

DG Internal Market and Services/Company Law,
Corporate Governance and Financial Crime Unit
European Commission
Brussels

Submitted by email to
markt-complaw@ec.europa.eu

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Dear Sirs

ICSA response to the European Commission Green Paper on the EU corporate governance framework

The Institute of Chartered Secretaries and Administrators (ICSA) is the professional body that qualifies chartered secretaries. Many of our members are company secretaries in public listed companies and take responsibility for ensuring that the UK Corporate Governance Code is embedded in the governance structure of their company and that appropriate disclosures are made about corporate governance to the company's shareholders, usually through the annual report.

The presence of company secretaries in the boardroom, and our direct relationship with the chairman and the board, give our community a clear perspective on the effectiveness of governance frameworks for companies operating in the marketplace. We have consulted this influential network and, in particular, the ICSA Company Secretaries Forum – which includes company secretaries from 30 large listed companies from the FTSE 100 and FTSE 250 – and its EU Committee, to formulate this response.

Our overall perspective is that visible and effective corporate governance supports business success and confidence in the markets. We have pursued this approach through the 'comply or explain' principles-based model, which has been established for UK listed companies since 1992, and is now strongly embedded within, and supported by, business and the markets.

We recognise, as the Green Paper indicates, that this model may not always be applied in all member states as carefully and comprehensively as might be hoped. When reaching a view on whether action should be taken to reinforce the model we would ask that the Commission consider the issues set out as follows:

- A. Key points for consideration by the Commission
- B. General comments on the Green Paper
- C. Responses to the specific questions in the Green Paper
- D. Examples of good explanations and shareholder engagement (appendix)

A. Key points for consideration by the Commission

A1. The UK approach to corporate governance is firmly rooted in a legal and regulatory framework, in a way which allows for flexibility of delivery.

It may be useful to set out the legal and regulatory underpin of the UK corporate governance regime. The main support for the UK Corporate Governance Code is in UK Listing Rule 9.8.6(5), which requires a listed company to give in its annual report a statement of how it has applied the main principles set out in the UK Corporate Governance Code, in a manner that would enable shareholders to evaluate how these principles have been applied and a statement as to whether it has:

- (a) complied throughout the accounting period with all relevant provisions set out in the UK Corporate Governance Code; or
- (b) not complied throughout the accounting period with all relevant provisions set out in the UK Corporate Governance Code and if so, setting out:
 - (i) those provisions, if any, it has not complied with;
 - (ii) in the case of provisions whose requirements are of a continuing nature, the period within which, if any, it did not comply with some or all of those provisions; and
 - (iii) the company's reasons for non-compliance.

The Listing Rules also require the Board to provide a report to shareholders which contains a number of directors' remuneration disclosures as set out in Listing Rule 9.8.8.

(For the full text please see <http://fsahandbook.info/FSA/html/handbook/LR/9/8>)

The UK Disclosure and Transparency Rules 1B and 7 give effect to the EU audit committee and corporate governance statement requirements.

(<http://fsahandbook.info/FSA/html/handbook/DTR>)

The Listing Rules and the Disclosure and Transparency Rules have statutory effect under Part VI of the Financial Services and Markets Act 2000.

Additionally, the UK Companies Act 2006 ss 420-422 and 439-440 require a directors' remuneration report and a shareholders' advisory vote on it. CSR and narrative reporting are supported by s417 of the Act, which relates to the business review.

(<http://www.legislation.gov.uk/ukpga/2006/46/contents>)

The "comply or explain" regime is highly regarded and respected by both business and the markets for the flexibility it affords in its application and for the additional levels of disclosure which it has encouraged. It captures the best of both worlds – it introduces obligations within

a soundly-constructed and properly-enforced legal and regulatory framework, yet allows room for manoeuvre for companies to decide in what way they wish to meet those obligations. In our view, the success of this regime would be undermined by enshrining measures in the form of regulation in a way which would likely erode the flexibility provided by the current UK regime.

A2. In contrast with the comprehensive approach to corporate governance adopted by the UK and a number of other member states, there has been a less robust approach from other member states. This is where the Commission might wish to focus its attention and, in doing so, consider an amendment to Directive 2006/46/EC. Also, of those member states which have taken action, some have only adopted a principles-based code recently and time is needed to embed the process.

As is noted in your Green Paper, Directive 2006/46/EC introduced the requirement for listed companies in each member state to publish a corporate governance statement from 5 September 2008. As part of this they are required to state which governance code they apply, **if any**. Indeed the Directive states: “The corporate governance statement should make clear **whether** the company applies any provisions on corporate governance other than those provided for in national law, regardless of whether those provisions are directly laid down in a corporate governance code to which the company is subject or in any corporate governance code which the company may have decided to apply.”

Since there is the possibility not to select and apply a governance code, we believe this directive should be amended to **require** listed companies to report against a principles-based governance code. Member states would then need to ensure that their local listing authorities, or similar, adopt ‘national’ codes, or formally adopt a code used in another member state (for example, in Ireland, there is an Irish listing rule requirement that companies report against the UK code but this is supplemented by an Irish annex, which sets out additional disclosure requirements for companies listed on the Irish Stock Exchange’s Main Securities Market).

