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

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

About AFM

1. The Association of Financial Mutuals (AFM) was established on 1 January 2010, as a result of a merger between the Association of Mutual Insurers and the Association of Friendly Societies. Financial Mutuals are member-owned organisations, and the nature of their ownership, and the consequently lower prices, higher returns or better service that typically result, make mutuals accessible and attractive to consumers.

2. AFM currently has 57 members and represents mutual insurers and friendly societies in the UK. Between them, these organisations manage the savings, protection and healthcare needs of 20 million people, and have total funds under management of over £80 billion.

The Board of Directors

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

Comments
UK business has for hundreds of years proved itself to be innovative, resourceful and successful. Much of this is as a result of the business climate, which has nurtured capitalism and entrepreneurship. **Most Boards recognise the tension that results from looking to serve the interests of owners and customers. In the corporate world these interests seldom overlap; in financial services for example, customers interests' are best served by a strong long-term performance for the company that enables it to offer a resilient capital position, make reasonable charges, provide good investment returns and high standards of service or pay claims when they emerge. Shareholders interests are primarily in the value of their equity investment and/ or the dividend payment and as a result are more short term.** **The basis by which these two competing interests are managed will determine to what extent a board has an effective long-term focus. Most corporate Boards find that the overarching priority to keep the financial analysts happy means that they are forced into developing a short term focus in order to bolster the share price.** **In comparison, mutual organisations do not have the two disparate audiences to satisfy, as the customers and owners are one and the same. This means that mutuals can aim to deliver long-term value to their owners and in so doing meet the needs of their customers.**

<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
We do not have sufficient information to answer this question.

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

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

Comments
Shareholder owned organisation will see the most significant aspects of engagement from institutional shareholders, who will provide the vast majority of voting at the AGM. This tends to be the focus therefore of corporate efforts. As mutual organisations we cannot comment on this, though our focus is on seeking engagement from policyholders, who generally have a very small holding in the organisation, even compared to the individual shareholders in corporates. **Our experience of gaining engagement from members is that this is best affected by creating a broader sense of ownership in the company, to seek to share an understanding in the strategy, culture and priorities.**

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

Comments

Question 6: 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 mutual organisations, our experience is that many member-owners take their voting responsibilities seriously, and recognise the role they play in shaping future strategy within the business. In general around 4% of members vote at the AGM, though this fluctuates significantly across organisations: for example, many of our members operate a delegate system, where a small group of representatives attend the AGM on behalf of all others, and it is generally the case that voting is much higher if there is an issue of contention. It is unclear how many of the very small shareholders in corporates vote.

As member owned organisations that typically rely on one member one vote with no block holdings we have no experience of institutional shareholding. Some of our members do however act as institutional shareholders in investing member funds, and there voting pattern and investment choices will be determined by their (investment) strategy which is presented each year to the AGM. Where a company acts in accordance with a strategy appropriately presented to the AGM we do not see significant extra benefit in disclosing how they have voted, though we envisage for smaller firms in particular that the costs of regular disclosure would be significant.

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

Comments
Financial analysts and rating agencies impose severe sanctions on firms with short term problems, and this necessarily increases the pressure on management to take a short term view. Rating agencies do not take proper account of the long-term value of a business: for example, in financial services, greater value should be achievable by managing the book of business for the long-term, but rating agencies tend to give undue attention to new business sales- which are themselves very often a drag on performance. Analysts need to understand better the underlying strengths of a firm and the drivers to long-term success, and reflect this in their commentary.

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
In part companies will increase long-term focus if the incentives are there for them to do so. Managers in particular focus on the short term due to the pressure to show success quickly, and because the length of tenure for CEOs in UK companies is quite short. **Aligning interests of the Board and managers with the long term interests of the company may be better achieved through the reward structures, but getting analysts and rating agencies to better understand the drivers to long-term success, and to reflect this in their commentary is key.** **That said, we are not convinced that corporates will ever focus successfully on the long-term- mutual models have been shown to be far more effective at achieving this. Modernising the legislation for**

mutuals, to encourage the creation of new mutuals and to enable them to compete on more equal terms with plc organisations will provide a better result overall.

