BIS | Department for Business Innovation & Skills

UK GOVERNMENT RESPONSE TO EUROPEAN COMMISSION GREEN PAPER

The EU corporate governance framework

JULY 2011

UK Government Response to the Green Paper: The EU corporate governance framework

8830/11 COM(11)164

The UK response to the Green Paper includes the views of the Financial Services Authority (FSA). The FSA regulates the financial services industry and has five objectives under the *Financial Services and Markets Act 2000*: maintaining market confidence; promoting public understanding of the financial system; securing the appropriate degree of protection for consumers; fighting financial crime; and contributing to the protection and enhancement of the stability of the UK financial system.

The FSA is responsible for the Listing Rules, which comprise the obligations that issuers of securities admitted to the UK Official list have to meet (including a number relating to corporate governance) and is also the UK Competent Authority for the *Prospectus, Transparency and Market Abuse Directives*.

The Financial Reporting Council (FRC) is the UK's independent regulator for corporate reporting and governance, with responsibility for the content of the *UK Corporate Governance Code*, and will respond in their own right.

Introduction

Maintaining and improving standards of corporate governance across the European Union is essential to attract investment capital, boost competitiveness and build trust within the single market. The UK therefore welcomes the *Commission's Green Paper* on the EU corporate governance framework as an important contribution to ensuring that we have the most appropriate measures in place in each Member State, to achieve these goals.

EU Member States have widely differing systems of company law and corporate governance. This necessarily reflects the different legal frameworks, business practices and ownership structures - amongst many factors - across Member States. The results of these differences is that each Member State has its unique and distinctive balance of legislation (whether in company or securities law), regulation and best practice procedures (including codes of governance): in order to best achieve overall governance goals.

Unitary or two-tier board structures, detailed shareholder rights enshrined in company law, and corporate governance codes which apply to companies and shareholders are just some of the varied ways in which Member States tackle corporate governance issues. To help further inform this debate it may be useful for the Commission to investigate the different board structures across the EU to better understand how the corporate governance framework relates to them.

The use of corporate governance codes and in particular the use of the principle "*comply or explain*" is addressed specifically in the *Green Paper*. In the UK this mechanism is part of a legal framework which underpins the regulation of companies by their shareholders.

The role of shareholders as owners of companies is crucial. It is they who are best placed to assess the governance of companies and engage with their boards on key governance and other issues.

The *comply or explain* mechanism gives companies the opportunity to develop governance policies and practice which reflect its particular circumstances (size, sector, strategy, stage of development etc); and for shareholders to consider companies' explanations and act accordingly.

Codes can be much more effective at raising standards than law. For example the formation of audit codes in the UK shows how higher standards can be set by codes. The 8th *Company Law Directive* was implemented throughout the EU in 2008, prior to this there was no legal requirement on companies in the UK to have an audit committee, but the UK code recommended audit committees in 1992. In 2003 the code was amended to state that all members of the committee should be independent.

The *Grant Thornton* survey for corporate governance in 2006 found that 100% of FTSE 350 companies had audit committees, of which 88% were fully independent. A survey commissioned by the FRC in 2006 of 465 small cap companies found that 99% of them had audit committees; and 57% had fully independent committees[1]. This compares well with the Directive’s requirement of at least a single member of the board being independent.

Codes also evolve easily over time and can respond to changing economic circumstances. For example, in the Netherlands, the State Secretary for Economic Affairs established a committee to study the relationship between corporate social responsibility and corporate governance. The committee made specific recommendations which were then adopted by the code. This process began in May 2008 and was completed by the end of the year.

Shareholders additionally have a wide range of rights enshrined in UK law to assist with engagement, and are encouraged to disclose their policy and practice by the FRC’s Stewardship Code. The role of the law and the regulator is of course important but should never detract from, or impede, the role of shareholders as owners of companies.

