Financial Reporting Council

Financial Reporting Council response to the European Commission's Green Paper on long-term financing of the European Economy

General comments

The theme of the Green Paper is of central relevance to our mission. We believe the Commission is right to raise the issue of long term finance and wish to contribute to the debate on those aspects where we have direct experience.

The Financial Reporting Council's mission is to promote high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, audit and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries and oversee the regulatory activities of the accountancy and actuarial professional bodies.

The issues raised in the Green Paper are vital to the future of the European economy. The changing balance of the world economy means all regions will have to compete for a limited supply of long-term capital. Europe must both make its own markets attractive to inward investment and seek to develop and nurture its own pools of long-term capital, if it is to provide the investment needed for sustained economic growth. In particular, equity capital is a key (if not the key) source of long-term growth.

All regulatory initiatives (past, present and future) in the market, securities and corporate sectors should be examined for their long-term impact. Some, notably the solvency arrangements for insurance companies, have unintentionally driven a short-term focus on solvency and diminishing demand for equity. The Paper rightly lays stress on the need to strengthen the debt markets, but it is also critical that more is done to reverse the long-standing fall in the size of Europe's listed equity markets and to correct regulatory and structural reasons for it. This is one of the main themes of our response.

What is needed now is broad-based open debate, led and facilitated by the Commission, and aimed at building capital markets capable of financing sustained economic recovery. The objective should not necessarily be a programme for action by the Commission but a greater understanding of what needs to be done at the European, national and market levels. European solutions are not appropriate for all the issues raised, although there is certainly a case for some initiatives at this level.

Our response makes a number of suggestions, based on our particular areas of operation and expertise. We are supportive of a broad debate, taking account of fundamental issues including the differential tax treatment of debt and equity, which are outside our remit[1]. The issues raised in the paper cannot be addressed by a single measure, or even a set of measures in a single area. A broad and coherent agenda should be the outcome.

<u>The contribution of equity markets</u>

Long-term investors are vital to the supply of new capital to the market. The Green Paper rightly points out that European companies cannot expect to rely on bank finance to the same extent that has been the case in the past. An important response to the challenges set out in the Green Paper should therefore be efforts to halt the decline, and nurture the development, of the listed equity markets.

Equity risk capital is the bedrock of business. Without it, companies cannot invest and grow. Nor can they generate the returns needed to service other forms of capital, including debt finance which is the focus of a large part of this paper. Policy-makers therefore need to ensure that the capital market is able and willing to supply equity capital to business. We believe that the health of the listed equity market should therefore be an important agenda item in any discussion about the provision of long-term finance.

In particular Europe needs to consider how to develop pools of long-term capital incentivized, through fiscal or other means, to invest in equities. While two decades ago such incentives existed for both the insurance and pensions industry, these have been eroded through regulation. As it stands European markets are relying heavily on overseas investors, such as sovereign wealth funds and pension funds to provide long-term investment. However, whereas Europe can ensure through its domestic arrangements that pools of long-term investment can be directed towards equities, we cannot determine the time horizons of overseas investors.

Unlike debt finance, equity does not have to be repaid. Unlike private equity, there is no predetermined exit point in the future where investors wish to cash in on their holdings. It is a fair criticism of the equity markets that some participants behave in a short-term way, but this should not obscure the fact that capital raised through listed equity is capital in perpetuity.

Moreover listed equity markets are an important means for absorbing risk and dispersing it across sectors. Companies financed through equity instead of debt are less likely to suffer from financial distress in times of economic turbulence, and, indeed, many Member States are now looking to the listed equity markets to recapitalise their banks. Shareholders will need to be satisfied that their rights are to be respected and that undue burden is not placed on them if this is to be successful.

[1] We note in passing that the recent UK Parliamentary Commission on Banking Standards report raises the issue of differential tax treatment: “The tax bias that incentivises companies to favour debt over equity did not by itself cause the financial crisis. The scale of its impact on the incentives for banks to become highly leveraged is unclear. But, at the very least, having a tax system that encourages banks to take on more risk certainly does not help. The more forces that are pulling in the wrong direction, the more difficult it is to design the regulation required to restrain them.”

Equity capital is also an important way in which relatively small innovative companies, that are vital for economic growth, can raise finance.

