

SUMMARY OF RESPONSES BY SHAREHOLDERS

This note contains a full summary of the 21 responses received from institutional and private shareholders, or bodies representing them, up to 14 August 1992. A full list of respondents is at Annex A. The submissions by the Association of British Insurers (ABI) and the National Association of Pension Funds (NAPF) are at annexes E and F.

General reaction to the report

Although all the respondents have comments or criticisms on particular aspects of the report, all those who express a general view (17 out of 21) are in broad terms welcoming and supportive of the report and the proposed Code. (The 4 respondents not expressing a general view are the Cleveland and Humberside County Councils, the Unit Trust Association, and the UK Shareholders Association (which represents the views of about 30 private shareholders).)

The Unit Trust Association is concerned that the Committee has strayed beyond its terms of reference and that its 'many very sensible remarks' on the financial aspects of corporate governance are overshadowed by the parts relating to the organisation of the board.

Pro Share challenges the assumption that institutional and private investors have identical interests and requests the inclusion of representation of private investors in future deliberations. David Craine (small shareholder) makes the same point.

Role of shareholders in corporate governance (2.5. and section 6)

The BR Pension Trustee Company share the view that the institutions have a responsibility to encourage sound corporate governance and draw attention to their recently adopted policy (Annex B).

PIRC (who act as advisors to 12 local authority pension funds and provide research to a number of US institutions) dispute the view that corporate governance is solely the responsibility of directors. 'The role of plcs is central to the economic and social welfare of the country at large. Corporate governance is therefore an issue of concern to all stakeholders... Directors are accountable to shareholders, but these in turn have close links throughout the community. Pension funds and insurance companies control two thirds of the share capital of UK companies, which places them in a position of responsibility for addressing corporate governance questions. They by turn are guardians of the collective savings of a wide section of the community and therefore their role in corporate governance is of public interest.

'Until recently many institutional investors had more an absentee landlord relationship with companies in their portfolio. The market provided the opportunity to move in and out of a company and the duty of a shareholder was limited to the proper conduct of trading activities. This is no longer considered an acceptable approach to share ownership, by PIRC and many other bodies.

'The five principles governing the activity of PIRC in relation to its corporate governance services are as follows:

- i) Shareholders should assume the responsibilities of ownership. This does not entail intervening in daily management tasks but in setting standards and ensuring they are upheld by directors.
- ii) Shareholders have three primary interests - to preserve their right to take action; to ensure that the company's corporate governance arrangements are consistent with the protection of their assets; and to ensure that the pursuit of long-term value is fostered within that system.
- iii) Shareholder voting rights are an asset. Voting rights should be managed with the duty of care, attention, and independence required of

those in a position of trusteeship.

iv) Shareholder votes should be exercised on both routine and exceptional matters in order to further the long-term interests of the beneficiaries.

v) A company's success is dependent upon it fully addressing its responsibilities to all of its stakeholders, including the employees, to whom the company has a duty under law. This gives shareholders a responsibility to ensure that companies achieve high standards on social, ethical and environmental matters.'

Edmond Jackson (private shareholder) comments that the report is very vague on defining the limits and scope of the ownership concept.

The Code of Best Practice, and statements of compliance (section 3)

Comments are as follows:

ABI: welcome the emphasis on a voluntary code. 'The framework of the Code with accompanying recommendations should enable responsible shareholders to identify deficiencies more readily and take appropriate action at an early stage. If the Code is to be effective, companies must be willing to observe its spirit, and shareholders must be willing to raise non-compliance with company boards.'

The ABI support compliance statements, believing that they will encourage improved dialogue between companies and their shareholders. Any sanctions applied by the Stock Exchange should be confined to a qualified listing and not a suspension of listing, as the latter course would positively disadvantage shareholders. 'The most effective sanctions that can be applied are those available to shareholders and it is a matter for shareholders to decide whether the standards of corporate governance in a particular company are falling short of what is desired.'

The NAPF state 'we will make every effort to ensure that the Code is widely adopted and adhered to.' However they are concerned that the Code will not have adequate sanctions to command the attention of companies. 'We well appreciate that institutional investors have a crucial role to play in the process of change that is needed. It is evident that an increasing number of pension funds are focussing on this issue but they will most certainly need all the help and encouragement that a significantly strengthened final report can provide.'

BR Pension Trustee Company: expresses concern that a voluntary Code will provide a good standard for those who are willing to change but will have little effect on those who do not wish to comply and where change may be most needed. It will be left to institutions to exercise persuasion but many companies who provide poorer standards of governance will be likely to justify their stance and resist change.

British Merchant Banking and Securities Houses Association (BMBA) endorse the non-statutory approach but are concerned that the initiative may be undermined by lack of effective sanctions and loss of momentum in respect

of the recommendations addressed to the APB and the accountancy profession in the two years up to the proposed review.

Pro Share similarly endorse the Code but express concern at the inadequacy of the proposed compliance mechanism. They urge that as a minimum, a system of regular reporting and review of the implementation of the proposals be instituted forthwith.

Phillips & Drew Fund Management state the gradual approach with regard to best practice advocated by the Committee seems the only realistic one. 'We would be disappointed if the Code was not widely enough accepted for the board of any major public company not substantially complying with it to be doing their company a disservice. For us, it will provide an economical basis for our discussions with directors about corporate governance safeguards, particularly for larger companies, so we can then quickly move on to discussions on strategy, which is their key contribution in a well-directed company.'

