Standard Life Investments

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Dear Claire

EU CORPORATE GOVERNANCE FRAMEWORK – GREEN PAPER

Standard Life Investments is a major European institutional investor with assets under management at 31 March 2011 of €177.5 billion. A very significant proportion of these assets are invested in securities listed on European stock exchanges. On behalf of our clients, we provide companies with long-term capital. Accordingly, we place great importance on corporate governance both when making investment decisions and in holding companies to account. Therefore, and as one of Europe's leaders in governance and stewardship, we welcome the opportunity to respond to the questions set out in the Commission's Green Paper and on other related matters.

We believe that the creation of a corporate governance framework in the EU that will be both effective and stand the test of time should serve to enhance the EU's credentials as an attractive place to do business and in which to invest for the long-term. This, in turn, will contribute to creating a climate that will encourage long-term investment that will yield benefits for not only shareholders but also the wider society.

At the outset, we should like to emphasise our support for 'comply or explain', since a number of commentators have suggested that this approach may be significantly undermined by the Commission's ultimate proposals. 'Comply or explain' provides a framework that affords companies with the necessary flexibility to implement corporate governance arrangements that are best suited to their business needs, taking into account best practice principles, that are set out in generally accepted corporate governance codes that operate throughout most of the EU. It is essential that shareholders - and institutional shareholders, in particular - play their part by holding companies to account, and are prepared to enter into a meaningful dialogue with the company in respect of non-compliance with these codes. To this end, we commend the approach which is embodied in the UK Stewardship Code for Institutional Investors. This Code not only provides clear guidance to institutional investors as to how they are expected to behave in fulfilling their governance responsibilities but also enables their clients, the asset owners, to hold them to account in this regard. Also, we commend the EFAMA Code for External Governance, which puts stewardship into a European context. We believe that 'comply or explain' is an approach that contributes to the competitiveness of European businesses as they seek to play their part in achieving the ambitious growth targets set by 'Agenda 2020'[1] and otherwise deliver sustainable returns to their shareholders.

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[1] See conclusions of the European Council of 17 June 2010 accessible at http://www.consilium.europa.eu.ueDocs/cms_Data/docs/presData/en/ec/115346.pdf.

Our responses to the questions in the Green Paper are set out in the attachment. We should like to highlight the following points:

- **Division of responsibilities.** Although we believe it is generally desirable for the functions and duties of the chairperson of the board of directors and the chief executive officer to be clearly divided, there are situations when it is appropriate for companies to combine the functions and duties of these two roles in one person. Accordingly, we should like to see the Commission giving clear encouragement – for example, in speeches and articles - to have the functions and duties clearly divided but we think it would be unwise to hardwire this division of responsibilities into European law.
- **Lead independent director.** The role of the lead independent director (sometimes called the senior independent director) can be extremely important when addressing corporate governance issues, particularly when the chairman is conflicted by the issue concerned. The Green Paper was relatively silent regarding the role and responsibilities of the lead independent director. It would be extremely useful if the Commission were to give further consideration to this role with a view to ensuring that its importance is recognised in future pronouncements.
- **Disclosures by nominations committee.** There is ample scope for improving the quality of disclosures made by nominations committees. These committees are the gate-keepers of European boardrooms and inherently determine the quality of directors and hence the quality of corporate governance that is brought to bear. The Commission should encourage the development of Pan European disclosure guidelines to provide improved transparency of the work undertaken by a company's nominations committee and other board committees.
- **Remuneration vote.** We would support arrangements whereby it was mandatory to put the remuneration policy and the remuneration report to a vote by shareholders. We believe the vote should be advisory provided that companies respond constructively to the voting outcome. In this latter regard, we suggest that companies should be required to provide an explanation to shareholders as to how they have responded to the advisory vote at the previous AGM. Such a measure would help to ensure that boards and their remuneration committees do not ignore the outcome of the advisory vote, especially when there is a significant level of dissent.
- **Asset owners and their investment managers.** We welcome the focus on measures to be taken to improve the relationship between asset owners and their investment managers. We believe consideration should be given to measures that would require asset owners to undertake an annual evaluation of how their long-term managers fulfil their governance and stewardship responsibilities. Currently, there is little evidence that this takes place.
- **European shareholder forum.** There is a strong case for establishing a shareholder forum which would enable Europe's larger institutional investment managers and asset owners to consider company specific governance and stewardship issues, and how they should be addressed in a co-operative yet robust manner. We believe that this should be a private sector initiative but the Commission should have a role to facilitate its creation and maintain its momentum until it is well established and respected in both the investor and corporate communities.
- **Proxy advisors.** It is essential that proxy advisors be more transparent and that their institutional investor clients use that transparency to enhance their understanding of how the proxy advisors fulfil their responsibilities. We should like to see proxy advisors being subject to a European Code of Practice, which would be regulated in a manner that will enable effective enforcement and, if necessary, sanction being brought to bear.

