Long-Term Value Begins at the Board:
The power and potential of active asset stewardship

Ronald P. O'Hanley
President and CEO, State Street Global Advisors
Vice Chairman, State Street Corporation

John L. Weinberg Distinguished Speaker, Extract of a speech given at the Weinberg Center 2017 Corporate Governance Symposium, University of Delaware, 7 March 2017

Good morning, everyone, and thank you for that kind introduction, Charles.

It's an honor to be here with you today, and I am grateful for the opportunity to share our perspectives on corporate governance.

First, I want to acknowledge the important work that Charles and his team do here at the Weinberg Center in promoting corporate governance.

The forum you provide for leaders in business, public policy and the legal community to discuss the governance issues that directly affect the ability of businesses to grow and prosper over the long run is absolutely critical.

These are existential issues not only for shareholders who want to invest in a vibrant future — but for our economy as a whole.

Today, I want to discuss our belief that "Long-Term Value Starts at the Board" and will review several key aspects:

1. The pressures of short-termism and the challenges and forces impacting long-term value creation today.
2. Why we believe asset managers like us have an important role to play in fostering good corporate governance.
3. The important role that effective, independent and diverse board leadership plays in focusing companies on the long term.
4. How we need to think of "Corporate Governance" much more broadly than we think of it today — and ensure it incorporates issues related to environmental and social sustainability.

And then I'll close by saying a few words about why partnership among shareholders, boards and institutional investors is essential to ensuring governance best practices for the long term.

Long-Term Value in a Short-Term World

But in order to understand the importance of long-term value and how we create it, it's critical that we first understand the factors working against it: what we call "short-termism" — that is, excessive focus on short-term results at the expense of long-term interests.

And certainly, financial markets aren't the only drivers of short-termism these days.

Everything from globalism to technology has created an "on-demand" expectation today that everything can and should be done quickly.

A few years ago, who would have thought that one day Amazon drones would be delivering our packages to our front doors hours after we've ordered them? Believe it or not, today that's right around the corner.[1]

That speed and efficiency are great in so many ways. But it's also created a mindset that the faster we can access and process information, the sooner we can move on to the next thing.

That's not always so great, and it's hard to look around without concluding that this kind of short-termism has manifested itself in a very profound way in today's businesses and financial markets.

Think about it. So many of the orientations, biases, and incentives in our capital markets and investment management systems today are implicitly or explicitly short term.

Public companies report earnings quarterly or, in some countries, semiannually.

Investment vehicles are increasingly valued daily or monthly. Indeed, an ETF gets revalued with every trade!

STATE STREET GLOBAL ADVISORS

Perhaps the heaviest finger on the short-term side of the scale is management. From annual bonuses comprising a significant if not predominant portion of senior management compensation, to the average CEO tenure in the U.S. being a painfully short five years — hardly enough time to drive innovation and lasting change[2] — to pressures on senior management.

A recent study found that 80 percent of CFOs at 400 large U.S. companies said they would sacrifice economic value for the firm to meet that quarter's earnings expectations.[3]

As one *Harvard Business Review* piece put it, it was less surprising that 80% of CFOs would do such a thing than that they would actually admit it!

Now, boards are typically longer tenured than the CEO. But they are under tremendous pressure to "keep the stock price up."

Indeed, the topic du jour for many boards today is how to deal with the kind of activist that is short-term oriented and trying to maximize the stock price before they sell the company.

But we can't blame it all on activists, many of whom share our interest in improving a company's governance and management.

Boards are responsible for overseeing a company's long-term strategy, but many are comprised of directors who, frankly, lack expertise, scope and the diverse views and backgrounds necessary to effectively do that.

As important as who is on the board are the governance issues they are focused on.

Indeed, even as a host of environmental and social sustainability issues become more prominent — from climate change impacts and water and waste management, to supply chain management and safety issues — too often, companies are not focused on the risks these issues pose to their long-term viability and health, or the new opportunities they may offer.

ESG [Environmental Social Governance] issues are long-term governance issues. But too often they aren't treated as such.

Asset Stewardship and the Role of Permanent Capital

So why do we care about this at SSGA? Well, our mission is to invest responsibly to promote economic prosperity and social progress.

We do that by helping clients achieve investment goals, whether it is saving for retirement, funding research and innovation or building the infrastructure of tomorrow.

Most, if not all, of these desired outcomes are long term in nature. Indeed, our fiduciary responsibility is to ensure that we are maximizing the probability of attractive, long-term returns on our clients' behalf.

