INTRODUCTION

This paper represents the response of The Association of British Insurers (ABI) to the consultative document issued by the High Level Group of Company Law Experts, comments on which have been invited by 21 June 2002.

The 400 members of ABI, as well as themselves being companies (both proprietary and mutual) have a particular interest in this subject from their perspective as institutional investors responsible for over £1,000 billion of funds under management (approximately €1,600 billion) around a half of which is invested in equity shares, mainly of UK companies but also including holdings in companies based in the rest of Europe and in the rest of the world.

GENERAL COMMENTS

An appropriate framework of European company law is of very considerable importance in helping to complete the development of the European single market and we welcome the opportunity to comment on this consultation document.

Care needs to be taken to distinguish between principles and intrusive prescription. We would emphasise the importance of concentration at EU framework level on the high-level principles while, in accordance with the principle of subsidiarity, leaving more detailed aspects, relating largely to implementation of those principles, to Member States.

These more detailed decisions may relate to assessing the relative merits of legislative solutions versus a disclosure-based approach. In principle we support disclosure and we also recognise the merit, for example, of the UK’s “combined code” approach to corporate governance which requires disclosure of compliance and, where applicable, the reasons for non-compliance.

In addition we would particularly emphasise the role played by regulations governing admission to listing and on-going obligations of listed companies. The Listing Rules approach is recognised by UK institutional investors to be an important and valuable one which underpins investor protection and good corporate governance in a number of areas where it works better than would
either provisions under company law or a voluntary code approach. This approach might usefully be enhanced: it should not be diminished.

We do not have specific comments to make on all the consultation questions, but those we do have are outlined below.

SPECIFIC COMMENTS

Q3
a) Do you agree that disclosure requirements can sometimes provide a more efficient regulatory tool than substantive rules?
b) In what areas of company law should the emphasis be on disclosure requirement rather than substantive rules?

The disclosure approach can be particularly appropriate in respect of corporate governance obligations. This is because of the significance of peer pressure in encouraging adoption of best practice and also the importance of ensuring flexibility in the development of best practice. A legislative approach, by contrast, is unlikely to afford the necessary flexibility.

Q5
Do you agree that company law should not be changed to include more compulsory rules, monitoring and enforcement regimes and procedures to achieve such regulatory objects as combating fraud and terrorism, but that such objects should be achieved by specific law enforcement instruments outside company law?

Yes. On principled and practical grounds, we believe company law should not be used for these purposes. Company law should not be viewed as an adjunct to, or alternative to, proper legislative and enforcement processes for combating criminal activity.

Q6
a) Taking into account the current and forthcoming Commission proposals in the field of securities legislation (eg prospectus, market abuse, periodic and ongoing reporting), should listed companies be required to maintain a specific section on their website as the single place where they publish all information they are required to file and publish, providing for two-way links with registers where such information should be filed and published, and to continuously update the information on this section of the website?
b) Should other companies be allowed to file and publish information on their website so long as they provide for two-way links with public registers where such information should be filed and published?
c) Should the European Union facilitate or provide for the co-ordination of public company registers in the Member States?
d) Beyond the current reflections at Community level on the establishment of a central electronic filing system for listed companies in each Member State, should the European Union, at some stage, promote the setting-up of a single European central electronic filing system for listed companies?
Companies already make fairly widespread use of web-site publication of relevant information about themselves for the benefit of those who, for whatever purpose, visit their sites. However, we see no benefits in introducing regulatory or legal requirements so to do. We would also emphasise that website publication is no substitute for a proper system of electronic regulatory news announcements which are essential to the proper operation of informed markets.

Q7
**Are efforts to improve or strengthen corporate governance necessary and important for efficient business in the EU and for an integrated European securities market?**

Efforts to improve and strengthen corporate governance are almost certainly worthwhile but optimum progress may not accrue from being pursued within the framework of company law. Disclosure standards for matters such as directors’ remuneration are better framed through a disclosure-based code approach although it may be noted that the UK government does now intend to introduce legislation in this area. There is no obvious reason why the framework at EU level needs to prescribe a legislative approach. Rather this should be left to Member States.

Q8
a) **Should there be more disclosure on corporate governance structures and practices of companies in Europe?**
b) **If yes, should such a disclosure be given only by listed companies or by all “open” companies or even by “closed” companies?**
c) **Should this disclosure include an indication whether a certain corporate governance code is followed and where and why the code is not complied with?**
d) **Should the remuneration of individual board members be disclosed, in particular if it is linked to the share price performance?**
e) **Should the shareholders have a role in fixing the principles and limits of board remuneration?**

We support the approach suggested in 8(c) that companies be obliged to indicate what corporate governance code(s) they follow and how they have complied. We see no need for the EU framework to address more detailed aspects. However, in passing, we would make the comment that linkage of remuneration to share price performance raises complex issues.