It should also be noted that although most member states now have a governance code (either their own, whether directly or by delegation to an appropriate code-setting body, or via adoption of another’s as described above), implementation has been recent in some cases and practice is therefore only just developing in those member states. Whilst such a code has existed in the UK since 1992, it is clear that more time is required in some member states to allow such national governance codes to develop and for best practice in their application to become established. In particular, markets need to adjust and to understand properly and fully the validity of explanations that companies choose to provide when reporting against this type of regime.

We would therefore encourage the Commission to take this opportunity to strengthen the existing Directive 2006/46/EC, as we suggest above, as a first order priority before introducing any further legislative measures in an attempt to reduce perceived corporate governance failures by EU companies.

A3. Strengthening market-based solutions provides an additional means for effecting progress in the effectiveness of corporate governance codes.

The recent introduction in the UK of the Stewardship Code which shareholders are encouraged to adopt is a further mechanism for addressing the agency relationship between a company’s directors and its shareholders. This approach encourages greater accountability through the shareholder route.

Strengthening the culture of disclosure reinforces the agency relationship between directors and shareholders, as well as allowing other stakeholders to exert legitimate pressures on companies to improve their transparency. In the UK we have introduced the ICSA Hermes Transparency in Governance Awards as a market-based incentive for rewarding companies for excellence in governance disclosure in their annual reports as a means of encouraging improvements in governance within the companies themselves.

A4. A balanced and proportionate approach to corporate governance is necessary if the EU is to remain competitive as a trading bloc

Faced with the inexorable re-orientation of world capital markets towards Asia, in particular to China and, in the medium term, India, as well as to the other BRIC economies and emerging markets elsewhere in the world, the creation/maintenance of a sustainable, globally competitive business environment for EU companies is critical. Recent years have seen layer upon layer of legislative and regulatory burdens being imposed upon companies which has had the net effect of hampering enterprise by escalating the cost of compliance. Whilst we do not dispute the importance of a clearly-defined legislative and regulatory regime for EU companies, this must not be at the expense of enterprise, and we consider that the point has now been reached where successive layering is in danger of hampering, or even stifling, such enterprise.

Points A1 – A4 above are the four key points that we would like the Commission to consider in its review of the EU's corporate governance framework.

We would, in addition, like to make three general comments directly related to the issues raised in the Green Paper.

B. General comments on the Green Paper

B1. Improving governance practice through 'comply or explain' engagement

We believe that codes can be more effective at raising standards than legislative solutions. Legal rules are likely to lead to more blanket compliance, but a lower overall standard (as companies are driven to comply with the letter of the law rather than the spirit of governance principles). Our UK experience is that 'comply or explain' fosters a best practice culture where leading companies strive to exceed the provisions of the UK Corporate Governance Code ('the Code'), such as by disclosing board evaluation outcomes and by making more detailed disclosure of remuneration arrangements than is required by the letter of the legally-binding directors' remuneration report requirements in the Companies Act 2006. Other companies then aspire to follow the lead of the pace setters.

Principles-based codes result in a circle of continuous improvement. Not all important governance developments in the UK start with a change in the Code. Some companies, often but not always the larger ones, voluntarily adopt processes which they think will help them improve their governance (ie develop their own best practice) and these then find their way into the Code if considered to be of general value. For example, some companies were holding annual director elections and externally-facilitated board evaluations before recent Code changes provided for these. The adoption of these tested practices by the Code then leads to other companies applying them in their own contexts. A significant advantage of principles-based codes over legislation is that they can evolve and be amended very quickly (as has happened in the UK on annual election of directors and gender diversity).

Also, many of the elements of principles-based codes do not lend themselves readily to enactment as legally enforceable obligations. Our Code is divided into principles and provisions. Important principles, such as 'every company should be headed by an effective board' or 'non-executives should constructively challenge' cannot be encapsulated in

legislation and regulated. Therefore many of the Code principles which help change board behaviours would be lost in any rules-based system. Through the Code, however, investors can enforce some of these principles – eg by taking steps to enforce an effective board through dialogue with directors and, ultimately, voting to remove directors from the board.

ICSA believes that ‘comply or explain’ can lead to improved governance practice as it reinforces the link between the shareholders and the company and so promotes good practice and strengthens accountability. In the Appendix are examples of engagement and ‘explanations’ that shareholders have found particularly helpful as they have enabled companies to adopt arrangements differing from those set out in the detailed provisions of the Code but which better suited the circumstances at a particular time. Legal rules tend to suppress these individual variations.

B2. Promoting growth

A tailored and insightful principles-based approach to governance by companies (rather than a ‘tick box’ rules-based approach) also allows companies to plan their approach to governance in line with available resources and the business needs of the organisation. By adopting an approach to governance which suits their business needs they are best placed to save time and resources and to optimise growth.

