From Responsible Saver to Stewarded Investor?

Prof Sally Wheeler, MRIA, AcSS
s.wheeler@qub.ac.uk

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Introduction

The financial and credit crises of 2008 have heralded a somewhat confusing plethora of reports; government commissioned inquiries, parliamentary inquiries and independent reports, that have looked at numerous aspects of financial "life". No stone has gone unturned in the mission to account for failed banks, banks too big too fail, executive compensation and the role of institutional investors. Each sector of the financial services industry and Government has been keen to explain blame and responsibility away while asserting that it is the appropriate level at which to situate preventative regulation. It is this last segment of the account, institutional investment, and its role within the wider community of "savers" that this chapter is concerned with. In its four sections the chapter looks at the nature of shareholding and the expectations that it carries for a variety of participating groups. It examines current patterns of share ownership and explains why these have changed so radically in the last 40 years. Finally it turns to the recent Stewardship Code (FRC 2010) to consider whether this offers a new way forward.

In the last three years or so discussions of the world of finance have exposed both the financial practises of large listed corporations and the web of financial relationships that are encompassed in the terms "shareholder" and "shareowner" in relation to publically traded companies. Conversations about the role of share owners in corporate governance are now openly about the positions of actors such as fund managers, asset managers, voting service agencies, trustees, institutional investors, beneficiaries and indirect investors**.** Markets practices such as stock loans, short selling and stock arbitrage are now discussed much more widely even if there is a general lack of clarity about what they are and what they achieve, both in theoretical and practical terms. Institutional investors, it seems, were to all intents and purposes "absentee landlords" (Myners 2009). They did nothing to question (Keasey and Veronesi 2008; House of Commons Treasury Select Committee 2008-9) the business models that under pinned the journey to financialization for corporations and positively revelled in the pursuit of shareholder value (Lazonick and O'Sullivan 2000; Ireland 2009). Their inactivity was said to be due to a general tendency towards passivity, which was further entrenched by their attachment to short term gains; the thinking appeared to be that as long as gains appeared in the short term, then there was no incentive to intervene and examine the underlying business model of an investee company.

This has had unfortunate financial consequences for what are term indirect investors; those whose interaction with corporations occurs at arms-length through their interest in pension funds, life assurance policies, annuities and other managed financial arrangements. For many their investments are now worth substantially less on maturity than they had anticipated and for others the amount invested dwarfs what the current investment surrender value. While financial participation through managed products is the province of only the more financially secure individuals in the UK, these individuals have been seduced into this participation by the discourse of choice and responsibility that surrounds it and by the knowledge that collective state based solutions will not be available to pay for the sort of previously publically provided welfare and services that they might wish to avail of (French and Kneale 2009; Langley 2006a, 2006b).

Financialization (Erturk el al 2008) refers to the process by which financial and non-financial firms come to see stock market activity as a profit making activity in its own right largely through the sale of securities and risk managed financial products (Engelen 2003) rather than simply as a mechanism for raising capital to support other productive capacity. Two examples serve to explain this concept:-Tesco PLC is no longer just a large retailer of grocery and household goods but also offers a wide range of insurance, loans and savings products. Enron was a corporation that built energy generation plants across the world; shortly before its insolvency it was trading energy. Corporate managers described satisfying the demands for dividend and share price growth by engaging in short term return strategies and creative financial engineering practices as “pursuing shareholder value” (Froud et al 2000). While short-term returns are superficially attractive particularly for institutional investors, these levels of return cannot be sustained and continued pursuit is thought to harm the long-term performance and even sustainability of some corporations. Concentration on short-term gains by institutional investors means that there is little interest in engaging with investee companies about their long term strategic challenges and plans.

As the examination of share ownership in the second section of the chapter demonstrates there have always been a variety of different types of shareholders and different ownership structures present within the financial markets. These differences have accelerated in importance rapidly in the last 40 years or so (Ryan and Schneider 2002). As the second section of this chapter explains even though the number of individual shareholders has actually decreased, participation in the financial markets by individuals has risen expeditiously through their indirect investment in financial products. For individuals this involvement has been a conscious choice even if it is a constrained choice between the least worst alternatives and a choice that is often far from one that is fully informed (Martin 2002) Supporting a house purchase through the use of an endowment mortgage is a good example. The endowment policy element involves managed investment in a range of companies, the identity of which the policy holder may not know and certainly does not

consider themselves as having control over the policy as a corporate shareholder. If the investments do not perform as expected over the lifetime of the policy then the policyholder is left with a shortfall.

