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
X	**Lawyer or accountant**

☐ **Other (e.g. consultant or private individual)**

The Board of Directors

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

Comments
In the smaller company sector, particularly companies quoted on the AIM market, companies and boards can have a different investment focus from those of larger listed companies. Companies raising money on AIM are doing so principally to raise development capital. AIM is seen as a stage in the company's development, with an exit likely to be through a takeover, a transfer to another market or through growth and the widening of a shareholder base. For such companies, boards' focus is on developing assets (such as mining exploration properties or drug candidates) until they can be re-financed or on building a business that is in a high growth phase. For these types of company, board focus is similar to that of private equity backed companies. Larger issuers tend to be subject to broader influences and pressures. Boards must manage the conflicting demands of the 'market' with shareholders exhibiting different investment horizons, risk profiles and performance objectives. Short term performance expectations of some investors can certainly drive short term board behaviour. Whist public company board's will typically understand their obligations to take actions that are in the long terms interests of shareholders, short term market expectations will inevitably have an impact on board decisions. A key question should therefore be what factors drive investor short-termism?

Question 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?

Comments
The current transparency framework that drives the disclosure of beneficial ownership of a company's shares (both the Companies Act and the Disclosure Rules and Transparency Rules) does not always provide full and up-to-date information on interests as it ultimately requires a conscious act on the part of the shareholder to comply with the disclosure requirements. In situations where a shareholder seeks to deliberately obscure beneficial ownership, significant time and effort can be expended by a public company in determining the facts. The growth in non-UK investors also brings

challenges where there may be less familiarity with the UK transparency regime.

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

With the inflow on non-UK investors into UK public companies comes different cultural attitudes towards corporate governance. For example, the way US public companies engage with their investors is different to the way UK companies engage with their investors as a consequence of the different regulatory and legal frameworks in each country. The increasingly international nature of investors in UK public companies is of course to be welcomed, but it is of fundamental import that the quality and rigour of corporate governance applicable to the UK equity markets is maintained. We believe Government has a role to play to ensure that UK public companies and their boards of directors are afforded the appropriate protections to ensure that they can continue to communicate and interact in a transparent and open basis with the market and investors without undue fear of litigation or regulatory intervention. The US equity markets have many qualities, but they can also foster a defensive relationship between boards and investors as a consequence of the regulatory and legal environment. The UK equity markets are already undoubtedly influenced by the US model where potential liability and risk rather than relevance increasingly dictate the transparency and disclosure agenda.

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

Comments

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

Comments

<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

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

Comments
We believe short-termism is a problem in the UK equity markets but believe there to be more far reaching structural issues within the UK equity markets. Grant Thornton US has conducted studies of US equity markets and concluded that there has been a systematic demise of IPO's in the US due to an array of regulatory changes that were meant to advance low-cost trading, but have had the unintended consequence of stripping economic support for the value components (quality sell-side research, capital commitment and sales) that are needed to support markets, especially for smaller capitalization companies. Underappreciated a decade ago is the fact that higher transaction costs actually subsidised services that supported investors. Lower transaction costs have accommodated trading interests and fueled the growth of day traders and high frequency trading, spawning the age of "Casino Capitalism". Whilst the decline of the IPO in the UK equity markets has not been as precipitous as in the US, there are many structural similarities between the US and UK markets. It is worth noting that the number of UK listed companies on the Main Market has decreased by almost 50% from 1,890 in January 1999 to 1,011 in November 2010. We believe investor short-termism is one aspect of a wider systemic issue impacting UK equity markets.

<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

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

Comments

<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

Directors' Remuneration

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

Comments

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

Comments
We believe the remuneration committee which is comprised of non executive directors to be the best mechanism for setting executive pay. If the market believes non executive directors are not sufficiently independent to align the interests of the directors to the longer term interests of the company and its shareholders then the matter of non executive independence should be addressed rather than widen the membership of the remuneration committee. Executive talent and how it is remunerated should be set by market forces and kept in check through transparency and disclosure and shareholder engagement

<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
Shareholders have a variety of informal measures and more formal tools at their disposals to demonstrate their displeasure with executive remuneration. We do not believe any change is required in this regard. We believe the recent introduction of the UK Stewardship Code will provide the focus and transparency necessary to provide more accountability as to how institutional investors engage with public companies on issues such as remuneration. We do not believe that shareholders should be directly involved in approval of

matters connected to remuneration and their annual approval of directors remuneration is an adequate level of engagement. An independent and properly informed remuneration committee is the best forum to decide on such matters.

<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

We believe remuneration on board disclosure should be relevant and strike the balance between over disclosure which can cause confusion and introduce unnecessary complexity, and insufficient disclosure that fails to inform a reader. We would support recommendations that seek to simplify disclosure although the nature of executive remuneration comprising salaries, bonuses, cash and share LTIPs, benefits, pensions and various approved and unapproved share option plans together with the increasingly legalistic detailed disclosure for each remuneration category does not easily lend itself as a topic that can be overly simplified.

We would support a recommendation to increase transparency surrounding performance criteria but recognise the practical issues surrounding the disclosure of for example bonus criteria that can include commercially sensitive information.

We believe that detailing the relationship between directors' pay and employees' pay would enable Trade Unions, investor protection organisations such as the Association of British Insurers and the National Association of Pension Funds and ethical investment funds to exert pressure on boards to limit excessive pay.

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 boards do typically understand the long term effect of takeovers but they are ultimately only stewards of a company that is owned by the shareholders who may have different time horizons influencing their investment decisions. The Takeover Code requires that offer documents detail, *inter alia,* an offeror's intentions regarding the future business of the offeree company, strategic plans, intentions regarding fixed assets and intentions regarding the future employment of staff. In addition, the Code requires that a separate opinion is included in the offer document from the representatives of its employees regarding the effects of the offer on employment, provided such opinion is received in good time prior to publication of the relevant document to be sent to shareholders. However, there are obviously other stakeholders of a company (eg customers and suppliers) who may be affected by a takeover and there is no specific requirement in the Takeover Code to communicate the implications of a bid to such stakeholders, as the board's comments regarding an offer typically focus on the shareholders. To a large extent, the opinion of the board of a target company is derived from the statements made by an offeror's long-term intentions regarding the offeree company. In a hostile situation, the offeror may not have access to sufficient information in respect of the offeree company and therefore may provide limited disclosure regarding its future intentions, enough to comply with the relevant regulatory requirements, in the offer document. We believe there is merit in reviewing the level of detailed disclosures surrounding the intentions of the offer that offerors are required to make, as is being proposed by the Takeover Panel in their response statement published on 21 October 2010 in relation to the 'Review of certain aspect of the regulation of takeover bids'.

<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
We are of the view that if an acquiring company based in the UK is required to seek shareholder approval, in all cases, in respect of takeover bids then this may potentially favour foreign companies looking to launch takeover bids for UK companies (as such companies may not have to seek shareholder approval, depending on their local regulatory requirements) and thus this may not be considered to be a level playing field for UK corporates looking to acquire other UK companies. Furthermore, the requirement of such shareholder approvals by acquiring entities may reduce the certainty regarding the deal deliverability and, arguably, this could lead to speculation regarding the ultimate outcome of a bid and may even create false markets as a result.

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

Comments