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

Comments
Evidence from the UK insurance industry shows that plcs remain heavily focused on maintaining dividend growth and the share price to the exclusion of good investment performance and new business growth. This means that the short term interests of shareholders are treated as paramount. **AFM research shows that amongst the six largest UK plc insurers dividends paid in 2009 were around £2.5 billion, and have remained static over time. This compares with a period where profit has come under pressure, where the premiums earned in the UK insurance market have fallen significantly, and where policyholder returns, particularly on the investment side, have eroded even more quickly.** **In a plc it is too often the case that the rewards of managers are short term and not focused on good outcomes for customers. For example, so investment managers will pay themselves a performance bonus for positive returns in a single quarter, even where this was preceded by three quarters of negative growth, and/ or the positive growth is below the market average.** **Interests of customers ultimately suffer, and the UK regulator (FSA), because it is not an economic regulator, feels unable to intervene where the market is distorted by failures in price of performance.**

<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

Fund managers have built up a false reputation for low charges, based on the incomplete disclosure rules they are subject to. AFM research has compared the average charges on an ISA/ unit trust with the average charges on mutual with profits policies (the latter have similar investment profiles, but benefit from underlying guarantees of capital and life cover). Charges are typical 12% lower for a mutual with profits policy.

Fund managers argue you "get what you pay for", but our evidence also shows that over the long term a mutual with profits policy outperforms a typical managed fund by 15%.

Mutual with profits policies also enjoy better service performance and are subject to much greater transparency- we conclude that the benefits of greater transparency would be to intensify the focus of managers on lowering costs and improving performance.

Directors' Remuneration

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

Comments
As we cite in response to Q.9, shareholder and director returns are not always directly linked to performance of the business. The main drivers tend also to include: benchmarking against market trends and last year's pay. The high turnover of directors means there is a disproportionately greater inflation in earnings and use of special incentives that may distort the whole. **AFM has recently issued its first report on remuneration in the mutual sector. Our analysis of the larger AFM members shows the median figure of total CEO remuneration was £313,373 for 2009, with a range of between £100,000 and £1.22 million. By comparison, The Daily Telegraph Executive Pay Report published in May 2010 showed that the average pay for FTSE 250 companies in 2009 was £1.22M. Most of our members would not fall into the FTSE 250 were they to demutualise, but even those that do generally earn significantly less that CEOs of equivalent organisations.** **The average CEO bonus for AFM members in 2009 was 19% of base**

salary. Recent research by Deloittes into FTSE 250 companies came up with a figure of 60%.

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

Comments
AFM members' run remuneration committees as sub-committees of the main Board. In most cases the Board of a mutual will include a number of individual policyholders, who therefore play an active role in remuneration. In a plc this would be the equivalent of holding places on the Board or its committees specifically for small shareholders. We conclude this will improve the transparency and accountability of pay. **Most large AFM members will include an advisory vote on executive pay at their annual general meeting, which ensures a broad understanding of pay across members. Full details of executive and non-executive pay are included in the annual report.** **Other forms of mutual organisation include employee-owned businesses. In these typically, staff share the benefits of a profitable year, and examples from John Lewis and similar indicate that this provides a healthy focus throughout the business of ensuring directors' remuneration is held in line with all staff.**

<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
We have no specific evidence, but we do not believe that on the whole shareholders are effective in this area.

<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 stated above, AFM members are transparency with the customers/ owners. Advisory votes at the AGM generally result in very high levels of approval- and members expect the explanation of pay awards to describe how pay interacts with corporate performance, which encourages a clear dialogue at the AGM.

Takeovers

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

Comments
As mutual organisations we have no evidence to offer on this.

<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
As mutual organisations we have no evidence to offer on this.

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

Comments