



**BIG
INNOVATION
CENTRE**

The Purposeful Company – Call for Evidence / Feedback

Big Innovation Centre, in partnership with a consortium of FTSE CEOs, Investment Houses, leading Business Schools and Business Consultancy Firms and supported by the Bank of England, has created a two year Taskforce to examine how the UK could boost the numbers and scale of domestically owned, value generating companies.

Following a successful first year of the project, the Interim Report is now published. It is a comprehensive effort to marshal the evidence supporting the importance of purpose, showing the degree to which Britain's ownership and financial ecosystem is an outlier by international standards so constraining British companies from expressing purpose. It also makes the clear link with the shortfall to the UK economy's indifferent productivity, innovation and investment record.

We have now launched a call for evidence / feedback in the next six weeks to 21 policy options before publishing the Final Report in the autumn with full policy recommendations and a programme for change and capability building. We are seeking evidence / feedback from business, investors, regulators, academia, government, interest groups and members of the public, in particular on the issues and questions raised in each policy option, as soon as possible and before the deadline 20th June.

A full copy of the Interim Report can be found at www.biginnovationcentre.com

If you have any questions please contact us on **0203 713 4036**, and ask for Brian Wagenbach or Helen Lawrence.

Generating policy recommendations

The results from the call for evidence / feedback will be addressed by the Taskforce in July 2016 at a meeting in the Bank of England and will draw on expertise from the whole economic ecosystem. The results of the policy development work will be published in the Final Report in the autumn of 2016, before moving into project's second phase focusing on implementation, piloting and awareness raising.

The call for evidence / feedback seeks input in the form of ideas, evidence and suggestions from all organisations and individuals with an interest in creating the conditions in the UK for economic growth. The 21 policy options we are asking for your input on are contained in Chapter 5 of the Interim Report and are clustered around the themes of:

- Implementation and Remuneration
- Corporate governance and Commitment devices
- Blockholding, Monitoring and Engagement
- Strengthening Asset Manager Capability
- Reversing the Decline in Equity Ownership.

Submissions

Please consider the 21 policy recommendations in the table below. They are an extract from the report.

Feel free to propose any other policy recommendations you believe should be included.

Please email your evidence / feedback on the 21 policy options or to add additional ones to Brian Wagenbach at b.wagenbach@biginnovationcentre.com

Alternative, you can post your submission to Big Innovation Centre, Ergon House, Horseferry Road, London SW1P 2AL.

Instructions:

- When replying to a specific policy option, please refer to numbering of questions in the table below (e.g. number 1c, 3a, 15b and 20c)
- If you have attached any documents, please list fully the name of the attached document
- Entitle your email or letter “**The Purposeful Company Call for Evidence**”)

Do also include

- Your name and contact details (email and postal address)
- Occupation
- Organisation / workplace
- Are you answering on behalf of yourself or your organisation? If you are not the main contact person regarding this submission, please list the relevant person.
- **Confidentiality:** Submissions will be referenced in the Final Report. Please inform us if you want your contribution anonymised.

Policy options to comment on:

Policy Option	Justification	Issues & Questions
Business implementation and Remuneration		
1. Require companies to incorporate around purpose. The process of incorporation is generally called 'formation' in the UK and there is no requirement to be explicit around the proposed business purpose.	As evidenced in Chapter 1 the success of a business depends on its relationship with the outside world – potential customers, staff and suppliers and shareholders, regulators, activists and legislators. Companies should therefore make it clear when they incorporate how fulfilling their purpose benefits society.	1a) What is to stop a company merely 'window dressing' with their purpose? How much flexibility would companies have to change purpose in changing circumstances? 1b) What, if any, duties flow from incorporating around purpose? What requirements would follow for reporting on business purpose post-incorporation? 1c) Should the Bank of England be required to interpret practices for the Banks and Insurance Companies?
2. Require companies,	This would create an externally verifiable template(s) for every company to	2a) To what extent would it ensure companies behave in