The Commission has an important role in establishing common standards upon which Member States can build which will benefit the EU as a whole. The starting point should be the already existing framework of Directives - both in the areas of company law and securities law - and the Commission Recommendations on directors' remuneration and the role of independent directors. The Commission also has an important role in encouraging individual Member States to aspire to high standards of corporate governance by spreading best practice which can be used by Member States in a way most appropriate to

[1] The survey was conducted for the FRC by Manifest. Sample calculated as follows: Those companies in the Small Cap/Fledgling indices as at the date of their AGM, where the AGM date was between1 Sep 2005 to 31 Aug 2006. The total sample included 465 UK listed companies.

each. It is essential; however, that the Commission should ensure that there is sufficient flexibility to accommodate the very wide range of companies across the EU with greatly differing needs based on cultural norms and practices. A prescriptive approach should be avoided. Instead it should follow an approach based on principles which is outcome focussed.

The UK Government is committed to ensuring that there is a robust corporate governance framework in place, and would be in favour of enhancing or improving corporate governance in areas where there is clear evidence that it has failed or needs to be improved. Overall, given the existing Directives and framework of regulation and codes used in different Member States the primary objective should be to identify ways of enhancing the effectiveness of the current framework rather than to impose new requirements that would fundamentally change the underlying philosophy.

Any proposals for changes to, or additional, EU regulation in this area should have a clear rationale and be supported by evidence which demonstrates the problem that exists and that the proposal will solve it. There should also be a clear explanation why EU level intervention is needed. A detailed Impact Assessment should be carried out clearly identifying the costs and benefits of any proposed changes.

In particular it must be recognised that the set of problems facing financial institutions, and the challenge of identifying measures to effectively mitigate the risks to consumers, shareholders and society as a whole of such institutions failing, is specific to that industry. The issues faced by non-financial listed companies are not the same, and great caution should be exercised before applying the same analysis of problems and solutions to non-financial companies as to financial institutions.

General points on company size and listed/unlisted companies

The integrity of, and clear standards for investor protection provided by EU regulated markets should be maintained; any desired flexibility for different sized companies (particularly small/medium-sized enterprises) can and should be built into the system without resorting to prescriptive measures.

There are very different challenges facing unlisted companies, ownership structures vary across Member States and many private companies are owned and controlled by single individuals or families and the concern is not primarily with the relationship between boards and external shareholders (as it is with listed companies). There may be aspects of corporate governance codes which could be applied to unlisted companies however at this stage we believe that the Commission should concentrate follow up to this Green Paper on listed companies.

UK Government response to specific questions

Q1. Should EU corporate governance measures take into account the size of listed companies? How? Should a differentiated and proportionate regime for small and medium-sized listed companies be established? If so, are there any appropriate definitions or thresholds? If so, please suggest ways of adapting them for SMEs where appropriate when answering the questions

The UK Corporate Governance Code exempts listed companies outside the FTSE 350 from certain code provisions, for example the Code requires FTSE 350 companies to establish an audit committee of at least three, or in the case of smaller companies' two independent non-executive directors. There are also lesser requirements for number of independent non-executive directors on remuneration committees and the make-up of the board.

By using codes Member States can determine whether modifications for smaller companies would be beneficial and aid growth. However, issuers whose securities are admitted to trading on EU regulated markets should not be subject to differing corporate governance requirements. Issuers who choose to take the benefits of access to regulated markets should also accept the obligations that go with those benefits.

Lower or relaxed requirements for smaller companies may well result in reducing the administrative burden, but this must be carefully balanced against giving shareholders confidence in the company and the Board and therefore their willingness to invest.

Reducing standards for smaller companies would dilute the clear standards of investor protection afforded by Directives underpinning regulated markets and may make such issuers less attractive to investors. This would reduce liquidity and increase the cost of capital for these issuers.

A '*comply or explain'* approach allows companies to decide what balance is most appropriate to their needs. Companies that prefer a lower compliance burden are able to seek admission to non EU regulated markets such as AIM or Plus Markets in the UK.

Q2. Should any corporate governance measures be taken at EU level for unlisted companies? Should the EU focus on promoting development and application of voluntary codes for non-listed companies?

