Intelligence MEMOS

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To: Investment World Watchers

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Re: **GameStop and the Future of Shareholder Activism**

The social media-driven GameStop phenomenon has given rise to analyses and commentary in several streams: market functioning, particularly excessive volatility; the need to help retail investors avoid major financial losses with improved investor protection; and the combination of monetary and fiscal policy that encourages excessive risk-taking by retail investors. While these are legitimate concerns, there is more afoot.

The GameStop phenomenon may be the harbinger of a fundamental change to the nature and scope of shareholder activism; the traditional mobilization of large numbers of individuals who buy shares to pressure corporations to change their behaviour to conform to a particular cause. Now that a Reddit crowd can be summoned with little effort and startling speed, the end of the present norms or "rules-based" approach to shareholder activism may have arrived.

There is nothing new about investors using their shareholdings in support of a cause or to protest a particular corporate behaviour, most frequently around ethics and social responsibility. The stampede into investments under the environmental, social and governance practices (ESG) umbrella demonstrates its popularity.

From the perspective of a public issuer, this ESG shift is predictable and interactions tend to be with institutional investors whose rules are simple. If a company performs well, institutional investors buy this firm's securities. If a public issuer has ESG issues, institutional investors tend to urge management to change behaviour. If persuasion fails, the investor can vote against management at the annual general meeting or sell.

In contrast, the retail investors driving the GameStop phenomenon move much faster and have given us a glimpse of the potential to permanently disrupt unofficial rules-based norms of shareholder activism. Individual pension plan members and investors will be able to more effectively mobilize to pressure institutions with social media campaigns.

Online trading platforms allow individuals to purchase as little as a fraction of a share for a nominal commission cost. A social media campaign could mobilize a large number of individuals to invest small amounts of money (say $5, $10 or $20) and then use the large block of shares held in the campaign to put pressure on management or influence the share price.

The combination of easy online access and the surge in social media's focus on securities markets is crucial. Joined to the broad movement to persuade companies to become better corporate citizens, it may be transformational, and public issuers and the regulatory system will need to adapt to this potential new reality. Few of them currently have the ability to effectively respond to retail mobilization campaigns because most cannot even monitor social media sufficiently, let alone counter a campaign. A further problem for public issuers is that their ability to respond to an activist campaign may be limited by existing securities regulation.

Corporations will need to develop the capacity to monitor potential issues online and deploy the requisite campaign expertise either through in-house or external sources. In the absence of effective monitoring and a campaign capacity, public issuers may be increasingly vulnerable to reputation risks.

In its recent report, Ontario's Capital Markets Modernization Task Force recommended that public issuers be given the right to rebut reports made by Proxy Advisory Firms. This recommendation reflects the current shareholder activism norms. But a right of rebuttal will not stop a mass mobilization of shareholders by itself; something more akin to a full-fledged campaign capacity will be required.

Securities regulation will need to change to better allow for public issuers to protect their reputations. Under current rules, companies do not even know the identity of all of their shareholders. This should change and the identity of beneficial owners of securities should be disclosed to the public issuer. The task force has also recommended that public companies and reporting issuers be given the ability to obtain the identities and holders of beneficial owners of their shares while respecting legitimate privacy concerns.

Another way to dampen the excessive spirits of GameStop crowds would be to grant long-term shareholders more rights than short-term shareholders by, for example, delaying the right to vote for a period of time. This concept of loyalty-driven securities was canvassed by Ambachtsheer, Pollice & Waitzer in their 2013 report and it may better fit an era where the longer term is the focus.

Regulatory changes favouring longer-term share ownership could result in better corporate citizenship that could reduce some of the pressures for short -term profit maximization such as meeting quarterly performance targets. In turn, this could lead to better ESG practices.

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