Especially in the current economic climate, a key priority must be to minimise costs to companies and to promote economic growth. A principles-based governance framework is less costly than a rules-based system, which will involve the costs of legal compliance and sometimes legal challenge and litigation.

B3. Impact assessment

The Green Paper refers to proposed measures being subject to impact assessment (see page 20). We would like to know more details of this, including who will carry it out and what its scope will be. We think it is important that there is an opportunity to look again at any proposals in the light of the impact assessment, and firmly believe that changes should only be introduced if a clear business case for doing so is demonstrated.

C. Responses to the specific questions in the Green Paper

(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 accept that there might be scope for having a more-light-touch regime for smaller companies, as long as it is consistent with the philosophy and principles on which the main national code is devised, allowing ease of transition from one level to another.

In terms of the argument for maintaining just one code, we consider that the existing ‘comply or explain’ framework takes account of the size of a company. The essence of ‘comply or explain’ is that it allows for a proportionate response by companies, having regard to their size and also to the scope and complexity of their business. It is implicit in the framework that companies may decide to apply certain provisions but take the view that other measures are not appropriate for them. Shareholders and other stakeholders tend to have higher expectations of the governance approach of larger companies, recognising that some measures are simply not practical for smaller companies or may not be in the best interests of those companies or their shareholders.

'Comply or explain' allows companies to develop and improve their governance as they grow in size and is therefore aspirational. Best practice tends to be developed more at the large company level and to cascade down gradually to smaller companies as they consider they are ready to embrace it. In the UK we have seen many examples of this trend over the last ten or so years.

However, if there are particular requirements which it is felt should only generally be applied to large companies, these can be included in an existing national principles-based governance code with an explanation that they would normally only apply at a certain company size level. In the UK Code, for example, the provisions on annual re-election of directors, external board evaluations at least every three years and half the board needing to be made up of independent non-executive directors apply only to FTSE 350 companies.

Nevertheless, some companies below the FTSE 350 level apply these provisions voluntarily because they wish to implement what they see as the best governance measures for their organisation, and because they aspire to grow to join the FTSE 350 index.

In the UK many other types of organisation apply the Code even though they are not required to do so. These might include unlisted companies and companies traded on the AIM market. Other sectors have specifically adapted the Code, eg the National Health Service, the Higher Education sector and mutual insurers (which have annotated the Code to delete reference to shareholders and to refer instead to their members). This has resulted in a general acceptance and understanding of the main principles of governance across the UK market.

That said, we are supportive of lighter governance provisions being generally applied to smaller companies, as long as it is made as consistent as possible with the main national Code, so that the boundaries between the two are not artificial, and so that there is ease of transition between the two in both directions (downwards as well as up). In the UK, for example, the Quoted Companies Alliance has produced guidelines for AIM and PLUS quoted companies based on the UK Code, and the IOD, in conjunction with ecoDa, has devised such guidance for unlisted companies (a model which has also been adapted for wider use in the EU, for example in the Baltic countries where most companies are unlisted and SMEs). Light-touch guidance, sensitively and intelligently constructed, can encourage companies to take the first step on the governance journey, and help such companies understand and view the role of governance as a driver of business benefit rather than as a costly compliance exercise. In such cases, however, the more light touch guidance has been based on the main Code, which ensures that an overall governance philosophy is in place.

(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?

Our answer to question (1) addresses this issue. We believe, however, that any code for smaller companies should be consistent with the national code, reflecting local economic conditions, rather than being based on a supra-EU model which will not sufficiently be able to take account of local market sensitivities.

One concern would be whether any unlisted code would be designed to apply to subsidiaries of listed companies. We believe that the governance arrangements within a group should support the compliance of the parent with the relevant code. There needs to be a consistency of governance approach across all group companies with subsidiaries reflecting the governance measures determined by the top company.

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?

We would not support regulation on this as 'one size does not fit all'.

We note that the text of the Green Paper pertaining to this question refers to the roles being 'defined' rather than 'divided' and are therefore unsure as to the precise nature of what we are being asked to consider.

We would certainly agree that the two roles should be clearly defined. This is helpful in bringing clarity to the issue of how the company operates at the most senior level, optimising board effectiveness. The chairman of the board will be responsible for the effective functioning of the board, whilst the chief executive officer will be responsible for running the operations of the company.

On balance, our view is that the roles are best divided, but there may unusually be some companies for which this is not the best structure (particularly temporarily at times of transition or following the sudden departure of one of the holders of the two key roles). The UK Code provides for separate roles, but of course companies are asked to 'comply or explain' against this and so it is not mandatory.

(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?

We would not support regulation on this.

We agree, however, that it is helpful for recruitment policies to specify the skills being sought for a particular role. This will be specific to the company and the role and will depend on what skills are already available to the board. Each company (usually the nomination committee) needs to assess this, ideally on an ongoing basis, and certainly at the time of each recruitment.

We believe this is best achieved at national level, through the use of 'comply or explain' provisions which should specify that the board itself, or the nomination committee or other committee, considers the skills of the existing board members and the future needs of the company in determining the skills needed in any particular recruitment.

