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by Ani M. Abdalyan

RÉSUMÉ

L'auteure analyse les objectifs gouvernant le processus de prise de décision et le contrôle des compagnies et plus particulièrement les liens entre les actionnaires, les cadres et la direction. Elle traite des rôles dévolus aux compagnies canadiennes d'assurance de personnes, en tant qu'investisseurs, dans le processus décisionnel, et elle compare ces rôles à ceux exercés par les compagnies d'assurance américaines et britanniques. Elle commente aussi les résultats probants d'un sondage ayant pour objet de mesurer le degré de contrôle des compagnies canadiennes d'assurance de personnes dans telles activités.

ABSTRACT

The purpose of this article is to analyze goals of corporate governance and specifically relationships between shareholders, directors and management. The author discusses appropriate roles of institutional investors in the corporate governance process. She also discusses the behaviour of life insurance companies in the United States as institutional investors and compares it with the British experience. Finally, she analyzes the degree of activity in Canada by life insurance companies in corporate governance. In this regard, some anecdotal evidence from a survey of life insurance companies is set out.

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■ I. INTRODUCTION

What role should life insurance companies, as institutional investors,[1] play in the Canadian corporate governance process? How should life insurance companies exercise their ability to pool information and to coordinate action about companies in which they invest? How active should life insurance companies be, as voters, in holding the board of directors and management of key corporations accountable? These fundamental questions may have repercussions for the long-term health of corporations in which life insurance companies invest, as well as the welfare of life insurance companies themselves.

The purpose of this paper is to analyze goals of corporate governance and specifically relationships between shareholders, directors and management. The paper discusses appropriate roles of institutional investors in the corporate governance process. The paper discusses the behaviour of life insurance companies in the United States as institutional investors and contrasts it with the British experience. The paper also analyzes the degree of activity in Canada by life insurance companies in corporate governance. In this regard, some anecdotal evidence from a survey of life insurance companies is set out.

Life insurance companies, like other institutional investors, acting as financial intermediaries, manage and invest funds for the benefit of others. An inherent wish in the investment of these funds is the maximization of returns on equity investments.

The ownership of equity portfolios by institutional investors is not such a recent phenomenon. There has been a significant growth in the equity holdings of life insurance companies in Canada during the past thirty years. The percentage of assets in equities held by life insurance companies has risen sharply from 2.58 percent in 1963 to 19.70 percent in 1992.[2] In 1992, institutional investors held 60 percent of the shares of publicly traded corporations in Canada, and constituted 75 percent of the equity trading on the Toronto Stock Exchange[3]. In the third quarter of 1995, the portfolio investments of life insurance companies in Canada were $83,809 million[4].

This shift in corporate power from retail investors to institutional investors in Canada, however, does not appear to have been paralleled by a trend of increased activism by major institutional investors, generally, and by life insurance companies, specifically. In Germany and Japan, equity ownership is concentrated mainly among institutional investors, which are significantly active in the

affairs of their portfolio companies. While life insurance companies in Canada have large equity holdings giving the ability to influence the decision-making structure and process in corporations in which they invest, as has been observed by Professor MacIntosh, life insurance companies have been relatively passive[5].

The thesis of this paper is that there appear to be a number of reasons for the inactivity or passivity, in Canada, of life insurance companies as institutional investors including legislative limitations and regulatory constraints, political, economic and even cultural constraints. The dynamics of institutional ownership are complex. While a comparative reference, from a national and historical perspective, is helpful, the development and future growth problems of life insurance companies, in Canada, as institutional investors will likely be tied in with developments in Canadian corporate and regulatory policy.

II. THE GOALS OF CORPORATE GOVERNANCE

An optimal corporate governance system will bring about efficient capital allocation and an effective framework for competition. Good corporate governance practices are in the public interest because they enhance shareholder value without neglecting the financial health of the corporation. As a result, good corporate governance processes and structures heighten confidence in Canada's financial system and help economic growth.

In widely-held corporations, it is difficult if not impossible to regularly consult with all shareholders in order to get their input in the decision-making process. As a result, directors are elected and officers are appointed to act in the best interests of the corporation. A good corporate governance system must address a number of goals including electing the board of directors, ensuring independence of the members of the board, curtailing self-dealing, implementing good management incentives, etc. Most significantly, a good corporate governance system must "solve the problem of delegated power from shareholders to directors and managers"[6].

In terms of corporate democracy, shareholders can monitor corporate directors and managers in two ways[7]: provide input into the decision-making process so as to improve corporate performance,

ex ante, and intervene, ex post, to minimize the adverse impact of wrong capital allocation decisions which have been made.

