

# “Corporate Governance Through Voice and Exit: Evidence from Standard Life Investments”

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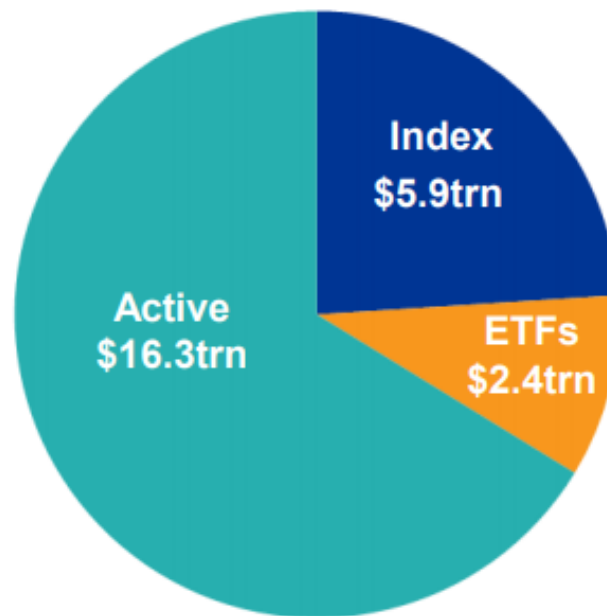
*Bocconi*

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# The global asset management industry 2015, \$ 24.6trn AUM



Of which activist hedge funds:  
\$150bn or 0.61%

Source: BlackRock estimates based on McKinsey, Markit, Bloomberg, Simfund and Broadridge data, as of year end 2015.

# UK-based active asset manager as the lab for studying voice and exit

- UK setting

- » “In short, Britain presents a model of what U.S. securities markets might look like if U.S. institutional holdings continue to grow – and with many fewer legal barriers to institutional investor participation in corporate governance.”

(Black and Coffee 1994)

- Standard Life *Investments*

- » among largest 50 asset managers worldwide, now 3rd largest UK asset manager
- » is a mostly active manager
- » provides opportunity for a unique view on role of stewardship in active asset managers

# Largest 50 asset managers worldwide

Asset manager	AUM (\$ bn)	Public firm	Intl. operations	Centralized stewardship	Asset manager	AUM (\$ bn)	Public firm	Intl. operations	Centralized stewardship
BlackRock	4,645	yes	yes	yes	Franklin Templeton	764	yes	yes	NA
Vanguard Group	3,399	no	yes	yes	T. Rowe Price	763	yes	yes	NA
State Street Global	2,245	yes	yes	yes	Prudential	755	yes	yes	NA
Fidelity Investments	2,036	no	yes	yes	Morgan Stanley	712	yes	yes	yes
Allianz Group	1,926	yes	yes	yes	Legg Mason	672	yes	yes	no
J.P. Morgan Chase	1,723	yes	yes	NA	Sun Life Financial	643	yes	yes	yes
Bank of New York Mellon	1,625	yes	yes	NA	MassMutual Financial	642	no	yes	no
AXA Group	1,489	yes	yes	yes	Sumitomo Mitsui Trust Hldgs.	641	yes	yes	yes
Capital Group	1,390	no	yes	NA	Ameriprise Financial	629	yes	yes	NA
Goldman Sachs Group	1,252	yes	yes	yes	Affiliated Managers Group	611	yes	yes	no
Deutsche Bank	1,217	yes	yes	yes	Nippon Life Insurance	596	no	yes	yes
BNP Paribas	1,196	yes	yes	yes	Mitsubishi UFJ Financial Group	594	yes	yes	yes
Prudential Financial	1,184	yes	yes	NA	Principal Financial	527	yes	yes	no
UBS	1,150	yes	yes	yes	New York Life Investments	498	no	yes	NA
Legal & General Group	1,106	yes	no	yes	Old Mutual	486	yes	yes	yes
Amundi	985	yes	yes	yes	Generali Group	471	yes	yes	NA
Wellington Mgmt.	927	no	yes	yes	Great-West Lifeco	471	yes	yes	NA
HSBC Holdings	896	yes	yes	yes	Schroders Investment Mgmt.	462	yes	yes	yes
Wells Fargo	890	yes	yes	NA	<i>Aberdeen Asset Mgmt.</i>	431	yes	yes	yes
Northern Trust Asset Mgmt.	875	yes	yes	yes	Aviva	430	yes	yes	yes
Natixis Global Asset Mgmt.	870	yes	yes	NA	Crédit Suisse	414	yes	yes	NA
TIAA	854	no	yes	yes	Royal Bank of Canada	411	yes	yes	yes
<i>Standard Life Aberdeen (Merged)</i>	806	yes	yes	Yes	DZ Bank	392	no	yes	NA
MetLife	779	yes	yes	NA	Dimensional Fund Advisors	388	no	yes	yes
Invesco	776	yes	yes	yes	<i>Standard Life</i>	375	yes	yes	yes
Aegon Group	773	yes	yes	yes					

# What do we know about how active managers engage with portfolio companies?

“[W]e have little direct knowledge regarding how institutional investors engage with portfolio companies, as many of these interactions occur behind the scenes—unless institutions publicly express their approval or disapproval of a firm’s activities or management, their preferences and private engagements with portfolio firms are not observable.” (McCahery, Sautner and Starks 2016)

“Many people who work in global funds management **seek a better understanding of their own industry**. It is diverse geographically and functionally, complex in structure and governance, and highly uneven in the availability of data sufficiently reliable for drawing meaningful conclusions.” (Walter 2015 *The Industrial Organization of the Global Asset Management Business*)

