

Ms Claire Bury
Acting Director of Capital & Companies and Head of Unit - F2
European Commission
DG Internal Market & Services
Rue de Spa/Spastraat, 2
B-1000 Bruxelles/Brussel
Belgium

18th July 2011

Dear Ms Bury,

Green Paper, the EU corporate governance framework - COM(2011) 164

Charles Cronin, CFA and Dr John Mellor welcome the opportunity to comment on the European Commission's ("the Commission") Green Paper on the EU corporate governance framework and take great pleasure in submitting their joint response, as citizens of the European Union.

Executive Summary

Whilst we believe that Europe has generally good standards of corporate governance, we agree there is room for improvement. We suggest the Commission takes particular interest in the role that shareholders have in bringing companies to account, price discovery and the efficient allocation of capital. We see a link between a low interest in corporate governance and engagement by investors and the development of short term behaviour in the capital markets.

Given that institutional investors account for most of the ownership of the capital markets it would seem logical to direct public policy towards them to correct deficiencies in market behaviour. However, we suggest that this assumption is incorrect. We are convinced that asset owners (trustees) are the weakest link in the chain of principal-agent relationships between the ultimate investors and issuers. We believe that asset owners are too narrowly defining the concept and application of their fiduciary duty. Not because of legal constraints, but due to lack of investment knowledge; they prefer to follow precedent, practice and sometimes poor advice. Hence we suggest that the Commission targets asset owners, rather than asset managers in its quest to reverse short termist behaviour in the European capital markets.

The asset owners supported by advisers design and award the investment mandates that govern the management of the fund. However many asset owners, particularly the trustees of pension funds, have very limited investment experience. Faced with huge responsibilities they delegate their functions to external agents. We feel that through this delegation the interests of the ultimate investors are not given sufficient attention, and become several times removed down the principal-agent investment chain. For example a member of pension scheme may have a relationship with that scheme that exceeds 60 years. Contrast this long investment horizon, with the common practice to measure the fund's performance quarterly to a benchmark over a rolling three to five year horizon. There is a clear mismatch between the interests of the scheme member and how his fund is managed.

The secondary effects of quarterly performance measurement to a benchmark cascade into market by encouraging short termist behaviour. Even active managers need to own a portfolio that closely matches the profile of the benchmark in order to control for tracking error risk. This may mean they own a portfolio containing many hundreds of securities and therefore they are unable to conduct fundamental analysis on their investments, having little time for thorough analysis, corporate governance and constructive engagement with management as thoughtful owners. These managers ability to add value to their clients is restricted to adopting relative trading strategies, which neither adds to the process of price discovery nor to the efficient allocation of capital. With markets dominated by passive managers and closet passive managers we are concerned that the market's ability to bring issuers to account and efficiently price assets has become impaired.

To address these issues we recommend that there is a thorough investigation into fiduciary role of trustees, with the aim of clarifying the relationship between the investment horizon of scheme members (their needs) and that of their fund. We recommend that all asset owner boards should contain at least one compensated professional investor, to raise professional investment capability and to balance the interests of scheme members against those of their agents. It follows that asset owners should direct their agents (the asset managers) to manage portfolios in the interests of ultimate investors, mindful of their investment horizon and compensate their agents with these interests in mind. This change in perspective is likely to reduce interest in short term benchmark tracking and promote investment in funds which are able to invest with a long term perspective. These long term perspective funds would be able to fulfil their obligations as owners, promoting good governance (internalising the work of proxy advisers) and the efficient allocation of capital.

We are strong advocates of increased transparency and the comply or explain principle of corporate governance, because of its flexibility to address the circumstances of each issuer. However, we recognise that the model fails to function unless there are a sufficient number of shareholders who are prepared to enforce its application. Our responses to this consultation are coloured by the hope that current investment practices will change enabling institutional shareholders to hold issuers to account. Hence generally we do not support legislative measures to address specific issues of governance. We stress that with access to many thousands of publically traded securities, European investors have plenty of choice to where they allocate their capital. Therefore we do not see need for special measures for smaller companies or for minority shareholders where dominant shareholders are present. Where poor governance and discriminatory practices are present investors should demand a discount, which raises the issuer's cost of capital.

