BIS | Department for Business Innovation & Skills

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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Organisation (if applicable): N/A

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
PI	**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
Board members (executive & non-executive) do not derive their main source of compensation from long term company performance (dividends). The focus of executives is on pay and other elements of their compensation package, both at their employer and prospective future employers. Size and prestige are more important than long term shareholder return. The focus of non-executives is on their performance at their main employer or, if retired, is likely to be on continued involvement with senior management for its own sake. UK boards are either under-representative or else entirely devoid of long term underlying beneficial shareholders. These are the only people likely to have the long-term vision required.

<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
The issue is more that the underlying beneficial holders have little, if any, right or opportunity to vote on important decisions. Where a holding is through a fund it is hard to see how this information could legally be obtained or how views could fairly be elicited. Where holdings are identifiable, e.g. through SIPPs, ISAs or on-line broker accounts, companies should have the right to look through the wrapper/nominee account. Similarly, the underlying beneficial holders should have the right to act as if they held their shares directly. Financial services firms operating the accounts should be under an obligation to provide this facility at a fair and reasonable cost or, ideally, for free.

Shareholders and their role in equity markets

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

Comments

There are far fewer long term private shareholders able to exercise voting or nomination rights. The people able to vote are likely to see these private shareholders as an unqualified irritation. Rather than seeking their (long-termist views) the boards of companies generally go out of their way to discourage the involvement of private shareholders in any form of decision-making. They are often discouraged from holding shares at all. It is worth noting how several recent major rights issues were timed so that payment was required just before the receipt of major dividends where shares were held in broker accounts, ISAs and SIPPs, but just after receipt of these dividends for other shareholders. Payment for HSBC's rights issue fell in the 2008/9 tax year preventing additional subscriptions to ISAs and SIPPs to help private shareholders take up their rights. This all tends to continue the trend of declining ownership by individuals with an interest in maximising the net present value of future dividends.

<u>Question 4</u>: What are the most effective forms of engagement?

Comments
Representation on the board and on certain committees of the board, e.g. remuneration committee, appointments committee (for appointments of non-executive directors).

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

Comments
The influence of investment firms is only likely to go as far as their direct influence on directors' pay and on other decisions taken by the board or by board committees. Non-executive directors tend to be drawn from only the top levels of management (Chairman/Chief Executive/Chief Financial Officer) at investment firms. Dialogue between managers with different functions within investment firms is therefore irrelevant.

<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
Disclosure could act as a guide to investors in institutions and through funds as to the quality of decisions being made on their behalf. It should result in better allocation of investors' money between institutions and different funds. There should be no significant cost in disclosing this publicly.

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

Comments
Short-termism in markets is not itself a problem. Sensible decision making by shareholders and fund managers should prevent sales at below a sensible value or purchases that inflate a bubble. One issue to address is the difficulty faced by regulated financial services companies, particularly banks and investment banks, in raising new equity capital when they are at risk of falling below regulatory minimums.

<u>Question 8</u>: 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
Improve the ability of long term shareholders to exercise their rights, perhaps by providing 'super-equivalence' or guaranteeing rights to nominate/appoint non-executive directors. Consider reducing the level of capital gains tax on long term holdings, or allowing rollover of the CGT annual exemption. I do not favour any distortion of the market by limiting rights to vote or receive dividends to a minimum holding period. This could give rise to a concentration of influence in the hands of holders keen to pursue a particular agenda and/or share price manipulation in order to encourage a transfer of shares at a critical time. Companies where a major holding changed hands could be vulnerable to even more short-term decisions driven by remaining holders. It would be even harder to work out at what point a controlling interest or a certain % effective level of control occurred, depending as it would on particular transaction quantities and dates. The inability of ISA and SIPP holders (and of pension funds) to recover income tax on dividends has generally reduced the corporate discipline to focus on dividends as the main return for long term shareholders. Clearly there would be a cost in reinstating tax recovery, but there would also be long term benefits in corporate governance and an immediate tax benefit from a reduction in pension fund deficits (or increase in surpluses).

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

Comments
Addressed in several other responses. There are significant agency problems. Direct look-through should be encouraged or enforced so far as this is possible. Any expense should be borne as far as possible by the agents with only reasonable and unavoidable direct additional costs passed on to underlying beneficial holders. Proportionate 'Grossing-up' of holdings where an underlying shareholder chooses to vote or make a nomination through an agent/nominee should be considered. It is worth noting that the ISA and SIPP holders are likely to be long term holders of equities generally, if not of any particular equity, although they will tend to prefer high dividend shares.

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

Comments

More transparency in decisions they make on behalf of underlying investors should encourage investors to trust additional investment funds with those managers making good decisions, or at least actively engaging in decision making, and vice versa.

Directors' Remuneration

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

Comments
It is in the interests of directors and those who set directors' pay for directors' remuneration to increase. Members of remuneration committees tend to be executive directors at other organisations. The boards of public companies, taken collectively, are a 'closed shop'. In order to be considered as a non-executive director, it is a necessary already to be a director of a public company. The greater the total amount of remuneration in the system, shared out between a fixed pool of recipients, the more each receives. Remuneration is also linked to company size. This tends to discourage the payment of dividends or return of capital to shareholders (which incidentally makes raising of temporary or permanent capital more difficult). It also encourages mergers and acquisitions.

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

Comments

Remuneration committees should contain a majority of members who are not executive directors of public companies. There should be substantial representation from long term individual shareholders.

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

Comments
This should be dealt with through rules on board appointments, election of directors and composition of boards.

<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

This risks being overcomplicated and over-prescriptive. Remuneration committees interested in long term shareholder value should make the right decisions and create an appropriate environment to encourage and reward performance.

Takeovers

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

Comments
Boards may not be interested in the long-term implications. Clearly, if they are aware of possible material adverse implications they will attempt to avoid communicating these, and may hinder their effective communication by others or by dissenting members of the board.

<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
Not in all cases, but where the takeover is material in size or potential impact, they should. Shareholders should be able to vote against any takeover before the board is able to make any binding financial commitment. Size should be considered in terms of gross assets as well as any other criteria used to determine size for any materiality test.

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

Comments
The FSA's non-executive director vetting panel should not be permitted to deter shareholders from becoming non-executive directors where they lack only recent experience of working in the financial services industry.