Gartmore

Gartmore Investment Management Limited

Gartmore House
8 Fenchurch Place
London EC3M 4PB
Telephone +44 (0) 20 7782 2000
Fax +44 (0) 20 7782 2075
Telex 896873 GIM G

www.gartmore.com

Adam Gray
Long-term Focus Consultation
Corporate Law and Governance
Department for Business, Innovation and Skills
1 Victoria Street l
London
SW1H 0ET

Email: clgconsultations@bis.gsi.gov.uk

12th January 2011

Dear Mr Gray

Re: A Long-term Focus for Corporate Britain – call for evidence

Gartmore is an independent, specialist asset management firm whose focus is the provision of investment products to a broad range of institutional and retail investors. Gartmore has offices strategically located in London, Tokyo, Boston, Madrid and Frankfurt. Interests in Gartmore Investment Management Limited are held by private equity funds affiliated with Hellman & Friedman LLC, and members of Gartmore's fund management and executive teams and a number of employees. Assets under management total some £20.7bn. (September 2010)

As a substantial investor in UK quoted companies on behalf of its clients, Gartmore has a keen interest in efforts to improve the long term returns earned by those companies and makes the following response to the government consultation in order to assist the process of the development of government policy in this important area.

THE BOARDS OF DIRECTORS

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

The appropriate time horizon will vary from company to company and from time to time depending on the nature of the company business and the business conditions which it faces. We consider that it is important for a company to communicate with its shareholders what its progress is likely to be and what its broad capital requirements are. That way a company is likely to attract a shareholder base matching its returns profile. Investors also have a variety of time horizons and fund managers need to deliver on the realistic expectations of those who have entrusted them to mange savings. With this in mind, fund managers will seek companies whose return profile matches that of their investors.

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?

Gartmore has always been willing to share with companies, or appropriately appointed representatives of companies, the details of holdings managed on behalf of clients including positions in contracts for difference where an economic interest but not a legal shareholding is created. We consider that the current 3% disclosure level, when taken with the additional

Gartmore Investment Management Limited is an appointed representative of Gartmore Investment Limited (GIL) which is authorised and regulated by the Financial Services Authority.

Registered Office as above. Registered in England No. 953703

requirements during takeovers, appears appropriate to allow companies to establish who their significant shareholders are.

SHAREHOLDERS AND THEIR ROLE IN EQUITY MARKETS

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

Gartmore considers that UK corporate governance sets a high standard driven by best practice, as articulated by business leaders, while allowing sufficient flexibility for adaptation to the peculiar requirements of individual companies. There is pressure from investors in other markets for improvements in governance standards which has led to some world wide convergence of governance principles, though differences remain, reflecting different legal and cultural backgrounds. As UK investors have diversified more into overseas markets, the same incentives have led to more overseas investors diversifying into the UK. The more diverse nature of the shareholding base imposes greater demands on companies in understanding the objectives of their shareholders and can makes co-operation between shareholders more difficult, if those shareholders have different legal requirements limiting the sharing of information or taking joint action. There are only a very small number of companies providing proxy research and advice. Where these advisors are inflexible about standards applied or operate with standards more applicable to the market of their clients than the UK, there is a danger of tick box voting at company general meetings which can operate against the best interest of the company concerned.

4: What are the most effective forms of engagement?

In UK equities, Gartmore has a bias towards smaller companies both in terms of the number of investments held and in the proportion of the company held on behalf of its clients. Such companies require a more 'hands on' approach than larger companies as they have less resources available to them. Gartmore meets regularly with the companies in which it invests with the aim of understanding the growth dynamic of the industry in which the company operates and its prospects for ongoing expansion the management, governance and the sustainability of the company strategy, and the financial viability of the company's strategy, and itsoutlook for earnings growth, cash flow generation, and gearing. We aim to communicate our expectations of the company to its management.

In a small minority of cases where we consider that the course being pursued by the company is not in the best interests of shareholders, we would aim to engage in further dialogue with the company offering advice on possible solutions to its problems and where desirable working on their behalf in strengthening the board or strategy of the company. While in most cases this results in an agreed programme of change, in a number of cases, Gartmore may feel obliged to vote against company proposals at a general meeting and has sought to call a general meeting to secure necessary changes.

The most effective engagement occurs where the dialogue between the parties is open, where confidences are respected and where there is agreement of mutual interests and practical objectives. This process is rarely assisted by public disclosure, though we recognise the legitimate interest of clients in the actions being taken on their behalf and try to meet these client expectations.