There are five exceptions where we would support legislative intervention: (i) requiring that shareholders have a binding vote on remuneration of the company's directors, (ii) curbing the scope of related party transactions, (iii) that issuers on junior markets such as London's Alternative Investment Market are made subject to codes of governance, (iv) that where companies depart from the comply part of a corporate governance code that they should provide investors with an explanation on why they have departed from that code and what measures they have put in place to uphold the governance of their business, and (v) to empower monitoring bodies to verify the quality of these disclosures and to include the issuer's corporate governance statement as part of regulated information.

Our response to the Consultation's specific questions is set out below. Please do not hesitate to contact us, should you wish to discuss any of the points raised.

Yours faithfully,



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About the authors

Charles Cronin, CFA - is the former head of standards and financial market integrity for EMEA at CFA Institute. He has over 22 years of experience as a financial markets practitioner, having held a variety of positions on both the buy and sell-sides of the market. He is also a member of the EIOPA occupational pension funds stakeholder group.

Dr John Mellor MBA is founder and executive director of Foundation for Governance Research and Education and a Visiting Professor in Governance at Bristol Business School, UK. A former international banker with Citigroup, he has been engaged in the field of corporate governance for 20 years as adviser to government and companies, and as lecturer and author.

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.*

We do not believe that other governance measures are required which take account of issuer size. It would be close to impossible to tailor a legislative regime that would fairly serve the needs and circumstances of all issuers by size. So far as codes are concerned, what matters is their thoughtful application by issuers and evaluation of this application by shareholders taking into account individual issuer circumstances. We are convinced that the flexibility of a 'comply or explain' regime, where there is a bilateral pact between the issuer and shareholders on the issuer's governance, is the most practical path to good governance. That is not to say that 'comply or explain' regime works well in all cases, indeed its effectiveness depends on shareholders thoughtfully using their rights. Our report on stewardship confirms that in the majority of cases shareholders are not effectively using their rights to make the management of issuers accountable for their actions¹. We comment on this issue later in our response.

¹ An investigation into Stewardship - Engagement between investors and public companies: Impediments and their resolution

http://www.eurocapitalmarkets.org/system/files/Stewardship_Project_Report.pdf

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 recommend the development of a pan-European governance code for non-listed companies. However, we do recommend that companies listed on junior markets such as London's Alternative Investment Market (AIM) are subject to compliance with a code of governance. Currently AIM market rules do not require these companies to adhere to the UK code, although the AIM market is a public forum for raising capital.

We do not see the development of a corporate governance code for unlisted companies as a crucial facet of the Agenda 2020 growth strategy. Smaller companies tend to be under owner manager control and in medium sized companies the founder tends to take an active interest in the management of the business. Hence there is a close alignment of interests between the owners and managers, resulting in governance structures which are good by default. While there may be some very large unlisted companies in existence, it is likely that few will remain unlisted in the long-term. For instance those who were originally in the public market that were acquired by private equity partnerships will invariably return to the public markets. The same applies for small companies that grow to become successful larger enterprises.

The underlying reason for this behaviour is that investors pay a substantial premium for securities traded on public markets. This is because public markets provide liquidity which reduces investor risk. Hence public markets provide the cheapest source of capital or the best venue in which to transfer ownership. Many studies have examined the value discount faced by investors and issuers in non-listed securities. A comprehensive summary of the American studies can be found in "Valuing a business: The Analysis of Closely Held Companies", 3rd Edition McGraw Hill © 1995², which suggests the discount ranges between 30% and 60%, with a mean value in excess of 40%. Because of the strong financial incentives for unlisted companies to go public we believe the Commission should focus its attention on the listed securities rather than the unlisted market.

We recognise there is a concern that private equity partnerships may acquire public companies and instigate asset stripping strategies, which enhance short term value to the detriment of society's longer term interests. However the financial environment that created these opportunities seems to have passed, for the time being, as leverage finance is now much harder to obtain. The restrictions on leveraged credit are likely to continue as the banking sector shifts from crisis to compliance with the new prudential regulatory framework. Hence we believe this societal concern has for the moment diminished.

