

# Harvard Law School Forum on Corporate Governance and Financial Regulation

## It's Time to Adopt the New Paradigm

Posted by Martin Lipton, Wachtell, Lipton, Rosen & Katz, on Monday, February 11, 2019

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**Editor's Note:** [Martin Lipton](#) is a founding partner of Wachtell, Lipton, Rosen & Katz, specializing in mergers and acquisitions and matters affecting corporate policy and strategy. This post is based on a Wachtell Lipton publication by Mr. Lipton. This post is based on a Wachtell Lipton memorandum by Mr. Lipton, [Steven A. Rosenblum](#), [Karessa L. Cain](#), [Sabastian V. Niles](#), [Amanda S. Blackett](#), and [Kathleen C. Iannone](#).

Capitalism is at an inflection point. For the past 50 years, corporate law and policy has been misguided by Nobel Laureate Milton Friedman's ex-cathedra doctrinal announcement that the sole purpose of business is to maximize profits for shareholders. Corporations have also been faced with technological disruption, globalization and the rise of China, capital markets dominated by short-term trading and focused on quarterly profits, and unrelenting attacks and threats by activist hedge funds. In response to these pressures, corporations focused primarily on increasing shareholder wealth in the short-term, at the expense of employees, customers, suppliers, long-term value and the local and national communities in which they operate. The prioritization of the wealth of shareholders at the expense of employee wages and retirement benefits, with a concomitant loss of the Horatio Alger dream, gave rise to the deepening inequality and populism that today threaten capitalism from both the left and the right.

Action by corporations, asset managers, and investors is imperative. We have developed *The New Paradigm*—a roadmap for an implicit corporate governance and stewardship partnership—based on the idea that corporations and shareholders can forge a meaningful and successful private-sector solution to attacks by short-term financial activists and the short-termism that significantly impedes long-term economic prosperity. *The New Paradigm* is structured to obtain its benefits without the ill-fitting encumbrance of legislation and regulation. It is flexible and self-executing by corporations notifying their investors that they have adopted it and by investors notifying the corporations in which they have invested that they have adopted it. It is not a contract and can be unilaterally modified.

## The Changing Landscape

After the 2008 fiscal crisis, the role of the corporation began to receive closer examination. This was fueled by, among other things, recognition of short-termism as a cause of the fiscal crisis, a growing concern about climate change, the failure of wages to keep pace with inflation, and a recognition in academia that Friedman's shareholder primacy, the related Chicago School theories of an efficient market (Eugene Fama), and agency cost (Michael Jensen and Fama) were fueling discontent and systemic imbalance. Within a few years after 2008, many corporations and investors, and most importantly the three major index fund managers, publicly recognized that action is vital.

This new mindset has been embraced by the major index fund managers who frequently own, in the aggregate, approximately 15% of the shares of listed companies. A prime example is the statement by Larry Fink (CEO of BlackRock) in his January 2018 letter to CEOs of major corporations (with similar views reiterated in his 2019 letter):

Society is demanding that companies, both public and private, serve a social purpose. To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate. Without a sense of purpose, no company, either public or private, can achieve its full potential. It will ultimately lose the license to operate from key stakeholders. It will succumb to short-term pressures to distribute earnings, and, in the process, sacrifice investments in employee development, innovation, and capital expenditures that are necessary for long-term growth. It will remain exposed to activist campaigns that articulate a clearer goal, even if that goal serves only the shortest and narrowest of objectives. And ultimately, that company will provide subpar returns to the investors who depend on it to finance their retirement, home purchases, or higher education.

Another major index fund manager, State Street, addressed similar themes in its 2019 letter to board members:

Our focus in recent years has been on good governance and other practices that affect a company's ability to generate positive returns for investors over the long run. Those issues span a variety of environmental, social and governance (ESG) topics material to sustainable performance. We approach these issues from the perspective of long-term investment value, not from a political or social agenda (aka 'values'). This distinction is especially important to understand in light of growing concerns about the influence of large index managers. It is the focus on long-term value that drives our engagement around effective, independent board leadership; board quality, including cognitive diversity enhanced by better gender diversity; and environmental sustainability.

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This year we will be focusing on corporate culture as one of the many, growing intangible value drivers that affect a company's ability to execute its long-term strategy. We acknowledge that corporate culture, like many other intangible assets, is difficult to measure and manage. However, we also recognize that at a time of unprecedented business disruptions, whether in the form of technology, climate or other exogenous shocks, a company's ability to promote the attitudes and behaviors needed to navigate a much more challenging business terrain will be increasingly important. We all know the old chestnut that culture eats strategy for breakfast, but studies show that intangibles such as corporate culture are driving a greater share of corporate value, precisely because the challenges of change and innovation are growing more acute.

