GC 100

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Dear Mr Gray

BIS: A long-term focus for Corporate Britain

I am writing on behalf of the GC100 in response to the above consultation paper. As you may be aware, GC100 is the association for the general counsel and company secretaries of companies in the FTSE 100. There are currently over 120 members of the group, representing some 80 companies.

The GC100 welcomes the opportunity to respond to this consultation, but before addressing each of the paper's questions in turn, we think it would be helpful to set out some general observations.

This consultation addresses a number of issues which have been covered by other recent consultations, including the Takeover Panel's consultation on the Takeover Code, the EU review of the Transparency Directive, the 2009 Walker Review of bank governance, the FRC's consultation on the Combined Code (which led to publication of the UK Corporate Governance Code), the Stewardship Code for institutional investors and the recent consultation on narrative reporting. Many of the issues were also covered in the recent EU Green Paper on corporate governance in financial institutions. There may be an argument for allowing the impact of these recent measures/developments to be seen before calling for evidence on where to take further measures.

Several of the areas of the consultation would likely be more meaningfully answered by investors and fund managers rather than General Counsel/Company Secretaries as indicated within the answers provided. Whilst the Companies Act 2006 has resulted in corporates adopting a collective stakeholder approach, we are yet to see the same agenda being adopted by institutional investors in the same way. For example, if investors were obliged to consider the community and employees of an investment target before making an investment decision, how would the landscape differ? This is a cultural question for the UK. Until the playing field is levelled the questions are arguably redundant. If there is a desire for the UK free market to remain as it is, then it is difficult to see what steps can be taken to limit short-termism without adversely affecting the market. With a substantial proportion of shares in UK companies now owned by international investors, should we be deterring such investment?

Ultimately the issue of investor short-termism is complex. Views on this topic differ greatly

dependent upon whether they stem from an investor or issuer and the business product of a company. More importantly, the make-up of a company's share register will impact greatly on a company's strategy and the time period that the strategy focuses on. Arguably companies with a less 'traditional' share register may be more at risk of short term behaviour from investors as the role of the shareholder activist gains greater prominence. In such a situation, a company may well enter into a considered engagement process to no avail. The answers provided below reflect those of a company with a more traditional share register, where a majority of shareholders are institutional investors.

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

It is generally agreed that UK boards have a long-term focus. In accordance with the Companies Act 2006 directors have a duty to promote the long-term success of the company; 'success' is generally regarded to mean a long-term increase in value. However, it must be recognised that time-scales will vary from company to company, particularly in relation to specific investment decisions. For example, utility companies may have to plan for projects which will take many years to implement, and healthcare companies may require a long lead time before they can launch products on the market. This compares to other companies which may have much shorter horizons.

Whatever the nature of a company's business, when it comes to strategy, the consensus is that UK boards do have a long-term focus. They will also have short-term objectives within the framework set by the long-term strategy. Undeniably, factors such as quarterly reporting mean that there is pressure on companies to demonstrate performance in the short term. Communication of the short-term objectives set against the strategy framework should help to demonstrate progress as part of the reporting regime and help to alleviate this. However, additional factors such as directors being subject to annual re-election may be construed as an extra influence in delivering in the short term. The extent of such influence will be dependent upon the make-up of a company's share register; those companies with largely institutional investors should be able to avert this by properly engaging with investors and fully communicating their strategy. It is recognised that share-based long-term incentive plans go some way towards ensuring that directors aim to create long-term value by aligning their interests with those of shareholders.

2. 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?

The boards of listed companies may receive information on beneficial ownership of company shares in a number of ways: through disclosures under the Disclosure and Transparency Rules, requests under Part 22 of the Companies Act 2006 (section 793) and through any analysis produced by the companies' corporate brokers and/or registrars. It is agreed that the section 793 process is far more transparent than the processes afforded to other EU issuers, such as Denmark and Spain. Furthermore, this matter is currently being considered as part of the review of the Transparency Directive.

However, there is some consensus that the process is still intensely manual, time-consuming (namely, regarding response times to requests for information) and can be expensive. It can be hard to determine the ultimate beneficiary where the shares are held through several levels of nominee accounts. Furthermore, obtaining information in respect of overseas legal holders can be much more difficult and costly.

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The current legal framework does permit a company to obtain full information on the beneficial ownership of its shares but the time that this process can take can be extensive. In addition, stock lending and more complex investment vehicles such as contracts for difference make the process more difficult. This can be problematic, particularly around timing on corporate actions and dividend record dates.

