UKSIF

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Adam Gray
Long-term Focus Consultation
Corporate Law and Governance
Department for Business, Innovation and Skills
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Dear Adam Gray

Consultation on a Long-term Focus for Corporate Britain

Thank you for the opportunity to respond to this consultation.

UKSIF warmly welcomes the consultation. In our view, public policy should encourage and support corporate Britain to take an effective long-term responsible approach to wealth creation and address those market failures which impede this. We believe that this is in the interests of both the UK economy and of responsible investors worldwide.

In our view, there is ample evidence that long-term wealth creation and the interests of responsible capital providers is not well served by a range of current practices within capital markets and across the investment chain. Instead, there are market failures leading to an excessive focus on the short-term.

UKSIF's response to this consultation has been informed by an expert roundtable organised in partnership with the Aldersgate Group and Forum for the Future. The roundtable was attended by representatives of leading investment managers and companies drawn from members and partners of the roundtable organisers. Reflecting the debate at the roundtable, this response focuses on your consultation questions on "Shareholders and their role in equity markets".

Our response is informed also by:

- UKSIF responses to past consultations on the UK Stewardship Code.
- Analysis we have undertaken on sustainable capital markets. Relevant material, including our Sustainable Capital Markets Library, is available at http://www.uksif.org/projects/policy.
- Our paper "Reshaping capital markets for a sustainable recovery" published in the Green Alliance pamphlet "From Crisis to Recovery" (2009). This includes a range of policy proposals to address the barriers to long-term responsible investment. It is available at http://www.green-alliance.org.uk/grea_p.aspx?id=4156
- Our report "Focused on the Future: Celebrating 10 years of responsible investment disclosure by UK occupational pension funds" (June 2010) which includes a list of ten key changes needed (see Page 7). It is available at http://www.uksif.org/about/Latest_News/News_Archive#5387001.

Our response addresses your consultation questions 1, 3, 7, 8, 9 and 10.

Please classify UKSIF as an "Investor representative organization" in your analysis of consultation responses.

The Board of Directors

Question 1: Do UK Boards have a long-term focus – if not, why not?
Recent decades have seen an increased focus on the short-term across UK society as a whole. In our view, a long-term focus for corporate Britain is critically dependent on a **shift to a more long-term focus within society**.

We would therefore encourage the government to play a leading role in driving and supporting this cultural change to long-term thinking within UK society. Areas of focus might include:

- A greater focus on the long-term in government policy and communications, including building cross-party consent for measures to encourage long-termism
- Longer ministerial terms of office, including for particularly relevant posts such as Pensions Minister
- Prioritised funding for relevant academic research
- Higher priority given to encouraging financial literacy and long-term thinking both within educational curriculums and among the general public

Shareholders and their role in equity markets

Question 3: What are the implications of the changing nature of UK share ownership for corporate governance and equity markets?

This consultation paper addresses a number of overlapping issues. Today:

- The balance of industry sectors within the UK economy varies significantly from that held by public shareholders through the London Stock Exchange (LSE). Many LSE listed companies are domiciled outside the UK; including an increasing number of natural resources companies. In addition, UK domiciled companies may draw a considerable amount of their revenue from activities outside the UK, while UK subsidiaries of international companies continue to have considerable economic impact within the UK.
- UK domiciled companies listed on the London Stock Exchange have shareholders drawn from around the world. Equally, a typical major UK asset owner will invest globally rather than mainly in the UK.
- As the consultation paper highlights, listed companies domiciled in the UK have a mixture of long-term and short-term shareholders with potentially conflicting interests. There are also drivers towards shorter shareholding periods.

As a result, in addition to a focus on the time horizon of investors, government policies should:

1. Clarify those **types of companies** where they wish to encourage a longer term approach, distinguishing as necessary between companies that are listed, domiciled and/or generating revenue within the UK.
2. Focus on the **global community of asset owners and their agents** rather than disproportionately on asset owners and/or their agents based within the UK.

Question 7: Is short-termism in equity markets a problem and, if so, how should it be addressed?

Yes, UKSIF believe that short-termism in equity markets is a critical issue. Evidence of this short-termism, in our view, goes beyond points highlighted in the consultation paper and includes:

- Our members tell us that investment managers are rarely incentivised by their clients to focus on the long-term; instead they are usually measured on their performance against short-term benchmarks.
- The analysis tools used by most investment managers do not place a high value on factors impacting corporate performance beyond, say, a five year time horizon.
- For many industry sectors, there are limited ways to assess the long-term value of companies. In our view, a long-term focus would be evidenced by robust measures of the social, intellectual and human capital of firms, and of their impact on natural capital. Instead, valuation models tend to be based on revenue predictions.

A more detailed analysis is given in our paper "Reshaping capital markets for a sustainable recovery" (2009)[1]. This paper describes also the public policy measures that UKSIF recommends to address this short-term focus. In addition, our report "Focused on the Future: Celebrating 10 years of responsible investment disclosure by UK occupational pension funds" (June 2010)[2] includes a list of ten key changes needed.