(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 would not oppose regulation requiring the disclosure of a diversity policy, but would prefer it to be dealt with in principles-based codes.

We believe that boards benefit from drawing their members from diverse backgrounds. Currently, the UK Code requires the search for additional directors to have due regard for the benefits of diversity on the board, including gender diversity.

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

We would not support regulation on this.

We are not in favour of quotas as these impose artificial measures on companies which take no account of their circumstances. We would prefer voluntary measures and targets to be given an opportunity to work. In the UK, the recent Davies Review of Women on Boards asks companies to set their own targets (although it does suggest a minimum threshold of what these should be for FTSE 100 companies). UK companies are now actively considering these issues in the light of their particular circumstances. We would support this aspirational and flexible approach.

The poor gender balance on many boards is a matter of concern to many stakeholders. It is clear that companies need to address this issue as a key priority in order to promote the competitiveness of companies throughout the EU. Companies would benefit from harnessing the largely untapped talent pool and more diverse boards may also have greater empathy with their customer base.

As well as the lack of women at board level, we are concerned that women's attrition rates in most organisations tend to increase with seniority. This means that the pool of suitable women candidates for board positions is smaller than that for men, the so-called 'leaking pipeline' problem. This is despite entry at lower levels being roughly equal, tough equality laws, maternity provision and the evolution of flexible working arrangements. We therefore believe that companies' gender diversity policies should address how women can be encouraged to progress through all levels of the organisation to reach senior levels. The Davies Review in the UK envisages the publication of statistics by companies on the proportion of women they employ at board level, executive level and throughout the company. It is hoped that the inclusion in national codes of a requirement for a diversity policy together with the publication of such statistics, will result in a re-balancing of the boards in all member states.

(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 would not support regulation on this.

It is the responsibility of the chairman of the board to ensure that, in searching for new non-executive directors, they satisfy themselves that candidates are in a position to spend adequate time in their role to enable them to understand the business sufficiently to ask the challenging questions necessary if they are to fulfil their duties to the company. Equally, as part of their own due diligence, non-executive director candidates must ensure that they have the capacity to take on a role, taking into account their pre-existing commitments, the travel requirements associated with fulfilling a new role, the complexity of the business in question, etc.

We reject the idea that a limit should be set on the number of directorships an individual may or should hold as this makes no allowance for the presence, or indeed lack, of individual commitments in addition to any directorships, or for the fact that the time commitment varies hugely between mandates. Also, the appetite for work and personal commitments differs for each individual.

We prefer that through the chairman, as supported by the company secretary, the board evaluation process covers time commitment issues and requires directors to comment on the adequacy of the perceived time commitment of their colleagues. (The UK Corporate Governance Code emphasises the need for directors to devote adequate time to their duties.) In the UK the level of attendance at board and committee meetings by each of the directors is stated in the annual report and accounts. Institutional investors focus on this and may recommend action if attendance is low, such as voting against the re-election of a particular director. However, any internal review of director time commitment should not be limited to a review of meeting attendance, as this may legitimise the notion that non-

executives are only directors of companies on board meeting days. Where it is felt that a director's other commitments are having a negative effect on his or her contribution, the chairman should take steps to resolve the issue.

Importantly, a rule to limit director mandates could have the unintended consequence of reducing participation on the boards of charities and other not-for-profit organisations.

We believe it is better to leave it to boards (and particularly those that chair them) to ensure that directors are not over-committed.

(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 would not support regulation on this.

We are, nevertheless, strongly supportive of the value of periodic external evaluation as this brings objectivity and best practice from outside the organisation. However, there may be circumstances when the time is not right for such an evaluation, or other times when it may be particularly helpful, depending on the particular circumstances of each company. During a period of significant boardroom change, for example, it will not be appropriate to conduct an evaluation. Conversely, it may be very helpful to do so once the changes have been embedded. We therefore believe that external evaluation should be carried out on a periodic basis (perhaps at least every three years) and that this should be on a 'comply or explain' basis.

We understand the provision in the UK Corporate Governance Code for external evaluations every three years was limited in its application to just the FTSE 350 as it was not felt that there were enough existing board evaluation service providers of suitable quality (as this is a developing market) to be able to cope with requests from **all** listed companies. This may be something to consider in the wider EU context.

(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?

We would not oppose regulation on this.

This is the approach we pursue in the UK, and we are generally in favour of it as an aid to transparency for shareholders and other stakeholders.

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

We would make the same response here as for question 9. We would add, however, that the vote should be an 'advisory' one, as is current practice in the UK. This allows shareholders to signal their views to the board. If the vote were to be given binding force this would be likely to give rise to a number of legal complications in directors' contractual arrangements (and other unforeseen consequences) and well-qualified candidates for board positions may be deterred from accepting such positions (for instance when choosing between positions at a listed company and in private equity) if their remuneration could be affected (or even withdrawn) after the event by shareholder votes.

(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 would not support regulation on this and think this should be dealt with under the 'comply or explain' model.