So too, Vanguard in its 2018 Annual Report:

In our engagements over the past year, it has been clear that more companies have a greater understanding and appreciation of their longest-term investors. We saw that companies and other market participants are coalescing around this way of thinking. And we observed that many themes continue to mature in the industry, with a stronger focus on long-termism, sustainability, and risk oversight.

Our funds can hold stocks for decades, and we were pleased to see long-termism come to the fore and be a key part of many industry discussions. For many years, we have advocated for companies to focus on delivering sustainable long-term value for shareholders. We were gratified this past year to see more and more companies make strides to incorporate sustainability into their strategy, risk planning, and disclosure, with this objective in mind.

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Central to our approach to these topics is our unwavering commitment to the long-term economic value of your funds' investments. While we recognize that our shareholders have a wide range of ideological perspectives, our decisions on these matters are grounded in long-term economic value. ...

Similar views as to strategy, purpose, and culture have also been expressed by other major asset managers and by many institutional investors.

On the academic front, in a widely-acclaimed 2017 article in the *Harvard Business Review*, “The Error at the Heart of Corporate Leadership,” Harvard Business School Professors Joseph Bower and Lynn Paine rejected shareholder primacy and made a compelling case for director-centric stakeholder governance:

Don't misunderstand: We are capitalists to the core. We believe that widespread participation in the economy through the ownership of stock in publicly traded companies is important to the social fabric, and that strong protections for shareholders are essential. But the health of the economic system depends on getting the role of shareholders right. The agency model's extreme version of shareholder centrality is flawed in its assumptions, confused as a matter of law, and damaging in practice. A better model would recognize the critical role of shareholders but also take seriously the idea that corporations are independent entities serving multiple purposes and endowed by law with the potential to endure over time. And it would acknowledge accepted legal principles holding that directors and managers have duties to the corporation as well as to shareholders. In other words, a better model would be more company centered.

On the legislative front, the Accountable Capitalism Act, a bill that would make all corporations with \$1 billion or more of annual revenue subject to a federal corporate governance regime (by requiring them to be chartered as a United States corporation), was introduced this past August by Senator Elizabeth Warren. Among other things, this regime would mandate that not less than 40% of the directors of a United States corporation be elected by employees, and that directors must consider the interests of all corporate stakeholders—including employees, customers, suppliers, investors, and the communities in which the corporation operates. In a recent *New York Times* op-ed, Senators Chuck Schumer and Bernie Sanders discussed federal legislation that would prohibit share buybacks (and perhaps dividends) if corporations do not meet specified employee wage and benefit levels. Although the passage of such bills in the United States currently seems highly unlikely, their introduction serves as a warning that legislative solutions could be imposed over time if the issues of sustainability and stakeholder interests are not adequately addressed by the private sector. It must be recognized that employee and public discontent lead to populism, and populism may well lead to state corporatism.

Finally, the British Academy has undertaken a study to create a framework for “The Future of the Corporation.” The project is led by Oxford Professor Colin Mayer, who presents a carefully considered reinterpretation of the nature of the corporation that focuses on corporate purpose, its alignment with social purpose, the trustworthiness of companies, and the role of corporate culture in promoting purpose and trust. This view of the corporation rejects shareholder primacy as the corporation's sole goal:

Corporate purpose is distinct from the consequential implications for the corporation's profitability and shareholder returns. The purpose of corporations is not to produce profits. The purpose of corporations is to produce profitable solutions for the problems of people and planet. In the process, it produces profits, but profits are not per se the purpose of corporations.

Professor Mayer believes this view of the corporation of the future will make capitalism sustainable and should be implemented by establishing a regulatory system that would promote an alignment of corporate conduct with social purposes and ensure that companies' ownership, governance, and measurement and incentive systems are appropriate for these purposes. His views are more fully reflected in *Prosperity: Better Business Makes the Greater Good* (Oxford University Press 2018). We are in full agreement with, and endorse, Professor Mayer's basic views and proposals, which hold the promise of promoting prosperity and safeguarding a responsible capitalism. We are not in accord with resort to legislation to achieve them. There can be no doubt that meaningful change is critical, and inevitable, through either legislation or voluntary action by corporations, asset managers, and investors.

