The Quoted Companies Alliance

The Quoted Companies Alliance
6 Kinghorn Street
London EC1A 7HW
Tel: +44 20 7600 3745
Fax: +44 20 7600 8288

Web: www.theqca.com
Email: mail@theqca.com

European Commission
DG Internal Market and Services
SPA2 - Pavillon
rue de Spa/Spastraat, 2
B-1000 Bruxelles/Brussels
Belgium

markt-complaw@ec.europa.eu

22 July 2011

Dear Sirs,

**European Commission – The EU Corporate Governance Framework Green Paper**

***INTRODUCTION***

The Quoted Companies Alliance (QCA) is a not-for-profit membership organisation working for small and mid-cap quoted companies. Their individual market capitalisations tend to be below £500m.

The Quoted Companies Alliance is a founder member of European**Issuers**, which represents over 9,000 quoted companies in fifteen European countries.

Our ID number for the European Commission's register of interest representatives is 45766611524-47.

A working group made up of members of our technical committees and specifically the QCA Corporate Governance Committee has examined your proposals and advised on this response. A list of committee members is at Appendix A.

***RESPONSE***

We welcome the opportunity to respond to this consultation.

We fully support 'comply or explain' and a principles-based approach to corporate governance and believe that this model is strongly enshrined in national laws. This allows companies to apply the principles of corporate governance outlined in various national codes and then comply with the specific provisions or explain why they have not done so. 'Comply or explain' ensures that companies are able to adopt relevant and appropriate corporate governance structures and processes for their stage of development and business model. This approach also allows companies to feel that they own the corporate governance code they apply rather than simply undertaking a compliance exercise which strict rules and regulations would generate.

As such, we would stress that the 'comply or explain' regime would be undermined by enshrining measures in the form of regulation or a directive. There are also many national differences in terms of governance models and legal systems in Europe that would make it difficult and almost impossible to create one model that would work in all Member States, thus further highlighting the need to maintain flexibility.

Most importantly, we stress that a proportionate approach should be adopted for smaller quoted companies in the European Commission's considerations of the EU corporate governance framework.

We do believe there are areas that the Commission could explore in terms of reinforcing the comply or explain regime and more generally promoting good governance throughout Europe. These include:

- Exploring the role of MiFID, Solvency II and Interim Management Statements (quarterly reporting) play in encouraging short-termism (see our response to Question 13)
- Creating a comply or explain Stewardship Code for institutional investors to encourage accountability and responsible ownership (see our response to Question 17)
- Increasing the transparency of proxy advisors' methods and conflicts of interests (see our response to Question 18)
- Improving the right of issuers to identify their shareholders (see our response to Question 20)
- Considering the effects of EU state aid rules on tax advantaged share schemes in Member States (see our response to Question 23)

Please find our responses to the individual questions below.

We note that the phrase 'comply or explain' is not necessarily an accurate reflection of a principles-based approach. Explaining why or how a company is or is not meeting a principle or provision is part of the process of compliance. A better phrase would be 'apply and explain'. For convenience in our response, we continue to use the widely used 'comply or explain' phrase throughout the docuyment.

***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 believe that a differentiated and proportionate approach for smaller quoted companies should be encouraged so that companies at different stages of development can tailor their approach to corporate governance accordingly. This does not necessarily mean that these companies should do less; they may do more in certain areas. What each company decides to do will involve considering the views of investors and other stakeholders. How well a company adopts a proportionate approach will have an impact on long-term value.

As an example, companies on the regulated market in London have to comply or explain with the UK Corporate Governance Code only if they have a premium listing; standard listed companies must describe which governance code they choose to follow. We believe that this proportionate approach allows for flexibility, appropriate governance structures and reasonable cost.

We attach copies of the Quoted Companies Alliance's Corporate Governance Guidelines for Smaller Quoted Companies and European Corporate Governance Guidelines developed by the Quoted Companies Alliance (UK), Middlenext (France) and Deutsches Atkieninstitut (Germany). Both are examples of a proportionate approach. They recognise that companies are at different stages of development so are principles-based rather than didactic in approach.

