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Update on The New Paradigm: The Evolution of Stewardship Principles

When *The New Paradigm* (which we prepared for the World Economic Forum) and similar corporate governance frameworks were published in 2016-17, there was a broad consensus among business leaders and investors on the critical need to restore a long-term perspective. Pervasive and acute pressures for near-term financial results have been discouraging R&D, capex, employee training and other types of expenditures that may weigh on short-term earnings but are essential for sustainable economic growth. *The New Paradigm* posited that both corporations and investors have important contributions to make to create an environment that facilitates long-term value creation. For their part, corporations need to demonstrate that they are well governed and have an engaged, thoughtful board and a management team diligently pursuing a credible, long-term business strategy. In return, investors should embrace stewardship principles and provide the support and patience that such companies require to pursue long-term strategies. Working together, these stakeholders can recalibrate systemic norms and expectations in order to better balance short-term and long-term horizons.

In many respects, the cautious optimism underlying *The New Paradigm* was not unfounded. While almost all of the governance principles it espoused for boards were already well-established norms, the investor stewardship principles it outlined were more nascent. Over the last few years, there have been a number of initiatives to develop, expand and solidify these principles. Among other things, *The New Paradigm* contemplated that investors should:

- Promote long-term-oriented investment.
- Devote sufficient time and resources for effective, practical engagement.
- Act in a manner consistent with the best interests of long-term beneficiaries, including voting on an informed basis without abdicating decision-making to third parties.
- Be active listeners and, where appropriate, be proactive in engaging in dialogue with a company as part of building a long-term relationship.
- If there are concerns about a company, seek to work privately and collaboratively with the company to address them through constructive engagement.
- Provide steadfast support for the pursuit of reasonable strategies for long-term growth, and speak out against conflicting short-term demands.
- In a contested vote, promptly inform the company of its position and reasons for taking such position.

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- Consider relevant sustainability, ESG and CSR factors when developing investment strategies and decisions.
- Proactively disclose their policies and preferences, including long-term investment policies, proxy voting and engagement guidelines, positions on sustainability, ESG and CSR matters, and guidelines for relations with activists.
- Establish their own culture of long-term thinking and patient capital that discourages a short-termist mindset and over-reliance on short-term performance metrics.

These principles have been recurring themes in the ongoing evolution of stewardship. Earlier this year, the Investor Stewardship Group's Framework for U.S. Stewardship and Governance became effective and includes six principles for investor stewardship to promote long-term value creation. In addition, the three largest index fund managers—BlackRock, State Street and Vanguard—have all issued policy statements as to what they expect in terms of governance and engagement. In his January 2018 letter to CEOs, for example, Larry Fink (BlackRock's CEO) noted that the responsibilities of asset managers have grown, and their "responsibility goes beyond casting proxy votes at annual meetings—it means investing the time and resources necessary to foster long-term value." In advocating for more meaningful and productive engagement between shareholders and the companies in which BlackRock invests, he indicated that "BlackRock recognizes and embraces our responsibility to help drive this change."

Furthermore, support for themes from *The New Paradigm* has not been limited to "passive" investors. In its recent description of its investment philosophy on shareholder activism, T. Rowe Price (TRP) emphasized its long-term perspective and the importance of being able to "cultivate constructive, private, two-way communications" with company management teams. It also noted that management teams have better information about their businesses than outside parties and accordingly their assessment of the company's opportunity set should be afforded a certain amount of deference. TRP made it clear that it does not permit activists to speak for or represent the views of TRP, it will not encourage activists to initiate campaigns to pressure corporations, and it will arrive at voting decisions in contested elections independently. It also indicated that, in the case of proxy contests, it will share its voting decision in advance of the vote at the parties' request.

While the impact of *The New Paradigm* continues to be a work in progress, it is clear that institutional investors have been reassessing their roles and responsibilities in the corporate governance ecosystem and thinking critically about the ways in which they inevitably impact the balance between long- and short-term pressures on companies.

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