

The New Economic Landscape – Rebuilding Confidence. A Policy Summit of the Institute of Chartered Accountants: 26 February 2009

Your question is how can Corporates reassure investors? Much of that answer lies in better dialogue and better governance.

Better communication to investors and better engagement with shareholders

This is a two-way process. Companies must understand the expectations of shareholders. But shareholders must make their views known. If both sides get this right confidence will grow. In particular, shareholders will not be presented with a fait accompli. There is nothing they like less than being asked to approve courses of action when to withhold that support would be to invoke a nuclear option.

If investors are not surprised, particularly at this time of financial stress, they will be more supportive and share prices will be less likely to suffer sharp falls. This is critical as we pass through the annual results season.

Shareholders also want companies to be realistic. To be open and accurate about the prospects for the business. And realism is judged in part through director's attitude to pay and incentives. Shareholders want sensible incentives for performance that will promote alignment with shareholders' interests. We want to encourage responsible risk-taking and discourage unsustainable growth. If targets have been missed, if retention is no longer an issue, and if the business environment has changed – pay and bonuses should reflect that reality.

Confidence also depends on good governance. In particular shareholders want companies to apply corporate governance best practice in the way the Combined Code intends: Comply or explain. If a departure from the Code is felt to be right then quality of explanation is key.

I have focussed on that part of governance that involves a relationship between the shareholder and the company. But there is more to governance than that. Good governance is a chain that starts with good risk management moves on to good Board supervision, good reporting and only lastly excellent investor dialogue. Investors want to know that all the links in the chain are strong. Otherwise the quality of the dialogue is immaterial. In the last year in banking we have seen failure in all parts of the chain.

So we want to have more certainty about the quality non-executive directors. Their capabilities and their independence are critical to ensuring well-functioning and effective Boards.

And we need to build confidence in financial reporting, particularly in financial services. We need to decide whether mark to market for asset values and liabilities is the right answer as far as investors are concerned? Fair value accounting has been pro-cyclical. It gives more weight to optimism than risk in rising markets and correspondingly drives values down in falling markets. This is inevitable. All prices in financial markets reflect expectations of future

earnings. And fair values do therefore give investors a view about a firm's prospects.

But that does not mean mark to market is always the right answer. The price achieved in a single sale in a thin market is not always the best representation of value. Firms have alternatives. They can model asset values. In some cases they can state values as if they intend to hold them to maturity. But to come back to my opening remarks they must explain clearly why they have decided on one route over another. And if they change their view, they must expect market suspicion so they need to be transparent. Good quality narrative reporting – principally through the Enhanced Business Review - is critical to ensuring a full understanding by shareholders. The numbers alone will not provide this!

Financial reporting is for the benefit of investors, and particularly of shareholders. Consistency and clarity need to be our watch words in a world gone mad.

So for better investor confidence: a strong, challenging Board, clear, consistent reporting, realistic assessment of prospects – all underpinned by excellent dialogue.