We hope our comments will assist you and your colleagues in your continuing assessment of corporate governance in the EU. We remain at your disposal, should you ever feel that we can be of assistance in the development of your proposals, which will undoubtedly shape the future framework of corporate governance in Europe for many years to come.

I am sending a copy of this letter to Steven Maijoor to keep him abreast of our views, not least since many of them envisage a role for ESMA.

Yours sincerely

Guy

Guy Jubb
Head of Governance & Stewardship
Standard Life Investments

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STANDARD LIFE INVESTMENTS LIMITED

THE EU CORPORATE GOVERNANCE FRAMEWORK

GREEN PAPER RESPONSE

PRELIMINARY QUESTIONS

Q1. Should EU corporate governance measures take into account the size of listed companies? How? Should a differentiated and proportionate regime for small and medium-sized listed companies be established? If so, are there any appropriate definitions or thresholds? If so, please suggest ways of adapting them for SMEs where appropriate when answering the questions below.

We do not believe that EU corporate governance measures should take into account the size of listed companies per se because there are inherent practical difficulties in establishing size thresholds that will not only enjoy general acceptance but also stand the test of time, given that size will be a constant variable. However, we do believe that there is an emerging case for having a differentiated and proportionate regime approach to corporate governance measures in the EU. In the past, we have tended to favour a 'one size fits all' approach and have been reluctant to support 'carve outs'. However, reflecting on the financial crisis and developments since then, including the increased cost burden of corporate governance, we believe that there is now a good case for best practice corporate governance principles being applied in a differentiated and proportionate manner to the following categories of companies:

- Banks and other financial institutions. The Commission has already identified that such entitles should adopt a more intensive risk-based approach to corporate governance and otherwise adopt measures that are proportionate to the shareholder and public interest risks that pertain to them.
- Other main market listed companies. Those companies which have a full listing on European stock exchanges should be expected to apply a proportionate governance regime which would be less onerous than that which applies for banks and other financial institutions but would be more onerous than that which applies to companies which are listed on the secondary or junior markets (see below).
- Junior market companies. They should enjoy the benefits of a lighter touch corporate governance regime. Many of the stock markets in the EU operate junior markets for companies which are typically young, small and medium-sized growth companies. From an investment perspective, it is generally acknowledged that such companies carry a higher investment and corporate governance risk. It is especially important that such companies flourish and prosper under entrepreneurial leadership in order to maintain the long-term competitive advantages that accrue to the European economy. A lighter touch corporate governance regime would seem to be consistent with their needs.

We encourage the Commission to work closely with the European Securities Markets Association (ESMA) with a view to introducing a differentiated and proportionate approach along the lines outlined above in a manner that would enable ESMA and the relevant local regulators to ensure that appropriate governance codes and enforcement measures are implemented and monitored.

In its continuing deliberations on this matter, we commend to the Commission:

- The approach used by the Brazilian Stock Exchange that is reflected in its Special Corporate Governance Stock Index and the 'Novo Mercado', which is designed to enable a company to lower its cost of capital by inclusion in an index that is based on companies which have good standards of corporate governance.
- "Different approaches to Corporate Reporting Regulations: How jurisdictions Differ and Why", a paper by Professor Christian Leug, which won the Allen & Overy Law Prize that was presented at the ECGI's General Assembly in April 2011. The idea at the heart of this paper is the creation of a 'Global Player Segment' which comprises companies that abide by the same reporting rules and face the same enforcement. This idea could be adapted to focus on European companies which meet a minimum but high standard of transparency. Such companies would benefit from a lower

cost of capital and a regulatory approach that reflects their lower risk profile. Although we have an open mind on the proposals, we do believe the approach is an interesting one, and it could provide an incentive to those companies who do not meet best practice standards to improve their approach in order that they can be included in the highest market segment.