<p>voluntarily or by law to produce purpose statements and annual performance reports (including materiality maps) that can be assessed against comprehensive, independent and transparent third-party standards.</p>	<p>operate with a meaningful purpose statement and demonstrate how they achieve long-term value creation. This would complement other recommendations such as incorporation, broadening of directors' fiduciary duties and accounting standards to strengthen the reporting and measurement of intangibles.</p>	<p>accordance with their stated 'purpose' and will consumers and investors act on the disclosure of this information? 2b) What should the third-party standard look like and who should be tasked to define it? 2c) What is the most effective way of determining and disseminating best practice among standards providers? 2d) To what extent should government play a role in standardisation or should decisions be left to the market? 2e) Are there alternatives to having firms employ 'purpose' auditors or external professionals of some kind to check that the information contained in annual reports is correct?</p>
<p>3. Accounting standards to be revised to reflect the growing significance of intangible assets – possibly around a common template. Companies to provide clearer guidance on the degree to which investments in both tangible and intangible assets are delivering against their corporate purpose, value generation prospects and risks.</p>	<p>Most of the discussion to date has been about disclosure in relation to ESG (as set out for example by the UN Principles for Responsible Investment) and adopted by several stock exchanges around the world, such as the Hong Kong Stock Exchange. However aligning disclosure with purpose goes well beyond this. It also refers to the relation of financial to other measures of performance, for example human, natural and social as well as financial capital. It also bears on the horizon of investors and the information that is required to promote a focus on long term investment, as discussed in the recent Investment Association report. It is also consistent with evidence that companies can to some extent select the types of shareholders they want through effective investor communication</p> <p>The task of accurately valuing intangibles would be assisted by the development of market-places to allow IP to be traded (the purpose of the Big Innovation Centre's Intellectual Property Exchange). This would replace the subjective judgements. Of directors and auditors with an objective valuation.</p> <p>Prescriptive regulation may not be appropriate in this area given the diverse forms of disclosure that are relevant to different corporate purposes. As the case of Unilever illustrates, it may be a matter of companies emphasising relevant measures of performance and investors seeking disclosure of them. The Investment Association suggests that institutions may be able to do a great deal through informal guidance.</p>	<p>3a) Are accounts the appropriate form, in which to provide valuations of imprecisely measured intangibles, human, natural and social capitals? 3b) What explains the progress (or lack of it) of related accounting and reporting initiatives (e.g. Integrated Reporting)? 3c) Will earnings guidance be sufficient to bring about fundamental changes in investor and corporate behaviour? 3d) Should guidance move from providing point estimates to communicating uncertainty around forecasts? 3e) Should companies receive more information from investors about their reasons for changing equity holdings – tantamount to an exit interview – so as to reduce any short-term reactions by company management?</p>

<p>4. Ask business schools and providers to develop a major 'purpose' component into their business education curricula (MBA, CFA etc.). To include the development of product sets that enable firms to move from abstractions and focus on specific purpose activities that are most important from a value creation standpoint.</p>	<p>This would complement other recommendations to stimulate and entrench culture change. Value creation can be damaged if those providing governance behave in a way that is in conflict with purpose.</p>	<p>4a) How can the provider market be stimulated to develop new product sets that are most important from a value creation standpoint? 4b) Is there evidence from similar initiatives in the past that these values have been internalised? 4c) Is there value in requiring candidates for appointment to board, trustee and investment committees to be 'purposeful financial market certified'?</p>
<p>5. Develop remuneration principles, guidelines, and practices for both firms and investment houses to reinforce the delivery of purpose and the creation of long-term value creation. The aim is to encourage managers to behave more as purposed engaged owners than short-term investors.</p>	<p>A principles-based approach with clear practical guidelines and evidence of good practice is the best way of giving remuneration committees and shareholders confidence that the change required has serious intent. It will give remuneration committees freedom to innovate purposeful pay programmes that deviate from the norm, while giving investors confidence that pay will remain aligned to long-term value.</p> <p>Incentives should be focused on long-dated equity rather than performance-based-vesting.</p> <p>Vesting horizons should be to the long term – ideally deferral and holding periods should be extended to 5 to 7 years in combination and in some industries longer timeframes may be required. In addition, CEOs should be required to hold shares for at least two years beyond their departure. This</p>	<p>5a) How long should the vesting period be? Can it be calibrated for sector and firm differences? 5b) Longer vesting and holding periods may result in executives discounting the value of awards and so demanding higher remuneration to compensate. Would this be politically acceptable? 5c) How would the guidelines be enforced and would they have to be internationally coordinated? 5d) Are guidelines sufficient to address any externalities arising from competition? 5e) Regardless of how compensation is designed, executives may continue to take myopic action because their jobs depend on it. How can these pressures be mitigated? 5f) What is the role of nonfinancial performance measures in executive compensation?</p>