# Data (1)

## Proprietary data

- Fund-level stock holdings at monthly frequency
- Shareholder meeting voting (incl abstentions)
- Complete communications data between portfolio firms and centralized governance function of the asset manager
  - » Who, what, when, how
  - » databases and documents (mostly PDF and Word)
- Complete internal (buy-side) analyst research reporting, including coded recommendations
- Documentation of internal processes
- Basic organizational charts
- Interviews/seminar with centralized governance function, analysts, fund managers

## Data (2)

### **Other data**

- Market data (London Share Price Database)
- Sell-side analyst recommendations (IBES)
- Institutional ownership (Lionshares/FACTSET)
- Activist campaigns
- Firm financials (WORLDSCOPE/FACTSET)
- Index membership (FTSE)
- Shareholder meeting proposals, shareholder voting, proxy recommendations (ISS)
- Exec compensation (COMPUSTAT)
- ESG performance data (THOMSON/ASSET4)

## Research questions

We want to address at least three (big) ideas

1. To what extent is engagement related to fund managers' trading of assets, and to long term holdings, trust and commitment?
2. Can we lift the veil on whether exit and voice are substitutes or complements for asset managers, or whether they matter at all?
3. Does the investment performance of buy-side research relate to governance and stewardship?



# Turnover and implied holding periods

All firms on LSPD (turnover due to births/deaths)	8.5
All firms held by SLI, aggregated	30.4
Average fund	53.4
All firms on CRSP (Barber et al 2001)	7.0
US mutual funds (Nanda, Wang, and Zheng 2012)	~80
US mutual funds 2003m12-2015m12, "EDYG"	88.9

1. Turnover is calculated in three steps. First, for each stock  $i$  in fund  $p$  as of month  $t-1$ , calculate the fraction it would have comprised of the portfolio at month-end  $t$  if there were no portfolio rebalancing. Denote this fraction by  $G_{it}$ , then

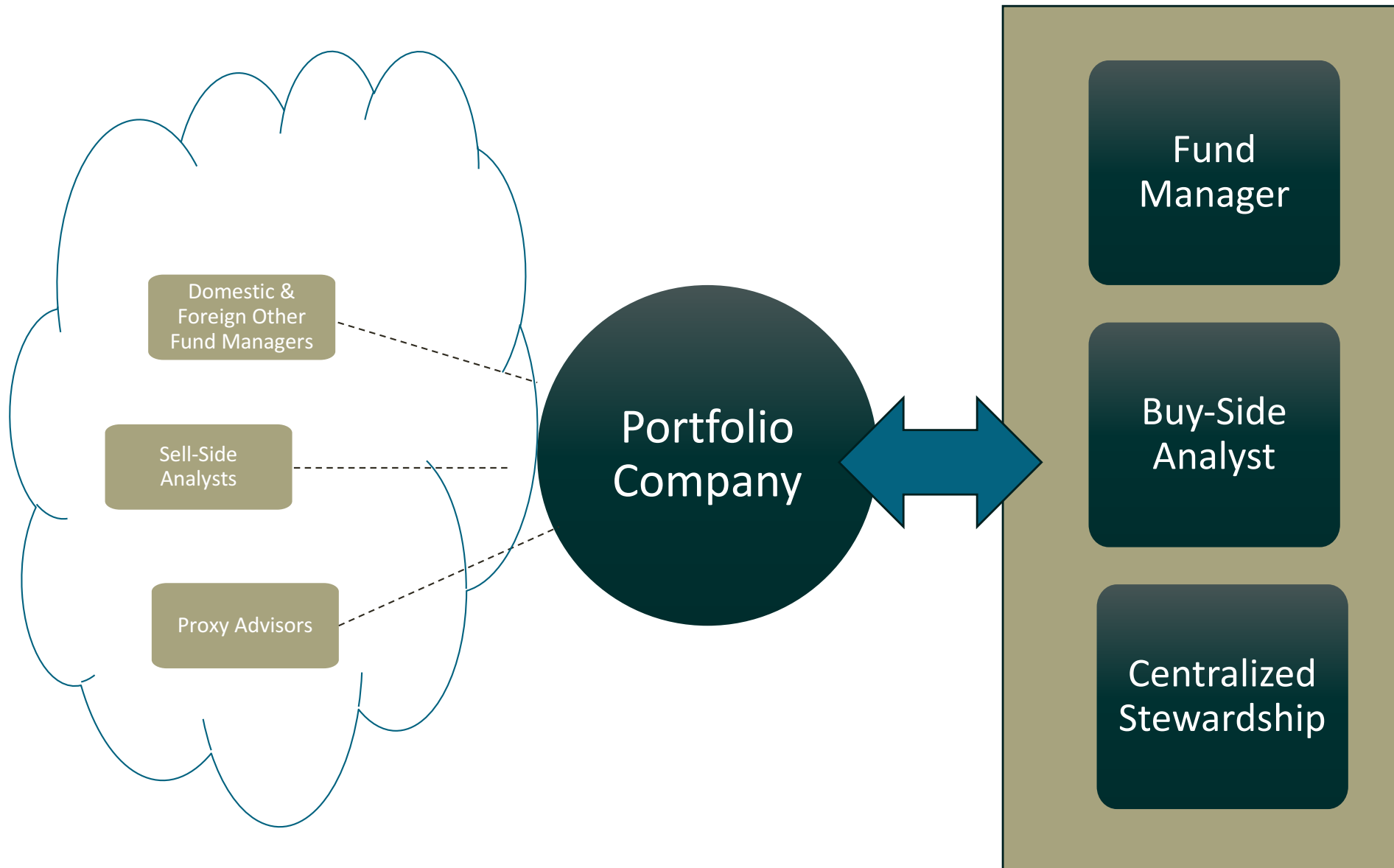
$$G_{it} = \frac{x_{it-1} \cdot (1 + R_{it})}{\sum_{i=1}^n x_{it-1} \cdot (1 + R_{it})}$$

where  $x_{it-1}$  is the market value of equity for firm  $i$  at month-end  $t-1$  divided by the aggregate market capitalization of all firms in portfolio  $p$  as of that month.

