Engaging with Drew Hambly of Morgan Stanley Investment Management

Drew Hambly
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CamberView Partners is pleased to present a series of conversations with the people and organizations shaping the evolving investor landscape. This interview has been edited and condensed for clarity.

Allie Rutherford: Drew, thanks for speaking with me today. Let's start with the basics – can you give us an overview of how Morgan Stanley Investment Management carries out its corporate governance responsibilities?

Drew Hambly: Allie, it's my pleasure to be with you. Morgan Stanley Investment Management (MSIM) has a team of five professionals who are responsible for reviewing global best-in-class corporate governance and voting proxies. Three of our team members sit in New York and two are in our Mumbai office. We do governance soup to nuts – from account set up to engaging with companies as it relates to shareholder meetings.

Q: As an active manager, your portfolio managers can be involved in shareholder engagement along with you and your team. What does that look like for MSIM?

A: We are a pure active shop, so we don't run index products per se. My team reviews all meetings and we will probably vote on 5,000 shareholder meetings this year. We've built our own internal system that allows direct dialogue with portfolio managers (PMs). For proxy voting, the way it works is that my team will review a meeting and then the PMs review our recommendation and add any thoughts.

On the engagement side, my team handles the basic annual meeting engagement calls. Eight years ago, this was done 90 percent by me and the governance team. Today, I would say probably about half of our engagement is done by the governance team alone and half includes our PMs.

Q: Are PMs becoming more involved in the off-season engagement, where the conversations are less focused on a vote?

A: Yes, our PMs are very involved in engagement with the companies they invest with. In the off-season there's less time pressure on both parties and we can have a more thoughtful conversation around a company's full ESG profile. The meetings focus on ESG topics that might be more material to that business. Our PMs have very deep knowledge about the companies they invest in and the potential value of the company. We work together with those investment professionals to arrive at good governance and voting decisions. Ultimately we want our engagements to be more closely tied to the investment process.

Q: When you're thinking about an engagement and initiating that conversation, what do you want to hear about – the strategic drivers, the business focus or something else?

A: In 2017, my team conducted proactive engagements on about 30% of the total engagements we did. They tend to take a couple of forms - if we're doing an initiative with ESG issues that are germane to the portfolio or if there's a significant news story with a company with a big position where we want a dialogue.

We do a lot of multiple engagements with the same company and we focus on companies where we are a top shareholder - generally those where we are in the top 20 - and it makes sense to spend time and to flesh out the topics more fully in the off-cycle. We may reach out to companies where our position is smaller, but we feel strongly about a topic and we want to share our view. We don't want to waste people's time but we do want to make sure we're included in discussions.

In the actual engagement meeting, it's good to remember that we have a PM who follows your company, which means that we don't need a 101 on your business strategy. We may try to tie your business strategy back to your compensation, but we don't need to see 5-7 slides on who you are. We want to link what companies are writing in their proxy or CSR report back to what the PM thinks are the drivers of the business, especially when it comes to compensation.

Q: When does it make sense for companies to bring in a director to participate in an engagement discussion?

A: We certainly appreciate when directors are made available. They are our representatives on the board, we vote on them and it's helpful if they have direct engagement. We don't demand director participation, but in certain instances where we think there are significant issues or if we see a company or board has been unresponsive, we would push harder to speak with a committee chair or lead director.

Q: What is one thing you never want to hear in engagement and one thing you always want to hear about?

A: My big no-no is don't ask if I'm familiar with what ISS or Glass Lewis has done. As we've said time and time again, we have our own policies and procedures. While we are, of course, aware of their research, we want to spend as little time as possible on the proxy advisors and as much time as possible on what the board and company are doing and what we believe they are doing well or not well.

We like to hear from companies how the board is getting information and is being active in that process. It's a simple premise – board directors are our representatives as shareholders. Whether it's directly from them or from management, we want to hear and understand how they're involved in decision-making, how they ask for new information and what the key topics on their agendas are.

Q: What are the ESG topics you are prioritizing this year?

A: For the "G", we always prioritize compensation and board and management succession. We think they're germane to every company. From there you can dovetail into bespoke issues, but those two things should always be of importance to any company.

On the E&S side, we are not prioritizing a particular topic at this time, but we are trying to prioritize key issues that a company or industry is dealing with. So for example, if I'm talking to an oil and gas company, I may want to talk about environmental risk and safety issues. If I'm talking to an IT company, it may be about workplace diversity and cyber risk. If we think gender diversity or supply chain management are key issues, we'll talk about that. We're not going to say greenhouse gases are not an issue for everyone, but we're not doing blanket coverage. Rather, we're trying to understand the priorities of the companies that we're invested in.