It is important to promote corporate governance standards for all companies and the standards for listed companies may provide a useful benchmark for unlisted companies. But caution must be exercised when considering whether these standards could be applied to unlisted companies as a matter

of regulation. Trying to produce a pan-EU approach in an area where existing law is based on national regimes without harmonisation would be extremely difficult to achieve.

It would be useful to consider which principles have some application for unlisted companies, and whether there are some aspects of national codes which could be applied to larger unlisted companies.

Q3. Should the EU seek to ensure that the functions and duties of the chairperson of the board of directors and the chief executive officer are clearly divided?

Requiring the roles of the Chair and CEO to be kept separate is generally recognised as good governance practice. However we are not convinced that introducing prescriptive rules on this matter would be the best course of action.

There are differing Board structures across EU Member States and the role of either the CEO or Chair differs between Member States in terms of responsibilities and importance. Suggesting prescriptive rules on dividing the roles may undermine the systems in place in some jurisdictions. In addition such a division may well put smaller companies at a disadvantage.

A system based on a code allows companies flexibility to adapt to changing needs and circumstances, whilst acknowledging different board structures within different companies. A code approach supported by 'comply or explain' would send a message to companies that dividing the roles should where possible be the default position and deviating from this for good reason or to deal with short-term issues would be subject to explanation to shareholders.

Q4. Should recruitment policies be more specific about the profile of directors, including the chairman, to ensure that they have the right skills and that the board is suitably diverse? If so, how could that be best achieved and at what level of governance, i.e. at national, EU or international level?

Corporate boards need to be comprised of high-calibre individuals with a mix of skills, experiences and backgrounds. When these roles are combined the Board will have the ability to consider issues and make balanced judgements in a way which are attuned to the needs of shareholders, investors and customers. Having the right balance of skills on boards is therefore imperative in ensuring sufficient challenge exists. It is the responsibility of the company to establish the skills they need and assess the suitability of candidates, and the Chair's responsibility to ensure the quality of the Board.

Companies should set out within their recruitment policies how they think the skills on their boards meet their needs. *The UK Corporate Governance Code*[2] already recommends that committees *"evaluate the balance of skills, experience, independence and knowledge on the board and, in the light of this evaluation prepare a description of the role and capabilities required for a particular appointment."* This ensures that the Chair annually considers their board make up and its effectiveness whilst acknowledging that all companies are different and have different requirements.

Q5. Should listed companies be required to disclose whether they have a diversity policy and, if so, describe its objectives and main content and regularly report on progress?

Individual company diversity policies allow companies to explore and consider what diversity means within their own organisations and to set out their route map to address any diversity challenges, including setting targets. All companies should have a diversity policy and they should be required to disclose this fact. Earlier this year Lord Davies recommended in his report *Women on boards* (2011)[3] that: *"The Financial Reporting Council should amend The UK Corporate Governance Code to require listed companies to establish a policy concerning boardroom diversity, including measurable objectives for implementing the policy, and disclose annually a summary of the policy and the progress made in achieving the objectives.*"

The Financial Reporting Council is currently consulting on the amendments to be made in the UK.

Q6. Should listed companies be required to ensure a better gender balance on boards? If so, how?

Gender diverse boards are better boards, benefiting from the holistic thinking brought to the table by individuals with a wider range of backgrounds and experiences, a departure from "*group think*" and a greater affinity to shareholders, investors and customers.

---

[2] The UK Corporate Governance Code 2010 http://www.frc.org.uk/corporate/ukcgcode.cfm

[3] Davies Report Women on Boards 2011 http://www.bis.gov.uk/assets/biscore/business-law/docs/w/11-745-women-on-boards.pdf

Although causality between board make up and performance is difficult to prove research by *McKinsey* (2007)[4] found strong stock market growth among European companies is most likely to occur where there is a higher proportion of women in senior management teams. *Catalyst* (2007)[5] noted that companies with more women on their boards were found to outperform their rivals with a 42% higher return in sales, 66% higher return on invested capital and 53% higher return on equity. Another study by *Wilson* (2009)[6] showed that having at least one female director on the board appeared to cut a company's chances of corporate failure by 20% and that having two or three female directors lowered the chances of bankruptcy even further.