Q2. Should any corporate governance measures be taken at EU level for unlisted companies? Should the EU focus on promoting development and application of voluntary codes for non-listed companies?

We do not believe that corporate governance measures should be taken at EU level for unlisted venture capital companies and small and medium-sized family controlled companies. Such measures would be inappropriately intrusive and they would generate a cost where the return, directly or indirectly, would be difficult to discern. However, we do believe there is a case for large unlisted institutionally backed companies and large family companies to apply voluntary codes of corporate governance and otherwise maintain high standards of stewardship.

1. Board of Directors

Q3. Should the EU seek to ensure that the functions and duties of the Chairperson of the Board of Directors and the Chief Executive Officer are clearly divided?

We believe that the EU should give clear encouragement – for example, in speeches and articles - to have the functions and duties of these two roles clearly divided but there are situations when it is appropriate for companies to combine the functions and duties of these two roles in one person. For example, when strong board leadership is required to enable a company to recover after a period of financial stress or difficult trading. Therefore, we do not believe that the division of responsibilities should be mandatory.

In addition, we should emphasise that the role of the lead independent director needs to be clearly identified and defined in a manner that makes the role an important check and balance within the board leadership. This is especially important in the event that the functions of the chairperson and the chief executive officer are combined in one person.

1.1 Board Composition

Q.4 Should recruitment policies be more specific about the profile of directors, including the chairman, to ensure that they have the right skills and that the board is suitably diverse? If so, how should that best be achieved and at what level of governance, i.e. at national, EU or international level?

Q.5 Should listed companies be required to disclose whether they have a diversity policy and, if so, describe its objectives and main content and regularly report on progress?

Q.6 Should listed companies be required to ensure a better gender balance on boards? If so, how?

4, 5 & 6. Our position on diversity, is set out in a Paper which can be found on our website[1] and is attached as an Appendix for ease of reference. You will see from this that we support the principles associated with diversity but would like to see an holistic approach developed when considering the overall diversity of a board. Furthermore, we believe that companies should discuss their approach to diversity with their key owners and investors.

[1] http://www.standardlifeinvestments.com/CG_Diversity_On_Board/getLatest.pdf

We support:

- Recruitment policies that are specific about the profile of directors, including the chairman, to ensure that the board is suitably diverse and skilled. As a practical matter, we should prefer that this approach is determined at a member state level bearing in mind the different cultural issues that arise.
- Listed companies being required to disclose whether they have a diversity policy, and report on its implementation annually.
- Listed companies having an appropriate gender balance on their boards. This should be consistent with their disclosed diversity policy (see above), which should be the subject of discussion, at appropriate intervals, with the principal owners.

Notwithstanding the above, we believe there is a risk of boilerplate disclosures arising and it is important that boards are made aware of this risk and seek to mitigate it. Furthermore, institutional and investors and, when appropriate, regulators, should seek to ensure that companies comply with the spirit of their diversity policies.

Most companies have a nominations committee. It would seem appropriate for the nominations committee to have the functional responsibility for diversity. In our opinion, there is ample scope for improving the quality of disclosures by nomination committees. The Commission should lend its support for improved disclosure and the development of disclosure guidelines to strengthen accountability of the nominations committee and other key board committees.

1.2 Availability and Time Commitment

Q7. Do you believe there should be a measure at EU level limiting the number of mandates a non-executive director may hold? If so, how should it be formulated?

No. It is better to adopt a flexible approach under a 'comply or explain' regime whereby common sense and transparency are brought to bear. Accordingly, we believe it would be useful if member states were required to adopt a governance code that incorporates the principle that boards and their shareholders should seek to ensure that all directors have adequate time to fulfil their commitments to the company effectively.

1.3 Board Evaluation

Q8. Should listed companies be encouraged to conduct an external evaluation regularly (e.g. every three years)? If so, how could this be done?

