



**The Quoted
Companies Alliance**

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Treasury Select Committee
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Dear Sirs,

Treasury Select Committee: Corporate Governance and Remuneration Inquiry

INTRODUCTION

The Quoted Companies Alliance is an independent membership organisation that champions the interests of small and mid-size 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 fourteen European countries.

The Quoted Companies Alliance 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 regarding corporate governance in systemically important financial institutions.

It is notable that whilst the objective of the inquiry is stated to relate only to corporate governance in systemically important financial institutions, the terms of reference go far beyond that. Whilst we represent small and mid-size quoted companies, we are quite concerned by the likelihood of far-reaching proposals that will seriously impact our sector. This may be an unintentional outcome, but the potential consequences could create further burdens on small and mid-size quoted companies. We feel that there is no evidence of widespread poor behaviour in this sector.

Corporate governance and the duties of directors were considered and debated at length in 2006. In 2009, the financial institutions' corporate governance had been discussed in depth under the Walker Review. We do not believe it is appropriate to seek to reopen this body of law at this stage when matters such as the BIS consultation on Long Termism in Corporate Britain, the EU Corporate Governance Green Paper and company law review remain outstanding.

It is also important to emphasise that the relationship between shareholders and directors is crucial when discussing good corporate governance. The trust between the two parties is the basis of a successful company. A lack of trust between the two, leads only to a greater demand for regulation. To engender greater trust between the shareholders and directors, there needs to be plenty of feedback from the shareholders to the directors. We have seen in the recent months there have been numerous occasions where shareholders have taken action against their directors without having to rely on regulation. The shareholder reaction to some proposed by the largest companies remuneration policies and the increase media coverage on appointing more women to boards, will serve to change behaviours and therefore require less regulatory and legislative change.

Board structure and composition

1. *What outcomes should corporate governance in the financial services sector seek to achieve?*

There should be no difference in the outcomes of corporate governance between sectors: Corporate governance principles should be the same and be consistently applied, regardless of the sector. We consider any proposal to impose differential treatment is both dangerous and counterproductive. We do believe though, that if there is to be a change in treatment (which is something that we would be vocal against) then a proportionate approach with regards to small and mid-size quoted companies would be appropriate.

2. *Are Board structures effective? For example, should UK financial institutions consider adopting alternatives to the unitary Board structure?*

We see no evidence for the need for any material change to the current standard board structure or to directors duties, the latter of which are now essentially codified in section 172 et seq. Companies Act 2006. To make any changes in a piecemeal fashion without identifying any specific issues to be addressed would be imprudent and potentially counterproductive.

The effectiveness of a board structure hinges upon the dynamics within that board, the personalities concerned and the manner in which a chairman manages his board. The structures within which boards operate matter less than the substance of how individuals on the board interact with each other, either formally or informally, with the proviso that board members should understand and optimise the corporate governance structure in which they operate as a matter of best practice.

We believe therefore that encouraging alternative board structures would not be a productive avenue to pursue, not least because:

- the majority of directors of UK companies are most experienced and familiar with unitary boards and it would seem sensible to allow directors to use existing, familiar structures to effectively “bed down” recent and significant developments in corporate governance ; and
- the legal basis for anything other than a unitary board under English company law would be unclear and untested, and require significant time and resources to develop without any clear, defined benefit.

3. *Does the UK approach to regulation and supervision of financial services incentivise Boards to perform their role effectively? Is more intrusive regulation a substitute or complement to effective corporate governance? Is a “comply or explain” approach an effective framework for governance?*

We believe that the combination of a clear legal regime, together with a renewed focus on good governance provides an appropriate and sufficient incentive for boards to effectively perform their role. We would welcome supportive and tailored supervision (for example, thematic reviews and engagement with directors and boards) by regulators within existing provisions, rather than incremental intrusive or aggressive, enforcement led regulation. Intrusive regulation is no substitute for effective corporate governance in the first instance, although we recognise there is a role for accountability and regulation where governance has failed.