What has become clear is that the picture of shareholder intervention rights, a key piece of the corporate governance matrix, are more complex and nuanced than might be thought from the descriptions that are found in traditional legally centred texts and that re-invigorating this area of corporate governance by emphasising the need for responsible share *ownership* (Mallin 2008) would go a long way towards creating at least the impression of stable and firm yet flexible shareholder oversight of corporate activities. Ownership can only be used in the loosest possible sense in relation to shares. Increasingly the shareholder claim looks like that of a creditor (Ireland 2009) or of an entitlement (O'Kelly 2009) that falls short of what Honore (Honore 1961; Tomorrow's Company 2008: 20-21) would have considered as ownership in a jurisprudential sense. Interestingly *Tomorrow's Company* describe long term investors as share owners and dealers as shareholders, an unusual distinction in the language of corporate governance but not one without merit (Tomorrow's Company 2004). Action, rather than passivity, and responsibility, rather than abandonment, should describe the behaviours that are demanded of institutional shareholders. Concerns about passivity are not new but are being expressed more shrilly and in a variety of different fora (Tomorrow's Company 2004; J Rushworth and M Schluter 2008; Butler and Wong 2011). Myners in his review of institutional investment in 2001 (Myners 2001) made exactly this point about the extent to which institutional investors were prepared to participate "actively" in corporate governance to enhance the position of their beneficiaries where issues with investee company performance had been found and has re-expressed these concerns in 2009 (Myners 2009b) making the point that the situation had persisted. The Treasury Select Committee Report (2009: para 179) on the banking crisis made exactly the same point as did the Walker Review of 2009 (Walker 2009) in respect of investee companies located in the banking and broader financial sector.

This chapter problematizes the identity of the "shareholder" in modern financial markets and looks at possibilities that are offered for adapting corporate governance to capture, or perhaps less ambitiously, to encourage the participation of the shareholder of the 21st century by the Stewardship Code promulgated by the Financial Reporting Council (FRC 2010). Whether such shareholder participation has the potential that is claimed for it (Talbot 2010), or to put it any other way, whether the supposed absence of shareholder oversight has a causal link to the crises and supposed governance failures of 2008 onwards is unproven and likely to remain so (Gillan and Starkes 2007: 60f). The position taken here is that what matters to the relationships between investors is that there is a perception of a gap in oversight or a lack of care which has resulted in unexpected losses to a type of investor that was unprepared for this loss. This chapter wonders whether the renewed importance placed upon institutional investor dialogue with investee companies creates an

opportunity to reconceptualise the company and the obligations that investors in it owe each other. The chapter considers the emergence of the notion of a "responsibility paradigm" expressed through the use of terms such as "stewardship" (Reisberg 2011), which has a political heritage of its own and a distinct intellectual hinterland within business ethics and management scholarship (Davis et al 1997), and the idea of a "circle of accountability" (Davis et al 2006) in relation to the company, and wonders whether any of these concepts can have any traction below the level of rhetorical flourish.

Corporate governance and the role of the shareholder in corporate governance have traditionally been tied to the agency model of governance. Shareholders appoint directors as their agents to preside over the professional managers that they have employed and ensure that managers run the corporation in the interests of shareholders and not themselves. Shareholders hold the residual powers described in the next section to enable them to do to ensure directors do this. The suggestion of this chapter is that the governance model that is emerging is one where institutional shareholders are *responsible* for and acting as *stewards* for the less powerful members of their own body; indirect investors. The interests of indirect investors are considered to be served by an environment of long hold investment that ensures that the investee company is a stable entity accumulating profits over time. It seems that shares are no longer to be thought of purely as tradable commodities (Myners 2009c) bought and sold by rentier investors (Ireland 1996) possessed of a trader mentality (Hendry et al 2006) or asset managers *apparently* pursuing fiduciary duty owed to beneficiaries but instead things, ownership of which, involves both a level of commitment to the corporation they are issued by and also, more significantly, to the *long term* financial well being of indirect investors. The phrase "long term" summarises what is being suggested and what is being condemned; holding shares with a view to long term investment in a corporation is both beneficial to the corporation and to indirect investors, short termism is to be discouraged. The idea of short termism is put in perspective by figures from 2006 which suggest that eight of the largest ten equity owners in the UK, all institutional investors, traded over a third of their portfolios in that year suggesting that their investment time span was considerably less than three years (Jackson 2008). A convenient parallel might be to see this level of share trading as akin to casino gambling rather than as investment in a well-managed company that will mature over time as successful strategic decisions within the company are converted into profits available for distribution.