Listed companies should be encouraged to ensure that they are well balanced including in terms of gender. The call for evidence to the *Davies Review* was overwhelmingly against the imposition of any form of quotas, fearing that this would encourage tokenism. *Lord Davies* recommended that:

> ***"Chairmen of FTSE 350 companies should set out the percentage of women they aim to have on their boards in 2013 and 2015. FTSE 100 boards should aim for a minimum of 25% female representation by 2015 and we expect that many will achieve a higher figure."* And that *"Chief Executives should review the percentage of women they aim to have on their Executive Committees in 2013 and 2015."***

The UK fully supports this approach. In line with this approach we would support discussions at an EU level on how board diversity could be reflected in governance requirements to ensure that companies are focussed on having effective strategies to increase their boardroom diversity.

The Commission may also want to consider further research on whether there are structural barriers lower down the 'career ladder' which mean women and other sections of the population are often poorly represented among the candidates for Board level appointments.

Q7. Do you believe there should be a measure at EU level limiting the number of mandates a non-executive director may hold? If so, how should it be formulated?

We fully support the underlying premise that directors need to devote sufficient time to their role. However, we do not consider that setting a limit on the number of mandates held would be the best way to achieve this.

---

[4] "Women Matter: gender diversity, a corporate performance driver", Geoges Desvaux , Sandrine Devillard-Hoellinger and Pascal Baumgarten, McKinsey & Company (Paris) 2007 http://www.mckinsey.com/locations/swiss/news_publications/pdf/women_matter_english.pdf

[5] "The Bottom Line: Corporate Performance and Women's Representation on Boards", Lois Joy, Nancy M Carter, Harvey M Wagener, Sriram Narayanan, Catalyst, 2007

[6] Women in the boardroom help companies succeed –Professor Nick Wilson LUBS The Times, News International Trading (London) March 19, 2009 http://www.thetimes.co.uk/tto/news

Individuals will approach directorships in many different ways and the amount of work associated with individual directorships will vary from company to company.

In addition any limit would not take into account other commitments aside from directorships which might prevent a director giving the necessary time to a role, and may not adequately deal with the issue of people holding multiple non-executive director roles within a group context.

Instead of limits, directors should be required to disclose any responsibilities that may affect their ability to adequately fulfil their responsibilities, including an assessment of the likely time commitments associated with these. Such an approach would be best dealt with in codes.

Q8. Should listed companies be encouraged to conduct an external evaluation regularly (e.g. every three years)? If so, how could this be done?

Yes, we agree that external evaluation should take place. We do not believe that a formal requirement is necessary. The UK *Corporate Governance Code* requires companies to disclose whether the external facilitator has any other connection with the company.

The evaluation must be conducted in a way that ensures that directors are candid and honest in their comments. Shareholders do not need to see details of the evaluation, but they need to know about its scope and boards should confirm that action has been taken to respond to implement recommendations.

Q9. Should disclosure of remuneration policy, the annual remuneration report (a report on how the remuneration policy was implemented in the past year) and individual remuneration of executive and non-executive directors be mandatory?

Yes, remuneration policy and directors' pay levels should be disclosed. Transparency allows shareholders to become more involved in monitoring individual pay levels and allows greater transparency of the link between pay and performance.

It is important that shareholders can see clearly what directors have been paid in detail in order to assess their performance in leading the company.

Such transparency allows pressure to be placed on remuneration committees. We see this as a basic requirement that is already part of the UK corporate governance framework and individual disclosure is recommended.

Q10. Should it be mandatory to put the remuneration policy and the remuneration report to a vote by shareholders?

There are varying ways in which shareholders can exercise influence over directors' remuneration. In some EU Member States, particularly those with dispersed ownership, a vote prescribed in law will likely be the most appropriate method.

This raises the complex question of whether the vote should be advisory or mandatory in nature and whether the vote is forward looking or relates to historical information about remuneration. The implications of mandating in these areas need to be carefully considered.

