



INSTITUTIONAL SHAREHOLDER SERVICES

Institutional Investors and Corporate Governance In the United States

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Overview

- Who: Institutional investor size and growth
- Why: Reasons for activism
- How: Kinds of activism
- 2003 proxy season
- Public policy victories
- Global impact
- Conditions for institutional involvement



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Growth of U.S. Institutional Investors

Share of U.S. Equity Markets

- 1960: 12.6%
- 1980: 37.2%
- 1990: 46.9%
- 2002: 55.8%

Share of Equity of 1,000 Largest Corporations:

- 1987: 46.6%
- 2000: 61.4%

Source: *The Conference Board's Institutional Investment Report*



INTERNATIONAL SECURITIES SETTLEMENTS

Institutional Categories & U.S. Equity Holdings

- All institutions: \$8.5 trillion in 2001
- Corporate pension funds
 - 12.5% of U.S. equity markets, or \$1.9 trillion
- Public pension funds
 - 8.0%, or \$1.2 trillion
- Mutual funds
 - 18.7%, or \$2.8 trillion
- Insurance companies
 - 7.1%, or \$1.1 trillion
- Bank & trust co.'s and foundations
 - 3.6%, or \$539.6 billion



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Corporate Governance

System of structures and rules that enable shareholders and boards to monitor and control corporations without interfering in day-to-day management



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Why? Reasons For Activism

Regulatory Requirements & Fiduciary Duty

- ERISA
 - Vote shares
 - Monitor & communicate with management
- Investment Companies
 - Have voting policies
 - Vote shares
 - Disclose voting record
- Registered Investment Managers
 - Voting policies and vote shares



Lower Risk

- Not by financials alone
- Russia in 1990s
 - Oil & gas companies
- U.S. scandals
 - Enron, Tyco, WorldCom
- Prevent
 - Theft
 - Conflicts of interest
 - Crisis
- Handle better in a crisis



Make Money

- CG=Better Performance?
 - Myriad studies
- Tangible cases: share prices
 - Premiums for mergers & acquisitions
 - Fidelity Intervention
 - Marine Midland Bank sale
 - Premium raised \$13 per share
 - Fidelity gains \$12 million



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Trust in Marketplace

Public Policy Benefits

- Watchdog role
- Leadership role
- Signal to rest of marketplace



Kinds of Activism

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- Exit: Wall St. Rule
 - But indexed funds cannot
- Vote shares
- Quiet diplomacy
- Shareholder proposals
- “Vote no” campaigns
 - ABCs: auditors, board, compensation
- Publicity and target lists
- Proxy fights



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Securities Class- Action Lawsuits

- Investor anger: the next stage?
- Corporate governance at gunpoint
 - WorldCom, Sprint, 4 others
- More than \$11 billion in settlements since 1999
- 20% growth expected, with more than 1,000 suits pending
- Institutional investors are lead plaintiffs



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2003 Proxy Season: Overview

- First 1K proxy season
 - 1000+ shareholder proposals filed
 - More than 800 governance resolutions
 - 25% more than last year
- Labor leads way with nearly 400
- 150 majority votes
 - Previous record: 106 in 2002
- More than 50 proxy fights expected



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2003 Proxy Season: Shareholder Issues

- 45 majority votes on pay proposals
 - Up from 3 in 2002!
- Antitakeover devices targeted
 - 53 poison-pill resolutions win majority support, all-time high
 - Annual board elections



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Independence or Else: “Just Vote No”

- Majority independent boards
- Independent key committees
 - Former Sen. Nunn: 23% withholds
 - ChevronTexaco (law firm services)
- Auditors:
 - Sprint: 38% against E&Y
 - Tyco: 23% against PwC



INTERNATIONAL SOCIAL INVESTMENT FORUM

Socially Responsible Investing

- 1980s: S. Africa anti-apartheid divestiture
- 2003: Reports on effect of AIDs in Africa
 - All but two proposals withdrawn
 - Except Pepsico (which then added info)
 - ExxonMobil
- 2003: International labor standards
 - Coca Cola bottlers in Colombia
- SRI becoming mainstream



Quiet Diplomacy

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- TIAA-CREF targeted poison pills
- 60 companies asked since 1998
 - 53 agreed before vote
 - 3 removed after strong vote



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Public Policy Victories

- **Ballot Access**
 - Union pension fund sparks major debate
- **Mutual fund landmark rule adopted 2003**
- **Wall Street settlement on analyst conflicts**
- **NYSE**
 - Grasso ousted
 - Structural reform imminent



Global Impact

ISS: INSTITUT FÜR SOZIAL- UND UMWELTBEWAERTUNG

“Unless companies start paying more attention to corporate governance, emerging markets could remain stuck in the backwaters of global finance for years to come”

- *Wall Street Journal*, Nov. 8, 2000



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Conditions for Institutional Involvement

- Corporate disclosure
- Meaningful voting authority
 - One share = one vote
 - No share blocking
- Conflicts of interest addressed
- Significant ownership
 - Counteracts free-rider problem
- Long-term view