We support an approach that encourages boards to undertake evaluations of their performance. The effectiveness of board committees is also important, and this must not be overlooked. Whilst we agree that regular use of an external facilitator could improve board evaluations by bringing an objective perspective and sharing best practices from other companies, we are wary of mandating such an approach since it may result in the evaluation being undertaken as a matter of rote rather than as a tool for maintaining and improving the board's performance. Therefore, we are comfortable with the suggestion that listed companies should be encouraged to conduct an external evaluation regularly but we would not favour a more prescriptive approach. This is another matter that would lend itself to application via a 'comply or explain' code.

1.4 Directors Remuneration

Q9. Should disclosure of remuneration policy, the annual remuneration report (a report on how the remuneration policy was implemented in the past year) and individual remuneration of executive and non-executive directors be mandatory?

Q10. Should it be mandatory to put the remuneration policy and the remuneration report to a vote by shareholders?

Disclosure of remuneration policy, the annual remuneration report (on how the remuneration policy was implemented in the past year) and individual remuneration of executive and non-executive directors should be mandatory. It is important that there is effective accountability in respect of these remuneration matters at a listed company and such accountability would not be possible without appropriate disclosure.

On balance, we believe it should be mandatory to put the remuneration policy and the remuneration report (preferably on a combined basis) to a vote by shareholders. As a practical matter, we believe the vote should be advisory provided that companies respond constructively to the voting outcome. In this latter regard, we suggest that companies should be required to provide an explanation to shareholders as to how they have responded to the advisory vote on remuneration matters as the previous AGM. Such a measure would help to ensure that boards and their remuneration committees do not ignore the outcome of the advisory vote, especially when there is a significant level of dissent.

1.5 Risk Management

Q11. Do you agree that the board should approve and take responsibility for the company's 'risk appetite' and report it meaningfully to shareholders? Should these disclosure arrangements also include relevant key societal risks?

Q12. Do you agree that the board should ensure that the company's risk management arrangements are effective and commensurate with the company's risk profile?

We agree wholeheartedly that the board should approve and take responsibility for the company's 'risk appetite', and report it meaningfully to shareholders. In principle, we support the proposal that the disclosure arrangements should include key societal risks but we suggest that further work is done in this regard to ensure there is a generally accepted understanding of 'key societal risks'. However, we question whether a disclosure regime will of itself provide a basis for effective accountability. Rather, the subject of risk appetite and risk oversight needs to be brought into the regular engagement dialogue that takes place between companies and their shareholders. If shareholders have concerns then they should communicate their views to the company in an unambiguous manner.

We agree that the board should ensure that the company's risk management arrangements are effective. We are uncertain as to whether the additional requirement that they should ensure that the arrangements are 'commensurate with the company's risk profile' is necessary insofar as it is inherent in having 'effective arrangements'. Again, the effectiveness of the risk management arrangements should be part of the engagement dialogue between the company and its shareholders.

2. Shareholders

2.2 Short-termism of Capital Markets

Q13. Please point to any existing EU legal rules which, in your view, may contribute to inappropriate short-termism among investors and suggest how these rules could be changed to prevent such behaviour.

We are not aware of any EU legal rules which contribute to inappropriate short-termism among investors but we do acknowledge that frequent changes in regulations and fiscal arrangements can have the consequence of making investments unattractive in the eyes of a shareholder with the consequence that the holding is sold earlier than would otherwise be the case.

We suggest that the focus should not be on the rules which contribute to short-termism per se. Rather, the focus should be on how to incentivise and reward those who are genuine long-term shareholders.

There is no easy solution to this but we welcome the work being done by the UK Government (and no doubt by other member states, as well) to address the perceived issue.

Whilst we accept that the perception of short-termism needs to be addressed, we believe that some statistics may exaggerate the degree of short-termism - for example, the turnover on major equity exchanges that is quoted in the Green Paper at 150% per year of aggregate market capitalisation may not present a ‘true and fair view’ of the long-term relations that subsist between investors and the company. Accordingly, it is important that any proposals to address short-termism are made only after very careful consideration of the reality.

2.3 The Agency Relationship between Institutional Investors and Asset Managers

Q14. Are there measures to be taken, and if so, which ones, as regards the incentive structures for and performance evaluation of asset managers managing long-term institutional investors’ portfolios?

