A LONG-TERM FOCUS FOR CORPORATE BRITAIN
Call for Evidence Response Form

A copy of the consultation available at: http://www.bis.gov.uk/consultations.

Responses to the Consultation should be received by 14 January 2011.

Completed copies of the response form should be returned:

Via email to: clgconsultations@bis.gsi.gov.uk

Via post to:

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Please tick the box from the following list of options that best describes you:

✓	**Quoted company**
	Other company
	Investor or investment manager
	Business representative organisation
	Investor representative organisation
	Non governmental organisation (NGO)
	Trade Union
	Lawyer or accountant
	Other (e.g. consultant or private individual)

The Board of Directors

<u>Question 1</u>: Do UK boards have a long-term focus – if not, why not?

Comments
As the consultation paper outlines, we believe that the introduction of a duty on directors to promote the success of the company under Section 172 of the Companies Act 2006 (the Act) ensures that UK boards continue to have a long-term focus. The Act provides that directors much have regard to the likely consequences of any decision in the long term. We fundamentally believe that good corporate governance is a critical component for the integrity, and long term success, of companies and is central to the health of the economy and its stability. Good corporate governance is about the board directing and controlling the company with a long term focus whilst balancing the expectations of its shareholders. Boards are accountable to the company's owners and must therefore account properly for their stewardship to ensure sound internal control. We strongly believe that good corporate governance means much more than complying with the letter of regulations and codes and that those companies that holistically embrace the spirit behind them are more likely to have effective boards. We recognise that the time-scale of the long term focus is likely to vary between companies and further believe that "uncertainty" will inevitably play a part in this focus. By way of example, the combined impact of the current regulatory changes and developments across our organisation's footprint is significant and the ongoing uncertainty around many proposed or suggested developments does not always support a long-term view. Ultimately, a long term focus requires all participants, including the board, investors, analysts and others (such as the media and politicians) to create an environment where individuals are willing to look at, and adopt, long-term strategies for growth and sustainable earnings. To incentivise the right investment behaviours, the interests of investors should be aligned with the company's interests. This includes long term performance incentives for investment managers and an emphasis on long-term, forward-looking metrics rather than more frequent information such quarterly reporting which can put pressure on companies to hit quarterly earnings targets.

<u>Question 2:</u> Does the legal framework sufficiently allow the boards of listed companies to access full and up-to-date information on the beneficial ownership of company shares?

Comments
Simply put, no. Whilst the Act and related disclosure obligations do provide a useful mechanism by which to access share ownership information, the regime is not comprehensive enough and also creates inefficiencies and needless costs. For example, the widespread and growing use of pooled nominee accounts by custodial organisations requires a greater reliance on Section 793 of the Act in order to uncover share ownership which is a costly, time consuming and error-strewn process. Furthermore, the growth in the use of Contracts For Difference (CFD), intended to avoid stamp duty and provide a cloak of anonymity, makes it very difficult for companies to get a full picture of share ownership. On a related issue, the framework is also inadequate when it comes to discovery of short interest which, arguably, is even more important to understand and where disclosure is only made during very specific situations such as rights issues.

Shareholders and their role in equity markets

<u>Question 3:</u> What are the implications of the chan ging nature of UK share ownership for corporate governance and equity markets?

Comments
The issues around share ownership (as discussed in question 2 above) have made life more difficult for corporates and equity markets. The lower levels of visibility of share ownership and short interest means that companies have greater difficulty in understanding what their shareholders feel about specific issues and also how they vote at meetings. The internationalisation of share ownership has brought many benefits, with one of the most obvious being the access to new pools of capital in North America, Continental Europe, the Middle East and Asia. That, of course, means that corporate management teams have to spend more time than they used to travelling to meet current and potential investors. The proliferation of hedge funds and other types of boutique investors has

made navigating the investor landscape more complicated for issuers. Many of these do not have a dedicated corporate governance resource and it is challenging for an issuer to establish any dialogue regarding corporate governance issues.

Also, the polarisation of investment strategies towards either index tracking (cheap beta) or focused stock-picking (expensive alpha) has made life more difficult. Index trackers do not always successfully integrate corporate governance in the overall investment decision process.

Moreover, the average holding period for any given share has fallen dramatically over the recent years, partly driven by the increased presence of short term trading strategies. High volume algorithmic trading makes it more difficult to understand who is trading in any given security and why.

