The Hundred Group
of Finance Directors

Investor Relations and Markets Committee

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

14 January 2011

Dear Adam

A Long-term Focus for Corporate Britain: Call for Evidence

We are pleased to submit our comments on the above call for evidence.

Who we are

The Hundred Group is a non-political, not-for-profit organisation which represents the finance directors of the UK's largest companies, with membership drawn mainly, but not entirely, from the constituents of the FTSE100 Index. Our aim is to contribute positively to the development of UK and International policy and practice on matters that affect our businesses, including taxation, financial reporting, corporate governance and capital market regulation. Whilst this letter expresses the view of The Hundred Group of Finance Directors as a whole, they are not necessarily those of our individual members or their respective employers.

Our views

We welcome the consultation by the Department for Business Innovation & Skills and the opportunity to respond on these issues. We set out in the Appendix to this letter our detailed comments.

We share the Government's view that successful companies, and the markets in which they raise capital, are vital to the health of the UK economy. In the current economic environment the importance of flexible and liquid capital markets cannot be underestimated: Public equity has been a significant source of finance for UK corporates, because of the comparative ease of access to that financing, notably when credit markets are in flux. That availability was important to a number of companies through the recent recession.

In drawing conclusions and making any recommendations we would encourage the DBIS to be mindful that regulatory responses to financial crises should be both balanced (against the potential increased cost) and effective (in assisting in alleviating recurrence). We strongly believe that a moderate and appropriate response in this instance is necessary. Lessons can, and indeed should, be learned, but in the context of a financial market which has survived the deepest recession of modern times and served most market participants well throughout that period. In our opinion changes and improvements can be made, but fundamental restructuring of corporate governance in the UK is not the answer.

As directors responsible for the management of many of the UK's largest Companies, we must, and do, have long term strategies for value creation, development and growth. Hundred Group members are responsible for the employment of circa 6% of the UK workforce and for 24% of all UK corporation tax. We have a responsibility to our employees and to wider stakeholders to ensure the longevity and prosperity of our institutions. Most of our shareholders understand that this is important too, and support our aims. Many would also recognise that, sometimes, decisions taken may not be beneficial in the short term, but are necessary for longer term growth and development. If well communicated and if management have credibility, any short term earnings impact should be more than offset by the longer term returns potential and hence be appropriately reflected in the Company's share price. It is this balance between long term growth and the short term investment that, in our opinion, has been so vital to the success of UK Plc and has contributed to a vibrant UK stock market.

Having said that, there has been over recent years, a trend towards more short term investment by professional "day traders", "prop desks" and some hedge funds of a "long/ short" nature, some using algorithmic trading approaches. Some of these investors trade the market, not through the equity itself, but through synthetic derivative products such as "contracts for difference", which make beneficial ownership more difficult to establish and upon which no stamp duty is paid. A number of Corporate management teams have also been pressured to take actions (such as taking on excessive debt) which with hindsight, have not proved to be in the longer term interest of all shareholders.

Over the past few years, access to the equity markets has increased in ease and decreased in cost, which has in turn encouraged some of these types of short-term behaviour. On balance we applaud greater equity market access and the depth of liquidity which accompanies it. However, we also believe that it would be appropriate for the Government to review incentives for long-term investment and consider whether a change to fiscal policies could be used to support long-termism. However, we would not support any changes which would increase the costs of short-term investment and consequently increase barriers to investment.

Please feel free to contact me if you wish to discuss our comments on the proposals.

Yours sincerely

R.F

Robin Freestone
The Hundred Group – Investor Relations and Markets Committee

APPENDIX

The Board of Directors

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

Yes, we believe that boards do have a long-term focus.

As set out in the Government's discussion paper, the role of an effective board is to be 'collectively responsible for the long-term success of the company'. The various requirements of a board are established through a number of statutory and other requirements, including the Companies Act 2006, the FRC's Corporate Governance Code and listing regulations. These requirements are not taken lightly. Indeed, the ability to operate effectively would be severely compromised by only taking the short-term view. In order to carry out their responsibilities effectively boards must, and do, develop risk assessments and understand strategies established to mitigate these risks. Without a long term view and strategy this is not possible.

From experience, boards routinely review long term strategies, including items such as acquisitions, growth strategies, cost alignment, strategic exit options, future valuation of businesses and long term financial plans. Depending on the industry involved these projections will be several years forward and involve numerous sensitivities. For all companies decision making will require some long term planning. For any industries with research and development activities, for example, cash inflows can be several years behind current year spending. Indeed, in our discussions with HM Treasury and HMRC, we have repeatedly emphasised the need for a stable taxation platform in the UK as strategic decisions taken in the short term often will not be value generative until the long-term.