It should be recognised that a one-size-fits-all approach to corporate governance would entail smaller quoted companies having to explain why they have not complied with large swathes of a code designed for the largest quoted companies. This is not helpful and does not motivate smaller quoted companies to positively adopt good corporate governance principles.

A proportionate approach does not, by definition, mean lower standards when applied to smaller companies. It does not follow that there will be an increase in the cost of their capital if companies follow a principles-based approach to create a governance structure which is designed to create long-term value for shareholders. A principles-based approach based on the comply or explain principle allows companies to avoid sudden and potentially disruptive increases in governance requirements; they are better able to develop their governance structures organically and in dialogue with their shareholders.

A principles-based approach avoids big step changes and allows for costs to be managed more deliberately. A comply-or-explain approach enables companies to decide what balance is most appropriate for them and to tailor their response accordingly.

**(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?**

Unlisted companies include quoted companies on MTF growth markets, such as AIM and PLUS-quoted in the UK, which have not been admitted to the Official List (also known as the London Stock Exchange Main List). The Quoted Companies Alliance believes that these public quoted companies should set out clearly their approach to corporate governance and should state which code or set of principles they choose to follow. We do not believe that corporate governance measures should be set at an EU level for these companies. However, guidelines such as the Quoted Companies Alliance's *Corporate Governance Guidelines for Smaller Quoted Companies* (attached to this document) and that of Middlenext in France should be encouraged and promoted as good practice by the European Commission.

We do not express a view on whether corporate governance measures should be taken at an EU level for private companies not traded on a public market, except to say that any company which has the potential to cause systemic problems should be required to make appropriate corporate governance arrangements with effective disclosure.

***Boards 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?**

We firmly support the principal that the functions and duties of the chairperson and the chief executive officer should be clearly divided. However we can envisage circumstances when it may not be appropriate or practicable for this to happen. The underlying issue is to ensure that there is adequate and effective challenge to the strategic and operational decisions being taken in the company.

Accordingly, we would prefer a statement that best practice would normally be for the chairperson and chief executive officer to be different people. We would not want to see regulation on this matter and would argue that a company and its shareholders should determine the appropriate structure for the individual company, rather than EU legislation.

**(4) Should recruitment policies be more specific about the profile of directors, including the chairman, to ensure that they have the right skills and that the board is suitably diverse? If so, how could that be best achieved and at what level of governance, i.e. at national, EU or international level?**

Recruitment policies should not be too prescriptive but rather be drafted so as to encourage an appropriate range of skills and experience across the board as a whole. Diversity is to be encouraged, but not at the expense of skill and experience. Prescriptive regulation to increase diversity at board level would be difficult to articulate and enact and could have negative side effects.

We believe that this is a matter which ultimately falls to a company's board and nomination committee to agree and so our view is that national level governance is the appropriate level for this.

**(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?**

As part of a "comply or explain" regime, companies should include a statement about that company's policy in the annual report. More important, however, is narrative reporting of how such a policy is being applied throughout the company. As such, we would support this as a matter best achieved through national codes and not through EU legislation.

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

As part of the process of expanding the knowledge, skill base and experience of the board, diversity is clearly a significant factor, However, while we fully support the advancement of women in business and their participation in the firm's board of directors and senior management, the focus should be on the needs of businesses to create sustainable wealth and jobs. While gender is an obvious indication of a single measure of diversity at a very basic level, the requirements of board thinking and decision-making demand a considerably more sophisticated approach.

Accordingly, we do not favour a quota-based regime but would, as set out in to our response to Question 4 above, encourage the adoption of a "comply or explain" regime as part of the company's annual reporting disclosures.

**(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?**

We do not favour such an approach as this would limit the available talent so that smaller companies will have to pay larger sums to hire directors with appropriate skills and experience. We consider that in most cases there is a practical limit, but believe this should be self-regulating.

The issue is not about the number of mandates but, about the time taken by each individual mandate as one company may require far more time commitment than another dependent on the nature of the company.

