UK corporate governance reform
Response from Insight Investment

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A BNY MELLON COMPANY℠

Insight INVESTMENT

Summary

Insight Investment (Insight) is headquartered in the UK and is a specialist in fixed income and liability driven investment, managing over £520 billion.[1] We invest on behalf of our institutional client base which consists of pension funds, insurers, public sector bodies and charities. These investments support the UK economy and provide employment and social opportunities throughout the country.

We invest in many large non-listed UK companies. These private companies are often wholly-owned subsidiaries of larger organisations, such as listed corporations; privately-held companies such as family-controlled or private equity firms; and assets owned in joint ventures, such as by pension funds and sovereign wealth funds.

Insight supports practical improvements to the UK corporate governance framework. Insight believes corporate governance standards must be upheld by all institutions, including unquoted companies, to maintain trust in our financial markets.

In the consultation response provided below we focus on two areas most important for Insight's business as a significant bondholder, namely remuneration and non-listed companies.

[1] As at 31 December 2016. Assets under management (AUM) are represented by the value of cash securities and other economic exposure managed for clients. FX rates as per WM Reuters 4pm Spot Rates. Reflects the AUM of Insight, the corporate brand for certain companies operated by Insight Investment Management Limited (IIML). Insight includes, among others, Insight Investment Management (Global) Limited (IIMG), Pareto Investment Management Limited (PIML), Cutwater Asset Management Corp. (CAMC), Cutwater Investor Services Corp. (CISC) and Insight North America LLC (INA), each of which provides asset management services. Excludes previous parent introduced assets prior to 2009.

Remuneration

3. **Do steps need to be taken to improve the effectiveness of remuneration committees, and their advisers, in particular to encourage them to engage more effectively with shareholder and employee views before developing pay policies? Do you support any of the options set out in the Green Paper? Are there any other options you want to suggest?**

We would encourage remuneration committees and their advisers to explicitly consider the views of bondholders. Dialogue with bondholders would ensure company executives consider the long-term views of a key investment group.

Taking due account of bondholder views is important because shareholder and bondholder interests are not always aligned. For example, companies may reward executives for taking excessive risks, such as through aggressive mergers and acquisition (M&A), by setting earnings-per-share targets. While such actions may be in the interest of shareholders, they may not be in the interests of bondholders, who often do not share the benefits of such actions but often face substantial downside risk.

4. **Should a new pay ratio reporting requirement be introduced? If so, what form of reporting would be most useful? How can misleading interpretations and inappropriate comparisons (for example, between companies in different sectors) be avoided? Would other measures be more effective? Please give reasons for your answer.**

We see both advantages and disadvantages to disclosing pay ratios. On the one hand pay ratios give investors a greater understanding of company culture, which is traditionally difficult to measure. On the other hand, it may be complex to compare accurately pay ratios across firms. We suggest that the FRC formally review the experiences with current reporting on gender pay ratios at UK firms, and use this to provide an evidence-based assessment of whether the scope or depth of such reporting should be extended.

In relation to the specific data that are reported, our general view is absolute figures are most useful, for this prevents data being misunderstood or inaccurately presented. We would also encourage companies to share details on how they benchmark executive pay; this would help provide more clarity on the total pay figures awarded to staff and support comparisons between sectors.

5. **Should the existing, qualified requirements to disclose the performance targets that trigger annual bonus payments be strengthened? How could this be done without compromising commercial confidentiality? Do you support any of the options outlined in the Green Paper? Do you have any other suggestions?**

There are situations when disclosing performance targets can affect companies' commercial prospects, although our experience is that these situations are rare. As such, we believe that there should be a general presumption in favour of disclosing performance targets.

We note that retrospective disclosure of targets reduces investors' ability to hold companies to account on remuneration, and should not be encouraged. Investors need current and relevant information to help identify future risks and to effectively engage with companies.

In terms of implementation, we suggest that enhancing the UK Corporate Governance Code may be the most pragmatic solution. If the relevant clauses of the Code can be structured to put the onus on companies to disclose information, this may begin to improve transparency on performance targets.

6. **How could long-term incentive plans be better aligned with the long-term interests of quoted companies and shareholders? Should holding periods be increased from a minimum of three to a minimum of five years for share options awarded to executives? Please give reasons for your answers.**

   Insight believes the question should focus not just on the long-term interests of shareholders, but on bondholders, too. Bondholders are also significant investors in companies and face unique risks, making aligning long-term interests essential to successful investment.