## The Path Forward

A number of private-sector initiatives are underway to establish a modern corporate governance framework that is calibrated to the current environment. For our part, at the request of the World Economic Forum, we prepared a paper titled, *The New Paradigm: A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth*, which was issued in September 2016. As part of that project, we sought to create a foundation for broad-based consensus and, accordingly, in the drafting stage we tested

*The New Paradigm* with a number of major corporations and incorporated the feedback we received. In addition, we took into account the published stewardship and engagement policies of the major index funds and institutional investors.

In essence, *The New Paradigm* conceives of corporate governance as a voluntary collaboration among corporations, shareholders, and other stakeholders to achieve sustainable long-term value and resist short-termism. It provides a roadmap for boards to demonstrate that they are providing thoughtful, engaged oversight and that management is diligently pursuing credible, long-term business strategies. In addition, *The New Paradigm* is attuned to the significant influence and role of asset managers and institutional investors, and urges them to embrace stewardship principles, reject activists, and provide the support and patience needed for companies to pursue long-term sustainable strategies. It posits that, while sometimes there may be differences of opinion and changes may be warranted, corporations and shareholders are almost always better served by working together on a collaborative basis than by doing battle or allowing an activist to interpose itself.

Since the time that we initially proposed *The New Paradigm*, a number of developments have prompted us to reassess and revise this framework, with a view to further tailoring it as a middle-of-the-road approach and enhancing its usefulness as a private-sector solution to combat short-termism, while hopefully warding off a new round of politically driven and potentially misdirected governmental intervention. The following is an updated version of *The New Paradigm* that we have prepared outside the auspices of the World Economic Forum. In addition, we are mindful of the ever-expanding assortment of corporate governance frameworks, codes, and principles for boards and investors to consider, and have accordingly sought to integrate these frameworks with a view to offering *The New Paradigm* as a comprehensive roadmap that could be adopted by all of the proponents of governance and stewardship guidelines.

Corporations, asset managers, and institutional investors that embrace *The New Paradigm* should endorse the efforts of the *Investor Stewardship Group*, *Focusing Capital on the Long Term Global*, the *Coalition for Inclusive Capitalism*, and similar organizations, to promote governance, stewardship and engagement principles consistent with *The New Paradigm*.

No legislation or regulation is necessary to implement *The New Paradigm*. Corporations, asset managers, and institutional investors can unilaterally announce their acceptance of and adherence to the principles of *The New Paradigm*. Consistent with observations made by Chief Justice Leo Strine of the Supreme Court of Delaware, in his 2017 *Yale Law Journal* article, "Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System," from both a corporate law and a trust law standpoint the principles of *The New Paradigm* are intended to achieve long-term growth in value while eschewing actions and policies that threaten future growth and value, or the franchise itself. Adoption of and adherence to the principles of *The New Paradigm* is consistent with the fiduciary duties of boards of directors to their corporations and shareholders, and of asset managers to investors and the underlying beneficiaries for whom they are acting.

*The New Paradigm* does not solve all the problems that corporations will continue to face, including challenges stemming from technological disruption, globalization, social media, and political instability, but it does take a significant step toward enabling corporations to better realize their potential to be drivers of broad-based socioeconomic prosperity today and in the future. And by curbing destructive short-term activism, *The New Paradigm* will negate a drift towards state corporatism.

## The New Paradigm

*The New Paradigm* is a roadmap for an implicit corporate governance and stewardship partnership between corporations and investors and asset managers to achieve sustainable long-term investment and growth rejects shareholder primacy and is instead premised on the idea that stakeholder governance and ESG are in the best interests of shareholders. While it recognizes a pivotal role for boards of directors in harmonizing the interests of shareholders and other stakeholders, it also assumes that shareholders and other stakeholders have more shared objectives than differences—namely, they have the same basic interest in facilitating sustainable, long-term value creation. In this framework, the board of directors can exercise business judgment to implement the company's objectives, and the company and its shareholders engage on a regular basis to achieve mutual understanding and agreement as to corporate purpose, societal purpose and

performance. Ultimately, the shareholders' power to elect the directors determines how any conflicts are resolved, if they are not resolved by engagement. However, since the company and its shareholders have the same fundamental objectives, there should be little room for activism and short-termism.

*The New Paradigm* is premised on the idea that companies and shareholders can forge a meaningful and successful private-sector solution to attacks by short-term financial activists and the short-termism that significantly impedes long-term economic prosperity. It is not a contract and can be unilaterally modified. The framework of *The New Paradigm* is divided into three buckets:

First, *governance* is about the relationship between a company and its shareholders (asset managers and investors) and between company management and the board of directors. Companies will embrace core principles of good governance and, in cultivating genuine and candid relationships with shareholders, will be in a position to demonstrate that they have engaged, thoughtful boards overseeing reasonable, long-term business strategies.