We want to understand which topics the board is reviewing and discussing and to get a sense of what they view as material on the risk or opportunity side. We're trying to be partners with our companies on these topics and to have a sense that the topics we're thinking about are also ones they are thinking about. There's a small portion of companies that may have stumbled and we may take a harder stance if the board acts entrenched. But overall we're trying to use the partnership approach and think about these issues in a systematic way so we can get comfort that they are being reviewed from the board all the way down.

Q: How does MSIM approach engaging with activists and what are your general thoughts on the state of activism?

A: While there has been a perceived rise in activism, as an active manager we're not always a shareholder at the companies with headline-grabbing campaigns because if we think there's too much noise we can stay away. Our portfolio of companies dealing with activism is much smaller than an index shop.

Our view on this is we will certainly take meetings with either side if we feel that it's going to be productive to further our understanding of what going on. We will always talk to management - those are the people we pick and invest in. We will engage with activists if we think it will be productive to our understanding, but we don't take every meeting. It's a healthy part of the market, it keeps people on their toes. We will engage with those who we feel best serve our clients interest, but the portfolio is much smaller.

Q: How do you analyze executive compensation, and what are the cautions or red flags that get your attention on compensation?

A: Our view is that compensation is a window into the effectiveness of the board and the compensation committee. We focus on the CEO because the CEO generally sets the tone for other named executives and the general working population of the company. We focus on grant date value pay and the change in pay over time - that period for us is five years. The average or median CEO tenure is 6-7 years, so we think looking at the office of CEO over a five-year period, and the change in pay over that time period, is a measure of the effectiveness of how the board sets pay.

In terms of red flags, we definitely pay attention to large changes in upward pay. At a mega cap, we don't like to see a 70 percent increase in grant date value pay and 4 percent raise in TSR where it appears that the increase in pay outpaces performance.

In addition to reviewing the summary compensation table, we read Form 4's that follow the fiscal year-end and make adjustments to account for additional grants. I think I am one of the few people trying to make adjustments so we get real year-on-year pay over a five year period (though we do back out the pension piece because we don't think that reflects the board's decision-making process). The reason we do this is because we think it's the best window into board effectiveness. We tell companies to put in that supplemental table because we think that shows how the board views compensation. We think that's the best way to do it, not everyone agrees with it.

Q: If someone was going to talk to you about your approach to your job, what would you want them to know?

A: I've been doing this for 20 years. I'm tough, but fair. I see my role as a little bit of devil's advocate. We want to keep management and boards on their toes to act in the best interest of shareholders. I am tough with my criticism, but also fair in trying to understand what's material and will have the biggest impact for clients.

Q: What do you see as 'next' in engagement or governance in general?

A: One thing I think is coming is that we're going to have to think about how effective this engagement is. Over the last couple of years in there's been a rush to engage. Ten years ago hardly anyone was talking about engagement and now there are a lot of conversations taking place. How do we judge how effective we're being in engagement? We may only do 150 of these meetings per year but we want to make sure we're keying in because you don't need to talk to a company every year on governance and environmental and social issues. I think we need to think harder about how effective we're being.

I'm seeing a lot of noise around greenwashing and I think our industry has to be careful about making sure we are not just doing this to tick a box but to really provide value. Going back to our earliest governance days, there was a lot of box ticking. I think it's gotten better, but we need to avoid just looking at the five metrics I need to know and dig in to think more closely about what's material in our investments.

Q: As we finish up here, I wanted to ask a couple of fun questions – what was your first job?

A: My first, first job was a maintenance worker at a local pool club where I worked in the snack bar, took out the trash and cleaned the filters. I was 14, the state required working papers and I could only work 25 hours. I got paid $3.35 per hour, which was minimum wage at that time.

Q: What's something you want to share about you personally that you think people would find interesting?

A: Fun fact, in high school I played on the men's volleyball team. In my senior year I was All-State. I am the shortest All-State volleyball player in Rhode Island history.

About CamberView Partners

CamberView Partners is the leading provider of investor-led advice to public companies on engagement and shareholder relations, activism and contested situations, sustainability and complex corporate governance matters. CamberView helps its clients succeed by providing unique insight into investors' perspectives on long-term value creation, interpreting the evolving governance landscape and creating proactive strategies to stay ahead of investor challenges.

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