   We broadly support the current approaches to remuneration. Specifically:

   - As bondholders, we agree that LTIPs and STIPs are important mechanisms to reward and incentivise executives.
   - We don't consider a general need for remuneration policies to be more prescriptive; rather any remuneration plan considered by remuneration committees must be better communicated and explained.
   - In most situations, three-years would be appropriate, but sometimes, such as with significant investments and projects, the rewards are much further into the future and five years may be more suitable. This is best decided on a case-by-case basis.

   However, we believe that the role of remuneration committees needs to evolve:

   1. Short-term risk-taking is still too often rewarded and not enough done to clawback or penalise executives.
   2. Remuneration committees should be expected to define what they consider long-term in remuneration reports and how their policies are commensurate with this goal.
   3. Quoted companies should pay more attention to the views of bondholders to align with the long-term interests of more stakeholders.
   4. We believe remuneration committees should hold discussions with bondholders on remuneration plans as much as they would shareholders. Specifically, we believe that remuneration committees should be required to explain:
      a) how they have engaged with bondholders,
      b) how remuneration packages account for and protect the interests of bondholders as well as shareholders.

Non-listed companies

10. What is your view of the case for strengthening the corporate governance framework for the UK's largest, privately-held businesses? What do you see as the benefits for doing so? What are the risks to be considered? Are there any existing examples of good practice in privately-held businesses that you would like to draw to our attention?

A governance code for private companies should not be prescriptive in setting governance standards. We consider the IoD *Corporate Governance Guidance and Principles for Unlisted Companies in Europe* framework a useful starting document for developing a code, which outlines less onerous governance standards compared with unlisted companies.

We broadly support developing a code for unlisted entities:

- It is reasonable to expect the largest firms to provide as much corporate governance transparency as listed entities.
- Any standard of reporting less than that of listed companies we do not consider an onerous activity for large businesses or of a sensitive or competitive nature.
- Sophisticated private companies with strong bondholder relationships and professional management are more likely to demonstrate good governance and follow basic requirements set out in industry codes.
- Corporate governance is a fundamental quality factor when making a long-term investment. We believe it is essential management demonstrates a commitment to minimum governance standards.

We would expect any code to consider:

1. A minimum standard of transparency and an effective corporate governance framework that can give investors more confidence that a business is well-run and considers the long-term interests of bondholders.
2. A focus on company websites, where some currently provide complete information and others with none. At a minimum we would expect information on board and senior management members; committees and their membership and terms of reference; ownership information; contact information; environment/social information when material; and strategy/financial documents.
3. Annual updates of critical information, such as personnel, documentation and ownership or control. Companies may be advised to inform a regulator or body, such as FRC or Companies House, that they have made any necessary changes to their websites, as we find that information can be outdated, such as board members not being added or removed.
4. Involving audit firms further in the corporate governance review of companies given their access to private information and management.

11. If you think that the corporate governance framework should be strengthened for the largest privately-held businesses, which businesses should be in scope? Where should any size threshold be set?

Every large private business with a headquarters or significant UK presence should be included in the scope of a corporate governance code. This includes private or holding companies that operate as subsidiaries of larger corporations; private equity and privately owned assets; and companies operating as joint ventures.

We would define ‘large’ as an entity with UK-based revenues of more than £500 million, that is not part of a larger listed company in the UK or elsewhere. We use this threshold as companies with significant revenue figures are more established and sophisticated, have internal resources to report, and potentially a greater stakeholder impact.

Small and fast-growing businesses with less than £500 million in revenues tend to have fewer resources and are less likely to use bond markets to fund themselves. These enterprises, however, would have close working relationships with banks, which face different challenges when assessing the financial viability of their clients.

We consider all private companies should aspire and be encouraged to implement any corporate governance framework.

12. If you think that strengthening is needed how should this be achieved? Should legislation be used or would a voluntary approach be preferable? How could compliance be monitored?

Significant progress has been made strengthening corporate governance with the UK Corporate Governance Code. This is reflected by its practical framework and the high level of institutional support offered by shareholders and other stakeholders. We encourage a similar approach for unlisted companies – a code that is supported by the investment market. We would be delighted to support the development of such a code and to lend our support to a final code.

13. Should non-financial reporting requirements in the future be applied on the basis of a size threshold rather than based on the legal form of a business?

We believe a revenue threshold is the most appropriate approach and the easiest to administer. We therefore encourage using reported audited revenue figures as a basis for non-financial reporting (see response to question 6).

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