GOVERNANCE PERSPECTIVES

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The "Commonsense Principles 2.0": Still Making Sense

IN SHORT

The Background: The group of prominent CEOs and investment managers that published The Commonsense Principles of Corporate Governance in 2016 released an updated version intended as a governance framework for public companies, their boards, and their institutional shareholders.

The Issue: The Commonsense Principles 2.0 espouse fundamental governance practices predicated on a long-term perspective.

The Outcome: The Commonsense Principles 2.0 also illustrate that good governance evolves, and is not absolute. As such, the one-size-fits-all mindset of proxy advisors makes blind adherence to their recommendations highly undesirable.

In 2016, a group of CEOs of major U.S. companies and investment managers published The Commonsense Principles of Corporate Governance, a framework for corporate governance for U.S. public companies, their boards, and their shareholders. The Commonsense Principles were notable not only because of the prominence and diversity of the sponsor group members, but also because they were built on the bedrock principles that corporations should be run with a long-term perspective, and that corporate governance is not a one-size-fits-all proposition. Last week, the sponsor group released an updated version of the Principles—dubbed The Commonsense Principles 2.0—that continues to emphasize the need for corporate America to focus on long-term value creation instead of short-term performance. The new version illustrates another fundamental principle: good governance—and good thinking about governance—evolves.

In particular, the new version of the Principles recognizes the seismic shift in shareholder engagement practices that has occurred in recent years. The SEC's recent announcement of its upcoming Roundtable on the U.S. proxy process noted that in 2017, 72 percent of S&P 500 companies reported engagement with shareholders, compared to just 6 percent in 2010. This is an incredible change in the practices of corporate America in a very short time.

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The Principles 2.0 also recognize the increasing responsibility of corporate directors to be active students of the businesses they oversee, and to seek information from a variety of sources outside of the boardroom. The updated principles also state that directors should be prepared to commit to board service for at least three years—a recognition that, while a full 90 percent S&P 500 companies now elect all of their directors annually, a corporate directorship is not a 12-month job. This point is particularly salient in an era where directors are often elected through proxy contests or appointed as part of a settled contest.

Further, the Principles 2.0 reiterate some concerns about proxy advisory firms that many—including investor groups and regulators—have raised over the last decade. In particular, the updated Principles state that asset managers should cast their votes based on the independent application of their voting policies, should disclose their use of proxy advisory firms, and should be satisfied that they are relying on accurate and relevant information in the voting process. While concerns about the role, influence, and regulation of proxy advisory firms are not entirely new, we expect that these issues will be a key subject for the SEC's upcoming Roundtable on the proxy process.

Finally, the updated Principles reiterate a theme from the original version—one that our clients often hear us say in their boardrooms: one-size-fits-all thinking is not only a cop-out, it can lead to outcomes that are adverse to the interests of all of a company's shareholders. Although the Principles 2.0 are designed to be used by public companies, their boards, and institutional shareholders (including both asset managers and asset owners), the sponsors reiterate that not every principle will apply to every company, and that companies may choose to apply the principles as they see fit, in light of their leadership, size, shareholder base, and other factors. This is particularly true in cases of governance practices like proxy access; while many large U.S. companies have adopted a form of proxy access, this practice does not make sense for every company.

As always, we encourage companies and their directors to continue their sharp focus on governance issues, and to expect that their governance perspectives and practices may evolve in response to changes in their businesses, global footprint, and shareholder base. More fundamentally, we urge companies to view their own governance frameworks from a long-term lens, keeping in mind that good governance is thoughtful and specific, not universal, and that as with the Commonsense Principles, change is inevitable.

TWO KEY TAKEAWAYS

1. Like the 2016 version, The Commonsense Principles 2.0 rest on two pillars that we consistently advocate—a long-term perspective on governance issues and a caution that one-size-fits-all governance solutions are unwise.
2. The update to The Commonsense Principles—published only two years after the original version—demonstrates that good governance evolves, and it should remind corporate directors that a periodic review of governance practices and policies is essential.


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