Robert G Hardy
Vice President

Adam Gray
Long-term Focus Consultation
Corporate Law and Governance
Department for Business, Innovation and Skills
1 Victoria Street
London
SW1H 0ET

14th January, 2011

Dear Adam,

A Long-Term Focus for Corporate Britain – Call for Evidence

J.P. Morgan Asset Management ("JPMAM") is a large fund management company with assets under management in excess of one trillion dollars globally. JPMAM views seriously its stewardship obligations to its clients. We vote at over 10,000 AGMs each year in 63 markets worldwide and engage actively on corporate governance issues at companies in which we invest, in order to promote our clients' best interests.

JPMAM is a member of the National Association of Pension Funds (NAPF) and the Investment Management Association (IMA) and we generally take their guidance into account when commenting on public policy. Whilst we have seen, and fully endorse, their responses to this Call for Evidence, it was felt that the issues raised were of sufficient concern to warrant our own, independent, response.

We would therefore offer the following responses to the specific questions raised:-

1. **Do UK boards have a long-term focus? If not, why not?**

   For the most part, yes. Although we recognise that boards can sometimes be distracted by short-term share price movements, or other external influences, such as wider market fluctuations, which may be beyond their control. The statutory duty of directors to act in the long-term best interests of companies is clear.

2. **Does the legal framework sufficiently allow the boards of listed companies to access full and up-to-date information on the beneficial ownership of company shares?**

   Companies increasingly use specialist agencies to understand their share registers, in order to better communicate with shareholders. In our experience, most large institutional investment managers, including J.P. Morgan Asset Management, are usually happy to co-operate with companies in

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disclosing their beneficial share ownership, where such information can be beneficial to both sides and help to enhance access to senior management of the companies in which we invest.

We agree with the NAPF, that factors such as the increasing use of nominee accounts, pooled funds and derivatives, coupled with the growing internationalisation of the industry and (perhaps most importantly) the increase in stock lending activity, make understanding the true position more difficult. We acknowledge that this is a complex area but one which merits further analysis. Whilst we would support improved disclosure relating to derivatives and stocklending, we would strongly oppose the arbitrary curtailment of the use of such instruments which, in our view, both enhance market liquidity and provide an important source of revenue for clients.

3. What are the implications of the changing nature of UK share ownership for corporate governance and equity markets?

As has been widely reported, the proportion of UK equities owned by UK institutional shareholders has declined from about sixty percent a decade ago to approximately forty percent today. This has implications for the degree of influence we can bring to bear on companies. The rise of other types of asset owners, such as sovereign wealth funds, implies a need for more collective engagement where possible and in the common interest (but with certain caveats – see response to Q4).

Another development worth noting is the increasing role of voting agencies, as fund mangers seek to increase efficiency and reduce costs by outsourcing or automating voting activity via specialist third-party providers. This may warrant further scrutiny.

4. What are the most effective forms of engagement?

J.P. Morgan Asset Management believes that regular contact with the senior managers of the companies in which we invest as fundamental to our investment process. We endeavour to meet with all our investee companies at least once a year, for the most part to promote the sustainability and success of the business in the long-term. We believe face to face engagement, backed up by informed, investor-led voting is a more effective approach than, for example, speaking at shareholder meetings. Engagement, by its very nature, is both sensitive and confidential, and it would not be in our clients' best interests if the detailed nature of these conversations were to be put into the public domain, where it may even negatively impact the share price. We would therefore discourage any requirement for mandatory public disclosure of meetings held.

We would also point out that, just because engagement is not visible to outside observers, this does not mean that it is not taking place. Most large institutional investors devote a large amount of time and effort to corporate governance engagement and stewardship activity, although we agree with the view of the NAPF, that the 'effectiveness' of this engagement is often difficult to measure in any systematic way. This is, in part, precisely because these are long-term issues which are being discussed, and the results, therefore, of such engagement may not be immediately visible, over shorter time horizons, to those not involved.