	<p>has the additional benefit of ensuring that executives will invest in succession planning and choose successors objectively. This approach is likely to lead to executives having shareholdings above current norms.</p> <p>Guidance should be given that executives be paid partially with debt to deter them from taking excessive risk. Final salary pensions, particularly if unfunded, provided such debt payments in the past. New long-dated debt vehicles are now required, and should ideally extend beyond the end of the CEO's tenure</p> <p>Any bonuses should be modest compared with pay components of long-term equity, and should be based on a balanced range of measures emphasising long-term value and purpose.</p> <p>Remuneration reports should clearly show how incentives are aligned to purpose and long-term value creation. Transparency rules should be strengthened and remuneration committees expected to reduce the earnings of executives via discretion or through underpinning conditions where there are quality of earnings issues. To enable this, definitions for incentive metrics should be disclosed and remuneration committees should fully disclose any adjustments made.</p>	
<p>Corporate Governance and Commitment Devices</p>		
<p>6. Remove the regulatory bias against staggered boards, which can be an important way of ensuring that purpose is sustained over time.</p>	<p>Evidence suggests that a modified form of staggered boards can serve as a commitment device. These devices may be a commitment device for companies to bond themselves to their counterparties by decreasing the probability that current management will be replaced and company policy altered. There appears to be a particular association of this with the relationships of companies with other parties and the need to provide commitment to them.</p>	<p>6a) Is the force of staggered board mechanisms diminished in the UK by a mandatory rule that shareholders may remove directors at any time by ordinary resolution? A shareholders meeting to vote on such a resolution can be requisitioned by 10% of the company's voting shares. Furthermore, in the US, staggered boards are controversial in some quarters and may have led to entrenchment, reducing value.</p> <p>6b) Staggered boards play out differently outside and inside of takeover settings (the latter is often accompanied by a poison</p>

	<p>It is also argued that staggered boards promote continuity and incentives to engage in long-term strategies that are not vulnerable to short-termism.</p> <p>On its own, this measure can be quite powerful. However, its potential importance is as part of a package of measures that moves away from prescriptive regulation based on a particular model of corporate governance to regulation that enables companies to adopt structures that are suited to the delivery of their purpose.</p>	<p>pill): what, if any implications does this difference have for the use and effectiveness of staggered boards?</p> <p>6c) Policy discussions and empirical evaluations have centred on the choice between a traditionally staggered board and a board at which every director stands for election at every year. What, if any scope is there for more intermediate or hybrid forms – i.e. a board that begins as staggered but automatically loses this status where it underperforms its peer group for a certain period of time?</p> <p>6d) In what other ways, might a staggered board be modified to balance costs and benefits?</p>
<p>7. Remove the regulatory bias against dual class shares (i.e. restrictions on premium listings) in order to permit founders and others to protect purpose.</p>	<p>The argument for dual class shares is that they allow entrepreneurs and founders to protect and promote the vision of a company after it has gone public. Dual class shares may mitigate underinvestment resulting from problems of contracting over firms' investment. The evidence from the UK is that equity ownership has become highly dispersed because of an inability to fund growth through equity issuance without diluting the control of families and founders. Many young companies consequently find it difficult to scale-up without losing control.</p>	<p>7a) Would moving from one share-one vote lead to abuse and entrenchment?</p> <p>7b) Has the LSE taken sufficient account of the interests of users of finance (companies) as well as the providers (investors) in its listing rule, which prohibit dual shares?</p> <p>7c) Other major stock exchanges, such as the NYSE, function successfully without such restrictions. Why should they be a more serious problem in the UK than the US?</p> <p>7d) What principles, if any, might inform the design of dual class shares to address the potential for abuse and unintended consequences e.g. sunset clauses, vote caps, minimum equity thresholds held by insiders, open eligibility criteria, basic voting rights for common shares and other governance requirements?</p>
<p>8. Review s.172 of the Companies Act 2006 to broaden the fiduciary responsibilities of directors to include the expression of purpose.</p>	<p>Under s.172 (1) directors of a company are required to act in ways that promote the success of the company for the benefit of its members as a whole (i.e. the shareholders) and in doing so have regard to a broader set of stakeholders (employees, suppliers, customers, community and environment, the company's reputation and long-term condition, as well as to act fairly between members of the company). As argued in Chapter 1, in reality directors practically have to take into account these heterogeneous interests. This formalises existing best practice.</p> <p>However the 'have regard' provision only weakly ensure the interests of the</p>	<p>8a) The scant use of existing mechanisms (both in the UK and abroad e.g. Canada) suggests the impact of modifying company law along these lines may not be very great. Even shareholders have struggled to bring derivative actions against directors given the extensive safeguards in place to weed out inadequate claims.</p> <p>8b) If broader stakeholders' interests were put on a par with shareholders', directors would have to weigh their different and potentially conflicting interests more transparently. How could such a weighing of interests be monitored or enforced?</p> <p>8c) Will courts feel they have the expertise to judge in such cases</p>