Where an investment manager holds a significant stake in a company, it is possible to identify the impact that the engagement has brought about. For large companies where shareholdings are widely dispersed it is much harder for individual shareholders or their agent to be certain of the influence that their engagement has secured and easier for a company to claim that 'no one else has raised this issue'. Co-operation between investors can mitigate this effect but is inhibited by concerns about concert party rules and insider trading. Further clarity in these areas would be helpful.

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

At Gartmore, the corporate governance manager is located close to the investment management teams and is involved in daily interaction with them over consultations by companies and on proxy voting decisions. In cases of disagreement or particular controversy, a process of escalation exists, ultimately to the executive committee of Gartmore. The engagement specialist for UK smaller companies forms part of the investment management team for that area and has had extensive appropriate experience in the field of private equity. In our experience, the work of monitoring the corporate governance of investee companies and ensuring that proxy decisions are appropriately taken is sufficiently important and of a significant volume as to require separate and specialist resource at most major investment management operations. Large companies and, increasingly, smaller companies recognise that this division of labour has taken place and know how to make the right contacts at investee organisations.

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?

The shareholder's right to vote on the election of directors, changes in company constitution, changes in capital and major transactions is critical to the whole engagement process. It is this right which gives shareholders the authority to ask for meetings with companies at which to engage on the development of the business or on the composition of the board. Voting at company meetings is also important as a signalling mechanism even where opposition to a proposal is only in a minority or where, as is the case of the vote on the remuneration report, the vote is only advisory. The background against which voting is taking place is one in which it is customary for management proposals to be carried by an overwhelming majority. Investors are, generally, voting at meetings of companies in which they have chosen to invest because they agree with the strategy being pursued and the agents (the board) executing it. In those circumstances a substantial minority vote against the board, and the attention it receives, can send a strong message to the board which should lead the directors to engage more closely with their shareholders.

Gartmore recognises that clients have a legitimate interest in the proxy voting undertaken on their behalf and in the processes by which such decisions are made. We are less convinced of the value of public disclosure of proxy voting and have not seen a strong case made for it. The most significant market where there is such disclosure is the US where, in our experience, the process has involved a very legalistic approach to the collection of records and a significant disconnect between the managers of the assets and those overseeing the proxy voting process. For many US investors, proxy voting is outsourced to a third party who can be accused of a tick box approach and there is not the well established UK process of engagement. Anecdotally, we

have received few enquiries from the general public about our voting at particular meetings and discussions with other fund management colleagues have not revealed any great demand for such disclosure.

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

The provision of liquidity to investors and new capital to companies at reasonable costs are key roles for equity markets. The time horizons of manifold investors and quoted companies can be expected to vary widely. Investors are reliant on the trading in markets to ensure that their investments are properly valued. Short-termism matters if the markets can no longer reflect these needs and if equities become seriously mispriced. While there may be evidence that holding periods have fallen, we have not seen evidence that the markets are failing in their functions or that there are better mechanisms against which the current system may be judged.

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?

In our experience, there are a number of reasons why UK equities are less widely held by investment institutions. Firstly, there is a wider range of alternatives available and funds have been encouraged to take advantage of them by their advisors. Secondly there is a wider range of instruments which combined with more liquid markets and competitive dealing costs facilitates shorter holding periods by reducing the penalty for transactions. Thirdly tax considerations (eg stamp duty) penalise holding equities rather than equity derivatives. Recent prolonged low interest rates and again tax treatment encourage companies towards debt rather than equity finance. Moves towards tax neutrality would be welcomed by equity markets.

It has been suggested that longer term holders should be awarded additional voting rights. We do not consider this to be appropriate. The most significant market where this is common is France where the practice serves to entrench a management through associated parties whose economic interest in the company is much less than their voting interest. For institutional investors there would be additional costs associated with tracking transactions through portfolios to establish voting rights at any time in consequence of portfolio changes which may reflect liquidity flows rather than changing views of the underlying investment.

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

Undoubtedly there are agency problems in the investment chain, for example an investment manager may invest for other clients in a company whose pension fund it also manages and may therefore be conflicted at votes at that company's general meeting. However, Gartmore and most major investors have processes to resolve this conflict which are disclosed under the Stewardship Code (Gartmore's policy may be found at: http://www.gartmore.com/NR/rdonlyres/A4A699EF-7ABD-4CB3-9A64-11781356B078/0/GartmoreStewardshipPolicy2010.pdf).