Board 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?

² Chapter 15, p331-365 - Discounts for Lack of Marketability

We do not recommend making mandatory the separation of the duties of the chairperson and chief executive. However, clarification of their respective functions is necessary for the effective functioning of a board. Circumstances may arise, in smaller companies for example, where a combination of the roles in the same person is appropriate, provided this is justified and the separate roles are clearly defined.

4. *Should the 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 support the goal of greater specificity on recruitment policies and its application at international level, but recommend the detail should reside at national level.

The composition of the board is ultimately the responsibility of the chairman following agreement on each job specification by the whole board, typically advised by the board nomination committee on the basis of careful consideration of the skills required and personality traits to complement and enhance the qualities of the existing team. Previous board experience should not necessarily be a key selection criteria, as this can significantly limit the pool of available talent leading to board group think and multiple directorships. Neither of these are in the interests of shareholders. So far as shareholders are concerned, reflecting their ownership responsibilities, we recommend their greater involvement in board appointments.

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 we agree; companies should have a diversity policy, which is open to shareholder scrutiny. Companies should report to shareholders on how they apply that diversity policy in the annual report and when they announce the appointment of directors. A more thoughtful approach to recruitment of senior appointments helps improve corporate performance. A diversity policy is an integral part of an effective recruitment strategy.

The objectives of the diversity policy should be to recruit and retain key people in the organisation, so that the board can draw from a pool of technical and generalist experience with complimentary personality traits and preferred working methods. A successful board requires all members to contribute to the policy making process as well as being able to challenge their colleagues during that process.

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

No we do not believe that introducing a gender balance requirement will further women's equality nor improve board performance. The temptation to tick the gender recruitment box will be overwhelming. Enlightened boards should make use of all aspects of diversity to increase board performance. It is certainly behoves companies to monitor applicants to posts for gender balance, professional

and international diversity and to reflect upon their diversity policy if they are not attracting a broad enough pool of talent, or if their selection process only favours particular types of individual.

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?*

Yes we agree with the spirit of the measure, but believe setting a ceiling on the number of appointments would not necessarily achieve the desired goal. Hence our approach is to open up to greater scrutiny the board appointment process. The issue concerns the amount of time required of a candidate non-executive director to effectively serve the designated role. We would recommend that this is specified in the job description and the board selection committee should assess candidates for their ability to commit the time required. Ahead of appointments that are subject to shareholder approval, the selection committee, in recommending a candidate, should specify the time requirement and justify the candidate's capacity to meet this requirement.

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

We recommend that an external evaluation of the board be conducted on a three yearly cycle by a professional consultant and facilitator, and that internal evaluations take place on an annual basis. Both evaluations should address the effectiveness of the board as a whole, as well as that of individual directors. An external evaluation has the benefit of objectivity. Whilst responsibility for evaluation of the board as a whole and of the individual directors lies with the chairman, responsibility for evaluating the chairman should lie with non-executive directors. Appropriate reports should be made available to shareholders, but, as a matter of course, shareholders should be vigilant in ascertaining the effectiveness of boards and individual members as a part of their responsibility for holding boards to account.

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, transparency is necessary for shareholders and other stakeholders.

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

Yes, the board are the agents of the shareholders. Shareholders should be able to see how much their agents cost, to evaluate their worth and vote accordingly. Experience in the UK suggests that an advisory vote (or, say-on-pay) has not been as effective as expected, indicating a need to increase shareholder rights by making the shareholder vote on the remuneration report binding on the company.

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 societal risks?*

Yes we agree; the return that a company earns is directly related to its ability to manage the risks associated with its operation. Risk management is a key aspect of the value and wealth created by an enterprise. As the agents of shareholders the board must be accountable and transparent to them for the assessment and evaluation of the risks faced by the enterprise. The management should have an obligation to discuss the specific risks of the business (not boilerplate disclosures) so that investors can understand how these risks are managed internally, mitigated through third parties or avoided.

