



ICGN

International Corporate Governance Network

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The Changing Global Balances

Conference Summary

By Courteney Keatinge

Opening Keynote Address by Minister of Finance, Jim Flaherty

Moderator: Jim Flaherty, Canada's Minister of Finance, is well known. He was recently awarded Euromoney Magazine's award for Finance Minister of the Year. He has been credited with enhancing Canada's reputation for sound fiscal policy while overseeing a strong regulatory regime that has kept the Canadian financial system out of chaos. Previously, for more than 10 years he served as a Member of Parliament. He also served as Deputy Prime Minister, Minister of Finance, Attorney General and Minister of Labour. Minister Flaherty is both a governor of the World Bank and the International Monetary Fund. He's a cum laude graduate of Princeton and Osgoode Law School.

Currently, he's championing national securities commission – a national securities commission for Canada that would replace the provincial system and he recently made headlines for opposing two taxes recommended by the IMF to fund future bank bailouts. And from the weekend's newspapers, it would appear that he won that battle. So one more thing about Minister Flaherty, I've heard that he had honed his hockey skills at Princeton which have proved to be very important to him as he is a skilled politician adept at stick handling the most complex political issues. Mr. Flaherty, welcome and thank you for coming to speak to us today.

Hon. Jim Flaherty: *Well, good morning. I did play a lot of hockey at one time. It is important to stick handle as finance minister. You also need to get your elbows up in the corners from time to time I can assure you in some of our international meetings especially.*

Bonjour. C'est un grand plaisir d'être ici parmi vous ce matin à Toronto.

It is good. I'm happy to be home in Toronto which is my home after three weeks of travel in India and South America and China and Korea. I'm happy to say that we made significant progress over the weekend on Friday, Saturday and Sunday in Pusan and I think it's a good example of the G-20 working well together in a time of crisis. The G-20, as directed by our leaders, is the primary economic forum in the world today. And we certainly support that concept. I've been a participant in the three summits so far — in Washington in November 2008 and then last year in London and in Pittsburgh. And, as you know, in a few weeks we will host the next G-20 Leaders Summit here in Toronto. Lots of work that needs to continue to happen between now and then so that our leaders will be in a position to make some important steps forward at the Toronto Summit

My recent trips along with those of our Prime Minister, Prime Minister Harper of Canada and some of our other ministers have been about helping our government prepare the way for some key decisions that need to be made at the upcoming Leaders Summit. Internationally, as you know, we are in the midst of a promising but fragile global recovery. This recovery is no accident. It is thanks to the unprecedented cooperation in the G-20. As we lead up to the Toronto Summit, the focus will remain on delivering on the commitments that our leaders have already made.

Your conference's theme of Changing Global Balances is a timely one. The world does require new approaches and continued global cooperation. This is the theme of the Toronto Summit, Recovery and New Beginnings. Following a lot of travel that has taken me to key G-20 economies these past few weeks, I am pleased to say that Canada's leadership in reaching a global consensus is recognized and welcomed.

And to fully understand the importance of where we are today in June of 2010, it's important to look back a little bit and to remember where we were and how serious the crisis was back in the autumn of 2008. I can remember here in Canada, it was Friday, October 10th, 2008, in the morning announcing that we would take certain steps to make sure our banks, our financial institutions were able to maintain a level playing field because other countries had taken over banks and had guaranteed banks' indebtedness and so on. We agreed to purchase some insured mortgages to ensure adequate liquidity in our financial systems.

And then going during the day to Washington, in the afternoon meeting in the Cash Board of the Treasury with the G-7 central bankers and finance ministers. And this was a meeting not like other meetings. I've been to lots of them over the course of more than four years now. This was a meeting where we threw away the script, we tore up the communiqué. You know these communiqués are prepared in advance of meetings which is a very peculiar habit that bureaucrats have. That's to avoid – I guess avoid elected people making serious decisions at these meetings. In any event, we tore that up. And it was quite a serious discussion.

At that point some German banks had failed, the United Kingdom had to take over, nationalize in effect some banks. Of course Lehman Brothers has just failed the month previously and it was an intense discussion with some blaming of others taking place in the room. The end result was we tore up the communiqué, created a five-point plan.

The reason I'm telling you all of this is a) this was a very serious crisis. The markets were unstable. It was unclear whether some markets would even open on the following Monday. And b) because the international bodies, the G-7, G-20, IMF, World Bank all got together that weekend in Washington and all adopted this same five-point plan which created a degree of certainty and certainly direction in terms of what we were going to do. Fundamentally, we were not going to let any more financial institutions fail and that was the fundamental commitment.

At that time, as you know, we were dealing largely with investment banks and banks generally. Now in 2010 the European challenge, which is a challenge for all of us, relates to some sovereign debt that needs to be addressed. We are all agreed in the G-20 that fiscal consolidation is mandatory and not just fiscal consolidation among those countries that need to reduce their level of indebtedness but also the will to follow it through. And this is essential as we go forward in the next few weeks leading to the G-20 Summit in Toronto.

After that weekend in October 2008, there followed the first G-20 Summit in Washington in November 2008 which was led by President Bush. Again, there was a high degree of cooperation among the leaders and the finance ministers who were present in Washington and then later – later in New York. We agreed then of the need for stimulus and all of the G-20 countries agreed to create stimulus in their economies — two percent a year over the course of two years; four percent of GDP. We did that in Canada. Fortunately, we had good cooperation by our federal partners, by the provinces and territories in Canada. And together we created a stimulus of in excess of four percent of GDP. It is a two-year package. There's much talk about exit strategies in the G-20. We've built in our exit strategy in that the majority of our spending is infrastructure spending and it is being terminated as of the end of March 2011.