2.  $G_{it}$  is compared to the actual fraction firm  $i$  makes up of portfolio  $p$  in month  $t$ , denoted  $F_{it}$ , taking into account rebalancing between  $t-1$  and  $t$ .
3. The decrease (if any) in the percentage holding of each of the date  $t-1$  securities is summed, yielding the month's portfolio turnover. Annual turnover is calculated by multiplying monthly turnover by 12. Denoted  $U_{it}$ , monthly turnover is defined as

$$U_{it} = \sum_{i=1}^{n_{pr}} \max \{G_{it} - F_{it}, 0\}$$

# Internal organization of asset manager

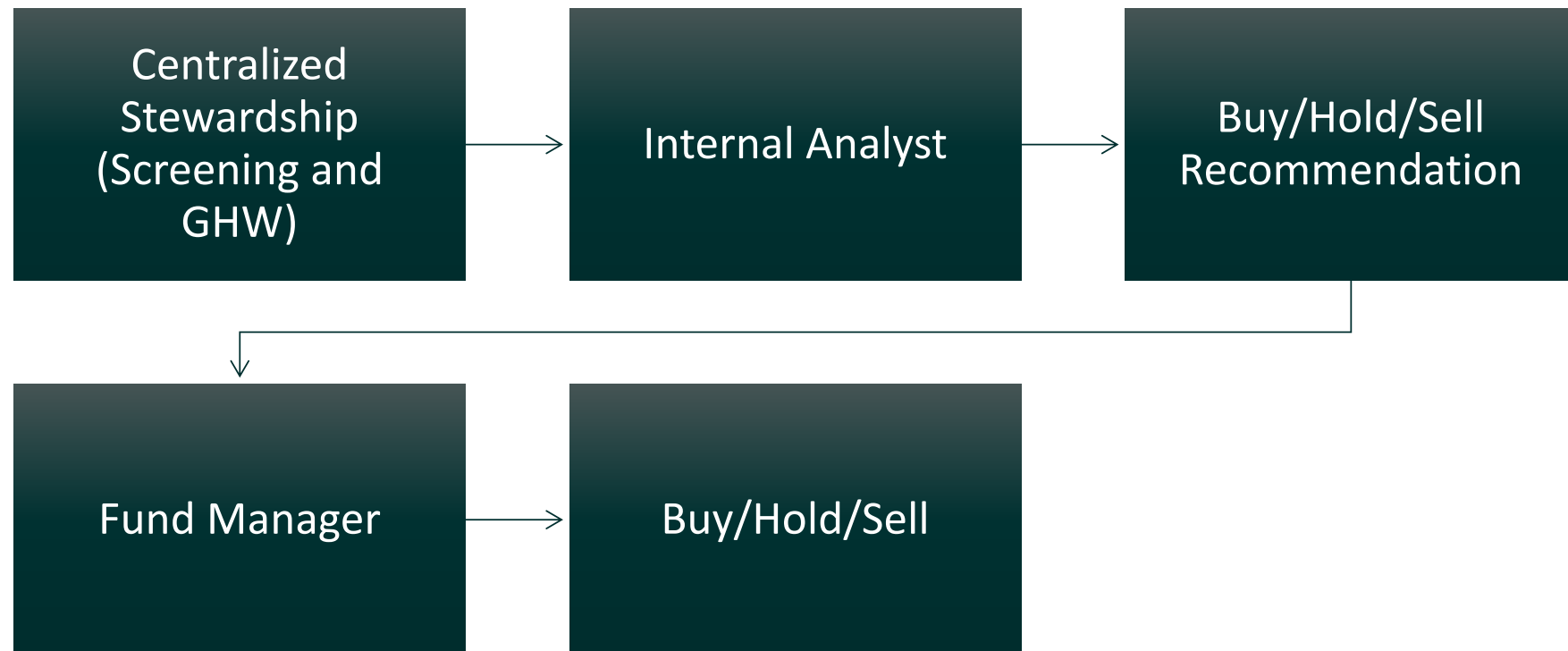


## Stylized Allocation of Engagement Responsibilities

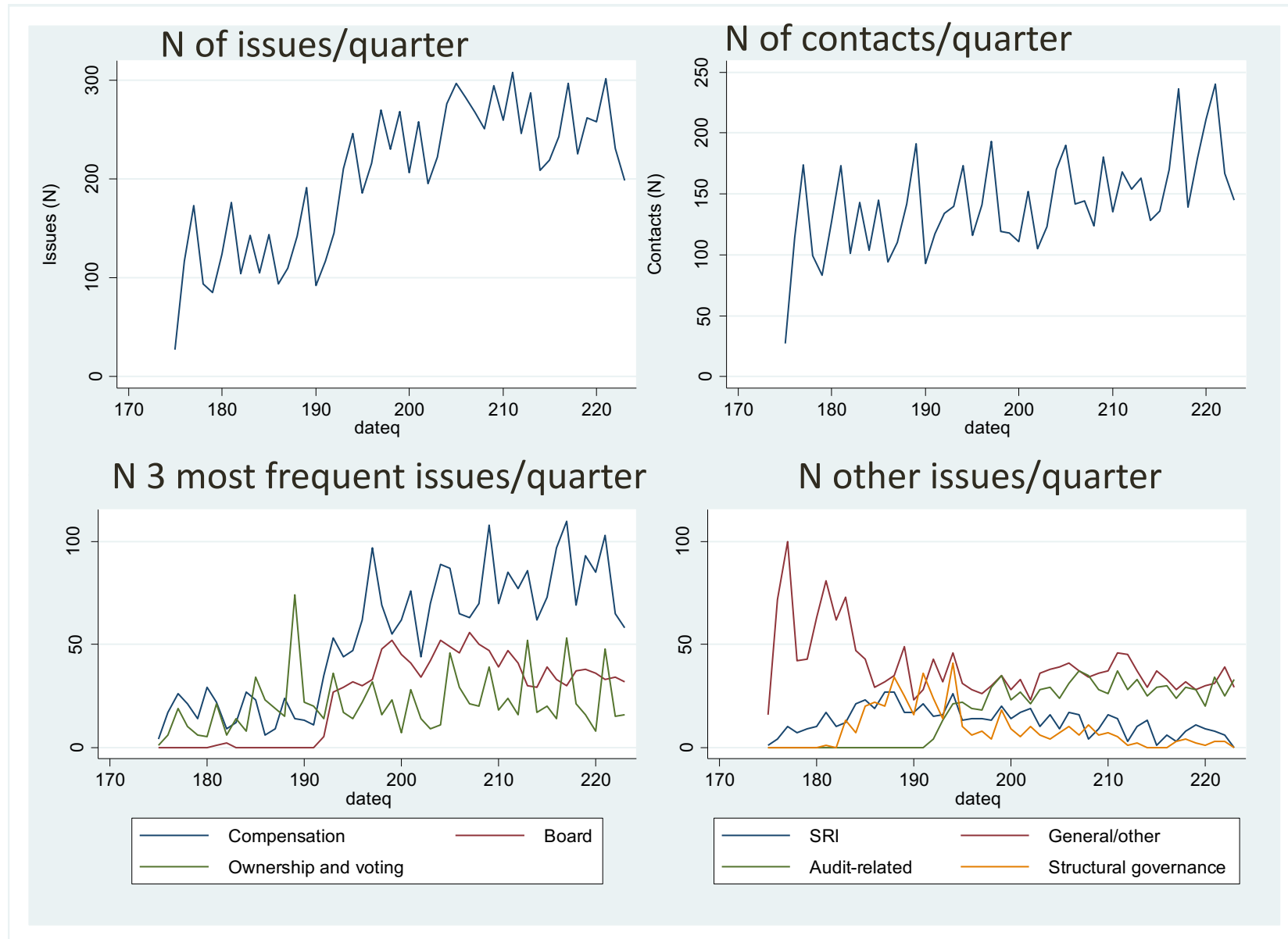
Item	Centralized Stewardship	Fund Manager/Analysts
Remuneration	X	i
SRI/CSR	X	i
Chairman	X	i
Non-Executive Directors	X	i
CEO appointment	x	x
Voluntary Delisting Vote	i	X
Rights Issues	i	X
Divestiture Vote	i	X
