# The EU Corporate Governance Framework: a response by the National Association of Pension Funds

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# About the NAPF

The NAPF is the leading voice of workplace pension provision in the UK. We represent some 1,200 pension schemes from all parts of the economy and 400 businesses providing essential services to the pensions industry. Ten million working people currently belong to NAPF member schemes, while around 5 million pensioners are receiving valuable retirement income from those schemes. NAPF member schemes hold assets of some £800 billion, and account for over one sixth of investment in the UK stock market. Our main objective is to ensure the security and sustainability of UK pensions.

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# Introduction

The European Commission (the Commission) is seeking to address three main issues: the effectiveness of boards; short-termism among shareholders; and the application of "comply or explain". As a representative body of UK company-sponsored pension schemes, the NAPF has an interest in all three. Effective boards hold to account the executive management and thereby can support the success of the company. A strong company is better able to meet its commitments, if any, to pay employee pensions. Pension funds have long-term liabilities and can therefore take a long-term view of asset returns. The NAPF is an advocate of the "comply or explain" regime which we believe is the best way to address the complexities of corporate governance. An effective board should be keenly interested in ensuring that it provides shareholders with a credible explanation of any areas of non-compliance with corporate governance best practice (as defined by a Code, in all likelihood). Institutional investors require good quality information if they are to engage constructively with the companies in which they are invested.

We believe that the existing EU corporate governance framework is generally adequate (allowing for appropriate interaction between national and EU rules to the benefit of companies and investors), but we agree with the Commission that existing rules could be improved in order to create more transparent and efficient capital markets.

However, we disagree with the Commission's assertion that "the majority of shareholders are passive and are often only focused on short-term profits". Long-term investors, such as pension funds, take investment decisions so as to maximise the return on their capital – typically through a growing stream of dividends over the medium-term. These investors choose to invest in companies that they expect will help them to achieve their longer-term objectives through the provision of dividends and capital growth. Long-term investment performance is driven by a series of shorter-term investment decisions, rather than taking a decision to hold one stock for a long period, and this may contribute to a perception of excessive turnover in markets. For example, a long-term investor might shift their position in a stock by selling (or buying) a portion of their holding. Even though they might still be a long-term and very engaged holder of this stock, the shorter-term rebalancing of the portfolio may contribute to higher turnover figures. In addition, investment banks and hedge funds, which may buy and sell in the very short-term, create a lot of 'noise' in capital markets. There is a perception that the investment banks create volatility in the market so as to benefit from it.

We have seen little evidence relating to rates of turnover and 'churn', and recommend that the Commission undertakes meaningful research on this matter.

As regards the passivity of investors, in the UK, at least, the surveys conducted by the NAPF and the Investment Management Association indicate clearly, and over several years, that institutional investors do engage with the companies in which they are invested, and that engagement can be effective. The growth in the use of index-tracking funds by pension funds over the past twenty years or so means that more funds have a permanent interest in the success of listed companies.

From the company perspective, an excessive focus on quarterly earnings and the share price may drive shorter-term investment strategies and impact the way in which companies behave, to the detriment of longer-term returns to shareholders.

The real challenge is to reconcile the legitimate need of the market to value a company's shares day-to-day with the longer-term objective of delivering to shareholders a satisfactory return on the capital which has been invested in the business. We therefore welcome the Commission's Green Paper on the EU Corporate Governance Framework and hope that our comments and recommendations are useful.

# Response to individual questions

## General Questions

1. **Should EU corporate governance measures take into account the size of listed companies? How? Should a differentiated and proportionate regime for small and medium-sized listed companies be established? If so, are there any appropriate definitions or thresholds? If so, please suggest ways of adapting them for SMEs where appropriate when answering the questions below.**

We believe there should be a minimum corporate governance standard expected of all listed companies, no matter how large or small. The incentive is that companies with good governance should be able to widen their shareholder base and raise capital on more favourable terms. It is important to recognise that there is no "one size fits all" approach to corporate governance, and therefore any corporate governance measures should allow companies the flexibility to interpret them as appropriate to their circumstances.