We strongly support the “comply or explain” approach to the implementation of corporate governance principles by companies and to the adherence to the principles for stewardship by investors. Good governance is an attitude of mind which must distil not only through a board, but through a whole organisation and therefore it cannot be best applied by either regulation or blind code compliance. It is, therefore, important for companies and investors to find governance solutions that are best suited for their business model, structure and organisational culture. We suggest, however, that the descriptor “comply or explain” be changed to “apply and explain”.

Once again we believe that the need for a proportionate response to corporate governance for small and mid-size quoted companies is essential. The large banks were unable to manage certain systemic

risk within the financial system and a number of large institutions were unable to protect themselves from such risks, leading to much hype about corporate governance, which ultimately should not disproportionately penalise small and mid-size quoted companies.

Corporate Culture

4. *What type of corporate culture should financial services firms seek to foster? In what way can this be encouraged? How effective are Boards at shaping corporate culture within their institutions?*

The corporate culture that every financial services firm should seek to foster is a clear focus on integrity, long-termism and serving the interests of its clients. Cultural leadership from the top of a firm is essential as senior management set and shape the cultural tone of a firm. Therefore, boards have a vital role in shaping the corporate culture of their respective organisations and should encourage an open and engaged culture where decisions are made and both challenge and ideas are encouraged without fear. It is also the board's role to ensure that individuals with the wrong cultural approach are appraised with this in mind as an important performance factor, and not in unchecked, senior management positions within their organisations.

This can be encouraged by considering measures to drive more positive and substantive disclosure about corporate governance, and commitment by shareholders to engage about the issue given their stewardship responsibilities.

Impact of previous reviews and new regulatory developments

5. *What difference would the proposals in the Independent Commission on Banking's report on the Boards of ring-fenced banks make to corporate governance in these institutions?*

We have no comment on this question.

6. *What benefits, if any, come from EU regulatory engagement with corporate governance issues?*

The benefits of EU regulatory engagement on corporate governance issues are significant as they filter through to, and add consistency to, a breadth of EU countries. It is therefore vitally important for EU member States to consider questions of corporate governance together to deliver constantly improving practice.

The European institutions are currently drawing together their conclusions following the Corporate Governance Green Paper of July 2011. The UK should wait and evaluate the conclusions from this process before pursuing alternatives which may confuse the picture further.

Whilst we support EU regulatory engagement as described above, we note that the "comply or explain" approach to corporate governance was a concept developed in the UK which has gained currency across the EU as a more effective and more immediate way to deliver appropriate best practice, rather than strict procedural legal obligations.

7. *What impact has the Walker Review (2009) had on corporate governance and corporate behaviour in financial services?*

We have no comment specifically on the financial services sector.

Non-Executive Directors

8. *Should non-executive directors bear greater liabilities than under current law? Should executives in FTSE 100 companies be able to hold non-executive positions in other firms?*

In general, liabilities should be appropriate to the role being discharged, and the first question should be answered with the benefit of a legal analysis of the different roles between executives and non-executives.

We feel it is inappropriate for us to comment on how the FTSE 100 companies should have to comply, however we do stress that we do not want any proposals to filter down inappropriately to small and mid-size quoted companies. We emphasise that if there is any prospective legislation, then it must offer a proportionate approach for small and mid-size quoted companies.

9. *Is the existing FSA approval process for significant influence functions (SIF), including non-executive directors, effective?*

We have no comment in relation to this, save to say that the formal approval process must be viewed in the context of the wider due diligence and selection process of a new director.

The role of shareholders

10. *Should shareholders be required to exercise a stronger role in systemically important financial institutions? What are the key barriers to greater shareholder activism by institutional investors in financial institutions? What risks are associated with it?*

We believe it is important to encourage a greater number of traditional long-term investors to act as responsible owners through the exercise of voting rights and engagement with investee companies, including systemically important financial institutions.

While we do not think that shareholders can or should be *required* to exercise a stronger role, it is certainly in the interests of their clients (where applicable) that they do so. In this context, we see the UK Stewardship Code as an important driver in broadening the base of active shareholders, although more needs to be done to encourage institutional investors (both asset owners and their investment managers) to exercise stewardship of their investee companies.