M & G: 'We support the idea of a non-statutory Code as a means of raising standards as being both a sensible and a practical approach. In our view the Code will only really work if institutional investors support it to the extent that they are willing to take action in the form of pressure initially and ultimately to use their voting powers to censure companies who either will not adopt the Code or who, if they do, are not prepared to abide by it. We believe that the members of IFMA, for example, should present a united front on the Code. We intend to support it as investors by commending it to companies where we hold a substantial interest by referring to it in our annual letter to them and also in our meetings with companies.'

M&G would prefer the title 'Code of Good Practice' to 'Code of Best Practice'.

Postel: 'strongly support the intention of the Stock Exchange to require all listed companies as a continuing obligation of listing to state whether they are complying with the proposed Code and if not, why not.'

The Institute of Investment Management and Research (IIMR) welcomes and supports in full the recommendations and the Code. In particular, it believes that the formation of an audit committee should be essential for

all listed and USM companies. It agrees that compliance with the Code should become a requirement for all listed and USM companies and enforced by the Stock Exchange. It comments that the text does not refer to USM companies, some of which are quite large, and recommends that these should be included.

The Unit Trust Association (UTA) is very strongly in favour of high standards of corporate governance and institutional shareholders playing their full part in that process. 'We believe the Code is a most useful checklist for investors to use but have reservations about making its use the subject of listing requirement. We would be very concerned that the Report as it stands could lead to a particular board structure and organisation being embedded in UK companies' behaviour. It is unclear to us that there is a single form of board structure which is right for all circumstances. Moreover to focus so much attention on these propositions brings with it the real danger that attention will be deflected from the more important issues of the nature and objectivity of board reporting to shareholders, and the role of auditors in that process.'

Institutional Fund Managers Association (IFMA): strongly supports the aim of establishing best practice on financial reporting and accountability and its proposal for a non-statutory Code as a means of achieving this; and also supports the suggestion that the institutions should be looked to to take action, with the backing of the ISC, where there is clear evidence of non-compliance with the Code.

IFMA however believes that full compliance with the Code will prove impracticable for many smaller companies and probably all investment trusts. On these grounds it opposes compliance statements, believing that it will undermine the credibility of the Code to oblige companies to state non-compliance with what is plainly impracticable for them. IFMA similarly oppose a listing obligation. It also doubts whether a compliance statement could be endorsed in any meaningful way by the auditors.

The Association of Investment Trust Companies (AITC), representing some 220 investment trust companies, concurs with IFMA that it may be unrealistic to expect small companies to meet all the requirements of the Code and that their problems may have to be recognised by laying down the minimum considered necessary to meet the spirit of the Code's objectives.

AITC however goes on to state that investment trust companies should have no problem in complying with the major recommendations of the Code and that it has no objection to the proposals for statements of compliance, and a listing obligation.

Foreign and Colonial Investment Trust very much welcome the thrust of the report but caution against allowing the superstructure of corporate governance to become unnecessarily expensive and bureaucratic or an impediment to the pursuit of efficiency, growth and profit. 'Corporate governance should be a means to an end and not an end in itself.'

Application to non-listed companies (3.1)

The ABI would like to see thought given to how the Code might be applied to non-listed companies, and suggest that the ASB should consider requiring a compliance statement.

Review of the Code (3.13)

Edmond Jackson (small shareholder) states that by not doing anything until the review in two years' time, the Committee loses a valuable opportunity to continue as 'the beacon for governance reform in the UK.' He suggests that submissions should continue to be encouraged so that new ideas and initiatives can be developed, published, and encouraged.

Small companies (3.16)

The ABI comment that in some instances it may be particularly important that smaller listed companies make every effort to comply with particular provisions of the Code, and they should be expected to explain what steps they are taking to observe them. The ABI would like to see the report strengthened by a recommendation to this effect.

Other respondents acknowledging the difficulties for small companies are IFMA, the Association of Investment Trust Companies (AITC), M&G, and the Unit Trust Association (UTA). The UTA comment that failure by smaller listed companies to produce satisfactory statements of compliance will either produce unnecessary criticism of them or, if non-compliance is quite widely accepted, the aim of the Code will be brought into disrepute.

The Board (section 4)

Several respondents echo companies' concerns that the report draws too great a distinction between the responsibilities of executive and non-executive directors and undermines the concept of a unitary board: ABI; IFMA; BMBA; UTA; Foreign and Colonial Investment Trust; Postel; and BR Pension Trustee Co.

The UK Shareholders Association would create two classes of NEDs, one appointed by the board to contribute to the 'leadership' of the company, the other appointed by shareholders to contribute to the 'control' of the company.

Board effectiveness (4.1 and 4.2, Code 1.1)

BR Pension Trustee Company state that good practice should require the board to review its own effectiveness annually and look at ways of improving it.

PIRC state that the Code should recommend companies to formalise key changes to their corporate governance procedures by incorporating them in the Memorandum and Articles of Association.

Combined roles of chairman and chief executive (4.6 and Code 1.2)

The NAPF, Postel, BR Pension Trustee Company, and PIRC regret that the Committee has not come out unambiguously against combining the two roles. BR Pension Trustee Company describe the suggestion that the NEDs should have an appointed leader as an unhappy compromise more likely to cause confusion and division than to strengthen the monitoring function. Postel ask why the appointed leader cannot be made the chairman.

M&G believe that a case can be made for combining the roles only where a company is in such difficulties that it needs to be placed in intensive care.