We made the clear from the beginning in the budget that I delivered in January 2009 which had the stimulus package in it that we would spend the money, we would spend it over two years but then it would end and we're going to make sure that it ends as of March 2011. That's important

because that gives us the opportunity immediately as of the next fiscal year to cut our deficit in half and by the following year by two-thirds and then move to balance in three to four years in the Canadian context.

We were running balanced budgets in Canada before the crisis. We listened to businesspeople and ordinary Canadians and certainly the investment community in Canada and decided to run a deficit, a fairly sizeable deficit over the course of a couple of years in order to stimulate the economy. It is working. The Canadian economy in the first quarter of this year grew 6.1 percent real GDP and that is above expectations. We're pleased with that result. We're still concerned with the unemployment rate which is about 8.1 percent right now. But relatively speaking it's better than what our neighbour to the south, what the United States is experiencing in terms of unemployment.

Now, as you know, in Europe, financial markets are looking with concern at the debt situation of some countries. In Canada we have a controlled debt situation, as I say, and we'll move to balance in the intermediate term.

We also have a good brand these days. The Canadian brand is of strong financial institutions. The World Economic Forum calls Canada's financial system the most sound in the world. I can recall being in China actually in January 2007 and some concerns being expressed by my counterparts there about Canada's banking system being boring and risk averse. Gee, you know, when I went back last week I didn't hear much of that. I heard things like healthy and stable and solid and prudent which is the Canadian financial system.

Our overall tax rate on new business investment this year will be the lowest in the G-7 and below the OECD average. We're reducing corporate taxes. The opposition here tells us we shouldn't do that but we have a long-term plan to get our federal corporate tax rate down to 15 percent. It was a little bit over 22 percent when we took office more than four years ago. We've been reducing it every year. We'll get it down to 15 percent by 2012. I have encouraged the provinces to join us in that, get their corporate rate down to 10 percent because in Canada both the provinces and the federal government levy corporate tax. So by 2012-13 we will have a combined corporate tax rate, business tax rate in most of Canada of 25 percent which will be easy to communicate and a clear brand for Canada. We have reduced our consumption tax by two percent as we promised to do. And this year in my budget we got rid of tariffs on inputs, on manufacturing inputs. We are now in Canada the first tariff-free country on manufacturing inputs in the G-20. All of this is part of a competitive advantage.

In terms of fiscal discipline, Canada today has the lowest debt-to-GDP ratio in the G-7. The IMF expects Canada to have the strongest recovery in the G-7 over the next two years. All of this is as a result of fiscal discipline which I as an elected person realize is not always the easiest thing to do and I understand the challenges faced by some of my colleagues elsewhere but the need is there to pay down substantial amounts of debt in Canada. In our first three years, we paid down almost \$40 billion of debt before the recession – the crisis and the recession happened. That helped us to be able to go into deficit briefly and then come back out of it without creating a structural deficit.

If Canada is going to call on other nations to follow through on fiscal consolidation, which we are, we had better do it ourselves. And I have a budget bill before the House of Commons. This is a little bit of domestic demand here. We are trying to get our budget bill through the House of Commons and in Canada we are a minority government so I'm urging my

parliamentary colleagues to do that. We have a budget vote tonight in Ottawa and I think we'll make some progress in moving our budget forward. We need to do that. We're asking other countries to exercise fiscal consolidation that we need to make sure that we're proceeding with our own Economic Action Plan as we are and that we're leading by example.

I am encouraged, and I'll repeat this, I am encouraged by the cooperation that we see in the G-20. There's much discussion on the number one issue which is strong, sustained and balanced growth. I chaired the discussion about that at the G-20 on Saturday. Our intent is to get a clear agreement on the principles needed to achieve real progress on reducing deficits and debt burdens. In Toronto we will push for clear, credible, concrete, timely fiscal consolidation plans that will reduce and eliminate our deficits to put debt burden on a downward and sustainable path. It is critical for all economies to go in this direction.

On financial sector reform, a lot of talk about bank levies and so on these past few weeks including on the weekend. Fundamentally, we are opposed to a bank tax, an ex ante bank tax for several reasons, most important of which, and we share this with the majority of G-20 countries, is that we did not put taxpayers' money into our financial institutions during the crisis. To impose a tax now, an ex ante tax on our financial institutions would inevitably flow through as a tax to – as a cost of doing business to customers. So we would in Canada be imposing a tax on Canadians whose money was not used to bail out banks during the difficult time. So we're not going to do that. I've had this discussion certainly with my colleagues in the G-20 but, as I say, the majority of countries in the G-20 will not be imposing an ex ante tax.

Now we all agree on the principle that to the extent a financial institution contributes to a crisis in the future, it is the debt holder and shareholders of the financial institution that should bear the cost of that contribution and not taxpayers. Now there are different ways of getting resolution of that principle, one of which Canada has suggested which is an embedded contingent capital provision. We've provided some detail of that to our colleagues and that is being looked at as well as one of the solutions.