The need to nurture the health of the equity markets is all the more acute given their history of decline in the developed world, including the European Union. According to the OECD[2], the number of IPOs in OECD markets fell to 650 over the past decade compared with 1,170 in the preceding decade. There was a corresponding drop in the average annual amount raised to US$69.8bn from US$134.3bn. Last year's Kay Review in the UK also said equity markets have not been an important source of new capital for British business for many years, while London Stock Exchange figures show the number of companies listed fell to 2,845 last year from 3,579 in 2008. Figures from the Federation of European Stock Exchanges show that, in the same period, the number of companies listed on the Deutsche Boerse fell to 740 from 858, while listings on NASDAQ OMX Nordic (Denmark, Sweden, Finland, Iceland and the three Baltic states) fell to 766 from 845.

Some observers believe that this trend is cyclical[3], reflecting the fact that in a period of very low interest rates it is cheaper to raise debt finance than equity. However, there also appear to be some structural reasons, including the relative impact of taxation of debt and equity, the growing costs of intermediation and the regulatory burden imposed on listed companies compared with those that are not listed. Structural aspects should not be ignored. Even though the equity markets have not recently been a source of capital for new investment, they played a vital role during the financial crisis and we should see them as a source of capital for the future.

The approach to regulation should take account of this and not single out the listed market for a particular burden. This means addressing problems on three fronts.

- First, the Commission should examine the reasons for the declining participation of insurers and pension funds in equity investment, including the role played by solvency, funding and accounting requirements.

- Second, it should examine the costs inherent in the equity investment chain and take steps to address these when they are the result of market failure or misdirected regulation. The review of the Securities Law Directive is an important and useful opportunity to remove inefficiencies in cross-border voting of shares and to make it easier for companies to identify - and therefore communicate with - their shareholders.

- Third, the Commission should seek to avoid legislation that brings an unfair burden on the listed sector. While recent initiatives on remuneration and boardroom diversity are legitimate and understandable, they single out the listed market for regulation even though high remuneration and lack of diversity persist in the unquoted sector. In addition, concerns have been raised with us about the potential burden arising from the Prospectus Directive.

[2] Isaksson M. and S.Celik (2013); Who Cares? Corporate Governance in Today's Equity Markets
[3] In fact the trend has been identified even longer ago. See Michael C. Jensen, The Eclipse of the Public Corporation, Harvard Business Review, September 1989

An ability to access capital at reasonable rates will become increasingly important to Europe's competitiveness as other fast growing regions seek to obtain a greater share of limited supply. While investors in developed countries hold the majority of financial assets (79 per cent), according to McKinsey[4], the share for emerging markets (21 per cent) has gone up from seven per cent in 2000 and is forecast to grow to between 30 and 36 per cent by 2020. The estimated share of global financial assets is expected to be 22 per cent by the end of this decade, down from 28 per cent in 2010. Global wealth is thus flowing to emerging economies. We need to consider how Europe can take the right steps to provide for an environment in which investment can flourish.

Financial and Non-financial Reporting

Within our own field we have been working for some time to introduce longer-term perspectives into the way companies and investors operate. The UK Corporate Governance Code, for example, now requires boards to present a fair, balanced and understandable assessment of the company's position and prospects including an explanation of the basis on which the company "generates or preserves value over the longer term." Alongside that, we have been consulting stakeholders on a broader definition of "going concern" which would give shareholders a longer-term picture from company disclosures. Our latest revisions to the UK Corporate Governance Code also place greater emphasis on audit committee and auditor reporting aimed at producing substantive disclosure rather than boiler plate.

These initiatives are based on the belief that, couched right, disclosure requirements will draw the attention of boards and investors to longer-term perspectives, and thereby discourage excessive short-term focus. Narrative reporting plays a crucial role in this, but an important principle is that reports should be both succinct and relevant. Disclosure for its own sake, which does not enhance understanding of the business, involves a compliance burden and can lead to boiler plate language. Our initial reading of the recent Commission proposals on narrative reporting is that they are too prescriptive about the subject matter of disclosures. The failure to preserve the concept of materiality, except for the use of KPIs, may increase disclosures without improving the relevancy of the information provided to users of financial statements.

In the accounting area, we believe that:

- The use of fair values/revaluation of some assets and liabilities is not counter to promoting long-term investment. In a UK context, revaluations have long been used as a basis of investment decision making. We believe financial reporting should present the effect of changes in fair values and provide disclosures that show the risks associated with those assets and/or liabilities. If the valuations vary, they reflect the short-term nature of the market rather than driving that short-term nature. Other factors drive short-termism such as the way asset manager performance is assessed by asset owners. We are pleased that UK Government has commissioned research into this as a follow up to the Kay report.