Classical economic theory provides that shareholders, as owners, driven by self-interest, will ensure the health of an enterprise. In 1933, however, Berle-and-Means[8] noted that, as a result of economies of scale and technology, in the modern public corporation the theoretical model of the firm had been altered producing a separation of ownership and management. They noted that large firms must raise capital from many shareholders and a shareholder's vote

> is of diminishing importance as the number of shareholders in each corporation increases...diminishing, in fact, to negligible importance as the corporations become giants. As the number of stockholders increases, the capacity of each to express opinions is extremely limited[9].

Berle-and-Means also noted that widely dispersed and apathetic shareholders exercise little real control over managers, and concluded that it was unrealistic to think that public corporations would be run by managers exclusively in the interests of shareholders.

Five decades later, the large public corporation which has balanced the need for capital, risk-taking and control by management has survived. A fundamental question is the extent to which, if any, insurance companies as institutional investors have inclinations or incentives to be active in the corporate governance of modern public corporations. How should insurance companies, as institutional investors, relate to their portfolio companies? Is shareholder oversight as useless as hypothesized by Berle-and-Means?

The Berle-and-Means paradigm has been held to be "overly bleak" by Daniels and Morck[10]. They assert that although there are agency problems in the modern corporation, institutional investors with their size, sophistication, and staying power can cause marginal gains[11].

The democratic paradigm is about the oversight of elected representatives and informal ongoing communications with the "constituents" is the "relationships" part of democratic theory. In terms of corporate governance and corporate democracy, the ongoing communication is referred to as "monitoring"[12] , "relationship" or "relational" investment. The institutional investor can play a vital role in the corporate democratic oversight process as a concerned, cautious, careful, informed and low-key monitor.

In recent years, interest in corporate governance by institutional investors has increased. It has been suggested that this

interest has been sparked primarily by situations in which there was the perception of abuse of shareholders' rights[13]. Growth of funds under management by institutional investors and increased concentration of institutional ownership are driving forces for heightened interest in corporate governance. Corporate restructurings leading to a decrease in the number of companies in which to invest as well as regulatory changes enhancing rights of shareholders can also lead to enhanced interest in the governance of corporations in which investments are made[14].

■ III. INSTITUTIONAL INVESTORS AND CORPORATE GOVERNANCE

A natural consequence of the Berle-and-Means paradigm i.e., the powerlessness of equity investors to influence corporate policies, is reflected in passive shareholder behaviour known as the "Wall Street Rule". The rule provides that shareholders "vote with their feet" i.e., express satisfaction or dissatisfaction with a firm by buying or selling shares. As a result, "shareholders are best off when they remain rationally ignorant of the details of a firm's operations, inform themselves only by reference to the firm's market price, and sell when that price becomes unsatisfactory given their overall investment objectives"[15]. However, as stated in the Toronto Stock Exchange's Interim Report of The Committee on Corporate Disclosure, "the small size of the Canadian capital markets, coupled with the large size of institutional investors and the statutory restrictions on the foreign content of institutional portfolios, means that institutional investors are not necessarily free to divest themselves of holdings quickly, or to find substitutes easily[16]."

An alternative to the Wall Street Rule is reform of corporate governance which can lead to improvement in the portfolios of institutional investors. In fact, an active corporate governance role [taken] by the institutional investor can enhance corporate performance and bring together ownership and control of a firm[17]. In response to poor corporate performance, institutional investors can become involved and informed voters and help the firm with corporate policy. Methods of being active include enhancing relationships with portfolio companies and establishing shareholder advisory committees. The selection of outside directors by institutional

investors is another possible approach to increased shareholder activism.

A model program for relationship investing by an institution could include focusing on a small number of well-performing companies in the investment portfolio, developing and maintaining a working relationship with the chief executive officer, board of directors and employees of the corporation and publicizing the names of the corporations with which relations are established. The institution, through systematic communications, could inject new ideas and perspectives. Where a relationship is established, the institution could also be a conduit for other investors as well as analysts and advise the companies of any concerns of investors[18]. Clearly, relationship investing is a concept which would occur naturally, and not artificially, between willing companies and investors.

Impediments, however, to involvement by institutions in relationship investing exist. Lack of expertise, willpower and organizational ability to act as monitor are often cited[19]. Concerns about involvement and political visibility by institutions have also been expressed. There is also the potential for an institutional investor to free-ride on the active monitoring efforts of other institutions[20]. The culture of passivity and passive investment strategy and the reluctance to become active may also [act as] barriers to institutional involvement.

As MacIntosh has pointed out, there are also a number of reasons to believe that institutional investors could play an effective role in corporate governance. Institutions can have the "ear of management"[21] and can have persuasive powers over management of a company. Institutions also have greater incentives than retail shareholders to sue management, be involved in corporate litigation or appeal to regulatory authorities for transactions which may not be in the public interest[22]. These methods, however, tend to be disfavoured because of costliness and time implications. Institutions can also play an active role in policy formation and changes to enhance their power.