In our experience, insufficient weight is given to how asset managers fulfil their governance and stewardship responsibilities. Most asset owners and, notably, their independent investment advisors do not take this into meaningful account when evaluating the performance of their long-term investment managers. We believe there are a number of contributory factors to this, including:

- Effective governance and stewardship being difficult to measure. Hence it does not lend itself to quantitative evaluation.
- Independent investment advisors not being sufficiently experienced in matters pertaining to governance and stewardship.
- Trustees and other representatives of asset owners not being familiar with governance and stewardship issues, and not being required to have any specific competency in these matters.
- The fiduciary responsibilities of trustees and other asset owners being, at best, unclear as to how they pertain to governance and stewardship.

Therefore, we believe consideration should be given to measures that would:

- Require asset owners to undertake an annual evaluation of how their long-term investment managers fulfil their governance and stewardship responsibilities.
- Require investment advisors and the trustees (or similar) of asset owners to be competent in governance and stewardship to a degree that will enable them to evaluate effectively the performance of relevant investment managers.
- Provide greater clarity regarding fiduciary responsibilities, such that there is no ambiguity regarding the status of governance and stewardship, which we believe should be an integral part of such responsibilities.

In addition to these measures, explicit encouragement should be given to asset owners to engage in a meaningful on-going dialogue with their long-term investment managers regarding how governance and stewardship responsibilities have been fulfilled. Explicit reference to these responsibilities should be made in the contractual documentation that pertains to the investment management relationship.

Q15. Should EU law promote more effective monitoring of asset managers by institutional investors with regard to strategies, costs, trading and the extent to which asset managers engage with the investee companies? If so, how?

As noted above, there is scope for measures to be taken to improve the agency relationship between institutional investors and asset managers.

2.4 Other Possible Obstacles to Engagement by Institutional Investors

Q16. Should EU rules require a certain independence of the asset managers' governing body, for example from its parent company, or are other (legislative) measures needed to enhance disclosure and management of conflicts of interest?

It is important that the clients of asset managers have a clear understanding of the measures, if any, that are in place to govern the conflicts of interest, such that the asset managers act always in the best interests of their clients. Accordingly, we would favour an approach, possibly rules based, that would require disclosure by institutional asset managers of how they manage their conflicts of interest. The UK Stewardship Code provides that those who comply with the Code should disclose their approach to conflicts of interest on their website. Mindful that compliance with the Code is monitored, this approach provides effective transparency.

Q17. What would be the best way for the EU to facilitate shareholder cooperation?

There is a strong case for establishing a properly constituted shareholder forum which would enable Europe's larger institutional investment managers and asset owners to consider company specific governance and stewardship issues and how they should be addressed in a co-operative manner. The constitutional arrangements of such a forum require careful consideration. In order for it to be effective, much of its activities will need to be conducted on a private and confidential basis. To conduct them in a public way would often be counter-productive. However, there would be a need for the forum to provide an account - say, in the form of an annual report - of the activities it has undertaken in the prior year. Also, as a practical matter there would be a need to provide for an arrangement whereby, on the one hand, there is effective governance and leadership of the forum, which by implication would vest in a defined number of its members, and, on the other hand, there is a mechanism which would enable institutional investors and others to bring legitimate concerns to the attention of the forum. We believe these and other aspects pertaining to the modus operandi can be resolved satisfactorily.

The forum that we envisage should be a private sector initiative but based on experience we firmly believe that the EU has a role to facilitate its creating and to maintain its momentum until it is well established and respected in both the investor and corporate communities, as well as by regulators and other stakeholders. Therefore, we suggest that ways should be examined to enable the European Commission to fund an independent secretariat for the forum for, say, its first three years, by when it should have sufficient momentum to start to stand on its own two feet financially. We do not regard the cost of such funding as being significant in the context of the Commission's budget.

As well as addressing shareholder co-operation, we believe that specific considerations should be given to how shareholders will escalate their engagement if their concerns have not been addressed through normal channels. It is important to emphasise that the cost of escalated engagement in member states can be significant, especially when it is necessary to take professional advice in order to exercise shareholder rights. We believe it is important that the Commission is mindful of this issue, which may merit further consideration and research.

Cross-border voting in Europe has improved over the last decade but there is still much to be done to enable shareholders to vote consistently at shareholder meetings of European companies in a cost-effective manner. We are pleased the Commission is aware of a number of difficulties and will be looking into the issue in relation to its work on harmonising securities law. However, we question whether this is sufficient and would suggest there is a case for creating a cross-border voting process working group to identify issues and monitor progress.