By way of example, in the UK, larger listed companies are expected to operate according to the UK Corporate Governance Code[1], which is applied on a "comply or explain" basis. The NAPF Corporate Governance Policy and Voting Guidelines (NAPF Guidelines) provide guidance to companies and investors on matters covered by that Code. We recognise that for some companies, such as SMEs, the UK Corporate Governance Code may require different interpretation, and we have therefore issued separate guidelines to help smaller companies to interpret the Corporate Governance Code as appropriate.

2. **Should any corporate governance measures be taken at EU level for unlisted companies? Should the EU focus on promoting development and application of voluntary codes for non-listed companies?**

Unlisted companies typically have a more concentrated ownership structure than listed companies, and therefore many general corporate governance principles may not directly apply. At this stage, we believe the Commission should continue to primarily focus its work on listed companies and companies with public ownership. In general, unlisted companies might be best dealt with by their shareholders, with the support of industry organisations or government as needed, and we recognise that this already takes place in some cases.

[1] Financial Reporting Council, UK Corporate Governance Code, June 2010

It could, however, be useful for the Commission to more actively encourage the implementation of enhanced corporate governance standards at European companies, regardless of their status as listed or unlisted. In particular, we recommend that the Commission specifically stresses that all companies issuing publicly traded financial instruments (ie not only equity) are expected to comply with such standards.

## Boards of Directors

**3. Should the EU seek to ensure that the functions and duties of the chairperson of the board of directors and the chief executive officer are clearly divided?**

The roles of chairman and chief executive are quite different and therefore should be clearly divided, however we do not believe this is a matter to be regulated.

With respect to the role played by the chairman of the board, the NAPF refers the Commission to provision A.2.1 of the UK Corporate Governance Code, whereby:

> "The roles of chairman and chief executive should not be exercised by the same individual. The division of responsibilities between the chairman and chief executive should be clearly established, set out in writing and agreed by the board."

The NAPF Guidelines reflect this provision and we believe the contravention of this principle, by either combining the role of chairman and chief executive or the designation of an executive chairman, would be cause for significant concern.

However, we recognise that there may be circumstances where there is just cause for the temporary combination of these roles – for example, where a chairman is required to bridge the gap between a departing chief executive and his/her successor – and hence we do not support regulated separation of these roles.

**4. Should recruitment policies be more specific about the profile of directors, including the chairman, to ensure that they have the right skills and that the board is suitably diverse? If so, how could that be best achieved and at what level of governance, i.e. at national, EU or international level?**

There should be a formal and transparent procedure for appointing new directors to the board and this should address the issue of a diversity of skills, experience and expertise. Boards should maintain a breadth of skills and experience, so we would not expect boards to limit the eligibility for directorship (particularly non-executive) to those who possess specific expertise and technical skills.

The search for board candidates should give due consideration to the benefits of diversity on the board. The terms of appointment and service contracts for each director should be made available to shareholders at their request.

This is covered under the UK Corporate Governance Code, Principle B.2, whereby:

> "The search for board candidates should be conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender.
>
> The board should satisfy itself that plans are in place for orderly succession for appointments to the board and to senior management, so as to maintain an appropriate balance of skills and experience within the company and on the board and to ensure progressive refreshing of the board."

Investors benefit from disclosure around the policy and procedure for appointing new directors, including what skills, experience and expertise are desirable. In order to make fully informed voting decisions on director appointments, investors would benefit from not only disclosure around skills, experience and expertise, but also around the value each director is expected to bring to the board and how the board expects him/her to contribute to and enhance board performance.

**5. Should listed companies be required to disclose whether they have a diversity policy and, if so, describe its objectives and main content and regularly report on progress?**

We support the Principle under the UK Corporate Governance Code, which states that there should be a section of the annual report describing the work of the nomination committee, including the processes used with respect to appointments to the board. The NAPF believes this section of the annual report should disclose the company's diversity policy (including the extent to which professional, international and gender diversity are considered).

**6. Should listed companies be required to ensure a better gender balance on boards? If so, how?**

We agree that there are benefits associated with board diversity, particularly gender diversity, however this should not come at the expense of skills and experience, and we do not believe that this is a matter to be regulated.