The concept of a shareholders" advisory committee "to represent shareholders' interests and to monitor management on behalf of other shareholders" was originally advocated by Adolph Berle in 1928[23]. The committee is intended to receive, from management, reports regarding the progress of the firm and express shareholder concerns to management. In recent years, the proposals have recommended the establishment of firm-specific shareholders' advisory

committees on an ad hoc basis i.e., upon poor firm performance, consisting of the largest nine to ten shareholders[24].

The shareholders' advisory committee, however, does not appear to be widely favoured in the sense that there is concern about "governance by referendum" as well as the fact such committees may have interests which may not be in the interests of shareholders in general. The shareholders' advisory committee may also lack the requisite expertise, be a "shadow board" or merely duplicate the efforts of outside directors.

Another model for institutional investors who wish to be active is to enable such institutions to affect the composition of corporate boards e.g. by influencing the selection of outside directors. Outside directors are independent and can help in running the corporation for the long-term interests of shareholders. As a result, such participation on corporate boards will not only benefit the institutional investor, but also other stakeholders in public corporations as well.

It is the view of Barnard that departures from traditional corporate governance structure and process are other possibilities to enhance long-term corporate performance. In order to make boards more effective, a number of strategies can be implemented including: (i) the addition of 'untraditional' directors to corporate boards to reduce reliance on chief executive officers, (ii) the use of an outside director as chairman of the board, (iii) the wider use of subcommittees of directors, (iv) the recognition of the value of diversity of opinion and the implementation of a compensation scheme based on contributions to the governance process, and (v) the open discussion of objections and concerns of directors[25].

The concept of a professional director has also been advocated as a measure to improve corporate performance. The professional director would have the skills, time commitments, and incentives to monitor the performance of management on behalf of shareholders. An editorial from the Economist proposed the following:

> [M]ake them [independent directors] truly independent, by creating a class of full-time (or "professional") non-executive directors , each sitting on the board of, say, half a dozen companies. To do this, institutional shareholders would have to get together to identify a pool of potential professionals, whom they would then nominate for boards. The big advantage would be that professional non-executives would be wholly dependent on the shareholders for their jobs...[T]hough still paid by the companies they served, the professionals would be financially

dependent on their role as non-executives – and on doing the job well[26].

IV. INSURANCE COMPANIES AS INSTITUTIONAL INVESTORS

(1) United States

Although life insurance companies in the United States jointly own more that five percent of the stock market, they tend to be passive institutional investors and have been referred to as "giants without power"[27]. The reluctance of American insurance companies to play an active role in corporate boardrooms and as institutional investors has been explored by Roe as the result of political history.

The insurance industry's present-day focus on the business of insurance and investment predominantly in debt rather than equity can be traced back to a 1905 scandal in New York, an opulent party hosted by the beneficiary of a trust which controlled the Equitable Life Assurance Society. The event attracted media attention and triggered investigations by the Armstrong committee into the internal practices and political influence of the insurance industry.

At the turn of the century, insurance companies, which were relatively free from regulation, ranked as the largest financial institutions in the United States. At the same time, there was general distrust of concentration of financial power. This distrust culminated in 1906, with the prohibition, in New York state, against insurance companies from owning shares so as to minimize their ability to influence or control other companies. Other states also brought in similar prohibitions. The Hughes Report, which was part of the Armstrong investigation, provides as follows:

> [Insurance companies might extend their control of] ancillary banks and trust companies [to] control of railroads and industrial enterprises. No tendency in modern financial conditions has created more widespread apprehension than the tendency to vast combinations of capital and assets... . [T]he officers and members of finance committees of life insurance companies [are] in positions of conspicuous financial power... . [There is a] necessity of guarding against abuses by the requirement of

conservative and durable investments. [Accordingly, i]nvestments in stocks should be prohibited[28].

The investment decisions of life insurance companies in the United States have been influenced, among other things, by wars, economic depressions and economic growths. From the period 1917 to 1929, life insurance companies invested heavily in corporate bonds e.g., railroad mortgage bonds, and residential and non-residential mortgages with some holdings in government securities[29]. From the period 1930-1939, life insurance companies invested heavily in public utility bonds, as these companies were growing, and mortgages. After World War II, life insurance companies gradually liquidated government security holdings and increased investments in corporate bonds and mortgages arising as a result of economic expansion.

The state prohibition against stock ownership by insurance companies, resulting from the investigations of the Armstrong committee, was revisited in 1940-1941 when the Securities Exchange Commission proposed that insurance companies be allowed to own stock. According to a 1941 financial study for the New York legislative committee, it was felt necessary, that for diversification purposes, insurance companies have some equity holdings in their portfolio[s][30]. The proviso, however, was that insurance companies not be allowed to own large equity holdings in a portfolio company.