M&A	i	X
Sell decision	i	X

i = input; X – lead decision maker; x – joint decision

# Stylised SLI Buy/Sell Process (Exit)



# Centralized Stewardship - Contacts



# Governance Health Warning (GHW)

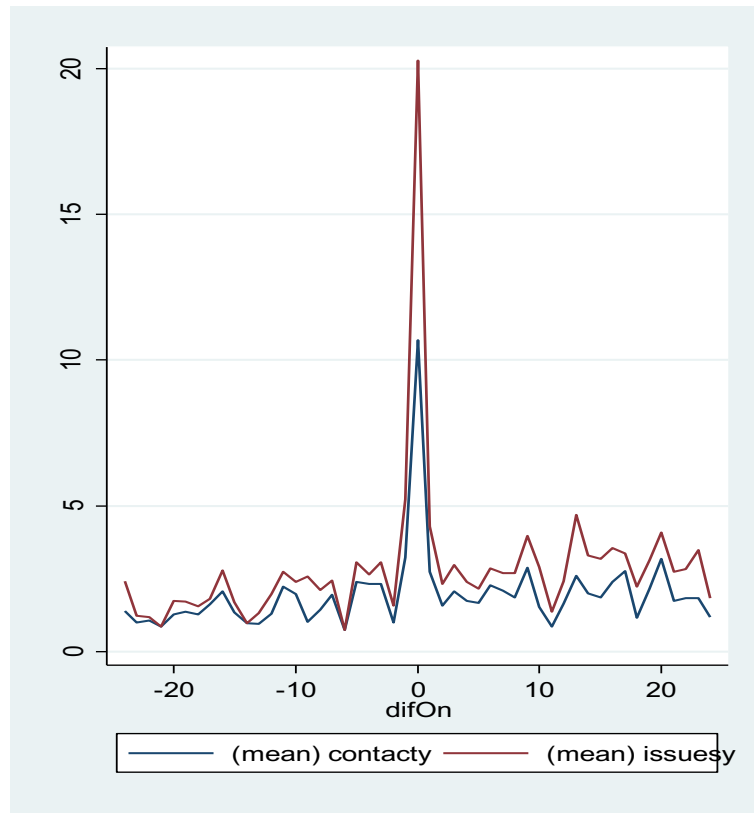
- Stewardship Function keeps track of a number of issues/concerns that might lead to raising a GHW. Company is not informed about a GHW.
- Analysts and fund managers receive prominent and repeated signals about whether or not firms have been flagged with GHW
- Issues and concerns potentially leading to GHW:
  - » Audit-related issues
  - » Blockholders and conflicts of interest
  - » Board issues
    - Including role assignment, independent directors, composition, turnover, commitment
  - » Compensation
  - » CSR / ESG performance
  - » Disclosure
  - » Legal/regulatory/internal control issues
  - » Resistance to suggestions
  - » Other