The ABI suggest that the recommendation that a senior NED should be appointed to take the lead where the chairman is also the chief executive should be amended to suggest that a senior NED should normally be appointed to the office of deputy chairman in such an instance.

Calibre and number of NEDs (4.8, Code 1.3, 2.1)

M&G would make it an explicit recommendation that there should be a minimum of two NEDs. PIRC note that various bodies have issued guidelines on boards and would like them to be harmonised through the Code. They would back the PRO NED line that at least 3 or approximately one third of directors on every board should be independent. The Institute of Investment Management and Research would like a clear recommendation on the minimum number of NEDs for the board and the audit committee.

Independence of NEDs (4.9, 4.10, and Code 2.2)

The NAPF and Postel argue that the report should come out very firmly against NEDs participating in share option schemes and receiving pensionable fees. The ABI echo the same point and suggest that the Code should contain a provision that, other than in exceptional circumstances, NEDs should not participate in share option or other performance-related rewards unless prior approval has been obtained from shareholders in general meeting and that they should not be significantly dependent on any pension arrangement provided by the company; further, if for any reason it is deemed appropriate for certain NEDs to participate in such arrangements, the details should be fully disclosed.

The NAPF and Postel point out that existing best practice is that all NEDs should be independent. The NAPF would like the Code expanded to ensure that if an executive director of company A serves as an NED of company B, then no executive director of company B should serve as an NED of company A. (M&G make the same point.) Postel argue that a director who is not independent should not be called non-executive, and indeed would prefer such a person not to be on the board but to be hired as a consultant or adviser to the board or management.

The ABI comment that in some cases it may be very difficult to find NEDs who are entirely 'free of any business or financial connection' and that a qualification as to materiality is necessary.

PIRC do not consider that all NEDs should be independent and understand that in certain cases a company may wish to retain a former executive on the board. However, a minimum number should be fully independent (three or approximately one third) and the criteria for independence should be:

(as per ISC and PRO NED)

- not having been employed in an executive capacity for the past five years by the company
- not being retained as a professional adviser by the company
- not being a significant supplier or customer of the company
- not being in receipt of share options, performance-related remuneration or membership of the pension scheme

additionally

- not being a representative of a major shareholder
- not being a relative of an executive director
- not having another directorship in common with any other director
- not having been an NED of the company for more than 5 years
- not being employed by a charitable organisation which receives a significant grant from the company.

An agreed procedure for NEDs to take independent advice (4.12, Code 2.4)

The ABI and Phillips and Drew Fund Management support the proposal. The ABI recommend that similar facilities should be available to executive directors, and that arrangements should be formalised through the articles. M&G suggest companies should determine how many directors' agreement is required before expenditure can be incurred, and set a limit on costs beyond which the sanction of the full board should be required.

NEDs should be selected through a formal process and their nomination should be a matter for the board as a whole (4.13, Code 2.5); nomination committees (4.24)

The ABI support nomination committees, but comment that they are of importance principally in the appointment of NEDs rather than executive directors. They would like to Code to read 'NEDs should be selected through a formal process, for example a nomination committee, and their appointment should be a matter for the board as a whole and for shareholders.'

The ABI dispute that there is a shortage of suitable NEDs. They suggest the problem is rather the perception that NEDs need to be prestigious personalities rather than, for example, the very able directors of subsidiaries or divisions of major companies.

PIRC are concerned that NEDs are drawn almost exclusively from the boards of other listed companies. 'This can lead to a degree of peer group loyalty on issues such as executive pay.... We would support independent directors being drawn from a much wider spectrum of society than at present. Those with a different background such as public service, or dealing with environmental issues could have much to offer. This would also draw from a wider group than the almost exclusively male preserves of current listed company boardrooms.'

Donald Brydon proposes a change in the procedures for electing directors, to assist in establishing the robustness of their independence. 'The change would be to require that before an individual be proposed for election to the board, nominations from investors holding a minimum of 10% of the eligible equity be obtained for that individual. It may be desirable to ensure that this minimum proportion of equity be held by, say, at least 3 investors where applicable, with the requirement that at least 2 must not themselves be members of the board. This procedure has merit in relation to the election of all directors, not just NEDs. The process of seeking nomination would ensure the presentation of a fuller justification for the appointment and consequently greater knowledge amongst shareholders about their company's board. The process need not be excessively onerous. Just as companies' financial advisers are in the practice of seeking votes for resolutions which require a minimum positive vote, they could also seek the necessary nominations.'

NEDs should be appointed for specific terms, and reappointment should not be automatic (4.14, Code 2.3)

The ABI support the Committee's conclusions but urge the Committee to recommend further that all directors should retire by rotation with one third submitting themselves for re-election annually. PIRC make the same point, commenting that many companies have provisions in their articles to prevent executive directors from having to retire for re-election by shareholders. They argue that this reduces directors' accountability and places an unnecessary burden on NEDs in having to remove executives when the normal election process would place candidates before shareholders. They also comment that different treatment for executive and non-executive directors is inconsistent with the principles of a unitary board.

Postel would like to see strengthening of the recommendations in line with current best practice to the effect that each term should be for no more than three years with usually only two terms of appointment and certainly no more than three.

The ABI suggest that brief biographical details of directors (executive and non-executive) should be made available to shareholders when the director is submitted for election or re-election. PIRC make the same point more strongly, calling inter alia for disclosure of other directorships, directorships held in common with the present board, and career history focusing on qualifications for the post, so that shareholders can judge whether the candidate is independent and has been put forward through a professional process or through personal contacts.