In the UK, the Financial Reporting Council's (FRC) has proposed new wording to the UK Corporate Governance Code[2], which states that "[the annual report] should include a description of the board's policy on gender diversity in the boardroom, including any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives". We would argue that this should not be limited to gender, and such disclosures should also include international and professional diversity.

We are not supportive of quotas for the number of women on boards. The Commission should be cautious of rapid changes in this area, as it could lead to 'box-ticking' or tokenism, and may come at the expense of board and company performance. Any increase in the number of women on boards should be through organisational development consistent with the company's strategic objectives.

The NAPF believes that there is a potential for shareholders to use their voting rights to encourage gender diversity, and therefore asks that boards explain to shareholders what steps they are taking to bring diversity to their boardroom. Where there is no statement on gender diversity policy,

[2] Financial Reporting Council, Consultation Document: Gender Diversity on Boards, May 2011

shareholders may choose to vote against the election of a director. We believe companies should be encouraged to look to innovative processes and procedures that will ultimately lead to greater gender diversity in senior management positions and on company boards.

**7. Do you believe there should be a measure at EU level limiting the number of mandates a non-executive director may hold? If so, how should it be formulated?**

We do not believe there should be a limit to the number of mandates a non-executive director may hold, however this should be carefully monitored by the boards on which a non-executive sits. It should also make up a part of the company's board evaluation process.

In the UK, the UK Corporate Governance Code and the NAPF Guidelines maintain that all directors should be able to allocate sufficient time to the company to effectively carry out their directorship. This would not prevent directors from undertaking directorships on other Boards, provided they fully disclose their other commitments. The Board should be aware that cross-directorship may give rise to concerns of independence. Boards should be responsible for determining whether the time commitment a particular director is able to give is sufficient for their requirements.

Investors also benefit from appropriate disclosure around board time commitments and attendance at board meetings. There should be disclosure in the annual report of all other commitments, and this should not necessarily be limited simply to other company directorships. Investors may also benefit from disclosure around non-executive directors' involvement on charitable boards, or other non-business related commitments (provided they are material), as this enables them to take a broader and more balanced view of the non-executive director in question.

**8. Should listed companies be encouraged to conduct an external evaluation regularly (e.g. every three years)? If so, how could this be done?**

We support the approach of using board evaluation to assess the performance of the board, and we agree that the use of an external facilitator could improve board evaluations. However, we do not support the compulsion of such external evaluations. The view of the NAPF is in accordance with that of the UK Corporate Governance Code on board evaluation, whereby "the Board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors". Further, companies are encouraged to comment on the results of the evaluation (in particular any issues and actions) in the annual report. Companies should certainly consider the appointment of external consultants to undertake the evaluation to ensure an objective approach is taken.

Where companies elect not to use an external board evaluation process, we would expect them to explain how the internal review is conducted and comment on its effectiveness. Any subsequent action resulting from the board review should also be included (together with progress reports on such action as and when appropriate).

**9. Should disclosure of remuneration policy, the annual remuneration report (a report on how the remuneration policy was implemented in the past year) and individual remuneration of executive and non-executive directors be mandatory?**

Yes, we believe that disclosure of remuneration, the annual remuneration report and individual remuneration of all directors should be mandatory. This disclosure is already a requirement under the UK Companies Act 2006, and is also a requirement in many other EU member states.

However the quality of disclosure is often poor and fails to set out the link, if any, between pay and performance. We believe that good disclosure of remuneration is essential and the structure of explanations is very important to ensuring investors and other stakeholders have a thorough understanding of the remuneration policy. Companies should be encouraged to better demonstrate clear links between pay and performance.

**10. Should it be mandatory to put the remuneration policy and the remuneration report to a vote by shareholders?**

We are in favour of a mandatory shareholder vote on remuneration. We believe it should be determined at a national level whether or not this should be a binding vote.

A non-binding shareholder vote has been in place in the UK since 2002. Some EU countries, such as the Netherlands, already have an ex-ante binding vote on remuneration principles, and we do not oppose this in principle in some member states. If individual countries wish to take steps towards more binding practices on remuneration, we welcome this, but we believe this should only be assessed on an individual country basis.