Second, *engagement* is the exchange of information and requests between a company and its shareholders. Engagement is dialogue, not dictates from either side. Engagement connotes expectations around a two-way commitment between companies and shareholders to proactively engage with each other on issues and concerns that affect the company's long-term value, and provide each other with the access necessary to cultivate long-term relationships. Companies commit to being responsive to the issues and concerns of shareholders, while shareholders will proactively communicate their preferences and expectations.

Third, *stewardship* is the relationship between shareholders (asset managers and investors) and a company. Stewardship reflects a commitment on the part of asset managers and investors to be accountable to the beneficial owners whose money they invest, and to use their power as shareholders to foster sustainable, long-term value creation. In embracing stewardship principles, asset managers and investors will develop an understanding of a company's governance and long-term business strategy, and commit to constructive dialogue as the primary means for addressing subpar strategies or operations.

In this framework, if a company, its board of directors and its CEO and management team are diligently pursuing well-conceived strategies that were developed with the participation of independent, competent and engaged directors, and its operations are in the hands of competent executives, asset managers and investors will support the company and refuse to support short-term financial activists seeking to force short-term value enhancements without regard to long-term value implications.

## Governance

**Purpose and Strategy.** The board of directors and senior management should jointly articulate the company's purpose and oversee its long-term strategy, ensuring that the company pursues sustainable long-term value creation.

- The board of directors should oversee the company's business strategies to achieve long-term value creation, including by having meaningful input over the company's capital allocation process and strategy.
- The board should help the company articulate its purpose and the ways in which it aims to make a positive contribution to society, recognizing that there are various stakeholders, including employees, customers, communities and the economy and society as a whole.
- The board of directors should go beyond a "review and concur" role to ensure that it understands the strategic assumptions, uncertainties, judgments and alternatives that underpin the company's long-term strategy.

**Management and Oversight.** The board of directors is responsible for overseeing the management of the company, monitoring company performance and preparing for senior management succession.

- The board of directors sets the "tone at the top" to cultivate an ethical culture and demonstrate the company's commitment to integrity and legal compliance. In setting the right tone, transparency, consistency and

communicated effectively throughout the organization and to the investing public. Companies should have in place mechanisms for employees to seek guidance and alert management and the board of directors about potential or actual misconduct without fear of retribution.

- The board of directors should periodically review the company's bylaws, governance guidelines and committee charters and tailor them to promote effective board functioning. The board of directors should be aware of the governance expectations of shareholders who hold a meaningful stake in the company, and should take those expectations into account in periodic reviews of the company's governance principles. Boards of directors of companies that currently have dual or multiple class share structures should review these structures on a regular basis and, where warranted, establish mechanisms to end or phase out non-economic controlling structures at the appropriate time, taking into account the stage of the company's development and all other relevant factors.
- The board of directors has two key roles with respect to management: oversight of management and partnership with management. The board of directors should work to foster open, ongoing dialogue between members of the board and management. This dialogue requires directors to have access to senior management outside of board meetings. Management has an obligation to provide information to directors, and directors should seek clarification and amplification where necessary. Deep understanding of a company's business cannot be gained or maintained solely in board meetings. At the core, every director should understand how the company makes a profit and fulfills its purpose, and the threats and opportunities it faces.
- The board of directors and senior management should jointly determine the company's reasonable risk appetite, oversee implementation of standards for managing risk and foster a culture of risk-aware decision-making. In fulfilling its risk management function, the board's role is one of informed oversight rather than direct management of risk. The board of directors should consider significant risks to the company, including technological disruption, cybersecurity and reputational risks. The board should not be reflexively risk averse; the board should seek appropriate calibration of risk to benefit the long-term interests of the company.
- Even with effective risk management, crises will emerge and test the board of directors, with potential situations ranging from the unexpected departure of the CEO to risk management failures and major disasters. Each crisis is different, but in most instances when a crisis arises, directors are best advised to manage through it as a collegial body, working in unison with the CEO and senior management team (unless the crisis relates directly to the CEO and/or management team). Once a crisis starts to unfold, the board of directors needs to be proactive and provide careful guidance and leadership in steering the company through the crisis. If there is credible evidence of a violation of law or corporate policy, the allegation should be investigated and appropriate responsive actions should be taken. The board of directors, however, should be mindful not to overreact, including by reflexively displacing management or ceding control to outside lawyers, accountants and other outside consultants.
- The board of directors should maintain a close, truly collegial relationship with the CEO and senior management that facilitates frank and vigorous discussion and enhances the board's role as strategic partner and evaluator. The board of directors should monitor the performance of the CEO and senior management.
- The board of directors and senior management should maintain a succession plan for the CEO and other key members of management, and oversee the cultivation of a pipeline that develops candidates with the requisite skills, expertise, diversity of backgrounds and perspectives, and other considerations. The board of directors should prioritize succession planning by addressing it on a regular rather than reactive basis, including having an emergency plan in the event of an unexpected CEO departure or disability. Direct exposure to employees is critical to the evaluation of the company's senior management. This is especially important in the current environment in which it is typical for the CEO to be the only management person with a seat at the board table.
- Companies should frame required quarterly reporting in the broader context of their long-term strategy and use quarterly reporting to address progress toward long-term plans. Companies should not feel obligated to provide earnings guidance.
- The board of directors should carefully consider extraordinary transactions and receive the information and take the time necessary to make an informed and reasoned decision. The board of directors should take center stage in a transaction that creates a real or perceived conflict of interest between shareholders and management, including

