The Hundred Group
of Finance Directors

Investor Relations and Markets Committee

By email: markt-complaw@ec.europa.eu

Mr Michel Barnier
Internal Market and Services Commissioner
European Commission
BERL 10/034
B-1049 Brussels
Belgium

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Dear Sir

Green Paper: The EU corporate governance framework

We are pleased to submit our views on, and our responses to the specific questions posed by the above Green Paper.

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 Commission's consultation and the opportunity to respond on these issues. Our responses and opinions are formed on the back of a period of recession and financial uncertainty. We are pleased to note that, contrary to the view from some quarters, corporate governance has been shown to be effective and resilient in the face of turmoil, in the non financial sector at least.

Our members fully support strong corporate governance principles, which enhance the quality of decision making at the Board level and enable the Directors to carry out their fiduciary duties on behalf of those to whom they are accountable (the shareholders as the legal owners). As well as underpinning the credibility and competitiveness of their companies, good corporate governance benefits other stakeholders and the communities in which our members operate and as such, we endorse measures that promote good Board room behaviours and effective shareholder engagement.

Various provisions are already in place both in the form of EU Directives and national level codes which have resulted in considerable behavioural change over a number of years which in our view removes the need for significant regulatory intervention at the EU level. We do,

however, see the case for less formal endorsement of current provisions by the EU (for example through an EU Recommendation) and we would be supportive of the Commission promoting the development of national codes to govern the behaviours of institutional investors and proxy advisors.

The essence of good governance is in the quality of actual behaviour – not just to comply with codes or regulation – and behaviours are unlikely to be influenced by detailed and prescriptive regulation. Instead, the most appropriate vehicle for ensuring good corporate governance is the promotion of national level codes which are adapted to the local environment, recognising the differing board structures that exist across member states by virtue of national law and custom and practice. Recognising too, that each company has individual circumstances, it is important that any framework allows the flexibility for companies to adapt their procedures to best suit their specific industry and own characteristics and consequently we firmly believe that any code should be supported by a 'comply or explain' framework.

Recent experiences in the UK, where the comply or explain approach has had time to become instilled, have shown that the limited instances of inappropriate and unexplained breaches to good governance behaviour that have occurred have been subject to much adverse media comment and significant shareholder action, which we believe fundamentally vindicates this approach.

In relation to the operation of the Board, we recognise the importance of diversity (including gender balance and appropriate international representation) in improving the quality of decision making and would additionally highlight the critical importance of board committees, in particular the Audit, Remuneration and Nomination Committees which provide a strong structure to reinforce good behaviours. Regular evaluation of those Committees ensures their continuing effectiveness, although we think that the use of external facilitation should be voluntary, recognising that increased cost and availability of credible suppliers might be an issue. We do not agree that measures should be taken to limit the number of directorships held by non executives as strong non executives are hard to find and good ones are very clear as to how much resource they will need to provide to each Board upon which they sit.

We strongly agree that Boards should take full responsibility for the risk appetite of a company and that meaningful disclosure of key risks is important in understanding the link between a company's strategy and performance. We believe that the current EU Directive which requires the disclosure of principal risks and uncertainties is sufficient and any extension to the current requirements will lead to less meaningful disclosures which divert attention from those key risks. We do not believe it is necessary to require the Board to seek external assurance on any disclosures it makes in connection with the effectiveness of risk management arrangements, as to do so should be its own prerogative.

We welcome measures that enhance shareholder engagement, as we see this being the most effective way of holding the Board accountable for its behaviours. Involvement of regulators in checking the quality of explanations provided for non compliance is unlikely to reinforce behavioural change, whilst leading to an increase in the volume of disclosures cluttering the Annual Report, which only serve to obscure the reality of the quality of the governance procedures adopted. Shareholder engagement should be encouraged, yet be voluntary, as its effectiveness would be tempered, or even undermined, by any moves to make it obligatory.

Finally, to the extent that this consultation results in any firm proposals, we would encourage the Commission to undertake a full impact assessment which considers the consequences of any changes in the context of both the current regulatory environment and of any other changes planned.

We set out below our detailed responses to your specific questions. Please feel free to contact me if you wish to discuss the views expressed in this letter.

