ICGN
International Corporate Governance Network

# ICGN Viewpoint

**Governance questions posed by the changing U.S. political landscape**

**February 2017**

---

Consistent with their stewardship obligations, institutional investors around the world regularly monitor and assess changing political dynamics, geopolitical tensions, economic stability and systemic risks. This broad purview of political assessment includes the outcomes of key elections in 2016 that triggered a new policy trajectory in important global markets where global institutional investors have considerable holdings and exposure. A particular focus is currently on the United States, with the new Trump Administration now in place. The specific policy changes of the Trump administration and their implications are still taking shape, and remain a point of controversy, both politically and economically. These developments in several cases challenge or may contradict established principles of corporate governance and sustainability, and present potential conundrums for companies and investors - and for standard setters and regulators who aim to attract inward investment whilst ensuring efficient markets.

Political assessment or advocacy relating to the Trump Administration is beyond the scope and mandate of ICGN's policy purview. But at the same time these political events have implications for both corporate governance and responsible investment practices. It is within ICGN's policy remit to explore the corporate governance questions for companies and their boards that may come with the Trump Administration policy direction - and to examine how these developments may affect global investors who invest in the U.S. market. A forthcoming Viewpoint on "Brexit" – the withdrawal of the United Kingdom from the European Union - will continue to explore important political changes affecting companies and investors globally.

In this Viewpoint ICGN focuses on the corporate governance implications of the U.S. election making reference to relevant ICGN guidance statements and policy priorities. It identifies areas where new U.S. policy may conflict with established ICGN positions, and poses questions that companies and boards might consider in the long-term governance of their companies. In many cases these are the same questions that investors may consider in their engagement with companies and their boards.

From this report, a key takeaway for investors and companies is that in a changing political environment, prevailing policy may not always the best predictor for making long-term decisions. This suggests that investors and companies cannot simply focus on existing political requirements and regulations. Rather companies and investors will need to anticipate long term trends material to their companies - and develop their own views as what policy approaches are likely to be most - or least - durable over time.

## A new direction from the United States

In the initial weeks following the Trump inauguration the U.S. stock markets and leading indices rallied significantly, a so-called "Trump Bump", reaching all time highs on the prospect of a pro-business agenda. This agenda features lower taxes, less regulation, a boost in infrastructure investment and nationalist trade policies favouring U.S. manufacturers.

While positive investment returns are certainly appealing to investors, they are meaningful only if sustainable. For investors, investment decisions and company engagement in countries, sectors and individual companies typically weigh current market forces against broader longer-term trends. In this context, both supporters and critics of the current political order will need to assess objectively how sound and sustainable a country's political and regulatory agenda might be in the face of overarching global economic, environmental and social dynamics. In the case of the new U.S. Administration, a number of governance-related issues are taking shape that call for attention in this context. While not presented here as an exhaustive list, some key governance considerations in the U.S. currently facing investors and companies include systemic financial risk, climate risk, protectionism, tax policy, business ethics and political influence.

## Systemic risk and financial markets

From a corporate governance perspective, systematic risks can be examined in the context of a key ICGN policy priority for 2017 - to promote long-term investment perspectives and sustainable value creation.[1] Through this policy priority ICGN encourages companies, boards and investors to think and act systemically with regard to preserving the integrity and stability of financial markets as a whole. This is to ensure that financial markets serve their intended purpose of promoting long-term economic growth and investment in the real economy by users of capital - while at the same time allowing institutional investors to fulfil their fiduciary duty to provide sustainable returns to clients and their beneficiaries over a long-term horizon.

The Trump Administration's review of the Dodd Frank Act and related financial regulation will seek to identify aspects of current U.S. regulation that it regards as unwieldy or presenting costs in the financial sector that it perceives to be unjustified. This move towards deregulation, and lesser regulatory cost, has had initially positive effects on U.S. bank stocks in anticipation of higher profitability and fewer lending restrictions.

