PIRC

PIRC RESPONSE / JULY 2011

Green Paper: The EU Corporate Governance Framework

The voice of responsible shareowners

We welcome the opportunity to respond to the Green Paper. Pensions & Investment Research Consultants Ltd (PIRC) has been an independent adviser to pension funds and other institutional investors for over 20 years. PIRC's clients have combined assets in excess of £1.5 trillion and include some of the largest pension funds, asset management companies and insurance companies in the UK and overseas. Together, they comprise a diverse group of institutional investors with long-term liabilities and broad fiduciary duties.

PIRC undertakes company research on corporate governance and corporate social responsibility issues at public companies, and provides advice to clients on proxy voting strategies and other active shareowner initiatives. Our comments are based on two decades of practical experience, which inform our views on the strengths and weaknesses of disclosures, governance structures, and the interaction of statute, regulation and codes of practice.

PIRC'S RESPONSE TO THE CONSULTATION

Response to specific 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 support the framework of application set out in the UK Companies Act 2006 that starts with the application of corporate governance best practice and the UK Corporate Governance Code for publicly listed companies. Whilst we appreciate that for some smaller listed companies there is usually time for adjustment to the requirements of corporate governance standards, we believe that the broad standards framework should be applied to all listed companies regardless of size. In our view the applicable governance standards enshrined in the UK Companies Act should also apply to the UK and any other publicly listed company listing regime across the EC.

(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?

We believe that there is a unique nature to the publicly listed company markets and thus recommend that the EC should focus on establishment a progressive set of governance standards for such regimes.

That said, subsidiaries of listed companies are themselves unlisted companies, often with different directors. The investor interest in the listed company is also dependent on the governance of the subsidiary companies. This is not an inconsequential matter given that the listed company may have economic exposure to: it's equity investment in the subsidiary, intercompany financing to the unlisted company and any guarantees made by the listed company to the unlisted company

We note that in some regimes (including recently South Africa) intergroup dealings require both disclosure and shareholder approval of material intergroup activity, as there may be considerable conflicts of interest at play" .

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?

Yes. As PIRC has commented recently, given the widespread acceptance of the principle of separation of powers, by both issuers and shareholders, we see little value in allowing the option of non-compliance.[1]

(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?

Yes. Publicly listed companies (PLCs) should take a leaf out of the public sector in the UK and Europe and operate up-to-date advertisement, recruitment, and personnel management strategies for PLC directors as for any other senior management post in large organisations. It would be helpful if a clear job description, person specification, employment contract (including salary and benefit package) for director vacancies be publicly advertised. This would help challenge the 'old boy network' and be advantageous to greater diversity on PLC boards across the EC.

[1] http://www.efinancialnews.com/story/2011-03-25/uk-proxy-adviser-says-it-is-time-for-governance-laws

(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?

Yes.

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

Yes. We support 'comply or explain' strategies in this regard but only for a limited period, of perhaps 3 to 5 years. Following the institution of such a regime for creating greater board diversity, we believe that where PLCs boards of directors were still found to be failing to achieve an appropriate % composition change, a statutory regime should then be considered. As the Commission will be aware, the pace of change in the UK in relation to this issue has been glacial. Therefore a mandatory approach must not be ruled out if voluntarism fails.

(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?

Again, we recommend a 'comply or explain' regime for a limited period with appropriate statutory disclosure monitoring. This might state that it is expected that PLC boards should comprise executive directors who are not recommended to sit on more than one other PLC board, or organisation of equivalent size and complexity; for non-executives this might entail no more than two other PLC boards or organisations of equivalent size and complexity Thus 3 in total). Again we suggest a period of 3 to 5 years over which this regime would operate, before assessment. In the event that such a regime was either broadly ignored by PLCs or found not to alleviate associated problems of conflicts or time commitments, we would then recommend that the requirements should become legally enforceable.

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

Yes. Through using completely independent third-party advisers.

(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. Furthermore such disclosures should provide a full track record of operation over the life time of any particular remuneration scheme for executive and non-executive directors and senior managers below board level where salary levels exceed €150,000.00

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

Yes. In addition this vote should be binding.

(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?

Yes.

(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.

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.

We have no comment to make on EU rules, however PIRC's response to the short-termism review in the UK may be of interest.[2]

(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?

Full disclosure of all remuneration arrangements for staff earning over €150,000 per annum.

(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 suggest that EU law consider adoption of a version of the UK Stewardship Code for EU based asset managers with an appropriate 'comply or explain' regime for annual reporting and disclosure. However, we would stress that we regard the recent EFAMA code wholly inadequate for this task as it is weaker than the equivalent UK Code and thus could lead to a 'dumbing down' if adopted on a Europe-wide basis.[3] We therefore strongly urge the EC not to endorse it in any way.

(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?

The EC should research and consult on the establishment of an appropriate statutory regime of conflict disclosure by EU based asset managers with regard to these matters.

(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?

We believe that it is appropriate for proxy advisers to demonstrate a degree of transparency and accountability in their operations commensurate with their loyalty to their clients and public disclosures, where these do not undermine their unique business models. PIRC has set out a set of Principles of Best Practice for Proxy Advisers.[4] We believe that a Code of this nature could be developed to be adopted on a 'comply or explain' basis, mirroring the requirements on companies and shareholders.

(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 believe that all proxy advisers should be under a 'comply or explain' obligation to disclose conflicts of interest. In practice PIRC does not provide consulting services to companies as we consider that this would indeed be a potential conflict of interest.

[2] http://www.efinancialnews.com/story/2011-03-25/uk-proxy-adviser-says-it-is-time-for-governance-laws
[3] http://www.pirc.co.uk/news/problem-self-regulation
[4] http://www.pirc.co.uk/sites/default/files/BestPracticePrinciples.pdf

(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 purchase of any publicly listed security should be fully disclosed at the time of purchase to the PLC. That such disclosure should be aggregated by size and fiduciary status. In addition we believe that such purchases or sales should be viewable on a public register across all financial markets in the EU. It would be for the EC to research and recommend the nature of the disclosures suggested.

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

Yes. Priority should be given by the EC to review the requirements for public company listing rules and % free float conditions. The current free-float obligations favour controlled companies and should be restricted. The recent example of Eurasian Natural Resources in the UK is worthy of review in this respect.

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

Yes. The EC should research and provide recommendations.

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

We are in favour of greater employee share ownership, but have no particular recommendation here.

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?

Yes, except for the detailed proposals going beyond ‘comply or explain’ set out in answers to previous questions above.

(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?

Yes. However the EC needs a new, competent and authoritative body, free from conflicts and experienced on governance monitoring to do this. Existing market bodies are not fit for this purpose, not free of conflicts and do not have the expertise in corporate governance monitoring.

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