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

We believe that the success of smaller quoted companies depends to a very great extent on the calibre of the individuals who make up the leadership team and their ability to work together as a coherent and functioning board. While other non-executive directors will bring talents, experience and oversight to a board, the primary dynamic which must be functional for a board to succeed is the relationship between the Chairman and the Chief Executive.

It is undoubtedly the Chief Executive's job to ensure that the business is managed effectively while the Chairman's role is to ensure that the board runs properly. In order to perform his role, a Chairman must continuously assess and evaluate the performance of the board as a whole and the performance and effectiveness of its individual members.

Against this background we believe that the judicious use of external facilitation to assist the Chairman in his efforts to evaluate the functioning of his board can be a highly valuable and effective tool, bringing fresh eyes to bear on a situation. In addition the use of external facilitation can provide a useful method to communicate difficult or unsavoury messages.

However we do not believe that the use of external facilitation should be mandated. Likewise we believe that there is no value in external evaluation or facilitation if it should become a box ticking exercise simply to be repeated at regular intervals and lead to banal observations.

We also believe that, while this is an area where best practice is evolving, it has not yet emerged to a sufficient degree of consensus that currently it would be appropriate to make external measurement of board behaviour or performance compulsory.

While 360° evaluation is common in many companies as part of the annual staff appraisal process, board evaluation is far more complex than a mere employer-employee review, due to a considerably more intricate balance between the interests of competing stakeholders, including shareholders, creditors, suppliers and customers as well as employees. The potential for conflicts of interest between these competing concerns is high.

As a result we very much support and encourage chairmen of smaller quoted companies to utilise external facilitation on a regular basis to assist them to improve their evaluation and encourage Senior Independent Directors to call on the services of external facilitators where they feel the need to do so to evaluate to performance of the Chairman.

However we do not believe that it would be appropriate to prescribe when and how such external support should be provided.

**(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?**

We continue to believe that progress in this difficult area will continue to be made as a result of shareholder engagement with companies on an individual basis and that the extension of mandatory reporting in this area will just increase compliance costs for companies with disproportionate returns for investors. We would also note that even where there has been regulation leading to greater disclosure, it does not necessarily lead to directors' pay becoming more responsive or aligned to shareholder interests and so this policy may fall short of its objectives anyway.

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

Most boards consult with their major shareholders on remuneration as part of their regular engagement. If shareholders are unhappy about remuneration, they already have ample opportunity to express their concerns privately and publicly and it seems difficult to prioritise an annual vote on this issue over others such as company strategy. As such, it is unclear if a mandatory vote would make a significant difference in influencing behaviour.

If a vote was to be made required, we would suggest that it be an advisory vote, so as to not affect any existing legal and contractual arrangements in Member States.

**(11) Do you agree that the board should approve and take responsibility for the company's 'risk appetite' and report it meaningfully to shareholders? Should these disclosure arrangements also include relevant key societal risks?**

In many jurisdictions, including the UK, ultimate responsibility for the affairs of a company lies with its directors. For example, the UK Companies Act 2006 (the "Act") has codified the law in relation to the duties of directors. These duties, set out in sections 171 to 177 of the Act, include the express obligation for a director of any company to have regard (amongst other things) to:

- the likely consequences of any decision in the long term; and
- the impact of the company's operation on the community and the environment.

English law holds every director individually and equally responsible for the acts of a company and, under section 174 of the Act, expects him to act with the care, skill and diligence which would be exercised by a reasonably diligent person with both:

- the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company; and
- the general knowledge skill and experience that the director actually has.

So if a director is, for instance, experienced in finance, and occupies the position of finance director or CFO, he would be expected to exercise a higher degree of care, skill and diligence in relation to financial matters than would a person who is not specifically skilled in that discipline.

However it should be noted that English law will not recognise the distinction between executive and non-executive directors save to the extent of the objective expectations arising from his carrying out the functions of a non-executive director.