However, for many investors, a swing of the regulatory pendulum to lighter touch financial regulation will not carry an implicit endorsement of lower diligence or urgency in risk awareness and management. Investors generally do not want to encourage the financial sector to focus on generating short-term returns if this could lead to further systemic risks and negatively impact overall portfolio returns. This is of

[1] For a full list of these policy priorities and other ICGN policy guidance and commentary, please visit: https://www.icgn.org

particular relevance to institutional investors who are both creditors and shareholders in bank securities. While investors in many cases were accused of encouraging ever riskier behaviour in banks leading up to the 2008 crisis, investor engagement in 2017 - in a lessened regulatory post-crisis climate - is likely to emphasise the ongoing importance of prudent risk management and systemic stability.

**Climate and environmental risk**

As recognized by the Financial Stability Board, the economic and social risks posed by climate change are both profound and systemic in nature. The 2015 Paris Alliance agreed at COP 21 reflects an important intergovernmental agreement, including the U.S., to confront these climate risks. In recognition of the adverse systemic effects resulting from climate change, ICGN has expressed support for this global policy framework and has published a Viewpoint examining climate change as a matter of good corporate governance and investor stewardship. [2]

As a point of contrast the new U.S. Administration appears to bring a sceptical attitude to the established scientific community's position on climate risk, suggesting possible loosening of climate and environmental legislation - potentially reducing U.S. adherence to its Paris Alliance commitments.

For companies and investors this development poses a potential dilemma that has strategic, economic and ethical dimensions. Should a company with a long-term investment horizon, in sectors directly or indirectly affected by climate legislation in the U.S., be encouraged to exploit potential externalities that may result from lesser climate regulations? This could bring profitability benefits in some sectors, at least in the short term - for example, to providers and users of fossil fuels. But how should this be factored into longer-term investment decisions?

This can be problematic, particularly for those investors and companies that accept the conclusions relating to climate risk by the global scientific community. Investors and companies focusing on systemic stability and sustainable value creation might understand that the impact of laxer climate policy may carry initial benefits for those companies tempted to cut corners; but investors and companies equally need to be alert to investment risks that may cut against the grain of scientific knowledge and environmental reality. For example, a long-term investment in brown coal, whose economics depend on laxer climate regulations, must also be scrutinised and scenario tested by companies and investors in anticipation that a more stringent set of policies could result from future policy agendas.

Also in the environmental and social sphere, institutional investors in the U.S. have recently united to challenge banks seeking to fund the controversial Dakota Access pipeline, which had been given the green light through one of the new Administration's executive orders[3]. This pipeline development, which is planned to

[2] See ICGN Viewpoint on climate change, November 2015: https://www.icgn.org/climate-change

[3] Financial Times, "Big investors press banks over Dakota Access pipeline, 17 February 2017: https://www.ft.com/content/f4487916-f4ab-11e6-95ee-f14e55513608

run through Native American land, poses risks of local water contamination and damage to cultural sites and practices, suggests only limited sensitivity by the current Administration to issues of this nature. Institutional investors with longer term horizons do recognise these significant environmental and social risks, and are encouraging banks to also share this longer term perspective - and to appreciate potential reputational risks that could come with the funding of this controversial project.

**Trade and protectionism**

Within the U.S., investors will monitor the economic effectiveness of a U.S. Administration policy to reduce free trade to support American industry - in particular those sectors that are competitively challenged by foreign imports and labour rates. While ICGN does not have a formal corporate governance position on trade policy, our focus on sustainable value creation and systemic risk is relevant to the increasingly protectionist policy regime in the U.S.

It is generally recognized in macroeconomic theory that aggregate global wealth is diminished with protectionism. The global economic impacts will not be balanced. Some market participants or sectors may benefit in the near term; some may be disadvantaged. For example, in the U.S., to the extent that protectionist trade policies support job creation in certain companies and sectors, this may ultimately come at the expense of U.S. taxpayers and consumers through higher prices, and thereby create new political tensions over time.