We are in strong agreement with the proposal in the first sentence of the question. In our view it is crucial that boards take responsibility for the risk appetite of their companies. We also believe that boards should be responsible for ensuring that risks are appropriately identified, mitigated and managed and that a risk-aware culture is embedded throughout the organisation. (We would also like to point out that, although risk appetite is not defined in the Code – due to the view that the term needs to be better understood in the corporate world before boards can meaningfully take appropriate action – the UK Institute of Risk Management is launching a consultation paper on the subject. The paper should develop the debate in this important area and the Commission may wish to contribute with its views).

However, we are not in favour of the specific reference to societal risks. While we agree that there is increasing recognition that such risks are extremely important, if these societal risks are key risks for the company they will be considered in any case as part of the company's review of its risk appetite and profile.

We note that the Accounts Modernisation Directive introduced a requirement for narrative reporting which has been transposed into UK law by the Business Review provisions of the Companies Act 2006 (s. 417). All member states should therefore be reporting such issues meaningfully. We question the extent to which this Directive has been fully transposed by all member states and suggest the Commission seek to enforce this.

(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?

Although they should seek to do so, we do not think that boards can absolutely 'ensure' that this is the case, and so would not support regulation on this.

However, we are in complete agreement with the concept of the board taking responsibility for risk management and refer to our response to question 11.

(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.

We have had an interesting debate amongst our members in relation to the requirement to publish Interim Management Statements (IMs). On the basis that the UK Disclosure and Transparency Rules require the timely publication of price sensitive information by listed companies, there is a view taken by some of our members who represent companies that operate businesses of a long-term nature (eg pharmaceutical and healthcare) that the IMs or quarterly report may encourage short-term perspectives amongst investors.

This is contrasted with the views of others of our members who work for companies that operate businesses with shorter-term dynamics (eg retailers and high value general insurers/reinsurers) as they understand why investors want and need regular flows of information.

We would suggest this is an area where member states should be allowed to relax the requirement, making IMs voluntary, on the basis that one size does not fit all and therefore the publication of an IMs should be optional with a 'comply or explain' requirement. If such an approach were adopted, this could then be left as a matter between companies and their shareholders.

On short-termism itself, the Institute takes the view that there is a range of different types of investors with different mandates and ways to engage. Some like to be involved and

engage, others buy and sell shares with rapidity. An element of short-term trading provides the liquidity which is important to the operation of a healthy stock market.

In the UK we are experiencing higher levels of institutional shareholder engagement, in particular since the introduction of the Stewardship Code, which encourages a long-term view.

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

We do not believe it would be practical or desirable to introduce any such measures. It is not possible, in our view, to legislate to take account of the differing business models and circumstances of individual asset managers, their clients and shareholders.

(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?

We believe it is best to let the market manage this itself. Some institutional investors want to engage and be involved, others prefer not to. We do not think this is an area suitable for regulation.

Investors can be encouraged to engage. In the UK, active investors commit to the Stewardship Code. It is too early to assess the effect of this but the indications are encouraging as can be seen by the list of those who have signed up, available at this link:

<http://www.frc.org.uk/corporate/stewardshipstatements.cfm>

A survey of adherence to the principles-based Stewardship Code by the UK Investment Management Association in May summarised the responses of 41 Asset Managers, seven Asset Owners and two Service Providers to a questionnaire that had been developed under the direction and oversight of a Steering Group chaired by the FRC's Chief Executive. The survey demonstrated:

- over 90% of institutional investors surveyed vote all or the great majority of their UK shares; nearly two thirds now publish their voting records;
- at the date of the survey, 43 out of 50 respondents had published a statement on adherence to the Stewardship Code, and another six have done so subsequently; and
- the 48 institutional investors in the survey employ over 1,300 people on stewardship activities.

The report also looked at how institutional shareholders dealt with issues including remuneration, board composition, environmental matters, mergers and financing. There were high levels of engagement on all these issues, including meetings at board level, consultation with other investors and, in one case, site visits. Please see details of the report at:

<http://www.investmentfunds.org.uk/research/stewardship-survey>

We welcome the introduction of the European Fund and Asset Management Association (EFAMA) code and similar codes might be encouraged elsewhere.

(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 issue may be best dealt with by local codes of practice produced by the sector. For example, in the UK the regulator already insists on the use of 'Chinese walls'.

(17) What would be the best way for the EU to facilitate shareholder cooperation?

This is a very wide area and might be the subject of a completely separate consultation. It covers the chain of ownership, voting processes, transmission of information from company to the end investor, and back again.

One practical point which militates against shareholder cooperation is the continued existence of bearer shares, which of course do not enable the existence of the shareholder to be identified, and so clearly does not facilitate shareholder cooperation.

We would be against the idea of an area on company websites for shareholders to blog about the company. This may result in ill-considered comments which lack judgment and a sense of proportion and so have a detrimental effect on the market. There might also be concerns around issuer responsibility for such comments and whether or not it would be appropriate for issuers to respond (sometimes it would not be possible to do so).

(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?

There needs to be a distinction drawn between the different proxy advisors as practices vary (with some advising how investors should vote, some only submitting votes, and some doing both) but we agree there should be greater transparency, that they should be regulated, and should have measures in place to avoid conflicts of interest.