We would point out that there can be problems associated with a binding vote on remuneration, including that of remuneration already agreed or paid.

If looking to strengthen the shareholder position on remuneration, the Commission may wish to consider practices in countries outside of Europe, where remuneration votes are not necessarily binding, but are stricter than a straightforward non-binding ex-post vote on remuneration policy. In Australia, for example, the shareholder ‘say on pay’ has been strengthened with the implementation of a ‘two strikes and re-election’ rule. The rule is initiated where a company’s remuneration report receives a ‘no’ vote of 25 per cent or greater. When this happens, the subsequent remuneration report must explain whether the concerns of shareholders have been taken into account (and if so, how; and if not, why not). If the subsequent remuneration report receives a ‘no’ vote of 25 per cent or greater, all members of the board may be subject to standing for re-election within 90 days.

**11. Do you agree that the board should approve and take responsibility for the company’s ‘risk appetite’ and report it meaningfully to shareholders? Should these disclosure arrangements also include relevant key societal risks?**

We believe that there is no ‘one size fits all’ approach to risk management, and that directors should be responsible for determining a company’s risk appetite and reporting it to shareholders. Risk is ultimately an issue of strategy, and therefore naturally falls under the remit of the board. We would suggest that there should be a robust executive function responsible for the day-to-day risk management of the company and that this executive function is answerable to the board. The board should then determine the company's risk appetite from a well informed position.

Long-term and non-financial risks (such as environmental, social and ethical) are connected with a company's "licence to operate" and they should therefore be reported meaningfully (including both the likelihood and impact) to shareholders and other stakeholders. Any disclosure should relate to risks that are materially significant to the individual company, and this will vary widely between companies.

When determining a company's risk appetite, we would not suggest that companies should necessarily endeavour to minimise risks. However, the return to investors should be commensurate with the risk taken.

**12. Do you agree that the board should ensure that the company's risk management arrangements are effective and commensurate with the company's risk profile?**

Yes, we agree that ensuring the risk management arrangements are appropriate to the risk profile of the company is ultimately the responsibility of the board. Whilst we do not suggest that the board should be responsible for the day-to-day aspects of risk management (this should be the responsibility of management), they should be governors of this process.

In very large organisations it may be beneficial to have a separate risk committee at executive level, as is common practice in the UK, due to the complexities associated with their business structures. We see merit in a risk committee which would review the broader risks facing an organisation as well as the reports on internal risk controls. Where there is a risk committee in place, the role of the committee should be clearly defined to determine its role as compared with the role of the board in relation to risk. Such a committee should be overseen by the board.

Investors would also benefit from improved reporting on the company's risk management arrangements and how the company reviews and measures the effectiveness of such arrangements.

We do not believe a prescriptive approach to risk management is desirable due to the complexities and differences between organisations. It may be beneficial for the Commission to develop a set of best practice guidelines in relation to risk management and reporting. However, any such guidelines would need to afford companies the flexibility to interpret them as appropriate to their particular circumstances so as to avoid boilerplate reporting.

## Shareholders

**13. Please point to any existing EU legal rules which, in your view, may contribute to inappropriate short-termism among investors and suggest how these rules could be changed to prevent such behaviour.**

Pension funds are natural long-term owners of listed equities. While investment strategy is the responsibility of the trustees, the sponsoring company can be heavily affected by short term volatility in investment returns as a result of the application of IAS19. The NAPF has pressed for reforms to

IAS19 but it remains a driver of short-term thinking by companies and has knock on effects on pension fund investment strategies.

Pension fund closures and the resulting maturity of schemes have prompted a move away from equity investment by funds. This reduction in equity investment has lead to a lesser focus on equity markets, thus perhaps contributing to a reduction in their longer-term stability.

We would also draw attention to the Markets in Financial Instruments Directive (MiFID), whose focus on trading issues may have resulted in a greater interest in trading strategies. This focus on improving liquidity may also contribute to short-termism in investment markets.

Finally, we should also point out that Solvency II may have negative implications for pension funds' investment policies.