We do that primarily through building investment capabilities that help clients invest in companies that are likely to help them reach their long-term investment goals.

But creating those capabilities is only the beginning. After all, once clients invest in our strategies, they also own the underlying companies.

And we believe our responsibility to our clients extends to our stewardship of those assets. As passive managers, this is particularly important.

An index fund is essentially permanent capital. Unlike active managers, we can't walk away from a company so long as it is in the index.

As Jack Bogle once said: If you're an active manager and you don't like what a company is doing, you sell it. If you're an index manager, you try to fix it.[4]

You engage with companies in your portfolio.

You share your views on the risks and opportunities that you believe will affect returns over the long run.

Each year our team identifies specific areas that impact value over the long term and issues guidance to companies on how we think about addressing those areas.

Through this patient and consistent engagement, using both our voice and our vote, we seek to promote positive change.

That is asset stewardship — it goes hand-in-hand with good corporate governance. And the hallmark of our approach to it is not passive inaction or adversarial interaction — but active, transparent engagement.

Our goal is to create a two-way conversation that generates light, not heat, on different perspectives.

Effective, Independent and Diverse Board Leadership

So, what do we focus those engagements on? First and foremost, on board leadership.

Having served on a number of public, nonprofit, health care and mutual fund boards over the years, I believe effective, independent and diverse board leadership is a precondition for ensuring that companies are focusing on the long term, and increasing the probability of attractive long-term returns.

It is also possibly one of the most effective counterweights to the short-term pressures I described a moment ago.

By *effective*, we mean having the right skills. By *independent*, we mean a board that is not captured by management, that has the ability to exert its influence in oversight and decision-making. And by *diverse*, we mean with the skills, experience and diversity of thought necessary to provide a broad perspective.

The board is responsible for overseeing a company's long-term strategy. They are the ones assessing management's performance, ensuring board effectiveness and providing a voice independent from management that is accountable directly to investors.

They ask important questions, like, "Is the company meeting its milestones and exceeding its benchmarks?"

"What are emerging challenges and disruptions?"

"From where will innovation emerge?"

And, "Is management executing as well as possible given the company's stated objectives for the next 5, 10 or 20 years?"

Now, the good news is that corporate boards have come a long way since the financial crisis. Today, they are more actively involved in setting strategy, mitigating risk and, thanks to partners like the Weinberg Center, they are getting better guidance on ethical and governance issues.

In fact, data shows that there has been a positive shift toward more independent leadership on corporate boards since 2008.[5]

Still, as of 2016 there were significant gaps: nearly a quarter of S&P 500 companies and more than a third of the Russell 3000 had no independent leadership structure.[6]

In Europe the situation was in some cases worse. Nearly 9 in 10 of the CAC 40 in France, almost half of the DAX 30 in Germany, and a quarter of the FTSE 350 in the UK were led by boards without an independent chair.[7]

Notwithstanding their important role, we see a number of challenges at the board level preventing more companies from achieving their potential.

Perhaps the biggest is the frequency with which the "urgent triumphs over the important" — pressing business and regulatory needs come first, leaving long-term strategy and focus to fall to the bottom of the corporate board agenda.

Asset stewardship can go a long way toward reprioritizing a board that struggles with these issues.

That is why we made effective, independent board leadership the central element of our corporate governance engagement program — providing specific guidance on governance structures that enhance effectiveness, from the selection process, to the tenure of the position, to performance evaluation and succession.

Clearly with over 9,000 underlying companies in our investment portfolios, we do not engage with each. However, we have regular interaction with large companies as well as select sectors and companies with particular issues.

The goal of these efforts is to ensure that boards and individual board members of our portfolio companies are skilled and independent.

One of the big flashpoints in this debate has been whether to separate the CEO and board chairman roles.

We believe it's far more important that companies have policies, procedures and a board culture in place to empower independent board leadership — and leaders with good communication skills, the requisite time commitment, relevant industry expertise, and personal effectiveness.

We also expect boards to protect the interests of long-term shareholders when activist investors appear on the scene.

This has been an ongoing focus of our engagements with boards, as a growing number of companies have been reaching quick-fire settlement agreements with activists that change a company's long-term business, capital allocation strategies and corporate governance structures.

That's why we have told boards that they need to consider the interests of long-term shareholders as they assess everything from the duration of the agreements and ownership thresholds to holding period requirements for continued board representation.

