water-cooler conversation has evolved into a core business topic; fully harnessed the support of investors and other stakeholder; diversity on boards and in leadership now a base expectation; data-driven approach and business appetite fuelling innovative ways of working; and modernising of business culture to benefit of men.

**Racial Diversity and Investment**
Melvin of Arkadiko Partners Ltd reports that the topic of racial diversity in the investment industry was recently raised in an open letter in the UK from a group called Black Women in Asset Management, challenging the industry to move beyond statements on solidarity and anti-racism. In Melvin's view it is time to ask what institutional investors can do to address the increasingly evident racial iniquities and their inconsistency with commitments to responsibility in business and investment. It is no longer sufficient that they simply declare what they expect of investee companies in respect to diversity. They need to act upon this and embrace diversity within their own investing institutions or asset management businesses. They have an opportunity to

draw parallels between the power of diversification in their investments and diversification in their hiring and management of talent, as adding significant value in both contexts.

**Corporate Governance, Business Group Governance and Economic Development Traps**
Dau of Northeastern University, Morck of University of Alberta, and Yeung of National University of Singapore argue that 'good corporate governance' can be a sideshow, and even a distraction, in countries where decision-making power substantially does not rest with the CEOs, officers, and directors of individual listed corporations. In many economies, corporations are organized into business groups. The stock markets of such countries may appear to contain hundreds of distinct corporations. Each has its own shareholders, creditors, employees, officers, directors, CEO, and stock listing. But many, perhaps most, of these corporations belong to one of a handful of business groups. All the firm in such a group share a common ultimate controlling shareholder, usually a powerful family with deep political influence. The CEOs of individual corporations can be 'hired help' in careers of service to the family.

**The End of the Anonymous Shell Company in the United States**
Appleton of Olshan, Frome & Wolosky LLP, refers to new US legislation, ie, the Corporate Transparency Act ( the CTA) which went into effect as part of the National Defense Authorization Act. The CTA, many years in the making, introduces major changes to transparency requirements of entities registered in the United States. No longer can anonymous shell companies, limited liability companies, and the like hide the identities of their owners. The CTA establishes a central database of beneficial owners of corporations, LLCs, and other corporate entities, available to law enforcement agencies (but not the public), and an affirmative obligation on the entity to identify and report its ownership. The CTA requires, with very limited exceptions, all US registered corporations, LLCs, or similar entities to report beneficial ownership information to the US. Department of Treasury's Financial Crimes Enforcement Network. The new registry will collect the names, dates of birth, addresses, and identification documents of individuals who own at least a 25% equity stake in the entity, or exercise substantial control over the entity, which will more directly tie the responsibility of the entity's conduct to specific individuals.

**Corporations Should Reconsider the Value of Their Political Action Committees**
Chia of Soundboard Governance reminds us that corporate political spending has long been an issue in corporate governance, and the objections have steadily grown louder and gained more support. Prominent corporate governance experts have been calling for regulatory action for years now, most notably 10 professors who filed a rule-making petition to the SEC in 2011 that received over one million comment letters in support, and Bruce Freed of the Center for Political Accountability who has led the movement to persuade corporations be more transparent about their political contributions. Former Delaware Supreme Court Chief Justice Leo Strine has also contributed scholarly work to the conversation. BlackRock has said that it has started to evaluate a company's disclosure and other publicly available information to consider how a company's political contributions and lobbying may impact the company, and where it sees 'material' inconsistencies with [the company's] stated public policy priorities, [BlackRock] may support a shareholder proposal requesting additional disclosure or explanation for such inconsistency.

**The ESG/TSR Activist 'Pincer Attack'**
Brownstein, Rosenblum, and Norwitz of Wachtell, Lipton, Rosen & Katz, advise companies to prepare for a new strategic threat: a two-front 'pincer attack' from environmental, social and governance (ESG) activists, on the one side, and financial total shareholder return (TSR) activists, on the other. An ESG activist attack presents an opportunity for TSR activists to pile on, free-riding on the ESG arguments that many institutional investors support. This is a new twist on 'wolf-pack' activism that provides new opportunities for activists to drive a wedge between a company and its key stakeholders. The risks of these pincer attacks are complicated by the proliferation of ESG metrics and inconsistent reporting expectations alongside evolving investor-side voting policies, all of which leave companies vulnerable to attack.

