

New Deal

UK minister demands market action on governance, or law will follow

In its first major post-election statement on corporate and fund governance, Britain's Labour government put boards and institutional investors on notice that they must take early steps to boost accountability—or face legislation requiring them to do so. The warning came in a milestone speech Wednesday by **Department of Trade and Industry (DTI)** minister Margaret Beckett before a conference sponsored by **PIRC**, the London-based governance consultancy. Her words were hardly empty. **Later in the day, in a Green Paper, the minister announced a sweeping, three-year overhaul of U.K. company law that could contain the legislative sticks to be wielded if the financial community fails to respond. Beckett's initiative is likely to accelerate deep reforms in board and investor behavior and influence governance worldwide.** Her key demands:

Corporate Governance

- ◆ **Votes on Pay.** Tackling public concern over “fat cat” salaries, Beckett wants “early evidence” of companies putting their annual remuneration committee reports to shareholder votes. If they don't, the minister pointedly outlined her options: making it mandatory in law, or requiring directors to stand for election each year, rather than every three years, as is normal. To date, only two companies have had ballots on pay reports.
- ◆ **Director Duties.** The government wants directors, in making decisions, to consider the interests of stakeholders such as employees rather than just the shareholders. Beckett's Green Paper explicitly raises the possibility of broadening director duties in statute. Her strong stakeholder language echoes recommendations of the **Centre for Tomorrow's Company**, but worries institutions who reject dilution of shareholder oversight.
- ◆ **Annual Meetings.** Electronic proxy voting and rule changes making it easier for shareholders to file dissident resolutions are on the DTI agenda for law reform.

Fund Governance

- ◆ **Share Voting.** Institutional investors should vote all shares and “make 1998 the first year in which there is a step change” in ballot participation. If they don't, Beckett made plain that she would put a voting requirement in the new company law bill. Now, only 40% of votes are cast.
- ◆ **Disclosure.** Institutions should annually issue voting policies and records so that they may be held accountable.
- ◆ **Activism.** Pension fund trustees should routinely ask fund managers how they vote, and check to ensure that their strategies seek long-term performance rather than short-term stock gains. Beckett is trying to prod fund manager activism

while tamping down trading that encourages corporate downsizing.

The Green Paper marks an abrupt end to Labour's 10 months of ‘radio silence’ on corporate governance. Suddenly the DTI is eager for on-going dialogue with the market. Indeed, the pace of the review—timed to conclude with a White Paper in March 2001 and legislation in the next Parliament—is to allow for consultation every step of the way.

Next January the department expects to launch a broad-based Working Group on corporate governance. In effect, the body will become a Whitehall-led successor to the **Hampel Committee** barely a year after the business-led group wound up. The Working Group will have 12 months to report its recommendations. This body, presumably, will advise on whether the market has met Beckett's targets—or whether the government should use its legislative sticks.

In an instant, Beckett reset the terms of the U.K. governance debate for the next 36 months. The minister's pay vote demand will likely introduce unprecedented owner oversight on remuneration. And her proposals on fund governance will compel institutional investors to break ground in transparency and activism. Further, expect Labour's corporate governance offensive to gain wide attention in Europe and other markets which look to the U.K. for ideas in this area. **Center-left governments with economic woes will pay particular attention if Beckett finds a way to lash kinder, gentler stakeholder values to harsh—but prosperous—Anglo capitalism.** Find Beckett's PIRC speech and Green Paper at <http://www.dti.gov.uk>.

Target: Japan, Germany

Fund opens new fronts in cross-border shareholder activism

Adding powerful fuel to corporate governance debates in Japan and Germany, CalPERS is set to endorse guidelines for the two markets later this month. Last March the US\$128 billion California retirement system issued guidelines for the U.K. and France—becoming the only pension fund anywhere to craft governance principles for specific non-home markets. Ironically, the CalPERS board is still at least two months away from approving guidelines for the U.S. **But the new documents, made available to GPW, are likely to emerge as a de facto template for global institutional investors voting shares in the two markets.**

In *Japan*, the CalPERS principles will call for:

- ⇒ **Principles.** Companies should show early compliance with best-practice reforms drafted by the **Corporate Governance Forum of Japan (CGFJ)** last October (**GPW** Nov. 7, 1997). CalPERS echoes the group's push for “some” independent directors on Japan's traditionally all-insider boards. The fund

also endorsed CGFJ's call for smaller boards capable of real monitoring, and all-independent internal auditors. **The CalPERS nod should give the CGFJ principles traction in Japan.**

- ⇒ **Code Panels.** CalPERS backs periodic reviews of best practices by committees which include institutional investors, including foreign shareholders.
- ⇒ **Transparency.** Firms should step up disclosure of board structure and director bonuses and attendance records.
- ⇒ **Longer Notice.** CalPERS wants earlier release of AGM notices, and meetings spread out through the year.
- ⇒ **Performance Pay.** Stock option plans should be linked to long-term improvement in shareholder value.
- ⇒ **Ending Insider Ties.** The fund urges boards to dismantle cross-shareholdings that entrench management and sustain inefficient business ties to corporate allies.