3. What are the implications of the changing nature of UK share ownership for corporate governance and equity markets?

20 years ago, 60% of UK companies' shares were owned by pension funds and other long term UK investors; today the level of ownership is closer to 30% with the remainder held by international investors and hedge funds. This change in ownership structure has implications for UK business. For example international investors may have different priorities to long term UK investors. In the context of corporate governance, it has arguably meant that shareholders are less likely to engage with the companies they invest in, with a view only to maximising their short-term return. The introduction of the Stewardship Code has admittedly gone some way towards encouraging institutional shareholders to adopt a more active and transparent role in the governance of the companies in which they invest. However, with an increasing trend for investor decision making to be short-term and the potential for non-traditional investors such as hedge funds to affect the overall market by investing in shares or contracts for difference on the assumption of a target share price, it will be interesting to see whether the Stewardship Code has gone far enough.

However, inward investment should be encouraged. Culturally, as a free market, the UK has always been an attractive place for inward investment and UK companies have benefitted enormously from it. The increase in international capital has helped to increase the liquidity of UK equity markets, reducing trading costs and, as a result, the cost of raising equity capital. Any steps taken towards implementing a regulatory check on investors should be considered with extreme caution to avoid the UK market becoming a less attractive investment prospect altogether.

4. What are the most effective forms of engagement?

The range of suggestions received indicates that different forms of engagement suit different audiences. Most companies maintain an open dialogue with their major shareholders, using various methods of communication. Such communication may take the form of a formal meeting, or be arranged in response to a particular announcement or set of results as is often the case for the principal institutional shareholders. Some investors may be keen to engage in small group sessions or individual calls. Others may be content to receive information from analysts and thereby have no direct engagement with the company. Companies may arrange for the Chairman and the Company Secretary to visit leading shareholders on an annual basis to discuss strategy, governance and particular issues of the moment.

A company's annual report and accounts will provide all shareholders with important information, but there are clearly certain cases where direct engagement is warranted.

The company's Annual General Meeting is the most obvious forum for private shareholders to engage in discussion. However, it has been observed in some cases that fewer than 1% of the company's shares are represented at the AGM and that some investors do not see the benefit of attending an AGM.

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Certain smaller and mid-sized institutions may be more resource-constrained. With this in mind, an important issue to address is the cost to institutional shareholders of engagement and the need to ensure they are undertaking the most appropriate engagement activity.

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

As above, the general perception is that practice varies. There are clearly some investment firms which use well-established methodologies, which are in turn supported by professional governance processes that are fit for purpose. However, in some cases, there still remains an apparent disconnect between the corporate governance and investment teams. For example it is not unheard of that an issuer may have engaged fully with the investment team of an investment firm but the assured approach is not then reflected in the actions of the corporate governance team.

While this question would be better answered by investors themselves, from an objective standpoint it would seem that there needs to be greater consistency of practice and cooperation between managers with different functions. Until such time that investment firms make a buy, sell or hold decision on the basis of a company's corporate governance practice, as they would on a company's financial performance, the argument will remain circular.

6. How important is voting as a form of engagement? What are the benefits and costs of institutional shareholders and fund managers disclosing publicly how they have voted?

Voting is a very important form of engagement. However, companies would far rather debate any issues throughout the year and during the run-up to a General Meeting rather than discover a high number of negative votes against a resolution on the day of a General Meeting. AGMs give shareholders the opportunity to vote on routine matters; more often than not, there is overwhelming support for resolutions at AGMs, unless they are particularly contentious. Again, companies would prefer to be contacted prior to a negative vote being cast so that the relevant issue can be discussed. Voting against the board should only be done as a last resort after proper engagement with the company. Situations in which intermediaries are involved require extra attention: the shareholder must make sure that the chain is sufficiently well-linked for his votes to reach the company in a timely manner.

The public disclosure of voting practices by institutions demonstrates that they are acting as responsible investors. Public disclosure of how institutions have actually voted could encourage institutions to vote in a more timely manner and would be of use to companies in analysing support in the run-up to a General Meeting. Although it could be argued that the benefit of disclosing how votes have been cast may be diluted where institutions rely on voting agencies for guidance on how to vote, it is still of use to companies to know when the votes have been lodged. Companies would rather shareholders came to them to discuss their concerns than follow advice from a voting agency. It has been argued that public disclosure of voting practices may be counter-productive insofar as many investors may simply choose not to vote or follow a box-ticking approach. It is hoped that the Stewardship Code, which provides guidance to ensure greater consideration and responsibility in voting, will be sufficient and that it will become an integral part of best practice for institutional shareholders and fund managers.