Accordingly English law requires the board to be aware of the risks inherent in a company's business and clearly holds the directors responsible for those risks.

The primary purpose of a company is to create value. The primary purpose of a listing for smaller quoted companies is to provide them with a platform from which they can access capital which will allow them to grow and, hopefully, grow significantly and quickly.

All business involves risk and, it can be argued, at a macro level growth companies will have an inherently higher risk profile than larger more established or mature businesses which are not growing at the same relative rate. However it is unlikely that such growth companies will be involved in the sorts of risks which significantly affect society as a whole or operate critical infrastructure, the disruption or destruction of which could have major cross-border impacts. It is that growth and commensurate risk appetite which will provide the jobs which are needed as more mature European companies shed employment.

We believe that it is clearly the responsibility of the board to decide on the nature and extent of the risks their company is willing to undertake in order to achieve its strategic objectives. For quoted companies, this assessment should be clearly reported to investors on an annual basis in an appropriate manner, which will clarify the board's intentions but not require the company to disclose commercially sensitive information.

However we believe it is for the board to decide what is or is not a risk to the business and how risk reporting should be done. We believe that anything which may create a tendency to "tick box" reporting will undermine the value of the process and should be avoided, including prescription around what should be considered as relevant societal risks.

**(12) Do you agree that the board should ensure that the company's risk management arrangements are effective and commensurate with the company's risk profile?**

As noted above in our response to Question 11, we believe that national law currently requires this within the legal tolerance limits of "reasonable care, skill and diligence". Accordingly all directors should strive to ensure that the company's risk management arrangements are effective and commensurate with the company's risk profile. But a director will only be legally liable for failure to do so where he has exercised less than reasonable care, skill and diligence as explained in the answer to Question 11 above.

***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.**

We believe that there are three principal areas where EU legal rules militate against long-term investment behaviours. These are: Solvency II, particularly its potential application (or the application of an equivalent standard) to the pensions industry; the Markets in Financial Instruments Directive; and the quarterly disclosure regime.

- **Solvency II:** We are concerned that Solvency II pushes institutions into investing in shorter-term assets. While this may be appropriate for general (property and casualty) insurance, we do not believe it is so appropriate for institutions with long-term liabilities. Indeed, for such institutions this approach increases risk by generating a greater discrepancy between the tenor of the assets and the life of the liabilities. Solvency II already applies to insurers and is having a significant impact on their investment processes, obliging them to shift from being long-term owners of shares to being shorter-term holders of bonds and other assets. This is unfavourable to long-term share ownership and its potential positive influence on European companies and long-term investment in the future of Europe's productive economy. If Solvency II were applied to pension funds which hold significant assets to help meet their long-term liabilities it would lead to a very significant shift in the current investment approach of some of Europe's largest long-term investors and it would be decidedly unhelpful to long-termism in the market. We would welcome regulation of the industry which actively reflects the need institutions have to match their assets to their liabilities; for institutions with long-term liabilities this means that short-term liquidity above a limited level is not a vital attribute.

  We are concerned that the move into bonds has a particularly detrimental effect on small and mid-cap quoted companies who typically do not issue bonds. Therefore, finance is steered away from this segment of the market and so these companies are unable to benefit from a lower cost of capital, raise finance and create employment.

- **MiFID:** The focus of the Markets in Financial Instruments Directive (MiFID) was principally on removing barriers to the free movement of capital across Europe's borders. It also sought to drive more efficiency in Europe's capital markets through removing unnecessary frictional costs.

  The focus on reducing transactional costs has some significant impacts on the markets, increasing the potential returns from trading strategies while decreasing the benefits of long-term investment. Shareholders in our members' companies tend to be longer term and the shares themselves tend to be more illiquid. The search for returns via trading strategies has been encouraged by MiFID, reducing the number of and willingness of investors prepared to hold or own small and mid-cap quoted companies shares for the long term.