I - The Mechanics of Shareholder Governance

A variety of shareholder intervention rights are encapsulated in UK companies' legislation (Companies Act 2006 s. 303 and s.328), augmented by the incorporation into UK law of the EU Shareholders' Rights Directive (SI 2009/1632). The package of rights as currently constituted is one of, if not the most, supportive of shareholder governance in the world

(Brunner 2010-2011: 323f). Shareholders, buttressed by a supporting holding of 5%, can call a general meeting of shareholders, place resolutions on the agenda of the Annual General Meeting of Shareholders or otherwise place questions on the agenda which the company must respond to. These direct intervention rights are supported by shareholders' residual rights to dictate to directors or to restrain directors from particular courses of action (Hill 2010), to appoint and remove directors, change the corporate constitution and decide whether to issue shares (Companies Act 2006 s.168, s.21, s.549). These rights are used but rarely, even in the face of considerable shareholder disquiet. The recent decision of shareholders at ENRC PLC not to re-elect two of its non-executive directors was the first time in 20 years that such a decision had occurred. The chairman of BSkyB, James Murdoch, was opposed in his bid for re-election by nearly half that company's independent shareholders, his position being preserved by the voting of News Corp shares, a company connected to BskyB (Fenton and Burgess 2011). Resolution based activism, in terms of voting against a board resolution or placing a resolution on the general meeting agenda, is also comparatively rare and tends to be concerned with a specific and clearly defined issue undertaken by an ad hoc coalition of shareholders. In the vast majority of cases those proposing the resolution know from the outset that it has no prospect of success but will raise the profile of the issue concerned. Recent incidents of this tactical manoeuvre can be seen at both Shell and BP's meetings. Resolutions demanding that coal tar extraction ceased were proposed, both failed, and were always going to fail, but they did have the effect of raising the profile of the issue as one of environmental concern. Falling outside of this structure in a formal sense but nevertheless still illustrating the shareholder centric focus of UK corporate law is the non binding "say on pay" vote that allows shareholders to vote against a corporation's directors' remuneration report (CA 2006 s.439). In 2010 there were 7 such votes against in FTSE 100 companies if a negative reaction is benchmarked at a vote of 20 percent or more (High Pay Commission 2011)

These intervention rights are buttressed by the structures of good governance for investee corporations suggested by the UK Code of Corporate Governance. While this Code is not binding on listed companies, it is a requirement for continued exchange listing that corporations state the extent to which they comply with the code and explain their non-compliance with any provision (Listing Rules, r 9.8.6). The only sanction for non-compliance, as long as that non-compliance is explained, is the valuation placed on that by the financial markets reflected through movement in share price. The Code suggests that there should be a continuing dialogue between the board, through its chair and senior independent director, and *major* shareholders (Code provision E1.1). There is an assumption within the Code that there are two types of shareholder; large and small. Large or major shareholders are given an enhanced position within the corporation's governance structure that enables them to comment upon and contribute to its strategic direction (Code provision E1.2). The contents of the communications and their consequences remain undisclosed. Thus the extent and frequency of communications is also unknown, although as this chapter explains below

there is some empirical evidence that can be drawn upon to suggest that intervention to date has occurred at best haphazardly and infrequently. The creation of effective channels of communication is given an impetus by the suggestion that all directors should be subject to annual re-election at the shareholders' annual general meeting. Section E of the Code ceased to have any application on the publication of the Stewardship Code in 2010 (FRC 2010).

It is instructive to look on a timeline basis at the way in which the possibilities of active management and intervention have been structured by the representative bodies of institutional investors. What is revealed is an on-going and steadily increasing commitment at least at the level of planning and rhetoric. In 1991 the Institutional Shareholders' Committee, now renamed the Institutional Investor Committee, (a loose affiliation of four large trade bodies, of which membership on an individual firm basis is not compulsory, representing the insurance industry, the investment fund industry and the pension fund industry) published, for the first time, a set of guidelines on corporate governance involvement for investor companies; the Statement on the Responsibilities of Institutional Shareholders in the UK (ISC 1991). These responsibilities were stated very briefly indeed. They comprised suggestions about the importance of communication at a senior level to discuss strategy, board membership, performance and quality of management and the support of the investee company's board through the positive use of voting power. The principles contained in this statement found their way largely unaltered into successive iterations of what has now become the UK Code on Corporate Governance (see Roach 2010 for a more detailed explanation). This is not to say that the involvement of institutional investors in corporate governance was not considered important but rather that it was considered sufficient that the Institutional Shareholders' Committee (ISC) should issue guidance on this and indeed the ISC Statement was revised and updated on several occasions. By 2005 the ISC Statement called on those adopting it to have a policy document that explained their approach to engagement with and the performance monitoring of investee companies and the circumstances under which an intervention would made (ISC 2005). Section 3 of this chapter sets out some of the impediments to engagement under these structures that have been identified by those working in both investor and investee firms.

In November 2009, following criticism of its perceived passivity by Lord Myners (Myners 2009b), the ISC released a Code (ISC 2009) that expanded slightly upon its previous Statements which would operate on the same "comply or explain" principle as the UK Code of Corporate Governance; investors that complied with the Code would have the nature of their compliance listed on the ISC website, those that did not comply would not be listed. Membership of the ISC is not compulsory and there are some trade associations that stand outside it, for example the Association of Investment Companies, thus a failure to be listed on the ISC website is unlikely to be a sanction that occasions much angst about reputational

loss. Reporting in late November 2009 the Walker Review (Walker 2009: Recs 16-20) advocated that the Financial Reporting Council (FRC) should take responsibility for both promulgating and keeping under review what was required of institutional investors in relation to corporate governance in a new code, albeit based upon the ISC Code, to be called the Stewardship Code.