Boards should have a formal schedule of matters reserved to them for decision to ensure that the direction and control of the company is firmly in their hands (4.19 and 4.20, Code 1.4)

The ABI comment that one of the first indications of problems developing in a company's financial structure is when alterations are required in bank borrowing arrangements. They suggest that 4.20ii should be amended to include 'any alterations to the bank borrowing facilities and any material changes thereto'.

The Unit Trust Association suggest that the schedule should be wider than the financial matters referred to and should contain matters such as senior appointments, human resource strategies, and other strategic issues.

Code of Ethics/Statements of Business Practice (4.23)

David Craine (small shareholder) argues that the issue of business ethics is of considerable importance.

Audit Committees (4.27 to 4.31; Code 4.1, 4.7)

Phillips & Drew Fund Management, commenting that they see the priority as tightly prescribed accounting standards and their monitoring by auditors, say they are particularly supportive of the proposal in respect of effective audit committees. The NAPF see no reason to allow a two year period of introduction. PIRC propose that the committee should consist only of independent NEDs and that annual reports should state the existence and membership of the committee.

The ABI, NAPF, Postel and M&G point out that, while the chairman of the audit committee (and of the remuneration committee) should be available at the AGM to answer questions, it should be for the chairman of the board to refer questions to them if he wishes to do so. The ABI suggest that 4.7 of the Code should be amended to the effect that the chairmen of the audit and remuneration committees should be available and prepared to answer questions at the AGM, but that questions should be directed through the chair.

Internal Audit

The BMBA feel that insufficient attention has been paid to the role of internal auditors, particularly in respect of ensuring effective control systems and the detection of fraud.

Disclosure of board remuneration (4.32; Code 3.2)

The ABI would like the recommendations amended to make clear that the requirement to explain the basis on which performance is measured refers to future performance-related payments as well as those already made.

M&G would prefer the Committee to recommend individual disclosure of each director's total emoluments including pension contributions, value of cars, and value of shadow options.

Directors' service contracts (4.33; Code 3.1)

NAPF and Postel state that best practice is that fixed term contracts, on the few occasions they are warranted, should not exceed three years, and that rolling service contracts should not exceed 1 year. M&G favour one year rolling contracts and believe anything in excess of that should require the approval of shareholders. They accept that a three-year contract can be appropriate to deal with recruitment in a crisis, but believe that it should be followed by a one-year rolling contract. The Unit Trust Association support the recommendation and take it to outlaw three-year rolling contracts.

Remuneration Committees (4.34; Code 3.3, 4.7)

PIRC propose that remuneration (and nomination) committees should consist of a majority of independent NEDs and be chaired by an independent NED. Membership should be disclosed in the annual report.

Shareholder voting on directors' pay (4.35)

The NAPF agree that it is quite impractical for shareholders to vote on the remuneration of an executive director. The Unit Trust Association also accept that shareholder voting would be impossible to carry out, although commenting that the pay issue has drawn the wealth creation process into disrepute and that some strengthening of control might be in the public interest.

PIRC are in favour of shareholder voting on pay. They argue that many pay increases are not justified by company performance or pay norms recommended to employees, and that their research shows that this happens even where a remuneration committee is in existence. They argue that there should be full disclosure for each director of all proposed salary, bonuses, and other payments, set against historic performance data for the company. Shareholders should vote on the package at the AGM, and if defeated the existing package should be maintained. In addition, the rules for allowing shareholder resolutions should be relaxed (see below), enabling shareholders to put forward positive alternatives where they disagreed with the directors' plan, in order to avoid leaving the situation unclear.

The UK Shareholders Association also call for resolutions regarding directors' remuneration to be voted on at AGMs, with disclosure on the lines now being required by the SEC.

Financial Reports and Reporting Practice (4.38 to 4.50)

The Unit Trust Association strongly support the conclusions in these sections and believe they are of far greater importance than matters of board structure.

Interim Reports (4.47)

The ABI and NAPF support the inclusion of balance sheet information in the interim report and the requirement that it should be reviewed by the auditors. The ABI comment that companies in businesses which require specialised valuations of assets or liabilities should not be required to incur the excessive cost of revising such valuations for interim reports. The NAPF would not want to see the inclusion of additional information used as an excuse for delaying publication.

M&G support the inclusion of balance sheet information, but see no point in giving a formal role to the auditors. They comment that a prudent board would, in any event, always wish to know what their audit committee and auditors felt about any controversial matter.

Communication with shareholders (4.50)

PIRC report the view of their pension fund clients that direct contact is valuable but no substitute for the consistent exercising of votes in order to support high standards. They note that it is not feasible for companies to have direct contact with more than a small proportion of shareholders.

Phillips & Drew Fund Management say that in their experience NEDs rarely meet investors except in crisis, and that they appear uncertain about the relationship and sometimes unclear about what constitutes "best practice". Edmond Jackson (small shareholder) comments that NEDs are hard to track down and reluctant to talk to him when he has points of concern.

Pensions Governance (4.51)

Comments are as follows;

M&G: It is accepted that a company's scheme should be separate and distinct from the company itself and adequately safeguarded, but where this is not entirely the case it would not be sensible to expect companies to move in advance of the government's report on the matter.

ABI: The report should consider the eligibility of directors as trustees of self-administered schemes. ABI recommends that all self-administered schemes should have at least one independent trustee, eg an NED. Where the role of chairman and chief executive is combined, that person should not be eligible to be chairman of the trustees of the scheme.