	<p>broader set of stakeholders are taken into account.</p> <p>First, the interests of shareholders have precedence (broader stakeholders' interests are taken into account only when they are in conflict with shareholders' interests).</p> <p>Secondly, there is no incentive-compatible mechanism for disciplining directors that fail to 'have regard' – only shareholders have the right to enforce a breach of duty.</p> <p>Thirdly, the provision seems to have had little effect in practice – there has only been one case where the broader scope of s.172 has been considered by a court.</p>	<p>(i.e. business judgement rule)?</p> <p>8d) In what other ways could s.172 be designed? Or, might it be more sensible to target policies at different kinds of stakeholders – e.g. potential conflicts between short-term and long-term interests of shareholders through company law (or, say, encouraging blockholders) or the interests of employees, customers, environment through specific legislation?</p>
<p>9. Introduce Public Benefit Corporation legislation, whether along the lines of the Blab model or more tailored approaches of individual US states (e.g. Delaware, the FPC in California).</p>	<p>This legislation provides for the creation of a company with an explicit declared public or specific purpose within its article of incorporation. This implies that its directors have a fiduciary duty to ensure the company follows that purpose. Together with should be combined with disclosure requirements (i.e. record of performance against a public or specific purpose in an annual report).</p> <p>It is an approach to allowing wider stakeholder interests to be taken into account by companies in a more tailored fashion than under a change in fiduciary duties in company law while representing a stronger form of option 1.</p> <p>The scope to set up as a benefit corporation has been introduced in 30 states in the US, with evidence of state-level flexibility and experimentation.</p>	<p>9a) Holding directors accountable treads a fine line between being too weak and too strong; standing to bring a benefit enforcement proceeding is largely limited to shareholders. Would they have an incentive to?</p> <p>9b) In part, it relies on courts being able/willing to assess whether a company has fulfilled its social purpose versus maximising shareholder value (see above).</p> <p>9c) What obstacles exist to adopting mission-aligned corporate structures suitable for the size and scope of large listed companies (to date, most benefit corporations have been start-ups and no listed firm has converted to a public benefit corporation)?</p> <p>9d) If incentives to set up as benefit corporations are introduced (e.g. tax incentives), who would check to make sure the 'social purposes' are meaningful/credible (not mere corporate cant)?</p>
<p>10. Restrict the role of short-term shareholders during takeover bids – whether by granting</p>	<p>Post Cadbury, the Takeover Panel has taken measures to protect long-term interests of investors and stakeholders. Put-up-or-shut-up requirements, greater recognition of employee interests, improved transparency of bidders' plans and increased clarity over post-offer commitments are steps</p>	<p>10a) What are the costs and benefits of merger arbitrage activity? How has its incidence and nature changed over time?</p> <p>10b) Would it be preferable to restrict votes or grant existing</p>