Tradeoffs of this nature feature in every political system, but for long-term investors in both U.S. and global companies, a significant policy deviation away from free trade poses important investment and strategic considerations. For example, should investors invest in or encourage companies to take advantage of business models that exploit or are dependent upon protectionist policies? If nothing else investors and boards should assess an individual company's economic dependence on protectionist measures - and anticipate the impact in the event that a future U.S. policy direction, possibly in a subsequent administration, could have upon a swing back to greater free trade.

Investors will also appreciate that the potential impact of the U.S. Administration away from free trade and towards protectionism has global reach. For example, the credit rating agency, Fitch, recently released a ratings report assessing the potential positives and negatives of new U.S. policy in terms of sovereign credit risk.[4] While noting some positives that may stem from deregulation and bolstered infrastructure spending in the U.S., it concludes that the balance of risks globally is more negative than positive. This includes impacts on trade relations, capital flows and migration – all of which can affect both financial and currency markets - including the credit ratings of companies and countries beyond the U.S. This linkage of protectionism to

---

[4] Fitch Ratings, "The Trump Administration Poses Risks to Global Sovereigns", 10 February 2017: https://www.fitchratings.com/site/pr/1018842

Saffron House 6-10 - Kirby Street - London - EC1N 8TS - UK
VAT No. 927 1665 09 | Registered in England No 6467372
t: +44 (0)207 612 7011
f: +44 (0)207 612 7085
e: secretariat@icgn.org
w: www.icgn.org
@ICGNCorpGov
ICGN

systemic risk implies ongoing diligence and scope for regulatory engagement by investors and companies not only in the U.S., but also in both the emerging and developed economies that are currently actively linked to the U.S.

**Tax Policy**

In recent years many companies have faced public scrutiny and growing criticism over tax avoidance arrangements, even if legal in nature. There is a growing awareness of social sensitivity to company tax policy, and potential financial and reputational risks that might come from tax arrangements that may appear to exploit tax legislation. ICGN has addressed this issue in a Viewpoint assessing tax policy in a corporate governance context, noting that growing scrutiny of company tax policies is damaging corporate reputations and public trust in business.[5] At the same time the unprecedented absence of personal tax or financial disclosure by President Trump, suggest a more relaxed tone from the top regarding tax minimization.

At a more macro level, the Trump Administration's main policy direction in the area of tax is to significantly reduce U.S. corporate tax rates for domestic businesses. This has scope to create financial advantage for U.S. companies, particularly those in struggling sectors. While potentially positive for some companies at least in the near term, the economic and political viability of substantially lower corporate tax regime will need to be demonstrated over time. As with climate and trade issues, both investors and companies will need to develop a view as to whether the maintenance of a significantly lower tax environment should be assumed as a factor in long term investment decisions. For business models or investment projects depending on lower tax rates to generate adequate profits a change in tax policy presents a potentially material external risk that companies cannot directly influence.

**Business ethics and political influence**

ICGN guidance and commentary has stressed the importance of business ethics as a critical component of good corporate governance, also noting the systemic importance of addressing bribery and corruption, both in terms of company governance and public policy.[6]

In a global context the U.S. has served as a leader in the area of anticorruption and ICGN has publicly supported the U.S. Foreign Corrupt Practices Act (FCPA).[7] ICGN

---

[5] See ICGN Viewpoint on corporate tax policy: https://www.icgn.org/corporate-tax-policy

[6] See ICGN Guidance on Anticorruption Practices http://icgn.flpbks.com/icgn_anti-corruption_2015/ and ICGN Guidance on Political Lobbying and Donations: http://icgn.flpbks.com/icgn_political-lobbying-donations_2015/#p=1.

[7] See Investor Statement in Support of the U.S. Foreign Corrupt Practices Act: https://www.icgn.org/sites/default/files/Foreign%20Corrupt%20Practices%20Act%202012_0.pdf

is also supportive of revenue transparency between companies and government in the extractive sector, as embodied in 1504 of the Dodd Frank Act. Both pieces of U.S. legislation demonstrate importance leadership stances in the fight against corruption and the promotion of greater transparency as a tool towards this end.