There are a number of immediate and relatively low cost measures that the government and the UK parliament could take that would clearly signal their commitment to address these issues and make a material difference in supporting a longer term approach to investment in the UK. We would encourage the government and parliamentarians to take immediate steps to implement these measures while they considered the other actions needed to address market failures:

1. **The Parliamentary Contributory Pension Fund (PCPF)[3] should become a signatory to the UN-based Principles for Responsible Investment** and make a public commitment to be a global leader among funds of its size in implementing the Principles. This would, of course, be a decision for the trustees of the fund but we believe that it would be quite proper for the government, as the "plan sponsor" that underwrites the fund benefits, and parliamentarians, as beneficiaries, to support and encourage this.
2. Government should review **international best practice in institutional design to support long-term responsible asset ownership** by pension funds, insurance companies and other asset owners. The review should address public policy development, implementation and oversight. The review should consider the most effective institutional design to support effective stewardship and investment by:
    - Occupational pension funds (where investment policy sits within the Department for Work and Pensions, and is regulated by the Pensions Regulator which reports in turn to DWP)
    - Local government pension funds (where investment policy sits within the Department for Communities and Local Government)
    - Charities (where investment policy sits within the Charity Commission)
    - Sophisticated and mass market private investors (where investment policy sits within the Financial Services Authority and HM Treasury)
3. Government should require **local government pension funds to undertake sustainable procurement of investment services**, perhaps using BS 8903[4], the new British Standard for Sustainable Procurement. It should also require these funds to (a) become signatories to the UK-backed Principles for Responsible Investment and (b) report online how their responsible investment policies are implemented.
4. Government should **review relevant past laws, regulations, standards and taxation policies for unforeseen consequences** in encouraging short-termism in investment markets and consult on actions to address these consequences. For example, it should consider whether policies have penalised illiquid or volatile investments when it would have be prudent otherwise for investors to have made longer-term choices.
5. Government should **consult further on the use of tax incentives** to encourage longer-term ownership. This includes considering the current differential corporate tax treatment of equity and debt.

Question 8: What action, if any, should be taken to encourage a long-term focus in UK equity investment decisions? What are the benefits and costs of possible actions to encourage longer holding periods?

Please see our answer to Question 7. This identifies a number of immediate practical steps that government should take that offer high potential benefit combined with relatively low implementation costs. It also recommends and signposts to UKSIF proposals for longer term measures.

Question 9: Are there agency problems in the investment chain and, if so, how should they be addressed?

In our view, it is widely accepted that there are agency problems in the investment chain.

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[1] Our chapter "Reshaping capital markets for a sustainable recovery" in the Green Alliance pamphlet "From Crisis to Recovery" (2009), available at http://www.green-alliance.org.uk/grea_p.aspx?id=4156.
[2] Available at http://www.uksif.org/about/Latest_News/News_Archive#5387001.
[3] http://www.parliament.uk/briefingpapers/commons/lib/research/briefings/snbt-01844.pdf
[4] http://shop.bsigroup.com/ProductDetail/?pid=000000000030203003

Please see our answer to Question 7. This identifies a number of immediate practical steps that government should take that offer high potential benefit combined with relatively low implementation costs. It also recommends and signposts to UKSIF proposals for longer term measures.

Question 10: What would be the benefits and costs of more transparency in the role of fund managers, their mandates and their pay?

In our view, significant benefits would result from requiring **significant UK asset owners such as pension funds, insurance companies and charities to make public disclosures of their responsible investment policies and how these are implemented**. These bodies should be accountable to their customers and beneficiaries and to the general public. Today, there are some requirements related to disclosure of these investment policies but they are not comprehensive, and requirements related to implementation disclosure are lacking.

Such disclosure measures, combined with demand drivers such as peer pressure and civil society scrutiny, should cause supply chain pressure within the investment chain.

While we support increased transparency by fund managers, we believe that greater transparency by their clients, combined with strong civil society and peer scrutiny, is the most critical driver for change.

UKSIF – the Sustainable Investment and Finance Association

UKSIF, the sustainable investment and finance association, supports the UK finance sector to be a global leader in advancing sustainable development through financial services. We promote and support responsible investment and other forms of finance that advance sustainable economic development, enhance quality of life and safeguard the environment. We also seek to ensure that individual and institutional investors can reflect their values in their investments.

UKSIF was created in 1991 to bring together the different strands of sustainable and responsible finance nationally and to act as a focus and a voice for the industry. UKSIF's 250+ members and affiliates include institutional and retail fund managers, investment banks, pension funds, financial advisers, research providers, consultants, trade unions, banks and non-governmental organisations. For more information about UKSIF, please visit www.uksif.org.

UKSIF supports long-term responsible investment and ownership. It focuses its corporate governance support on the interface between governance on the one hand and social, environmental and ethical issues on the other.

With best wishes

Penny Shepherd

Penny Shepherd MBE
Chief Executive
UKSIF – the sustainable investment and finance association