<p>existing shareholders' additional votes or limiting voting rights acquired during the offer period.</p>	<p>in this direction. For some commentators, the collapse of Pfizer's bid for AstraZeneca is evidence that the new rules are serving their intended purpose.</p> <p>Despite these changes, the takeover regime remains a halfway house, unlikely to deter serious bidders that want to build large positions in the target stock. Recall that after Kraft had announced its Cadbury bid, 31% of the Cadbury register had become owned by short-term investors in the first 44 days. Such merger arbitrage activity still allows shareholders to sell down some of their holdings to lock in the higher post approach share price as an insurance against the bid ultimately failing – in the process increasing the pressure that merger arbitrageur specialists can put on boards to accept a bid.</p> <p>The idea of limiting the rights of short-term shareholders during takeover bids has parallels elsewhere. One example is the French <i>Loi Florange</i> which doubles votes after two years, though its rationale and remit go beyond merger arbitrage. The French approach, however, is less likely to be effective than a policy to restrict voting rights as it amounts to new shareholders having half voting rights rather than none. It also risks entrenching established shareholders (including in France the state) to the detriment of newer shareholders, notwithstanding its value as a reward for longer-term shareholding.</p> <p>A policy to grant existing shareholders additional voting rights on the announcement of an offer period, by contrast, would address the permanence issue of the <i>Loi Florange</i> yet would be less draconian than stripping all votes from shareholdings acquired during the offer period.</p>	<p>shareholders additional rights? How long would measures be in force? If shareholders were granted additional rights, what would the voting structure look like (i.e. double voting rights)?</p> <p>10c) Given the intermediation of shareholding structures, can eligible shares be precisely and rapidly identified? Would additional mechanisms be necessary to prevent votes being traded separately from their underlying economic interest?</p> <p>10d) Can steps be taken to mitigate unintended consequences? One concern is that existing long-term shareholders or white knights who wanted to acquire more shares in order to reject a takeover would be discriminated against by these rules. Another issue is that rules would reduce the demand for a company's shares which would simply increase the chances of a successful takeover at a lower price?</p> <p>10e) Would this policy adequately address the role of short-term investors that take a speculative position in a company <i>before</i> the announcement of an offer period?</p> <p>10f) What other alternative remedies might be considered i.e. raising the offer acceptance level condition from 50% to 60%?</p>
<p>11. To resolve stakeholder disputes over purpose,</p>	<p>Conflicts between different stakeholders will need to be resolved if wider stakeholder interests are to be taken into account. The panels would have</p>	<p>11a) What would be the trigger for calling in the panels? Would the power to call in the panels lie solely with the directors? I</p>

<p>specialist panels with representatives from finance, law, management, consumer associations, and other relevant disciplines should be created. This would be especially important if stakeholders are to be legally empowered (see options 7 and 8).</p>	<p>clear triggers for their intervention, and be part or even fully publicly funded (like Acas).</p> <p>Panels of relevant specialists should be created to seek resolution in stakeholder disputes rather than cases being taken to court. Courts are reluctant to go beyond narrow rulings because of lack of expertise.</p>	<p>11b) not, how could disparate groups of stakeholders (e.g. customers) coordinate to call in a panel? Who would pay for the panels? Would they need to be public bodies?</p>
<p>Blockholding, Monitoring, and Engagement</p>		
<p>12. Introduce loyalty shares that offer financial incentives rather than additional voting rights to shareholders who hold their stock for a particular period.</p>	<p>One argument for loyalty shares is that it rewards costly monitoring by blockholders. The benefits of blockholding are spread across the entire shareholder base; but the blockholder shoulders most of the costs of these activities – ones that often entail substantial involvement with the company over a number of years. By enabling shareholders to purchase additional stock at a fixed price after a period of time, of, for example, three years, loyalty shares, in turn, enable the formation of larger blocks.</p> <p>Providing financial incentives rather than additional voting rights are less likely to result in entrenchment and reduce liquidity. There is also little evidence that granting more votes strengthens shareholder engagement.</p> <p>Several countries (e.g. France and Italy) and some companies (e.g. Toyota) have introduced loyalty share provisions.</p>	<p>12a) Aside from the potential for entrenchment, what is the relationship between prospective shareholding in the future and the past? Shareholders who have held in the past may be more inclined to sell in the future. How can allocation of cash-flow or control rights be linked to prospective future investments rather than past holding periods?</p> <p>12b) How are the risks of passive long-term holdings to be avoided?</p> <p>12c) Where financial incentives are introduced, should these take the form of special dividends or warrants? What are the strengths and weaknesses of each? Which is likely to perform in particular market conditions e.g. periods of volatility – when a committed shareholder base may be particularly important to the firm?</p>
<p>13. Incentivise blockholders by creating 'safe-</p>	<p>At one level, there is an incentive for companies and executive teams to have a continuous dialogue with their largest shareholders over the</p>	<p>13a) To what extent would this privilege large institutional shareholders over other actors who will have access to</p>