We welcome the introduction of the Stewardship Code which encourages institutional investors to be more active and transparent in the governance of companies in which they invest. We believe that transparency, through public disclosure, is imperative in demonstrating and exercising accountability. We would encourage the FRC to continue to review this, particularly with respect to the inclusion of proxy voting advisory companies under the Code (see question 9 for further details). In noting that foreign investors are invited to adhere to the Code on a voluntary basis, we firmly believe that it is critical that a level playing field is maintained between UK and foreign investors in terms of their disclosures and voting practices.

Question 4: What are the most effective forms of engagement?

Comments

There are many effective ways that issuers can engage with investors. Each serves a particular purpose. For simple dissemination of static information the corporate website and media channels are very effective.

However, the most effective way for corporate management teams to build strong, long term relationships with current and potential shareholders is through direct personal contact by email, phone, and, most critically, in physical meetings. The corporate investor roadshow remains the mainstay of the investor relations programme though the trend is to use ever more efficient formats.

Given the unique footprint of our organisation, we also find it very useful to take our top shareholders on a tour of our markets every two years, to allow access to regional operational management. This gives investors a unique opportunity to gain a deeper understanding of how the company is run from within. This is particularly important given that over 60 per cent of our register

is represented by UK or US investors who do not naturally get to see the Group operating on a day to day basis

We believe strongly that it is important to engage our shareholders in relation to our corporate governance practices as well as in relation to the investment proposition we offer. Annually the Chairman hosts a Governance dinner where institutional investors are invited to join an open dialogue with the Company on its governance and management structure. The Chairman and the Chair of the Remuneration Committee also meet individually with shareholder representative bodies (such as the ABI) as well as individual shareholders to discuss key governance issues. We also participate in a broad range of industry conferences and other investor events to ensure all investors seeking access to the Company have plenty of opportunities to engage with us. The Chairman, Group Chief Executive, Group Finance Director and other members of the senior management team are regularly present at these investor events.

Shareholder feedback is communicated to senior management within the Group. The Board receives a quarterly investor relations report that provides updates on communication activity, investor access to senior management and investor reactions to financial results and corporate events.

Annual general meetings of shareholders are an effective form of engagement with shareholders since they give all holders, regardless of holding size (which is often the criterion which excludes some of them from ever meeting management on a roadshow), the opportunity to express themselves and seek justification for their management's decision making.

Question 5: Is there sufficient dialogue within investment firms between managers with different functions (i.e. corporate governance and investment teams)?

Comments

Our experience is that communication between managers with different functions has improved significantly in recent years. For example, those responsible for Environmental, Social and Governance (ESG) issues within institutions are now much more integrated within the mainstream investment decision-making process than they ever used to be and are much more likely to attend meetings with management teams alongside the portfolio managers and analysts. In large part this trend was accelerated by the financial crisis, which in many ways was driven by failures in corporate governance.

<u>Question 6</u>: How important is voting as a form of engagement? What are the benefits and costs of institutional shareholders and fund managers disclosing publically how they have voted?

Comments
As discussed in question 4 above, voting is a very important form of engagement since it bestows the right to every shareholder to influence a decision according to their proportional interest in the company. However, the growth pooled savings schemes and consolidation in the asset management industry has led to a corresponding concentration of voting power in a small handful of institutional investors. Thus, a small number of individuals now wield considerable influence over corporate Britain. Hence, this is even more important to ensure that the processes by which they exert influence over companies are robust and appropriate. Whilst we support the introduction of the UK Stewardship Code, we believe that more could be done to enhance the disclosure of voting policy and activity. For example, it is not always clear who makes the voting decision on shareholder resolutions and the extent to which a company's corporate governance practices are taken into account when making voting decisions. In light of the work done by Lord Myners to identify 'lost votes' we believe that institutions should be encouraged to make the following disclosures: o the communication process with the investee; o how votes move from the beneficial shareholder through to the final voting submission; o who has the final responsibility to make the vote; o how proxy voting service companies (e.g. Manifest), or proxy voting advisory companies (e.g. ABI, PIRC, NAPF) are used; and o full disclosure of the communication policy with the investee company if logging an 'abstain' or 'against' vote.

<u>Question 7</u>: Is short-termism in equity markets a problem and, if so, how should it be addressed?