We are aware of situations where investors have delegated voting decisions to proxy advisors, but the proxy advisors then refuse to engage with the company, making it impossible for companies to discuss the vote or any aspects of corporate governance with either investors or their agents. We believe that this prevents proper engagement between issuers and investors, and is detrimental to good corporate governance.

Therefore, we would propose that investors who wish to delegate their voting decisions to third parties should be required to disclose which proxy advisor they use, and the extent that they follow the guidelines determined by the proxy advisors. Some investors follow the guidelines prepared by their proxy advisors, but may also use their own judgement in certain cases to depart from these guidelines. Other investors delegate the entire decision process to third parties. In addition, if investors choose not to engage with issuers directly they should be required to authorise and facilitate the means for their proxy advisors to engage with the issuer on their behalf.

We believe that proxy advisors should be required to disclose their voting guidelines publicly. If issuers are aware of the proxy advisors used by their investors and the voting guidelines that these advisors use, issuers are better able to introduce and implement measures which are in harmony with the wishes of their investors.

It may be a good idea for proxy advisors to work with issuers and shareholders to develop a code of transparency for proxy advisors.

(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?

We would not support regulation on this.

In contrast to practice in the USA, we do not consider that it is appropriate for a proxy advisor to act both for the investor and for the issuer. It is a clear conflict of interest. We suggest this be dealt with by a code of practice rather than by legislative means.

(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 that the current divergence of practice across Europe in respect of the right of issuers to obtain information concerning the identity of the beneficial holders of their shares is not conducive to good corporate governance. In some member states, issuers are enabled under local law to make enquiries of all underlying shareholders, however few shares they may hold. Issuers in other member states, however, do not enjoy such extensive rights and, in some cases, are only able to ascertain the identity of their shareholder base at limited times of the year (typically ahead of an AGM or corporate action), or only for holdings in excess of a certain percentage. We note that in those states where there is greater visibility of the shareholder bases, there tends to be a higher level of voting.

Greater visibility concerning the identity of shareholders enables issuers to engage more effectively with their underlying shareholders and hold meaningful discussions about corporate governance matters which may be of concern or interest to investors. We do not believe that a system whereby such enquiries are only made ahead of a corporate action is good practice, as the making of such an enquiry may alert some sections of the market prematurely to the possibility that a corporate action may be planned. This has the potential to distort the market and provide some sections of the market with information not generally available to all shareholders.

We note that the Transparency Working Group of the TARGET2 Securities (T2S) project has reviewed this issue in depth and has made progress in three key areas, notably the development of standard messaging formats, the flow of disclosure messages and suggestions for changes to European legislation to enable issuers to be in a position to identify their underlying shareholders. We therefore support the findings in section 6 of the Final Report of the T2S Taskforce on Shareholder Transparency to the T2S Advisory Group on 7 March 2011. The full report may be accessed at:

http://www.ecb.int/paym/t2s/progress/pdf/subtrans/st_final_report_110307.pdf?6e8d90e3ac22c7f13d4283678d69a0dc

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

We understand that this may be an issue in some member states. It would be helpful if the Commission could clarify the issue.

In the UK the Companies Act affords protection to minority shareholders.

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

Please see our response to question 21. In the UK, the Companies Act affords comprehensive protection.

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

Employee share ownership plans should be encouraged in order to motivate and retain employees and align their interests with those of other shareholders. Differing legislative and tax treatments of employee share plans between EU countries make the operation of such plans across a number of different EU countries, particularly when staff are mobile between different jurisdictions, more complicated than is optimal. Some level of consistency in tax treatment, even if necessarily not in tax rate, would be very helpful and avoid the pressure to operate a multiplicity of different plans for different countries.

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 agree and believe it is extremely important. It is fundamental to the operation of the 'comply or explain' framework. Recent research by Grant Thornton stated:

"The Code recognises that non-compliance may be justified in particular circumstances if good governance can be achieved by other means and the company's rationale is provided. This year we see a continued move towards providing more informative disclosures with 87% (2009: 83%) of FTSE 350 companies either claiming full compliance or providing 'more' detail as to their reasons for non-compliance.

Not only are companies giving more detailed information to support their rationale for non-compliance, more companies are updating these explanations to reflect their changing environment. This year 34% (2009: 14%) of those who chose to explain made substantive changes to these explanations."

(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 not agree. The directors are accountable to the shareholders and the value from the current operation of 'comply or explain' is in the dialogue between the company and shareholders (even recognising that it is only certain shareholders that engage – it does not need to be all of them). Involving a monitoring body would cut across the relationship between the company and its shareholders.

This would turn a constructive dialogue into a compliance operation. There is a high likelihood it would result in 'boiler plate' reporting and compliance. It would be very difficult for a monitoring body to make a subjective judgement on the 'informative quality' of the explanation. It could only check that an explanation had been made.