In Member States with less dispersed ownership, or where dual-board structures are more prevalent, a legal requirement for a shareholder vote might not be a necessity.

Q11. Do you agree that the board should approve and take responsibility for the company's 'risk appetite' and report it meaningfully to shareholders? Should these disclosure arrangements also include relevant key societal risks?

We do not believe that it is as meaningful to think in terms of 'risk appetite' for non-financial companies as it is for financial institutions. Financial companies choose the amount or 'quantum' of financial risk that they want to take on in order to achieve a particular *return* for their investors, and vary this with changing market conditions.

Non-financial companies face risks which are a natural and on-going part of the consequences of their business. For non-financial companies, we agree that the board should approve and take responsibility for their strategy in taking on and controlling these risks, and should report them meaningfully to shareholders. As part of their general duties under UK company law, directors should have regard (amongst other things) to the likely long-term consequences of their decisions. Companies are required under EU Directives (4th/7th *Company Law Directives*) to describe the principal risks and uncertainties facing the business as part of their annual business review.

We also agree that companies (other than those entitled to the small company's exemption) should be encouraged to be mindful of key societal risks. This is reflected in UK company law by the general duty on directors to have regard to the impact of the company's operations on the community and the environment, and by the requirement for quoted companies to include information about environmental, social and community issues "*to the extent necessary for an understanding of the development, performance or position of the companies business*" in the business review.

The Department for Business is planning to consult further on narrative reporting, and in particular we will consider whether the audit report should contain further information about the principal accounting and audit judgements.

Q12. Do you agree that the board should ensure that the company's risk management arrangements are effective and commensurate with the company's risk profile?

Yes we agree that the Board should set the company's risk tolerance and its risk strategy. The Board should then monitor how the executive delivers this strategy and holds management accountable, and be responsible for reporting on performance.

Q13. Please point to any existing EU legal rules which, in your view, may contribute to inappropriate short-termism among investors and suggest how these rules could be changed to prevent such behaviour.

The UK Government published a call for evidence *A Long-Term Focus for Corporate Britain*[7] in October 2010. This was in response to concerns that capital markets may be increasingly focused on the short-term to the detriment of long-term sustainable growth. The responses to the call for evidence suggested that there may be a number of issues with short-termism and agency problems in the investment chain, but these are complex and may not lend themselves readily to a regulatory solution.

The UK wishes to ensure that UK equity markets continue to perform to the benefit of both companies and investors. The *Business Secretary* has now commissioned *Professor John Kay* to conduct an independent review of UK equity markets and their impact on long-term decision making and competitive performance by UK businesses. The full terms of reference for the Kay review are available at *URL*:

www.bis.gov.uk/assets/biscore/business-law/docs/k/11-1015-kay-review-terms-of-reference.pdf

The scope of the review will include a consideration of the impact of the existing regulatory framework, at both national and EU levels, on the decisions of investors in UK equity markets and in UK companies. The Government expects the Kay Review to publish a final report in summer 2012.

It would not be appropriate to prejudge the findings of the review at this stage. We would anticipate that *Professor Kay* may wish to engage directly

[7] http://www.bis.gov.uk/Consultations/a-long-term-focus-for-corporate-britain

with the European Commission during the course of his review and before making formal recommendations to the UK Government.

Q14. Are there measures to be taken, and if so, which ones, as regards the incentive structures for and performance evaluation of asset managers managing long-term institutional investors' portfolios?

Institutional investors should be encouraged to evaluate the performance of asset managers over a longer time horizon, and to remunerate asset managers using incentive structures that reflect the long-term nature of their investments.

The Kay Review will specifically explore:

- **Whether government policies relevant to institutional investors and fund managers promote long-term time horizons;**
- **Whether there is sufficient transparency in the activities of fund managers, clients and their advisors, and companies themselves, and in the relationships between them;**
- **The quality of engagement between institutional investors and fund managers and UK quoted companies, and the importance attached to such engagement, building on the success of the Stewardship Code; and**
- **Whether the current legal duties and responsibilities of asset owners and fund managers, and the fee and pay structures in the investment chain, are consistent with asset owners' long term objectives.**

Again we would not wish to prejudge *Professor Kay's* findings at this time.