## Sustainability

### Climate Activism: Status Check and Opportunities for Public Companies

The business imperative of climate change is clear. The imperative is equally applicable to public and private companies. Shirodkar, Meshulam and Salinger of DLA Piper provide a brief summary of the actions of a particular group of investors who have formed a group, Climate Action 100+ and the commitments and other measures the group is seeking from targeted companies.

### Coordinated Engagements

In their recent paper, Coordinated Engagements, Karakas of University of Cambridge, Dimson of University of Cambridge and Li of London School of Economics study the nature of and outcomes from coordinated engagements by a prominent international network of long-term shareholders cooperating to influence firms on environmental and social issues. They examine the targeting and engagement strategy, success rates and financial outcomes of institutional investors who have coordinated their engagements through the Collaboration Platform provided by the Principles for Responsible Investment.

## Financial Services

### European Central Bank could step up monitoring of gender targets

The Committee on Economic and Monetary Affairs of the European Bank has discussed whether it could use existing EU legislative and regulatory guidelines setting targets for gender diversity in banks as a basis for supervisory evaluations. The composition of management boards, internal targets, board nomination committees as well as succession and selection processes could all be considered.

### Banks, shadow banks and business cycles

Credit spreads on household and business loans move in lockstep and spike in every recession. Becard and Gauthier from the Bank of England propose a theory as to why banks tighten their lending standards following a drop in market sentiment. The key feature is a procyclical shadow banking sector that shifts risk from traditional banks to investors through securitisation.

### The case for an open financial system

Bailey from the Bank of England has given a speech about the benefits of a global financial system, and talks about the UK's current and future role in it. He argues that these benefits are global in nature rather than regional. Global cooperation is needed to ensure a safe and strong financial system.

### Lessons from the pandemic

Segal-Knowles from the Bank of England explores whether the simpler post-2008 financial system held up, and where we go from here. She looks at whether the derivatives market held up during the market turbulence of spring 2020, and what the 'dash for cash' in the early days of the pandemic told us about financial system resilience.

## Auditing

### The Future of Audit Oversight

Brown, of the Public Company Accounting Oversight Board (PCAOB) notes that the profession's authority to write its own auditing, quality control, ethics, and independence standards and to discipline itself was removed sometime ago, and replaced by an independent regulator required to act in the interests of investors and the public. The PCAOB's implementation of the investor protection mission, however, is not complete. More needs to be done to integrate this mission into the standard-setting, inspection and enforcement processes.

### More 'bite' for the German Federal Financial Supervisory Body

Since Wirecard Berlin has announced a seven-point plan to reform BaFin. The proposals include stronger investigative powers, a new supervisory body and new ways of handling whistleblowers. A special financial task force will be able to carry out forensic audits of companies suspected of fraud.

## Reporting

### ESG and the Earnings Call: Communicating Sustainable Value Creation Quarter by Quarter

Eckerle,from the Stern Center for Sustainable Business, Tomlinson from the CEO Investor Forum and Whelan from the NYU Stern Center for Sustainable Business discuss concerns that existing reporting practices, including those used on quarterly earnings calls, underweight ESG disclosures and amplify short-term pressures on corporate management. they set out practical recommendations and a framework for how issuers can embed disclosures on ESG and long-term strategy into the content of the quarterly earnings call.

## Capital Markets

### The Rise of Growth Equity—Connecting PE and VC

Turner and Lo of Latham & Watkins LLP note that emerging companies have historically been backed by venture capital funds, but as Europe's start-up scene matures, involvement by more traditional private equity investors is growing, particularly in the tech, consumer and digital health sectors. The number of private equity investments in emerging companies has increased year on year, with investments in companies such as Wolt, Moonbug Entertainment, Zwift, Klarna, Epic Games, and Oatly demonstrating the range of opportunities available to private equity sponsors in these sectors. While private equity investors are increasingly familiar with venture capital deal dynamics, they are also pushing to align growth-deal terms more closely with traditional buyout concepts.

### Financing Year in Review: From Crisis to Comeback

Arfa, Pessin, and Sobolewski of Wachtell, Lipton, Rosen & Katz remark on how quickly global financial markets quickly stabilized after the commencement of the coivd-19 crisis. Markets and banks proved to be a source of strength for large and mid-sized companies of all credit profiles. Companies moved quickly to stockpile liquidity and secure temporary covenant relief. Some companies, such as Expedia and Gap, fully reconfigured their capital structures, moving swiftly and nimbly to strengthen their balance sheets and ride out the storm. Government stimulus programs and central bank activity buoyed markets and set the stage for this binge on new borrowings. However, 2021 brings new questions.