# What are GHW episodes related to?

Dependent variable: GHW (1/0)

	(1)	(2)	(3)	(4)
Discussions w/Firm	0.20*** [0.017]	0.19*** [0.017]	0.269*** [0.019]	0.260*** [0.019]
Aggregate Stake	-0.0056** [0.0024]	-0.0042** [0.0021]	-0.005** [0.002]	-0.003 [0.002]
Past Month Returns	-0.024*** [0.0093]	-0.047*** [0.011]	-0.025*** [0.008]	-0.038*** [0.008]
Past Year Returns	-0.043*** [0.0095]	-0.058*** [0.011]	-0.041*** [0.008]	-0.042*** [0.007]
FTSE 350 Member	0.024** [0.012]		0.024* [0.013]	
Size		0.019*** [0.0059]		0.013*** [0.004]
Fixed effects	Month	Month	Month	Month
Observations	84,624	84,624	83,884	84,624
Adj./Pseudo R-2	0.135	0.144	0.275	0.269
Estimation	OLS	OLS	Probit	Probit

## Event: GHW



Dependent variable	(1) Contacts	(2) Issues
GHW On	0.58*** [0.16]	1.42*** [0.26]
FTSE 350	0.34 [0.21]	0.093 [0.31]
Constant	1.55*** [0.19]	2.47*** [0.27]
Monthly fixed effects	Yes	Yes
Observations	6,930	6,930
Adjusted R-squared	0.021	0.037

GHW announcements are associated with more intensive engagements.



# Buy-Side vs Sell-Side Research

Year	SLI			IBES			t-test dif	t-test dif
	Buy	Hold	Sell	Buy	Hold	Sell	Buy	Sell
2003	0.38	0.43	0.19	0.43	0.4	0.17	ND	ND
2004	0.43	0.36	0.2	0.48	0.38	0.14	ND	ND
2005	0.42	0.32	0.26	0.44	0.38	0.17	*	***
2006	0.46	0.36	0.17	0.45	0.4	0.15	ND	***
2007	0.49	0.37	0.14	0.5	0.37	0.12	ND	ND
2008	0.42	0.39	0.19	0.5	0.36	0.15	***	***
2009	0.43	0.38	0.19	0.48	0.36	0.16	***	***
2010	0.52	0.36	0.13	0.56	0.33	0.1	***	***
2011	0.46	0.39	0.16	0.54	0.35	0.11	***	***
2012	0.43	0.37	0.2	0.51	0.37	0.12	***	***
2013	0.39	0.4	0.21	0.49	0.39	0.12	***	***
2014	0.37	0.38	0.25	0.51	0.38	0.11	***	***
2015	0.36	0.42	0.23	0.48	0.4	0.12	***	***

# GHW, Analyst Opinions and Fund Trades

	(1) Sell	(2) Buy	(3) % Held
GHW On	0.044*** [0.016]	-0.053** [0.022]	-0.87*** [0.17]
FTSE 350	0.078*** [0.018]	0.47*** [0.034]	-2.77*** [0.41]
Constant	0.022 [0.016]	0.095*** [0.025]	6.33*** [0.37]
Fixed effects	Month	Month	Month
Observations	6,905	6,905	6,744
Adjusted R-squared	0.053	0.207	0.211

## Around GHW

- “Sells” increase by 44% (0.044/0.099), “Buys” decrease by 13% (-0.053/0.397)
- Aggregate holdings decrease by 22% (-0.87/3.907)

## Voting – Against Management and Abstentions

Asset manager	Number of meetings voted	% of meetings voted against one or more management recommendations	% of proposals voted against management recommendation	Sample period
SLI (UK holdings)	6,925	8%	0.9%	2003Q4-2015Q4
... pre financial crisis			0.5%	2003Q4-2008Q4
... post financial crisis			1.3%	2009Q1-2015Q4
..."abstain"	6,925	12%	1.8%	2003Q4-2015Q4
... pre financial crisis			1.0%	2003Q4-2008Q4
... post financial crisis			2.6%	2009Q1-2015Q4

# Voting Against Management

Dep. Variable	(1) Vote Against Mgmt (any issues)	(2) Abstention (any issues)	(3) Board Related	(4) Compensation Related	(5) Capital Related	(6) M&A Related	(7) SRI Related	(8) Other Issues
FTS 350 Member	0.057*** [0.0078]	0.065*** [0.0090]	0.011*** [0.0023]	0.052*** [0.0069]	-0.0058*** [0.0016]	0.00091 [0.00062]	0.0017** [0.00074]	0.012*** [0.0028]
GHW	0.13*** [0.022]	0.11*** [0.022]	0.045*** [0.0092]	0.11*** [0.021]	-0.0012 [0.0018]	0.0010 [0.0016]	0.0011 [0.0017]	0.0048 [0.0060]
Fixed effects	Month	Month	Month	Month	Month	Month	Month	Month
Observations	79,053	76,708	79,053	79,053	79,053	79,053	79,053	79,053
Adjusted R-squared	0.055	0.034	0.021	0.052	0.007	0.001	0.003	0.007
Sample	SLI Holdings	SLI Holdings	SLI Holdings	SLI Holdings	SLI Holdings	SLI Holdings	SLI Holdings	SLI Holdings