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Collective engagement with other investors is also something with has existed for many years in the UK. The involvement of a wider constituency may also be desirable but may not always be possible for the reasons stated above. Mutual trust between all parties and absolute confidentiality are essential to the engagement process, and experience shows that this cannot always be achieved with a wider collective engagement. Desired outcomes may also differ the larger the group becomes. It is also worth pointing out that the investment objectives of certain overseas investors, or other categories of investors, may be to seek a one-off, near-term event, such as a breakup of the company or sale of a subsidiary, in order to realise short-term gain.

5. Is there sufficient dialogue within investment firms between managers with different functions (i.e. corporate governance and investment teams)?

J.P. Morgan Asset Management has embedded its corporate governance specialists in the 'front office' for many years and, in our experience, most large institutional investment managers, who are committed to serious engagement on corporate governance issues, have sited their governance teams with portfolio managers and analysts in order to bring about more 'joined up' governance. In our view, it is impossible for meaningful engagement to take place if it is partially outsourced, or left to disjointed teams within compliance or operational functions. Indeed, outsourcing engagement to a third party or specialist 'engagement overlay' provider may in fact lead to outcomes which conflict with desired investment objectives of fund managers.

We agree with Stephen Green's recent comments, that meaningful engagement with companies can only take place when there is a "single conversation" involving both portfolio managers and corporate governance specialists.

6. How important is voting as a form of engagement? What are the benefits and costs of institutional shareholders and fund managers disclosing publicly how they have voted?

We believe that informed, investor-led voting can be an effective tool, when coupled with ongoing monitoring and engagement with companies. However, JPMAM believes that detailed content of our proxy voting activity is a matter exclusively for our clients and not the public, whose objectives may not be aligned with those of our clients and their beneficiaries. In our view, resources diverted to checking and maintaining exhaustive public vote disclosure would be better employed generating value for our clients.

7. Is short-termism in equity markets a problem and, if so, how should it be addressed?

Different investors have different objectives, time horizons and investment styles, and therefore their holding periods will differ greatly. Similarly, holding periods vary within JPMAM, depending on the respective investment strategy chosen by our clients. For example, the typical turnover of one of our core manager-driven portfolios ranges between 17% to 39%, which implies an average holding period of anything between two and a half years to nearly six years. A typical behavioural finance portfolio might turn over five percent of the portfolio a month, implying a holding period of 1.66 years. We can point to some investments which have been held for ten years or more. A further challenge is that the

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typical lifespan of a client mandate is six to seven years, with trustees or their consultants typically requiring a quarterly performance update. Similarly, managers are compelled to undertake a quarterly 'mark-to-market' of pension assets. All of these structural issues need to be addressed if we are to move away from short-termism within the industry.

8. **What action, if any, should be taken to encourage a long-term focus in UK equity investment decisions? What are the benefits and costs of possible actions to encourage longer holding periods?**
As stated previously, different investors have different objectives, time horizons and investment styles, and therefore their holding periods vary. All are legitimate in our view.

Our experience suggests that incentives to long-term investors tend to have unintended consequences. The granting of double voting rights for long-term ownership, for example, is actually used as a tool to entrench management and their core shareholders (often family or employee groups) in every market where they exist, and actually inhibits the ability of minority shareholders to engage effectively or hold directors to account. There may be merit in exploring an enhanced dividend for longer term shareholders, although this would require more evidence to prove that these article mechanisms do not distort capital allocation.

9. **Are there agency problems in the investment chain and, if so, how should they be addressed?**
Investment managers act as agents on behalf of their clients, which generally (but not always) includes voting shares on their behalf, where we are mandated to do so. As has been widely discussed, there are a number of issues in the extended voting chain between decision maker, custodian, registrar and issuer, and these are being gradually addressed by the Shareholder Working Group and others. Asset managers devote a great deal of resource into risk management and compliance functions to ensure that any potential conflicts of interest are dealt with appropriately, and this extends to voting and engagement issues.