Q15. Should EU law promote more effective monitoring of asset managers by institutional investors with regard to strategies, costs, trading and the extent to which asset managers engage with the investee companies? If so, how?

It is important that there is transparency throughout the investment chain so that investors understand the risks and fees that they are being exposed to. As noted above, the Kay Review will explore these issues, and we would not want to prejudge its findings at this stage. However it is not clear whether additional laws are required in this area.

Institutional investors typically have a fiduciary responsibility to the underlying owners or beneficiaries of the assets that they control. We would have concerns that caps on portfolio turnover could lead to unintended and undesirable consequences (for example preventing the sale of an asset at a time when that is in the best interests of the underlying investor). The FSA's requirement on asset managers to comply with the UK's Stewardship Code or to explain their alternative strategy should increase the propensity of asset

managers to engage with investee companies, while recognising that there are other valid investment strategies.

Q16. Should EU rules require a certain independence of the asset managers' governing body, for example from its parent company, or are other (legislative) measures needed to enhance disclosure and management of conflicts of interest?

Once again, the *Kay Review* is likely to explore this question, and we would not want to prejudge its findings at this stage. In the UK, asset managers are subject to requirements to manage conflicts of interest under MiFID and the UCITS Directive[8], and under FSA Principle 8 (and, will be in future, under the AIFM Directive).

The presence of a large number of asset management firms that are independent of larger financial groups (as is the case in the UK) is a strong mitigant to this issue, as institutional investors are able to choose managers who are likely to have fewer conflicts of interest, if this is perceived to be a concern.

Q17. What would be the best way for the EU to facilitate shareholder cooperation?

The *Green Paper* states that the Commission recognizes that clearer and more uniform rules on acting in concert would be beneficial. The concept of "acting in concert" is a difficult one, which has to be determined by national regulators on the basis of the facts of each particular case; we do not therefore, believe it would be helpful to seek greater uniformity of EU provisions. However, we consider that if Member States have implemented existing provisions in such a way as to put obstacles in the way of shareholder co-operation, they should clarify their rules in order to remove those obstacles.

In the UK, The FSA has set out how, its rules apply to activist shareholders who wish to work together to promote effective corporate governance in companies in which they have invested:

- **The market abuse rules do not prevent investors from engaging collectively with the management of an investee company. However, trading on the basis of knowing another investor's intentions or working jointly to avoid disclosure of shareholdings could constitute market abuse.**
- **FSA rules on disclosure of major shareholdings require that investors who have agreed to pursue the same long-term voting strategy should**

[8] http://ec.europa.eu/internal_market/investment/ucits_directive_en.htm

- **aggregate their shareholdings when considering whether their shareholdings reach the threshold for disclosure (3% of a company's shares). However, this disclosure would be unlikely to be triggered by ad hoc discussions between investors on particular corporate issues.**
- **Under the EU Acquisitions Directive that was implemented in 2009, where investors are "acting in concert" they require FSA approval if they reach a controlling shareholding (10% or more of a company's shares) in a regulated firm. "Acting in concert" is not defined in the Directive but the FSA does not view the requirement as preventing ad-hoc discussions or understandings between investors that are intended solely to promote generally accepted principles of good corporate governance in firms in which they have invested.**

The Takeover Panel has addressed the issue of shareholder activism in Note 2 on Rule 9.1 of the Takeover Code. That note states that the Takeover Panel does not normally regard the action of shareholders voting together on a particular resolution as action which of itself indicates that such parties are acting in concert. However, the Panel will normally presume shareholders who requisition, or threaten to requisition, the consideration of a board control-seeking proposal either at a general meeting or an extraordinary general meeting in each case together with their supporters as at the date of the requisition or threat, to be acting in concert with each other and with the proposed directors. The Note goes on to set out the factors to which the Panel will have regard in determining whether a proposal is board control-seeking. The Panel's application of Note 2 is elaborated on in its Practice Statement 26 (http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/PS26.pdf), which makes it clear that in practice it is rare for a resolution to be ruled to be "board control-seeking".