In 2010 the FRC published the UK Stewardship Code that it addressed to "firms who manage assets on behalf of institutional investors such as pension funds, insurance companies, investment trusts and other collective investment vehicles" (FRC 2010). This is a much more accurate and extensive definition of financially interested parties than that of "major" and other shareholders used by the UK Code of Corporate Governance. It is a definition which acknowledges the investment chain that stands between the investee company and the indirect investor and recognises implicitly that investment activities might be carried by some actors on behalf of others and that consequently there are contractual, fiduciary and agency relationships captured within the institutional investor, indirect investor and asset manager relationship. Asset managers compete with each other for funds to manage on behalf of institutional investors. This competition encourages the pursuit of short-term gains by asset managers to demonstrate competence and secure the retention of funds. The contents of the Stewardship Code and its comply and explain structure are examined in more detail in the fourth and final section of the chapter, but the point to be made here is that the breadth of this address and the independence of the Financial Reporting Council have the effect of mainstreaming the Code into the central business activity of institutional investors and, as is argued below, ushering in a whole new language with which to consider the nature of intra-corporate relationships.

II - The Nature of Shareholding

Understanding the identity of shareholders and the nature of shareholding goes a long way towards explaining the importance of the new era in intra-corporate relationships that could potentially be created by the Stewardship Code. The last fifty years or so have seen a re-emergence of concentrated share or stock ownership but in the form of institutions rather than the individuals that concerned Berle and Means in the pre-WW2 years (Pichhadze 2010). Assets under the control of institutional investors have trebled since 1995 (Ferreria and Matos 2008). In the UK the 2008 share ownership survey (ONS 2010) revealed that only 10% of shares were in the hands of individual owners, a figure that has decreased steadily from 54% in 1963 and a picture that is replicated in the US (Hawley 1995). In the UK this picture emerges notwisthstanding the share issues of the Thatcher years in previously publically owned utilities. This programme of privitization might have increased the proportion of the adult population in the UK that owned shares as individual retail investors from under 7% in 1979 to 20% in 1989 (Social Trends 1990, Dobek 1993: 32-34) or from around 3 million individuals to 11 million individuals but the involvement of institutions in

those floatations means that little impression was made on the drift away from retail investment (Prosser 1995-6: 227-228). As the Walker Review (Walker 2009) pointed out it is logistically impossible for these retail shareholders to initiate or participate in engagement activities. update

According to the 2008 survey 39% of the shares in quoted corporations were owned by a combination of unit trusts, mutual funds, pension funds, banks and life companies; institutional investors. This figure of 39% is one that has remained little changed from 2001, but is significantly less that the figure of 62% that represented their holdings in 1993. The 39% share can be further broken down, and the breakdown is important, as it reveals that while the share of institutional investment represented by the traditional "long hold" (Clarke and Hebb 2004) sectors of pension funds and insurance companies has remained reasonably steady since 2006, the share of the institutional investment pot held by these actors has nearly halved since the early 1990s with the share held by pension funds at their lowest since the 1960s. The consequences of this decrease in share ownership participation by "long hold" funds are something that is explained below. This decrease can be explained by several factors, the most significant of which are the globalization of investment strategies which has seen foreign owned institutions take a significant stake in the equity of UK public companies – 41.5% of shares are held by overseas investors - while UK institutional investors have moved into foreign exchanges (*Institutional Investment Report* 2009*,* OECD 2008: 8-12) and the move by pension funds towards bonds as a preferred form of investment in the light of regulatory requirements surrounding required funding levels and consequent risk management (Pensions Act 2004 and the Occupational Pension Schemes (Scheme Funding) Regulations 2005). However the driver for this move may become less significant as the current relatively high level of inflation pushes the yield on bonds and the yield on dividends further apart in favour of dividend return. The 1970s and 1980s were characterised by such a move in similar circumstances (Blackburn 2006:51). While the data provided by the Share Ownership Survey allows us to form a picture of market segmentation at a macro level it does not reveal the percentage of shares that are subject to stock lending arrangements, derivative contracts or held pursuant to a contract for difference. These practises are of some important for the discussion that occurs later in this chapter, as those who hold shares as a result of them are unlikely to be enthused by ideas of Stewardship and responsibility (IMA 2009: 25-27). It is impossible to tell the extent to which within the 39% of shares held by institutional investors there are significant holdings spread amongst a few institutions or the extent of membership of trade associations, both of which are factors which might be significant in the amount of traction that the Stewardship idea is able to assemble. update