<p>harbour' provisions.</p>	<p>strategic direction of the company.</p> <p>In contrast, institutional shareholders have little incentive to build large positions in companies. Liquidity in the secondary cash equity market is limited, and there are additional transaction costs to institutional shareholders building significant stakes in companies, which can be material. This is especially true for institutional investors managing portfolios with daily liquidity requirements.</p> <p>At the same time, the UK regulatory agenda has championed the view that retail and private investors should not be disadvantaged by an asymmetric dissemination of information that would favour institutions. Consequently, institutional shareholders with large stakes in a company are restricted to the same level of disclosure as a retail investor owning a single share.</p> <p>As a consequence together, the combination of high liquidity costs and the regulatory approach to disclosure, discourage institutional shareholders from building strategic blockholder stakes in publicly quoted companies. The current regulatory framework should be amended to create 'safe harbours' where companies can discuss price sensitive information with their largest shareholders.</p> <p>Blockholders who stayed invested in companies would play a useful signalling role to other investors.</p>	<p>'inside' information but not face civil or criminal penalties?</p> <p>13b) What would be necessary to mitigate these risks? For instance, blockholders might commit to holding their shares for extended periods of time, backing company purpose statements and submitting themselves to the scrutiny of the same independent panel established to ensure the observance of fiduciary obligations defined in terms of purpose.</p> <p>13c) Would an additional provision that blockholders could not act on such information within certain proscribed time periods make sense?</p>
<p>14. Require fund managers to disclose measures that signal their degree of conviction and engagement with companies.</p>	<p>Sustainable value creation relies on shareholders to price and allocate capital among different business opportunities. It is supported when they bring new and unique information through their analysis and monitoring of corporate performance. Competition based on relative performance, reinforced by the rise of passive investing, may have had ambiguous consequences for price discovery and accountability of asset managers.</p> <p>While information on monitoring activities is provided by fund factsheets and investment research providers such as Morningstar, it is often scattered,</p>	<p>14a) Would a focus on hard information come at the expense of equally valuable soft information – and how might this be addressed?</p> <p>14b) Rather than relying on a specific metric like active share, for instance, might a duty requiring closet indexers (however calculated) to explain their stock selection/investment process be preferable?</p> <p>14c) Which other measures might have valuable informational content?</p>

	<p>rationalised in very narrow terms (e.g. fees/costs) and not always easy to understand.</p> <p>There has been movement in this direction, with the popularisation of measures like active share, understood as a fund managers deviation from the benchmark index (or 'conviction') which some researchers have linked to outperformance, albeit this link is not uncontroversial.</p> <p>Other measures might include average size of holdings and number of stocks, level of research required to trade, the fund's approach to intangibles, the number of professionals involved in investment decisions and company engagements.</p> <p>Funds might also be prevented from reporting only short-term performance – e.g. a fund with minimum performance horizon of 3 years would not be allowed to report 1 and 2 year performance without also reporting the 3 years. There could also be the encouragement/regulation to stimulate formation of non-for-profit mutuals aggregating and exercising proxy votes.</p>	
<p>15. Develop a Stewardship Standard / kitemark to enable differentiation of asset managers by investors and companies.</p>	<p>Being a PRI or Stewardship Code signatory conveys little meaningful information about the stewardship approach of different fund managers.</p> <p>A minimum standard / kitemark and benchmark for best practice would improve accountability and good practice among fund managers. A standard would allow asset owners, retail investors and indeed companies to easily assess which fund managers are committed to exercising their stewardship commitments in a meaningful fashion. It could be modelled on the International Standards on health and safety and environmental management.</p>	<p>15a) A standard/kitemark may only give assurance over the processes a fund manager has in place. To what extent would it shine light on quality of outcomes?</p> <p>15b) How far would a standard/kite mark influence savers' behaviours? Significant survey evidence suggests savers would prefer their savings managed in line with stewardship and long-term value creation, though actual behaviour from the marketplace is mixed. What accounts for this gap between intentions and actions and how might it be reduced?</p>
<p>Strengthening the capabilities of asset</p>		