  In addition we would argue that the investment and trading activities which led to the financial crisis were benefited at least in part by the velocity of trade in the European and world markets. Costs are added to other parts of the economy because companies and long-term investors perceive greater need to hedge against this additional market volatility. In addition, longer-term investment activities can become swamped by this noise, and the impact on public companies can at times be actively detrimental: they feel the need to respond to short-term investors and temporary share price volatility rather than focusing on generating long-term returns for their investors and building their businesses to the benefit of all stakeholders. We would welcome this Directive's review in light of issues in relation to the downsides of excess liquidity.

- **Disclosure rules – interim management statements under the Transparency Directive:** While the requirement for public companies to issue two interim management statements as well as half-year and full year accounts is less onerous than a requirement for full quarterly reporting, we do believe that it tends to promote a quarterly approach to companies considering their performance and for investors in considering that performance. We regard this as an unhelpful and indeed pernicious step in the European financial markets, encouraging shorter-term thinking and on occasions discouraging investment for the long-term. Research in the US has indicated that quarterly reporting tends to drive companies not to make investments which would be positive for the long-term but which might harm perceived performance on a quarterly basis. Over time, this erodes value creation and economic performance, and we fear that the process of producing interim management statements in the EU marks a step in this direction. We do not believe that long-term investors

need companies to report more regularly than every six months – provided there is a robust ongoing disclosure regime under which companies are obliged to disclose promptly genuinely new developments between the six-monthly reporting, and that this ongoing disclosure regime is rigorously enforced by regulators – and would welcome the Commission giving active consideration to removing this requirement for quarterly market disclosures.

**(14) Are there measures to be taken, and if so, which ones, as regards the incentive structures for and performance evaluation of asset managers managing long-term institutional investors' portfolios?**

We believe that there is a need for clearer alignment of asset manager incentives with the interests of asset owners and long term interests of investee companies. Given the incentives described earlier in this section, the short-term trading rather than long term holding of shares, the incentives of both individual fund managers and their firms should be encouraged to be long-term in nature. Changes in this area could have a positive effect in the smaller quoted company segment of the market

We believe that one way to encourage this would be for specific provisions in Stewardship Codes for institutional investors to ensure fees and salary structures are compatible, and are seen to be compatible, with investors' objectives.

**(15) Should EU law promote more effective monitoring of asset managers by institutional investors with regard to strategies, costs, trading and the extent to which asset managers engage with the investee companies? If so, how?**

We believe that asset owners should indeed actively manage their fund managers with regard to strategies, costs, trading and stewardship activities. However, whether there is a need for EU legislative intervention is open to debate. We believe that the most that should be considered at this stage is transparency requirements: requiring public reporting in each of these areas by fund managers would be useful additional accountability. We also believe that such disclosure could help companies understand the viewpoints of their investors.

**(16) Should EU rules require a certain independence of the asset managers' governing body, for example from its parent company, or are other (legislative) measures needed to enhance disclosure and management of conflicts of interest?**

We believe that there are risks of conflicts of interest between fund management organisations and their owners where those owners are not long-term investors. We would welcome the European Commission giving active consideration to a regulatory response to these issues that might assert that the fund manager needs to have some body which clearly represents the fiduciary interests of its clients, and ensures that performance for clients over the long term is delivered in practice and not undermined by the interests of the parent company or some other organisation. How fund managers seek to deliver this would be up to them, but it would be an expected role for regulators to seek assurance that this fiduciary body is in place and effectively carries out this role.

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

We welcome engaged and visible shareholders. We believe that in order for shareholders to co-operate it is necessary for them to know who the major shareholders are of given companies. We therefore would welcome renewed attention being given to the transparency around share ownership in the EU. Please see our response to Question 20 for more detail.

We believe that one of the areas where the most potential improvement lies is namely the stewardship of companies by responsible investors.

We firmly believe that institutional investors should be encouraged (but not obliged) to adhere to a code of best practice, such as the ICGN Statement of Principles on Institutional Shareholder Responsibilities or the UK FRC Stewardship Code for Institutional Investors. We think that compliance with such codes should be on a comply or explain basis.

