Standard Life Investments

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The Kay Review
Department for Business, Innovation and Skills
Spur 2, Floor 3
1 Victoria Street
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SW1H 0ET

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Dear Sirs

THE KAY REVIEW OF UK EQUITY MARKETS & LONG-TERM DECISION-MAKING

On behalf of Standard Life Investments, which is a major UK institutional investor with assets under management of £150 billion as at 30 September 2011, I have pleasure in submitting our comments in response to your call for evidence.

We welcome the Review but we consider that its terms of reference should have encompassed all types of long-term capital that are available to companies. In particular, it should have embraced private equity and bonds. We believe the exclusion of these categories of long-term capital may undermine the cohesiveness of the recommendations made by the Review, bearing in mind that in practice companies seek to optimise their cost of capital and source it from a variety of providers. Therefore, we recommend that the review team hosts a small and appropriate number of round-table meetings with private equity and bond investors with a view to gaining a useful understanding, supported by evidence, of the approach that they take to achieve attractive long-term returns on their clients' investments.

I should like to highlight the following views and recommendations:

- We recommend that regulations be introduced to impose an appropriate health warning in respect of communications to beneficiaries that offer and recommend index tracking investment funds and strategies so that the beneficiaries are on notice that such funds and strategies do not take into consideration the underlying competitive strengths of the individual companies to which the beneficiary is exposed.

- The increased incidence of listed companies providing quarterly updates on their trading and financial position, and the behavioural consequences thereof, do not encourage boards to focus on the long-term development of their business. Whilst we recognise the importance of keeping the market properly informed, we should like to see the Government taking steps that would encourage companies to consider the usefulness of providing quarterly updates to the markets, especially in the light of proposed revisions to the Transparency Directive.

- It is the role and responsibility of boards and their remuneration committees to determine the remuneration policies and practices that are used in their businesses. However, we should like to see the Government give leadership by lending its support to those that seek significant improvement in remuneration practices that will achieve a much improved alignment of interest between executives, boards and the long-term shareholders of publicly listed companies. Therefore, we recommend that the Government set up an independent standing committee to monitor progress and undertake other market initiatives to stimulate change with a view to achieving the improved alignment.

- It is self-evident that investment bankers and other professional advisers are not rewarded in a manner that is designed to align their interests with the long-term development of their client's business. We recommend that consideration be given to developing a code of conduct for investment bankers and other advisers, which would operate on a comply or explain basis and serve to condition the interaction between investment bankers and professional advisers and their clients in a manner that is consistent with the long-term development of the client's business. In addition, there should be an additional Code Provision in the UK Corporate Governance Code that provides that the company should have policies for paying professional advisers and investment bankers on terms that are aligned with the long-term success of the company.

- We recommend that BIS consult to determine what needs to be done to bring greater clarity to the legal and fiduciary responsibilities of institutional asset owners and trustees in order that they can have greater confidence as to what is required and expected from them in fulfilling their responsibilities.

- We believe there is scope to extend the time horizons which performance based fees for investment managers are calculated, with a view to strengthening the alignment of the interests throughout the investment chain.

- We have no evidence to suggest that international investment trends have adversely affected the quality of engagement between shareholders and quoted companies. Nevertheless, we recommend that BIS ask the Financial Reporting Council to commit to publishing an annual review of stewardship in the UK, which should include not only recommendations to improve best practice but also provide an appropriate commentary on the geographic ownership of UK companies and its implications.

We hope our evidence and recommendations will assist the review team in fulfilling its terms of reference. If you have any questions, please contact my colleagues Guy Jubb (guy_jubb@standardlife.com) and Jonathan Cobb (jonathan_cobb@standardlife.com).

Yours faithfully

Keith

cc. Rt Hon Mark Hoban MP, Financial Secretary to HM Treasury