owners		
<p>16. Accelerate the merger of subscale pension schemes.</p>	<p>The nature of small-scale pension funds in the UK (there are ~45,000 occupational pension schemes in the UK, 90% of which have fewer than 100 members) results in increased principal-agent issues; difficulties for individual schemes to access certain asset classes/strategies, and a lack of expertise in governance arrangements. In turn sponsoring companies:</p> <ul style="list-style-type: none"> • Divert funds from long-term productive use to manage shorter-term pension deficits; • Diverting potentially distributable profits away from providers of capital • Diverting potential contributions available to be provided to current employees (and thus invested on their behalf) to fund benefits to retired employees <p>The UK should follow Australia's example and introduce a positive duty on trustees to consider annually whether the fund has sufficient scale to deliver value for money as measured by long-term net returns. Such explanations could be reported to and considered by the Pensions Regulator. In addition, TPR could be provided with the tools to force mergers of schemes where performance is poor and/or recovery plans are not likely to be met.</p>	<p>16a) What steps would need to be taken to merge funds with different liability profiles and funding arrangements?</p> <p>16b) How would this interact with other developments i.e. the shift to global passive tracker funds?</p> <p>16c) Is the DC market a better candidate for consolidation where scale may be easier to achieve?</p> <p>16d) How can the independence of a resultant 'super fund' be maintained (i.e. commercial Master Trusts have scale but not necessarily the same fiduciary duties towards beneficiaries)?</p>
<p>17. Clarify the requirement for pension fund trustees to take advice.</p>	<p>Section 36(3) of The Pensions Act sets out the requirement for trustees to obtain and consider proper advice before investing in any manner. 'Proper advice' means from an appropriately authorised adviser. This is generally interpreted to mean that funds must obtain the services of investment consultants for whom commercial realities incentivise churning of managers and the provision of often generic strategic advice. This interpretation thus means funds incur not insubstantial costs and potentially receive advice which is not value enhancing from agents whom are not the subject of much oversight by funds and not accountable to beneficiaries or regulators.</p> <p>Clarifying the requirement to take advice may be met by the establishment of a suitably qualified internal investment executive may result in overall</p>	<p>17a) How would policy address the current grey area between advice over asset allocation and investment instructions, which would necessitate FCA authorisation?</p>

	cost savings through better governance and better oversight of agent relationships including better alignment in mandate terms, less reliance on benchmark comparisons and reduced churning of managers.	
18. Impose a positive duty on providers of tax-advantaged savings vehicles to 'do' stewardship (or to outsource to an overlay provider).	<p>In a bid to encourage a greater savings culture individuals can now invest up to £15,240 annually in a stocks and shares ISA. Investments in an ISA wrapper enjoy significant tax advantages; however, there is no obligation on those managing those investments to vote their shares or be engaged with the companies in which they invest. Similarly, a focus on fees in DC pension schemes is pushing providers to offer low-cost passive funds. Passive investing is not necessarily at odds with good stewardship but there may be limits to what it can achieve.</p> <p>As a quid pro quo of attracting savings through the tax-advantaged wrapper (certain) firms should be expected to do engagement and voting or to outsource such responsibility to an independent provider of these services – or not-for profit mutual could be established to fulfil this function (see above).</p>	<p>18a) Who would be subject to this duty given many firms do not have the scale or resources to do stewardship? Should there be a size limit in order that only the largest firms are caught by the duty?</p> <p>18b) Would it be sufficient to have duty on firms to have arrangements in place that could be satisfied by outsourcing the responsibility to independent providers of engagement and voting?</p> <p>18c) Would this require legislative change or can this be achieved through the publication of formal guidance by the DWP or by the Pensions Regulator?</p> <p>18d) Should such a duty be framed as a transparency obligation, if not who would be responsible for enforcing the duty?</p> <p>18e) To what extent would a duty result in box-ticking voting behaviour and outsourcing of responsibility to proxy voting agencies?</p>
Reversing the Decline in Equity Ownership		
19. Establish a UK sovereign wealth fund (SWF) to provide long-term equity financing.	<p>In principle, a UK SWF would have a higher risk tolerance and long-term investment horizon.</p> <p>It might help address the equity financing gap left by institutional investors such as pension funds and insurance companies.</p> <p>It can direct funds to support social and economic development goals and investment principles, which could include 'stewardship' and 'purposeful' investment.</p> <p>It could address externalities arising from the gap between private and</p>	<p>19a) How would the SWF be funded (e.g. debt backed by government guarantee, repurposing the National Employment Savings Trust and/or local government schemes or some other source)? Countries with sovereign wealth funds typically have Balance of Payment (BoP) surpluses, fiscal surpluses, official foreign currency operations etc. – which is not the case in the UK.</p> <p>19b) Which areas/asset classes would it focus on and how would its mandate be structured to ensure investment decisions were made on the basis of economic and financial considerations?</p>