We note here as well the importance of non-executive directors in the construction of an effective board. Non-executives have a vital role to play in challenging and developing strategies proposed by executive management, and are also able to bring experiences and best-practice from other positions held.

We have commented previously on the strength of the UK Corporate Governance structure, and reiterate its importance in ensuring that the deepest recession of recent times has not caused the widespread collapse of UK Plc that was initially feared. This has much to do with the strength of our corporate governance – not just in terms of regulation, but the spirit in which this is interpreted and implemented by boards across the UK. The survival of companies has both to do with long-term strategies that permit fluctuations in performance in the near term, but also to do with short-term flexibility to protect cashflows and respond to unprecedented market volatility. In our opinion this is precisely the balanced relationship that our markets, and investors, should reflect.

2. Does the legal framework sufficiently allow the boards of listed companies to access full and up-to-date information on the beneficial ownership of company shares?

As noted in the Government's discussion paper, effective communication with all stakeholders, including shareholders, is a key requirement of good corporate governance. In our response to the consultation on the Future of Narrative Reporting we noted the level of resource dedicated to Investor Relations which demonstrates the ongoing commitment of preparers to clear communication. As we noted, clear, relevant and timely communication of information has been consistently shown to improve investment decisions and boost investor confidence.

However, such efforts can be hampered by an inability to identify beneficial owners of our shares. Under Part 22 of the Companies Act 2006, we are able to require those who have an interest in the company's shares, whether through the equity itself or through a synthetic or derivative product (eg a "contract for difference"), to provide information about themselves. However, this transparency can be significantly reduced when dealing with overseas ownership. In some cases it is not possible for companies to easily identify their shareholders - driven by the number of exchanges, transactions and a lack of international policy on disclosure.

International investment has been a vital and growing source of funds to UK business, which is likely to continue to grow in future as many developing economies open up their investment funds to equity ownership opportunities outside their home countries. Faced with this trend, we would encourage a European or International framework which would support disclosure of ownership at similar thresholds to the current UK requirements.

Shareholders and their role in equity markets

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

We support the Government's view that growing overseas investment has had a positive impact on UK business and supported growth in the UK economy. In particular we welcome and encourage such investment and would be opposed to any restrictions which would impede cross-border investment.

However, this investment has sometimes come at a price of decreased transparency and also a restriction on the ability to regulate investors – as the recent Stewardship code demonstrates UK regulation can only regulate UK investors.

The increase in the rate of turnover of shareholdings can cause some tension when long term strategies to generate long term growth conflict with shareholders who can focus on short term performance and results, for example manifesting in undue focus and attention on quarterly performance ratios and results. In response to this, we continue to ensure that our communications with investors are focused to meet both long-term and short-term needs in order that both are fairly reflected in share prices.

4. What are the most effective forms of engagement?

In our experience the most effective forms of engagement are driven through face to face and direct engagement, supported by effective ongoing communication through our website, publications and investor events.

The most constructive engagement, from our perspective, comes through those relationships where investors understand and are aligned with our long term strategy, and hold a sufficiently deep understanding of our businesses to challenge and engage constructively and objectively.

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

In our experience the behaviour within investment firms varies significantly. We have had experience where, in our opinion, there is insufficient dialogue between investment and corporate governance teams, but also good examples of consistent, coherent behaviour.

6. How important is voting as a form of engagement? What are the benefits and costs of institutional shareholders and fund managers disclosing publically how they have voted?

Voting is a key part of shareholder engagement and an integral part of the Corporate Governance framework.

We cannot comment on the costs to institutional shareholders and fund managers of public disclosure of their voting records. However we can assess the volume and frequency of AGM voting required and would question whether the volume of data then to be disclosed is really an impediment, particularly if restricted to abstentions and negative votes.

We note with some concern the trend for smaller investment funds to outsource to third party "specialist" companies their AGM voting responsibilities and would like to ensure that adequate control is exercised by the ultimate equity holder of how their votes are cast by their agents.

7. Is short-termism in equity markets a problem and, if so, how should it be addressed?
We note the comments made in the Government's discussion paper over the changes in the marketplace which have encouraged short-termism, including a reduction in costs and improvements in technology which have improved access to equity markets. As an overarching principle we strongly support an open market and would be opposed to any measures that would restrict an open market, or indeed a mindset that only long-term behaviour is beneficial to companies. Whilst some long-term behaviour is undoubtedly helpful and more likely to be aligned to the strategy of the company and the board, short-term behaviour can also be constructive and provide vital flexibility and agility to the market. However, the growing trend towards algorithmic trading in equity; through "contracts for difference" and via other short term methods needs careful and ongoing assessment. We note that some synthetic equity products do not attract stamp duty, which would itself appear to incentivise trading through these products.