- GHW associated with more votes against management, abstentions
- Effect concentrated on management proposals related to board composition, compensation (in line with mandate of Stewardship)

## Exit – probability of partial and full exit, unconditional

	Prob (exit) in month $t$	of which % Trading Exit
Stake to zero (1)	0.9%	97.0%
Stake -50%, cumulative past 3m (2)	4.8%	96.1%
Stake -90%, cumulative past 3m (3)	2.9%	95.1%
Any Exit (1) to (3) – (4)	4.9%	95.9%

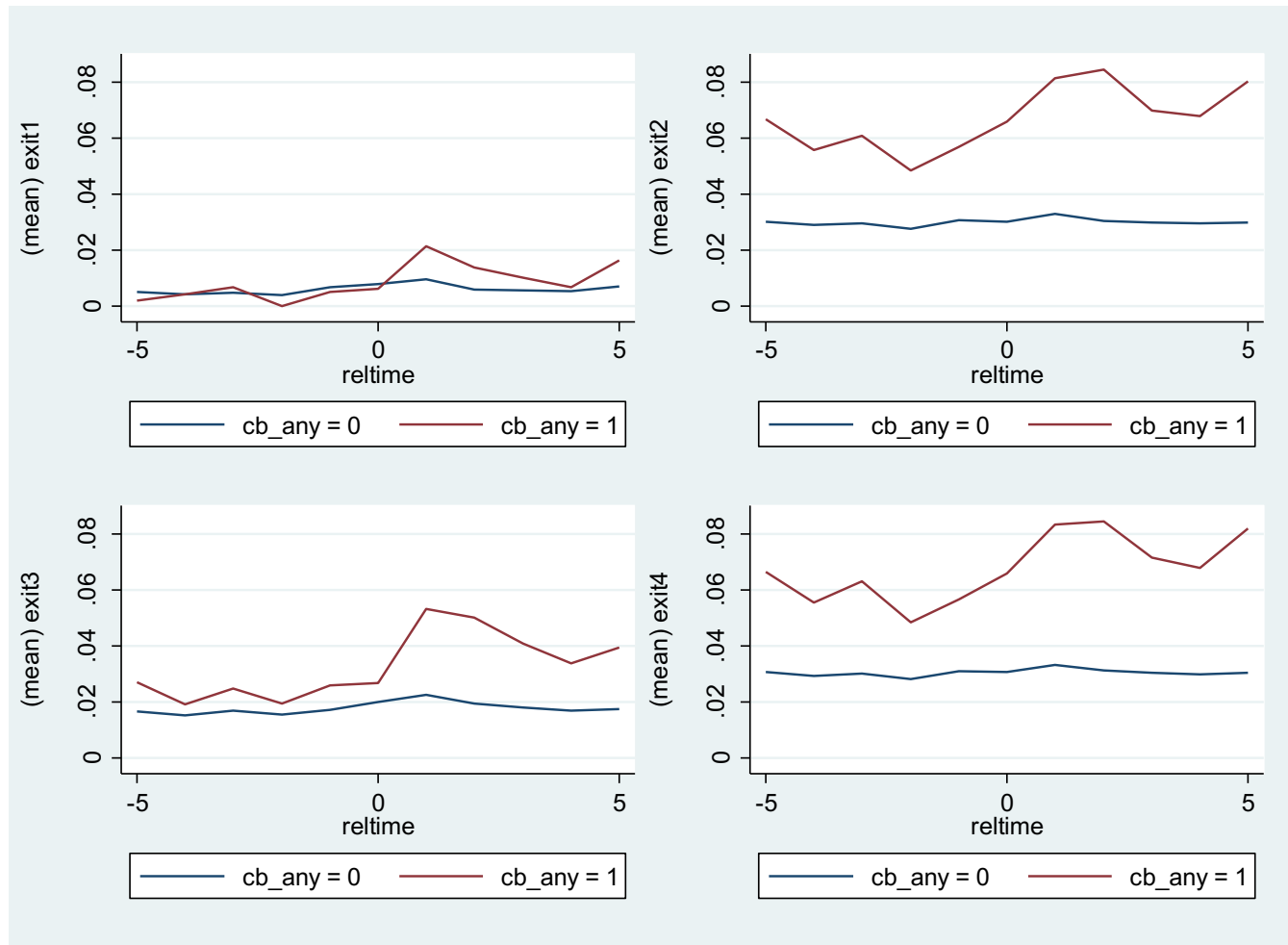
- How to measure exit?
- Anecdotal evidence: Fund managers interpret GHW very differently
- Exit appears to be overwhelmingly deliberate
  - » Non-Trading Exit (cases where asset manager exit is within 3m of takeover/liquidation/delisting) represents only 3-5 percent of exits.