The possible use of monitoring bodies also raises several difficult issues. To whom would monitoring bodies owe their duty? What would be their powers? What would be their precise role? What would be the status of their findings? To what extent could they make qualitative judgments? Who would have the primary communication with the company – the monitoring body or the shareholder?

In general we believe it should be up to the market to determine whether they are happy with the explanations given and that it should not be a matter for public regulation.

Should some kind of monitoring system be introduced we prefer the wording 'authorised to' in the question rather than the later 'require', so that the body could make selective checks of various market sectors in its ongoing surveillance.

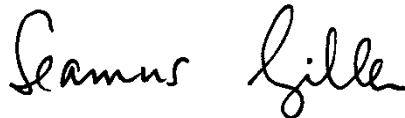
Cost implications would be a concern and we question who would bear the costs of the monitoring work? Neither governments nor companies are likely to be keen to absorb this work and cost, and it would be especially unhelpful during current economic difficulties.

Conclusion

In conclusion, we would like to express our thanks to the Commission for being invited to comment on these important issues. Strong corporate governance in companies delivers trust and confidence among shareholders and other stakeholders and provides many business benefits – as long as the measures are proportionate, appropriate and grounded in the commercial reality of the markets.

Please do not hesitate to contact us should you like to discuss in more detail any of the points we raise.

Yours faithfully

A handwritten signature in black ink that reads "Seamus Gillen". The signature is written in a cursive, flowing style.

Seamus Gillen
Director of Policy
Phone: 020 7612 7014

D. APPENDIX

Examples of shareholder engagement and 'comply or explain' disclosures

Shareholder engagement

1. There are six case studies on shareholder engagement in the IMA survey, please see:

<http://www.investmentfunds.org.uk/research/stewardship-survey>

See Appendix 4 of the survey for these detailed practical examples.

2. Unattributed example

The Code states that a CEO should not go on to become Chairman of the same company but gives the flexibility under 'comply or explain' to do this in exceptional circumstances. The company concerned did this as a suitable independent Chairman could not be found at that time and they felt the CEO was the best person for the job. They engaged on the point with investors who confirmed they would support the appointment of the CEO as Chairman provided a strong independent Deputy Chairman was appointed to ensure separation of the Chairman and CEO roles.

Comply or explain disclosures

1. Amlin plc – from report and accounts

We start with an old example, dating back to Amlin's Report and Accounts in 2004. We include this to illustrate that some companies have been providing good explanations for many years, and because Amlin received, at the time, a letter of commendation from a major investor praising the section on board composition, part of which is quoted below, for its openness and transparency. Amlin plc went on to be the overall winner in the FTSE 250 category for its 2009 report and accounts at the ICSA Hermes Transparency in Governance Awards in 2010.

"Board membership and independence

... Apart from Mr Joslin, all the non-executive directors during the year were determined by the Board as being independent in character and judgement with (in the words of the New Combined Code) "no relationships or circumstances which may appear relevant" to such determination. Until 31 December 2002 Mr Joslin was Vice Chairman of State Farm Mutual Automobile Insurance Company (State Farm), which is a 10.1% shareholder in the Company and provides material Letter of Credit facilities to the Group (on commercial terms). In the light of this, he was classified as a non-independent director throughout 2003. However, with effect from 1 January 2004, Mr Joslin is now classified as independent, notwithstanding provision A.3.1 of the New Combined Code which suggests that a three year period must elapse following such relationship. The Board considers that an exception to this provision is justified from the current year as neither State Farm nor the Board consider him as any form of conduit of information between them, he has no continuing personal interests in State Farm and, most importantly, his previous directorship of State Farm does not, in practice, affect his independent judgement as an Amlin director. On this basis, Mr Joslin has joined the Audit Committee from 1 January 2004, bringing his considerable, relevant and recent financial and insurance experience to its deliberations.

Mr Kemp was classified as independent throughout 2003. He is a director of a company in the same group as One Beacon Insurance Company, which had an interest in over 3% of

the Company's shares until February 2003, but the Board maintained its previous view that the shareholding was not sufficient to impair Mr Kemp's independence. Since June 2002 Mr Kemp has held a temporary position as Chief Financial Officer of Montpelier Re Holdings Limited, with which the Group's managed syndicate already had a qualifying quota share arrangement (on commercial terms) prior to his appointment. As the position remained a temporary secondment, and the arrangement with Amlin had been put in place before it commenced, the Board also did not consider that this should alter his independent status. However, for commercial reasons as part of its 2004 reinsurance programme, the syndicate entered into more substantive reinsurance arrangements with Montpelier Re. As a result of this, the business relationship has become sufficiently material, with effect from January 2004, for it to be no longer appropriate for Mr Kemp's independent classification to continue. Accordingly, he left the Remuneration Committee in January 2004.

The Board notes that Messrs Kennedy and Sanders have both served on the Board since October 1993 and, as the Board continues to classify each of them as independent, the New Combined Code accordingly requires the Board to state its reasons for doing so notwithstanding their length of service. The Board is mindful that the merger of the Company with Murray Lawrence in September 1998 so transformed the size and scope of the Group's business as to render the earlier service of questionable relevance to such considerations. Furthermore the Board has recently reaffirmed its view that each of them remain, in practice, robustly independent in character and judgement. Notwithstanding provision A.3.1 of the New Combined Code, the Board accordingly continues to classify them as independent ..."