Auditing (section 5)

The Unit Trust Association comment that they agree with the analysis and most of the conclusions in this section (eg on internal control, going concern, fraud, and other illegal acts) and particularly support the views expressed in 5.8 about effective accounting standards.

Quarantining of Audit Services (5.10 to 5.11)

The NAPF and Postel do not think that the Committee's conclusions deal adequately with the conflict of interest to which attention is drawn in 5.10. The Unit Trust Association also queries why the Committee was not persuaded by the arguments in 5.10, although it comments that it does not particularly favour quarantining.

PIRC argue that auditors should be barred from performing non-audit work for their clients, on the grounds that auditors may be reviewing the fruits of their own labours (eg if they have established financial control systems within the company), and that consultancy fees represent a penalty an auditor with unwelcome views must be prepared to pay.

Rotation of Auditors (5.12)

The NAPF and the UTA support the Committee's approach. The NAPF would not wish any guideline to allow too great a measure of flexibility. M&G suggest that the directors' report should explain periodically (say every 5 years) why new tenders for the audit are not being invited and the reasons for remaining with the existing auditors. PIRC believe that audit firms should be changed every three years. The UK Shareholders Association also support compulsory rotation of audit firms.

Internal Control (5.16)

The Institute of Investment Management and Research would like to see users of accounts included among those who should be involved in the follow-up work.

Going Concern (5.18 to 5.23)

The ABI, NAPF, and Phillips & Drew Fund Management support the Committee's recommendations. The ABI stress the importance of very clear guidelines that are fully understood and properly applied.

M&G support the requirement for directors to report on the going concern basis, but are dubious that auditors should give an opinion.

The Institute of Investment Management and Research suggest that an alternative way of dealing with the issue is by means of a statement of working capital as required by the Stock Exchange for inclusion in listing particulars and certain circulars to shareholders.

The Foreign and Colonial Investment Trust oppose the recommendations on the grounds that qualifications in support of the going concern statement might gravely hinder the recovery/refinancing prospects of a company in difficulties, and could cause unnecessary alarm among creditors or customers. 'Auditors are already required to state that a company is "dependent on the continued support of its bankers", or make similar qualifications, when for example banking covenants have been breached, and we believe that this requirement provides an adequate safeguard on its own.'

Fraud (5.24 to 5.28)

The Institute of Investment Management and Research comment that detailed guidelines should be developed for audit committees on detection of fraud, perhaps as part of the work recommended at 5.16 on internal control.

The ABI welcome the Committee's recommendation in 5.28. The NAPF disagree strongly with the Committee's comment that it is not persuaded that the imposition of a statutory duty on auditors to report fraud would make any practical difference.

Other Illegal Acts (5.30)

The NAPF support the Committee's recommendation and suggest that there may be a case for establishing a legal audit to be carried out by solicitors rather than the auditors.

Auditors' Liability (5.31 to 5.33)

The BR Pension Trustee Company stress that users of accounts should be able to have faith in them, and thus regret the lack of a recommendation by the Committee to review the law following the Caparo judgment. NAPF and the Institute of Investment Management and Research say the law should be changed, and the Unit Trust Association and M&G also register disquiet.

The ABI comment that concern still remains at the implications of the judgment, and that further consideration should be given to the position of those shareholders who may individually have suffered loss but in circumstances where the shareholders are unable to take action as a class.

The Institute of Investment Management and Research have submitted a detailed commentary which attempts to refute the arguments against extending auditors' duty of care set out in the appendix to the report (Annex C).

Shareholders (section 6)

M&G do not feel that inviting shareholders to send in written questions in advance of AGMs would serve a useful purpose, or circulating a summary of points raised. 'Importantly, however, such meetings should provide, after the formal business has concluded, an opportunity for shareholders to meet and question directors on an informal basis.'

M&G accept that institutional shareholders should vote at company meetings and have a duty to oppose resolutions with which they disagree. The comment that there will be instances where opposition should initially take the form of behind-the-scenes lobbying, which can be very effective.

Pro Share endorses all the proposals for making the AGM an effective vehicle for wide communication, but points out the limitations for private investors - eg most are at work at the time, many have long distances to travel, and many do not understand their rights or how an AGM works. Pro Share says that it recognises the part it must play in the educational process, and that it is also encouraging the use of night-time television recording of AGMs. It also comments that companies should not rely solely on AGMs and must use other forms of direct communication, an area which it is exploring.

David Craine (small shareholder) argues that there is no accountability at AGMs and that too often they are public relations exercises. The suggestion that shareholders put questions in advance (6.5) 'would simply increase board control of the meeting, add to the anodyne nature of the reply and limit the possibility of two-way dialogue which a supplementary question or participation in a debate can create... The only way to improve the process is for the adoption of a system enabling shareholders to place issues formally on the agenda of the meeting. The legal basis of the Companies Act discourages this and makes the bringing of a resolution very difficult and potentially expensive for shareholders. A simpler system, such as that used in the US, would enable resolutions on a number of topics to be tabled and sent to shareholders and would make the meeting much more interesting, with advance notice of debates being given. A number of imaginative possibilities then open up by which serious and orderly discussion could take place, followed by a vote.'

David Craine disputes the Committee's objections to Shareholder Committees (6.2), arguing that a simple voting system for shareholder representatives sent out with the annual report would be straightforward, inexpensive, and entirely legitimate. He argues that such Committees would provide a valuable point of contact and consultation for shareholders.