Given the change in the market, we would consider it appropriate for the Government to consider whether long-term behaviour should be encouraged. We would not support any changes which would increase the costs of investing or changing investments.

8. What action, if any, should be taken to encourage a long-term focus in UK equity investment decisions? What are the benefits and costs of possible actions to encourage longer holding periods?
In our opinion long term behaviour could be appropriately encouraged through a review of fiscal incentives, particularly when compared with those available to holders to debt, rather than equity.

9. Are there agency problems in the investment chain and, if so, how should they be addressed?
We would encourage a review of the investment chain and the nature of fees charged and the incentives, or disincentives, that this may create with respect to underlying trading. In order to encourage a platform whereby investment decisions and recommendations are truly independent there should not be a significant difference in fee earning for investment portfolios which frequently change their underlying investments and those that do not, other than that which is driven by a change in value of the underlying investments.

10. What would be the benefits and costs of more transparency in the role of fund managers, their mandates and their pay?
Whilst we are not primarily placed to comment on the benefits and costs of such a proposal we would note the benefits of increases to the disclosure of the role of directors and their remuneration and the parallel that can be drawn between the two sides of the investment chain.

In improving the transparency of the mandate of directors, how their remuneration is set and what their objectives are, investors were given a clearer basis to make investment decisions. Likewise, when considering who to ask to manage their investments we believe that investors should be able to have a clear understanding of how their managers are remunerated. In our opinion transparency, to an appropriate level of detail, would be a constructive improvement to the investment chain.

Directors' Remuneration

11. What are the main reasons for the increase in directors' remuneration? Are these appropriate?
In order to appropriately consider Director's Remuneration there must be a recognition of the platform on which our members operate. The UK's largest companies operate on a truly international basis. As such, when appointing, rewarding and retaining their Directors, boards understand that there is an element of international competition which must be reflected in salaries. We have seen a number of times that individuals operating at this level are not averse to geographic relocations to take up positions in the company of his/her choice.

As noted in the Government's discussion, CEO pay in the US is considerably higher than that of the UK. Against this background we would not be supportive of any measure which results in the UK being put at a competitive disadvantage in terms of attracting top talent for the most senior management positions.

This is, however, an area where the law of unintended consequences can have a significant impact. It could be observed that the combination of most Corporates wishing to provide at a very least "median pay" plus increased disclosure of directors remuneration has itself been instrumental in driving market prices in this area upwards.

As a representative body for Financial Directors we make no further detailed comments on this issue, but provide our support for undertaking changes to disclosures to improve transparency of remuneration decisions if the Government consider this appropriate.

12. What would be the effect of widening the membership of the remuneration committee on directors' remuneration?
We see little benefit in this proposal, but would reference our answer to question 11.

13. Are shareholders effective in holding companies to account over pay? Are there further areas of pay, e.g. golden parachutes, it would be beneficial to subject to shareholder approval?
Shareholders already have very significant rights in this area which are appropriately exercised.

14. What would be the impact of greater transparency of directors" pay in respect of:

- **linkage between pay and meeting corporate objectives**
- **performance criteria for annual bonus schemes**
- **relationship between directors' pay and employees' pay?**

Given the scale of reporting of directors remuneration already, we would have some difficulty establishing what additional data could usefully be disclosed.

Takeovers
15. Do boards understand the long-term implications of takeovers, and communicate the long-term implications of bids effectively?
Yes, we believe that boards do understand, and fully consider, the long-term implications of takeovers. Indeed, a lack of consideration would be indicative of a board not carrying out its fiduciary duty. In our experience, significant time and focus is given to the long-term strategic 'fit' of the company to be acquired, the future value to be generated and the correlation between this and the amount to be paid.

In our response to the consultation by the Takeover Panel we noted that, in our opinion, guidance over disclosures for offeror's intentions post acquisition could be improved, and suggested that a Practice Statement could be an appropriate way of implementing such a change. We refer Government to the responses made by investors as to whether or not they consider communication has been effective in past cases.

In our letter to the Panel we also reinforced our commitment to a UK market which encourages investment both domestically and from overseas, and the creation of a regulatory environment which permits investment and acquisition in a free market. The UK market has long benefited from investment through takeovers and we would caution against any changes which might place UK companies in a disadvantageous position when considering acquisitions or when being acquired.

16. Should the shareholders of an acquiring company in all cases be invited to vote on takeover bids, and what would be the benefits and costs of this?
In our opinion the current requirements for shareholder voting are already appropriately rated to ensure that voting is required when bids are made on significant transactions. We would be concerned that such a requirement would primarily serve to increase regulation with limited, if any, benefits.

Other
17. Do you have any further comments on issues related to this consultation?
No.