Q18. Should EU law require proxy advisors to be more transparent, e.g. about their analytical methods, conflicts of interest and their policy for managing them and/or whether they apply a code of conduct? If so, how can this best be achieved?

This is an issue which is potentially within the scope of Professor Kay's review and he may wish to look at the role of proxy advisors and consider whether there is sufficient transparency in their activities.

We understand that ESMA has recently issued a questionnaire to proxy advisors in order to research a possible discussion paper on the role of proxy advisors. The results of this exercise should be awaited before taking any firm decisions. We note that so far the evidence on whether proxy advisory functions pose risks that require a regulatory response is mixed.

Q19. Do you believe that other (legislative) measures are necessary, e.g. restrictions on the ability of proxy advisors to provide consulting services to investee companies?

Unless there is clear evidence that a regulatory response is necessary and justifiable in cost benefits terms, the UK would favour a non-regulatory measures, such as an appropriately worded code of conduct against which proxy advisors make disclosure, to address any problems identified in this area.

Q20 Do you see a need for a technical and/or legal European mechanism to help issuers identify their shareholders in order to facilitate dialogue on corporate governance issues? If so, do you believe this would also benefit cooperation between investors? *Please provide details (e.g. objective(s) pursued, preferred instrument, frequency, level of detail and cost allocation).*

There are, of course, already detailed provisions in the *Transparency Directive* for the disclosure of ownership subject to certain thresholds and changes to holdings.

In the UK, Part 22 of the *Companies Act 2006* allows companies to find out who owns or controls their shares, with penalties (the removal of shareholder rights) for those who do not respond to company requests for this information, and highly developed industry best practice

Q21. Do you think that minority shareholders need additional rights to represent their interests effectively in companies with controlling or dominant shareholders?

In the UK, minority shareholders are well protected by existing provisions in company law and the Listing Rules of the FSA. We would be happy to share the UK approach with other EU Member States, but would not necessarily want to promote this approach to all other Member States because of their differing financial traditions and rules.

Q22. Do you think that minority shareholders need more protection against related party transactions? If so, what measures could be taken?

We consider it important that minority shareholders are adequately protected against abuse by related parties and therefore the UK Listing Rules have a whole chapter devoted to this topic, which apply to Premium listed companies. Unless a related party transaction is not material, companies must obtain shareholders' approval, send them a circular and ensure that the related party does not vote on the transaction. Consideration could be given to whether these protections should be extended to all issuers whose securities are admitted to trading on regulated markets.

Q23. Are there measures to be taken, and if so, which ones, to promote at EU level employee share ownership?

We agree that there is good evidence that giving employees a stake in a business and an influence in how it is run can improve business performance, employment relations as well as the working environment. The UK Government therefore believes that businesses should consider positively, the benefits of employee ownership and engagement.

Practically this is commonly achieved through employee share ownership schemes. The UK Government provides four types of tax-advantaged employee share schemes, to encourage employers to give employees a stake in their business and help improve business performance and growth. Such incentivisation measures remain matters for individual Member States' tax policies. Any EU measures might therefore share best practices between Member States to promote employee share ownership; and engage also with relevant industry-led initiatives.

Businesses may alternatively choose to adopt an ownership structure under which part or indeed all of the business is mutually-owned by its employees, often through an employee trust. The UK Government is committed to supporting the creation and expansion of such employee-ownership models, and indeed other mutual forms. Although they will not be appropriate for all businesses, or in all sectors, we believe that they have a significant role to play as part of our wider strategy for sustainable economic growth.

We do not believe that legislative measures are needed to enable this kind of mutual ownership – the existing UK company law framework is sufficiently flexible to facilitate a wide range of ownership models. The UK Government is also modernising its legislative framework for industrial and provident societies – which provide an alternative legal form specifically for mutual businesses.