In 1951, amendments to New York Insurance Law removed the ban against investing in stocks and up to 3 percent of the assets of an insurance company could be invested in shares. An insurance company, however, was prohibited from investing in more than 2 percent of the voting shares of a portfolio company's stock[31].

In the 1980s, New York Insurance Law was again revisited and investment rules for life insurance companies were liberalized to allow up to 20 per cent of assets to be invested in shares[32]. The Armstrong legacy, however, continued. The 1982 Governor's Advisory Report recommended that even with the widening of allowable stock investments, the passivity principle of insurance companies be retained[33].

Although insurance companies have enhanced ability to invest in stocks as a result of the 1980s revisions to state insurance legislation, Roe notes that they continue to be passive institutional investors in the United States. As explanation for this passivity, Roe considers a number of explanations including preference for liquidity

rather than owning large blocks of equity, cultural lag and lack of necessary skills[34].

Roe suggests that perhaps insurance companies continue to remain passive institutional investors because of high costs of "creating a new organizational form, changing executive style, upsetting traditional customers, and possibly inciting a challenge from insurance regulators"[35]. Roe also notes the potential dangers of adverse regulation if insurance companies were to be perceived as being influential in the corporate governance of companies in which they invest[36].

Roe's hypothesis is that insurance companies in the United States are passive not as the result of the Berle-and-Means paradigm, but as the result of the "politics" of the American corporation. By implication, Roe suggests that deregulation will decrease the costs of coordination among shareholders.

☐ (2) United Kingdom

In contrast to the American experience, British insurance companies are significantly more active institutional investors.

The 1989 common stock holdings of British insurance companies equaled 23 percent of their total assets[37] and in 1992, they held 21 percent of British equities. This is in sharp contrast to American insurance companies which, in 1992, held 2.4 percent of American equities[38].

Unlike the American insurance regulatory environment, British insurance companies do not have legislative caps on equity investments. The governing British framework is "freedom with publicity – freedom for the insurers to determine their own...investment and other policies in return for publicity about their financial condition[39]." Likewise, in contrast to the United States, the United Kingdom does not regulate collective shareholder action.

In contrast to American insurance companies which on average have a portfolio turnover twice a year, British insurance companies tend to be long-term investors. In 1986, life insurance companies in Britain had an annual turnover rate of 15 percent and less than 10 percent in 1980[40].

Black and Coffee, who have examined the role of insurance companies as institutional investors in the United Kingdom, assert that "British patterns of corporate governance may foreshadow

future developments in the United States" to the extent that deregulation occurs in the United States[41].

British institutional investors generally, and insurance companies specifically, are active and have a prominent role in the corporate governance of corporations in which they invest. Oversight is ingrained in British culture.

A mechanism of oversight, which is apparently unique to Britain, is the use of self-regulatory organizations such as trade associations with committees which are set up on an ad hoc basis. The Association of British Insurers, the lobbying organization for the insurance industry, plays a significant role in corporate governance. "Case committees" have historically been used by the Association of British Insurers to facilitate negotiations between corporations and insurance companies. The role of case committees has been explained as follows:

> When a public corporation neared insolvency or faced some other long term crisis, the Association of British Insurers would assist in forming a committee of the insurance companies holding the largest stakes in the firm to meet with its board and typically negotiate changes in management. Membership on the case committee was usually kept nonpublic, as was the committee's existence, because its formation would cast doubt on the corporation's solvency and could depress the stock price if publicized. The committee members understood themselves to be barred from trading the corporation's securities, perhaps because this would be viewed as insider trading[42].

Apparently, the use of case committees has dwindled in recent years and today intervention is more likely to be done on the basis of a loose coalition.

The Association of British Insurers have also drafted guidelines on executive compensation, the term of directors' contracts as well as a number of other issues pertaining to corporate governance[43].

In 1973, the Institutional Shareholders' Committee, an umbrella organization with representation from major financial institutions other than banks, was formed. The Institutional Shareholders' Committee has generally played an interventionist role on a company-by-company basis. In recent years, however, there has been a shift to formation of general policy positions. Black and Coffee suggest that the shift in the role of the Institutional

Shareholders' Committee demonstrates the limited ability of institutional investors to take collective action[44].

☐ (3) Canada

(i) Legislative and Regulatory Environment. Similar to the legislative environment for insurance companies in the United States, insurance companies in Canada have traditionally had legislative limitations on their investments. The legal for life concept was the governing framework until 1992 when the prudent portfolio standard replaced the antiquated framework for investments of insurance companies.

The investments made by insurance companies were reviewed by the Report of the Royal Commission on Banking and Finance (the "Porter Commission"), released in 1964. The Porter Commission Report contained recommendations regarding investment powers, and solvency and surplus requirements of insurance companies.