On the level of the individual what is significant is the amount of household assets held in life assurance and pension funds. In 2010, as a percentage of GDP, these assets stood at 159% or £2,313 billion (ONS 2011). While this figure was higher in percentage terms in 1999

(176%) it was lower in asset value at £1,631 billion. The steady rather than huge rise to the 2010 figure reflects the rollercoaster of equity values in the last decade. We can break this down further using data found in the 2006-8 Wealth and Assets Survey (ONS 2009). This allows us to look at the picture of market based savings across households:-

Market Based Savings Product	**Percentage of Households 2006-2008 participating in particular products**
Cash ISAs	35.8
Stocks and Shares ISA	10.1
UK Shares	14.9
Insurance Products	10.5
Fixed Term Bonds	8.3
Personal Equity Plans	7.3
Employee Shares and Share Options	7.3
Unit/Investment Trusts	5.9

(compiled from ONS 2009)

To this should be added the pension contributions of those who contribute to a defined contribution pension plan as part of an occupational pension scheme or as part of a personal scheme (all private pension plans are defined contribution schemes). Around 14 million people in the UK are active participants in private as opposed to state pensions; of these 7.4 million hold all or part of their pension contribution in a defined contribution scheme (ONS 2010b, 2011). As the percentage of shares owned by individuals has declined so the percentage owned by institutional investors has increased. What the contents of the table above and the figures for pension contributions make clear is that the holdings of institutional investors represent the financial participation commitment of millions of individuals. Institutional investors and those to whom the Stewardship Code is expressly addressed "firms who manage assets on behalf of institutional investors such as pension funds, insurance companies, investment trusts and other collective investment vehicles" stand at the front of an investment chain. At the back of the investment chain stand individuals making the financial participation effort described above and who, as indirect investors, lack the intervention rights bestowed on those at the front of the chain. Indirect shareholders are the beneficial owners of their shares but not the legal owners. Only the legal owners of shares can exercise the governance rights that attach to those shares, despite some partial enfranchisement of indirect investors as the receivers of information and the potential holders of proxy votes under the Companies Act 2006 (CA 2006 secs 146, 324; Nolan 2003). This creates a disjuncture between those who are actually able to exercise governance rights and those who accrue any benefits that come from the exercise of such rights (Coffee 1991, Nolan 2006). This is a theme which runs through the financial participation experience for indirect investors.

The marketization of individual savings and the apparent take up of such, through the

purchase of collective investment vehicles such as ISAs and investment trusts, has come about as the result of various factors, some of which are more significant than others. Final salary schemes have been converted into defined contribution schemes across the world (Bridgen and Meyer 2005) to take account of increased beneficiary longevity, inaccurate predictions of equity market growth and earlier employer contribution holidays. Occupational pension schemes tend to attach to heavy industry and public sector employment, both now in relative decline, thus individuals looking to create retirement savings are pushed towards personal plans held through the equity markets (Ring 2005). This trend has been further exacerbated by the pronouncements of national governments, including the UK, that both the state pension system and private schemes will be unsustainable for the future without increased individual contributions (HMSO 1998). In the UK there was a specific policy of encouraging individuals to opt out of state based pension saving (Budd and Campbell 1998) and taxation policy was used to incentivise a culture of private saving. The 1980s saw a sustained period of deregulation regarding the type of investments that could be offered as structured financial products on both a retail and commercial basis (Augar 2000) **this can probably go**. The practicalities of individual retail share trading became more difficult in 1996 when the LSE embraced the use of CREST – an internet-based paperless transaction system. Membership of CREST is required in order to trade shares electronically and so more cheaply than the alternative paper-based system so those individual retail investors who still own shares frequently do so through a nominee account. They therefore cede their intervention rights to these nominees and no longer appear as individual investors in the share ownership survey. Trading technology has advanced and electronic trading has replaced open outcry on most exchanges. This allows both faster and higher frequency trading meaning that shares are often "churned" in circumstances where previously they would have been held. This creates a greater fractionalization of shareholdings and a disincentive to monitoring or engagement as was explained in the introduction to this chapter.

This supply of financial products, offered in the rush to financialize corporations, such as corporate bonds, life assurance policies and annuities met both commercial demand and retail demand – in 2002 the Sandler Review estimated that there over 3,000 savings products available to individuals (Sandler Review 2002: 3.18) who were hoping to accumulate retirement wealth to replace the steady erosion of such provision within welfare states (Sievers 2003: 197); those who wished to access higher returns than were available through more traditional "high street" based mutual societies; and pension funds which were eager to make up for the low returns of the 1970s, the fiscal demands created by the increased life expectancy of beneficiaries and the effects of the pension "holidays" taken during the 1990s. Individuals pulled into the purchase of structured financial products, which generally operate to meet a particular need eg an income stream or lump sum in ten years time to coincide with retirement, say, and operate by pooling risk across a group of indirect investors so changing ratio of the cost of capital to risk or selling that risk

to another, are those on whose behalf stewardship of corporations needs to be exercised. The huge falls in asset values experienced in the current financial crisis and the historically low annuity rates are carried in no small part by those to whom the idea of the financialised corporate sector in which they were encouraged to participate was represented as an unassailable growth vehicle. Financial participation through investing in collective vehicles was explained to individuals as the way to achieve choice and personal control of one's economic future (Langley 2007).