We think that a strong Stewardship Code would have at least two beneficial effects: it will best encourage good corporate behaviour, and it will provide the best basis for fund manager accountability to their clients.

It is clear that the need for long-term owners of public companies to live up to their responsibilities has never been greater than it is now. This was evident in the passive role played by shareholders, who did not act as responsible owners of the companies, in the origins of the current financial crisis.

We therefore would strongly encourage the European Commission to consider the possibility of endorsing a similar Code for European investors, and we are aware that such codes are being actively considered in various EU markets. The introduction of a European Stewardship Code, on a comply-or-explain basis, would assist both agents of end owners, institutional shareowners and their ultimate beneficiaries – long-term savers and pension scheme members – to fulfil this essential role in the further development and strengthening of the European markets and financial systems. We firmly believe that this would enhance the performance of the European economy as a whole.

In particular, the European Stewardship Code for institutional investors we envisage should include an expectation of active corporate engagement and not just the mere developing and publishing of investors' "investment and voting policies". From this point of view, we think that "engagement" also needs to be defined, and the clear distinction drawn between, on the one hand, proactive value-driven engagement and, on the other, dialogue around voting, which while important does not of itself amount to stewardship.

We believe that the Code should clearly state that its objective is to help long-term returns to shareholders, but the most important and ultimate objective is better run companies which should lead to better performance, ultimately benefiting individual beneficiaries and the economy as a whole.

**(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 believe that these steps would be helpful, in applying a professional discipline to an emerging profession which has significant influence on Europe's commercial life. Regulation in the form of a Directive requiring such transparency and disclosure would enable clients to apply the disciplining force of the market so that quality standards are maintained and conflicts of interest are transparent and effectively 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?**

We would hope that, by requiring some form of transparency and disclosure from proxy advisors (as outlined in our response to Question 18), the market could provide the necessary disciplining force so that there would not be a further need for any strict regulatory requirements that outlined what proxy advisors may and may not do.

**(20) Do you see a need for a technical and/or legal European mechanism to help issuers identify their shareholders in order to facilitate dialogue on corporate governance issues? If so, do you believe this would also benefit cooperation between investors? Please provide details (e.g. objective(s) pursued, preferred instrument, frequency, level of detail and cost allocation).**

We believe that the current divergence of practice across Europe in respect of the rights of issuers to obtain information concerning the identity of the beneficial holders of their shares is not conducive to good corporate governance. In some Member States, issuers are enabled under local law to make enquiries of all underlying shareholders however few shares they may hold. Issuers in other member states, however, do not enjoy such extensive rights and in some cases are only able to ascertain the identity of their shareholder base at limited times of the year (typically ahead of an AGM or corporate action), or only for holdings in excess of a certain percentage. We note that in those states where

there is greater visibility of the shareholder bases, there tends to be a higher level of voting. In our experience, this is truly effective when supported by member state law.

Greater visibility concerning the identity of shareholders enables issuers to engage more effectively with their underlying shareholders and hold meaningful discussions about corporate governance matters which may be of concern or interest to investors. This facilitates two-way transparency between shareholders and companies, which makes for improved governance.

We do not believe that a system where such enquiries are only made ahead of a corporate action is good practice. The making of such an enquiry may alert some sections of the market prematurely to the possibility that a corporate action may be planned, which has the potential of distorting the market and providing some sections of the market with information not generally available to all shareholders.

We note that the Transparency Working Group of the TARGET2 Securities project has reviewed this issue in depth and has made progress in three key areas, notably the development of standard messaging formats, the flow of disclosure messages and suggestions for changes to European legislation to enable issuers to be in a position to identify their underlying shareholders. We therefore support the findings in section 6 of the Final Report of the T2S Taskforce on Shareholder Transparency to the T2S Advisory Group on 7 March 2011. The full report may be accessed at:
http://www.ecb.int/paym/t2s/progress/pdf/subtrans/st_final_report_110307.pdf?6e8d90e3ac22c7f13d4283678d69a0dc

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

We understand that this may be an issue in some Member States, although the Companies Act provides protection in the UK. It would be helpful if the Commission could clarify the issue.