Over time , concern has been expressed about the efficiency of the chain by which proxies are delivered to registrars with some evidence that some 'votes' are 'lost'. Since custodians are generally paid in a bundled fashion and have incentives to operate omnibus accounts there

appears to be little incentive for them to improve the efficiency of this service to the underlying owners of the assets.

The consultation documents suggest that "fund managers can generate income for themselves through fees related to the number of portfolio changes (which could lead to excessive churn in the equity markets) yet these may not necessarily result in increased long term value for their clients"[1]. We believe that this comment is inaccurate.

Gartmore is paid fees related to a percentage of funds under management and the performance of the funds under management. Client assets are held separately from the manager. There is no incentive to trade as the trade costs are not paid to us as investment manager and because the associated costs are netted against the measured performance of the funds under management and therefore (ceteris paribus) may reduce investment performance. Trading commissions accrue to market makers and brokers, not to investment managers, whose interest it is to keep such costs to a minimum.

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

The basis for fees charged by collective investment vehicles managed by Gartmore is disclosed in the scheme documents. Fees charged to other institutional clients are negotiated with them and clearly disclosed to them. Remuneration of individual fund managers is currently subject to the FSA's implementation of the Capital Requirements Directive, and it is too early to see any impact from these new regulations which would suggest that it is too early for further regulation.

DIRECTORS' REMUNERATION

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

Remuneration of executives is a complex issue as there is only limited exchangeability of executives and therefore it is difficult to present the market as completely free and competitive. The increasing use of benchmarking appears to be associated with increased remuneration, as advisors and directors are more aware of rates of pay elsewhere and their efforts to achieve a given point on the benchmark itself raises the benchmark for all later comparisons. Ironically, the greater disclosure of director remuneration appears to have contributed to this process.

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

Changing the composition of the remuneration committee would not remove the pressure on boards to ensure that 'their' directors receive the 'right' amount. Limited anecdotal evidence from other European jurisdictions does not suggest that widening the remuneration committee to include representatives of the workforce would be a panacea.

[1] Paragraph 4.25

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?

The introduction of the vote on the remuneration report has promoted much discussion between shareholders and companies and has changed the structure of executive pay and this may be taken as evidence of accountability but the enhanced dialogue has not controlled the level or the tendency for executive remuneration to continue rising. Among the changes resulting from the dialogue between companies and their shareholders has been a reduction in the length of contracts and consequently compensation for loss of office (though this has been counteracted by the growth in salary and bonus levels). We do not believe that there is a major problem of golden parachutes in the UK, compared, say, to the US but we believe that there has been a growth in rewards to new executives 'signing on' to compensate them for the loss of incentives in changing companies.

14: 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?***

The current levels of disclosure appear to take account of most of the elements which make up executive remuneration but because so many elements are conditional it is difficult to arrive at a total value for remuneration. Further disclosure in this area may assist.

Performance criteria for long term incentives are almost always of greater significance than the criteria for bonuses as the potential rewards are greater. The performance related elements of longer term elements of executive remuneration have been subject to a number of conventions which sometimes have only an indirect link to the strategy being pursued by the company but this is an issue which needs to be resolved between companies and their owners rather than subject to further regulation.

Disclosure of bonus performance criteria at the beginning of a period tends to be limited because of the risks of divulging information to competitors. Enhanced disclosure after the bonus period would be helpful in assessing how well the company performed against the short term criteria it set itself and in assessing the performance of the remuneration committee.

TAKEOVERS

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

Gartmore considers that the UK system for bids and the processes leading to them is generally well constructed by international standards. An efficient market in corporate control is a significant spur to companies to ensure that they deliver on the potential value available to the company and not tolerate management weakness. In our experience companies generally understand the implications of making bids though that does not always mean that potential benefits are always achieved. Companies wishing to oppose a bid they have received are

inevitably at the disadvantage of offering risky future prospects against the value of demonstrable current value which gives an intangible advantage to the bidder.

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?

Since a bidder nearly always has to pay a premium to achieve control, a case can be made to require a bidder submit a case to a vote of its holders. Anecdotal examples of overoptimistic bids at the wrong time in the market cycle are not hard to find which might strengthen a case for requiring the bidding company to substantiate its case to its owners. However, we would be concerned that this would disadvantage quoted UK bidders compared to overseas bidders or to unquoted vehicles.

OTHER

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

No.

If you wish for any further information, we would be only too happy to assist.

Yours sincerely

Tony Little
Head of Corporate Governance