2.5 Proxy Advisors

Q18. Should EU law require proxy advisors to be more transparent, e.g. about their analytical methods, conflicts of interest and their policy for managing them and/or whether they apply a code of conduct? If so, how can this best be achieved?
Q19. Do you believe that other (legislative) measures are necessary, e.g. restrictions on the ability of proxy advisors to provide consulting services to investee companies?

Proxy advisors are playing an increasingly influential role in determining the outcome of shareholder meetings and, thereby, the European governance landscape. We recognise that they play a useful operational role in enabling institutional investors to process their clients' voting instructions in a scalable manner but we are concerned that institutional investors may not always exercise sufficient care in ensuring that the voting recommendations of the proxy advisory firms are consistent with the best interests of their clients. The 'big picture' situation is compounded by a small number of major proxy advisors accounting for a very significant proportion of the votes cast at European AGMs.

Against the background, we believe that it is essential that proxy advisors be more transparent and that their institutional investor clients use that transparency to enhance their understanding of how the proxy advisors fulfil their responsibilities and hold them to account. We would like to see proxy advisors being subject to a European Code of Practice, that is regulated in a manner that will enable effective enforcement and, if necessary, sanction being brought to bear in the event of Code failure. We would emphasise the importance of enforcement. In the light of the market structure for proxy advisors, it would be unfortunate if they merely comply with the letter rather than the spirit of the Code.

We suggest that the role and regulation of proxy advisors merits independent research in order that the full extent of their activities and influence can be assessed in order to enable well-informed decisions about reform and transparency. Such research should encompass how proxy advisors interface with the companies that they evaluate. It is not uncommon for companies to complain to us regarding analysis inaccuracies by proxy advisors as well as inadequate engagement and dialogue taking place, such that companies often feel 'ambushed' by the proxy advisors. On the face of it, this is not a satisfactory situation.

2.6 Shareholder Identification

Q20. Do you see a need for a technical and/or legal European mechanism to help issuers identify their shareholders in order to facilitate dialogue on corporate governance issues? If so, do you believe this would also benefit cooperation between investors? Please provide details (e.g. objective(s) pursued, preferred instrument, frequency, level of detail and cost allocation).

We firmly believe that it would be enormously useful to have an effective mechanism that would enable issuers to identify their shareholders in order to facilitate dialogue on corporate governance issues. Provided that such a mechanism enabled transparency to be provided regarding the ownership, we are confident that it would benefit co-operation between investors, especially if initiatives such as those outlined in the response to Q17 above are implemented. This transparency could be provided on the company's website, updated on, say, a quarterly basis, with disclosures being made to the market in the interim when there are changes in significant shareholdings above a specific threshold. We believe the UK approach to shareholder identification and transparency works well and we commend it to you. We would expect the Commission to co-ordinate transparency regulations with ESMA and other relevant bodies.

2.7 Minority Shareholder Protection

Q21. Do you think that minority shareholders need additional rights to represent their interests effectively in companies with controlling or dominant shareholders?
Q22. Do you think that minority shareholders need more protection against related party transactions? If so, what measures could be taken?

We believe that the scope for improving arrangements for minority shareholder engagement and the functioning of 'comply or explain' where there is a controlling or dominant shareholders is an increasingly important issue, especially when the controlling and dominant shareholder is domiciled in a country which is not subject to the same standards of corporate governance and stewardship as operates in Europe. Therefore, we believe that it is important that:

- There is effective transparency of the contractual and business relationships between the controlling or dominant shareholder and the company (including any of its subsidiaries and/or joint ventures).
- There should be a lead independent director whose responsibilities include representing the views of minority shareholders to the board, when appropriate. This lead independent director should stand for annual re-election and the controlling or dominant shareholder should not be permitted to vote on the relevant resolution.

We support, in principle, the suggestion that significant related party transactions should need approval by shareholders at the general meeting but we are wary of creating a climate that engenders a negative pre-disposition to all related party transactions. Related party transactions can be a very integral part of the business model and essential for the long-term success of the company. Hence, we should welcome further consideration of this issue by the Commission with a view to further consultation in the event that it decides to proceed with additional voting or other governance measures.

2.8 Employee Share Ownership

Q23. Are there measures to be taken, and if so, which ones, to promote at EU level employee share ownership?