The reality is that no amount of financial literacy training (Sandler Review 2002, FSA 2004, Clark 2009) will place individual indirect investors in a position to understand and manage the type of complex financial products that were being sold in a climate where monitoring duties were carried out by a totally different class of investor and/or manager with a different exposure to and view of risk (Guyatt 2008) whose remuneration was linked to often investment levels and short term profits returns in terms of their likelihood of retention as managers, rather than performance over the long term ending in a fixed point in time such as the retirement of an individual indirect investor (Erturk et al 2007). This suggests a certain amount of wilful blindness on the part of institutional investors and their asset managers to the risks that they were imposing on indirect investors through both product design and subsequent passive management. A more nuanced view might be that the steady increase from the 1970s onwards in the complexity of models of risk, finance and valuation (Mark 2011) made the promised returns on products for designed for retail savers fraught with difficulties that were not always obvious to the sponsors and that conflicts of interest inherent to the asset management industry were allowed to trump engagement and even the voting of shares. **To this add pension fund trustees etc**

III The Idea of Shareholder Engagement

The Walker Review (Walker 2009: 5.17) summarises the reasons why, on both sides of the relationship, the idea of engagement between investee company and large investor, so simply articulated by the Cadbury Report (Cadbury 1992), has proved to be unpopular to the point of being unworkable. Walker received evidence from a number of individual institutional investors and fund managers, banks (as his Review was primarily concerned with the Banking sector) and the broad sector based groups such as the National Association of Pension Funds. The issues on the monitoring side were that considerable resource was required for monitoring but that any benefits accrued would be shared more widely, intervention that became public could damage the reputations of those involved and affect the share price adversely which would be counter productive, the problem of fractionalisation of ownership which meant that voting against the board of directors of the investee company was unlikely to be successful and the unwillingness of investee companies to engage with investors on anything other than a very general basis. To this list could also be added the presence of indexing as an investment strategy. Indexing involves

tracking a number of shares selected from a set of firms such as those listed on the FTSE 100 for example. It is almost certain to be a passive strategy as shares in companies that not matching or bearing the return available on the set as a whole can be disposed of without the effort of intervention (Daily et al 2003: 377). The interest in passive investment instruments and strategies is expected to rise in the next 10 years (Wong 2010)

What emerges from this is the idea that in the period before the Stewardship Code both intervention and the use of voting power are considered to be activities that have no dimension of wider interest to the managers and sponsors of collective investment vehicles that might overcome the free rider problem or the adverse publicity problem. Resources required for effective intervention are in excess of what can be recouped through product charges. Interaction and intervention occur when there is a crisis and not as a matter of course (Walker 2009: 5.20; Arcot et al 2010: 199). There are the instances of intervention in environmental issues in particular that are referred to above and these could be added to but the number of interventions would still be very small when looked at against the backdrop of corporate activity. Loose coalitions of institutional investors do emerge around certain issues of social responsibility and some pension funds such as Hermes and CaLPERS for example would have a reputation for this type of activity. The fact that these two funds are known to have an activist stance where voting is concerned is evidence perhaps of the passivity of others. What Walker presents is a synopsis of the generally held view.

For those on whom the Cadbury Code (Cadbury 1992) had imposed the duty of conveying information to their large investors: investee companies, the issues identified by Walker concerned fears about confidentiality and damage to share price, the problem of one investor's concern not necessarily being shared by another, the inability to secure a dialogue rather than an event-triggered intervention because of the quality of investor representation and the focus by investors on short term returns, the pursuit of which were not necessarily in the investee company's interest. While some of this appears a little disingenuous – the disavowal of shareholder value for example – it is in broad terms a mirror of the concerns identified by investors. Both sides see themselves as vulnerable to the other and the market generally with the consequence that little intervention occurred.