# Determinants of exit

Dep variable	(1) Exit 1	(2) Exit 2	(3) Exit 3	(4) Exit 4	(5) Exit 1	(6) Exit 2	(7) Exit 3	(8) Exit 4
New Sell	0.00046 [0.0031]	0.077*** [0.011]	0.014** [0.0060]	0.077*** [0.011]	0.00063 [0.00062]	0.029*** [0.0077]	0.0011 [0.00089]	0.029*** [0.0077]
New Buy	-0.0031* [0.0016]	-0.0058 [0.0044]	-0.0043* [0.0024]	-0.0045 [0.0045]	-0.0016*** [0.00052]	-0.0024* [0.0013]	4.9e-06 [0.00016]	-0.0040*** [0.0015]
Sell	-0.0026* [0.0015]	0.0028 [0.0062]	-0.00025 [0.0030]	0.0022 [0.0062]	-0.00079* [0.00044]	0.0044 [0.0047]	0.00058 [0.00064]	0.0036 [0.0046]
Buy	-0.0041*** [0.0011]	-0.043*** [0.0039]	-0.011*** [0.0020]	-0.044*** [0.0040]	0.00086* [0.00050]	-0.023*** [0.0028]	-0.0012*** [0.00029]	-0.023*** [0.0028]
Past Year Returns	-0.0012 [0.0019]	-0.037*** [0.0070]	-0.014*** [0.0041]	-0.037*** [0.0071]	-0.0021 [0.0017]	-0.0046 [0.0044]	-0.0014** [0.00056]	-0.0067 [0.0047]
Discussions w/Firm	-0.0094*** [0.0012]	-0.013*** [0.0044]	-0.014*** [0.0022]	-0.014*** [0.0044]	-0.0034*** [0.00088]	-0.0056** [0.0026]	-0.00095*** [0.00034]	-0.0090*** [0.0029]
Fixed effects	Month	Month	Month	Month	Month, Fund	Month, Fund	Month, Fund	Month, Fund
Observations	41,340	41,340	41,340	41,340	633,205	633,205	633,205	633,205
Adjusted R-squared	0.010	0.021	0.012	0.021	0.016	0.022	0.006	0.022
Level	Agg	Agg	Agg	Agg	Fund	Fund	Fund	Fund
Sample	Rec	Rec	Rec	Rec	Rec	Rec	Rec	Rec

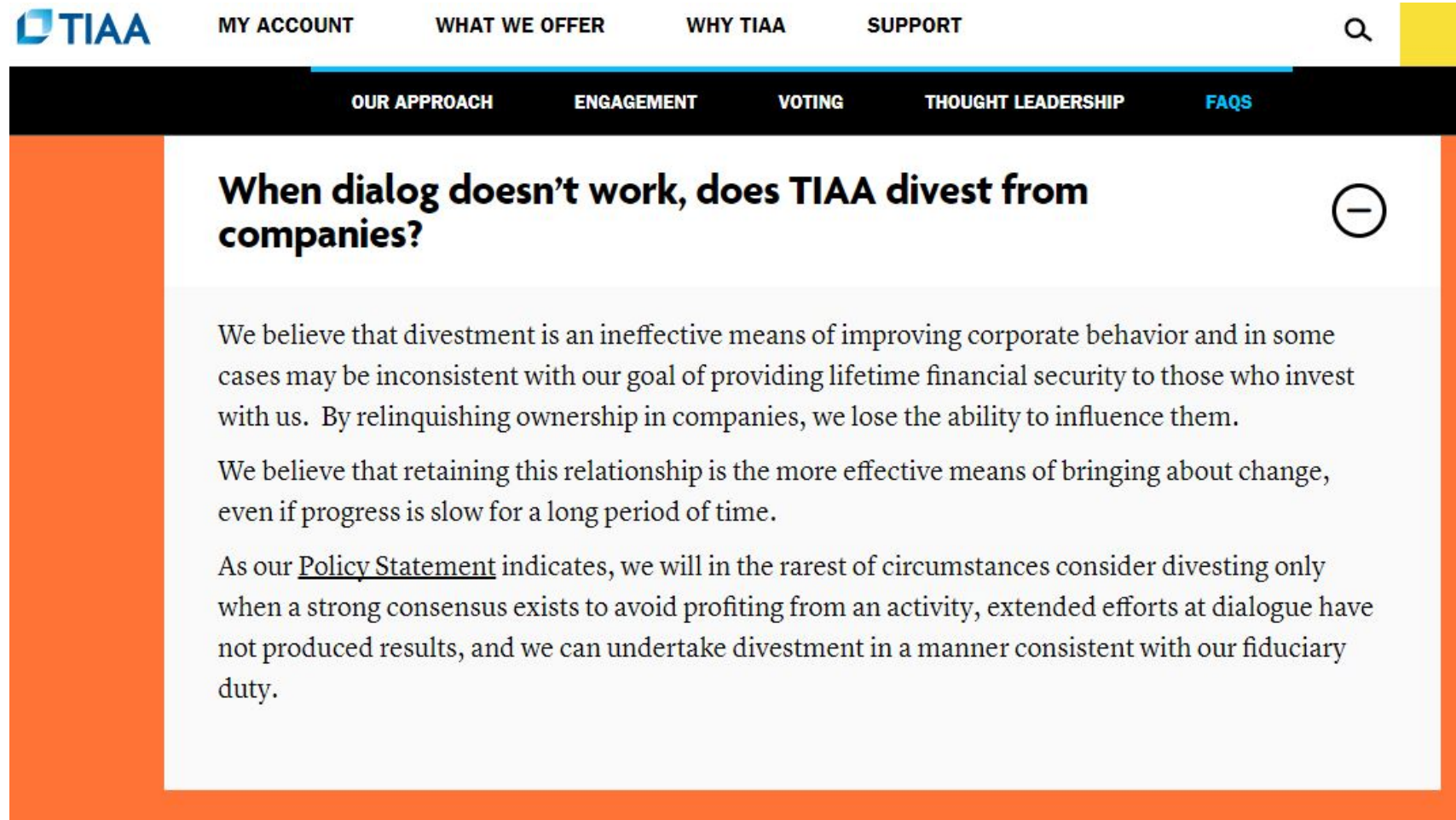
- Exit correlated with Discussions w/Firm. Fact-finding or voice?

