Key themes emerging from the round table for the BIS consultation on "A Long-term Focus for Corporate Britain" on what interventions the UK Govt could make.

On 12th January 2011, Forum for the Future, UKSIF and the Aldersgate Group co-convened a round table with senior-level representatives from investment institutions and large (mainly FTSE 100) businesses to debate the BIS consultation "A Long-term focus for corporate Britain".

The points expressed in this document reflect the individual views of round table participants and are not necessarily shared by any of the organisations attending or hosting.

(1) Strengthen tax incentives for long-term holding

- There seems to have been a move away from incentives for longer-term holding through differing rates of Capital Gains Tax in the recent past and we should understand why.
- Where the investment is through a fund, we need to distinguish properly between incentivising an individual investor to invest for the long-term, and incentivising the fund manager to make longer-term investments in the underlying assets. Incentivising the former won't change the investment strategy.
- Loyalty dividends would be interesting but have created legal problems when some companies have tried to introduce them.
- We are not necessarily trying to make people hold for longer. We are trying to redirect the economy to invest in key areas. This could be incentivised in other ways.
- You need a crude financial incentive so that the short-term disbenefit of not playing the market on a day-to-day basis is rewarded in the longer-term.
- It may be difficult in practice for a company to track exactly who its shareholders are.
- Equity finance is disadvantaged in tax and this has created a move towards other assets.

(2) Take care on interventions to slow down the number or frequency of transactions

- Given that UK institutional investors are not the majority of the investors in the UK, a significant transactions tax could risk sending capital elsewhere.
- You need to include externalities in trades so that the incentives to trade are different. Trading's not a bad thing if you've taken into account all the relevant factors.
- In some emerging markets, policies to introduce transactions taxes have resulted in a flow of capital out of the market.
- Incentives for long-term holding may be a better route.

(3) Undertake a wholesale review of structure of, and performance appraisal in, mandates

- It is difficult for asset managers to make investments in long-term propositions showing lower short term returns than the alternatives, because they are reporting to clients on a quarterly basis.
- We need longer-term mandates with strong get-out clauses benchmarked against growth in GDP and fundamentals rather than an index.

- The way pension funds have been regulated has contributed to short-termism in the market. The minimum funding requirement for pension schemes introduced in the 1995 Pensions Act was well-intentioned but had a completely perverse effect.
- There is too much emphasis on the form and not enough on the substance – for example, pension funds ask fund managers for detailed disclosure on how they are approaching sustainability and claim to support that approach, but behave very differently in their practical decisions about mandates.
- Asset managers are not incentivised to control transaction costs because they don't bear them, so they nibble away at performance. Pension funds need to be much more robust about their questions on transaction costs.

(4) Require greater disclosure by pension funds on how they are engaged on long-term thinking

- Support the development of ratings / metrics to assess the performance of pension funds in this area.
- The way the investment chain works, and the relationship and reporting between asset owner and asset manager creates a focus on returns not strategy. The amendment to the Pension Act in 2000 [to require disclosure on management of social and environmental issues] was a good start but more is needed.
- It would help to have better information on the age profile of pension funds – working with future beneficiaries on long-term issues will be more effective in pension funds with younger members than for those already in pay-out mode.

(5) Create policy certainty

- The regulatory framework favours the laggards rather than the leaders. In all areas, investors need credible long-term policy frameworks including, for example, on carbon, on planning requirements.
- There has to be a much clearer policy direction so that companies and investment managers have confidence to invest in key areas. We have an enormous separation between sustainability risk and financial risk and this is compounded by a host of poor decisions by government that make regulatory risk huge.
- Corporate Britain has to work in a highly political environment and the political horizon is very short, so politics is always changing the ground rules. There's a paradox in asking businesses to take a longer term view when the fundamental ground rules change so rapidly.
- Coal India recently floated quite successfully and this caused a hubbub, and there was less appetite for Enel's Green Power flotation. But this is not surprising given the regulatory signals. Markets take into account the factors that are there.
- Further policies on pricing externalities are needed. The government started the process on carbon and the floor price for carbon will help. But it's really only just started and if you look at other resources we've only just scratched the surface so more research is needed.
- The UK Government will need to encourage an international response to addressing these issues.

(6) Walk the talk on procurement and public sector pensions

- Government has to procure sustainably so that this drives more investment in sustainable companies.
- Government could send some clear signals about how pension funds can be managed for the long-term, through the way it requires its own pension funds to be managed.

(7) Require more strategic and longer-term thinking in company reporting

- The primary focus for company reporting should be on strategy, not on returns.
- At the moment there is very little focus on how a company is investing for long-term sustainability and investors tend to give very little credit for it.
- There should be greater disclosure on how 5-year plans fit into a sustainable future.
- The current culture is such that even in the context of a discussion on long-term trends, the focus reverts to the present.
- There is work going on in the House of Lords about the role of audit, and this could be an important area of focus.
- Companies need to have more resources for long-term thinking or have a platform to enable them to share future insights across markets so that there is more momentum around longer-term thinking.
- There's still a disconnect between sustainable investment and mainstream investment. Some companies are beginning to present their sustainability information in a way that interests mainstream investors and more work is needed in that area.
- It would be valuable to assess how investors would rethink their fiduciary duty if companies were being held in perpetuity. This long-term strategic view from investors would then be reflected in their approach to returns and company engagement.
- Long-term, sustainability-related KPIs need to be included in the remuneration of directors.

(8) Consider institutional decision-making structures in Government

- The UK Government could review and learn from the structure of ministerial responsibilities within other governments that have successfully adopted a more long-term approach. For example, in Australia the links between pensions and business are closer as pensions, company law and Treasury all sit within one Govt department.
- Need to make sure that responses on the many government consultations (eg environmental taxation, disclosure) are tied together and coherent, both in submissions and in Government's response.
- Need to review past and future policies for their impact on long-termism. Several drivers of the current short-termism are the unintended consequences of otherwise desirable past policies - for example on pensions. Policies like these should be reviewed to identify where this has occurred and what could be done to address this.

(9) Contribute to a better narrative / cultural shift

- Tell a better story about the relevance of longer-term to our wealth and well-being.
- Tell a better story about the relative importance of liquidity and stability, and the trade-offs between them.

- We have a psychological problem in that investors feel they are expected to make deals and behave "as gamblers" and there is a cultural bias against longer-term strategies.

(10) Provide support for collaboration on measuring and managing long-term risks

- It's becoming harder and harder for people to think in the long term because they know that black swans can happen from anywhere at any time. They focus on the short term because it is easier to predict and control.
- One powerful way to incentivise people for longer-term holding is to demonstrate that this does generate more robust and stable returns for investors, and this can only be done through more focus on fundamental long-term systemic risks. Government could help with research.
- There are unforeseen risks with the management of issues like climate change but also water, biodiversity and other resources, and more research is needed.
- Better assessment of long-term risks, and research into different ways of valuing them, would help in the integration of financial and sustainability agendas, so merits government support.