As I have previously noted[45], the Commissioners felt that:

> the "legal for life" legislative restrictions on the investments of life and health insurance companies plus the legislative authority of the Superintendent of Insurance to examine the investment and to approve the manner of calculation of policy liabilities had brought about overly conservative investment policies, to the ultimate detriment of policyholders and shareholders.

With regard to solvency and surplus requirements of life insurance companies, the Commissioners felt that there should be more flexibility in the "methods of valuing liabilities so that they may be adjusted in some degree to the same market forces as affect asset values[46]."

The overhaul of Canada's financial sector legislation made in 1992 introduced prudent portfolio investment standards for insurance companies replacing the antiquated legal-for-life standard. The general constraint on investments is that:

> the directors of a company shall establish and the company shall adhere to investment and lending policies, standards and procedures that a reasonable and prudent person would apply in respect of a portfolio of investments and loans to avoid undue risk of loss and obtain a reasonable return[47].

Federally incorporated insurance companies are also subject to legislative constraints on equity holdings in a single company and are prohibited from controlling shares which have more than 10

percent of the voting rights or from owning more than 25 percent of the shareholders' equity of a company[48]. Similarly, under the Insurance Act (Ontario)[49], a provincially incorporated insurance company is prohibited from owning more than 30 percent of the common shares or 30 percent of the total issued shares of a corporation.

Federally incorporated life insurance companies are prohibited from investing more than 70 percent of the regulatory capital of the insurance company in common shares[50]. Similarly, they are prohibited from investing more than 100 percent of the regulatory capital of the company in common shares and real property[51].

Provincially incorporated insurance companies are prohibited, under the Insurance Act (Ontario), from investing more than 10 percent of the book value of the total assets of the insurance company in any one security or corporation[52].

Although the prudent portfolio standard governs the investments of federally incorporated insurance companies, provincially incorporated companies remain subject to the legal-for-life test for investments[53].

The solvency and surplus requirements imposed on life insurance companies also affect investment decisions. The Porter Commission had recommended that greater flexibility be introduced "into the methods of valuing liabilities so that they may be adjusted in some degree to the same market forces as affect asset values[54]."

With the 1992 reforms of federal financial institutions legislation, new solvency and surplus requirements entitled "Minimum Continuing Capital and Surplus Requirements for Life Insurance Companies" ("MCCSR") were released. The MCCSR formula is comprised of (i) a risk-based formula to calculate capital requirements and (ii) calculation of available capital consisting of tier 1 (core capital) and tier 2 (supplementary capital).

Investment in stocks affords the opportunity to achieve a higher return, for a higher risk. Risk-based capital requirements, as calculated by MCCSR, however, enable only life insurance companies with a comfortable capital ratio to take a stronger presence in equity investments. Life insurance companies with a low capital ratio are likely to find MCCSR requirements to be onerous where they invest in equities.

(ii) Survey of Corporate Governance Activity of Life Insurance Companies. In order to assess the degree of corporate governance activity in Canada by insurance companies, I surveyed executives at

Aetna Canada, The Canada Life Assurance Company, Mercantile & General Life Reassurance Company of Canada, Munich Reinsurance Company of Canada, The Prudential of America Life Insurance Company (Canada), Sun Life Assurance Company of Canada and The Wawanesa Life Insurance Company. Unless otherwise indicated, survey results are to remain confidential. I am, however, able to release the results so long as the participants are not identified individually.

Survey results indicate a generally passive attitude of life insurance and reinsurance companies toward the corporate governance of corporations in which they invest. It is also no surprise that each life insurance and reinsurance company has its own style in this regard.

The first question in the survey was: *Are you a long-term investor? Do you retain equity holdings for the length of time originally intended? Why?*

Generally speaking, the results show that life insurance companies tend to be long-term investors. Products sold by life insurance companies include life, health and disability insurance, annuities, pensions, mutual funds, trust and banking, investment management for pension funds and wealthy individuals. The matching of assets and policy liabilities is an integral part of the life insurance business. The investment policy of an insurance company will determine the allocation of funds to various categories of investment. Specific investment portfolios with requisite yields and returns will be established to match the product or products in question.

A life insurance company may purchase equities to capitalize on inconsistencies between current valuation and perceived future value. The time required to correct the inconsistency may be less or more than that established at the time of investment.

Some insurance companies use outside investment managers to manage their investment portfolios. The investment manager may invest by indexing i.e., manage a particular portfolio by following the markets (e.g. TSE 300 index) rather than focusing on specific companies. The investment manager may also hold or sell shares based on performance measured against expected rate of return.

Another strategy exercised by life insurance companies is to have a portfolio with core holdings of stock. The remaining stocks may be traded every three to five years. Where a particular holding period was considered at time of purchase of the stock , such stocks are likely to be held for the time originally intended, although this

may vary from company to company. Ultimately, the decision to hold or sell the stock in question is driven by the concept of value.