We are concerned that Solvency II pushes institutions into investing in shorter-term assets. Whilst this might be appropriate for general insurance, we do not believe it is necessarily appropriate for pension funds, given their long-term liabilities. Indeed, this approach increases risk by generating a greater divergence between the nature of the assets and the life of the liabilities.

Solvency II is already having a significant impact on the investment processes of the insurance companies to which it applies, obliging them to move from being long-term shareholders to being shorter-term holders of bonds and other assets. This is unfavourable to long-term share ownership and its potential positive influence on long-term investment in the future of the European economy.

We are very concerned that the European Commission is now considering how Solvency II can be adapted and applied to pension schemes, through the current review of the main EU pensions legislation – the Directive for Institutions for Occupational Retirement Provision. We note that the Commission's Call for Advice to EIOPA on review of the 'IORP' Directive raises the prospect of a harmonised approach to technical provisions, drawing on Articles 75-86 of Solvency II. Not only would this increase scheme funding requirements, potentially accelerating the closure of defined benefit schemes and the shift towards defined contribution arrangements, it would also lead to a very significant shift in the current investment approach of some of Europe's largest long-term investors. This would be decidedly unhelpful to long-termism in the market.

We welcome regulation of the industry which actively reflects the need for institutions to match their assets to their liabilities; so for pension funds with long-term liabilities, short-term liquidity requirements are not considered to be essential.

**14. Are there measures to be taken, and if so, which ones, as regards the incentive structures for and performance evaluation of asset managers managing long-term institutional investors' portfolios?**

Fees and any other performance incentives are set out in the investment management agreement and are a matter for negotiation between a pension fund and its agents. In assessing the appropriateness of a fee structure it is legitimate for a pension fund to be satisfied that the remuneration structure within an asset management firm is consistent with the mandate to be awarded. The structure of the fees paid should match the objectives of the individual investor.

We encourage asset managers to be clearer in their disclosures around incentive structures. Where a manager can demonstrate the structure is in line with the client's objectives, the actual amounts paid are usually a lesser concern.

With respect to measures to ensure incentive structures and performance evaluation align better with long-term objectives, it should be noted that long-term non-financial factors are difficult to measure. Therefore it is difficult to incentivise managers based on them. For example, you cannot necessarily demonstrate the performance you have added in a portfolio by taking into account long-term environmental or social factors.

There is no evidence that fees are of interest to the general public and we do not believe they are necessarily the concern of the general public. Greater clarity from asset management firms on pay structures would certainly be welcomed by pension funds; and we would also recommend greater clarity from pension fund trustees to fund members. But we do not believe this is a matter to be publicly disclosed.

Finally, it is also important that pension funds effectively monitor and manage their investment consultants to ensure that incentive structures are set up in a way that does not promote frequent manager turnover.

**15. Should EU law promote more effective monitoring of asset managers by institutional investors with regard to strategies, costs, trading and the extent to which asset managers engage with the investee companies? If so, how?**

Due to the variety of investment processes and investor needs, we believe that a best practice framework is appropriate for monitoring asset manager behaviour, as opposed having this enshrined in EU law.

We agree that regular and ongoing monitoring of asset managers to ensure their actions and strategies remain aligned with the asset owner's investment objectives is important. It is already integral to an effective and professional delegation arrangement. Asset managers should, as a matter of course, keep costs (associated with trading, for example) at a minimum in order to minimise the cost to the asset owner and maximise returns.

We believe there is scope to review what is included in standard asset manager mandates to ensure factors such as strategy, costs, trading and engagement are sufficiently dealt with from the perspective of the asset owner. A review covering this matter, the Kay Review, was announced in the UK in June 2011. However, we reiterate the point that this is a matter of contract negotiation, and not legislation. There is no 'right' level of portfolio turnover, there are no 'right' costs, and there is no 'right' strategy, as each investment strategy is individual and contract terms need to be in the context of that strategy. Asset owners should have firm views on what they expect from their asset managers, and this should be covered in the contract.

