

**ICGN Annual Conference Paris, France, September 12-14, 2011****Keynote Address: The Rt Hon Vince Cable MP, Secretary of State for Business Innovation and Skills, United Kingdom, introduced by Carl Rosén**

Good afternoon. It's a real pleasure to be here in Paris to address the International Corporate Governance Network's Annual Conference.

The ICGN has a truly global reach and immense expertise among its members, including institutional investors who, collectively, represent more than \$12 trillion of funds and assets.

So yours is an essential voice as the debate about corporate governance intensifies, here in Europe and internationally. And your stated mission – to raise standards of corporate governance worldwide – has never had more resonance.

Market economies are critically reliant on the relationship between investors and those who manage their assets. Effective oversight of assets is the essential bedrock of a dynamic corporate sector, which, in turn, is essential for sustainable economic growth.

But the turmoil unleashed by the global financial crisis has exposed shortcomings in the Theory of Efficient Markets, which has held sway in recent decades, and raised serious questions about the way companies are owned and managed.

The orthodox view was that shareholders knew what they were doing, as did fund managers and company executives. The facts tell a different story - while investment in capital assets in areas such as infrastructure and manufacturing withered, the banking sector, for example, indulged in a frenzy of speculative trading and financial engineering.

We all know what came next and, as we get on with the task of clearing away the wreckage, the proposition that markets are always efficient and rational is difficult to sustain.

The main charge is short-termism: a focus on pursuing immediate gains at the expense of long-term value.

Andrew Haldane and Richard Davies of the Bank of England, published a paper in May which analysed the pricing of companies' equities.

They say they have found significant evidence of short-termism in investment decisions – and evidence that the phenomenon is growing. They also found evidence that long-run returns are being substantially undervalued. As Haldane and Davies put it: 'Myopia is mounting.'

European Commission green paper

But this is not a problem unique to the UK. In April, the European Commission published a green paper on corporate governance in Europe.

It posed a series of questions about the best way to create a governance framework that incentivises business leaders to make the long-term decisions that are good for companies, good for investors and good for European economies.



I believe that, across the continent, we all share the same overarching goal – a system that enables well governed companies to access the capital they need to invest for the long term and deliver a reasonable return.

And there are a number of areas where the UK backs the Commission's emerging thinking.

We agree that the company board must set the organisation's risk management strategy and ensure it is adequate to monitor its risk profile. In some cases it seems boards were asleep on the job, so a clear responsibility to hold executives to account and report on performance is a sensible step forward.

Similarly, we support companies having a diversity policy. The UK Financial Reporting Council has consulted on making changes to the Corporate Governance Code to recommend that listed companies have a boardroom diversity policy, with measurable objectives.

But it is critical that the Commission avoids an overly prescriptive approach, which fails to take into account the divergent legal systems, ownership structures and business practices and traditions that exist among member states.

For example, in the UK share ownership is much more dispersed, as opposed to the block holdings you might see on the Continent. Our boards structures vary - the two-tiered board in Germany is unlike the single UK board.

A one size fits all approach, set down in a welter of new directives and regulations, will not do. Instead, member states need to collaborate to reach conclusions that meet our shared objectives while respecting our differences.

For Britain, that means building on the 'comply or explain' principle that runs through our corporate governance code, under which companies must follow its provisions or explain to shareholders why they haven't.

This approach is one of the acknowledged strengths of our regime and it complements the long-standing structure of UK corporate ownership, which makes shareholders the custodians of our companies.

It works because it gives companies the opportunity to develop governance policies and practices that suit their size, sector, strategy and stage of development.

In addition, a code offers more flexibility than a rules-based approach in that it can evolve over time and, if needed, change quickly to meet shifting economic circumstances.

So although we may sympathise with the suggestions in the green paper about ensuring the chair and chief executive roles are separated, we would oppose making this mandatory as it might be difficult for smaller companies to achieve.

Similarly, although it is important that non-executive directors have enough time and energy to devote to their roles, mandatory prescribed limits are not appropriate.

As the Commission considers the 400 responses it has received to the green paper, I would encourage it to assess proposals against three criteria:



Are they sufficiently flexible to meet the widely differing needs of companies?

Do they have a clear rationale?

And are they supported by evidence that demonstrates how they will improve governance?

UK approach – Stewardship Code

These criteria underscore the work we are undertaking in the UK to bolster our system of corporate governance and address the systemic flaws that were exposed by the financial crisis.

We are not redesigning the system from scratch. In some respects Britain has been at the forefront of establishing high standards of corporate governance, most recently with the introduction of the Stewardship Code, which sets out the responsibilities of shareholders in holding directors to account.

That responsibility is often clear to individual investors, but institutional investors operate at one step removed and are not always effective in meeting their obligations.

The Stewardship Code seeks to address that – and so far over 170 asset managers, owners and service providers have signed up to it.

The early signs are that signatories are taking its provisions seriously. A report by the Investment Management Association in May examining adherence to the Code found that:

- two-thirds monitor all their investments in companies;
- over 90 per cent vote over 75 per cent of their UK holdings;
- and almost two-thirds publish their voting records.

But clearly the Stewardship Code on its own is no panacea, and we have no monopoly on wisdom.