But one size does not fit all on this issue. There are a few countries that are interested in an ex ante bank tax and they may proceed, a few of them, doing that. But there will not be a global tax of that nature, a global ex ante bank levy.

It also concerns me as a finance minister, I can tell you, when countries are running deficits and if they impose some kind of bank levy and the idea is that this bank levy money will be used later on when there's a crisis, one wonders whether the money would really be there later on and I say that as someone who has to manage budgets and looks at deficits and the tendency would be for any government to use that money to reduce their deficit when they have it at hand rather than have it put aside for another time.

Christy very kindly mentioned securities reform which I've been working on here for several years. Canada does have a strong financial system. We have an effective regulatory system. As you know, most of the financial institutions that failed during the crisis were regulated — not well, but they were regulated. So in our discussions, I always emphasize with my colleagues the importance of effective supervision, not just having a supervisory framework. In Canada we do have an effective supervisory framework of our financial institutions through the Office of the Superintendent of Financial Institutions. We also have the Financial Consumer Agency of Canada. I know some other countries are looking at that type of agency. We've had one for some years. The Bank of Canada of course responsible primarily for monetary policy. The

Canada Deposit Insurance Corporation and my department, the Department of Finance.

This group, the leaders in the institutions that I just mentioned meet regularly. That's our macro economic overview in Canada. But what we are missing is a common securities regulator in Canada. Right now, we have 13 provinces and territories in the business of securities of regulation so in the five budgets that I've done here we have consistently proposed that we would work with participating provinces and territories to create a Canadian securities regulator. We have created a Canadian Securities Transition Office.

Ten of the provinces and territories have been working with the Government of Canada toward creating the Canadian securities regulator. We have in fact created the draft law, the bill which I tabled in the House of Commons about 10 days ago. We referred the bill to Supreme Court of Canada for a constitutional interpretation. Our view is that the federal government has the constitutional authority in the Canadian context to legislate in this area but we want to have certainty for investors and certainty for business and certainly in the securities area so we are asking our highest court to give us that ruling.

Then we would be able to fill what is really the missing chair, the empty chair at the table with the Department of Finance, the Office of the Superintendent of Financial Institutions, the Bank of Canada, the Canada Deposit Insurance Corporation and the Financial Consumer Agency of Canada. I expect that we'll see the ruling of the Supreme Court of Canada in 10 to 18 months so that's our timetable and the would make any changes we needed to make and proceed.

So we've made a lot of progress, more progress than has ever been made before on creating a Canadian securities regulator.

Now I've gone on almost as long as it seems. I'm glad to see most of you are still awake and let's look at the big picture for a moment. Leadership is measured not by what we say but by what we do and that includes in the G-20. In so many ways, Canada has done well during the crisis. We do have a world leading financial system. We have a competitive advantage through tax relief and we have had budgetary prudence. We do have to work with our colleagues now in the G-20 to make sure that we have a sound basis for sustainable growth going forward. This doesn't mean growth at any cost. It means sustainable growth over time. The discussions that we had on the weekend were largely about fiscal consolidation in this area but also about mutual assessment practices so that we will be able to country to country be assured that there is financial system integrity from country to country, dealing with that interconnectedness that Christy referred to. It is important that we make progress in that area at the summit in Toronto and we are all agreed that we need to push forward seeking concrete results in a cooperative and committed way so that we can have balanced growth. The concern of course given the weakness in some of the vulnerable European sovereign states is that their need to exercise fiscal consolidation will have a negative effect on growth so it is important in terms of balances that the emerging economies like China increase domestic demand. China is in fact going in that direction intentionally, increasing domestic demand so this can help balance the effects of fiscal consolidation in other – in some of the developed economies.

I wish you every success at your conference. Thank you for the invitation. Thank you for the opportunity to be here this morning. You're doing important work and a contribution to the balance that we are seeking internationally.

(Transcription prepared by Media Q Inc. exclusively for Department of Finance Canada)

The New Global Economic Balance

Antonio Borges, Chairman of the Hedge Fund Standards Board and the European Corporate Governance Institute in Portugal, discussed sovereign debt policies in Europe and described how Greece may have impacted the recovery process. He described the need to stop blaming the markets, and start taking steps to ensure policies are put in place to effectively boost economies, rather than continuing business in the same fashion and subsequently relying on bailouts.

Christian Strenger, Government Adviser and Director of DWS Investment GmbH, Germany, described the breakdown in communication between politicians and financial intuitions. He stressed that the root causes of these issues are the fundamental deficits in budgetary discipline.

George Lewis, Group Head of Wealth Management at RBC Royal Bank in Canada discussed the importance of balancing global trade as well as fiscal imbalances. He noted that countries could accomplish this balance by focusing on savings instruments, and not by investing solely in the country's consumption. He stated that the sources of instability that we see in the financial system are sourced from a country's tendency to accommodate existing global imbalances. By placing emphasis on fiscal consolidation, countries may be more able to address their issues with trade and thus stabilize the global imbalance.

The panel discussion focused on how Europe, as a whole, is in balance, due to the surpluses in some countries cancelling out the deficits in others. The panel noted that competitiveness is the real issue that must be addressed in Europe. Countries that have healthy economies will likely continue to attract capital because they will use finances efficiently, however many countries are misusing capital, which is the most pressing issue that is facing Europe. By focusing on competitiveness and sustainable growth, the panel agreed that countries will be able to successfully cultivate healthy economies. Additionally, the panel discussed the importance of savings and proper investment policies that will foster a healthier economy, as well as the importance of creating a common culture of ethical values that will build confidence in the market and allow for more effective policies. Also noted by the panel was the importance of investor protection in financial markets. This protection will allow investors to assist in greater oversight of markets, more effective creation of capital, and foster more transparency and disclosure.

