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GOVERNANCE PERSPECTIVES

The "Commonsense Principles of Corporate Governance" Make Sense

- A group of prominent CEOs and investment managers has endorsed a set of corporate governance principles for U.S. public companies. Although these principles are not particularly provocative, they are built on two fundamental principles that are diametrically opposed to precepts of many activist investors and the corporate governance industry generally: businesses should be run for the long-term, and one-size-fits-all governance thinking is wrong.
- The sponsoring group included an activist investor—further evidence that at least some activist shareholders should be taken seriously even when they speak inconvenient truths.

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In July 2016, an ad hoc group of prominent CEOs, investment managers, and investors published the "Commonsense Principles of Corporate Governance," a series of principles recommended as a basic governance framework for public companies, their boards, and their shareholders. The Commonsense Principles were born of conversations between Warren Buffett of Berkshire Hathaway and Jamie Dimon of JPMorgan Chase, and they are sponsored by a veritable who's who of industrial America as well as the heads of major institutional investors. The group even includes an activist shareholder for good measure.

The Commonsense Principles were published with much fanfare, including a full-page ad in *The Wall Street Journal* and an open letter signed by the sponsors,[1] and drew a great deal of public interest and some skepticism. Of course, much of the buzz generated by the Principles can be attributable to the relative celebrity status of the sponsors. In addition, some of the sponsors, including Warren Buffett and Larry Fink of BlackRock, are well-known governance advocates, with audiences keen to hear their latest views on issues facing U.S. corporations. Regardless, we applaud these executives staking a claim on behalf of corporate America even if the Principles are largely tried and true.

The most notable feature of the sponsor group is not the prestige of its members but their diversity. Some may say that this particular group came late to the governance conversation, noting that many experts, as well as special interest groups, have published volumes of governance principles over the past

1 The Commonsense Corporate Governance Principles, the open letter and related materials are available at www.governanceprinciples.org.

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several decades. In our view, however, meaningful discussions among individuals with disparate interests and diverse points of view enhance the discussions, no matter when or how. Of course, recommended principles that result from group discussions are often negotiated principles, typically more so when the group members are diverse and strong-minded. As such, it is not surprising that the final Commonsense Principles trend toward more conventional and familiar practices such as the importance of board diversity, director independence, and constructive shareholder engagement. In any event, the Commonsense Principles do not lack value simply because the recommended tenets are familiar rather than groundbreaking.

Even familiar concepts can gain nuance when read in new contexts. In this case, the SEC's recent concept release relating to disclosure modernization provides an important counterpoint to the Commonsense Principles on public reporting requirements. In the concept release, the SEC actually asked whether companies should be required to report financial results more frequently than quarterly. While the Commonsense Principles do not expressly refer to the SEC's concept release, the principles relating to public reporting and quarterly financial results refer repeatedly to long-term goals and views, and specifically reject quarterly guidance, clearly counter to the SEC's trial balloon regarding the merit of more frequent financial reporting.

More fundamentally, the Commonsense Principles rest on two pillars that we have consistently advocated—a long-term perspective on governance issues and a caution that one-size-fits-all governance solutions are unwise. These are important principles, directly at odds with the lemming-like views articulated by the loudest, most persistent voices on corporate governance—the proxy advisory firms, many public pension funds, Harvard's Shareholder Rights Project, and their ilk.

Finally, we note that the sponsors of the Commonsense Principles included an activist investor, Jeff Ubben of ValueAct Capital. The inclusion of an activist in this thought-leadership group recognizes the now-central role of activists in the governance arena. Perhaps more importantly, it signals that the group's CEOs recognize that some activists can have thoughtful and valuable insights and can contribute to discussions in a meaningful and collegial way.

In the same vein, we encourage corporate directors to continue to assess activist investors with a critical eye but an open mind. Of course, not every activist investor is experienced, sophisticated, or interested in a company's long-term strategic goals. Conversely, however, activists' ideas should not be resisted simply because they ask questions that may have unwelcome answers.

In sum, the Commonsense Principles offer yet another endorsement that corporate leaders are willing to be thoughtful. Here's hoping the investor classes are willing to think long-term.

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