

## Presenter

- Mark Burgess

**Mark Burgess:** Corporate governance is important, because it's to do with the policies and procedures by which a company is controlled, in terms of the management of that company, and the oversight of that management, by the board, and indeed by the shareholders, and it's critically important, because we've just seen in the last couple of years, when it goes wrong, the ramifications of it going wrong can be quite profound, both for the company, but in some instances, for the wider economy. The Combined Code is there to oversee how companies are governed, and the sets of procedures that it recommends, have, in our view, pretty much stood the test of time, but have been very sorely tested in the last couple of years. We are not recommending completely throwing out the Combined Code, but clearly, it needs to be more effective. Indeed, the Combined Code's first and principle recommendation is that a company needs to be governed by an effective board. Clearly, in many instances, we've seen in the last couple of years, that's not been the case.

UK Institutional shareholders are best placed to oversee corporate governance in the UK because they control such a large percent of your stock market. In aggregate, we in aggregate own 40% of the UK stock market by value, so our interests are aligned, if you like. It's very definitely in our interest for companies to be governed well and to perform well. We're best placed to fulfil that role, because we're much more objective about the performance of a company, than a company itself. Companies can very often be quite inward looking in the way they look at themselves, but clearly, we've got a broader perspective of companies, and are able to compare and contrast the good operating performance from one company, with perhaps the bad operating performance of another company, so I would argue that UK institutions are very well placed to oversee corporate governance in the UK.

Not all institutions see it that way, and there are cases, instances, where institutions don't fulfil their role as owners of the business, and they may think that it's not part of their investment process, for example. They may have a quant driven structure so they may not want to engage with companies. They may think that if they don't like what a companies doing, they can just sell the shares and move on, and they may think it's a waste of time and money.

As the largest owner of UK equities, where L&G own some 4.5% of the UK stock market, clearly option number two, which is selling and moving on, isn't open to us. We've got no choice but to engage with companies and to endeavour to work with them for the best outcome for shareholders, and it's very definitely our experience that early and constructive engagement is the way forward. We do this quite extensively. In 2008, we met with some 635 companies, of which 133 were for corporate governance reasons, and so we have engaged extensively with companies, and most of what we do is done behind the scenes. Again, we think it's most effective. You're able to have more constructive conversations with companies – debate wider issues, if what you talk to them about stays within the four walls of those meetings, so behind the scenes, we undertake our engagement.

As the largest owner of UK equities, with some 4.5% of the UK stock market, we like to think that we're leading from the front in terms of setting the corporate governance agenda and looking to improve corporate governance best practise in the UK market. We have numerous meetings, with numerous companies, covering a wide range of topics, from balance sheet structure, to boardroom succession, and we will continue to have these debates behind closed doors, constructively engaging with companies. Nonetheless, we think there are a number of changes that can be made to improve engagement between institutions, and companies with whom they have shareholdings, and this is...the key recommendations that we have are shown on this chart.

We think that non-executive directors need to be accountable for their actions and for the decisions that they make, within the boardroom, so we strongly believe that the Chairman, the Senior Independent Director, and the Chairmen of the various committees, Audit, Remco and Nomco need to stand for annual re-election, so that the shareholders get to show their

approval or not of decisions they've made. We think in the fullness of time, all directors should stand for annual re-election, but in the first instance, it should be the principle non-execs that stand for re-election, as I've just discussed.

The second key recommendation is that Non-executive Directors need to undertake a broader and deeper role within companies. Non-executive Directors look after our key interest, so the principle point of focus for shareholders, in terms of challenging the Chief Executive, questioning the strategy, and making sure that the Company's being run for the best interest of shareholders, and in order to enable them to do that, we think non-execs need to have a broader and deeper role. They need to dig down into the key operating companies, below the board. They need to get a form of relationship with the key Executives that run those companies. They need to have a better understanding of the risk management framework, and they basically need to spend more time working in the companies on whose board they sit. The implications of this probably are that non-executives generally have fewer roles than they have at the moment, and in order to compensate them for the extra work that they're doing, they probably need to be paid more.

The final point is that we strongly believe that there should be a forum by which institutions can come together and collectively engage with companies. Clearly, there is a role for one on one meetings, and they will continue, but there are instances where collective engagement, where institutions can come together and better represent their common interest, is probably better in terms of getting the appropriate response from companies, so having a forum for collective engagement is something we strongly believe in. We don't think that there needs to be more government interference or more regulation. What there needs to be is more effective regulation. If one looks back at the last couple of years, one might argue that the regulatory framework in the UK and indeed in the Western developed world, failed us, and the lessons learnt from that would be that regulation needs to be more effective. It needs to be better implemented, and it needs to be globally co-ordinated. Some of the industries that clearly have come under immense pressure, like the banks, are global industries. They have common problems, and to have different regulatory frameworks, in each country, is arguable not a good idea, so co-ordination at government level, such that there's one common approach from the regulators, to make it more effective, I would argue, is

the way forward. I think the lessons learnt from the last couple of years, is that governance plays a critically important role in the way companies are managed. Institutions are, as owners of the business, play a vital role in that, and I think we need to be more effective in our engagement with companies. I think the suggestions that we've made with regards to how the governance framework improves are also important. We don't need to throw out the combined code, we just need to have it more effectively implemented, and in particular, the Non-Executive Director, who plays a crucially important role in the boardroom, in looking after shareholders' interests, needs to have a broader and deeper role, such that they are better positioned to challenge Chief Executive, and oversee the correct implementation of the company strategy.