The Business Case for More Women on Boards

Eli Sætersmoen, Managing Director of Falck Nutec AS in Norway, discussed how diverse teams generally make better decisions, and she stressed the pressing need for a more equal distribution of power in the corporate world. She discussed regulation in Norway that requires women's participation on boards, which she argues has led to better recruitment processes, more competent directors and a heightened atmosphere of professionalism in the boardroom.

Faye Wattleton, former Chair of the Nominating Committee for Estée Lauder in the United States, discussed her experience on several boards and expressed her belief that women who currently sit as directors hold the responsibility to bring more women on boards. She cited the Catalyst study on this topic and noted the importance of bringing the critical mass of women to boards in order to further gender equality as well as company profitability.

Daniel Ferreira, Reader (Associate Professor), Department of Finance Director, Corporate Finance and Governance Programme, Financial Markets Group (FMG), London School of Economics, in the UK, has previously published research on Women in the Boardroom. He stated that data from his research clearly gives the business case for women directors on boards. He stated that women's participation on boards generally leads to increases in good governance practices as well as profits. For example, women on boards have typically higher attendance ratings and also help to improve the attendance of the other members of the board. He noted that the most pressing area of attention should be women sitting on compensation committees, as there is very little female representation in that area. Mr. Ferreira noted that women are generally tougher board members and behave differently from men in the boardroom, for example women are more likely to hold CEO's accountable for poor performance and are more willing to scrutinize details of management reports.

Deborah Gillis, Vice President of Catalyst in North America, discussed how diversity is good for business and agreed that it allows for better decision-making and governance practices. She cited the Catalyst study in which it was found that companies with more women directors had significantly higher financial performance than those without and that a critical mass of 3 or more women serving as directors will indicate even stronger financial results. Ms. Gillis stated that women's presence on boards generally indicates more openness to perspectives and can set the tone at the top for the company. She additionally noted that research suggests that the presence of women directors can lead to more women corporate officers, which has also been linked to better financial performance.

The Evolution of Capital Markets - Threats to Good Corporate Governance

Claire Bury, of the European Union, argued that politicians need to stop blaming the market for the current financial crisis and instead take steps to improve regulatory conditions. She noted a breakdown in communication between interested parties, and the need for all stakeholders to generate participative solutions to market issues. Ms. Bury discussed issues of transparency, voting rights, derivatives and short selling as all playing a role in the current financial crisis and the subsequent regulatory environment.

Tom Kloet, Chief Executive Officer of TMX Group in Canada explained how Canada has set up regulation in a 2-tier context in order to accommodate both junior and senior listed companies. He noted that this is an important factor in applying the right amount of regulation to a company, depending on its size and scope. He criticized schemes such as Sarbanes-Oxley for over-regulating some companies and instead favors a cost-benefit approach to proportionate regulation that will ensure the best oversight for various companies. Mr. Kloet also discussed the role of high frequency trading on the Canadian market as well as the importance of ETFs for product innovation and cost-effective ownership rights.

Marcel Jeucken stated the importance of consistently exercising voting rights. He also discussed cross-border voting and the issues of votes not being counted. He urged investors to make their voices heard to the companies in which they have ownership in order to affect the greatest positive changes for the companies and their portfolios. He also stressed the importance of transparency in the voting process.

The panel discussed the various regulatory monitoring systems across countries, especially as is related to say on pay and market transparency. The panel agreed that there needs to be

more communication in the market about these issues, and there should also be a clarification about where greater transparency is needed. The panel also discussed the need for more communication and discussion between regulators and financial institutions on issues of transparency.

The New Balance in Corporate Social Responsibility

David Collyer, President of The Canadian Association of Petroleum Producers, argued that oil, especially that which is produced in Canada is responsible energy. He noted the changing stakeholder expectations regarding energy production and that while critics of fossil fuels want to move away from oil and gas altogether, demand is steadily growing, mainly due to population growth. He cited that while energy demands in the developed world have begun to stabilize, forecasts say that there will be a 50% increase in energy demand by 2030, and that demand will double by 2050. While he stated that the industry supports the diversification of energy sources, he also stressed the importance of being realistic about how quickly those new sources can be developed. In the meantime, the world will become more reliant on nontraditional oil sources, such as those from Canada's Oil Sands. He noted that energy production from the Oil Sands has enjoyed reduced greenhouse gas emissions through improvements in technology and additionally offers Canada benefits such as jobs and increased state revenues. He also noted the majority of approval for oil production from the Oil Sands within Canada is due to its economic benefits to the country. Mr. Collyer stated that communication and future performance are key in the success of continued Canadian operations and that he is committed to continuing the dialogue about energy production with policy makers and investors.

Brian Ferguson, President and Chief Executive Officer of Canada-based Cenovus Energy stated that having an environmental strategy is an important part of his company's corporate social responsibility initiatives. He believes that strong environmental leadership is critical and stated that he is committed to the use of technology to improve environmental performance.