	<p>social returns for a project, which would not receive private financing based on private returns (i.e. act as a multiplier/syndicator for other investors, e.g. as required for renewable energy finance and project finance structures).</p> <p>It enjoys support from both ends of the political spectrum and the asset management industry (e.g. Aviva Investors, Newton, Invesco etc.).</p>	
<p>20. Equalise the tax treatment of equity and debt.</p>	<p>At the margin this could encourage equity issuance over debt.</p> <p>Equity finance can be considered more long-term (perpetual contract) and has attractive risk-sharing features. Without equalisation, managers may take on too much debt and hence risk.</p> <p>Evidence of countries that applied an Allowance for Corporate Equity (ACE) system regarding the effect on aggregate capital structure and investment. 2001 corporate tax reform in Croatia as natural experiment, shown to have resulted in increased equity levels and decreased long-term debt levels for SMEs; another quasi-experimental setup based on introduction of ACE in Belgium (in 2006) that provides evidence for an increase in investment activity by small and medium-sized firms (~3% in response to the ACE reform); there has been part adoption of ACE in Brazil but capital structures have not changed much.</p> <p>Comparison of ACE implementation between Belgium and Italy underlines the importance of complementary measures: The ACE regime installed in Italy -with its incremental character and stricter tax avoidance framework- is viewed as an example of good practice, successfully matching short-run costs with long-term benefits.</p> <p>The Mirrlees Review makes a powerful case for this and sets out how it should be done. What is required is political will.</p>	<p>20a) What are the advantages of debt relative to equity? Can risk-shifting behaviour be dealt with in other ways?</p> <p>20b) Should policy restrict tax deductibility – if so how would arrangements be phased in (e.g. to ensure the cost of meeting interest payments without tax relief did not undermine solvency for some companies). Or should policy allow corporate equity – if so how would the base of the allowance be computed and the anti-avoidance framework revised to tackle abuses?</p> <p>20c) What lessons can be learned from the experiences of other countries (e.g. Italy and Belgium) for design and implementation, especially regarding ramifications for public finances? What is appropriate and feasible in a UK context?</p>
<p>21. Extend the already familiar and well-running Employee Stock Ownership Plan (ESOP) to other</p>	<p>Creates financial reward for behaviour that helps create purposeful companies by employees and other stakeholders, such as loyalty, dependence and trust (in ESOPs, stake/vesting often based on a formula proportional to compensation and years of service).</p>	<p>21a) Is it possible to distinguish between ‘good’ and ‘bad’ sides of patronage (customer loyalty or dependence may be a sign of firm purpose, but in excess it may erode competition)?</p> <p>21b) What practical issues would need to be resolved to</p>

<p>stakeholders, notably long-term customers, creating a new form of ownership i.e. CuSOPs.</p>	<p>By making stakeholders equity owners, it promises to align their interests with those of the company and its shareholders. In turn stakeholders may have greater confidence to make long-term, irreversible investments in the company. It also creates a mechanism to give stakeholders an actual say in the company.</p> <p>ESOPs can help create a hybrid ownership form between pure shareholder and worker ownership (cooperative) structures – which also depends on ownership rights affiliated with employee stocks.</p> <p>Proven precedents/mechanisms in place that could be introduced off-the-shelf with minimal adaptation.</p> <p>CuSOPs would arguably enjoy broader public support than traditional ESOPs.</p>	<p>21c) implement CuSOPs (e.g. beyond wholesale customers)? What formula would be used to determine a CuSOP stake, given beneficiaries unlike employees in ESOPs, might be harder to delineate?</p>
<p>Anything we missed?</p>		<p>Feel free to propose any other policy recommendations you believe should be included.</p>