The board should include societal risks within its strategic plan, we are concerned and this is related to short termism that societal risks are not given the attention they deserve. Where the probability of an adverse event is small, there may be a tendency by executive management to over discount the event's implications on the business and its occurrence during their tenure. If such an adverse event were to occur, they may forfeit their position in the organisation, but their general level of wealth may well remain unchanged, unless a significant part of their wealth is held in the company's shares. This defines a risk asymmetry for investors, when a major environmental and social issue arises, the costs of compensating the victims for the harm done to them is one issue, the other is reputational damage and possible ensuing regulation that may severely compromise the company's ability to function in the future. The cost of a failure in risk management on such issues is disproportionately felt by investors; hence higher levels of management disclosure would be of benefit to investors.

Another issue to consider is that the ultimate investors are part of society; hence the actions of issuer management either directly or indirectly affect their current and future wellbeing. Therefore their agents: the asset owners and fund managers, ought to be able to evaluate the issuer's risks in order to best serve the interests of the ultimate owners.

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 we believe that business risks need to be evaluated by the board to identify where the company can add value by taking responsibility for that risk, where the risk needs to be transferred, because a third party can better manage that risk, or avoided where the risk can neither be managed nor mitigated.

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.

No comment.

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 investor's portfolios?

We agree with the Commission that short termism is a material factor behind asset mispricing and would add that this mispricing leads to the inefficient allocation of capital, lower economic growth and employment opportunity. We do not see the

source of the problem as lying directly with the asset managers, but with the investment mandates provided to them by the asset owners. Our report on investor engagement with public companies: impediments and their resolution, identifies the asset owners as the weakest link in the principal-agent chain from the ultimate investors to issuers³. The asset owners or trustees of collective schemes such as pension plans are frequently selected from the staff of the employer who has sponsored the scheme. Aside from a few exceptions most of these trustees have very limited investment experience. Faced with the huge sums of money under their fiduciary care, they recognise their limitations and delegate the responsibility for managing those assets to external experts. We feel that through this delegation the interests of scheme members are not given sufficient attention, and become several times removed through the ensuing principal-agent investment chain. *To help resolve this problem we would recommend that at least one member of the trustee board must be a former or practicing professional investor. This should be compensated position.*

A key risk management tool of these collective schemes is to measure the performance of the portfolio on a quarterly basis to an agreed benchmark or index. Whilst the investment horizon of the scheme members could exceed sixty years⁴, asset owners evaluate the performance of portfolios quarterly over a rolling three to five year horizon. This immediately establishes a mismatch between the investment horizon of the portfolio and its beneficiaries. It is worth considering that the fund needs to hold assets that preserve the real value of the scheme members contributions and provide an income stream for a decent retirement. In the case of equity investments the simplest form of matching of the scheme member's liabilities is to hold assets in the companies that provide the goods and services that the scheme member will consume in retirement. Hence the portfolio's investment horizon is very long and needs to anticipate the needs of scheme members in their retirement. *To correct this mismatch the trustees of collective savings schemes need to consider not only the type of assets that the portfolio should contain but also the appropriateness of the portfolio performance monitoring system as it applies to the scheme members investment horizon.*

A secondary effect of evaluating portfolio performance to a benchmark on a quarterly basis is the behavioural effect it has on fund managers. The market for fund manager services is divided between active and passive services. As active managers compete for business with passive managers they are acutely aware of benchmark tracking error in their quarterly returns. In order to reduce tracking error risk the active fund manager will mimic the benchmark which often results in portfolios that contain over two hundred stocks. This makes it nearly impossible for the fund manager to gain a detailed insight of the business offering/strategy of the underlying investments in the portfolio or indeed evaluate their performance against that strategy. Active fund managers will seek to add value by making trades, which intend to exploit short term relative pricing opportunities. While this provides the useful service of adding liquidity to the markets; neither passive management nor relative active management contribute to price discovery or the efficient allocation of capital. Indeed such investment strategies may be pro-

³ An investigation into Stewardship - Engagement between investors and public companies: Impediments and their resolution

http://www.eurocapitalmarkets.org/system/files/Stewardship_Project_Report.pdf

⁴ A scheme member beginning his working career at the age of 20 could continue to contribute to the scheme as an employee for 40 years, and then draw down on the scheme for 20 years or more years of retirement.

cyclical, as market prices will be driven by arbitrary flows of funds rather than the pursuit of intrinsic value.