They also need to consider any risk to the company's share price posed by a lack of board oversight on significant pledging activities by activists serving on the board.

Boards and Gender Diversity

Now, remedies such as board refreshment improve effectiveness and independence. What about diversity?

We think boards that embrace a broader range of perspectives are more likely to avoid groupthink and achieve better outcomes.

While we believe in and support board diversity on principle, we have been especially focused on gender diversity for a simple reason: Because of the compelling research connecting greater gender diversity with better performance.

A report by the Conference Board in January suggested that this outperformance is largely attributable to the new perspectives women bring.[8]

Notwithstanding this growing evidence, there are still far too few women serving on corporate boards.

A quarter of Russell 3000 companies still don't have a single woman on their boards — and for nearly 6-in-10 that do, less than 15% of their board members are women.[9]

It's not only at the board level where gender diversity matters. Evidence is also mounting that shows companies with higher levels of gender diversity in their senior leadership outperform companies with less diversity.

We are calling on the more than 3,500 companies we invest in in the US, UK and Australia to increase the number of women on their boards.

We are also issuing guidance to help them go about doing this. These principles are based on research showing the need for boards to expand the search for candidates beyond existing director networks and to address sources of unconscious bias that might inhibit the recruitment of women.

In addition, I have something else to share on the subject of gender diversity.

More than 25 years ago early one December morning the famous "Charging Bull" bronze sculpture was erected on Wall Street in front of the New York Stock Exchange.

The sculptor wanted the Bull to celebrate the "can-do spirit of America" and Americans' determination to work hard and be successful. The Bull was actually removed the same day it was installed.

Then there was a groundswell of support from New Yorkers, and then Mayor Koch and the Bowling Green Association found a permanent home for the Bull at the Bowling Green Park nearby where he stands today.

Today, we are giving him a new counterpart. [Refers to *She*, a sculpture of a defiantly posed little girl.]

She is a daring and confident girl celebrating the "can-do spirit" of women — who are taking charge today and inspiring the next generation of leaders.

She stands as a reminder to corporations across the globe that having more women in leadership positions contributes to overall performance and strengthens our economy.

Now this is just a mock up because she was actually just placed there a couple hours ago.

But you can check out some real photos during the day today on our State Street Twitter handle and our website ssga.com.

She will be with the Charging Bull for at least the next week — go visit her!

Incorporating Sustainability into Corporate Governance

The broader point here is that a long-term horizon requires a focus on sustainability. Sustainability issues, both environmental and social in nature, are increasingly being seen as drivers of long-term value and better outcomes for companies.

And boards have a big role to play here, and are often better equipped than the day-to-day management to see these issues over longer time horizons.

As all of you know, environmental and social sustainability encompasses a broad range of issues, from climate change and water and waste management, to supply chain management and safety issues, and workplace diversity and talent development.

And we see the evidence that these issues are becoming more important all the time.

Corporate scandals of the last few years, such as those around automotive emissions, food safety or labor issues emphasize the need for companies to assess the impact of ESG risks.

Of the top 10 global risks the World Economic Forum has identified in terms of their likelihood and impact, 70% were associated with environmental and social risks.[10]

It is not surprising, perhaps, that climate impacts feature largely here, as we continue to set new high annual temperature records.[11]

All of which is to say, sustainability matters.

Consumers value ESG.

Now, clearly we do not have the answers. That is the point. The range of outcomes that can happen is greater than what will actually happen. This is the definition of a risk and why we believe boards must incorporate ESG factors into the board's oversight of risk.

As ESG becomes a more mainstream risk factor, investing strategy and contributor to talent acquisition, it is changing how we think about governance.

Since 2013 we have had more than 2,000 engagements on ESG issues with over 1,200 companies in our global portfolio on a variety of issues.

For example, one sector project focused on oil and gas companies explored how businesses are navigating the challenges of falling crude oil prices, geopolitical risks, climate change, and emission reductions.

Talks with a Taiwanese packaged food company centered on monitoring food safety within its supply chain.

Meetings with a garment sector company raised ways that labor supply chains and fire safety standards can be improved.

After a multiyear engagement with various companies on environmental standards, we saw significant improvements in the quality and transparency of reporting around hydraulic fracturing, water and waste management practices.

As we have engaged with companies on these issues over the years, we have seen the good, the bad, and the ugly of how companies are — or are not — considering ESG impacts.

This was especially true after our votes in 2016 supporting shareholder resolutions on climate change initiatives set us apart in the industry.