PIRC argue that shareholders should take more responsibility for their position as owners of companies, but that in order to play an effective role there are numerous barriers which need to be overcome, some requiring legislation. PIRC's specific proposals are at Annex D. In summary:

- i) the rules in the Companies Act on the submission of shareholder resolutions at AGMs should be amended so that any shareholder owning 100 shares for a period of a year should be allowed to submit items for consideration. Shareholder resolutions should be scrutinised by an independent agency;
- ii) the rules on circulation of resolutions should also be reviewed to remove present obstacles;
- iii) the voting system should be reformed (on a basis of one vote per share) and should be transparent;
- iv) the quorum requirement for AGMs should be increased to encourage attendance;
- v) shareholders should be entitled to a copy of the share register free of charge on request.

PIRC do not support the Committee's suggestion on written questions (6.5) on the grounds that it will provide the opportunity to avoid difficult ones. PIRC agree however that summaries of AGMs should be circulated. They propose that the minutes of the AGM together with the results of votes should be made available upon request within one month, and circulated within six months, possibly with the interim figures.

The UK Shareholders Association contends that overwhelming power rests with the board and that without some measures to shift the balance more towards the owners, corporate governance will not significantly improve. It argues that

reform, not the minor developments suggested by the Committee at 6.5. It recommends:

- i) the number of members needed to requisition resolutions should be reduced from 100 to 10;
- ii) circulation of such resolutions should be at the company's expense;
- iii) voting should be by show of hands of all members present;
- iv) in the case of resolutions which are passed, the company should notify all members in writing within three months what action the company is taking;
- v) three classes of questions should be recognised - written, supplementary (on the answers given to the written question), and oral - with agreed procedures. A minimum of one hour should be devoted to questions. Members should have the right to put questions directly to the auditor or the chairman of the remuneration committee.

The Association does not support the Committee's proposals regarding written questions (6.5) on the grounds that 'they will reinforce the already regrettable tendency for AGMs to be totally stage-managed depriving the meeting of any remaining value from the members' point of view'. The Association adds 'Establishing new procedures for questions will need action by members. Our Association sees as one of its important tasks the improvement of members' ability to draft effective questions about the information conveyed to them in the annual report.'

Edmond Jackson (small shareholder) comments that he sees few investors who want to work at consistent, patient monitoring that might reduce scandals of accountability and management failure. He suggests that institutions should be encouraged to experiment with larger stakes in fewer companies and that this would justify their developing the internal resources to monitor companies on a long-term basis.

Other submissionsColin McLean, Managing Director of Scottish Value Management

A long submission about conflicts of interest that can arise when the director of an investment trust makes a personal investment in a company alongside the investment trust's investment. The submission argues that the issue should be dealt with by disclosure and that all main board directors should be required to state any financial benefits they receive from undertakings in which the parent company has made an investment. It points out that the Companies Act requires disclosure of material transactions connected with directors but that a broad range of contracts and interests are not declared because they fail the vague materiality rules. It calls for the Committee's final report to encourage a set of rules.

Cleveland County Council

A letter expressing support for the submission made by PIRC, and calling in addition for the Code to be given statutory authority; for the Caparo judgment to be reexamined; for any financial interest between the audit firm's partners and the company or its directors to be banned; and for company contributions to political parties to be subject to shareholder approval at the AGM.

Humberside County Council

A submission echoing the recommendations made by PIRC. It departs from the PIRC submission however in not calling for a ban on the provision by auditors of non-audit services to their clients, but instead suggesting that full disclosure of the nature of such services should be made in the report and accounts.

LIST OF RESPONDENTSa) Institutional investors

Association of British Insurers (ABI)
Association of Investment Trust Companies (AITC)
British Merchant Banking and Securities Houses Association (BMBA)
Institute of Investment Management and Research (IIMR)
Institutional Fund Managers Association (IFMA)
National Association of Pension Funds (NAPF)
Pensions Investment Research Consultants (PIRC)
Unit Trust Association (UTA)

British Rail Pension Trustee Company Ltd
Cleveland County Council
Donald Brydon (Barclays de Zoete Wedd Investment Management Ltd)
The Foreign and Colonial Investment Trust
Humberside County Council
M&G Group plc (responding as a listed company and as an institutional investor)
Philips and Drew Fund Management Ltd
Postel Investment Management Ltd
Scottish Value Management

b) Private investors

U K Shareholders Association (representing about 30 private shareholders)
Mr David Craine
Mr Edmond Jackson
Pro Share

BRITISH RAIL PENSION TRUSTEE COMPANY LIMITED

CORPORATE GOVERNANCE : POLICY STATEMENT

Introduction

1. The British Rail Pension Trustee Company (BRPTC) relies on the long term quality of international equity markets to safeguard the pensions of past and present Railway staff. As at 31 March 1992, the equity investments of the Fund were valued at £5.4bn, equivalent to 73% of the total assets under management. United Kingdom equity investments were £3.6bn, 67% of total equity investment.
2. Because of its size BRPTC inevitably holds substantial stakes in many UK companies. It has 17 holdings which exceed 5% of companies equity. In 53 companies a stake of 3% or more is disclosed as required by the Companies Act. Size alone requires a responsible approach to corporate governance. The interest of pension scheme members in the long term security of investment markets is also a paramount concern. BRPTC's corporate governance policy has two main aims: to support and promote efficient and effective equity markets and to protect shareholder value.
3. The main focus of the policy at present is upon UK companies. With the growing internationalisation of investment markets and portfolios, an important area for future development will be the major overseas markets in which BRPTC also has substantial investment holdings.

