



**UK Shareholders Association**

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3 June 2009

Sir David Walker  
The review of corporate governance of the UK banking industry  
25 The North Colonnade  
Canary Wharf  
London E14 5HS

Dear Sir David,

Interim comments on the problem of "ownerless corporations"

Although we appreciate that we are three days behind your deadline, the UK Shareholders Association (UKSA) would like to offer some brief comments as a pre-submission to your review. As you are no doubt aware, UKSA is the principal independent body in this country representing private shareholders, who are in the main long-term investors.

We wish to address what Lord Myners has described as 'ownerless corporations', relevant to the fourth subject of your terms of reference: 'the role of institutional shareholders in engaging effectively with companies and monitoring of boards'.

The recent ninth Treasury Committee report into the banking crisis, corporate governance and pay in the City covered shareholders and shareholder engagement in paragraphs 159-179. We believe that the dysfunctional behaviour to which the Committee refers is caused by modern shareholder ownership structures and that these have received insufficient attention, either by the Committee or elsewhere. We fill that gap below, for the convenience of the Review.

It is essential to understand that there are few institutions that benefit financially themselves from the performance of the companies they own. Those that do not are:

- Institutions that hold shares as nominees for private investors (which includes all investors through ISAs);
- Institutions that run index funds ('trackers');
- Institutions that run pseudo-trackers;
- Institutions that run actively-managed funds whose performance is benchmarked against an index and whose holding in a company is the same weight as in the index (a rising tide raises all boats);
- Institutions that hold shares for short-term trading;
- Institutions that have borrowed stock to cover short sales (whether for themselves or for clients);

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- Institutions that have used derivatives to abdicate their beneficial interest.

There are further categories of institution that would benefit from good corporate performance but whose financial interests are not served by active engagement with companies:

- Institutions that position themselves as low cost; active engagement is expensive (and, once again, a rising tide raises all boats);
- Institutions that judge that selling the shares of an under-performing company and re-investing in something better managed is a better use of their clients' funds than incurring the costs of active engagement;
- Institutions that judge that active engagement is worthwhile in terms of improving corporate performance, but cannot justify the expense because it gives them no competitive advantage over other institutions who also hold the shares;
- Institutions that recognise the benefit of active engagement but take the zero-cost option of riding on the back of concerned institutions such as L&G.

But it's worse than that. Investing institutions are frequently part of major financial conglomerates whose activities will include in-house trading, buy-side and sell-side broking, fundraising, underwriting, corporate advice, mergers and acquisitions, disposals and investment banking generally. The profits from these activities will tend to dwarf those that can be made from the corporate performance of companies in which they hold shares. Some situations where the interests of the institution will diverge from those of the company are:

- where the institution, either directly or through derivatives, is net short of the company's shares;
- decisions affecting company risk (increased volatility is good for trading, and also for broking which feeds on a diet of 'stories' and 'interest');
- mergers, acquisitions and disposals, all of which deliver investment banking income;
- funding strategy.

In the light of this analysis, the almost palpable sense of frustration emanating from the evidence of fund managers to the Committee is instructive. It is plain that mere exhortations for further shareholder engagement will be ineffective or worse. And we are not convinced that regulations alone will lead to the deep cultural changes needed to change the mindset of institutional investors towards a long term perspective. Any proposal that really moves the debate forward can only be a cocktail of enfranchising more beneficial owners, disenfranchising unengaged shareholders and/or introducing new governance structures that give stakeholders powers more representative of their stakes. See for example The Protection of Shareholders Bill; <http://www.publications.parliament.uk/pa/cm200809/cmbills/076/09076.1-i.html>

Such a proposal will be contentious and opposed by powerful vested interests. (It will also have relevance, we note in passing, for all quoted companies, not just the financial sector). We therefore ask, whatever the conclusions of the Review, that it includes a clear analysis of the problem so that there is a sound basis for the critical debate that is bound to follow.

In this letter we have focused on what is, to us, the most fundamental cause of the poor governance of the banking sector, and of many public companies in all sectors. We would very much welcome the opportunity to enter into any dialogue with your Review. In which case, please reply in the first instance to the following members of our regulatory policy team:

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Yours sincerely

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