[4] The Emerging Equity Gap: Growth and Stability in the new Investor Landscape, McKinsey Global Institute, December 2011

- That is not to say that accounting cannot be improved. The improvements in respect of financial instrument reporting being developed by the IASB are key to establishing consistent and relevant reporting in this area. The UK's Parliamentary Commission on Banking Standards agrees. European endorsement should be accelerated.

- The EU should seek to ensure that stewardship is an explicit part of the revised conceptual framework being prepared by the International Accounting Standards Board. A stewardship approach which seeks to show how management has utilised the assets entrusted to it by shareholders is in the interests of long-term investors. A decision-usefulness approach which aims merely to help investors make a short-term decision on price is less so. The current Maystadt review needs to ensure that the European voice is effective in representing the views of long-term investors.

- More work should be undertaken by regulators and investors to ensure that fair value measurements are properly understood so that volatility can be interpreted in a more considered manner. A snapshot view of solvency is not a guarantee of solvency in the long term. Making insurance companies and pension funds demonstrate solvency on a continuous basis inevitably makes them into short-term investors even though their liabilities are actually long term. Regulators should encourage the market to look also at long-term cash flow projections, as these may well put the volatility arising from fair value accounts into a better perspective.

- For smaller listed entities in Europe, reporting under IFRS (as adopted in the EU) may be unduly burdensome. Consideration might be given to permitting reporting under a more proportionate basis. In the UK we have developed a basis of accounting for unlisted entities (some of which are large and/or are public benefit entities) based on IFRS for SMEs. Our initiative has been lauded and we should like to be able to explore applicability to smaller listed entities.

<u>The role of investors</u>

The FRC has also pioneered the Stewardship Code in the UK. This has now 278 signatories, including both asset owners and asset managers, as well as some service providers, all of whom commit through their policy statements to take a long-term view. The extent to which the Code has changed behaviour in a qualitative sense is hard to measure but we have found evidence that the quality of dialogue between companies and investors has been improving[5]. Surveys carried out by the Investment Management Association show a consistent level of engagement between shareholders and companies, including some effective collective engagement. We are pleased that, within the EU, stewardship codes have been developed by EFAMA at the European level and by Eumedion in the Netherlands, while Italy is in the process of developing one.

[5] See Developments in Corporate Governance, FRC, December 2012

International participation in the Stewardship Code has been slow to develop. This partly reflects worries about acting in concert, which are now being addressed, and partly the reluctance of some of the new equity holders, notably sovereign wealth funds, to become involved. We are seeking to reassure these investors. It is important that Europe, as a whole, actively welcomes long-term investment by sovereign wealth funds and ensures that their rights as investors are respected.

This is important, not least because of the need to build a critical mass of long-term investors in European capital markets. Recent years have seen a significant desertion of the equity markets by UK pension funds and insurance companies who now hold only 5.1 per cent and 8.6 per cent of the UK equity market, compared with a combined share of almost half the market 30 years ago. That is not to say that those holding an increasing proportion of the market are necessarily short-term, but to highlight that incentives for long-termism to be effective will need to cover a broader range of investors with potentially different motivations than the matching of long-term liabilities.

Given the above analysis and the fragmented ownership structure of the equity market:

- We reaffirm our view that those authorised to manage investments on behalf of others in the European Union should state whether they subscribe to a Stewardship Code, and, if not, why not.

- Stewardship will be more effective if shareholders are able to coordinate their response to governance concerns at companies. The work now being undertaken by ESMA to clarify the rules on acting in concert is important and we support it.

- Greater focus on the content of investment mandates would help ensure a longer-term approach by asset managers. We believe that a requirement for those issuing mandates to state that they have made a considered decision taking account of the needs of their beneficiaries, including time horizons, could have a substantial impact on market behaviour.

- We do not consider that there is merit in moving to a regime whereby long-term holders of equities receive rewards either in the form of extra voting rights or extra dividend. Requiring such an approach would interfere with freedom of contract, be difficult to operate, add to the risk of management entrenchment and make it harder for some companies to raise additional capital.

Specific answers

Our answers to the specific questions in which we have an interest are set out below.

20) To what extent do you consider that the use of fair value accounting principles has led to short-termism in investor behavior? What alternatives or other ways to compensate for such effects could be suggested?

"Fair value" is not a new concept. It has been permitted in the UK since the Companies Act 1948, when it was introduced to assist companies to fund post-war reconstruction by borrowing against re-valued property assets. Businesses and banks have told us that it remains important to facilitate lending and support growth. We have seen no evidence that fair value accounting principles of themselves have led to short-termism in investor behaviour.