Our report has clearly identified a shortfall in the quality of engagement between UK institutional investors and issuers. With a few exceptions, engagement is confined to short term financial considerations rather than to the long term value creation of the business. This short term perspective is consistent with relative trading strategies described above. *We believe there is a clear need to define the concept of a stewardship fund or such equivalent named fund at a European level, to serve the interests of investors who have a long term perspective⁵. Section 7.4.4 on page 29 of our report outlines the structure and investment philosophy behind such a fund. Once defined as a concept, the Commission could facilitate their recognition so that asset owners are readily able to identify these investment strategies of these funds. This recognition could extend beyond the institutional pension fund sector to include the retail sector through flagging in the Key Investor Information Document for UCITS. This would enable retail investors to recognise this type of fund and consider its suitability in their investment portfolio.*

The remuneration of asset managers, particularly with regard to performance related pay is an additional consideration. Section 4.2.3 C (iv) on page 20 of our report discusses fund management compensation structures. We believe there is too much focus on the fund manager's annual performance, which is generally not consistent with the fund's investment horizon. *A best practice solution would be to compensate fund manager bonus payments on deferred measures controlled by longer term fund performance and other factors such as client retention.*

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 investee companies? If so, how?

We do not recommend this proposal for resolving the issues of issuer accountability, price discovery and the efficient allocation of capital. It is the asset owner's concept of fiduciary duty that needs investigation. Too many asset owners believe that their fiduciary duty is limited to a series of short term risk adjusted returns (quarterly performance monitoring). The asset owners approve the specification of the investment mandate and award those mandates. Whilst fund managers are not purely passive in the process of designing the specification of the investment mandate, their duty is to execute the instructions of the asset owners. We believe that the restricted interpretation of fiduciary duty by asset owners has created many of the problems that the Commission is seeking to address through this Green Paper. The solution comes through an investigation into fiduciary duty, not only with asset owners but along the principal-agent investment chain, with the purpose of clarifying obligations of each of the parties involved in the chain. Our report recommends that clarifying fiduciary duty through an equivalent Section 172 from the UK Companies Act 2006 would realign the behaviour of asset owners towards the desired outcome. We believe there is the opportunity to insert a similar clause in Section 18 'Investment Rules' of the IORP directive, currently under revision. Similar clauses could be inserted into

⁵ The authors are conscious that the term 'stewardship' does not readily translate across Europe.

investment rules other directives to cover collective vehicles outside the scope of the IORP directive.

16. Should EU rules require a certain independence of 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?

Conflicts of interest concerning interlinking business interests between asset managers and investment banks, asset managers and their clients and senior asset manager staff who have directorships in listed companies are a real concern and in all cases should be avoided if at all possible.

The condition where an investment bank and a fund manager have a common parent creates a clear conflict. The fund manager can become the distribution arm of the investment bank and benefit from underwriting revenues made possible through client assets; benefits which are not shared with the client. The best environment is where the fund management firm is an independent entity. Where this is not possible, clients and potential clients should be made aware of these conflicts and told how the asset manager has put measures in place to prevent the adverse consequences of these conflicts from affecting the client's best interests.

Perhaps the most difficult conflict to overcome is where the fund manager's client is an issuer who the fund manager's investment analysts believe is an unattractive investment. This conflict is particularly acute where a positive re-rating of the stock can only be achieved through the reversal of an entrenched position of the issuer's management. Naturally it is in the interest of the fund management firm to have a good relationship with the client, which is further underscored by the operating leverage of the fund management business model. Therefore it is difficult to reconcile candid discussion by the investment team with the client's management and indeed voting against the board where this relationship exists. Perhaps the most effective way of preventing this conflict is to completely separate the management of the investment scheme from the influence of the sponsoring firm.

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

No comment

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 agree and would add that the interrelationship of some proxy advisers with issuers and investors to some extent parallels the relationship between credit rating agencies with banks and users, prior to the introduction of the EU regulation. Therefore we would support measures that increase proxy adviser transparency, particularly with reference to analytical methods and how conflicts of interest are avoided or managed.