We concur with the views set out in the Green Paper, which point to the benefits from employees share ownership that help to sustain the long-term success of a company through an effective alignment of long-term interests. We welcome and generally support well-structured corporate sponsored share ownership programmes which operate in accordance with generally accepted principles.

At a time when the importance of ensuring that pay in the boardroom has regard for pay in employment conditions elsewhere within the company, we are surprised that there is not greater use of profit sharing schemes by European companies, since these provide an obvious way of providing a performance related incentive that rewards all employees in a fair manner. We should like to see the Commission exploring further how profit sharing schemes can be developed and promoted more effectively in the EU.

We are struck by how little engagement there is between the boards of European companies and their employee shareowners. Whilst most companies have developed effective channels for their chief executive and executive business leaders to communicate corporate governance developments to employees, it is generally a 'one-way street'. Often, there is not an effective forum for employee shareowners to feed back comments to the board. Also, non-executive directors are rarely involved in the process. Therefore, we suggest that the Commission give consideration to arrangements that would require a board to engage with its employees' shareowners, possibly through a 'town hall meeting', which would be akin to an AGM insofar as it should enable the board to report to its employ shareowners on the progress and governance of the company, and the employee shareowners to provide the board with useful feedback in a 'safe harbour' environment. The arrangements proposed by the Commission should be pitched at 'a high level', so that companies are given scope to enact the provisions in a flexible manner that takes into account their particular circumstances, such as employee location and access to technology. We would envisage that the chairman of the board would be required to report on the town hall meeting at the next AGM and/or in the next annual report.

3. Monitoring and Implementation of Corporate Governance Codes

Q24. Do you agree that companies departing from the recommendations of corporate governance codes should be required to provide detailed explanations for such departures and describe the alternative solutions adopted?

Q25. Do you agree that monitoring bodies should be authorised to check the informative quality of the explanations in the corporate governance statements and require companies to complete the explanations where necessary? If yes, what exactly should be their role?

We agree that companies departing from the recommendations of corporate governance codes should be required to provide detailed explanations for such departures and describe the alternative solutions adopted. It is clearly important that such disclosures are not boilerplate in nature; rather, the explanation should relate to the context of the company and its corporate governance arrangements in a discursive and meaningful manner. In our experience, many companies in the UK and certain other member states already provide detailed explanations. The problem is that the explanations are often buried in the detail of the corporate governance statements and hence are not communicated effectively. Therefore, we encourage the Commission to explore ways to improve communication. Options that the Commission may wish to evaluate include:

- Repeating the compliance statement in the AGM notice that is sent to shareholders in order to reinforce its voting relevance.
- Companies being required to put their corporate governance statement to an advisory vote at each AGM to enable shareholders to register concerns about code compliance or other aspects of corporate governance in a constructive yet clear manner.

We do not advocate these options but we do suggest that they merit evaluation. If the latter option were adopted, consideration must be given to other standard resolutions that are currently in use – such as the resolution to approve the report and accounts, in the UK – to ascertain whether or not they are rendered redundant.

On balance, we support moves that would enable monitoring bodies to check the informative quality of explanations in the corporate governance statements and require companies to complete explanations where necessary. That said, we believe that the approach taken should have a firm but light touch insofar as a too heavy enforcement and monitoring regime will tend to result in a move towards boilerplate and/or standardised statements, which would be neither informative nor useful. Hence, we should like to see the Commission engaging with bodies such as ESMA with a view to them taking steps to oversee the establishment of effective European monitoring body. The role of this body should be to evaluate disclosures on both a risk based and a random sampling basis. It should have powers to require companies to re-state publicly their corporate governance statements in the event that the review body considers the existing corporate governance statement to be misleading and/or insufficient. The relevant listing authorities should have an ability to suspend the listing of the company's shares after a reasonable period in the event that the company has not responded constructively to the requirement to restate. The review body should publish its findings annually, both to provide accountability and to shape emerging best practice by promoting examples of top notch disclosure. Any requests by the monitoring body to re-issue statements and/or enforce sanctions should be disclosed to the market.

Appendix – Diversity on the Board: Standard Life Investments Position Paper.
http://www.standardlifeinvestments.com/CG_Diversity_On_Board/getLatest.pdf

Edinburgh, 22 July 2011