We believe the ICGN's Model Mandate Initiative is a useful initiative in this respect. The project promotes best practice in agreements between asset owners and asset managers and aims to influence more long-term behaviour in investment markets. This initiative includes issues of asset manager pay; transparency around trading and associated costs; stewardship; and risk management, and how these can best be included in the investment management agreement to ensure alignment of the manager's behaviour with the asset owner's interests.

We believe that oversight of an asset owner's agents' engagement activity is important, and in the UK the Stewardship Code goes some of the way towards addressing this matter. Whilst pension funds may not always be able to become directly involved in engagement with investee companies, they can make a significant contribution by, for example, monitoring how their asset managers do this on their behalf. The NAPF has produced guidance (*Stewardship Made Simple*) for pension funds to help them carry out their stewardship responsibilities and effectively monitor their agents.

**16. Should EU rules require a certain independence of the asset managers' governing body, for example from its parent company, or are other (legislative) measures needed to enhance disclosure and management of conflicts of interest?**

This question appears to be largely based on an assumption that conflicts arise at the parent company level (ie that banks typically own asset managers). We would urge the Commission to consider any rules carefully so as not to affect privately owned asset managers, of which there are many. We would also welcome clearer definition from the Commission as to specifically which organisations this question is addressed at.

We do not think it is possible or desirable to eliminate all conflicts of interest in asset managers. We also do not believe it would necessarily help to separate asset managers from the parent company, as there may still be an indirect influence (and thus conflict). However improved disclosure of potential conflicts and of the policies that are in place to ensure primacy is given to the interests of the customer would be welcome.

The UK Stewardship Code is a good example whereby signatories must have a robust policy for managing conflicts of interest and such a policy must be disclosed. Such disclosure should not only describe how conflicts are managed, but how conflicts are determined and defined. We recognise that in many cases disclosures around conflicts of interest could and should be improved.

Perhaps the Commission would consider issuing best practice standards relating to management and disclosure of conflicts of interest, as opposed to EU rules. Such best practice standards might include, for example, recommendations as to when and how specific conflicts should be disclosed; and recommendations as to when structural separation of two conflicted businesses may be most appropriate (as opposed to measures such as "Chinese Walls").

**17. What would be the best way for the EU to facilitate shareholder cooperation?**

We believe that acting collaboratively with other shareholders has the potential to improve the effectiveness of engagement with the boards and management of investee companies.

We are concerned that there are barriers to effective shareholder cooperation, due to EU rules relating to acting in concert. We see an immediate necessity to clarify EU rules on acting in concert to ensure it becomes clear to investors that collaboration on issues of corporate governance is permitted when it is not in relation to a change of control.

There are also concerns regarding cross-border voting, whereby investors voting on overseas shares cannot always be sure their votes will be counted. If the EU were to take steps to improve cross-border voting efficiency shareholders would see more value in cooperating more widely.

There are already a number of organisations and initiatives operating in this field, which have proved successful in promoting greater shareholder cooperation. Good examples of these include Eumedion in Europe, the Australian Council of Superannuation Investors in Australia, the Council of Institutional Investors in the United States and, on a global scale, the United Nations Principles for Responsible Investment. In the UK, shareholders tend to collaborate effectively (both through organised forums and otherwise) and are faced with few legislative barriers which restrain such collaboration. We believe this type of process should continue to be left to evolve naturally.

If the EU were to facilitate shareholder cooperation, this could be achieved in a number of ways. For example, the EU could provide some form of clearing-house for collaboration; or could take a more active role in promoting shareholder cooperation and highlighting the importance of getting to know, and working with, peers in the marketplace. It may be useful for investors to make an engagement contact available so that like-minded investors could connect, and there may be a role for the EU in facilitating such a process.

Greater disclosure around shareholder identity may also benefit this process – see our response to question 20 below for further details.