activist situations. It may be desirable for the board of directors to retain experienced outside advisors to assist with major transactions, particularly where there are complicated financial, legal, integration, culture or other issues or where it is useful for the board of directors to obtain independent objective outside guidance. However, the board should be careful not to create unnecessary divisions through the use of special committees with their own separate advisors when there is no legal requirement for a special committee.

**Quality and Composition of Board of Directors. Directors should have integrity, competence and collegiality, devote the significant time and attention necessary to fulfill their duties and represent the interests of shareholders and other stakeholders. The board of directors as a whole should include diverse backgrounds, experiences and expertise that are tailored to the company's needs.**

- Every director should have integrity, strong character, sound judgment, an objective mind, collegiality, competence and the ability to represent the interests of shareholders and other stakeholders. After competency and integrity, the next most important (yet often underemphasized) consideration is collegiality.
- When filling vacancies, directors should take a long-term strategic view focused not merely on filling immediate vacancies on an ad hoc basis, but on constructing a well-rounded board that works well together and is bonded together by mutual trust and respect. The quality of team dynamics may have a significantly greater impact on firm performance than the sum of individual director contributions.
- The composition of a board should reflect a complementary diversity of thought, background, skills, experiences and tenures. The board of directors should develop a system for identifying diverse candidates, including women and minority candidates, and for effectively integrating new members into the board dynamic.
- A substantial majority of the board of directors should be independent. The board of directors should consider all relevant facts and circumstances when evaluating independence. Long-standing board service should not, by itself, disqualify a director from being considered independent.
- The board of directors should have an independent board leader. The board of directors should decide, based on the circumstances, whether to have separate or combined chair and CEO roles. The board of directors should explain its decision to shareholders, and, if the roles are combined, should appoint a strong lead independent director. The lead independent director should serve as a liaison between the chairman of the board and the independent directors, preside over executive sessions, call meetings of the independent directors when necessary, guide the board's self-assessment or evaluation process, and guide consideration of CEO and senior management compensation and succession.
- The size of the board of directors will depend on the nature, size and complexity of the company and its state of development. In general, the board of directors should be large enough to include a diversity of perspectives and as small as practicable to promote open dialogue.
- Companies should consider limitations on the number of other boards of directors on which a director sits to ensure a director's ability to dedicate sufficient time to the increasingly complex and time-consuming matters that the board of directors and committees are expected to oversee.
- The composition of a board of directors should reflect a range of tenures. The board of directors should consider whether policies such as a mandatory retirement age or term limits are appropriate, but board refreshment should be tempered with the understanding that age and experience can bring wisdom, judgment and knowledge. Substantive director evaluation and re-nomination decisions will serve better than arbitrary policies.
- Directors should spend the time needed and meet as frequently as necessary to discharge their responsibilities and should endeavor to attend all board and committee meetings, as well as the annual meeting of shareholders. The full board of directors should have input into the board agenda.
- Time for an executive session without the CEO or other members of management should be on the agenda for each regular board meeting.
- Confidentiality is essential for an effective board process and for the protection of the company, and director confidentiality is not inconsistent with engagement pursuant to *The New Paradigm*. Directors should respect the

confidentiality of all discussions that take place in the boardroom. Moreover, directors generally owe a broad legal duty of confidentiality to the company with respect to information they learn about the company in the course of their duties.