At present, however, the direction may be shifting. The pending review of the Dodd Frank Act by the Trump Administration is likely to target Section 1504 as one of the Act's provisions for elimination - on the basis that it presents a competitive disadvantage to U.S. companies. Whatever the merits and durability of these competitive arguments, this policy direction against revenue transparency sends an awkward signal to investors and companies in the extractive sector and their efforts to address issues relating to bribery and corruption.

Further signals raise questions with regard to the new Administration's commitment to high ethical standards. This includes conflicts of interest relating to the President's own business interests – which remain undivested and with taxes undisclosed. Similar issues exist with other Trump appointees. An early ethics violation in the new administration came when a White House official publicly endorsed a commercial brand of one the President's children. Ethical questions were also raised with regard to the short-lived National Security Advisor's links to Russia and providing "incomplete information" to senior government officials. Even if these activities are beyond not the scope of the law, they suggest questionable tone and body language at best with regard to respect for ethical standards.

While investors increasingly focus on ethics and culture as critical components of good governance for both companies and markets, the current climate in the U.S. does not suggest that government policy will place strong emphasis in this area. Therefore investor engagement with U.S. companies should focus on these companies maintaining appropriate ethical policies, behaviours and cultures to provide private sector leadership - in the event it is not forthcoming from the public sector. A particular area of scrutiny is in the area of lobbying and political influence.

**Conclusion: ongoing vigilance and critical scrutiny by companies and investors**

The Trump Administration is not the only political development facing investors and companies in 2017, but it is bringing a political agenda that in many areas suggests dramatic change from previous U.S. governments, and presents contradictions to principles and norms held by many investors - particularly those with long-term horizons. While recognizing and respecting the public support that has lead to this sea change in policy, investors and companies face important questions, and possible challenges, relating to corporate governance in this new political era.

From an economic lens investor concerns might at the core relate to the potential short-termism of new policy dynamics: a looser approach to financial regulation, less urgency in addressing climate risk, protectionist support of uncompetitive sectors, along with mixed signals on private and public ethical standards. This report has highlighted policy changes in place, or on the horizon, which stand to conflict in tone

Saffron House 6-10 - Kirby Street - London - EC1N 8TS - UK
VAT No. 927 1665 09 | Registered in England No 6467372
t: +44 (0)207 612 7011
f: +44 (0)207 612 7085
e: secretariat@icgn.org
w: www.icgn.org
@ICGNCorpGov
ICGN

and substance with important aspects of corporate governance that ICGN has championed in its policy work, both in the U.S. and globally. Investors and companies with long-term perspectives should be alert to where potential areas of tension might lie and be prepared to develop their own views of what policies are potentially questionable or unsustainable from the perspective of good corporate governance and overall systemic stability.

Investors and companies will have to assess the dynamics of this new political agenda in terms of its macro significance and systemic risks, as well as how this agenda might affect or influence the governance of individual companies.  They will need to assess the soundness of existing policies and be prepared to assess where policies may likely to stand the test of time and which may be of lesser durability. Where divergence is identified, this raises economic and ethical questions as to what to do.

Should companies "dance while the music is playing" and exploit policy changes that might generate additional profits, at least in the short term? Should investors encourage companies to do this? Or should investors, companies and their boards also anticipate what might happen when the music does come to an end and adopt policy positions that are most compatible with sustainable value creation? For both investors and companies maintaining a focus on longer-term decision-making and preserving systemic market integrity may provide the most robust guide to promoting sustainable value creation in these changing political times.

**About ICGN Viewpoints**

ICGN Viewpoints provide opinion on emerging corporate governance issues and are intended to generate debate, whilst not defining a formal ICGN position on the subject. ICGN Viewpoints are produced by the ICGN Secretariat and ICGN Policy Committees. For more information contact:

George Dallas, ICGN Policy Director: george.dallas@icgn.org
Kerrie Waring, ICGN Executive Director: kerrie.waring@icgn.org