

INSTITUTIONAL SHAREHOLDERS' COMMITTEE

The Responsibilities of Institutional Shareholders in the UK

1 INTRODUCTION

- 1.1 The ISC's Statement of Best Practice on the Role and Duties of Directors was published in April 1991. Implicit in that document was the understanding that shareholders are the true proprietors of a company. This ownership gives rise to responsibilities which have, for many years, been acknowledged by a large number of institutional shareholders. This document considers the nature of those responsibilities against the background of the overriding obligations of institutional investors, which must be to those on whose behalf they invest.

2 COMMUNICATION

- 2.1 Because of the size of their shareholdings, institutional investors, as part proprietors of a company, are under a strong obligation to exercise their influence in a responsible manner. Many institutions already have effective channels of communication with the Board of companies in which they invest, both directly and through advisers. Such channels need to be developed more widely if the communication process is to be made more effective.
- 2.2 Shareholders receive Reports and Accounts and other explanatory circulars from companies which are required by statute or for example by the Stock Exchange. They also have the right to attend company meetings where they can raise questions about the affairs of the company. These are formal methods of communication, but in themselves they may not be sufficient to establish the type of direct relationship which enables directors and shareholders to obtain a deeper understanding of each other's aims and requirements.
- 2.3 It is felt, therefore, that institutional shareholders have a responsibility actively to encourage contact with companies which will include contact at senior executive level on both sides. Such dialogue will enable shareholders to gain a better appreciation of the management's objectives, the problems confronting it and the quality of those involved, while also focusing the attention of management more sharply on the expectations and requirements of shareholders.
- 2.4 Institutions do not wish to be made insiders, and such contacts should not include the transmission of price-sensitive information. Where, exceptionally, there are compelling reasons for a Board to consult institutional shareholders on issues which are price-sensitive, those shareholders may have to accept that such consultation would involve the receipt of confidences which will require that they suspend their ability to deal in the company's shares. It is important that such confidences are not

disclosed to investors by companies or their advisers inadvertently or without the investors' prior consent.

- 2.5 A meaningful and established communications process will assume a special importance when there is a bid, whether the company concerned is the recipient of a bid or is itself the offeror.

3 VOTING

- 3.1 Shareholders' ability to influence management depends on the proportion of the votes which they can exercise and the use they make of these votes.
- 3.2 It is considered important that institutional shareholders support Boards by a positive use of their voting rights unless they have good reasons for doing otherwise. Such shareholders should register their votes wherever possible on a regular basis. 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.
- 3.3 There will be occasions when an institutional investor will feel it appropriate to vote against a proposal which it considers undesirable. In such circumstances 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. Where a satisfactory outcome cannot be achieved on an important issue, it may be desirable for a spokesperson to attend the relevant meeting of the company and explain why the particular proposal is being opposed. In such cases a poll should be demanded to ensure that the vote is duly recorded.
- 3.4 In view of the foregoing, institutional shareholders have for many years been opposed to the creation of equity shares which do not carry full voting rights and have sought the enfranchisement of existing restricted voting or non-voting shares.

4 COMPOSITION OF THE BOARD

- 4.1 The composition 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 which are initiated by the existing directors, and there is a growing acceptance that a properly balanced Board is essential to the wellbeing of a company. Institutions individually, or where appropriate collectively, are increasingly prepared to suggest change to remedy perceived weaknesses and where necessary to encourage Boards to appoint an adequate number of independent non-executive directors. Institutional shareholders seek to identify serious deficiencies at an early stage, and to initiate appropriate action. The most effective action is taken quickly, and without publicity. It is exceptional for such initiatives to be taken collectively, because of the need for speed of action, and confidentiality. It is also undesirable for more than the minimum number of individuals to receive information or knowledge of events which at times may be highly price-sensitive.
- 4.2 Institutional shareholders have urged, and should fully support, the appointment of Remuneration and Audit Committees, whose value is becoming widely recognised.

5 EMOLUMENTS OF DIRECTORS AND SENIOR MANAGERS

- 5.1 As a matter of general principle the emoluments of Executive Directors and Senior Management are a matter for the Board, and this should be dealt with by an independent Remuneration Committee. Adequate disclosure of the principles upon which directors' emoluments are determined is essential, however, so that shareholders are made aware of performance-linked contracts and so as to ensure that in the event of a contract being terminated prematurely, any compensation for loss of office will not become a matter of contention between shareholders and remaining directors.

6 TAKEOVER BIDS

- 6.1 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. There may be added tension when a bid emanates from overseas, where the offeror may not be vulnerable to the same market pressures.
- 6.2 Institutional shareholders have a primary duty to those on whose behalf they invest and they should, therefore, consider all offers objectively. They should listen carefully to the arguments of both offeror and offeree before coming to a decision on their merits. They should not, and generally do not, commit themselves to a particular course of action until they have taken the opportunity to consider the best information available.
- 6.3 When a bid is in the form of cash or shares with an underwritten cash alternative, additional considerations will apply because the future value of income stream or capital growth is crystallised. This value is certain and may well be at such a high level that the institutions' fiduciary responsibilities cannot be ignored.
- 6.4 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 hostile bid will succeed. Where good relations have been established and shareholders understand the long term objectives of management they are more likely to support the incumbent Board in its resistance to an unwelcome bid.
- 6.5 Some considerations, such as the impact of a takeover on competition or on the public or national interests, must be the direct concern of government. The professional and fiduciary obligations of institutional shareholders must override such considerations, in the absence of government action.

SUMMARY

The foregoing may be summarised in the following principles of good practice:

- (a) Institutional investors should encourage regular, systematic contact at senior executive level to exchange views and information on strategy, performance, Board membership and quality of management.

- (b) Institutional investors will not wish to receive price sensitive information as a result of such dialogue but may agree to accept it on an exceptional basis as the price of a long-term relationship, although this would require that they suspend their ability to deal in the shares.
- (c) Institutional investors are opposed to the creation of equity shares which do not carry full voting rights.
- (d) Institutional investors should support Boards by a positive use of voting rights, unless they have good reasons for doing otherwise. Reasons for voting against a motion should be made known to the Board beforehand.
- (e) Institutional investors should take a positive interest in the composition of Boards of Directors, with particular reference to:
 - (i) Concentrations of decision-making power not formally constrained by checks and balances appropriate to the particular company.
 - (ii) The appointment of a core of non-executives of appropriate calibre, experience and independence.
- (f) Institutional investors support the appointment of Remuneration and Audit Committees.
- (g) Institutional investors encourage disclosure of the principles upon which directors' emoluments are determined.
- (h) In takeover situations institutional investors will consider all offers on their merits and will not commit themselves to a particular course of action until they have reviewed the best and most up-to-date information available.
- (i) In all investment decision-making institutional investors have a fiduciary responsibility to those on whose behalf they are investing, which must override other considerations.

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December 1991