In some instances, fair value clearly remains the most appropriate basis for valuation. For example, the historic cost of a derivative, often zero, is completely irrelevant to its current value. Equally, in other instances historic cost is more appropriate, for example where the asset is held to maturity. This distinction is currently permitted under the Accounting Directive, under IFRS as adopted in the EU and will continue to be permitted under the changes being proposed by the IASB in the future.

The post-Enron financial instrument standard did not give sufficient clarity as to which measurement basis should be used in which circumstances. The IASB is currently updating its conceptual framework. We hope that those changes will address the need for clearer measurement principles as to when fair value is appropriate for accounting and when other bases should apply.

Moreover, even when fair value may be the most appropriate basis of accounting, we believe more should be done to ensure financial reporting makes clear that reported performance is measured using values which fluctuate with market movements.

Within the scope of IFRS 9, the IASB is seeking further to amend and simplify the classification and measurement of financial instruments held at fair value, as well as addressing hedge accounting requirements. IASB's exposure draft including proposals on classification and measurement was issued in November 2012. However unless the EU accelerates its endorsement process, it could be a number of years before adoption.

21) What kind of incentives could help promote better long-term shareholder engagement?

There are at least two aspects to this question. First, the way fees are paid by asset owners to asset managers may encourage short-term behaviour on the part of the latter. Second, the personal remuneration of asset managers may encourage individuals to take a short-term approach. The questions are related but need to be considered separately. Both aspects may usefully be addressed by a more disciplined approach to the award of investment mandates, which is developed in our answer to Question 22.

Traditionally fees paid by asset owners are calculated on an ad valorem basis so that they rise and fall in line with the value of the portfolio. This may encourage managers to seek short-term increases in share prices, although we are not aware of any conclusive evidence that this is the case and it is difficult to see an alternative method of charging.

A more significant factor may be the desire not to fall behind competitors in a market where clients traditionally scrutinise and compare short-term performance. This was a problem identified by Lord Myners in his original report for the UK Government on Institutional Investment in the UK, published in 2001. Lord Myners suggested fund managers be given tenure so that they could adopt a long-term horizon. This has dangers. It could lead to under-performing asset managers being locked in to a mandate. Yet it is right that asset owners give due consideration to time horizons when awarding mandates.

The Myners review also focused on dealing costs, and its publication was followed by a transparency regime for UK institutions. The results have been disappointing because asset owners do not appear to pay sufficient attention to dealing costs. Their readiness to move funds from one manager to another always involves dealing costs, but they also appear not to have sufficiently used the opportunity to hold their asset managers to account for the value they create (or fail to create) through trading. Over the lifetime of a fund, dealing costs can consume a very large amount of capital.

Transparency is needed and asset owners need to take more responsibility. For example, they could be required to report back to beneficiaries on dealing costs, including those resulting from their own decisions. To ensure such reports are complete, they could be expected to require asset managers to report on how dealing has added value and even, possibly, to set limits for dealing costs each year which could only be exceeded with the express approval of trustees.

As for personal remuneration, asset managers have told us that individual remuneration arrangements for their employees usually take greater account of medium term performance than critics believe. Asset managers have assured us that variable remuneration is never paid just for beating the benchmark in the latest quarter, but is dependent on consistent performance over the medium term, typically one and three years. To dispel any doubts over this, it would make sense for those authorized to manage funds for clients in the EU to disclose their policy for remunerating fund managers.

It has been suggested that asset managers could be expected to invest variable pay in their own funds. We are wary of unintended consequences, since the manager's personal interest will not always be aligned with the particular objectives of a specialized fund. There is thus a risk of conflict of interest.

Also, we do not believe in regulating asset manager remuneration through caps on variable pay as this cannot be calibrated to long-term performance achievement. This would therefore make it harder to encourage a long-term time horizon.

Disclosure of remuneration policies should allow those who award mandates to see whether the portfolio manager's interests are aligned with their own.

22) How can the mandates and incentives given to asset managers be developed to support long-term investment strategies and relationships?

<u>Mandates</u>

Mandates are critical to ensuring that asset managers are working in the interest of asset owners. There is therefore a case for intervention to help ensure greater discipline around the way they are awarded. This would create an opportunity for asset owners to demand more from their asset managers in terms of engagement as a means of securing long-term value. Regulation cannot prescribe an investment style, as this ultimately has to reflect the specific interest of the beneficiaries. Any regulatory intervention therefore has to be non-prescriptive, while drawing attention of asset owners to the choices before them and encouraging them to take an active, considered approach.