Hal Kvisle, Chief Executive Officer of TransCanada, stressed his emphasis on having safe and reliable operations. He gave an overview of his company and talked about future operations, including building a large-scale natural gas pipeline. He noted the political and capital issues of executing this project and mentioned the role of NGOs in energy production. Mr. Kvisle also noted the difficulty of tackling the consumption addition and stressed the importance of focusing on cleaner sources of energy and technology's use in dealing with this issue.

Damon Silvers, Director of Policy and Special Council for the AFL-CIO and Member of the Congressional Oversight Committee for the United States' Toxic Asset Recovery Plan, then responded to Mr. Collyer, Mr. Ferguson, and Mr. Kvisle. Mr. Silvers stated that there is a need for fossil fuels, and that their sources of energy have been the driving force behind furthering society. Additionally, he recognized the creation of jobs that the oil and gas industries bring. He noted, however, the industry's horrifying history of social exploitation and environmental destruction. He also noted that investors must realize that oil prices, especially those of BP are down and this is a consideration that they must take into account when making future investments. Mr. Silvers stated that it will be very difficult to break our consumption of fossil fuels and that society must accept the subsequent collateral damage, but ultimately, he believes that it is our only option for creating a better future.

The panel then discussed the importance of diversifying energy sources, as well as managing

and diversifying risks in the industry. The panel noted that due to the recent disaster in the Gulf of Mexico, increased scrutiny of the industry is likely. However, all those on the panel who had operations in the Oil Sands suggested that their operations could be found attractive, due to the minimal risk, relative to other forms of exploration and drilling.

International Financial Reporting Standards- Was Accounting a Root Cause of the Global Financial Crisis?

Paul Cherry FCA, Chairman of the Standards Advisory Council in Canada discussed accounting standards' impact on the financial crisis, especially that of fair value accounting, provisions for loan losses, and off-balance sheet arrangements. Because accounting, he argued, has been typically pro-cyclical in nature, in that it exaggerates profits and underreports losses, it could have played a large role in the crisis. Mr. Cherry also discussed the IASB's current use of a mixed value model of reporting, as well as a proposed expected loss model. He also emphasized the need for regulatory agencies to ensure that they don't rush to implement new standards, and that they take the time to ensure that whatever regulation is put in place be thorough and effective.

Shyam Sunder, James L. Frank Professor of Accounting, Economics and Finance at Yale School of Management in the United States stressed that corporate governance and accounting are closely intertwined, and thus responsible and vigilant investors are the key to good governance. He also discussed fair value accounting, but prefers to refer to it as mark to market accounting, as it is a more accurate description of the practice. He discussed how accounting practices have moved progressively from GAAP to statutory interpretations of accounting principles and how this shift to a broader scope has eliminated room for judgment through aggressive clarification of rules. He argued that the more specific the rules are, the easier they are to circumvent, and suggested that there is a need for balancing statutory and common law approaches to accounting. Mr. Sunder also suggested allowing several standards to be used by companies, and allowing competition to determine which standard is most appropriate for the market.

The panel then discussed the need for global standards and agreed that guidance is immediately required in order to ensure market efficiency. They discussed how the issues in accounting standards are mainly a North American problem, and also agreed that governance needs to be improved in this area by making the standard setters independent entities.

The New Balance: Strategic Environment for Business

Lowell Bryan, Director (Senior Partner) of McKinsey & Company in the United States discussed the recent fundamental shifts in the world's economy.

He noted the massive increase in global GDP growth fueled by demographic shifts and urbanization would lead to increasing technology, more jobs, and higher standards of living. This shift in demographic composition will force companies to fundamentally change their business models, and noted that many innovations will blowback to disrupt developed markets. Additionally, he stated that demand for natural resources is expected to increase significantly, and that innovation will lead to increased consumption. These changes, he stated, are likely to create substantial volatility.

Mr. Bryan noted that US employment has showed a small recovery, but it will likely take years before employment will recover to pre-crisis levels. He believes that if domestic fundamentals remain unbalanced, there is a reasonably high probability of more financial earthquakes to come. McKinsey research showed that many people see that the probability of financial crisis in the next three years is very or fairly certain and advises organizations to be more aware of subtle shifts, become more resilient and flexible, and align leadership so the organization can effectively navigate through uncertainty. He also advises organizations to take scenario planning seriously, manage strategic investments more dynamically, continue to invest in improving risk/reward management skills, pay greater attention to banking relationships, err on the side of being overcapitalized and over liquid and over prepared, and to reexamine the critical assumptions based in business models.

He also discussed a dynamic approach to strategic investing, which entails continually evolving core beliefs and aspirations, continually sourcing investment ideas, mapping ideas on commonly agreed parameters, prioritizing ideas based on performance across scenarios, launching no-regret initiatives, creating options, investing in strategic bets, and identifying triggers that would make de-prioritized ideas attractive again.

Mr. Bryan also gave advice on navigating firm-wide direction through early surfacing of issues, continuous exploration of alternatives, and consequences, keen awareness of time horizons, advance debate of issues with senior leadership and board so that eventual decisions can be made quickly, and making just-in-time decisions.

He asserted that companies can prosper despite uncertainty, and that profit opportunities are enormous as four billion people quadruple their incomes and wealth over the next 20 years.