For *Germany*, CalPERS will advocate:

- ⇒ **New Laws.** The fund supports corporate governance legislative reforms proposed by the **Deutsche Schutzvereinigung für Wertpapierbesitz** shareholder group. Many of these were already passed by the Bundestag last month and will come into force August 1.
- ⇒ **Best Practices.** A code of best practices in corporate governance should emerge either through legislation or market initiative. The fund makes no mention of foreign shareholder involvement.
- ⇒ **Share Voting.** CalPERS recommends allowing mail or electronic voting, and abolition of the requirement to block shares from trading days before the annual meeting.
- ⇒ **Board Structure.** Supervisory boards should have an unspecified number of independents in addition to employees and representatives of large holders. Moreover, the outsiders should form audit, pay and nomination panels. Today, almost none exist. Boards should annually describe how they operate, and supply information on member backgrounds and attendance records. Shareholders should elect members annually rather than on the now-common staggered, four-year cycle.
- ⇒ **Financial Statements.** Firms should report in either international accounting standards or U.S. GAAP.
- ⇒ **Activism.** Shareholders should use dissident resolutions and counter-proposals 'to foster improved governance.'

The Japan and Germany draft principles were introduced at the CalPERS board's Feb. 17 meeting, and are scheduled for a final vote during the March 16-18 session. Revisions are still possible. When adopted, the texts will be posted on the CalPERS web site: <<http://www.calpers.ca.gov>>.

☑ **Wanted: Floodlights** **EU pressed for action to end** **"alarming" corporate secrecy**

"Alarming" information gaps in Europe could be disabling shareholder oversight and undermining companies' ability to compete for global capital, according to an influential new report. Economists linked through the **European Corporate Governance Network** (ECGN) presented the sweeping indictment to **European Commission** (EC) officials Feb. 20.

Many in the Network are urging mandatory, European Union-wide corporate disclosure rules to fix the problem.

In a swift response, Commission director Susan Binns declared last week that the EC could have corporate disclosure standards addressed early by its proposed advisory forum on company law, if the Commission approves the body next month (GPW Dec. 19, 1997). **The forum could fashion voluntary disclosure benchmarks or recommend regulatory initiatives such as collecting company information in a central EU depository, according to Binns, who handles disclosure matters in the DGXV internal market and financial services directorate.**

The ECGN set out to spotlight how ownership of stock correlates with voting rights. But the report, a year in the making, concludes that "none of the directives and regulations the Union has adopted" on disclosure allow for comprehensive cross-state comparisons of ownership information or voting power. "Access to ownership and control information is usually difficult within a member state, but even more difficult from another," it found. **Where voting rights are unequal, it is especially tough for investors to determine who exerts real control in companies whose shares they may purchase.** For instance, large voting blockholders may dominate a company with only small equity stakes, putting minority shareholders at a serious disadvantage, the ECGN argues. Paper filings in 11 languages, the proliferation of document offices (some 720 in Germany alone) and spotty enforcement of disclosure rules further cloud transparency.

Observers often find information gaps damaging because institutional investors slap a high-risk price discount on shares when data is scarce or voting rights appear unequal. This raises the cost of capital, undermining Europe's ability to compete for globally-mobile investment. The ECGN intends research to pinpoint the costs to investors when firms feature devices that inequitably entrench interests of certain owners.

Many in the group call for central EU collection of company information—perhaps in an EDGAR-style electronic system such as the U.S. SEC uses. They also advocate new EU directives requiring disclosure of ownership, unequal voting rights and private shareholder agreements similar to the way the 1934 Securities and Exchange Act does in the U.S. Self-regulation cannot ensure high across-the-board standards, assert the authors.

Binns, though, hits the caution light. "I should warn against jumping to the conclusion that just because something is a Good Thing that it necessarily justifies Community legislation." **She wants the forum, which is to include executives and shareholders, to craft non-legislative proposals, and new directives only "where really needed."**

The ECGN, founded in mid-1996, is a non-profit research network of scholars. In its first year, the body received nearly US\$90,000 in funding from the European Commission, a foundation of **ENI**, the Italian oil and gas company, and Italy's **Politecnico di Milano**. ECGN Executive Coordinator Dr. Marco Becht is based at the **European Centre for Advanced Studies in Economics** at the **Solvay Business School, Université Libre de Bruxelles**. Last week the group opened its web site for business. The ECGN plans for it to become a focal point for information on corporate governance in Europe. Visitors can register on the site for updates and research. Visit at <<http://www.ecgn.org>>.