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

Please see our response to Question 21.

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

One of the biggest impediments to securing wider employee share ownership over the last few years has been the EU Prospectus Directive passed in 2003 which failed to contain adequate exemptions or provisions for lower disclosure for offers of shares to employees. Changes in 2010 have removed some of these problems, and we would encourage the Commission to press ESMA and national authorities over the coming months to prioritise transposing these amendments into Member State law to take advantage of these reliefs and also to implement uniform interpretations on common issues, which has been lacking and which has also prevented obstacles to companies operating cross- EU share schemes efficiently.

A particular concern is the impact of EU state aid rules on approved employee share schemes. In the UK, tax-favoured Enterprise Management Incentive (EMI) options have been limited to companies or groups with 250 or fewer full-time equivalent employees. The UK HM Revenue and Customs announced at the time of the change that this was the result of European Commission concerns that to continue without this cap would otherwise cause the EMI tax reliefs to be impermissible state aid. The basis of this conclusion has not been shared publicly, but the EMI scheme has been a significant conduit for the extension of employee equity participation in the UK particularly in smaller quoted companies, and the cap has not been helpful as it has prevented companies and groups which would otherwise consider themselves small from benefiting from the tax advantages available.

We suggest that the European Commission consider the effect of EU state aid rules on Member States' ability to create attractive share scheme structures, which would further encourage employee

share ownership. However, overall we do not believe that there is a need for a prescriptive approach or measures to be taken at EU level on employee share ownership.

***Monitoring and implementation of Corporate Governance Codes***

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

Explanation underpins the comply and explain regime throughout the EU. We agree that companies should provide detailed explanations for departures from corporate governance codes. Moreover, even when applying the recommendations and provisions of national corporate governance codes, we believe that companies should provide similar explanations and elaborate on how they have adopted the principles. In both cases – complying and explaining any derogations – boards should explain why the company's governance arrangements are the best for the company at its current stage of development.

The purpose of corporate governance is to create and maintain a flexible, efficient and effective framework for entrepreneurial management that delivers growth in shareholder value over the longer term. Accordingly, all explanations should be able to demonstrate how their governance arrangements contribute to long-term growth in shareholder value.

However, we would not support any strict or detailed information requirements outlining what must go into companies' explanations. This would lead to more standard information disclosures and promote a 'box-ticking' approach to corporate 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?**

We would note as we have done in our answer to Question 24 that the Commission's main focus should be encouraging the value of illustrating disclosure.

We are concerned about authorising a body to check the quality of explanations – ultimately, directors are accountable to their shareholders under the comply or explain regime and introducing a monitoring body would impact this relationship.

In addition to altering the relationship, we are concerned that introducing a strict form of monitoring would result in more standard information in terms of explanations and compliance checks by lawyers, thus, potentially decreasing the overall value and quality of explanations rather than the intended aim of improving them. For example, even without a hard legal requirement to comply or explain in the UK, companies often report in a defensive, legalistic manner.

We also are concerned that the use of monitoring bodies would raise difficult questions regarding their powers, role and also how they would evaluate qualitative statements about governance, as there are no standards. 'Quality' could only be judged based on whether an explanation has been made.

We suggest that shareholders have the first responsibility to integrate governance into their investment decisions and also into engagement with the companies. Ultimately, monitoring is the responsibility of the shareholder and so attention in this area should focus on engagement by shareholders with companies.

---

If you would like to discuss any of these issues in further detail, we would be happy to attend a meeting.