The New Balance- The World's Largest Shareholders

David F. Denison, President and Chief Executive Officer, Canada Pension Plan Investment Board, discussed risk concentration, primarily systemic risk. He stated that systemic risk is very difficult to manage and control, as opposed to other forms of risk and that it is impossible to diversify away systematic risk. As such, one should not rely purely on prediction, and must pay close attention to portfolio composition. Mr. Denison also stated that when markets aren't functioning well, valuation and due diligence are a concern and that investors must pull back from true market base evaluations and instead focus on the larger investment picture.

Anne Kvam, Global Head of Ownership Strategies, Norges Bank Investment Management in Norway stated that developing a well-functioning and efficient market is key concern and that dealing with short-term risk is of less importance. She commented that being properly diversified and having a long-term perspective are the most important considerations when looking at investments.

Scott Evans, President and Chief Executive Officer of TIAA-CREF Investment Management and Teachers Advisors in the USA, discussed the importance of risk concentration, due diligence, and a long investment horizon. He stressed that investors must look at directors and company fundamentals and that they must focus on the selection of individual securities not spend as much time looking at the macro issues. Mr. Evans urged investors to dedicate people within an organization to look at the risk management of the fund and to not expose to too much risk in one section of the market. He stated that when liquidity has a heightened premium, it is

more difficult for investors to structure investments and that when securities have high levels of illiquid investments, investors must pay closer attention to them and their valuations.

The panel then discussed investing in emerging markets, and how long-horizon investors are looking at multi-generational investments in these markets. They stressed how it is important to develop capabilities of assessing and accessing these investments, especially due to the fact that emerging markets have higher volatility, especially during times of crisis. Because exposure to emerging markets is increasing, investors must evaluate the priorities and challenges of these investments. Because many of these markets operate under different systems, it is important that investors look at their tools of engagement and their shareowner rights, as well as the capital allocation of these investments.

The panel also discussed board accountability and compensation, as well as government's role during the financial crisis. The panel agreed that the system must be recalibrated to mitigate systematic risk in the future and that those who take risks must bear the consequences of failure. Additionally, the panel noted that regulation must focus on capital leverage and caps on leverage instead of stifling innovation. Additionally, there must be appropriate measures in place to lessen risk. It is the role of governments, the panel noted, to create a well-functioning, efficient, and legitimate market.

Breakout Session Review:

Executive Compensation

Ken Hugessen of Hugessen Consulting Inc. in Toronto moderated a session in which there was a discussion of the history of the evolution of executive compensation in the US and UK with a view to regulation and how there is compelling evidence to suggest that regulation has had a detrimental effect on compensation. The panelists discussed how board dynamics and social culture were significant indicators of compensation and also discussed CEO pay levels and the imbalance of power that is established when hiring an outside CEO, rather than promoting one from within. The additional risk of hiring an outside candidate, rather than promoting internally was also discussed. The panel devoted considerable discussion to the need for empowered compensation committees and shareholders and how a competent and independent compensation committee is essential to effective and appropriate compensation levels. It was also noted that the shareholders role in executive compensation is to put pressures on those committees to ensure their best interest.

Carrots, sticks or codes? How can we make shareowners become good stewards?

John Stout, Vice President, Chair of Corporate Governance and Investigations Group at Fredrikson & Byron moderated a panel that discussed the issues surrounding stewardship codes. There was support from the panel for an articulation for best practices of shareholder engagement of the code. In order to be effective, it was discussed that whatever code is adopted should be a mix of regulatory and voluntary.

Panelist **Peter Montagnon** discussed the adoption of the FRC's stewardship code. He noted that the primary objectives of this code would be: communication and effectiveness of code, to generate a critical mass of supporters of engagement of those willing to establish and adhere to this code, and to clarify the relationship between fund managers and the pension fund trustees who employ them. Additionally, Mr. Montagnon noted that the obstacles to the FRC's code

would be: getting the right balance between investors and regulators, the internationalization of codes, and changing the mindset of investors through allocation of resources and incentives.

The panel also discussed that the initiative to adopt a stewardship code requires an independent organization to seek compliance and achieve adherence to the code. Adherence must be driven by the shareowners, and there must be both carrots and sticks in order to ensure an effective stewardship code. It was noted that in the US, regulation of a code is less likely, but there is a desire to understand best practices in order to develop a more universal code for pension funds, as adherence to the code will come from an example set by the larger funds. The panel named disclosure as a way to make a behavioral shift in this area.

What boards have learned from the financial crisis

Robert Adamson, Executive Director of CIBC Centre for Corporate Governance in Canada moderated a panel where it was discussed that there was not only one lesson that could be learned from the financial crisis, but that the panel had determined that there are more problems to identify than solutions to known issues. The panel identified that there were certain types of risk that boards need to focus on, namely, financial sector diversification and liquidity risk. The panel noted that board judgment, prudence, and discussion could help facilitate the future mitigation of risk for companies. The panel identified that areas that need more attention were: risk management, executive compensation, and board composition.

The panel noted that ensuring that the right people are on the board is a key consideration for companies and that attention has to be paid to making sure the composition of the board allows for consideration of key issues and that the board also allows for adequate time and allocation of resources to facilitate these conversations. The panel discussed how risk committees should be on boards to facilitate conversations about risks, as boards that had these committees typically fared better in the crisis than those who did not. The panel also discussed how instilling accountability and responsibility in the board is key to ensuring the best interests of the investors and how making the boards liable for risk would likely ensure better results for shareowners.

