

Beyond the myth



Understanding differences between UK and US capital markets is crucial for investors. **Kerrie Waring** debunks the myth of an Anglo-American approach to corporate governance

Last month, the ICAEW hosted a roundtable in London showcasing the findings from the institute's year-long *Pressure points* consultation as part of our 'Beyond the myth of Anglo-American corporate governance' initiative. It follows a roundtable held in Washington DC in December 2005 where 21 questions addressed differences between US and UK corporate governance systems. Both events convened counterparts from business, investment, accounting and regulatory communities from both sides of the Atlantic.

The aim of the initiative is to highlight areas of consensus and disagreement about the successes and failures of the US and UK systems. In doing so, the ICAEW hopes to promote understanding of pressures and opportunities that arise in increasingly international capital markets. Recognising that corporate governance is an evolving discipline, a number of areas for interdisciplinary research on an international basis have been identified from the consultation to further

knowledge in the area.

Since the launch of the 'Pressure points' consultation, mayors Michael Bloomberg and Ken Livingstone of New York and London respectively have endorsed further research into the attractiveness of US and UK capital markets. Two high-level bipartisan groups: the Commission on the Regulation of US Capital Markets in the 21st Century and the Committee on Capital Markets Regulation, have been established to consider US legal and regulatory frameworks and capital market competitiveness. In the UK, the City of London published a report, *Cost of Capital: An International Comparison* (Oxera Consulting Ltd) in June 2006.

Means to an end

Corporate governance is a means to an end and not an end in itself. Good corporate governance promotes economic activity and prosperity by inspiring trust in companies and corporations so that people have confidence to do business and invest. Since the establishment of the Cadbury Committee in 1991, the ICAEW has played a significant role in the development of corporate governance in the UK. For example, the *Turnbull Guidance on Internal Control* published by the ICAEW was approved by the US Securities and Exchange Commission (SEC) as a framework for compliance with 404 of the Sarbanes-Oxley Act.

Through reporting and auditing, chartered accountants support transparency and the flow of reliable information between management, boards, shareholders, regulators and other stakeholders. It is therefore appropriate for the ICAEW to convene those responsible for the direction, control and oversight of companies. By bringing together counterparts from the US and UK, we aim to encourage dialogue on issues relevant to the policy, investment, business and accounting communities.

The increasing impetus for dialogue in corporate governance reflects the wider international capital market environment within which the US and the UK have much to contribute and much to learn. National regulators have traditionally worked in isolation but the extra-territorial effects of the Sarbanes-Oxley Act emphasised the important need for dialogue to mitigate regulatory conflict and overload. Moreover, the potential consolidation of trading platforms and regulatory arbitrage are increasing the need for information sharing.

Shared approach?

It is widely believed that the US and the UK share an Anglo-American approach to corporate governance. Indeed common language, similar ownership structures,

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high levels of transparency and unitary board models would seem to justify such an assumption. This is significant because the success of US and UK capital markets encourages the desire to emulate them. However, their historical origins and underlying principles are distinct and lead to different corporate governance practices.

In both systems, public company boards and institutional investors are each agents for the same principal – the beneficial owner, or more broadly, the investing public. Boards and institutional investors are therefore mutually responsible for acting in the best interests of a shared beneficiary. However, despite this shared purpose there are conflicting perspectives between market participants in the US and the UK about their roles and the level of control that each agent should maintain.

In the UK, board directors are responsible for directing the affairs of the company and are accountable to shareholders for the stewardship of their investment. The fact that UK shareholders have the authority to appoint or remove a director encourages an environment where the use of such power is rarely needed. The threat alone is sufficient to ensure that boards take shareholders' concerns seriously and are sensitive to shareholder opinion on governance matters.

In contrast, US shareholders can do little to influence board composition except to withhold votes to signify their dissatisfaction. In fact, shareholders in the US have little redress in holding boards to account save for resorting to litigation or, provided that their portfolios are not index-linked, selling their shares.

There is a higher concentration of shareholding among fewer institutions in the UK compared with the US, which has led to unique engagement behaviour. Close proximity of institutions facilitates an organised and generally cohesive approach to engagement. The UK regulatory environment supports shareholder collegiality by permitting dialogue between boards and investors and not presuming that such dialogue represents privileged

disclosure, which is restricted by fair disclosure regulation in the US; allowing dialogue among investors without triggering concert party issues; and it is free of the divisive threat of class action litigation.

In contrast, the sheer size of the US markets and the greater number of institutions mean that mobilising shareholders to defend collective interests is more difficult.

Regulated disclosure

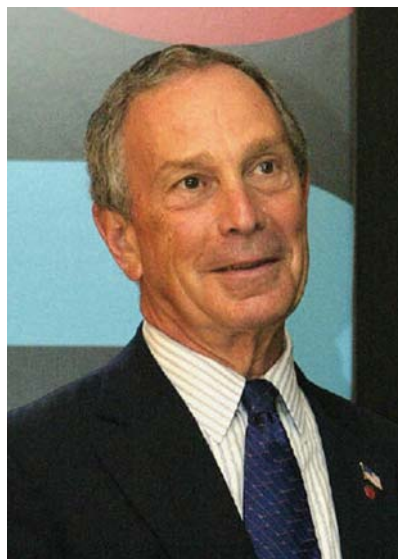
References to a US regulator-led approach to corporate governance should acknowledge that the US model is primarily one of regulated disclosure. The SEC has historically been prepared to allow entities of differing governance quality to have access to US capital markets provided that disclosure requirements are satisfied to ensure that investors can make informed choices. By contrast, UK regulators have generally delegated regulatory powers to sponsors and, in the case of the alternative investment market (AIM), to nominated advisers (NOMADs) to judge the merits of potential market entrants and their suitability for listing.

Under this merit-based approach, companies can be denied access to UK markets for a variety of reasons including governance arrangements that are judged to be inadequate.

The 'Beyond the myth' initiative aims to generate discussion and broaden debate on the differences between US and UK corporate governance systems. This dialogue is reflected in the findings outlined in the *Emerging Issues* publication launched at the London roundtable. We recognise that corporate governance evolves in response to a host of economic, organisational and regulatory influences. We therefore encourage interdisciplinary research on an international basis into corporate governance to inform policy, investment, business and accounting developments.

We also welcome dialogue among interested parties to consider the wider international capital market environment within which the US and the UK have much to contribute and much to learn.

There are **conflicting perspectives** between market participants in the US and the UK about their roles and the level of control that each agent should maintain



Mayors Bloomberg and Livingstone: Endorsed further research into the attractiveness of US and UK capital markets