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?

No we do not believe this is currently necessary. If our report's recommendations with respect to asset owner behaviour become effective, our hope is that changes in asset owner behaviour will force changes in fund management practices. Consequently fund managers will take a much more active interest in their investments, thereby internalising much of the existing work carried out by proxy advisers.

20. Do you see a need for 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 it would be beneficial for issuers to have more readily available access to who owned their shares. We understand that many issuers employ agents to perform this service, and that it can take days or weeks to complete. This is unsatisfactory particularly when the information can become rapidly redundant where trading turnover is high in the issuer's securities.

A possible solution to this problem is to allot each investor with a unique identification code, which would be attached to series of codes disclosing the investor's: depository, custodian, fund manager, adviser or broker. Issuers would then be able to rapidly identify their shareholders by making inquiries through depositories and custodians. In form this identification code would have similar qualities to the ISBN code used to identify books.

Alternatively, though less comprehensive, regulation to lower the threshold where investors have to make public their ownership of an issuer would assist issuers in knowing who their investors are. However the notification process would need to be streamlined, so as not to adversely increase the administrative burden on fund managers.

In either solution, both issuers and investors would benefit from a common record keeper; who would supply access to share ownership information for a modest fee. We are unsure as to whether these measures would increase shareholder cooperation, but they would facilitate the opportunity.

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

Generally the interests of controlling and minority shareholders are aligned, providing they have identical rights. Where the rights of the controlling shareholder discriminate against the interests of minorities, the cost of that discrimination should be reflected as a discount in the value of the securities. This in turn raises the issuer's cost of capital, which acts as a deterrent to minority shareholder discrimination. Fundamentally, the decision of where to invest is entirely in the hands of the minority shareholder. If he chooses to invest in a company with differential rights he is obliged to evaluate the implication of those

differential rights in the purchase price of the security. Investors have plenty of choice given that there are many thousands of securities in issue across Europe, hence we do not believe that they need further rights to better represent their interests in companies with controlling or dominant interests.

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

Related party transactions damage the interests of shareholders, where shareholder funds are used to subsidise transactions at below commercial cost. Scope for these transactions should be severely limited, particularly between directors of the issuer and other companies where the director has an interest, either by position held or personal investment. The Commission should consider the introduction of principles based regulation to curb the scope of related party transactions.

If evidence suggests that the current regulation controlling the quality and timeliness of disclosure of related party transactions is defective, then the Commission should further examine the issue. Best practice would suggest that information concerning a related party transaction should be labelled as such and released to the market without delay. If on the other hand the issue is a failure by national authorities to supervise and enforce current regulation, then the Commission should use its powers and authority to call on Member States to take action to resolve this problem.

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

As correctly pointed out in the consultation employee share ownership carries its own costs and benefits. The benefits to the issuer are employee motivation, commitment and an alternative source of compensation; to the employee it is a direct stake in the success of the business. The cost to the employee (aside from deferred compensation) is that failure of the business directly impacts wealth. It may have a multiple effect on the employee, if loss of employment due to failure of the employer coincides with a significant loss of wealth due to an undiversified portfolio. On balance we feel that employee stock ownership places asymmetric risks upon the employee and should not be considered as an instrument to promote long-term-orientated investment. Further, unless the employee has a very senior position in the company, it is unlikely that the employee's views on corporate strategy, composition of the board and other matters will be given any serious consideration by the employer.

Monitoring and implementation of Corporate Governance Codes

24. Do you agree that companies departing from recommendations of corporate governance codes should be required to provide detailed explanations for such departures and describe the alternative solutions applied?

Yes we feel it is important that where companies depart from the comply part of their respective national corporate governance codes, they should explain why they have chosen not to comply and what procedures and/or safeguards they have put in place to uphold the integrity of their governance.

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 we believe that monitoring bodies should be authorised to check the informative quality of explanations in corporate governance statements. Defining the corporate governance statement as regulated information coupled with a quality of explanation requirement, should put pressure on issuers to make more informative disclosures.

18th July 2011