Comments
Whilst there is a need for sufficient short term behaviour to drive price discovery, market efficiency and liquidity in equity markets, short-termism can be a problem owing to the growth on high frequency and momentum-driven trading strategies that seek to profit from the sensitivity of share prices to news flow.

This could be addressed by increasing the level of transparency on share ownership and most particularly short interest.

Question 8: What action, if any, should be taken to encourage a long-term focus in UK equity investment decisions? What are the benefits and costs of possible actions to encourage longer holding periods?

Comments

Increasing incentives to hold securities for longer periods would be sensible in encouraging a long term focus in equity markets. Such incentives could be effected through more shareholder rights for time-weighted voting or taxation law, but clearly the latter would have state budgetary implications. So too, increased regulation to curtail short term investment strategies may encourage the UK's large asset management industry to move some of its operations abroad with the obvious impact on employment and wealth creation.

Another action could be to consider an increase in the transactional costs of churning shares.

Question 9: Are there agency problems in the investment chain and, if so, how should they be addressed?

Comments

There are numerous agency problems in the investment chain given the number of agents involved and the difficulty in aligning interests within a regulatory framework.

Firstly, the main agency issue is aligning the interests and actions of institutional investors with the interests of their underlying investment clients. A more robust and transparent framework that allows investors and corporates to understand how institutional investors operate, what they own (and what they have a short interest in), how they vote on specific issues, how they manage potential conflicts of interest, and how they ensure sound and independent governance of corporate issuers would be helpful to address some of the agency issues.

Secondly, an agency issue may arise if interests of sell-side analysts and the investment banks they represent are not fully aligned with those of the buy-side who are the recipients of the research they publish. Chinese Walls between research and investment banking as well as close monitoring of all

published research against the market activity by an independent party could help detect and/or eliminate some of the agency issues.

Thirdly, an agency issue may arise on a corporate side, when there is a misalignment of interests between the board of directors of the issuer and the underlying shareholders. This is best prevented through robust corporate governance structures and effective shareholder voting mechanisms.

Fourthly, the use of proxy voting agencies can create issues in terms of the transparency on how the institutions use agencies to log their votes or use them to obtain guidance on how to vote. We consider that it does not matter how good the chairman and the investor relations team may have been in communicating adequately with investors, if the decisions on voting shares are taken by proxy voting agencies then such discussions are arguably wasted.

In referring to the Stewardship Code (the Code), we felt that the voting service agencies (e.g. Manifest) should have been asked to commit to the spirit of the Code, and that it may have been useful to have included an appendix providing 'best practice' guide for these agencies. This may include guidance on their minimum service level, commitment to avoiding 'lost votes', transparency on their processes, and disclosure of the institutions they vote for.

Furthermore, we would also like to see more disclosure from the proxy voting advisory companies (e.g. ABI, PIRC, NAPF) including disclosure on how they assess companies resolutions and the basis that 'abstain' or 'against' votes are recommended. They should also disclose their policy on engaging investee companies before they issue their voting report especially in regards to 'abstain' or 'against' votes. We would also like to see a list of institutions they represent and disclosures on the steps that they take to ensure that they are correctly representing their members' views

Question 10: What would be the benefits and costs of more transparency in the role of fund managers, their mandates and their pay?

Comments

The benefits of more transparency have been addressed above. More transparency is needed on fund managers' roles and their mandates, but not necessarily on how much they are remunerated. What is important to understand is that managers are remunerated for achieving long term investment performance and following coherent and sound corporate governance policies.

Directors' Remuneration

<u>Question 11</u> : What are the main reasons for the increase in directors' remuneration? Are these appropriate?

Comments
We would question the hypothesis that there has been an increase in director's remuneration, especially in relation to base salary where increases have not been significant over the period. The data in the FTSE 100 CEO average remuneration graph provided in the consultation paper shows that the majority of any increase is related to variable compensation, which itself is linked to the achievement of targets that provide an increase in value of the company e.g. share price or total shareholder return. As such the payments are rewarding for value created in the business. It is not possible to tell how expected value has been calculated for this purpose. We do not consider the role of CEO to be a good indicator of directors' remuneration in general. The average tenure of a CEO is approximately three years. For this reason, when a new appointment is made a premium is paid for bringing someone into the position, giving way to a natural increase. It is also important to take into account the internationalisation of the FTSE 100 composition. There is now a global talent base from which senior employees are sourced. The nature of companies and where they carry out their business has also become increasingly international.

