

Responsible Voting - A Joint ABI - NAPF Statement

1 Introduction

- 1.1 The Hampel Committee's Report on Corporate Governance¹ confirms the principle that Boards are accountable to shareholders of companies. Share ownership also gives rise to governance responsibilities which have, for many years, been acknowledged by a large number of institutional shareholders. In addition, institutional investors have an overriding fiduciary responsibility to those on whose behalf they are investing.
- 1.2 The ABI and the NAPF fully support the principles of good governance recommended by the Hampel Committee, which in many respects build on those evolved by the earlier Cadbury Committee². This joint statement responds to Hampel's proposal that "the ABI and the NAPF should examine the problem caused by the existence of different and incompatible shareholder voting guidelines" (Hampel 5.8). The ABI and the NAPF recognise that responsible shareholders may wish to brief boards of directors on their particular expectations but recommend that, when voting policies are introduced, or such policies are reviewed, due account is taken of the guidance below.

2 The need for joint guidance

- 2.1 Between them, ABI and NAPF members own or manage shareholdings representing by value more than half the UK stock market. Additionally, overseas institutional shareholders are increasingly investing in the UK and are seeking guidance on UK corporate governance practices. For UK investors, corporate governance is seen as a core issue and many recognise that a joint authoritative exposition of investor views could be helpful.

3 Why voting is important

- 3.1 Shareholders' ability to influence management depends to a considerable degree on the proportion of the votes which they can exercise and the use they make of these votes. Indeed, voting rights and the exercise thereof, in pursuit of responsible and effective corporate governance and the achievement of long-term shareholder value, may be recognised as an important and integral part of the investment management function. A considerable number of institutional investors have made an active and considered voting policy a priority and this is reflected in their creditable voting record in recent years.

- 3.2** The right to vote is, as the Hampel report identifies, an asset and institutional investors owe it to their clients to make considered use of it. The responsibility for voting is also one which, increasingly, ultimate beneficiaries are expecting to see fulfilled. Voting, though, is only part of the dialogue that should exist between investors and boards of directors. The report of the Myners Working Group³ sets down the principles to be followed.

4 The need for responsible voting

- 4.1 Responsible voting involves the application of informed decisions reached within the framework of a considered corporate governance policy. The ABI has long-established guidelines on a range of shareholder issues and ABI members will, in the main, reflect these in the application of their voting policies. The NAPF also strongly encourages its members to vote responsibly, and whenever reasonably possible. The ABI and the NAPF believe that the requirements of the Combined Code⁴ should become a starting point for these policies.
- 4.2 A simple "box-ticking" approach to corporate governance, by contrast, does not lead to considered and responsible voting. The Hampel report also recognised the strong arguments against making voting compulsory since this would be unlikely to improve overall standards of corporate governance.
- 4.3 It is important that institutional shareholders support Boards by a positive use of their voting rights unless they have good reasons for doing otherwise. Where a Board has received steady support over a period of time, it should become a matter of concern to the Board if that support is not forthcoming on a particular matter.
- 4.4 Where an institutional investor would judge it appropriate to vote against a proposal which it considers undesirable, it is important that, wherever possible, representations are made in time for the problem to be considered and for consultation to take place with a view to achieving a satisfactory solution.
- 4.5 The ABI and the NAPF liaise closely with their members through their respective voting services to provide relevant information about resolutions and related corporate governance issues. These services are now being widely used within the investment community as investors increasingly realise that considered advice is needed to secure responsible voting decisions.

5 Composition of the Board

- 5.1 The composition, balance and effectiveness of a company's Board must be a matter of legitimate concern to shareholders. They have the opportunity to confirm all appointments to the Board and to re-elect directors as, routinely, they retire by rotation. Shareholders will be particularly concerned to ensure the appointment of a core of non-executives of sufficient number and of appropriate calibre, experience and independence and to identify where there may be undue concentrations of decision-making power not formally constrained by checks and balances appropriate to the particular company. The ABI's and the NAPF's voting services have an agreed definition of independence (see Appendix 1).
- 5.2 Institutional shareholders fully support the appointment of Audit, Remuneration and Nomination Committees, and the value of these committees and the importance of the role played generally by non-executive directors are increasingly widely recognised.

6 Emoluments of directors and senior managers

- 6.1 Institutional shareholders support the key recommendations of the Study Group under the chairmanship of Sir Richard Greenbury⁵ and the framework this has provided for shareholders to vote on share-based long-term incentive schemes, which involve either dilution or the commitment of shareholders' equity.
- 6.2 Overall remuneration strategy as it affects executive directors and other senior executives, including the proportions of fixed and performance-related variable components of pay, should be dealt with by a Remuneration Committee which, in accordance with the Greenbury and Hampel recommendations, should be composed wholly of non-executive directors. It is essential that shareholders are, through the annual report on remuneration, informed clearly and concisely of the principles upon which directors' emoluments are determined, the details of performance-linked contracts and the potential for compensation on premature termination of contract.
- 6.3 It is considered essential that challenging performance criteria should govern the vesting of awards or the exercise of options under any form of Long Term share-based Incentive Scheme. Investors will expect these criteria to demonstrate the achievement of a level of performance or rate of growth in a defined financial measure which is demanding in the context of the prospects for the company and the wider economic environment in which it operates.