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

Short-termism plays an important role in improving liquidity in equity markets, which in turn attracts investors, reduces trading costs by narrowing spreads and, consequently, reduces the cost of equity capital for UK companies. This has a beneficial impact on the UK economy, as it better enables UK companies to raise equity capital and thus to sustain and grow their workforce, invest in research and development, and fund their growth strategies. Although some argue that companies would prefer to have long-term shareholders, they would not prefer to do so at the expense of market liquidity. There is a debate around the potentially negative influence of less traditional investors (e.g. short-term focused hedge funds) and their impact on UK corporates. However this will depend on the risk appetite of the investor, the size of the company it invests in, the size of its float and what the company is actually doing.

It is hoped that where companies clearly communicate their strategies and quantify their risks, appropriate investment decisions will be made. There is little a company can do to combat short-termism in equity markets other than maintain an ongoing dialogue with investors in order to explain how the company is meeting its short-term targets as part of the longer-term strategy. Periodic financial reporting should ideally support this and not create a short-term perspective among investors.

As is the case for question 5, investors would no doubt be able to provide a more value-added response to this 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?

It is agreed that the ability to trade freely is a key benefit to the UK market. Any action to encourage long-term investments, by imposing legislative or other requirements, may have the negative effect of reducing liquidity and therefore the appearance of the UK market as attractive for investment.

While longer holding periods may be beneficial, it should be the responsibility of both investors and management to effectively develop dialogue and understanding, rather than having longer holding periods enforced as a result of some legislative requirement.

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

This is another question on which investors may be in a better position to comment. However, from the issuer perspective, voting is one area which has the potential to be problematic. Where custodians hold the shares, they have little incentive to ensure that votes get through. Indeed, if investors believe that voting is important, they should make sure that custodians, and any other intermediaries further down the chain, are subject to accurate and prompt voting procedures as part of their service level agreements.

Our response to question 6 considered the importance of engaging through voting: given that it can often be difficult to determine the underlying holder of shares, it may be the case that companies do not have a firm indication of voting before a General Meeting, which, as discussed earlier, is not ideal. Therefore, since the voting chain can be long and easily

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broken, it would be helpful for investors to take ownership of the process by ensuring that their decision-makers are able to check that the voting instructions have been carried out properly.

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

Again, investors are better placed to consider issues regarding the structure of the fund management industry. More transparency would be preferred in terms of their engagement policies and engagement activity as opposed to with regard to their role, mandates and pay. From an objective standpoint it could be hard to justify the additional costs that would surely be involved in increasing disclosure as suggested in the question.

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

There is a fundamental need for companies to attract, motivate and retain executives of the right calibre. This is one of the main reasons for the increase in directors' remuneration; it is appropriate and should not be forgotten. However other factors to be considered include the pressure from US-style practices and the increased international mobility of directors, which have had a significant influence on the decisions made by UK boards. Furthermore, there has been an increase in pressure from investors and regulators to focus on performance-related pay.

Public disclosure of remuneration and third party consultants have also played an important role in increasing directors' pay. In a competitive market this transparency has made it easy for directors to compare their pay packages. Benchmarking such as stating remuneration policy against a market quartile has the obvious effect of ratcheting up pay packages.

12. What would be the effect of widening the membership of the remuneration committee on directors' remuneration?

This would depend on how exactly the membership was widened; accordingly, this question requires clarification.

The remuneration committee currently consists of independent non-executive directors who understand the business but have no personal interest in the decisions on remuneration which they are making; there is some consensus that there does not appear to be any real benefit from bringing people onto the committee without any relevant understanding.

On the assumption that membership would be extended by including employee representatives, said representatives would likely require extensive training in order that they have sufficient knowledge to understand the complexities involved. There is some concern that these individuals could face potential liability as shadow directors of the company, since the remuneration committee is a committee of the board of the company.

In terms of the effect on directors' remuneration, on the assumption that the employee representatives would unlikely make up more than a majority of the full remuneration committee, it is unlikely that widening membership would effect actual remuneration levels.

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13. 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?

It is agreed that the shareholder advisory vote on the remuneration report is an effective way for shareholders to express their views on pay. The obvious advantage of this is that there is one vote on pay, which is made after shareholders have had time to consider the whole remuneration package and make their views known on any particular areas. Where a significant number of votes are made against a remuneration report, or to abstain from voting, a powerful message is given to companies and their remuneration committees that they should review their remuneration practice. In addition the requirement for shareholder approval of incentive plans further empowers shareholders in this arena. A consultative approach to the design of incentive arrangements allows shareholders to influence executive pay arrangements at the outset. In addition companies are increasingly consulting with at least their largest shareholders prior to amending remuneration policy.