Now I want to be clear: making ESG a priority isn't about imposing morals or values.

It's about our belief that these issues have a long-term impact on the health of companies in our portfolio and, as such, are potential risks we think companies need to assess as they would any other.

We believe asset stewardship can help companies get out ahead of these issues.

As we have spoken out about these issues, boards have asked us for guidance on how to incorporate a sustainability lens into their long-term strategy.

That is one of the reasons we decided to make environmental and social sustainability the focus of our asset stewardship engagement in 2017.[12]

It is focused on six main areas.

1. First, has the company has identified material environmental and social sustainability issues relevant to its business?
2. Second, has the company done the work to assess these implications and, where necessary, incorporated them into their long-term strategy?
3. Third, does the company consider long-term sustainability trends in its capital allocation decisions? Are they spending money on it?
4. Fourth, do they have the right people with the right skill sets to evaluate and monitor these issues?
5. Fifth, are companies tracking and measuring performance in this area? Are they incorporating key sustainability drivers into performance evaluation and compensation programs with specific performance indicators?
6. And finally, has the company adequately communicated its approach to sustainability issues and its influence on strategy to shareholders and other key stakeholders?

We think getting more companies and boards to commit to focus on these areas will lead to a dramatic improvement in how ESG issues are considered from a business perspective.

Our preferred approach to all these issues — effective, independent board leadership, gender diversity and ESG — is through active dialogue with company and board leadership.

And in the event that companies fail to take action despite our best efforts to engage with them, we will use our proxy voting power to effect change.

Notwithstanding their important role, it shouldn't all be on the boards' shoulders. We all — investors, asset owners and other stakeholders — have a part to play in making corporate governance a priority.

That's why, in January, we helped launch a set of comprehensive stewardship and governance principles as part of the Investor Stewardship Group — a collective of large U.S.-based institutional investors and global asset managers.[13]

We took a leading role in the ISG, which is the first time that both asset managers and asset owners in the US have signed on to a common set of principles.

These principles, which you can find on the conference website, encourage all investors to become active owners and engage with the companies in their portfolios across all relevant ESG issues.

Already we have been inundated with requests from institutional investors to sign on to the principles.

Perhaps most importantly, ISG principles require us to work with other institutional investors to encourage their adoption.

Even though State Street manages $2.4 trillion in global assets, McKinsey reports that global assets under management total more than $68 trillion.[14]

That tells us that only as more and more of our fellow asset managers use their voices and votes alike can we make corporate governance the priority it needs to be.

Taking the Lead on Corporate Governance

But most of all, that tells us that to advance corporate governance, my industry needs to lead.

That as institutional investors, we can encourage businesses to be on the leading edge when it comes to long-term value creation, or behind the curve.

That we can either do the minimum for our clients, or act with a heightened fiduciary responsibility to the millions of individuals who entrust their financial futures with us through retirement plans, endowments and foundations, financial intermediaries, and sovereign institutions.

By being active stewards of the assets we hold — and by pushing boards at our portfolio companies to put a premium on diversity, sustainability and long-term value creation — we can enable economic prosperity, advance social progress and

create the future investors want to invest in.

We look forward to working with the Weinberg Center to help make it possible.

Thank you.

1 CNN, "Amazon makes its first drone delivery in the U.K.," 12/14/16.
2 Fortune, "CEO exit schedules: A season to stay, a season to go," 5/6/15.
3 Harvard Business Review, "Yes, Short-Termism Really Is a Problem," 10/9/15.
4 Bloomberg, "Q&A With Jack Bogle: We're in the Middle of a Revolution," 11/23/16.
5 SSGA Letter to Directors and Guidelines on Effective Independent Board Leadership, 2016.
6 Ibid.
7 Ibid.
8 Darren Rosenblum, Daria Roithmayr "The Effect of Gender Diversity on Board Decision-making: Interviews with Board Members and Stakeholders," The Conference Board, January 2017.
9 Equilar press release: "Boards Will Reach Gender Parity in 2055 at Current Pace," 2/1/17.
10 World Economic Forum, "Part 1 – Global Risks 2017".
11 New York Times, "How 2016 Became Earth's Hottest Year on Record," 1/18/17.
12 SSGA.com ESG Guidelines, 1/26/17.
13 Investor Stewardship Group Press Release, "Leading Investors Launch Historic Initiative Focused on U.S. Institutional Investor Stewardship and Corporate Governance," 1/31/17.
14 Deloitte, "The new principles of brand leadership," 2017.

ssga.com

Marketing Communication

State Street Global Advisors EMEA Entities

Belgium: State Street Global Advisors Belgium, Chaussée de La Hulpe 120, 1000 Brussels, Belgium. T: 32 2 663 2036. F: 32 2 672 2077. SSGA Belgium is a branch office of State Street Global Advisors Limited. State Street Global Advisors Limited is authorised and regulated by the Financial Conduct Authority in the United Kingdom.