Broadly, linkage to share price appreciation is beneficial in that it promotes alignment of interest between management and shareholders. However, share price appreciation of itself will not necessarily demonstrate performance justifying what, in some share market conditions, could prove substantial rewards. Shareholder concerns may be particularly justified where share-based reward is delivered through options to subscribe for dilutive (i.e. new issue) shares. This will be particularly so in the absence of proper accounting for the cost of share-based payment under prevailing accounting standards. The particular significance of dilutive share-based remuneration is recognised
in the long-standing obligation on companies under the UK’s Listing Rules to obtain shareholder approval for any share scheme which may involve the issue of new shares.

Q10
Should the European Union introduce a framework rule which would hold company directors accountable for letting the company continue to do business when it can no longer pay its debts?

It is right that directors should be accountable for the consequences of companies continuing to trade when they are no longer able to pay their debts. Further consideration should therefore be given to the introduction of a framework rule.

Q11
a) Is there a need for a voluntary European corporate governance code in addition to or instead of the various national corporate governance codes?
b) If yes, please give examples of what rules and recommendations a European corporate governance code should contain.
c) Should the European Union facilitate the co-ordination of national codes in order to stimulate development of best practice and convergence?

We see no merit in the concept of an EU-sponsored corporate governance code though encouragement should be given to enhanced standards of disclosure. Convergence of best practice, while desirable in principle, will be difficult to achieve given different legal and cultural environments. However, to the extent that convergence is attainable, this is likely to be at least in part a market-driven phenomenon reflecting common underlying economic factors.

This viewpoint is very largely consistent with the findings of the review undertaken by Weill Gotshal & Manges on behalf of the European Commission Internal Market Directorate General and we would encourage careful attention to be given to this report.

We believe that the key aspects on which focus should be given at EU level is to achievement of a reduction in the legal and regulatory barriers to shareholders exercising their rights, in particular ability to cast their votes whether in person or by proxy, and in barriers to flows of information, in order that shareholders can take well-informed decisions in support of both their investment decisions and their governance obligations. Enclosed with this response is a position paper that deals with these matters in greater detail.

Q12
a) Should listed companies be required to establish on their websites devices (bulletin boards, chat rooms or similar devices) that allow for electronic communication between shareholders and the company and among shareholders prior to general meetings, including with respect to notices of general meetings, submissions of proposals and questions and solicitations of proxies?
b) If listed companies are required to establish these or similar devices on their websites, should the shareholders then be required to communicate by electronic means and thus be compelled to abandon the use of traditional means of communication, or should electronic communication only be an alternative available to those interested?

No, we do not support any of the proposals to require use of websites and other electronic means of communication. Replacement of traditional means of communication with electronic should, from shareholders’ perspectives, be entirely voluntary.

Q13
a) Is there a need, at the European Union level, to provide for minimum standards regarding the right for shareholders to ask questions and submit proposals for decision-making at the general meeting?
b) If so, what should these minimum standards be (minimum shareholding for raising questions and submitting proposals; time of submission of proposals for decision-making)?

Current practice in these respects varies significantly among Member States and in some EU jurisdictions requisitioning of resolutions can be difficult and/or expensive. In practical terms this an area where we consider that a levelling up of standards would be desirable, though we are unsure that what might be seen as relatively detailed prescription is desirable within the EU framework. This subject is, however, an important one that merits further careful consideration.

Q14
a) Should listed companies be required to provide facilities for proxy voting by all shareholders?
b) Should listed companies be enabled or required to offer to their shareholders electronic facilities for proxy voting or should they and their shareholders even be required to use electronic proxy voting and thus abandon the use of traditional proxies?
c) Should companies be enabled or even required to allow absentee-shareholders to participate in traditional general meetings via electronic means, including via the internet (webcast) and satellite?
d) Should companies which offer a comprehensive electronic process of information to, communication with and decision-making by shareholders be enabled to abandon the traditional type of general meeting?

Where a company is listed, we would consider that facilities for proxy voting are essential and would expect that Listing Rules would require it. This is an important matter of principle though it may well be that this is a matter best dealt with within the scope of the EU directive on admissions to listing. We are unconvinced of the need for the EU company law framework to address this and the other matters outlined. Some of the particular suggestions have merit though some do not. However these more detailed matters would be best left to Member states to address.
Q15
a) Should institutional investors in Europe, or, alternatively, all shareholders holding a certain percentage of the share capital, be required to disclose their policy as regards the investments they make, and as to how they exercise their voting rights?
b) Should institutional investors be required to exercise voting rights with respect to share they hold?

The rights, duties and obligations of shareholders under company law should, in principle, not vary according to the identity of shareholder for the time being. The particular nature of institutional investors is that they may hold larger shareholdings than private individuals but it should be recognised that institutional investors generally hold shares on behalf of ultimate end-investors and the purpose of so doing is to achieve the benefits of equity investment for their clients and, unlike many non-institutional substantial shareholders, not to enjoy benefits of control. We reject the characterisation, at least in the UK context, of institutional investors seeking to “invest in internal control within the company”.