- The board of directors should have a well-developed committee structure with clearly understood responsibilities. Decisions about committee membership should be made by the full board based on recommendations from the nominating and governance committee. Committees should meet all the full board of directors and management apprised of significant actions.
- Companies should conduct a robust orientation for new directors and all directors should be continually educated on the company and its industry. New board members should receive extensive education about the company's business, purpose and strategy. That process should include sessions with the CEO, other directors, members of senior management and, in appropriate cases, major shareholders.
- Companies may find it useful to have an annual two- to three-day board retreat with senior executives to conduct a full review of strategy and long-range plans. Companies should also provide directors with regular tutorials and site visits as part of expanded director education, and external experts, such as independent counsel or other consultants, in appropriate circumstances to assure that, in overseeing complicated, multi-industry and new-technology businesses and strategies, the directors have the information and expertise they need. Companies and boards may also find it useful for directors to have access to the workforce.
- The board of directors and CEO should together determine the information the board should receive and periodically reassess the board's information needs. The key is to provide useful and timely information without overloading the board.
- The board of directors should evaluate the performance of individual directors, the full board of directors and board committees on a continuing basis. Evaluations should be substantive exercises. Evaluations should be led by the non-executive chair, lead independent director or appropriate committee chair, and externally facilitated evaluations may be appropriate from time to time.
- In an uncontested election, directors should be elected by a majority of the votes cast "for" and "against/withhold" (abstentions and non-votes should not be counted) for terms consistent with long-term value creation. Boards of directors should adopt a resignation policy under which a director who does not receive a majority vote in an uncontested election should tender his or her resignation for consideration by the board of directors.
- Investors who own a meaningful stake in the company and have owned such stake for a sufficient period of time should have a meaningful opportunity to recommend director candidates for nomination by the nominating and governance committee to appear on the management ballot.

**Compensation. Executive and director compensation should be designed to align with the long-term strategy of the company and incentivize the generation of long-term value, while dis-incentivizing the pursuit of short-term results at the expense of long-term results.**

- The board of directors should develop management compensation structures that are aligned with the long-term strategy and risk compliance policies of the company. The board of directors should carefully consider whether management compensation structures promote risk-taking that is not consistent with the company's overall risk appetite. A change in the company's long-term strategy or risk compliance policies should trigger a re-evaluation of management compensation structures.
- Executive compensation should have a current component and a long-term component. A substantial portion should be in the form of stock or other equity, with a vesting schedule designed to ensure economic alignment with investors. In general, executives should be required to hold a meaningful amount of company stock during their tenure and beyond.
- The board of directors or its compensation committee should understand the costs of compensation packages and the maximum amount payable in different scenarios. In setting executive compensation, the compensation

committee should take into account the position of the company relative to other companies, but use such comparison with caution, in view of the risk of an upward ratchet in compensation with no corresponding improvement in performance.

- In considering executive compensation, companies should be sensitive to the pay and employment conditions elsewhere in the company and take into account the pay ratios within the company. The board of directors should also consider the views of shareholders, including as expressed in “say-on-pay” votes, but should not abdicate its role in deciding what is best for the company.
- Companies should monitor, restrict or prohibit executives’ ability to hedge the company’s stock and oversee the adoption of policies to mitigate risks, such as compensation recoupment or clawbacks.
- Directors should receive compensation that fairly reflects the time commitment and exposure to public scrutiny and potential liability of public company board service, with appropriate benchmarking against peer companies. Independent directors should be equally compensated, although lead independent directors and committee chairs may receive additional compensation and committee fees.
- If directors receive additional compensation from the company not related to service as a director, such compensation should be disclosed and explained to the entire board and to shareholders.

**Corporate Citizenship. Consideration should be given to the company’s purpose and its stakeholders—including shareholders as well as employees, customers, suppliers, creditors and the community in which the company does business—in a manner that contributes to long-term sustainability and value creation.**

- Companies should be good citizens of the communities in which they do business and produce value and solutions for stakeholders, with consideration of relevant sustainability and societal issues in operating their businesses. Good stakeholder relationships are good business and are good for business.
- Companies should identify and articulate their purposes—e., their objectives and contributions to societal and public interests. Profits are not the *raison d’être* of a company, but rather are a product of its pursuit of its corporate purposes.
- The board of directors and senior management should integrate relevant ESG matters into the company’s strategic and operational planning, budgeting, resource allocation and compensation structures. The company should communicate its policies on these subjects to shareholders.
- Companies have an important perspective to contribute to public policy dialogue on issues related to the company’s business or purpose. If a company engages in political activities, the board of directors should oversee such activities and consider whether to adopt a policy of disclosure of the activities.

