Consultation on future priorities for the Action Plan on Modernising Company Law and
Enhancing Corporate Governance in the European Union.

The Association of Investment Trust Companies (AITC) response.

The AITC welcomes the opportunity to comment on the future priorities for implementing the
Commission’s Action Plan. We strongly support the principles which underpin the current
review. That is, that the Plan should seek to stimulate economic activity in Member States and
that any measures introduced should incorporate best practice in terms of ‘better regulation’.

Investment companies are closed-ended companies which pool capital and offer investors
access to a diversified portfolio of assets and specialist management skills. They have
traditionally been very cost effective and remain an excellent way for people of moderate
means to gain exposure to a range of shares and securities.

Investment companies do not ‘trade’ in the same way that a conventional company, such as a
retailer or manufacturer, might. Instead their shareholders are, in effect, their customers.
Investors buy and sell their shares on the stock market to either gain exposure to the fund’s
performance or redeem their investment. Investment companies are regulated by a variety of
legislation. Critically this includes company law and the Listing Rules of the UK Listing
Authority.

The UK listed investment company sector comprises just over 300 companies which manage
over £75billion of assets.

Detailed comments

This response is targeted on the questions of most concern to the investment company sector.

Question 2: Comments on the application of better regulation principles to corporate
governance and company law.

The AITC strongly supports the Commission adopting principles of better regulation. We
strongly support the tests for appropriate regulation which apply in the UK. These state that, to
be effective, regulation must be:

- Proportionate – regulators should only intervene when necessary and the remedies
  should be appropriate to the risk posed;
- Accountable – decisions must be properly justified;
- Consistent – regulations should be ‘joined-up’ and implemented fairly;
- Transparent – regulations should be as simple and user friendly as possible; and,
- Targeted – rules should be focussed on a specific problem and seek to minimise side
  effects.

These principles will be most effectively delivered where, in advance of any legislation being
passed, a full Regulatory Impact Assessment (RIA) is carried out. An RIA seeks to identify all
the possible implications of the proposal for key stakeholders. A critical part of an effective RIA
is the production of a cost benefit analysis (CBA). To date the AITC has been particularly
concerned that Commission proposals have not always been subject to a comprehensive
analysis of this nature.
All proposals for legislation which emerge from the Commission should be accompanied by, at the least, a preliminary RIA. We recognise that such assessments are complicated by the fact that the European Union covers many Member States. However, it is right in principle that the Commission should understand the implications of legislation it is putting forward – if it does not have a clear view on the impact of its proposals then it has no justification for putting them forward in the first place. Such an attitude risks playing into the hands of critics who portray the Commission as unaccountable and determined to pursue its own agenda without proper regard to the impact its actions could have on Member States.

An increased focus on pre-legislative analysis will mean that proposals which are implemented will be more likely to secure the desired outcome without unintended consequences and targeted on real problems. This will increase the confidence of all stakeholders in the work of the European institutions.

European policymaking will only be fully-effective when its decisions are informed by the best information possible. We recommend that the Commission adopt the highest possible standards of assessment in its approach to the Action Plan. Failure to do so risks compromising its ability to deliver its primary goal of delivering growth and employment. Regulation, particularly in relation to company law and governance, should only be introduced where specific market failures need to be addressed. If legal solutions are imposed simply to create theoretically desirable outcomes there is a real risk that unintended consequences and costs will negate any possible benefits.

Question 3: Value of addressing ‘shareholder democracy’ issues.

The AITC supports in principle the Commission taking action on ‘shareholder democracy’ where appropriate. For example, it is particularly valuable where the issues involved have cross-border implications and a failure to address them will create a specific risk. We will be responding in due course to the Commission’s proposal for a directive on the exercise of voting rights.

We are particularly happy to support common rules which would ensure that internationally based shareholders are able to exercise their rights without prejudice. We therefore, for example, recommend that proposals to end share blocking should be taken forward as soon as possible.

Clear and fair mechanisms, implemented across boarders, should also help the development of effective capital markets as they will ensure that companies are subject to market forces and that shareholders are able to have a proper input into critical strategic decisions facing the company concerned (for example, in relation to takeovers etc). With this in mind we would strongly recommend that Commission proposals to end practices that compromise the principle of ‘one share, one vote’ be taken forward. It is correct in principle and practice that shareholders should have a say in the future of a company that fully reflects their economic interest. It is highly inappropriate to limit the voting rights of a shareholder to an arbitrary level. Apart from other distortions, it could create significant problems for takeovers. This is
undesirable as it could hinder industry restructurings which would be invaluable to achieving the Action Plan’s goal of supporting the Union’s economic competitiveness.

We believe the costs of the rule changes discussed above will be minor and transitional. Some companies may have to amend the documents which establish their constitution (the equivalents to Articles of Association in UK company law) but we envisage the cost will be small. They will also be one-off – and not create an additional cost burden for companies established in the future.

We envisage the most appropriate means to impose a ‘one share, one vote’ rule across the Union would be a Directive. We have no strong justification for this route in particular, but envisage that any instrument with lesser force would be insufficient to drive required reforms across all Member States.

We envisage that the issue of limiting ‘golden shares’ - where a Member State government retains a veto over key corporate actions, for example, takeover bids for strategically important assets – are dealt with for the most part in European competition law. To the extent that this might not be the case it would be appropriate to cover this area in any proposed legislation.

Question 4: Addressing questions related to ‘rights of shareholders’.

The AITC does not believe that the issues discussed in the consultation document in relation to nomination and dismissal of directors needs to be addressed at an EU level.