Yours faithfully,

Tim Ward
Chief Executive

**APPENDIX A**

**Quoted Companies Alliance – Working Group on the EU Corporate Governance Framework Green Paper**

| | |
|---|---|
| Tim Goodman (Chairman) | Hermes Equity Ownership Services |
| Tim Bird | Wedlake Bell LLP |
| Anthony Carey | Mazars LLP |
| Peter Swabey | Equiniti |
| Donald Stewart | Faegre & Benson LLP |
| Nicholas Stretch | CMS Cameron McKenna LLP |
| Kate Jalbert | Quoted Companies Alliance |
| Tim Ward | Quoted Companies Alliance |

**Quoted Companies Alliance Corporate Governance Committee**

| | |
|---|---|
| Tim Goodman (Chairman) | Hermes Equity Ownership Services |
| Edward Beale | London Finance & Investment Group PLC |
| Tim Bird | Wedlake Bell LLP |
| Dan Burns | McguireWoods |
| Nigel Burton | Petrosaudi Oil Services |
| Anthony Carey | Mazars LLP |
| Louis Cooper | Crowe Clark Whitehill |
| Madeleine Cordes | Capita Registrars Ltd |
| Tim Bird/Edward Craft | Wedlake Bell LLP |
| Kate Elsdon | PricewaterhouseCoopers LLP |
| Nicola Evans | Hogan Lovells International LLP |
| Clive Garston | Davies Arnold Cooper LLP |
| Nick Graves | Burges Salmon |
| Eugenia Jackson | F & C Asset Management plc |
| Colin Jones | UHY Hacker Young |
| Dalia Joseph | Oriel Securities Limited |
| Derek Marsh | China Food Company PLC |
| Georgina Marshall | Aviva Investors |
| James Parkes | CMS Cameron McKenna LLP |
| Nick Teunon | FTSE International Limited |
| Andrew Viner | BDO LLP |
| Melanie Wadsworth | Faegre & Benson LLP |
| Cliff Weight | MM & K Limited |
| Kate Jalbert | Quoted Companies Alliance |
| Tim Ward | Quoted Companies Alliance |

**APPENDIX B**

## THE QUOTED COMPANIES ALLIANCE (QCA)

A not-for-profit organisation funded by its membership, the QCA represents the interests of small and mid-cap quoted companies, their advisors and investors. It was founded in 1992, originally known as CISCO.

The QCA is governed by an elected Executive Committee, and undertakes its work through a number of highly focussed, multi-disciplinary committees and working groups of members who concentrate on specific areas of concern, in particular:

- taxation
- legislation affecting small and mid-cap quoted companies
- corporate governance
- employee share schemes
- trading, settlement and custody of shares
- structure and regulation of stock markets for small and mid-cap quoted companies;
- political liaison – briefing and influencing Westminster and Whitehall, the City and Brussels
- accounting standards proposals from various standard-setters

The QCA is a founder member of European**Issuers**, which represents quoted companies in fourteen European countries.

**QCA's Aims and Objectives**

The QCA works for small and mid-cap quoted companies in the United Kingdom and Europe to promote and maintain vibrant, healthy and liquid capital markets. Its principal objectives are:

*Lobbying* the Government, Brussels and other regulators to reduce the burden of regulation, which falls disproportionately on smaller quoted companies.

*Promoting* the smaller quoted company sector and taking steps to increase investor interest and improve shareholder liquidity for companies in it.

*Educating* companies in the sector about best practice in areas such as corporate governance

*Providing a forum* for small and mid-cap quoted company directors to network and discuss solutions to topical issues with their peer group, sector professionals and influential City figures.

Small and mid-cap quoted companies' contribute considerably to the UK economy:

- There are approximately 2,000 small and mid-cap quoted companies
- They represent around 85% of all quoted companies in the UK
- They employ approximately 1 million people, representing around 4% of total private sector employment
- Every 5% growth in the small and mid-cap quoted company sector could reduce UK unemployment by a further 50,000
- They generate:
    - corporation tax payable of £560 million per annum
    - income tax paid of £3 billion per annum
    - social security paid (employers' NIC) of £3 billion per annum
    - employees' national insurance contribution paid of £2 billion per annum

The tax figures <u>exclude</u> business rates, VAT and other indirect taxes.

For more information contact:
Tim Ward, The Quoted Companies Alliance
6 Kinghorn Street
London EC1A 7HW
020 7600 3745
www.theqca.com