# Budget 2011
## FairPensions' Response

PARLIAMENTARY BRIEFING

In the wake of the financial crisis, it is increasingly recognised that institutional investors did not do enough to prevent the banks they owned from pursuing excessively risky strategies. Responsible investor behaviour matters enormously to the ordinary taxpayer, both because the assets invested are ultimately our savings, and because of its importance to financial stability.

The government's 'growth review' document, published last November, stated that corporate governance *"will be one of the Government's priority areas over the coming months"*.[1] BIS is currently undertaking:

- A review of economic short-termism (begun October 2010)
- A review of companies' narrative reporting (begun August 2010)

This briefing examines the implications of the Budget and accompanying 'Plan for Growth' [2] for this vital agenda.

## Corporate governance & investor behaviour

### Background

In October 2010, BIS published a call for evidence entitled 'A long-term focus for corporate Britain'. Its stated aim was to ensure that the capital markets support long-term value creation rather than fixating on short-term profits, and that the proceeds of growth are not *"captured by a small number of intermediaries at the expense of the many who provide the capital."* [3] The document encompassed issues such as investor engagement, directors' pay and takeovers.

### The Budget & Plan for Growth

The Plan for Growth indicates that the government's proposals on economic short-termism will not be published until "the summer".[4] Meanwhile the Plan contains a brief section on corporate governance, which focuses largely on reducing the burden of financial reporting and audit requirements on business. It also contains proposals on narrative reporting (see below).

### FAIRPENSIONS' RESPONSE

- We welcome the government's work on corporate governance but are somewhat disappointed by the low profile given to these issues in the Budget and Plan for Growth. In the wake of the biggest financial crisis for almost a century, it is clear that the capital markets, and in particular the way institutional investors manage our money, are vital to achieving stable and sustainable growth in the UK.

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## FAIRPENSIONS' RESPONSE (CONT.)

- We are concerned that the government's current proposals focus solely on areas where the governance framework presents a 'burden' on business. It would be concerning if good corporate governance and investor stewardship came to be seen as a barrier to growth rather than as an asset to be celebrated and built upon. We await the publication of the government's proposals on economic short-termism, which we trust will include positive commitments to enhance the UK corporate governance framework.
- In particular, we very much hope to see a formal government review of the fiduciary duties owed by institutional investors to the individuals whose money they manage, to ensure that the legal framework promotes responsible long-term behaviour and applies equally to all financial intermediaries looking after people's savings.

# Corporate reporting

## Background

The coalition agreement stated the government's commitment to:

> *"reinstate an Operating and Financial Review to ensure that directors' social and environmental duties have to be covered in company reporting, and investigate further ways of improving corporate accountability and transparency."* [5]

Following this commitment, BIS initiated a consultation on 'The future of narrative reporting'.[6] This consultation addressed itself to the broader question of whether companies' narrative reports were adequate to allow investors to judge the principle risks facing the company, but had only a limited focus on environmental and social issues.

## The Budget & Plan for Growth

The Plan for Growth notes that:

> *"Good narrative reporting should tell the company's story effectively and in a balanced way that puts financial information into context… most companies comply with the legal requirements but some reporting is of poor quality or lacks relevance to investors."*

However, the government's plans on company reporting have been reduced to a commitment to *"materially simplify narrative reporting for quoted companies in the UK to make it clearer and more focussed."* [7]

There is also a new commitment to *"seek views from business by the end of July 2011 on the best ways to reduce burdens"*.[8]

The document makes no reference to the original coalition commitment or to the importance of social and environmental reporting.

## FAIRPENSIONS' RESPONSE

- We welcome the government's recognition of the importance of good narrative reporting and the need to raise standards.
- However, we are concerned that the original commitment to improve social and environmental reporting appears to have been wholly displaced by the government's deregulatory agenda and the focus on 'simplification'. In the wake of the Gulf of Mexico oil spill, it is increasingly clear that environmental and social issues pose material financial risks, yet this remains an area of weakness in most company reports.
- Although we agree that reports can be too long and complex, we remain unconvinced that simplifying the reporting regime will by itself deliver the necessary improvements in reporting.
- The regulatory regime must ensure that reporting requirements are robust and properly enforced. In particular, better social and environmental reporting remains unlikely unless government and regulators give them specific profile.

# Financial Regulation

The Budget confirms the government's intention to introduce legislation in 2011 to implement its plans to reform the existing tripartite system of financial regulation.

FairPensions will shortly be producing a separate briefing on these proposals. We believe it is vital that the new system seeks to achieve consistency between the regulatory and legal obligations governing different investment intermediaries, particularly those managing pension savings.

Currently, the protection enjoyed by consumers varies arbitrarily according to the form of their pension arrangements: occupational pension schemes are subject to an entirely different regulatory regime from insurance companies who sell pension products to individual savers. While it may not be possible to bring all these actors under a single regulator, FairPensions believes that more could be done to ensure that the regulatory approach is consistent and that there is a level playing field between types of provider.

These issues are explored further in FairPensions' upcoming report, 'Protecting our Best Interests: Rediscovering Fiduciary Obligation'.

## ABOUT FAIRPENSIONS

FairPensions is a registered charity established to promote Responsible Investment (RI) by pension schemes and fund managers, and to ensure that ultimate beneficiaries are well served by institutional investors and other professional agents in the investment world.

RI most often entails engagement with investee companies, including through the exercise of shareholder rights, to ensure that extra-financial issues which pose potential financial risks are monitored and managed.

FairPensions is a member organisation whose members include various organisations representing pension savers, including the National Federation of Occupational Pensioners, UNITE and Unison, as well as thousands of individual pension fund members.

fairpensions.org.uk

**Further information:**

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1. 'The Path to Strong, Stable and Sustainable Growth", November 2010, para 1.42, available at http://www.hm-treasury.gov.uk/d/growth_291110.pdf
2. Plan for Growth, March 2011, http://cdn.hm-treasury.gov.uk/2011budget_growth.pdf
3. Vince Cable, Foreword, BIS, 'A long-term focus for corporate Britain', available at http://www.bis.gov.uk/assets/biscore/business-law/docs/l/10-1225-long-term-focus-corporate-britain.pdf
4. Plan for Growth, para 2.139
5. The Coalition, Our Programme for Government, p10
6. 'The Future of Narrative Reporting', Aug 2010, http://www.bis.gov.uk/Consultations/the-future-of-narrative-reporting-a-consultation
7. Plan for Growth, para 1.35, 2.147/148
8. Plan for Growth, para 2.147

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