That Green Paper

by Peter Parry

The following is the covering letter that was submitted to BEIS on 17th February 2017 with UKSA's response to the Green Paper on corporate governance.

Dear Sirs,

This response to the Green Paper has been developed jointly by The UK Shareholders' Association (UKSA) and the UK Individual Shareholders' Society (ShareSoc). Both organisations represent the interests of private shareholders who invest (directly or indirectly via nominee accounts) in public companies or in other forms of equity-based investment. Both are independently funded by concerned individuals who pay a membership fee.

Fundamental Issues

Engagement between shareholders and companies is not working. Shareholders are not exercising effective stewardship and control, and boards are failing to fulfil their fiduciary obligations to members. As a result, public trust in business is low. This is bad for business and for long term investors. It needs to be addressed.

The ownership structure of public corporations means that the views and interests of ultimate beneficial owners are not given sufficient weight. The bulk of public company shares are controlled by institutions whose interests are often not aligned with those of the beneficial owners. BEIS (when it was BIS), to its credit, addressed this in its recent report on share ownership (Research Paper 261).

Shareholder Committees: We strongly support the concept of Shareholder Committees, provided that they represent the interests of all shareholders, including private investors and investors in employee share plans. Our recent very disappointing experience with the Board of the Royal Bank of Scotland Group plc suggests that UK boards are unlikely to implement shareholder committees unless these are mandatory.

Problems of the voting chain: This is not highlighted in the Green Paper. The proliferation of shareholders who are not directly interested in the companies in which they own shares– for example, intermediaries, ETFs, tracker funds and other index-related funds - corrupts the governance and stewardship process and the associated governance checks and balances. This is exacerbated by stock-lending – a process which is actually a sale-and-repurchase in which ownership rights (including the right to vote) pass to the 'borrower' for a fee. This prejudices the concept of corporate governance based on shareholder oversight, and places too much influence over our companies in the hands of traders - the ultimate cause of short-termism.

Theresa May - a friend to the private shareholder?

Disenfranchisement of individual shareholders: The Green Paper recognises the problem that most private investors are now obliged to hold their shares in pooled nominee accounts wherein shares are legally owned by an intermediary. The ability and rights of informed individual investors to influence the affairs of companies in which they have invested is fundamental to good governance. With current digital technology it should be feasible to ensure that, at a minimum, the names of beneficial owners are placed on the share registers of the companies in which they invest so that they can receive normal shareholder communications and voting rights.

Complexity of boardroom pay: Systems of remuneration for directors have become excessively complex as a result of the structural governance weaknesses identified in the Green Paper. The mechanisms for triggering bonus payments have become opaque, the quantum of the payouts is often impossible to predict, the true motivational impact has become questionable while the reporting to shareholders has become cumbersome and often obscure to the point of incomprehension.

Peter Parry
Policy Director

Weaknesses of long-term incentives: Boards and their advisors have taken advantage of the lack of voting integrity to implement complex LTIPs as a major part of the overall remuneration package. It is widely accepted that the longer a reward is deferred the less motivational impact it has on the recipient. It is also accepted that for performance incentives to work, the achievement of outcomes must be within the control of the recipient. The current system of long-term incentives fails both these tests. The current system to a large degree reflects guidance from institutional investors (who via engagement and voting have insisted companies pay directors this way). We take a simple view: the use of complex financial incentives to do a responsible and challenging job properly is inappropriate. It can also encourage perverse behaviour which we do not want from those who run our companies.

Shareholder Committees are a core part of the solution to the problems of corporate governance. There are many other elements of governance and control that can be improved and we have commented in our response on those where we have specific knowledge. However, without Shareholder Committees, and concomitant reform to restore the rights of individual shareholders, other changes to corporate governance are unlikely to produce meaningful change.

Our responses to the specific questions set out in the Green Paper are given below*. ShareSoc and UKSA would be pleased to discuss these and the summary above in more detail with the Department.

Please note although we remain separate organisations, UKSA and ShareSoc are working increasingly closely together. In recognition of this we have decided that we should each submit a response to BEIS but that the response should be exactly the same in each case. We would however like to be listed separately on your list of those organisations who have responded to the Green Paper.

Yours sincerely,
Peter Parry, Policy Director

*Refer news item on our website.