<u>Question 12</u>: What would be the effect of widening the membership of the remuneration committee on directors' remuneration?

Comments
In order for the remuneration committee to work effectively each member needs to understand their role and time commitment, have a thorough knowledge of the business and undertake an appropriate induction to make appropriate decisions. A well managed and independent remuneration committee is key rather than its size. The remuneration committee already has the remit to seek external advice from an array of other stakeholders including other specialist areas of the business (e.g. risk and control), external advisors and government groups. Ultimately, the remuneration committee is accountable to the owners of the business as determined by re-election and the "say on pay" vote that they are able to exercise at the Annual General Meeting (AGM).

<u>Question 13</u>: Are shareholders effective in holding companies to account over pay? Are there further areas of pa y, e.g. golden parach utes, it would be beneficial to subject to shareholder approval?

Comments
We are not aware of any evidence that investors are calling for a greater level of involvement. Shareholders are already using negative votes in increasing numbers to make their points heard, including rejections of the remuneration report at AGMs. There are already an increasing number of guidelines and provisions which give both prescriptive and informative detail on how pay is managed, determining how remuneration is structured. This is particularly true in the financial industry. Our experience is that the majority of investors do not want to enter into an argument with management. Ultimately, if investors are unhappy with the way in which policy is managed they will respond by selling their holdings. Engaging shareholders for approval on other areas of pay, such as golden parachutes, seems extremely impractical. How this would work in practice is unclear, especially as termination arrangements by their nature are often acrimonious. It is unlikely that it would be possible to approach shareholders before the compromise agreement was put in place.

It should also be noted that shareholders are not a homogeneous group. Shareholders have many motivations for holding equity and the level of involvement on a range of matters will be dependent upon this profile.

We would also argue that most organisations already have due regard for appropriate governance and consideration to the important factors.

<u>Question 14</u>: What would be the impact of greater transparency of directors' pay on the:

- **linkage between pay and meeting corporate objectives**
- **performance criteria for annual bonus schemes**
- **relationship between directors' pay and employees' pay?**

Comments

As highlighted in the average remuneration graph in the consultation document, the majority of directors' total compensation is already performance related.

There are already guidelines in place ensuring that there is more than adequate disclosure of directors' pay. Within this, companies already provide clearly articulated performance indicators of the business within their disclosures.

We would suggest that the most important things to focus on in relation to remuneration are the principles and structure of arrangements rather than focusing solely on the quantum.

Finally, there seems to be an underlying assumption that directors are the highest paid employees in the company. In the majority of financial services companies the CEO is not the highest paid person, particularly when variable remuneration is factored in.

Takeovers

<u>Question 15</u>: Do boards understand the long-term implications of takeovers, and communicate the long-term implications of bids effectively?

Comments
We believe that boards do understand the long-term implications of takeovers and will always seek to communicate the long-term implications of bids effectively. Any communication would include the compelling rationale for the takeover as well as an indication of the long term value it would create for investors. Consistent with the Act, UK boards will also have regard to other stakeholders, such as employees and the local community.

<u>Question 16</u>: Should the shareholders of an acquiring company in all cases be invited to vote on takeover bids, and what would be the benefits and costs of this?

Comments
The UK Listing Rules already required UK-listed companies to seek shareholder approval for major transactions and we consider that the threshold level at which shareholder approval is required remains appropriate at this time. If companies were required to seek shareholder approval in all case, the cost and timescale of preparing shareholder documentation may outweigh the benefit of the acquisition. As an international organisation operating in over 70 countries, we recognise that a UK-listed company could potentially be at a disadvantage if it was required to obtain shareholder approval for an acquisition where a non-UK competitor bidder was not. We believe that it is critical that a level playing field is maintained and that, if any new legislation must be introduced, it is done so equivalently on an international basis.

<u>Question 17:</u> Do you have any further comments on issues related to this consultation?

Comments
In noting that some of the questions in this consultation overlap with those addressed elsewhere in other consultations, we believe that a more integrated and co-ordinated approach would be helpful going forward. Ultimately, there is a need for one comprehensive and consistent framework of “comply or explain” principles that can be applied on an international basis, are clear and easy to follow and which provide incentives for those who apply them in an exemplary manner and consequences for those who do not.