### Corporate Adolescence: Why did 'We' not work?

Langevoort and Sale of Georgetown University say that in academic and public commentary, entrepreneurial finance is usually portrayed as a quintessential American success story, an institutional structure whereby expert venture capitalists with strong reputational incentives channel much needed equity to deserving entrepreneurs, then subject them to intense monitoring to assure they stay on the path to hoped for success in the form of an initial public offering or public company acquisition. Yet, in recent years there have been gross embarrassments and allegations of outright criminality, at companies like Uber, Theranos, and the subject of their paper, WeWork. In short, the authors argue that fiduciary deficits and rent-seeking behaviours abound and the costs are not only borne by venture capitalists or other investors.

## Tax

### Developing Capacity in Times of COVID-19

The OECD's 2021 Capacity Building report provides an update on the Global Forum's capacity building programme and outreach activities carried out in 2020. This report sets out the technical assistance and trainings activities provided in the context of the COVID-19 pandemic. Capacity building activities relate to both the exchange of information on request and automatic exchange of financial account information standards.

### Taxing Energy Use for Sustainable Development: Opportunities for energy tax and subsidy reforms in selected developing and emerging economies

The OECD examines energy taxation in 15 developing and emerging economies in Africa, Asia and Latin America and the Caribbean. The report finds that well designed energy and carbon taxes can strengthen efforts to improve domestic revenue mobilisation. While the revenue potential varies across countries, the report finds that, on average, the countries could generate revenue equivalent to around 1% of GDP if they set carbon rates on fossil fuels equivalent to EUR 30 per tonne of $CO_2$.

## Selected ICAEW CEO Insights since 09 February 2021

24/03/2021 - ICAEW joins socio-economic diversity taskforce

25/03/2021 – Audit and governance: a 'whole system' approach to reform

26/03/2021 - Ending Modern Slavery: why accountants have a role to play

30/03/2021 - Economic crime: have the courage to call it out

## Related work across ICAEW

### Assessing the impact of COVID-19 on business strategy

ICAEW has published six questions with associated guidance which are designed to help boards review their business strategy to manage risk: what lines of business are currently not viable; what government financial support has been received; what assets are being used less; what contract obligation might you not honour and what contract rights might you not enforce; and why do the accounts matter.

### Vaccinations: employer obligations and employee rights

As the nationwide COVID-19 vaccination programme gathers pace, ICAEW has given guidance to employers to help them assess the dilemmas and responsibilities facing them if an employee refuses to be vaccinated. Chartered accountants are confident sales will grow and employment will rise over the next 12 months as the COVID-19 vaccine rollout picks up pace, according to new research from ICAEW.

### Paying dividends: only if there are profits in the business

In the current economic landscape, ICAEW has suggested a number of key questions that directors of small companies should ask before undertaking to pay dividends to shareholders.

### FRC issues 'comply or explain' reporting guidance

ICAEW has drawn attention to the FRC's latest guidance on 'comply or explain.'
The FRC's latest annual review of corporate governance reporting included familiar criticisms of companies' over-reliance on boilerplate language. However, the FRC has addressed the particular problem of companies providing inadequate explanations for their non-compliance with code provisions in new guidance. It is a thorough exploration of the problem and potential solutions and includes real-life examples of good and bad reporting practice.

**Anti-Money Laundering**
ICAEW issued a news release to announce the fifth instalment of a six-part educational series on the basics of anti-money laundering, in conjunction with the International Federation of Accountants. This segment focused on tax advice, and the ways in which tax services may be vulnerable to money laundering.

**Audit quality: how to raise the bar**
What steps can and should audit committees, audit regulators, investors and auditors in the UK take to improve audit quality? This essay from ICAEW's Audit and Assurance Faculty examines audit quality in terms of ownership, behavioural aspects, and structural drivers.

**Developing a meaningful Audit and Assurance Policy**
ICAEW suggests that introducing an audit and assurance policy could render corporate information more informative: augmenting the understanding, utility and value of audit and assurance activities, enabling them to be driven by the needs and expectations of key users, and making them more accessible in order to facilitate more appropriate resource decisions. If the policy is to fulfil its potential, UK plc will need to engage fully and follow the nine recommendations in this report.