Board Communication

Frank Curtiss, Head of Corporate Governance of RAILPEN Investments in the UK moderated a panel that discussed the growing consensus for better communication in boardrooms. It was noted that there is an important role for better communication, as boards must be informed of the opinions of interested parties. The panel stated that engagement can be productive, and need not be combative when communicating to boards, and that there is a distinct difference between quality of communication and quantity of communication. Additionally, it was noted that there could be genuine legal obstacles to communication in different jurisdictions.

Shareholder Litigation

Michelle Edkins, Managing Director, Head of Corporate Governance Europe for BlackRock in the UK moderated a panel in which the many roles that litigation plays for shareholders were discussed. While there are clear remedies when boards or directors commit fraud or breaches of duty, the panel noted that it is not always clear when to seek remedies under a breach of a duty of care. It was also noted that the unintended consequence of a tendency to litigate is that companies are forced to take steps to limit litigation options, which may not always be in the

best interest of shareowners or the company, as these options do not always lead to the best decision outcomes. Additionally, the panel identified Sarbanes-Oxley as a potential factor in the financial crisis, as it gave boards a false sense of security that their risk management was being sufficiently addressed. The panel also noted some benefits of shareowner litigation, including information sharing and a better understanding of their rights. Additionally, it was noted that litigation is an appropriate option if company engagement fails.

Governance issues in controlled and private companies

Julie Hudson, Head of SRI & Sustainability, Equity Research, UBS Investment Bank, UK, moderated a panel in which the governance of private companies was discussed. Specifically, the panel mainly addressed the issues with controlled companies and the role of minority shareowners. The panel concluded that controlled companies should show independence or majority independence, a key alignment of management and stakeholders, protection for minority shareowners, and implement cumulative voting for directors. The panel agreed that minority shareholders should have board representation, transparent voting processes, visibility and transparency of directors, minority shareowner representation on the board, and a clear understanding of practical versus legalistic governance issues. It was also noted that controlled and private companies have the opportunity to implement real corporate governance practices, rather than simply comply with regulatory corporate governance standards.

The Quality of Shareholder Votes

John Wilcox, Chairman of Sodali Ltd in the USA, named the quality of votes as the main concern for shareholders in implementing good corporate governance practices. He mentioned that in many corporations, good governance is simply a compliance issue. He stated that a problem for institutional investors is that the traders are typically not paying close attention to corporate governance. However, he stated that there are trends that are changing this issue for example: the amplification of the role of directors; the accomplishments of the leading active and activist investors that have made votes matter; increased regulation and legislation around corporate governance; the environmental and social movements; the financial crisis, and the oil spill in the Gulf of Mexico.

Henry Hu, Risk Director for the US Securities and Exchange Commission explained the issue of ambiguity in decision making when voting shares, and made the argument for quality voting. Traditionally, he stated, the more economic interest is held by an investor, the more of an economic incentive the investor has to vote correctly. However, he described how many votes have been emptied of economic interest by holding put options, for example. Debt and equity decoupling has furthered the inability for votes to always be correct and in the best interest of the company and he stated that this furthers the misalignment of shareowner votes from the economic success of a company.

Erik Breen, Head of Responsible Investing for Robeco in the Netherlands, discussed the costs associated with voting, and stated that this is the reason why many votes are not cast. He acknowledged the difference between the knowledge of companies and the breadth of portfolios between active and passive investors and agreed that processes should be more intertwined in order for institutions to vote more effectively.

The panel discussed how the SEC has been engaged in a comprehensive review of the way proxies are distributed and voted and, ultimately, Mr. Hu stated that the commissioners would

vote on a concept release. The SEC is currently looking at why voting is incorrect, the frequency of these mistakes, and the extent to which borrowed shares being used overseas and how this behavior can be deterred. It was noted that the SEC is also looking at the role of proxy advisors and what conflicts of interest currently exist and what safeguards are in place.

The most critical concept to effective voting, the panel noted, would be to align all processes in-house in order to most efficiently realize economic returns. It was also discussed how the relationship between decoupling and disclosure is an enormously complicated issue. The panel agreed that this is an extremely important issue, as voting issues and the quality of voting impacts every area of corporate governance.

Paying for Long-Term Performance

Lucien Bebchuck, Friedman Professor of Law, Economics, and Finance Director, Program on Corporate Governance, Harvard Law School in the USA delivered a lunch keynote on how to fix pay structures to link executive payoffs tightly with long-term performance while avoiding excessive risk-taking incentives. He stated that standard pay arrangements have typically rewarded executives for short-term gains, even when those gains were subsequently reversed. This generated incentives to take excessive risk and otherwise trade off long-term shareholder value.

Mr. Bebchuck also noted that in order to tie executive compensation to long-term results, there must be a focus on equity compensation. Current pay arrangements provide broad freedom to cash out vested equity incentives, and this can lead to a distortion of incentives, particularly with early unwinding of equity leading executives to focus on short-term results at expense of long-term value. He suggested that executives should be required to hold a fraction of their shares until retirement; however, this may cause executives to retire prematurely and gives departure incentives rather than retention incentives. He suggested that another solution could be to have executives hold awarded equity incentives for fixed number of years after vesting, and this schedule should have a gradual unwinding of the equity. However, he also noted that grant-based restrictions are often insufficient in that long-time executives may amass large amounts of equity incentives they may immediately unload at the first sign of a crisis. Firms should also limit how much of otherwise unloadable equity can be sold in each year. Mr. Bebchuck believes that this would assist in avoiding a short-term focus for the executive. He also discussed the need for robust anti-hedging policies within companies. Without such policies, he stated that executives can use hedging and derivatives to undo the effects of equity incentives.

