Confederation of British Industry
Centre Point
103 New Oxford Street
London WC1A 1DU
Telephone 071-379 7400
Facsimile 071-240 1578
Telex 21332

Director-General
John M M Banham

Deputy Director-General and Secretary
Maurice Hunt

CBI

CAD-01017

CONFIDENTIAL

PC 26 91

TO THE PRESIDENT'S COMMITTEE FOR THE MEETING ON 3 JUNE 1991

CORPORATE GOVERNANCE

1 A number of initiatives under this broad heading are now in train. They are reported to the President's Steering Group on Long-Termism and Corporate Governance. All are related in one way or another to the objective of improving the relationship between companies and their shareholders, especially the institutions.

2 Two of the more significant ones have come from City associations, the Institutional Shareholders' Committee (ISC - a body composed of investment managers representing pension funds, insurance companies, unit trusts and investment trusts) and the Association of British Insurers (ABI). These two initiatives are at root an attempt to codify the attitudes of institutional investors towards companies on a number of key issues. Whilst it would be wrong to think that investment managers in the institutions all accept every word of the documents they have issued and will adopt or support them in every detail, it is likely that the texts will influence how they cast their votes and more generally conduct their relationships with boards of listed companies. The CBI Companies Committee has the responsibility for defining the CBI's position on these questions and would welcome the views of members before bringing a paper to the CBI Council.

THE ROLE AND DUTIES OF DIRECTORS

3 After consultation, the ISC published a Statement of Best Practice on this issue in mid-April. It is being sent to the chairmen of listed companies, inviting them to accept its broad thrust and to depart from its provisions only in special circumstances. The ISC statement contains the following main recommendations:

- The roles of chairman and chief executive should not normally be combined.
- Articles of Incorporation should provide for a maximum as well as a minimum number of directors.
- Non-executive directors should not, under normal circumstances, be offered participation in share option schemes nor should they be entitled to any compensation for loss of office.
- Non-executive directors should hold other directorships in the same industry only with the approval of the board.
- Service contracts should be approved by a compensation committee.
- The compensation committee should be appointed by the board, consisting solely or mainly of non-executive directors; its composition should be disclosed in the annual report.
- Brief biographical details of each director should be set out in the annual report showing the director's relevant experience and suitability.

4 On the advice of the Companies Committee and after discussion at the March meeting of the President's Committee, the CBI has welcomed this Statement as a contribution to the corporate governance debate, adding that, whilst there is a place for a statement of good practice, such a benchmark would not automatically ensure success or prevent failure: some well-managed and successful companies do not adhere to all or even most of the ISC recommendations; while some companies which adhered to them all have experienced trading difficulties.

5 The CBI has also warned of the potential disadvantages which could result from proposals which suggest a two-tier board structure. There is a clear risk of this where one group of directors is prescribed a role which consists of having a supervisory or monitoring function over others. Such a concept (with or without employee representation on the board) appears in the Commission's proposals for a Fifth Company Law Directive and a European Company Statute. The CBI believes that structures of this kind are not compatible with the UK's unitary board system.

6 We hope that members of the President's Committee would support this position and urge that it should be deployed where relevant in discussions with institutional investors.

THE RESPONSIBILITIES OF INSTITUTIONAL SHAREHOLDERS

7 The remainder of this paper invites the President's Committee to look at some issues the CBI needs to address in framing a response to the ABI discussion document (summary attached) on the role of institutional shareholders. The ABI paper will most probably go on to the ISC who will develop it and issue it as its own.

8 The ABI paper proposes that institutional shareholders should take a more active role in the companies in which they invest and that communication should exceed formal mechanisms, such as the receipt of regular reports and accounts and attending annual meetings. The paper alludes to the difficulties of communicating business plans which may contain price-sensitive information and the possibility of becoming "insiders" under current proposals to enact the EC Directive on Insider Dealing into UK law (a concern that the CBI has put to the DTI).

9 The need for improved communication between the management of a company and its owners has been a strong CBI message in recent years and this aspect of the paper is likely to be well received by the institutions and corporate sector alike.

10 Potentially, institutional shareholders have the ability to exercise a decisive influence on the boards of directors and should be in a position to ensure that the board fulfils its role. In practice, however, institutions have not claimed to be expert in the management of companies but rather in the selection and management of investments. They consider that their primary responsibility, which is again stated in the ABI paper, is to their own policyholders.

11 One major problem perceived in this situation is that a significant proportion of the investment funds of institutional shareholders is indexed; in other words, investment is made in a basket of shares representing a cross section of the market. This ensures that the investment manager runs little risk of his fund under-performing against the market. In other words, their portfolio of investments is often so broad that they cannot be knowledgeable about the affairs of each company in which they invest.

* * *

12 Bearing in mind the CBI response to the ISC paper 'The Role and Duties of Directors' (see paragraphs 4 and 5 above) members' views would be welcome on the following:

a Should the CBI generally support the ABI document;

b The paper states that the institutions' responsibilities as shareholders are subject to overriding obligations to those for whom they invest. Although the legal obligation may be clear, the problem, if it exists, may be in how they interpret that objective. For example, members may wish to comment on the paper's statement that in the case of a cash takeover bid it may be that the institutions' fiduciary responsibilities cannot be ignored.

c The paper fails to mention both the quality and quantity of institutional analysts. Should the CBI make the point that there is a need for an adequate number of ably trained and competent analysts if institutions are to be in a position to take a 'more active role in the companies in which they invest'. Will institutions be willing and able to support the overhead costs involved?

d It is proposed that institutional investors will not wish to receive price-sensitive information and will accept it on an exceptional basis as the price of a long-term relationship. Should the CBI question whether this is a reasonable position? In terms of developing and strengthening long-term relationships should institutions be more willing to become 'insiders'? This is made more delicate because of potential difficulties under impending EC law of a proposed wider definition of "price-sensitive information" and the increasing risk of normal business activity falling within this category.

e Are there any other points that the CBI should make?

SUMMARY OF ABI DISCUSSION DOCUMENT **ATTACHMENT**

The nine principles of good practice for institutional shareholders are:

1. Institutional investors should encourage regular, systematic contact at senior executive level for the purposes of an exchange of views and information on strategy, performance, board membership and quality of management.

2. Institutional investors will not wish to receive price sensitive information as a result of such dialogue but will accept it on an exceptional basis as the price of a long-term relationship, although this may require that they suspend their ability to deal in the shares.

3. Institutional investors are opposed to the creation of equity shares which do not carry full voting rights.

4. Institutional investors should support Boards by a positive use of voting rights, unless they have good (and stated) reasons for doing otherwise.

5. Institutional investors should take a positive interest in the composition of Boards of Directors, with particular reference to:

   5.1 Concentrations of decision-making power not formally constrained by checks and balances appropriate to the particular company.

   5.2 The appointment of a core of non-executives of appropriate calibre, experience and independence.

6. Institutional investors support the appointment of Remuneration and Audit Committees.

7. Institutional investors encourage disclosure of the relevant details of directors' contracts.

More.....

8. In takeover situations institutional investors will consider all offers on their merits and will not commit themselves to a particular course of action until they have reviewed the best and most up-to-date information available.

9. In all investment decision-making institutional investors have a fiduciary responsibility to those on whose behalf they are investing, which must override other considerations.

- E N D S -

<u>Note for editors</u>

A copy of the ABI discussion paper "The Responsibilities of Institutional Investors" is attached.