Dubai: State Street Bank and Trust Company (Representative Office), Boulevard Plaza 1, 17th Floor, Office 1703 Near Dubai Mall & Burj Khalifa, P.O Box 26838, Dubai, United Arab Emirates. T: +971 (0)4 4372800. F: +971 (0)4 4372818.

France: State Street Global Advisors Ireland Limited, Paris branch is a branch of State Street Global Advisors Ireland Limited, registered in Ireland with company number 145221, authorised and regulated by the Central Bank of Ireland, and whose registered office is at 78 Sir John Rogerson's Quay, Dublin 2. State Street Global Advisors Ireland Limited, Paris Branch, is registered in France with company number RCS Nanterre 832 734 602 and whose office is at Immeuble Défense Plaza, 23-25 rue Delarivière-Lefoullon, 92064 Paris La Défense Cedex, France. T: (+33) 1 44 45 40 00. F: (+33) 1 44 45 41 92.

Germany: State Street Global Advisors GmbH, Brienner Strasse 59, D-80333 Munich. Authorised and regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht ("BaFin"). Registered with the Register of Commerce Munich HRB 121381. T: +49 (0)89 55878 400. F: +49 (0)89 55878 440.

Ireland: State Street Global Advisors Ireland Limited is regulated by the Central Bank of Ireland. Registered office address 78 Sir John Rogerson's Quay, Dublin 2. Registered number 145221. T: +353 (0)1 776 3000. F: +353 (0)1 776 3300.

Italy: State Street Global Advisors Limited, Milan Branch (Sede Secondaria di Milano) is a branch of State Street Global Advisors Limited, a company registered in the UK, authorised and regulated by the Financial Conduct Authority (FCA), with a capital of GBP 62,350,000, and whose registered office is at 20 Churchill Place, London E14 5HJ. State Street Global Advisors Limited, Milan Branch (Sede Secondaria di Milano), is registered in Italy with company number 06353340968 - R.E.A. 1887090 and VAT number 06353340968 and whose office is at Via dei Bossi, 4 - 20121 Milano, Italy. T: 39 02 32066 100. F: 39 02 32066 155.

Netherlands: State Street Global Advisors Netherlands, Apollo Building, 7th floor Herikerbergweg 29 1101 CN Amsterdam, Netherlands. T: 31 20 7181701. SSGA Netherlands is a branch office of State Street Global Advisors Limited. State Street Global Advisors Limited is authorised and regulated by the Financial Conduct Authority in the United Kingdom.

Switzerland: State Street Global Advisors AG, Beethovenstr. 19, CH-8027 Zurich. Authorised and regulated by the Eidgenössische Finanzmarktaufsicht ("FINMA"). Registered with the Register of Commerce Zurich CHE-105.078.458. T: +41 (0)44 245 70 00. F: +41 (0)44 245 70 16.

United Kingdom: State Street Global Advisors Limited. Authorised and regulated by the Financial Conduct Authority. Registered in England. Registered No. 2509928. VAT No. 5776591 81. Registered office: 20 Churchill Place, Canary Wharf, London, E14 5HJ. T: 020 3395 6000. F: 020 3395 6350.

Investing involves risk including the risk of loss of principal.

The whole or any part of this work may not be reproduced, copied or transmitted or any of its contents disclosed to third parties without SSGA's express written consent.

The information provided does not constitute investment advice and it should not be relied on as such. It should not be considered a solicitation to buy or an offer to sell a security. It does not take into account any investor's particular investment objectives, strategies, tax status or investment horizon. You should consult your tax and financial advisor. All material has been obtained from sources believed to be reliable. There is no representation or warranty as to the accuracy of the information and State Street shall have no liability for decisions based on such information.

Risks associated with equity investing include stock values which may fluctuate in response to the activities of individual companies and general market and economic conditions.

ID12215-2040492.1.1.GBL.RTL 0218 Exp. Date: 28/02/2019