In addition to the short-termism problem, Mr. Bebchuck discussed how financial executives had another source of risk-taking incentives- their payoffs were tied to highly leveraged bets. In order to remedy this situation, he stated that government should provide shareholders with rights and tools that would enable them to prevent pay structures that are detrimental to long-term shareholder value. For non-financial firms, he believes that government intervention should be limited to improving internal governance. Ultimately, Mr. Bebchuck stated, pay arrangements can and should be better designed to align executives' incentives with long-term performance. Doing so, he stated, will improve long-term corporate performance.

The Evolving Role of Hedge Funds in Corporate Stewardship

Expert Panelist, **Jane Buchan**, Chief Executive Officer of Pacific Alternative Asset Management Company in the USA gave an overview of hedge funds. She described hedge funds has having

very different investment strategies that are highly focused in application and/or number of positions. She noted that hedge funds are highly adaptive and are more likely to adjust to changing market conditions. However, she described some of the issues associated with hedge funds, including: transparency, liquidity, fiduciary responsibility, short-termism, and fraud. Despite this, there are many funds that are interested in improving companies, sometimes using direct activism.

Cliff Asness, Managing and Founding Principal of ACR Capital Management, LLC, USA, described himself as a quantitative hedge fund investor. He stated that quantitative managers look for preferable characteristics of companies and believe that certain qualities lead to profits. He noted that hedge funds are adaptive, in that they are constantly trying to improve their investment processes, however, he noted that it is important that hedge funds to not get “over adaptive” and risk losing returns. He also noted that it is important for hedge funds to constantly assess their models and what is profitable and what is not.

Omar Asali of Harbinger Capital Partners, USA, described his fund as capital agnostic, dealing with both capital and equities. He also discussed its activism with the New York Time and its governance initiatives.

Eric Knight, Chief Executive Officer of Knight Vinke, USA, noted how he trades in large-cap companies due their potential value. He described them as less likely to be taken over, as publishing a large amount of information which largely goes unread, and as having consolidated financial statements which must be very carefully analyzed to ensure a proper picture of the actual financial standing of the companies. Unlocking value of the large-cap companies requires a great deal of effort and he believes that no group of shareholders is large enough to bring about substantial change in large cap companies. However, he noted that these large-cap companies are typically controlled by their stakeholders (e.g., government, consumers, unions, media), so it is prudent to find those with similar interests in those groups when seeking engagement.

The panel discussed how strong, but not rapid, growth is typically profitable in the long-term. Companies, however, that do not employ poison pills, dual-class shares, or any other anti-democratic governance practice don't typically outperform the market. The panel also noted that hedge funds are not typically high frequency traders, and that most of the trading that is done within these funds is in rebalancing in nature.

The New Balance in Economic Growth- The Emerging Economies

José Luis Osório, Founding Partner of Jardim Botânico Partners discussed the current state of corporate governance in Brazil. He noted that there are now much better governance practices in place in the country and that the government has taken many steps, though new regulations, in order to improve protection in the investment markets. Freedom of the press, he stated, has allowed for the success of many governance principles in the market. Mr. Osório also spoke about new and simplified proxy voting mechanisms and transparency in executive compensation as examples of many corporate governance reforms being put in place in Brazil. He spoke optimistically about the future of corporate governance in Brazil and its implications for investors.

DR YRK Reddy, Founder Trustee, Academy of Corporate Governance spoke about how India is handling corporate governance issues. He noted the exponential growth in the economy in

the last several decades and how the strong holding in state-owned and family businesses may need to be reduced so that minority shareholders are protected. However, Mr. Reddy stated that the listing standards in India and their state-owned nature could ensure that listed companies follow stricter standards than others within the country. India also presents significant cultural challenges to corporate governance, as many family businesses have large amounts of stock in their companies, which can bring about issues of board independence. Mr. Reddy argued that foreign investors are one of the driving forces behind the new attention to corporate governance standards. He also noted that abroad, Indian companies have acquired in many foreign companies and have been investing heavily abroad, especially in the UK.

Jamie Allen, Secretary General, Asian Corporate Governance Association spoke about China's implementation of corporate governance practices. He discussed the fiscal stimulus response to the crisis and how this may have been purely a short-term strategy. He noted, however, that in the last five years, banks have become increasingly more traditional in their operation and management (e.g., decreasing nonperforming loans, and improving governance and risk management). Additionally, independent directors and board committees have placed emphasis on corporate financial reporting. Despite this, there is still a strong influence from the Communist party, and all state owned enterprises have a committee that looks out for the interest of the state, however, there is increasing disclosure about who is on the Communist party committee within these companies. Mr. Allen also noted the growing diversity in companies. Despite this, he stated that lack of freedom of press has had an impact on minority shareholders and will likely constrain China's growth at some point. Additionally, the Chinese generally believe that buying stocks is essentially gambling and if they lose money on investments, it is their own fault. However, while they are currently experimenting with legal remedies, governance has not played as large of a role because of the public's perception of the responsibility of a company to investors. Mr. Allen also discussed China's capital control regime and the difficulties of investing abroad within the country.

END

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