**Engagement By the Company. The board of directors and senior management should engage with major shareholders on issues and concerns that affect the company’s long-term value and be responsive to those issues and concerns.**

- Companies should disclose their adoption of and adherence to *The New Paradigm*.
- The board of directors and senior management should establish communication channels with investors and be open to dialogue. Boards should be responsive to asset managers and investors and be proactive to understand their perspectives.
- Companies should clearly articulate for asset managers and investors the company’s vision, purpose and strategy, including key drivers of performance, risk and evolution of the business model. The company should explicitly describe how the board of directors in particular has actively reviewed long-term plans and that it is committed to doing so regularly.
- Companies should explain and make the financial case for long-term investments, including capital projects, investments in equipment and technology, employee education, workforce training, out-of-the-ordinary increases in wages and benefits, research and development, innovation and other significant initiatives.

- Companies should make adequate disclosures on a variety of topics, including: how compensation practices encourage long-term growth; the director recruitment and refreshment process; succession planning; consideration of relevant sustainability, citizenship and ESG matters; climate risks; political risks; corporate governance and board practices; anti-takeover measures; material mergers and acquisitions; and major capital commitments and capital allocation priorities. Companies should explain the bases for their recommendations on the matters that are submitted to a shareholder vote.
- Companies should disclose their approach to human capital management, including employee development, diversity and a commitment to equal employment and advancement opportunity, health and safety, labor relations and supply chain labor standards.

**By Shareholders. Asset managers and investors should be proactive in engaging in dialogue with a company as part of a long-term relationship and should communicate their preferences and expectations.**

- Asset managers and investors should disclose their adoption of, and adherence to, *The New Paradigm*.
- Asset managers and investors should actively listen to companies, participate in meetings or other bilateral communications and communicate their preferences, expectations and policies with respect to engaging with and evaluating companies.
- Asset managers and investors should accept their responsibility to understand the purpose and strategy of companies in which they invest, and to eschew ideological positions not tailored to each company's position and needs.
- Asset managers and investors should clearly state their expectations for a company and provide candid and constructive feedback.
- Asset managers and investors should address and attempt to resolve differences with a company promptly, by first engaging privately in a constructive and pragmatic manner that is intended to build trust and a common understanding, and should give due consideration to the company's rationale.
- Asset managers and investors should acknowledge their role in supporting the long-term interest of the company and its stakeholders as a whole, provide companies with candid and direct feedback and give companies prompt notice of any concerns. To the extent that an asset manager's or investor's expectations for any given company evolve over time, the asset manager or investor should proactively communicate those changes to the company.
- Asset managers and investors should invite companies to privately engage and should work collaboratively with boards of directors and management teams to correct subpar strategies and operations, but this does not mean that the asset manager or investor needs to abandon its support for companies in resisting the short-termism advocated by activists. Asset managers and investors should make it clear that activists do not speak for them. Asset managers and investors should provide an opportunity for a company to engage privately on an issue or concern before publicly disclosing a negative opinion about the company.
- Asset managers and investors should disclose to the companies in which they invest their preferred procedures and contacts for engagement and establish (and disclose) clear guidelines regarding what further actions they may take in the event they are dissatisfied with the outcome of their engagement efforts. Those procedures and policies may differ on a company-by-company basis depending on the relative stakes involved and the shareholders' views about the value of differing levels of engagement with particular companies.

**Shareholder Proposals and Votes. Boards of directors should consider shareholder proposals and key shareholder concerns, but asset managers and investors should seek to engage privately before submitting a shareholder proposal.**

- Boards of directors should respond to shareholder proposals that receive significant support by implementing the proposed change if the board of directors believes it will improve governance, or by engaging with shareholders and providing an explanation as to why the change is not in the best long-term interest of the company if the board of directors believes it will not be constructive.

- Investors should raise critical issues to companies as early as possible in a constructive and proactive way, and seek to engage in a dialogue before submitting a shareholder proposal. Public battles and proxy contests have real costs and should be viewed as a last resort where constructive engagement has failed.
- Long-term asset managers and investors should recommend potential director candidates if they know the individuals well and believe they would be additive to the board.
- Shareholders have the right to elect representatives and receive information material to investment and voting decisions. Indeed, it is an essential element of correcting shareholder-corporate relationships that key shareholders be informed on a company-specific basis and accept the responsibility that comes with their role in *The New Paradigm*. It is reasonable for shareholders to oppose re-election of directors who have persistently failed to respond to their feedback after efforts to engage constructively.
- Boards of directors should communicate drivers of management incentive awards and demonstrate the link to long-term strategy and sustainable economic value creation. If the company clearly explains its rationale regarding compensation plans, asset managers and investors should give the company latitude in connection with individual compensation decisions. As noted, the board of directors should take into account “say-on-pay” votes.