This picture of inactivity would not necessarily be the one that was understood from looking at the various surveys carried out at regular intervals since the Institutional Investors' Committee first promulgated their Statement of Responsibilities in 1991 by the Investment Management Association of their members' responses to it. The 2009 survey is, perhaps unsurprisingly given the criticisms of the ISC that had recently been made, the most detailed and is based on data for the years 2006-2008 ending in June 2008. The number of responses has remained constant at 32 or so and for the 2009 survey these 32 firms managed between them 68% of all UK equities held as managed stock (IMA 2009). A substantial part of the Statement of Responsibilities requires firms to formulate policies around issues such as

engagement, escalation of activity in the event of unsuccessful engagement, managing conflicts of interest and voting practices and either to make these policies public or be prepared to make them public. Almost without exception each of the 32 firms indicated that they had a policy on these issues. On this basis these 32 firms look committed to active management of their shareholdings. However things look rather different when their actual practises rather than policies are examined. In the 2007 survey (IMA 2007) the highest level of engagement was a twice-yearly meeting with investee company management survey. For the majority of firms there was only a board level meeting with non-executive directors when there were considered to be "issues". The majority of the 32 firms did not submit a resolution to the shareholders' meeting or make any form of public statement prior to the meeting. In an attempt to counteract what looks like a very low level of activity, the 2009 Survey departs from collecting information about the amount of interaction and sets out instead 7 vignettes of instances where engagement occurred. Two of these instances were the classic crisis scenario involving banking sector firms (RBS and Northern Rock) and three involved votes on remuneration reports leaving just two examples of interaction and intervention around strategic direction and corporate governance. If this low level of active management is considered alongside the high charges levied by asset and fund managers (Blake 2003) then the end investor looks to be in a vulnerable position and far from the empowered consumer making a sophisticated choice of investment product (FSA 1999; FSA 2006).

IV – The Stewardship Code; a new adventure?

The Stewardship Code (FRC 2010) was announced by the FRC in July 2010 and addressed broadly, as explained above, to the investment management industry. The Code follows the comply or explain structure of the UK Code of Corporate Governance in that those firms within its ambit are expected to disclose how they comply with the Code or set out which parts of the code they do not comply with and explain the reasons for their non-compliance through publishing information on their website, even though there is no sanction for non-declaration of the degree of compliance other than non-publication. However the independent nature of the FRC may add more of a reputational sting to non-inclusion than that carried by the ISC. The Financial Services Authority has given more bite to the comply and explain structure by adding to its authorization structure the direction that those firms who carry on investment business for professional clients (asset managers in other words) must indicate, publically, their commitment to the Code or face a fine or censure or both. In terms of the Code's adoption post its announcement there are indications that it has gained a considerable following amongst its target firms. Within four months of its announcement 80 firms had signed up, growing to 147 by March 2011 with its adoption standing at 234 firms, most of which are asset management firms, by December 2011 (FRC 2011).

The Stewardship Code has seven principles and supporting guidance notes for each one:- in broad terms these principles concern the public disclosure of engagement policy, disclosure and management of conflicts of interest, the monitoring arrangements for investee companies, the escalation strategy for engagement if one is needed, collective action, voting policy and the disclosure and reporting of stewardship activities to those positioned more remotely in the investment chain. The FRC itself refers to the Code setting "out good practise on engagement with investee companies to which the FRC believes institutional investors should *aspire*"(my emphasis), the Code encourages compliance rather expects compliance (FRC 2010: 1). In textual terms the Stewardship Code is similar to the ISC Code (ISC 2009) but with several differences, it is submitted, that might, depending on the reading given to the concept of "Stewardship", be of crucial significance to our reading of shareholder relationships with the company, broadly understood as a community of diverse interests. These differences are explored below. This potential is not recognised by those who have commented on the code thus far. It is criticised for its lack of ambition, depending so heavily as it does on the previous ISC codes, and predicted to disappoint because it, from a structural perspective, reaches only certain domestically based institutional investors and asset and fund managers (Cheffins 2010; MacNeil 2010) and is silent about the implications for its contains in relation to practices such as stock lending (IOD 2010). The section of the market that is held by overseas investors (some 40%) such as sovereign wealth funds are outside the Code's remit although the FRC hopes that they too will commit to it (FRC 2010b: 5). In reality very little is known about share ownership strategies and investment ideologies in many of the jurisdictions that have sovereign wealth funds represented on the UK markets. There is nothing to suggest that with increasing familiarity of the Stewardship Code it will not become the familiar standard with trans-world reach that the UK Corporate Governance Code has become.

The Investment Management Association carried out a survey (IMA 2011) of its members to gauge both compliance and behaviour under the Code and the tone of its report is considerably more vigorous than the tone of its reports commented on above. The criticisms of the code have in common their failure to recognise the importance of changing behaviour through developing social norms rather than through control based regulation (Coffee 2000-2001: 2170). The relatively high number of firms that have endorsed the code might be an indication that it is seen as no more onerous than the ISC and that nothing further needs to be done in order to state that compliance has been achieved. However the introduction of comply and explain might be a game changer as, even without a sanction for non-compliance, it opens up another head of potential comparison between firms in the competition for business and might thus result in a race to the top. The Code creates through the voluntary comply or explain mechanism exactly the kind of socially constructed risk that Power et al (Power et al 2009: 312) identify as being at the heart of reputational risk calculations. The closed world of the asset management firm, the institutional investor as client, the investee company as subject and the FRC as the current regulator present the

type of forum in which "regulatory conversations" (Black 2002) about the nature and requirements of code compliance will take place, particularly if the alternative is thought to be more serious regulatory intervention inspired by the recommendations of the Kay Review, due to report in July 2012 (Kay 2011).