Current Policy

4. In exercising its share ownership responsibilities in respect of UK companies, BRPTC adopts the following general policies:
 - 4.1. voting on resolutions placed before company meetings;
 - 4.2. meeting company managements regularly where a Companies Act disclosable interest is held and periodic formal attendance at company AGMs where very large interests are held;
 - 4.3. actively supporting the work of the Accounting and Auditing standard setting bodies, with particular emphasis on improvements in reporting quality and clarity;
 - 4.4. co-operating with and supporting, wherever possible, the promotion of best corporate governance practice by the National Association of Pension Funds (NAPF), Institutional Shareholders Committee, and the Association of British Insurers (ABI);
 - 4.5. establishing informal links with other large investors as a means of exchanging information on matters of common concern.
5. In both its formal and informal contacts with company managements BRPTC will encourage best practice as exemplified by:
 - 5.1. proper structuring of company Boards including the separation of the roles of chairman and chief executive, the presence of an appropriate number of independent and capable non executive directors and suitable arrangements for audit, and remuneration (including directors' incentive schemes) committees;
 - 5.2. fixed tenure of office for directors, normally three years, subject to re-election;

- 5.3. independent appraisals of proposed management buyouts of part or all of a company.
6. Wherever possible BRPTC will support the recommendations of best practice made by NAPF, ABI, Institutional Shareholders Committee, other institutional groups and official bodies (e.g. the Cadbury Committee).
7. Additionally a more formal reporting and liaison structure is being developed with BRPTC's investment managers, preliminary steps are being taken to form links with overseas institutions (initially in North America) and a calendar of regular monitoring and development reviews is being established for the Policy

Conclusion

8. BRPTC is conscious that its responsibility, first and foremost, is to the membership of the pension schemes on whose behalf it invests. None of the activities listed above imply a collegiate approach towards corporate governance. The strict criterion on which all decisions will be based is the promotion of the long term interest of scheme members and the protection of their current and future pensions.

David Adams
Chief Executive
June 1992

EXTRACT FROM SUBMISSION BY INSTITUTE OF INVESTMENT MANAGEMENT AND RESEARCH (IIMR)

8. THE CAPARO CASE

The Institute does not agree with the conclusion reached by the Committee in respect of the Caparo case. The members of the Institute are concerned in their professional lives in making recommendations and decisions about the purchase and sale of shares. In all cases, there is considerable dependence on the latest audited accounts.

The conclusion reached in the Caparo case is doubtless correct in law. However, the Institute considers that the law should be changed. The Draft Report sets out arguments against 'extending' the auditors' duty of care in paragraph 6 of Appendix 4. The Institute comments on each of these arguments as follows:

Argument 1

This argument seems to relate to the idea that liability would be increased by an unknown amount to an unknown group and hence the 'classic words of Cardozo CJ'. Indeed, there is a reference to an 'unlimited liability' in paragraph 4 Appendix 1. However, an analysis of the situation shows that the effect of the Caparo case is potentially to reduce the liability of the auditors where there have been changes in shareholders.

The Caparo case judgement seems to imply that those shareholders to whom the audit report is made can as a body bring a claim against the auditors. However, if some of the shareholders sell their shares after the audit report and before a problem related to the accounts (ie before the need to make a claim) becomes public knowledge, then that shareholder will have suffered no loss (since the share price at the time of sale should not then have been affected by knowledge of the problem related to the accounts). As the new shareholder is precluded from claiming (because of Caparo) and since the old shareholder has suffered no loss, the potential claim against the auditors will have been reduced purely as a consequence of a change of ownership.

It should be possible for legislation to identify the shareholders who have actually suffered loss irrespective of the date of purchase of their shares.

Argument 2

While it may be difficult as a matter of law to 'prove' that an investor had relied on audited accounts, as a matter of fact it is almost certainly the case that purchasers of shares rely on the accuracy of previously published audited accounts. It ought to be possible for the law to be adjusted so that it was for the auditors to prove that the investor had not relied on the audited accounts.

Argument 3

This argument cannot work. The law relating to prospectuses is very detailed and penalties are significant. The legislature in a wider sense is very concerned with the protection of both the public at large and investors. Prospectus law deals with the primary markets. The Institute is recommending that there should be comparable legal protection for the secondary market. Furthermore, the Caparo case itself made it clear that the shareholders as a body have a right to claim against the auditors.

Argument 4

The liability should reflect the loss suffered. There is no obvious reason why a relationship should exist between liability and audit fee.

Argument 5

While directors do bear ultimate responsibility, they also rely on the auditors as do the shareholders. Only the auditors should or could be responsible for their own negligence and must therefore foot the bill on their own. This is not a valid argument against extension.

Argument 6

The availability of adequate insurance cover is a reflection of the perception in the insurance market of the likelihood of claims. Presumably, for the most competent firms, claims are low and insurance cover is available. The Institute believes that the threat of legal action is an important tool in motivating auditors to maintain the highest professional standards.

Argument 7

The third parties have relied on the audited accounts to make an investment. This should be sufficient to establish the liability of the auditors. As regards payment, if the auditors have been paid surely no further payments are necessary. It should be possible for legislation to deal with the situation where third parties rely on the auditors but make no payment to them. At present, auditors are paid by the company and not by shareholders.

Argument 8

This is unlikely since, as argued above, extending the liability of auditors to prospective shareholders does not, in the view of the Institute, increase the overall liability of the auditors to shareholders - it merely prevents the auditors benefitting from a reduction in their liability which results directly from the Caparo case.