Corporate Britain

Nevertheless, responsible investor behaviour is a critical component of a vibrant corporate sector. So to get a better understanding of the factors driving investment decisions the UK government issued a wide-ranging call for evidence.

The responses left us in no doubt that there is scope for further improvement to UK corporate governance.

There was a clear consensus that fragmented ownership of substantial British companies reinforces the need for remaining large investors to engage with the companies they take stakes in.

But the complexity of the investment chain often militates against effective engagement – a barrier reinforced by a lack of transparency.

And there are obstacles preventing even the most well-intentioned of investors from exercising their powers and responsibilities effectively.



Narrative reporting

First of all, we need to ensure shareholders have the tools for the job.

I often hear complaints about the increasing length of company reports. In many cases, it seems, investors have too much data and not enough information.

So we are examining ways to raise overall standards of narrative reporting and ensure investors get the information they need - in a digestible format - to be active and committed owners, but without increasing compliance costs to business.

But improving the information available to investors is the easy part of the answer. There are much deeper and more complex issues underpinning investor behaviour, and we need to arrive at a proper understanding of these if we are to ensure stable foundations for long-term growth.

Kay equity markets review

For this reason, I have asked Professor John Kay, who has one of the most incisive economic minds in the UK, to conduct an independent review of investment in UK equity markets.

The increasing focus on short-term returns has profound implications for investment in long-term projects, such as improvements to infrastructure or the development of new technologies, which are likely to yield returns only after a period of years.

It is especially urgent that we work out how equity investment can better support the long-term interests of companies as well as underlying beneficiaries, such as pension fund members.

Professor Kay and his advisory board will scrutinise patterns of equity investment in publicly traded UK companies and the impact on the long-run performance and governance of UK quoted companies.

He will examine the way that the investment chain currently works - from end investors, through pension funds, advisers, fund managers, and the markets to company boards. And he will consider what is needed to ensure the UK hosts successful companies, with access to the capital they need to deliver reasonable returns.

Professor Kay will be consulting on all these issues this autumn and will report back to me next year.

Executive pay

There is another area where I want to see real change and that is ending the culture of excessive executive pay – especially rewards for failure – that seems to have taken root in recent years. I know this is something that bothers investors too.

The UK undoubtedly has world class executives. But let's not forget that, using the FTSE 100 as a benchmark, investors have barely seen a return since the turn of the century.



Startlingly, total CEO median remuneration has increased by 323% between 1998 and 2010 and in the same period, median turnover of FTSE100 companies has increased by just 128%.

This yawning gap between pay and performance points to a breakdown in corporate governance arrangements.

Let me make it clear, though, that my goal is emphatically not to set limits on pay. Generous rewards in themselves are not an issue, where a company has achieved strong long-term performance.

But rocketing remuneration and the need to demonstrate immediate results has to be a factor driving the search for short-term profitability, which all too often comes at the expense of long-term value.

Remuneration must be structured to appropriately incentivise and reward executives for long-term sustainable growth. This has important implications, for companies, their shareholders and for wider public confidence in the corporate sector.

I've been meeting remuneration committee chairs, investors, business leaders and regulators to talk about this. I know that many of them are already engaged and have ideas about how the pay-performance link can be strengthened and demonstrated to shareholders.

Transparency is important, but only gets us so far – and could even have the perverse effect of encouraging a race to the top.

Ultimately, however, there is no substitute for leadership from companies themselves and their owners.

Remuneration committees and institutional investors need to take a much stronger line. In future, they need to act collectively to prevent rewards for failure and insist on responsibility in pay rounds. To reward performance, not just people.

Women on boards

Finally, I would like to touch briefly on another issue where we are looking to the City of London to show leadership – and that's opening the upper echelons of large quoted companies to talented women.

The best boards draw on a wide range of experience and perspectives. This is an issue of business performance, not one of political correctness.

It makes no sense to squander the abilities of 50% of the workforce.

It's an issue that Lord Davies of Abersoch, the former chair and chief executive of Standard Chartered Bank, examined for the UK government.

He recommended that all chairs of FTSE 350 companies should publish aspirational targets for the number of women they expect to have on their boards in 2013 and 2015.

However, Lord Davies' key recommendations are for companies themselves. And it seems they are beginning to pay attention. Within the FTSE 100, 23% of board



appointments since Lord Davies published his report last February have been women.

On this issue as on others, I think the best solutions are those generated and driven by investors, managers and companies.

I don't want to see quotas and evidence suggests UK companies are starting to get their house in order without the need for regulation. But we will continue to monitor progress.

Conclusion

These then are the issues the UK government is focusing on as we strive to bolster our corporate governance framework and ensure that UK based companies are run in the long-term interests of the owners, the beneficiaries and the economy.

This is a shared agenda: governments across Europe and around the globe are grappling with exactly the same issues. We all want stable, well-run companies that provide solid foundations for sustainable economic growth.

That best route to achieving that is one that promotes common standards while respecting national differences – and, which, critically, has investors and industry on board.

The UK will continue to work with our international partners to achieve these common objectives, so that together we may create an environment that will enable our companies to flourish and our economies to grow for the long term.