**Interaction and Access. Companies, asset managers, shareholders and other key stakeholders should provide each other with the access necessary to cultivate engagement and long-term relationships.**

- Engagement through disclosure is often the most practical means of engagement, though in other cases, in-person meetings or interactive communications may be more effective. Opportunities to engage with shareholders include periodic letters—both from management to articulate management’s vision and plans for the future, and from the board of directors to convey board-level priorities and involvement—as well as investor days, proxy statements, annual reports, other filings and the company’s online presence.
- Independent directors should be available to engage in dialogue with major investors and asset managers in appropriate circumstances.
- The ultimate decision-makers of the company’s key stakeholders—including investors and asset managers with significant holdings and unions, labor or other employee groups—should have access to the company, its management and, in some cases, members of its board of directors, and likewise the company should have access to stakeholders’ ultimate decision-makers.
- Boards of directors and senior management should cultivate relationships with the government, the community and other stakeholders.
- Companies, asset managers and investors should cooperate to develop metrics to measure the value of ESG and sustainable investments, such as those advanced by the Embankment Project of the Coalition for Inclusive Capitalism.

**Beneficial Owners. Asset managers are accountable to their investors—the beneficial owners whose money they invest—and they should use their power as shareholders to foster sustainable, long-term value creation for their investors and for the companies in which they invest.**

- Asset managers and investors should provide steadfast support for the pursuit of reasonable strategies for long-term growth and speak out against conflicting short-term demands. An asset manager’s support should be expressed through constructive engagement, public expressions of support, and voting in favor of management proposals. The support of institutional investors, and the vocal endorsement from respected and influential asset managers to act as a “champion” for a company, can be decisive in curbing short-termist pressure.
- Asset managers and investors who have policies supporting ESG and sustainable long-term investment strategies should not invest in activist hedge funds whose tactics promote short-termism.
- Asset managers should establish a firm-wide culture of long-term thinking and patient capital that persists through cycles of short-term turbulence, including through the design of employee compensation to discourage the sacrifice of long-term value for short-term gains.

- Asset managers should adopt, disclose and follow guidelines and practices that help them oversee the corporate governance practices of a company. Disclosure should include the asset managers' long-term investment policies, evaluation metrics, governance procedures, views on quarterly reports and earnings guidance, and guidelines for relations with or policies towards short-term activists. Asset managers should also disclose whether they use consultants to evaluate strategy, performance and transactions and how a company can engage with those consultants. Asset managers and institutional investors should disclose their acceptance of, and adherence to *The New Paradigm*.
- Asset managers should evaluate the performance of boards of directors, including director knowledge of governance and other key investor concerns, as well as the board of directors' focus on, and understanding of the company's long-term strategic plan. That evaluation may be shared with the board of directors through the lead independent director or independent chair, with candid feedback expected in return.

**Voting. Asset managers should actively vote on an informed basis consistent with the long-term interests of their investors, which aligns with the long-term success of the companies in which they invest.**

- Asset managers should devote sufficient time and resources to the evaluation of matters for shareholder voting in the context of long-term value creation. Asset managers should consider increasing their in-house staffing and capabilities to the extent appropriate to dedicate sufficient time and attention to understanding a company's business plan and long-term strategy, getting to know its management and engaging effectively with the companies in which they invest.
- Asset managers and investors should not abdicate decision-making to proxy advisory firms; rather, asset manager votes should be based on the independent application of internal policies and guidelines, and the assessment of individual companies and their boards and management. Asset managers may rely on a variety of information sources to support their evaluation. Third-party analyses and recommendations, including those of proxy advisory firms, should assist but not be a substitute for individualized decision-making that considers the facts and circumstances of each company.
- Asset managers should disclose their proxy voting and engagement guidelines and report periodically on stewardship and voting activities.
- Asset managers and investors who have announced their adoption of, and adherence to *The New Paradigm* or who have policies supporting ESG and sustainable long-term investment strategies should explain any vote in favor of a proposal by an activist hedge fund that is opposed by the company.
- Asset managers should have clear procedures that help identify and manage potential conflicts of interest in their proxy voting and engagement and disclose such procedures.

**Investor Citizenship. Asset managers and investors should consider value-relevant sustainability, citizenship and ESG factors when developing investment strategies.**

- Asset managers and investors should consider the ways in which ESG factors are relevant to sustainable growth, and integrate such factors into their investment analysis and investment decisions.
- Asset managers should disclose their positions on social and societal purpose and on other ESG matters.

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