Yours sincerely

Robin Freestone
Chairman
Hundred Group – Investor Relations & Markets Committee

General questions

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

In our view, there is no need to legislate different regimes for SMEs if an appropriate comply or explain framework is maintained across all member states. Comply or explain is by definition proportionate as it caters for the different characteristics of a company, including its size. Introducing different regimes for different sizes of entities introduces unnecessary complexity and reduces a company's flexibility to adapt its disclosures to its particular circumstances. This is likely to lead to less meaningful and uninformative boiler plate disclosures without necessarily leading to the positive behavioural change that underlies the rationale for introducing governance measures.

(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 do not believe there is a case for introducing measures for unlisted companies. The shareholder base of these companies tends to be significantly more concentrated, with lower levels of diversity and consequently there is less of a need to ensure the protection of shareholder interests. Company law already provides for adequate shareholder protection and further measures risk adding to the regulatory burden which already risks stifling the competitiveness and entrepreneurship of smaller unlisted companies.

That is not to say that good governance is the preserve of listed companies. To the extent there is shareholder or public interest in the governance standards of an unlisted company, the company can voluntarily adapt its governance standards to respond to this market demand.

(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?

In a number of member states, alternative board structures exist which already ensure this separation. Clearly separating the role of the Chairman and Chief Executive does make for good governance and indeed for many companies it enhances performance by clarifying roles and responsibilities and assisting the smooth operation of the Board. However we recognise that there are circumstances where it is appropriate for the same individual to perform both roles, therefore it is more appropriate for this separation to be achieved through a comply or explain framework, than through regulation.

(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?

Our members recognise that the performance of the Board is enhanced by recruiting individuals with a mix of skills and who come from a diverse range of backgrounds. The requirements will vary considerably according to the characteristics of the company therefore

a ‘one size fits all’ approach is unlikely to be capable of addressing diversity without becoming overly complex in its implementation.

We support the Nomination Committee of the Board taking responsibility for ensuring that the appropriate board diversity is maintained and promoted, having regard to a national code suited to the local environment. Compliance with the provisions of the code would be most appropriately reported on a comply or explain basis.

(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?

It is best practice for companies to have a diversity policy. We would caution against mandating its disclosure in the Annual Report, as alternative means of publishing this information are likely to be more suitable. The Annual Report is already cluttered with additional disclosure requirements that have been bolted on over a number of years in response to specific issues, resulting in the presentation of extensive information in a manner that lacks clarity and coherence.

In our view, a company should be able to adapt its disclosures so as to present in the most informative manner, information that is important in enabling an understanding its strategy, its risks and its performance. This will result in the disclosure of a diversity policy in the Annual Report if it is critically important to this understanding.

As noted in our response to question four, a company’s diversity policy is likely to vary considerably depending on its characteristics and any disclosure framework should recognise that a ‘one size fits all’ approach is unlikely to result in the presentation of higher quality, more relevant information in a manner most suited to its audience.

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

As noted in our response to question four, company performance is enhanced by ensuring the appropriate diversity amongst the Board of Directors. Gender balance is an important part of any diversity policy, but it is important to recognise that it is not the only consideration and focussing solely on this issue risks missing other important aspects of board room balance.

Any involvement from the authorities in matters of diversity should be limited to indicating broad targets to which companies may aspire. Since a diversity policy should be adapted to a company’s particular circumstances, compliance with this measure is best reported on a comply or explain basis.

(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?

No. For a Board to operate to the best of its ability, it needs to ensure all of its members devote the appropriate amount of time to a range of activities, including preparation for and attendance at Board meetings. A regulation to ensure that this is the case is a blunt instrument, which either neglects the fact that different board appointments carry with them a range of time commitments, or is forced to address this issue through a complex set of rules which will be difficult to monitor or enforce in practice.

We strongly believe that it is for the individual Board member to determine, and the Nomination Committee to judge, whether he or she is in a position to fulfil the appropriate board level responsibilities. It would not be appropriate to regulate in this area at any level.

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

It has long been good practice for listed companies to undertake a periodic board level evaluation and indeed in the UK, using external facilitation to achieve this has been a recommendation of the national code since 2010.

In determining whether to undertake an externally facilitated evaluation, a Board will typically evaluate the cost and availability of credible external facilitators and initiate an evaluation if the resulting benefits are likely to be greater. A board may choose instead to undertake an internally facilitated evaluation if it feels this is more appropriate in the circumstances. We therefore support an external evaluation being a voluntary process, reported on a comply or explain basis.

We strongly agree with the Commission that a degree of confidentiality should be maintained. We would caution against mandating the disclosure of an evaluation statement, even if it is limited to a description of the review process. In our experience, descriptions of process usually result in boiler plate disclosures which only serve to increase clutter in the Annual Report without providing useful information.