**18. Should EU law require proxy advisors to be more transparent, e.g. about their analytical methods, conflicts of interest and their policy for managing them and/or whether they apply a code of conduct? If so, how can this best be achieved?**

*Before commenting on questions 18 and 19 we must first declare a conflict of interest. The NAPF has an advisory relationship with ISS, who use the NAPF Corporate Governance Policy and Voting Guidelines when issuing their proxy voting advice on UK companies.*

It is widely recognised that some proxy voting advisers face conflicts of interest. However, there are also conflicts of interest along the entire investment chain, so we do not believe there should be a particular focus on proxy advisers. We would welcome greater transparency around the proxy advisers' voting policy and how this policy has been created and is applied. We would point out however that under a "comply or explain" regime the way the policy is applied is a matter of judgement. Proxy advisers are accountable to their clients, and therefore it is them to whom any disclosures should be directed.

Proxy voting firms should explicitly set out any conflicts along with the procedures for managing them on their website.

We recognise that proxy advisers can have a lot of influence in the market, although it remains rare for management to be defeated in a proxy vote despite a negative recommendation from the advisory firms. However, there is a danger in over-regulating them, as it may confirm their position in the market and potentially strengthens their influence.

We would welcome more specific disclosure around conflicts, rather than general disclosure that conflicts exist. But we would suggest that this should be done on a case-by-case basis, rather than formulaically, in order to avoid boilerplate disclosures. For example, if Proxy Adviser A provides voting recommendations on Company B, and Company B is also a client of Proxy Adviser A; this specific conflict should be disclosed. This is as opposed to a broad disclosure that Proxy Adviser A experiences conflicts of this nature from time to time. We would also expect that such disclosures are made readily available to the necessary stakeholders, as opposed to being 'fine print' disclosures.

**19. Do you believe that other (legislative) measures are necessary, e.g. restrictions on the ability of proxy advisors to provide consulting services to investee companies?**

No, we do not believe that legislative measures are required, and we believe that better disclosure of conflicts should be the first route. It would also be beneficial if the Commission were to undertake further research into the implications of the perceived problem.

**20. Do you see a need for a technical and/or legal European mechanism to help issuers identify their shareholders in order to facilitate dialogue on corporate governance issues? If so, do you believe this would also benefit cooperation between investors? Please provide details (e.g. objective(s) pursued, preferred instrument, frequency, level of detail and cost allocation).**

We believe companies should be able to identify their major shareholders and this is a matter that could be facilitated by the Commission. In order to effectively engage with companies on matters of corporate governance, investors need to be able to hold directors to account. However in order to do this, through voting rights for example, there must be evidence of the beneficial ownership right. In many cases, this can be difficult due to the complexities associated with the investment chain and the structure between the issuer and the ultimate beneficiary. Issues associated with cross-border voting are also relevant. We believe there should be a simple process for shareholders to evidence their holding in a company and, similarly, for a company to be able to verify the identity of their shareholders.

Having such identification processes in place would benefit both companies and shareholders. For example, companies would be able to identify long-term shareholders in the company as well as those who buy and sell large stakes. The board would then be better positioned to understand why such positions are taken. Having an understanding of the longer-term investors in the company would allow the board to facilitate better engagement with, and between, those investors.

Before developing mechanisms for achieving greater shareholder identification, it is important to understand what exactly the company hopes to achieve by having this information. Generally, we would expect that a company would want to identify the key voting and investment decision-makers in order to improve engagement channels, as these are the people with whom they are likely to engage on matters of corporate governance.

Whilst we agree that a mechanism for identifying shareholders would certainly be beneficial in terms of shareholder cooperation, the Commission should be wary of processes that could be used for the purposes of entrenchment.

In terms of the mechanics, shareholder identification may be possible, for example, through electronic registration of shares through a centralised system. We would recommend that any such disclosure should be on an identity only basis, and that disclosure of economic interest should remain confidential. We would also recommend a threshold whereby it is only necessary to identify shareholders where they hold over 3% of the company's listed equity.

Whatever the mechanism used, we would recommend that this should only be at the companies' request, and should not be ongoing disclosure by shareholders.

**21. Do you think that minority shareholders need additional rights to represent their interests effectively in companies with controlling or dominant shareholders?**

In the UK, minority shareholder interests are protected under the Companies Act 2006. The Act provides that minority shareholders have the right to complain to the court if they believe the majority shareholder (or shareholders) runs the company in a way that damages their position and the value of their shareholding.