While shareholder engagement is critical for effective oversight of the governance practices of financial institutions, we believe it is important to be realistic about what shareholder engagement can achieve in view of the "asymmetry of information" available to the management of financial institutions, supervisory authorities and the market. Higher transparency of financial institutions and more meaningful disclosure on governance, risk (including non-financial risks) and internal controls would help improve quality of shareholder engagement. However, shareholders cannot be expected and should not attempt to micromanage.

11. *Is it realistic to expect sovereign wealth funds and hedge funds to undertake a more active role?*

We have no comment on this question.

Remuneration

12. *What role should institutional investors, remuneration consultants, employees and others play with respect to remuneration in the financial services sector?*

We have no comment specifically on the financial services sector.

13. *Is there a case for introducing still greater transparency for senior executives with respect to remuneration in the financial services sector?*

We have no comment specifically on the financial services sector.

14. *Should there be further reform of the remuneration arrangements of senior executives in the financial services sector? Should this extend to those highly paid individuals who sit below executive level?*

We have no comment specifically on the financial services sector.

15. *The Chairman of the Financial Services Authority has argued that there may be a case for changing the personal risk return trade-off for bank executives. He has suggested either a 'strict liability legal sanctions or an automatic incentives based approach. What are the merits and drawbacks of these proposals? Are there other ways to achieve the same objective?*

We have no comment specifically on the financial services sector.

Governance of risk

16. *Has the management of risk in firms improved since the financial crisis?*

We have no comment specifically on the financial services sector.

Diversity and background

17. *What is the relationship, if any, between Board diversity and company performance in the financial service sector?*

We have no comment specifically on the financial services sector.

If you would like to discuss this in more detail, we would be pleased to attend a meeting.

Yours sincerely,



Tim Ward
Chief Executive

QUOTED COMPANIES ALLIANCE CORPORATE GOVERNANCE COMMITTEE

Edward Beale	Western Selection Plc
Tim Bird	Field Fisher Waterhouse
Dan Burns	McguireWoods
Anthony Carey	Mazars LLP
Richard Chin	Oriel Securities Limited
Louis Cooper	Crowe Clark Whitehill LLP
Madeleine Cordes	Capita Registrars Ltd
Edward Craft	Wedlake Bell LLP
Kate Elsdon	PricewaterhouseCoopers LLP
Nicola Evans	Hogan Lovells International LLP
David Fuller	CLS Holdings PLC
Clive Garston	DAC Beachcroft LLP
Tim Goodman	Hermes Equity Ownership Services
Nick Graves	Burges Salmon
David Isherwood	BDO LLP
Kate Jalbert	The Quoted Companies Alliance
Colin Jones	UHY Hacker Young
Dalia Joseph	Oriel Securities Limited
Derek Marsh	China Food Company PLC
Claire Noyce	Hybridan LLP
James Parkes	CMS Cameron McKenna LLP
Anita Skipper	Aviva Investors
Julie Stanbrook	Hogan Lovells International LLP
Jacques Sultan	The Quoted Companies Alliance
Eugenia Unanyants-Jackson	F&C Investments
Melanie Wadsworth	Faegre Baker Daniels LLP
Tim Ward	The Quoted Companies Alliance
Cliff Weight	MM & K Limited

THE QUOTED COMPANIES ALLIANCE (QCA)

An independent organisation funded by its members, the Quoted Companies Alliance champions the interests of small and mid-cap size companies, their advisors and investors. It was founded in 1992, originally known as CISCO.

The Quoted Companies Alliance 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 Quoted Companies Alliance is a founder member of **EuropeanIssuers**, which represents quoted companies in fourteen European countries.

Quoted Companies Alliance's Aims and Objectives

The Quoted Companies Alliance 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 costing and time consuming 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 and investor relations.

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 exclude business rates, VAT and other indirect taxes.

For more information contact:

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