We would support a simple principle that all those issuing fund management mandates on behalf of beneficiaries in the EU should demonstrate that they had made a considered decision that took into account the needs and objectives of those beneficiaries. This would involve stating publicly that they had taken account of an agreed range of issues reflecting the requirements of beneficiaries. These might include fund objectives, time horizon, choice of benchmarks, willingness to pay dealing costs, expectations that the asset manager will engage with investee companies on their behalf and that remuneration structures are in line with the interests of the client. In particular trustees should be expected to justify any decision to choose a relative benchmark rather than an absolute return target.

While this appears largely a transparency measure, the nature of such a disclosure requirement would likely result in behavioural change. The precedent is the decision by the UK in 1999 to require defined benefit pension schemes to include in their Statement of Investment Principles an explanation of their approach to corporate responsibility. As fund managers had to take note of these statements, they began to apply a substantial increase in resource to this area with the creation of specialist teams in larger investment firms.

Similarly it is reasonable to expect that a requirement on asset owners to state that they have considered their expectations on time horizons and engagement when issuing mandates would have a considerable effect on the content of mandates and thus the behaviour of asset managers. Yet the compliance cost would be low and complete freedom of choice over investment style would remain.

Mandates would not have to require long-term horizons. Asset owners who issue them would simply have to show that they had given the relevant issues due consideration, and those who advise them would also have to take these issues more consciously on board. Our own dialogue with the market shows UK pension fund consultants have already started to adjust their advice, to reflect the Stewardship Code, which is entirely voluntary. Two of the three largest consultants have developed stewardship rankings.

A good starting point for the determining the factors for consideration by those awarding mandates would be the recent International Corporate Governance Network paper on model mandates, of which the Commission is aware[6]. There would need to be discussion of the scope of such a requirement. Clearly it would apply to trustees of pension funds and charitable foundations. It should also apply to the long-term regulated business of insurers, even when they are issuing a mandate to their in-house fund managers.

A principle as described above should not be seen as a silver bullet but rather as part of a package of measures aimed at strengthening behaviour. It would reinforce a particular part of the investment chain – the relationship between asset owners and their managers – at a point where it is currently weak. It would not compel investors to think more long term but it could force them to consider the need to do so. It would not capture all investors (for example, UCITS firms and retail investors would be excluded) but should capture a sufficient critical mass of long-term institutional investors to affect the behaviour of asset managers.

Shareholder rewards

The Paper asks whether long-term shareholders should receive incentives in the form of extra voting rights or dividends. This is the mirror image of the discussion around one-share-one-vote launched by the Commission in the middle of the last decade. A strong argument mounted by those against mandating one-share-one-vote at the time was based on freedom of contract. It was argued that imposing a particular relationship between companies and their shareholders infringed this freedom. As this argument was accepted by the Commission, it would be inconsistent now to impose a requirement to offer incentives which would also infringe freedom of contract. There is thus a problem with seeking to make additional voting rights mandatory.

UK law permits differential voting rights and a very few companies still retain them, but the market has chosen to move to a one-share-one-vote norm. An important driver has been the need for new capital. A large number of smaller family-owned companies moved to a one-share-one-vote structure during the 1990s at the behest of institutional investors who were otherwise reluctant to provide new capital. A further reason for avoiding prescription in this area is therefore the risk that shareholders might not put up new capital.

A paper drawn up by the European Corporate Governance Forum in 2007[7], and with which the Commission will be familiar, raised the additional concern that differential voting rights add to the risk of management entrenchment. While the need to respect freedom of contract means they should not be banned, the risk of entrenchment means they should not be encouraged either. Moreover, the existence of such differential rights would exacerbate the problems facing minority shareholders in companies with block holders determined to pursue their own interest as we have recently seen in the mining sector of the UK stock market.

[6] ICGN, 2012. Model contract terms between asset owners and their fund managers, available on https://www.icgn.org/images/ICGN/Best%20Practice%20Guidance%20PDFS/icgn_model_mandate_mar2012_short.pdf

[7] Statement of the European Corporate Governance Forum on Proportionality, with accompanying paper, available on http://ec.europa.eu/internal_market/company/ecgforum/

Additional dividends have no direct impact on control rights, although the risk of entrenchment would remain if a large body of investors sat passively on the register simply to benefit from the extra dividend. Nonetheless, there are practical questions. The object of the change would certainly be defeated if investors were allowed to claim additional dividends on shares which had been lent. The volume of lending could therefore shrink, and while this might not matter within limits, it could reach the point where market liquidity was affected. Worries about liquidity have always been a reason why the authorities have resisted pressure to restrain stock lending directly. This suggests care should be taken with a measure which might restrict stock lending indirectly. The UK Stewardship Code now calls on signatories to disclose their policy on stock lending, which we consider should be sufficient to encourage a responsible approach.