In Europe, many of the major stock exchanges require only a small free float to list on the main market. In the UK, for example, the London Stock Exchange requires a minimum 25% free float. In such cases it may be difficult for minority shareholders to influence the board of directors.

We believe that if listing standards are robust enough, then minority shareholders should be somewhat protected. However, we recognise that this may not always be the case. In 2007, for example, ENRC (a Kazakh mining company, registered in the UK) listed approximately 18% of its shares on the London Stock Exchange. This is despite the requirement for a 25% free float and despite a high incidence in the company of related party transactions and conflicts between the controlling and outside shareholders. Indeed, investors need to be cautious when seeking to invest in a company where there is already a significant shareholder, and this may often be a case of "buyer-beware". However, this is particularly concerning for pension funds (and other investors) who are invested in index funds, where they cannot sell their holding, nor can they influence the company through exercising their voting rights.

Perhaps a recommendation for consideration by the Commission is shareholder involvement in the nominations committee. This would ensure that minority shareholders have a clearer voice when it comes to matters of board selection.

We do not support the granting of additional voting rights to longer-term shareholders and we believe that each share should be treated equally.

**22. Do you think that minority shareholders need more protection against related party transactions? If so, what measures could be taken?**

Related party transactions are a cause for concern, and we agree that measures could be put in place to protect minority shareholders in such circumstances. For example, related party transactions should be subject to a shareholder vote – however those parties who are related or conflicted should be removed from the voting process. We would also suggest that any related party should not be permitted to take part in board discussions on the transaction.

Another option would be to conduct and report a materiality test to determine the likely impact of the related party transaction. In France, for example, a separate auditor report is required for related party transactions, and this too could be a requirement at EU level.

**23. Are there measures to be taken, and if so, which ones, to promote at EU level employee share ownership?**

We do not believe that there is a need for active promotion of employee share ownership at EU level. Whilst we do believe that employee share ownership can be an effective means for aligning the interests of the company with its shareholders, we acknowledge that it can also give rise to issues, including conflicts of interest. In some cases, employee share ownership can be used to entrench management. We therefore see a need to ensure that issues associated with voting rights are addressed (for example, by ensuring that voting is not conducted in-house. Also, we would not favour the promotion of employee share ownership where this is likely to be excessively dilutive.

Ultimately, the company should determine the appropriateness of share ownership plans, with appropriate disclosures made to shareholders.

## Monitoring and implementation of Corporate Governance Codes

**24. Do you agree that companies departing from the recommendations of corporate governance codes should be required to provide detailed explanations for such departures and describe the alternative solutions adopted?**

We strongly believe in the “comply or explain” model, and we agree that companies departing from corporate governance codes should be required to provide meaningful and credible explanations for such departures. These need not necessarily be detailed explanations in each case; they should provide the appropriate level of detail as required by the situation.

**25. Do you agree that monitoring bodies should be authorised to check the informative quality of the explanations in the corporate governance statements and require companies to complete the explanations where necessary? If yes, what exactly should be their role?**

We do agree that in some cases, explanations are lacking in substance and this needs to be addressed. However, given the wide range of different circumstances and issues that inevitably surround each explanation, we believe that this is essentially a matter for oversight by shareholders rather than regulators. We have not seen any evidence to suggest that the regulatory bodies are well equipped to undertake such a position of oversight.

We believe that shareholder oversight could be strengthened by the development of best practice standards of explanation and that the monitoring bodies could provide useful assistance in developing those standards. Oversight of this nature is best left up to the individual member states, as it is important to suit the local laws and business cultures.

As a starting point, we believe a ‘good explanation’ would comprise of the following:

1. How the company’s approach is different from accepted best practice (or Code);
2. The reasons why the company’s approach has been adopted and how its approach accords with the intent or ‘spirit’ of the accepted best practice (or Code); and

3. That the company understands the relevant issues and has considered the impact of its alternative practices (especially the impact on shareholders).

Furthermore, shareholders should be encouraged to report instances of repeated failure to provide a credible explanation to their monitoring body which can in turn examine the case and if necessary bring additional sanctions to bear.