However, the question of liability to other third parties who are not shareholders needs to be considered separately. This group includes lenders and other security holders (eg bond holders), suppliers who grant trade credit and so on. The

Institute can see no reason why auditors should not be liable to these groups. In this way, the liability of auditors will be extended. This may lead to an increase in cost but it seems most unlikely that it would become 'uneconomic'.

EXTRACT FROM SUBMISSION BY PENSIONS INVESTMENT RESEARCH
CONSULTANTS LTD. (PIRC)

II. Shareholder Responsibility: Making it effective

- i. We support the Committee's view that the organisation and effectiveness of AGMs needs to be strengthened. The vast majority of shareholders do not vote. Those which do are not necessarily providing an effective influence because the regulations are anachronistic and designed for the days when companies were owned by a small number of individuals.

One reason why so few shareholders attend or vote at AGMs is that they have little or no access to formulating AGM agendas - in other words they feel powerless to effect change, they can simply endorse what the Directors have chosen to place before them.

We propose that the threshold for shareholders to propose a resolution to the annual general meeting be reduced, from 5% of the issued share capital (which is prohibitive to virtually all investors with diversified portfolios) or 100 shareholders acting together (which is administratively cumbersome) Instead we consider that any share holder owning 100 shares for a period of a year should be allowed to submit items for consideration at the AGM.

These would still be bound by such existing duties under Company Law such as not to cause harm to the company or interfere in day-to-day business decisions.

Shareholders resolutions should be scrutinised by an independent agency rather than the Company Secretary in order to ensure that these provisions are not misused to prevent legitimate matters being raised.

- ii. The current procedures for shareholders wishing to propose resolutions or nominate directors are also unhelpful and off-putting for shareholders. In a number of ways they are either contradictory or undemocratic.

For example, there are two separate timetables for proposing resolutions and directors, one governed by the Companies Act, the other by the company's Articles of Association; the deadline for proposing resolutions falls before the company is obliged to give notice of the AGM and send out its annual report, so shareholders have no knowledge of what the report contains before they are

expected to lodge resolutions; the company can charge shareholders substantial sums to circulate resolutions and can print and circulate the AGM agenda before the deadline for receiving resolutions has passed.

We think this whole area needs careful consideration, but an initial series of reforms could be:

- a) AGM dates should be set one year in advance;
 - b) the deadlines and requirements for proposing shareholder resolutions and directors should be harmonised;
 - c) annual reports should be sent to all shareholders at least 8 weeks before the AGM date. These should include a reminder of the date of the meeting and an invitation to submit resolutions;
 - d) shareholders should then have another four weeks to submit any resolutions to the company;
 - e) the notice of the meeting including all properly submitted resolutions and proxy forms, should be despatched to shareholders four weeks before the meeting;
 - f) proxy forms should be lodged with the registrars not less than 48 hours before the meeting.
- iii. The exercise of shareholder votes is equally confused at present. There is effectively a dual system of one member one vote which operates on a show of hands at AGMs, and one vote per share held which operates for proxies voted. All resolutions pass on a show of hands unless a poll is called when the proxies come into play. The numbers of proxies voted for any resolution remains confidential to the company unless a poll is called.

We think that the system should be reformed so that only one voting system operates which is completely transparent. However, there are problems in that if the show of hands is abolished, the votes of small shareholders are effectively overwhelmed by those of institutions and they will have little incentive to attend AGMs, whereas if proxies are discounted, institutions have no more say than an individual. On balance, we think that proxies have to be given more prominence and we propose the following reforms:

- a) Voting should be one vote per share, rather than one vote per member. The current system of voting by show of hands should be abolished in favour of ballots.
- b) The number of proxy votes cast prior to the meeting for and against each resolution should be announced at the AGM.
- c) All votes at the AGM should be by proxy form (ballots). If they have previously voted by proxy, a shareholder can change their vote at the meeting.

- iv. At present the quorum requirement for AGMs is a handful of shareholders. We think this should be increased to encourage attendance, and could be related to percentage of shares represented at the AGM rather than number of shareholders.
- v. We think all shareholders should be encouraged to participate and ask questions at AGMs. We do not agree with the Committee's suggestions that written questions should be dealt with. In our experience this can lead to a filtering process before the meeting which leaves no time for the difficult questions, or those which are unpopular either because they have not been thought of by a large number of shareholders or because the directors do not want them raised in the meeting.

AGMs should continue until all shareholder questions have been dealt with.

- vi. Shareholders do not have a record of the proceedings of the AGM at present. We support the Committee's suggestion that summaries of AGMs are circulated.

We propose that minutes of the AGM together with results of votes be circulated to shareholders within six months, possibly with the interim figures and that they are made available upon request within one month.

- vii. As initiatives for change require shareholders to act together it is important they are able to identify each other. This is true for resolutions as well as EGMs. Shareholders wishing to contact other shareholders face several problems at present. Shareholder registers at Companies House are kept in alphabetical order and are often out of date, those kept by registrars can be searched for individuals, but not scrutinised as a whole, companies can charge prohibitive sums for complete shareholder lists, many shareholders are unidentifiable due to use of nominee accounts.

We propose that beneficial shareholdings should be identified on shareholder registers and that share registers should be updated on a more timely basis at Companies House and that shareholders should be entitled to a copy of the register free of charge on an annual basis upon request. Now that share registers are computerised, they should be made available in a useful format, such as according to size of holding.