The second question in the survey was: *Should you be a long-term investor? Why?*

The responses are consistently positive and highlight the fact that investment objectives must tie in with incoming cash flow at any point in time i.e. fixed, growing or declining cash flow. Minimization of volatility is a concern. The criterion of growth in value is tied in to the objective of enhancing shareholder value. Experience indicates that longer term investment returns from equities tend to reflect nominal economic growth, corporate developments and benefits of improved technology.

The third question in the survey was: *If yes to (2), should you be able to protect your interests through communication with management of the corporation in which you invest?*

Where an insurance company uses an outside investment manager, reliance is placed on the investment manager to safeguard the interests of the investor.

Where investment decisions are made internally at an insurance company, there is certainly a desire to have communication with management of the corporation in which investment is made so long as passivity is maintained. Communication with management is helpful in assessing competence and philosophy and understanding long-term corporate strategy.

There is a feeling that management is required to meet the needs of diverse constituencies. To the extent that the shareholder base is stable, the stability facilitates the implementation of business plans by the companies in which life insurance companies have invested. Moreover, a stable shareholder base also facilitates the investment decisions of the company in which the life insurance company has invested.

The fourth question in the survey was: *Are you aware of/advised of long-term strategies of corporations in which you invest?*

The survey results indicate various degrees of awareness by life insurance companies of the long-term strategies of the companies in which they have invested. Some insurance companies are not aware at all, some rely on the media while others rely on the

information they obtain from their outside investment manager, e.g. corporate analysis and annual reports.

Where investment decisions are made internally, by industry analysts and portfolio managers at a life insurance company, there tend to be visits by members of the management of the companies in which investments are made by the insurance company. These meetings tend to focus on outlining the business plan as well as the investment strategy of the company. The industry analyst and the portfolio manager of the insurance company will attempt to look for evidences as to how the company in which the insurance company has invested will use capital and what types of returns are anticipated. In other words, some insurance companies are as aware as they can be i.e. there is awareness of the key criteria that drive the value of the company as well as the possible risks and adverse consequences which are indigenous to a company.

The fifth question in the survey was: *Do you have any views with regard to the ratio of inside/outside directors of corporations in which you invest? What are your views?*

The responses here indicate a general consensus regarding the appropriateness of at least a minority of outside directors. The prevalent view is that there is a great deal of merit to outside directors primarily because of their objectivity. Outside directors should not be self-interested, adversarial directors but rather should represent the interests of the whole constituency of shareholders. Some life insurance companies do not have any views with regard to the ratio while others feel that a high proportion of outside directors is appropriate for any public corporation.

One insurance company indicated that the independence of the chairman of the board should be a function of the industry in which the company operates, e.g. high technology industry.

Although not much merit is seen to the requirement that a majority of the board of directors be Canadian residents, there is a view that a better balance can be achieved by rotating the term of directors as well as rotating directors on various committees of the board.

The sixth question in the survey was: *Do you sponsor shareholder proposals in order to influence corporate governance? Should you?*

Survey results indicate that life insurance companies in Canada do not sponsor shareholder proposals and generally do not have an interest to do so. If the company in which the investment is made is

closely-held, there appears to be some slight degree of interest in the possibility of sponsoring shareholder proposals. Life insurance companies, however, have on occasion made representations to corporations in which they have invested.

The seventh question in the survey was: *Is it appropriate for you to meet with corporate management to talk about the performance of the corporation in which you have invested?*

All responses indicate the appropriateness of meeting with corporate management either by the outside investment manager or by internal investment staff of the life insurance company. Apparently, corporate management is more likely to visit the investment personnel of the life insurance company in good times whereas representatives of the life insurance company are more likely to arrange meetings with corporate management where corporate results are poor.

The eighth question in the survey was: *Are your votes solicited for (i) election of directors, (ii) compensation issues, (iii) mergers, (iv) major strategy changes, (v) social issues.*

Life insurance companies who do index investing responded in the negative. All other life insurance companies responded in the positive with regard to solicitation of votes for election of directors and mergers. There is generally a tendency to vote for management or the board of directors unless the performance results have been extremely unsatisfactory. Some life insurance companies have been solicited for compensation issues as well as major strategy issues. No solicitation of votes has occurred on social issues, e.g. doing business in South Africa, Chile.

The ninth question in the survey was: *Would you want to have a right to vote on any specific issues?*

The survey responses indicate a range of results. Some companies do not have concerns about any specific issue. One life insurance company expressed a desire to be able to vote on major strategy changes specifically where such changes may have a significant impact on the company's future direction and earnings. Another life insurance company expressed an interest in having a right to vote on dividend policy.