(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, and indeed our members already present this information in line with our national code.

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

Involvement in senior level remuneration is an important part of shareholder engagement. Amongst our members, Remuneration Committees seek to take into account the views of major shareholders when formulating remuneration policies. A vote on the remuneration report is one element, but not the only element, of shareholder engagement in setting Directors pay.

Directors remuneration arrangements are often complex, involving multi year provisions to introduce an element of incentivisation beyond the short term, so whilst a vote by shareholders in important, it should be advisory in nature, in order not to disrupt the contractual arrangements currently in place.

(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 strongly believe that setting the risk appetite and regularly reviewing the risk register is one of the key responsibilities of the Board, and amongst our members is often achieved through the operation of the Risk Committee of the Board. The meaningful reporting of

principal risks is a key part of the narrative section of the Annual Report as it gives the Directors the opportunity to link the company's overall strategy to its historical performance.

EU Directives already require the disclosure of principal risks and uncertainties, and we support this approach. This requirement already captures the disclosure of societal risks where these are viewed by the Board as being important in understanding the company's strategy and performance. We do not believe there is merit in extending the existing requirements as the result will be the disclosure of less material risks which do not enhance the reader's understanding of the Company, whilst cluttering the Annual Report with uninformative disclosures.

(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?

As outlined in our response to question 11, this is a key responsibility of the Board, having regard to the characteristics of the company. We do not believe it is necessary for the Board to seek external assurance on any disclosures it makes in connection with the effectiveness of risk management arrangements.

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.

Regulations concerning taxation, solvency and liquidity have a significant impact on the decisions of long term investors, however trading is increasingly straddling international boundaries, so the relative impact of European legal rules is diminishing. Measures should only be taken at the EU level if they are not detrimental to the relative competitiveness of EU companies and the effectiveness of EU trading markets.

(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?

We would support the Commission in promoting national level, voluntary codes (such as the UK Stewardship code) which govern the behaviours of institutional investors.

(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?

Please see our response to question 14.

(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?

Please see our response to question 14.

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

We do not believe that additional regulation would serve to improve shareholder cooperation. However we observe positive behavioural changes being driven by voluntary 'stewardship' codes which recommend best practice in the relationship between institutional investors and management. In our view, the EU should support the development of national stewardship codes as a way of effecting improved shareholder engagement.

(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?

Our members observe an increase in the influence of proxy advisors and at the same time, a divergence in the quality of their output. We support the development of a national voluntary code which includes measures to enhance transparency and introduces a level of accountability to the companies most impacted by the recommendations proxy advisors make. In our view, adopting such a code and reporting on a comply or explain basis will be the most effective way of changing behaviours in this sector.

(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?

As outlined in our response to question 18, we do not believe that it is appropriate to introduce legislative measures, but we would support the Commission in promoting a national voluntary code.

(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 support Companies having the legal right to know the identification of its shareholders and consequently we welcome measures that would facilitate this.

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

No response provided.

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

No response provided.

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

We strongly believe that this is a matter best determined by a Company's Remuneration Committee having regard to the Company's overall strategy and individual circumstances. We do not see a role for national or international regulation.

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?

One of the key pillars supporting the comply or explain framework is the quality of explanations given for non compliance. The best explanations are those which give a description of the reason for the non compliance which is specific to the Company's current circumstances and relevant to the part of the code under consideration. It is also important to provide a description of the alternative solution adopted and the reasons why this addresses the particular aspect of the code.

However we recognise that there are circumstances where there is no alternative solution (e.g. the Company simply does not comply) and consequently it would be inappropriate to mandate the requirement to disclose the alternative solution.

(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 that there is a role for the authorities here. In particular we would be very concerned if the monitoring bodies were to be given a remit which allowed them to judge the appropriateness of the governance policies and procedures adopted by the Board.

In our view, this is best done by shareholders on the basis of the regular dialogue they maintain with management, having regard to the explanations provided in the Annual Report. Engagement by shareholders, particularly institutional ones, serves to drive the right management behaviours, whereas the response of management to regulatory oversight is likely to be more disclosure providing less informative clutter which obscures the reality of the quality of the governance procedures adopted.

The key to improving the quality of the explanations provided by management is better shareholder engagement, which in our view is best achieved by a voluntary stewardship code of practice governing the relationship between the shareholder and the company.

We also have concerns over the likely cost and additional bureaucracy that the creation of a new monitoring body would involve at a time when there are already strains on public budgets.