The Companies Act 2006 prohibits payments to directors for loss of office without prior shareholder approval.

Overall, it is generally felt that shareholders have the tools to hold companies to account. It is thought that increasing the number of matters which require shareholder approval would simply have the effect of reducing the flexibility of the board to run the company's business smoothly.

14. What would be the impact of greater transparency of directors' pay in respect of:

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

Linkage between pay and meeting corporate objectives

Shareholders are already demanding more information on this and institutions will make their views known if disclosure is weak. There is clearly a fine balance between the current level of transparency and disclosing commercially sensitive information. It is questionable whether remuneration reports could be more transparent without putting the company at risk of making such a disclosure.

Performance criteria for annual bonus schemes

As above, there is a fine balance between transparency and disclosure. There is some consensus that the current balance appears to be appropriate from a company perspective.

Relationship between directors' pay and employees' pay

This can prove difficult in practice for a multinational company, whereby the expectations and market norms vary from country to country and disclosure would provide a misleading picture of a company's activities if most of its activities take place outside of the market where its directors are based. Additional disclosure requirements could also prove to be

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misleading, even for a UK based company, as there would also be considerable discrepancies in the relationship depending on the sector reporting with some showing a much wider variation, for example the service industries. Given that the Companies Act 2006 already requires disclosure in the annual report regarding how pay and employment conditions of employees are taken into account when determining directors' remuneration, no further disclosure is felt necessary.

15. Do boards understand the long-term implications of takeovers, and communicate the long-term implications of bids effectively?

It is agreed that boards do understand the long-term implications of takeovers and communicate the long-term implications of bids effectively. Board teams must ensure that they consider any premium offered against long-term prospects, since it may be difficult to avoid taking a short-term gain if it seems to represent the best value for shareholders.

Clearly, while the board will be keen to communicate any potential synergies of the takeover to its shareholders, it will have to be wary of communicating any information which might constitute a profit forecast or which might expose the company to future liabilities. Bid documentation may be complex, but boards do take steps to communicate in a way which is readily accessible for shareholders, particularly private shareholders. With Class I transactions requiring shareholder approval, the importance of communicating effectively with shareholders can not be underestimated. As for acquiring companies, takeovers rarely benefit their shareholders. Perhaps more explanation is needed of the effects but if this applied only to UK companies it could potentially put them at a disadvantage.

Ultimately, it is hard to provide a general answer to this question when every takeover is different and the long-term implications will often only become clear after the event. It is also unclear whether BIS distinguish between public takeovers and private acquisitions, and whether there should be a difference between the two.

16. 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?

This issue was covered in the recent Takeover Panel consultation. Listed companies already have to seek shareholder approval for major transactions (in accordance with the Listing Rules), whether they are public takeovers or private acquisitions. It has been argued that it would be perverse for these to be treated differently, unless there was clear evidence to suggest that premiums paid in public takeovers lead to higher prices paid than those for private auctions.

On the other hand, the current balance for seeking shareholder approval has regard for what is practicable. As a general principle it is important to ensure that any changes to takeover regulation do not distort the proper operation of the market and encourage investment in UK companies. We therefore believe it is important that proportionate checks and balances are applied. Companies will frequently make small acquisitions which do not require shareholder approval. The cost of preparing shareholder documentation would far outweigh the benefit of the smaller acquisitions and in some cases may even cost more than the acquisition.

As an alternative the level at which shareholder consent is required (class test) could be reviewed although most agree that the current class tests remain appropriate. In the

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context of a cross-border takeover, a UK-listed company could be at a disadvantage if it needed to obtain shareholder consent while a rival bidder in another jurisdiction did not.

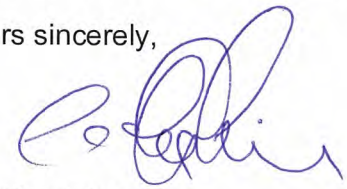
17. Do you have any further comments on issues related to this consultation?

There could be more co-ordination with regards to the different consultations being published. Many of the questions in this consultation seem to have been addressed elsewhere in recent consultations.

Please note, as a matter of formality, that the views expressed in this letter do not necessarily reflect those of each and every individual member of the GC100 or their employing companies.

If you would like to discuss any of these points further, we would be happy to do so.

Yours sincerely,



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