There is also a concern that current custody arrangements, especially the prevalence of omnibus accounts in which the holdings of several different investors are combined, might make it hard for investors to assert their right to additional dividend. Current discussions around securities law show that it is not always clear who actually has title to a security. A regime which gives extra rights to specific investors on a discretionary basis must be reliable and fair. If it is not, market confidence will be lost. Finally, such schemes are much harder to operate in markets where bearer shares are the norm.

23) Is there a need to revisit the definition of fiduciary duty in the context of long-term financing?

We believe this is very difficult to do at European level given the different legal traditions in member states. Following the Kay Review, the UK Law Commission is currently examining the issue to see whether market practitioners are interpreting the concept too rigidly as being a requirement to obtain the highest possible return in the shortest possible time. It seems likely that UK case law allows for a broader definition, particularly with regard to time horizons. It is reasonable to argue that the duty of an asset owner is to deliver the best possible returns over the time horizon relevant to the beneficiaries.

Going further through legislation would carry considerable risks. A granular definition of fiduciary duty will increase the risk of litigation. A poorly drafted law would ultimately mean that investment decisions could be driven by fear of litigation rather than what is in the best interest of beneficiaries.

24) To what extent can increased integration of financial and non-financial information help provide a clearer overview of a company's long-term performance, and contribute to better investment decision-making?

We agree that integration of financial and non-financial information can be a positive step forward in providing a clearer overview of the company's long-term performance and contribute to better investment decision-making. However, we believe that when deciding on the best way to approach such integration is to maintain a focus on investor needs. More is not always better; we are concerned to avoid reporting overload at the behest of competing regulators.

The FRC has already taken a number of important steps designed to enhance disclosure.

Narrative reporting by the directors of a company on its performance enables shareholders and others to review their stewardship of the company. This is an area where the FRC provides existing guidance for companies. We are currently in the process of updating this guidance to ensure that the narrative report provides information of strategic importance as well as promoting linkage with other parts of the annual report.

Another key area of concern has been the “going concern” process. The FRC asked Lord Sharman to review the guidance to directors on going concern, liquidity and solvency. Certain of his recommendations are specifically relevant to banks (and potentially other financial institutions). The extra disclosures he proposes are narrative in form, and require greater analysis of risks to going concern over a longer period than required by accounting standards. We believe this should encourage a longer-term focus on solvency and liquidity.

Another initiative launched by the FRC in recent years is the concept of a Financial Reporting Lab, a safe space for preparers and investors to experiment on potential changes to the information presented in annual reports without the need of introducing binding standards. Our recent successes in this area include arriving at a methodology to calculate a single directors’ remuneration number which was well received by both preparers and investors. We are currently working on a number of other projects, including one on accounting policies.

There is potential to expand this model of working to Europe which may facilitate understanding of investor needs in particular areas.

30) In addition to the analysis and potential measures set out in this Green paper, what else could contribute to the long-term financing of the European economy?

As part of the consideration of tax aspects, we believe the Commission should explore whether taxation arrangements unduly favour share buybacks over dividends. Share buybacks are popular with some shareholders and companies because they can bolster performance and returns in the short term, but pressure on companies to provide them is a distraction from long-term investment. Investment banks derive fees from advising on them. It would be quite wrong to limit share buy backs through regulation. There are circumstances where it makes sense for companies to return capital that cannot otherwise be used productively, but there is equally a need to avoid excessive emphasis on this device, and the choice between share buy backs and dividends should not be influenced by extraneous considerations such as tax.

Because dividends are paid out of taxed profits and then taxed again as income in the hands of recipients, they are an expensive way of remunerating shareholders. Yet dividends, which must be paid year in year out (and increased each year if the company has a progressive dividend policy), constitute a commitment to long-term profit generation and impose on management a long-term horizon. Again, it would be wrong to legislate to make companies pay dividends rather than use share buy backs, or to imply that they should be paying dividends they cannot afford.

The choice must be left to companies but the playing field should be level.