## Probability of exit around shareholder votes, comparison of votes for and against management



Diff-in-diff: Significant increase in prob(exit) following shareholder votes for meetings where asset manager votes against mgmt

# Should we expect active owners to exit when “voice” fails?



The screenshot shows the TIAA website navigation and a specific article. The top navigation bar includes the TIAA logo and links for MY ACCOUNT, WHAT WE OFFER, WHY TIAA, and SUPPORT. A search icon is also present. Below this is a secondary navigation bar with links for OUR APPROACH, ENGAGEMENT, VOTING, THOUGHT LEADERSHIP, and FAQs. The main content area features a large orange sidebar on the left and a white article box on the right. The article title is "When dialog doesn't work, does TIAA divest from companies?" with a minus sign icon to its right. The article text discusses TIAA's stance on divestment, stating it is an ineffective means of improving corporate behavior and that retaining relationships is more effective for bringing about change. It also mentions that divestment is considered only in rare circumstances when a strong consensus exists to avoid profiting from an activity, extended efforts at dialogue have not produced results, and the divestment is consistent with the fiduciary duty.

**TIAA** MY ACCOUNT WHAT WE OFFER WHY TIAA SUPPORT

OUR APPROACH ENGAGEMENT VOTING THOUGHT LEADERSHIP **FAQS**

## When dialog doesn't work, does TIAA divest from companies?

We believe that divestment is an ineffective means of improving corporate behavior and in some cases may be inconsistent with our goal of providing lifetime financial security to those who invest with us. By relinquishing ownership in companies, we lose the ability to influence them.

We believe that retaining this relationship is the more effective means of bringing about change, even if progress is slow for a long period of time.

As our [Policy Statement](#) indicates, we will in the rarest of circumstances consider divesting only when a strong consensus exists to avoid profiting from an activity, extended efforts at dialogue have not produced results, and we can undertake divestment in a manner consistent with our fiduciary duty.



# Do Changes in Recommendations by Analysts Coincide with Abnormal Returns?

Recommendation change	Buy to Hold	Buy to Sell	Hold to Sell	Sell to Hold	Sell to Buy	Hold to Buy
[-1m, +1m]	-1.52*** [0.53]	-10.0*** [1.78]	-5.88*** [0.70]	-1.05 [0.73]	4.43*** [1.38]	1.68*** [0.50]
[0m, +1m]	-2.76*** [0.43]	-6.84*** [1.63]	-5.16*** [0.62]	0.31 [0.59]	5.01*** [1.19]	1.72*** [0.42]
[+1m]	-0.61** [0.29]	-0.018 [0.77]	-1.35*** [0.41]	-0.28 [0.39]	1.65** [0.67]	-0.082 [0.30]

Table shows the percentage market-adjusted returns measured for the month before, the month of, and the month following changes in recommendations. Returns are measured as the 3, 2, and 1-month buy and hold return less the return on the FTSE350 index.

- Yes. But no view yet on causality.

# Do Changes in Recommendations by Analysts Coincide with Abnormal Returns?

	Downgrades					
	Buy to Hold		Buy to Sell		Hold to Sell	
[-1m, +1m]	-1.35** [0.54]	-2.73 [1.80]	-8.37*** [1.79]	-21.0*** [6.20]	-6.31*** [0.73]	-3.05 [2.29]
Observations	935	135	151	23	625	95
Sample	No	GHW	No	GHW	No	GHW

	Upgrades					
	Sell to Hold		Sell to Buy		Hold to Buy	
[-1m, +1m]	-1.29* [0.76]	0.39 [2.43]	4.29*** [1.49]	5.57 [3.50]	1.89*** [0.52]	0.074 [1.72]
Observations	596	95	136	17	922	119
Sample	No	GHW	No	GHW	No	GHW

- No significant differences around buy/sell recommendation changes with and without GHW
- Table shows the percentage market-adjusted returns measured for the month before, the month of, and the month following changes in recommendations. Returns are measured as the 3, 2, and 1-month buy and hold return less the return on the FTSE350 index. Subsamples are based on whether at the time of the recommendation change a given stock is subject to a GHW (1) or not (0).

## Where are outcomes in all of this?

- We will at minimum consider three types of outcomes
  - » compensation
  - » acquisitions/takeovers
  - » board changes
- Are successful outcomes correlated with investment performance as in hedge fund activism?
- E.g. we already know anecdotally that votes against compensation lead to board resignations.

# Conclusions

- To what extent is engagement related to fund managers' trading of assets, and to long term holdings, trust and commitment?
  - » Overall, Stewardship activity is related to fund managers' trading. We do not know yet about trust and commitment.
- Can we lift the veil on whether exit and voice are substitutes or complements for asset managers, or whether they matter at all?
  - » Over 50% of discussions by Stewardship Function are concerned with compensation, board composition and voting
  - » Votes against management and abstentions are significantly more likely for companies with GHW. Concentrated on compensation and board composition
  - » Probability of exit is significantly greater for target companies where the asset manager abstained or voted against the firm
- Does the investment performance of buy-side research relate to governance and stewardship?
  - » Internal analysts more "hawkish" than (external) sell-side analysts
  - » Large abnormal returns around analyst recommendation changes
  - » Internal analysts are 44% more likely to issue sell recommendations for companies with Governance Health Warnings; Aggregate Holdings are 22% lower for these firms.

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# Project Governance

- Independent study
  - » Under sole responsibility of three academic authors
- Non-Disclosure Agreement between authors and SLI
  - » Authors may not disclose names of individuals or companies without prior consent, unless information is in the public domain
  - » SLI is provided with drafts and has the right to comment
- Funding from the Norwegian Finance Initiative (NFI)
  - » NFI funded by Norges Bank
  - » Project selection and funding overseen by independent NFI scientific committee
  - » NFI has no influence on contents
  - » Project ends June 2018