NIRI Virtual Chapter

Program Wrap-Up

Program Title: Building Better Relationships with Passive Investors

Program Date: December 11, 2019

The so-called "Big Three" passives of *BlackRock / Vanguard / SSgA* continue to accumulate assets and concentrate themselves at the top of the shareholder bases of US companies. To get an idea of the scale involved, Harvard's Lucian Bebchuk suggests in a 2019 paper that the voting power of these investors already exceeds 25% of the voting in S&P 500 elections, and on existing trends will reach 34% in ten years and over 40% in twenty. This necessitates IR teams to understand these investors' investment and voting decisions, and to build lines of communication and effective relationships with these investors, as the passive universe already has the scale to swing voting in just about any election.

How do you build support with firms that *aren't* making active investment decisions? The *NIRI Virtual Chapter* is on the case – as usual, by assembling experts with experience in successfully implementing engagement strategies with passive investors. NIRI VC board member Barbara Doyle (VP of IR for *H.B. Fuller*) moderated a discussion including the insights of:

- Peter Michelsen, MD and Head of Americas Activism & Shareholder Advisory, *Goldman Sachs*
- Sean Hanley, Senior Analyst, Strategic Capital Intelligence, *Nasdaq*
- Shannon Votava, Legal advisor, former General Counsel at companies including Itron and Honeywell

A few points that jumped out from the ensuing discussion that on shareholder engagement strategies:

- **Passives are expanding globally as well as in the US** – In particular, the EU has seen a faster spread of the ETF structure, with a broader universe of EU managers building out their passive portfolios both for domestic as well as international / global portfolios. Don't be surprised if, barring any type of broader market downturn, you start to see EU passives rising in your shareholder list; while some of the names may overlap with the US, they're a different audience elsewhere.

- **Passives stewardship teams are *not* just interested in governance, and do want to hear from companies** – While passives aren't able to sell specific company shares, they certainly have the ability to vote against management, and potentially in favor of activists that might present their own plans for the company; hence, stewardship teams want to have a grasp of company business strategy and risk management practices, not just board structure and other governance concerns. Environmental and social matters often present material risks for a company – expect to hear from passives on non-financial matters within the overall risk discussion as well.

- **Any stewardship team engagement should include the right individuals from the issuer…** In "normal course" engagements without a specific issue or concern, IR and corporate secretary / general counsel typically lead the discussion. However, staffing the issuer's side of the table

appropriately is important – if there are governance concerns, *a lead independent director* or *head of nominating / governance committee* may need to be involved. Exec comp matters may require the *head of the compensation committee* or other HR professionals. It may make sense to others involved (CEO / CFO, sustainability leads, finance, strategy) as well; if you need to engage in the middle of proxy season, having directors or other senior individuals involved may heighten interest from investors seeking to allocate their time.

…and the right individuals from the investor side… Most large companies disclose the details of their shareholder engagement programs in the proxy statement, so it's easy to see what your peers are doing in terms of outreach. Outreach to the passives as well as holders with large dedicated governance staffs (think Fidelity or T. Rowe) make sense, but many companies also reach out to top 20 or more investors' governance teams to offer normal course communication. Stewardship teams often have central inboxes (with email addresses provided on their asset stewardship websites) that will route requests to the right individuals – don't swamp your buy-siders with repeated one-off emails.

…and be driven by the right collateral. – Participants suggested a tight agenda with a short presentation that covers: a) business strategy and financials up front, b) governance structure and policies, c) exec comp structure and policies, d) non-financial risks including E&S, and e) any other material matters to the company. Most normal course engagements are short (30-45 minutes) but can become far more detailed if a specific issue is being discussed.

- **Shareholder engagement is an opportunity for the company to tell its story**. The ability to "control the narrative" through engagement, and point out to investors the specific risks and opportunities the company is addressing, makes particular sense for passives. You're not likely to find a stewardship team (where each contact may have coverage of hundreds of companies) that will have nearly the depth of knowledge of your business that an active PM has; giving your "elevator pitch" will frame what investors should be watching for going forward. Shareholder engagement at this level may also help bring holders on board with major changes to business strategy - - helping to focus both investment and voting decision-makers on your thought process for any change.