We recognise that there may be different procedures for nominating and dismissing directors in different member states. Differences in process are acceptable as long as all shareholders have equal rights to influence them according to the proportion of their holdings. (This perspective reinforces the importance of the ‘one share, one vote’ principle, discussed in Question 3.)

Procedural questions relating to the appointment of directors should only be addressed insofar as there is any question that cross-border shareholders may be compromised in their ability to influence the process. The AITC recommends that the Commission should not take action in relation to procedures employed to appoint directors except in this one respect.

The consultation also notes the issue of communications between shareholders in relation to nominating and electing board members and asks if their might be a case for legislation. It is not clear how introducing legislation would contribute to the goals of the Action Plan or help deliver the Commission’s wider objective of delivering a single market. On the evidence supplied we have no reason to think legislation in this area at an EU level is required and recommend that the Commission does not pursue this agenda.

We are also unconvinced about the need for legislation to introduce a common right for ‘special investigations’ with accompanying procedural rules. We cannot identify any cross border implications which necessitate action at a European level. We recommend that the Commission should not take action in this area.

Question 5: Disclosure of voting policies.
The current proposal is for institutions to disclose their voting policies and to give beneficial owners a right to request specific information on particular votes. The AITC is unconvinced that there is a case for legislation on this matter at a European level.

The legislation will not have any impact on competition or single market issues. It is also not clear what risk is created if voting policies are not disclosed. Furthermore, there is no more generalised market failure in this area as institutional investors are increasingly disclosing their policies in response to consumer requests. Consumers can therefore choose to invest with institutions on the basis of their approach to disclosure if they wish. There is little case for action on this agenda either in terms of the Lisbon agenda or because of the single market imperative. Certainly the AITC has seen no evidence put forward to make the case for action on these terms. Until such evidence is compiled the AITC recommends that this issue should not be addressed at the European level.

In the event that any proposal is taken forward at all at a European level, the AITC strongly recommends that it should be restricted to disclosure of the institution’s general voting policy and creating a right for consumers’ to seek information on specific votes. We are aware that, in the UK, there have been suggestions that legislation should require a blanket disclosure of all votes. This should be resisted as it would be highly burdensome and completely disproportionate – generating significant costs for no consumer benefit.

The primary duty of an institutional investor is to deliver returns for the many hundreds of thousands of private citizens whose savings they are looking after. They should not be distracted from this task by having to complete unnecessary administrative tasks, particularly when demand from the public for this information on voting records is negligible. A RIA on this issue by the UK government suggested that compulsory disclosure of votes could cost UK institutional investors 40,000 - 60,000 working days each year to undertake. If this sort of requirement was extended across the Union the administrative workload would be magnified many times over. This would be directly counter to the Commission’s purported goal of regulating in line with best practices on ‘better regulation’ and encouraging effective economic activity.

The AITC has strongly argued in the UK that detailed disclosure requirements are unjustified given the lack of a market failure and negligible demand for the information. It believes that, where there is political pressure for disclosure, it is driven by lobby groups which target companies for reasons which have nothing do with promoting effective corporate engagement and performance in the underlying holding and are entirely focussed on pursing their narrow sectional agenda. This has nothing to do with supporting the consumer/shareholder interest and should not be a concern for the Commission’s Company Law Action Plan.

Question 6: Wrongful trading rules and disqualification of directors

The AITC supports the principle of collective responsibility for directors and has no reservations about this being confirmed in European law.

We are unconvinced that a right of special investigation into directors’ actions should be created at a European level. Before the Commission takes such a step the AITC recommends
that it must justify legislation in relation to its fundamental policy objectives i.e. the single market objective and/or delivering the competitiveness concerns set out in the Lisbon agenda. The AITC recommends that this justification should also be undertaken in relation to the possible introduction of rules on directors’ disqualification. While the AITC supports the highest standards of conduct by directors, legislation on issues such as this (which could have major implications for the lives of individuals) should not be taken without proper consideration of their rationale. It is not good enough to simply see a measure as a ‘good thing’ and therefore to be undertaken. Ill-disciplined policy development of this nature is the root of the sort of regulatory creep which has ultimately damaged confidence in the value and activities of the Commission.

Question 8: EU rules on board structures.

The AITC has no objection in principle to companies within the EU having a choice of either a one or two tier board structure. We are non-committal about the need for any legislation in this area. The critical issue is that board arrangements – whatever they are – are transparent and that shareholders have ultimate sanction of appointments.

If legislation is to be introduced on board structures it must not be prescriptive about the make up of boards. UK investment companies, for example, have a one-tier board usually made up exclusively of non-executive directors. Exclusively non-executive boards arise where the company outsources its executive functions to a regulated fund manager. While this is somewhat unusual in the overall context of company structures, it is a well established approach within the investment company sector. It would be unacceptable for these types of arrangement to be prohibited by legislation arising from Europe. If legislation is adopted the AITC recommends that it must be sufficiently flexible to incorporate boards made up entirely of non-executive directors.

Question 14: Simplification of the EU regulatory environment

The AITC agrees that the wide variety of Directives and amending acts makes European company law far more difficult to comply with and interpret than is ideal. The variety of sources involved also means that this body of legislation may be inconsistent and have not addressed issues which should be covered at a European level.

The AITC recommends the Commission should create a consolidated text incorporating all European company law, including amending acts, as suggested in the consultation paper. This will be invaluable where stakeholders are considering the European Legislation, how it affects them directly and how it interacts with relevant domestic legislation.

For more information on the issues raised in this paper please contact:

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