

Hermes Equity Ownership Services: Imperatives arising out of the crisis



Given the current US market conditions, we as institutional investors – long-term owners of companies – feel that it is an appropriate time to push for reforms which will enhance accountability to shareowners and thus help prevent future crises which lead to the destruction of value.

The following are basic – but key – rights that need to be granted and/or extended to shareowners of US companies:

Meaningful Director Elections

Majority voting for directors

Despite the adoption by most of the S&P 500 of director resignation bylaws or policies, the final say as to whether or not a director remains on a board still rests with other directors; shareowners should have this say. Meaningful elections would ensure that shareowners would be able to support outstanding director candidates and would also encourage a shift away from unhelpful withhold campaigns, shifting the focus to effective and constructive engagement.

Proxy Access

A significant number of shareowners in many other jurisdictions may nominate director candidates on management's slate. In the US, however, this has not been allowed. This has led to costly and distracting proxy fights. While this right has to be exercised prudently, and within appropriate limits, it is important that shareowners have the ability to nominate candidates for election to the board in a constructive. Such a right would ensure that elections are in fact more meaningful.

End to broker voting for the election of directors

It is time for the SEC to ratify the NYSE's recommendation to re-classify director elections as a non-routine item and thereby prohibit brokers' votes (often cast in a rote manner in favour of management) from being counted towards the election of directors. Doing so would further enhance shareowners' right to elect directors and ensure enhanced accountability.

Enhance Board Accountability to Shareowners

Independent chairs

We urge companies to consider appointing independent Chairs to be accountable to shareowners and to hold CEOs to account. We do not generally think that lead or presiding directors without a robust scope of duties, or those appointed on a rotating basis, are able to provide a sufficient level of accountability to shareowners. The current economic climate has revealed that it is too difficult for CEOs to both be running the company and chairing the board – they are in fact two distinct roles and should be filled by two individuals.

Advisory vote re compensation

The current economic situation has revealed that performance-based compensation has lacked, in many cases, a sufficient link to long-term shareowner value. We believe that holding the compensation committee to account, on an annual basis, through an advisory vote, would lead to improved and constructive engagement between compensation committees and investors to ensure that future compensation is structured so as to reward executives for outperformance, in which shareowners are also participating. This has, to a large extent, been the chief impact of the advisory vote on compensation in the UK and Australia.

For more information about this document please contact:

Bess Joffe

Hermes Equity Ownership Services Ltd
+44 (020) 7680 2107

Version as at November 2008

Disclaimer

We are making every effort to ensure that information contained in our materials is accurate and useful. However, the information provided is intended for guidance only and should not be construed as legal or investment advice.