2. Aggreko plc – from report and accounts 2009

A more recent example, on the same subject of board composition comes from another of the ICSA Hermes Transparency in Governance Award winners in 2010 (joint overall winner in the FTSE 100 category), Aggreko plc:

"We support the Combined Code on Corporate Governance published by the Financial Reporting Council in June 2008 (the 'Code'). We consider that the Group complies and has complied throughout the year ended 31 December 2009 with all of the provisions of the Code with the exception of the Code provision that at least half of the Board, excluding the Chairman, should be independent Non-executive Directors; the reasons for this are explained in detail in the paragraph below entitled 'Non-executive Directors' ...

Non-executive Directors

Non-executive Directors bring a wide range of experience to the Company and Nigel Northridge, David Hamill, Robert MacLeod and Russell King are considered by the Board to be independent as defined in the Code. Andrew Salvesen, who retired from the Board on 29 April 2009, had served as a Director of the Company for more than nine years and therefore was not considered to be independent by the Board for the purposes of the Code.

The Code states that at least half of the Board, excluding the Chairman, should be independent Non-executive Directors. However, the Directors believe that, beyond a certain size, Boards risk becoming ineffective at control and decision-making; they certainly become more expensive as they grow larger. Ideally, in our view, the Aggreko Board works most effectively, and represents best value for shareholders, with no more than ten people sitting round the table.

Applying the 'no more than ten round the table' rule leaves nine places for Executive and Non-executive Directors. Operationally, Aggreko is organised into three regions, and the choice in terms of the number of Executive Directors sitting on the Board is two, or five.

The Board has concluded that the ability to hold to account the line managers who run the business on a daily basis, to get their input into decision-making, and to get the additional Board-level visibility which comes from having these executives as part of the Board adds real value, and is the appropriate choice. We have therefore decided not to comply with the Code in this respect only, having four Non-executive Directors, rather than the five we would need to be in line with the Code.”

3. Fresnillo plc – from report and accounts

“The 2008 Combined Code on Corporate Governance (the Code) establishes, in Section 1, seventeen main principles of good governance in four areas: Directors, Directors’ Remuneration, Accountability and Audit, and Relations with Shareholders. For the financial year ended 31 December 2010, the Company has complied with Section 1 of the Code, save in the following two respects:

- Code Provision A.2.2: The Code states that the chairman should on appointment meet the independence criteria set out within the Code.

The Chairman was not independent at the time of his appointment. Alberto Baillères has been a board member of Industrias Peñoles, S.A.B. de C.V. (Peñoles) since 1962 and its chairman since 1967. Peñoles retains a 77.1% holding in the Company. Mr Baillères has been responsible for overseeing the successful development of Fresnillo over the many years before Fresnillo was listed and, therefore, the Board considers that Mr Baillères’ continued involvement as Chairman is very important to the Company at the present stage of its development. Furthermore a transparent governance system has been established, primarily through the Relationship Agreement between Fresnillo and Peñoles, which ensures that the Company benefits from Mr Baillères leadership and experience whilst being able to demonstrate to other shareholders that the Fresnillo Group is capable of carrying on its business independently. In particular, the Relationship Agreement ensures that transactions and relationships between the Fresnillo Group and its major shareholder are at arm’s length and on normal commercial terms.

- Code Provision B.2.1: The Code provides that the Board should establish a remuneration committee of at least three Independent Non-executive Directors.

The composition of the Fresnillo Remuneration Committee is made up of three members including two Independent Non-executive Directors one of whom, Lord Cairns, is the Chairman of the Committee. The Chairman of the Company, Mr Baillères, who was not independent at the time of his appointment, is also a member. The Board believes that Mr Baillères’ experience and knowledge of the Group and the Mexican market and his considerable contribution to the Remuneration Committee’s deliberations justifies his membership of the Remuneration Committee.

Mr Baillères is not involved in matters concerning his own remuneration.”

4. Associated British Foods PLC – from report and accounts

“Combined Code Provisions Status Explanation

A.4.4. – The terms and conditions of appointment of non-executive directors should be made available for inspection

Galen Weston has not entered into a formal letter of appointment. This is due to his relationship with the Company’s ultimate holding company, Wittington Investments Limited of which he is a director and shareholder. Galen Weston receives no fees for performing his

role as a non-executive director and Associated British Foods plc does not reimburse him for any expenses incurred by him in that role. In accordance with the Combined Code, he is subject to annual re-election.

B.2.1 – The Chairman should not chair the Remuneration committee

Charles Sinclair is both Chairman and chairman of the Remuneration committee. The board of Associated British Foods plc does not accept this recommendation as it considers that Charles Sinclair, due to his experience, is best suited to chair this committee. The Combined Code now recognises that the Chairman can be a member of the Remuneration committee. No director has any involvement in the determination of his own remuneration.”