Prior to the Walker Review (Walker 2009) selecting it as its nomenclature of choice for the governance behaviour that it was advocating for institutional investors, the term "stewardship" was not one that was even unusual parlance never mind commonly used in the discourse of corporate governance. It was a term completely without a hinterland of meaning in this context and yet it was the name given to the behaviours that were needed to secure confidence in the investment chain. Stewardship implies a responsibility for and an obligation to look after that which has been entrusted (Tomorrow's Company 2009). It requires us to think through who is being stewarded, by whom and why. This is the point that is most important in relation to the Stewardship Code (FRC 210). It indicates that there is to be a significant and overt change from the past. The "information moguls" (Davis et al 2006: 20) in the form of asset managers, institutional investors and ratings agencies will now be concerned not with quarterly performance figures, sums under management and short term gains but with strategies that enhance the position of the indirect investor. It seems, from the account of stewardship theory posited below, that what are to be stewarded are those financialised individuals who are indirect investors. They are to be moved from responsible citizens to looked after individuals whose investments are under the stewardship of institutional investors and asset managers. While in legal terms this relationship is not new and might have been previously considered as expressed in the term "fiduciary duty" or encapsulated within the terms of the investment contract, it is a relationship which needs to be relaunched, rebranded and rearticulated in the light of spectacular corporate collapses, serious asset value falls, continuing mis-selling scandels and a lack of confidence in the mind of the indirect investor.

While stewardship as part of the language of corporate governance is a new idea, stewardship theory as a concept is used in both business ethics and management studies scholarship to create an alternative organizational theory to that of principal and agent. It has been used mainly to explain the relationship between managers and shareholders and seeks to offer an alternative to what has become the accepted discourse that underpins that relationship. Corporate governance, as a field, has absorbed alternatives to principal and agent theory in the past and these alternatives have had little traction and made no real discernable impact. Stakeholding as a conceptual tool would be an obvious example of this. Stewardship however has an opportunity to create an impact because it can be used to theorise the relationship that the institutional investor and the distressed end investor need to establish post the financial shocks of 2008 onward rather than try to, in the manner of stakeholding, rewrite the narrative of corporate existence (Ireland 1996) or reconcile seemingly intractable conflicts of interest between different groups (Caldwell and Karri

2005), although one influential reading of stewardship does assert that it emerges from the demise of stakeholding (Caldwell et al 2008). Stewardship requires some unpacking of its basic tenets if it is to be used successfully to explain the relationship between shareholders *inter se* and their collective relationship to the investee company rather than to suggest how and why managers should be align their interests with those of their principals (Donaldson and Davis 1991). The key ideological currency for stewardship is its insistence on the sacrifice of the short term self interested gain for longer term economic well being for more generally beneficial and collective ends.

There are a number of linguistic and terminological changes exhibited in the Stewardship Code (FRC 2010) compared with the ISC Code (ISC 2009) on which the journey to stewardship can be founded. The Stewardship Code, unlike the ISC Code, speaks not of "beneficiaries" but of "end investors". It uses the terms "responsibility", "dialogue" and more obviously "stewardship" to delineate its relationships. The almost complete switch from using the language of beneficiary to that of end investor suggests not an arm's length largesse in terms of managing for the end investor, with fee income for the intermediary the primary concern, but instead a chain of responsibility starting with the institutional investor and ending with the individual indirect investor. Through embracing stewardship institutional investors and asset managers will take on a degree of involvement with the fate of the responsible saver and purchaser of financial products. Dialogue means not only an exchange with the investee company about its corporate governance arrangements which has already shown itself to be an inadequate control and protection measure but a much more extended dialogue down the chain of investment which explains what dialogues have taken place and how the privileges of ownership such as voting have been exercised. Involvement is a key element of stewardship theory (Davis et al 1997: 37) and it is stressed in the Stewardship Code both in terms of investee companies but also in relation to end investors.

Hernandez describes stewardship as adding a "moral belief" to fiduciary duty (Hernandez 2012) and as creating a psychological contract between those involved in it. Both of these suggestions seem appropriate in the context of the Stewardship Code (FRC 2010). Trust in those who are stewards is key to successful stewardship and that trust must be based not just on a belief in competence but on a belief in integrity. A belief in the integrity of institutional investors and an idea of a chain of responsibility spanning the investment experience are crucial to restoring the trust of reluctant investors. It is too soon to assess whether the active protagonists in the Stewardship Code will allow this to happen.

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