Q24. Do you agree that companies departing from the recommendations of corporate governance codes should be required to provide detailed explanations for such departures and describe the alternative solutions adopted?

Companies should be required to give details and the reasons for any non-compliance with codes, but it may be justified in particular circumstances to give an alternative to following a code provision; if good governance can be achieved by other means. Where that is the case, reasons should be clearly and carefully explained by Boards to shareholders: who may wish to further discuss the situation with the company.

Q25 Do you agree that monitoring bodies should be authorised to check the informative quality of the explanations in the corporate governance statements and require companies to complete the explanations where necessary? If yes, what exactly should be their role?

In the UK compliance with the Corporate Governance Code is monitored in a number of ways. Both investor and private sector organisations scrutinise compliance with the Code picking up specific company compliance and monitoring trends. Auditors are required under the *Listing Rules* to verify reporting against some parts of the Code, primarily those relating to financial reporting and the audit committee, and regulators monitor the mandatory corporate governance disclosure requirements under the 4th and 8th *Company Law Directives*. However ultimately it is the shareholders responsibility to determine whether an explanation offers sufficient information to make an informed Investment decision.

It is important that shareholders continue to make these decisions and it is not for government or regulators to interfere inappropriately or without clear justification in these relationships. For this reason monitoring bodies should not take on the role of checking the quality of explanations, and comply or explain statements should not become regulated information under the terms of the Transparency Directive[9].

However we note that there are concerns about the informative quality of explanations and ongoing discussions between Member States on what constitutes an explanation. If such guidance could be given to those writing and receiving the explanations it is possible that the quality of explanations may improve significantly and shareholders themselves may become more adept at questioning an explanation. In the UK the Financial Reporting Council will shortly begin an exercise with the aim of developing a consensus about what constitutes a proper explanation.

[9] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:390:0038:0057:EN:PDF

Annex – Glossary of Organisations and References

A Long-Term Focus for Corporate Britain (2010)
http://www.bis.gov.uk/Consultations/a-long-term-focus-for-corporate-britain

BIS Department for Business, Innovation and Skills http://www.bis.gov.uk

Davies Report *Women on Boards* (2011) http://www.bis.gov.uk/assets/biscore/business-law/docs/w/11-745-women-on-boards.pdf

FSA Financial Services Authority http://www.fsa.gov.uk/

Kay Review http://www.bis.gov.uk/assets/biscore/business-law/docs/k/11-1015-kay-review-terms-of-reference.pdf

The Bottom Line: *Corporate Performance and Women's Representation on Boards* (2007), Lois Joy, Nancy M Carter, Harvey M Wagener, Sriram Narayanan, Catalyst.

The UK Corporate Governance Code (2010)
http://www.frc.org.uk/corporate/ukcgcode.cfm

UCITS Directive http://ec.europa.eu/internal_market/investment/ucits_directive_en.htm

Women Matter: *gender diversity, a corporate performance driver* Geoges Desvaux (2007) Sandrine Devillard-Hoellinger and Pascal Baumgarten, McKinsey & Company (Paris)
www.mckinsey.com/locations/swiss/news_publications/pdf/women_matter_english.pdf

Women in the boardroom help companies succeed –Professor Nick Wilson LUBS The Times, News International Trading (London) March 19, 2009 http://www.thetimes.co.uk/tto/news

Crown copyright 2011

You may re-use this information (not including logos) free of charge in any format or medium, under the terms of the Open Government Licence. Visit www.nationalarchives.gov.uk/doc/open-government-licence, write to the Information Policy Team, The National Archives, Kew, London TW9 4DU, or email: psi@nationalarchives.gsi.gov.uk.

This publication is also available on our website at www.bis.gov.uk

Any enquiries regarding this publication should be sent to:

Department for Business, Innovation and Skills
1 Victoria Street
London SW1H 0ET
Tel: 020 7215 5000

If you require this publication in an alternative format, email enquiries@bis.gsi.gov.uk, or call 020 7215 5000.

URN 11/1097