How these institutional investors exercise voting rights is a matter that should be dealt with according to the contractual relationship between institution and client and the legal framework governing law of contract, and possibly through financial services legislation (though this should be a matter for Member States), but not company law.

ABI members attach considerable importance to the effective use of voting rights and to considered voting decisions. We believe, however, that compulsory voting, whether such obligations are made explicit or are implicit, would be of no benefit in this regard since it would not encourage considered voting but, rather, would create a box-ticking compliance culture. Effective corporate governance would thereby be reduced whilst costs to institutional investors, and in turn to their underlying clients, would be increased.

Qs 16, 17
a) Do you believe that legal capital serves all of the functions listed above?
b) Are there possibilities of reaching the same results by means of other techniques?
c) Do you consider that European companies are at a disadvantage as against companies in jurisdictions with a more flexible capital regime?

a) What is your general impression on the three approaches outlined here?
b) Which is the approach that you consider worth pursuing (if any)?

The concept of paid up capital is a fundamental conceptual building block of the limited liability joint-stock company. Protection of creditors is the overarching concern. There is some significance in the secondary considerations outlined though these are more in the nature of protection of the interests of shareholders. However, where there are no protection of
creditor considerations, there should be no objection in principle to companies having the power to vary their capital structure where this is approved by shareholders in general meeting by the requisite majority. A requirement for shareholder approval is the appropriate safeguard of shareholders’ interests. For example, recognition of the significance of legal capital would not be incompatible with shareholders being given the power to agree to companies issuing shares at below accountable par.

We do not favour the revolutionary approaches to capital regulation outlined as options in the consultation document. There may nevertheless be scope for useful incremental reform without the need for revolutionary change. Procedures for companies to reduce their share capital in appropriate circumstances should exist, subject to creditor protection, though it should be recognised that return of capital to shareholders is qualitatively distinct from payment of dividends out of earned profits. It is not, however, desirable to have a regime that encourages circumvention through artificial manufacture of distributable reserves.

Solvency of the company is obviously a key consideration where funds are proposed to be distributed whether by way of dividend or return of capital. While the ratio of assets to liabilities can be of considerable relevance in helping determine this, reliance on this concept could encourage the use of off-balance sheet financing techniques to circumvent the intent of such a test.

We do not believe that European companies are at a disadvantage as opposed to companies in jurisdictions with a “more flexible” capital regime and we do not consider that the characteristics of the US regime which vary compared to those of the UK and other EU Member States are particularly desirable.

Q18
a) Do you see the minimum capital requirement as an appropriate impediment to starting up a company?
b) Or would you abolish the minimum capital requirement or rather impose a stricter minimum capital requirement than the one presently in force?
c) Do you consider that “wrongful trading” is an effective instrument for creditor protection?
d) Do you consider that subordination is an effective and desirable way of enhancing creditor protection?
e) Are there any other possibilities worth considering?

Minimum capital requirements do not impose inappropriate impediments to starting a company. Capital adequacy and maintenance regimes are probably a necessity but should be no more onerous than necessary for creditor protection. Whether capital available to the company is otherwise adequate is essentially a matter of commercial judgment for which companies should be accountable to their shareholders and not the courts.

Q19
a) Do you believe that other forms of consideration, such as services, should be allowed as valid forms of consideration for capital?
b) Do you think the prohibition of financial assistance for the acquisition of own shares should be eliminated or at least that financial assistance should be allowed if it complies with the general rules for distributions to shareholders?

We are concerned that allowing services to be used as consideration for issue of capital could be subject to abuse. As a minimum, the value of such services should be properly measured and, to guard against such shares effectively being issued at a discount, a means be sought for existing shareholders to be given pre-emption rights over such shares.

We suspect that financial assistance regulations are probably necessary and that it would not be sufficient merely to require that funds used for this purpose be charged against distributable reserves.

Q28
a) Should Member States be required to introduce provisions enabling a majority shareholder (the majority to be set at not less than 90% nor more than 95%) in a company to buy out the minority for a fairly appraised price?
b) Should minority shareholders have a corresponding right to be bought out where the 90-95% threshold has been reached?
c) In companies with more than one class of share should the rule operate on a class by class basis?

The framing of squeeze-out provisions which are both efficient, and also fair as regards the rights of individual shareholders, is a complex and technical matter best left to implementation by Member States. However, it is important that a fair balance be sought and that this can be achieved within the relevant EU framework. The detailed suggestions in the consultation document regarding thresholds, although superficially attractive, in fact differ significantly from those currently applicable in the UK. We agree with the principle that such rules as are in fact prescribed should apply on a class by class basis.

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