The tenth question in the survey was: *Do you think in the next decade you will become more active in corporate governance of corporations in which you invest?*

The results of the surveys indicate a restrained "perhaps" attitude. Insurance companies will continue to monitor the performance of

companies in which they invest and hesitantly express an interest in playing an active role in corporate governance, as institutional investors. Apparently, the degree of activity will be a function of the responsiveness of the Canadian legal and regulatory system.

■ V. CONCLUSION

It is a fair generalization to state that the investment characteristics of life insurance companies attempt to obtain the highest yield consistent with the safety required by the nature of their policy liabilities. As a result, life insurance companies tend to have an investment portfolio consisting of money market instruments i.e., public and private bonds, mortgages, and equities. During the last few decades, equity ownership by life insurance companies has been on the rise.

Ownership of corporate stock by institutions, including insurance companies, is a latent power in Canada. The governance role that insurance companies in Canada can or will play in corporations in which they invest is tied in with existing investment attitudes, legal limitations, and valuation requirements. There is no doubt that the corporate governance role played by life insurance companies is relevant to the operational realities of firm governance.

The Standing Senate Committee on Banking, Trade and Commerce recently examined corporate governance in Canada. The hearings focused on a number of key issues, including the role of institutional investors. Although the Standing Senate Committee on Banking, Trade and Commerce is not expected to make any firm proposals with regard to institutional investors,

> [t]here's concern about the increasing proportion of company ownership held by big institutional investors such as pension and other investment funds. They account for 40% of the value of shares traded on our major stock exchanges. They wield power and influence – CEOs listen when they call. But they operate behind closed doors and aren't subject to the same governance conditions as the companies they invest in[55].

It appears that a less interventionist government may cause Canadian insurance companies to reassess their passive role as institutional investors, and take on a more active corporate governance role. An alliance between business corporations and insurance companies, with improved shareholder communication with directors, may strengthen corporate performance and enhance the

competitive position of Canadian companies. The Toronto Stock Exchange's Interim Report of the Committee on Corporation Disclosure has recommended

> that a committee be established to represent the private sector to provide advice, when asked and on its own initiative, to the Securities Regulatory Authorities ("SRAs") with respect to continuous disclosure rules, to comment on disclosure expectations of the investment community and to identify and alert the SRAs to disclosure violations and inadequacies. We recommend that the committee, to be designated the Market Participant Advisory Committee, be broadly constituted and be composed of representatives of private and public sector pension funds, mutual fund managers and investment counsellors, Canadian societies of financial analysts, The Canadian Institute of Chartered Accountants, the Canadian Shareowners Association (or other comparable organizations) and Canadian university faculties[56].

The more progressive life insurance companies are already examining the possibilities regarding alliances. As the Standing Senate Committee on Banking, Trade and Commerce has noted, the corporate governance role of institutional investors is an area "that should be kept under public scrutiny. It's a down the road issue[57]."

Notes

1. Institutional investors are generally grouped into five categories (i) endowments and foundations, (ii) bank (non-pension) trusts, (iii) insurance companies, (iv) investment advisors, investment companies, and (v) private and public pension funds. The paper does not deal with the investments of property and casualty insurance companies primarily because of the very low if not negligible holdings of stock. The general feeling in the property and casualty insurance industry is that the companies are in the risk business anyway. As a result, there is a tendency to invest very conservatively and hold relatively insignificant holdings of stock in the portfolio of investments.

2. Jeffrey G. MacIntosh, "Institutional Shareholders and Corporate Governance in Canada," (1996) 26:2 Canadian Business Law Journal 145 at 182 [hereinafter MacIntosh].

3. "Board Directors and Corporate Governance: Trends in the G7 Countries," (1992) 50 Oxford Analytica.

4. Statistics Canada, Ottawa, Quarterly Financial Statistics for Enterprises, 3rd quarter, 1995, tables 30 and 31.

5. MacIntosh, supra note 2 at 180.

6. Ronald J. Daniels and Randall Morck, Corporate Decision-Making in Canada, (Calgary: University of Calgary Press, 1995) at 23.

7. John Pound, Institutional Monitoring, "Creating Relationships Between Institutional Investors and Corporations", (Harvard University, unpublished) at 5 [hereinafter Pound].

8. A.A. Berle, Jr. and G.C. Means, The Modern Corporation and Private Property, (New York, MacMillan, 1933) [hereinafter Berle-and-Means].

9. Ibid. at ixx.

10. Canadian Corporate Governance: The Challenge, in Corporate Decision Making in Canada, (Calgary: University of Calgary Press, 1995) 9.

11. Ibid. at 10.

12. Pound, supra note 7 at 10.

13. Kathryn E. Montgomery, "The Role of Institutional Investors in Corporate Governance," (1996) 26 Canadian Business Law Journal 189 at 190 [hereinafter Montgomery].

14. Ibid. at 191-192.

15. Jayne W. Barnard, "Institutional Investors and the New Corporate Governance" (June 1991), 69 N.C.L.Rev. 1135 at 1150 [hereinafter Barnard].