- 6.4 Remuneration Committees may propose performance criteria requiring, as the primary focus, outperformance on the chosen financial measure (or total shareholder return where this is supported by underlying financial performance) of the mean or median achieved within a defined peer group. Where consideration is given to devising other types of performance criteria these will need to be fully explained, demonstrated to be robust and demanding, and linked clearly to the achievement of enhanced shareholder value.
- 6.5 When considering remuneration policies, the ABI and NAPF voting services have regard to the above considerations and seek to assess the extent to which the stated aims are relevant and likely to be achieved. The ABI has detailed guidance on a number of aspects of remuneration policy, including share schemes and incentive elements of pay, with which the NAPF is in broad agreement. Both associations welcome the opportunity to discuss remuneration policies at an early stage.
- 6.6 While directors' service contracts are available for inspection in all instances, shareholders do not generally have the opportunity to vote on these. There has been a clear trend towards shorter length contracts. However, a particular area of concern is in circumstances of early termination, especially where the duration of the contract is in excess of one year, leading either to a perception of payment for failure, or concern where the individual commences new employment, often shortly after receiving a very substantial compensation payment. There are a number of ways of addressing the problem of early termination. One which deserves careful consideration is to phase compensation payments over the length of the notice period, with these payments ceasing when the individual concerned commences alternative employment.

7 Takeover bids

- 7.1 The greatest potential for tension between management and shareholders arises when a company becomes the object of a takeover bid which is launched without prior agreement of the incumbent Board. However, where a company has kept its shareholders informed of its long-term plans, confidence and understanding will have developed between management and shareholders, making it less likely that a contested bid will succeed. Where shareholders understand the long-term objectives of management, they are more likely to support the incumbent Board in its resistance to an unwelcome bid.

8 Conclusion

- 8.1 The overall objective of ABI and NAPF members is to achieve, on behalf of those for whom they act, a competitive return on the funds invested. The exercise of their voting policy, in respect of the range of matters on which shareholder decisions are sought, will be in support of the proper management of companies and directed towards the enhancement of long-term shareholder value and the wider economic benefits which this should also engender.

8.2 Corporate governance practices, both in the UK and overseas, are evolving rapidly and it is likely that the ABI and the NAPF will continue to develop further guidance as necessary.

1 Committee on Corporate Governance, Final Report (1998) chaired by Sir Ronald Hampel, available from Gee Publishing (tel: 0345 573113)

2 Report of the Committee on the Financial Aspects of Corporate Governance (1992) chaired by Sir Adrian Cadbury, available from Gee Publishing

3 Developing a Winning Partnership (1995), report of a joint City/Industry Working Group chaired by Paul Myners, available from DTI Innovation Unit (tel: 0171 215 1994)

4 Committee on Corporate Governance, The Combined Code (1998) derived by the Committee on Corporate Governance from the Committee's Final Report and from the Cadbury and Greenbury Reports, available from Gee Publishing

5 Directors' Remuneration: Report of a Study Group chaired by Sir Richard Greenbury (1995), available from Gee Publishing

Directors' independence

The issue of a non-executive director's independence has been highlighted by the Hampel Committee and a company's viewpoint on an individual's status is likely to be challenged from time to time. The ABI and the NAPF suggest the criteria set out below as the minimum likely acceptable to institutional investors. This is not, though, necessarily an exhaustive list of factors in the nature of significant financial or personal ties to a company or its management, the existence of which may lead to a perception of lack of genuine independence on the part of the non-executive director concerned.

An individual director's integrity is highly relevant and it is understood that the level of a director's independence can vary, depending on the particular issue under discussion. In assessing the independence of a non-executive director, the assumption is that the individual is independent unless, in relation to the Company, the director:

- was formerly an executive
- is, or has been paid by the Company in any capacity other than as a non-executive director
- represents a trading partner or is connected to a company or partnership (or was prior to retirement) which does business with the Company
- has been a non-executive director for nine years - ie three 3-year terms
- is closely related to an executive director
- has been awarded share options, performance-related pay or is a member of the Company's pension fund
- represents a controlling or significant shareholder
- is a new appointee selected other than by a formal process

- has cross-directorships with any executive director
- is deemed by the Company, for whatever reasons, not to be independent.

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