We echo the comments of the IMA regarding the point made in section 4.25 of the Call for Evidence: there is a fundamental misunderstanding that asset managers can somehow generate more revenue for themselves by 'churning' the portfolio. This is not the case. Asset managers are paid by agreed, arm's length fees, normally a percentage of assets under management. Asset managers are not incentivised to over-trade portfolios. In fact quite the reverse is true, as the associated trading costs would simply erode the alpha generated for the portfolio, reducing investment performance and therefore revenues.

10. **What would be the benefits and costs of more transparency in the role of fund managers, their mandates and their pay?**
We are fully transparent about our fees and pay structures with our clients. We do not feel it is appropriate to comment further, other than to endorse the response of the NAPF. We would also observe that putting such information in the public domain would be of most informational value to competitors.

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11. What are the main reasons for the increase in directors' remuneration? Are these appropriate?

There are a number of reasons for this, notably the use of peer benchmarking to set their incentive rates, which leads to pay 'ratcheting' (as well as generating fees for remuneration consultants). and this can result in regular increases in both base and incentive payments. We generally oppose the use of peer benchmarking, unless it is applied infrequently and then only as a singular part of the remuneration committee's overall assessment of remuneration policy. Similarly, globalisation has led to increased competition for talent, where companies often propose that incentive packages need to be better aligned with those of their competitors. As has been highlighted elsewhere, executive pay in the UK tends to be lower than in the US, and this leads to companies looking to better align their remuneration schemes with their international counterparts. We agree with the IMA, that remuneration is ultimately determined by market forces in a free economy.

12. What would be the effect of widening the membership of the remuneration committee on directors' remuneration?

We would echo the view of both the NAPF and the IMA in relation to this point: we see few benefits from widening the membership of the remuneration committee to include either representatives from outside the company board, or remuneration experts. Indeed, such a structure might dilute the cohesion of the board and may even create conflicts of interest.

13. Are shareholders effective in holding companies to account over pay? Are there further areas of pay, e.g. golden parachutes, it would be beneficial to subject to shareholder approval?

We would echo the view of the NAPF, and point to the many successes achieved in this area in recent years, from the disappearance of three year contracts for directors, the retesting of share options, guaranteed bonuses, all of which have practically disappeared from the UK remuneration landscape.

There may be value in exploring a vote on so-called 'golden parachutes' as this has been successful in other markets (notably France). We would also highlight the practice in Australia, whereby in addition to shareholders' approving new stock option plans, approval must be sought for individual grants of options to directors each year. This may warrant further exploration.

14. What would be the impact of greater transparency of directors' pay in respect of:

- **a. Linkage between pay and meeting corporate objectives;**
- **b. Performance criteria for annual bonus schemes; and**
- **c. Relationship between directors' pay and employees' pay?**

We agree with the NAPF that greater disclosure of each of these points would be of benefit to companies and shareholders. Transparency of remuneration policy enables shareholders to better understand the company, and assists them to make well informed investment decisions. It is also important that companies disclose the information in a way which is clear and meaningful. Many shareholders are concerned that remuneration policies are too complex to be readily understood and

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that the symmetry between remuneration, shareholder returns and the long-term objectives of the company is lost.

15. Do boards understand the long-term implications of takeovers, and communicate the long-term implications of bids effectively?

The duty of directors in these situations is clear. The offeree board must consider whether the bid offers better value than what the existing management expects to deliver, and balance the value of taking cash now versus the uncertainty of equity. The benefits of a level takeover playing field for the UK economy are self-evident, and most industry observers are of the view that protectionism in any form undermines competitiveness and cannot work in the long-term.

16. Should the shareholders of an acquiring company in all cases be invited to vote on takeover bids, and what would be the benefits and costs of this?

Yes. Although this may not be possible in all instances or overseas jurisdictions in the case of cross-border takeovers.

17. Do you have any further comments on issues related to this consultation?

We have no further comments.

I hope the above is helpful. Should you wish to respond on any of the above points, or discuss corporate governance issues further, please do not hesitate to contact me.

Yours sincerely

Robert G Hardy
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