16. Interim Report of the Committee on Corporate Disclosure, "Toward Improved Disclosure," The Toronto Stock Exchange, December 1995, 12 [hereinafter "TSE Report"]. The Committee on Corporate Disclosure (the "Committee") has been formed by the Toronto Stock Exchange to monitor continuous disclosure by public corporations in Canada, to review the adequacy of such disclosure and to determine whether new remedies should be available to investors or regulators where corporations do not comply with such disclosure rules. Continuous disclosure provides information i.e. documents and statements, to markets and provides information about the company to retail and institutional investors. The Committee has made a number of recommendations which can be grouped into two categories: "(I) the creation of a limited statutory regime whereby issuers and others who are responsible for misleading continuous disclosure are liable in civil actions brought by injured investors to recover their damages and... (ii) other initiatives to improve the effectiveness of regulatory network that creates, monitors and enforces continuous disclosure rules in Canada," at (iv).

17. Allen D. Boyer, "Activist Shareholders, Corporate Directors and Institutional Investment: Some Lessons from the Robber Barons," (summer, 1993) 50 Washington & Lee Law Review 977 at 978.

18. Pound, supra note 7 at 3.

19. Ibid. at 36.

20. MacIntosh, supra note 2 at 158.

21. Ibid. at 174.

22. Ibid. at 176, 177.

23. Supra note 15, at 1138.

24. Ibid. at 1139.

25. Ibid. at 1172.

26. Redirecting Directors, Economist, November 17, 1990, at 19-20.

27. Morton Kelter, The Life Insurance Enterprise, 1885-1910, A Study in the Limits of Corporate Power ix (1963).

28. 7 Joint Committee of the Senate and Assembly of the State of New York to Investigate and Examine into the Business and Affairs of Life Insurance Companies Doing Business in the State of New York (1906) (Hughes Report) 253.

29. Dan M. McGill, Life Insurance, (Homewood: Richard D. Irwin, Inc., 1967) 853.

30. Mark J. Roe, Strong Managers, Weak Owners: The Political Roots of American Corporate Finance, Princeton: Princeton University Press, 1994, footnote 65 [hereinafter Roe].

31. Ibid. at 82.

32. N.Y. Ins. Law. s. 1405(a)(6),(8).

33. Roe, supra note 30 at 88.

34. Ibid. at 86.

35. Ibid.

36. Ibid. at 87.

37. Bernard S. Black and John C. Coffee, "Hail Britannia?: Institutional Investor Behavior under Limited Regulation," (1994) 92 Mich. L. Rev. 1997 I at 11 [hereinafter Black & Coffee].

38. Ibid. at 12.

39. Central Office of Info., Reference Pamphlet No. 133, Insurance in Britain 23 (1979) at 37.

40. Black and Coffee, supra note 37 at 14.

41. Ibid. at 4.

42. Ibid. at 21.

43. Ibid. at 22.

44. Ibid. at 24. The Council of Institutional Investors in the United States has played a similar role as an umbrella organization.

45. Ani M. Abdalyan, "The Porter Commission Report Revisited," Banking & Finance Law Review 11:1 September 1995, 57 at 62-63.

46. The Order-in-Council, P.C. 1961-1484, Royal Commission on Banking and Finance (1964) Report (Ottawa: Queen's Printer) at 248 [hereinafter "Porter Commission Report"].

47. Insurance Companies Act S.C. 1991, c.47, s.492 [hereinafter ICA]. The Office of the Superintendent of Financial Institutions has also published the "Prudent Person Approach" guideline which outlines a broad framework for directors and managers to use in developing investment policies and standards for their company.

48. Ibid. at s. 493. Pursuant to section 498, an insurance company is entitled by way of a temporary investment of up to two years, to hold up to 50 per cent of the voting rights attached to all of the outstanding shares of a corporation which is the subject of investment.

49. R.S.O. 1990, c.I.8, s.435(1)(d) [hereinafter Insurance Act].

50. ICA, supra note 47 at s. 508.

51. Ibid. at s.509(e). Property and casualty insurance companies are prohibited from investing in excess of 25 percent of the assets of the insurance company in common shares, or 30 percent of the assets in real property and equities. See s. 508(f), 509(f), (g).

52. Insurance Act, supra note 49 at s.435.

53. Ibid. at s. 433. Although the Report of the Insurance Legislation Review Project to the Ontario Insurance Commission was released in May 1991 with a view to modernizing the Insurance Act (Ontario), there does not appear to be interest in introducing legislation to modernize the provincial insurance legislation.

54. Porter Commission Report, supra note 46 at 248.

55. Financial Post, Senate Committee looking at key changes: Corporate governance to get facelift, March 21, 1996, 17.

56. TSE Report, supra note 16, at 11.

57. Ibid.