International
Capital
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Association

ICMA

ASSET MANAGEMENT AND INVESTORS COUNCIL

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

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Sent by email

Dear Mr Gray,

BIS Call for Evidence – A long-term focus on Corporate Britain.

The ICMA Asset Management and Investors Council (AMIC) was established in March 2008 to represent the buy-side members of the ICMA membership. ICMA is one of the few trade associations with a European focus having both buy-side and sell-side representation.

Taking into consideration the changes that have occurred in the industry, the AMIC composition embraces the diversification and the current dynamics of the industry – taking the asset management representation to a broader and global level. The AMIC is concerned by issues affecting investors-led organisations rather than issues related to fund distribution.

The AMIC welcomes the opportunity to respond to the BIS Call for Evidence entitled 'a long-term focus on corporate Britain'. The AMIC has been very interested and engaged in the issue of shareholder participation and will be responding in detail to this part of the questionnaire, and make some general comments on other parts of the consultation where it has the adequate expertise to do so.

GENERAL REMARKS

The AMIC is of the view that the BIS support to the Financial Reporting Council's Stewardship Code is welcome and the FRC initiative to encourage investors to publish a statement on their website of the extent to which they have complied with the Code.

Institutional investors have been criticised for not exercising their responsibilities as shareholders and failing to hold boards to account for their activities. Regulators are calling upon institutional investors to be more proactive in participating in the management of companies. The members of the AMIC have already stated that the industry needs to improve in this area. Asset managers have clients worldwide, all

subject to different sets of rules. The AMIC believes that it is good practice to be transparent (and publish voting records for instance) and to ensure that clients are made aware of certain issues to be voted on.

The AMIC welcomes efforts that have been made to improve corporate governance standards through market-led initiatives such as the FRC Stewardship Code. The AMIC believes that the asset management industry should adopt the Code. Council members recognise it is on a comply-or-explain basis. Although the AMIC considers that being engaged is part of the commitment when taking a stake in a company, it is important to emphasise that asset managers are not the ultimate owners of the assets. Any regulation trying to regulate the agents as a proxy for encouraging desired behaviour by principals may be counterproductive, as agents can only act on behalf of their clients as contractually agreed. If principals decline to empower agents, or go further and positively instruct them not to act, agents have no authority to follow regulators' instructions to do otherwise.

The AMIC is of the view that different lines of defences should have worked to avoid the financial crisis, including Non-Executive Directors, Auditors, Credit Rating Agencies, shareholders and regulators. The AMIC believes that all lines of defences have failed for one reason or another and that a holistic solution should be sought, rather than measures aimed at individual aspects alone, such as shareholder governance.

SHAREHOLDER ENGAGEMENT

Institutional investors have been criticised for not exercising their responsibilities as shareholders and failing to hold boards to account for their activities. Regulators are calling upon institutional investors to be more proactive in participating in the management of companies. The members of the AMIC recognise that the industry needs to improve in this area. However, there is little objective evidence that engagement produces superior portfolio returns and yet it comes with a cost. Indeed, the separation of ownership and control raises fundamental questions about representation of interests.

The AMIC believes that good corporate governance does not necessarily imply activism, and no proposal should encourage the buy-side to be activist. Some asset managers decide to follow an investment policy based on activism to ensure positive investment returns. But there are in fact different options for asset managers once they bought shares. They may understand the management's strategy and agree with it, or disagree and then decide to engage with the management. Asset managers would take a view on the company's future, and may choose to engage with the company. A number of outcomes are possible. Management may choose not to listen, or asset managers may give wrong advice. Asset managers may also choose to sell their shares. If a possible legislative proposal were to be drafted, this flexibility should be maintained. The AMIC believes that this is a complex issue and that it is difficult to actually quantify 'the return on engagement'.

As mentioned earlier the AMIC welcomes efforts that have been made to improve corporate governance standards through market-led initiatives such as the UK FRC Stewardship Code. One of our members explained that their engagement on behalf of their clients is based on a dialogue with companies; voting records are published on the

web with a three-month delay; and a full-time member of staff is employed to oversee the whole process.

Although the AMIC considers that being engaged is part of the commitment when taking a stake in a company, it is important to emphasise that asset managers are not the ultimate owners of the assets. Any regulation trying to regulate the agents as a proxy for encouraging desired behaviour by principals may be counterproductive, as agents can only act on behalf of their clients as contractually agreed. If principals decline to empower agents, or go further and positively instruct them not to act, agents have no authority to follow regulators' instructions to do otherwise. Sovereign Wealth Funds (SWFs) are for instance known as often preferring to be passive owners, and asset managers have to be able to respect this choice without being in breach of well-intended regulation. There would be a litigation risk if clients' wishes were not respected by the agent because of the agent's regulatory obligation to vote on its clients' behalf. Pooled funds complicate matters further, as there may be multiple principals behind the fund and following the owners' wishes, or even ascertaining them, is not always practical.

Legislative proposals would in effect turn the shareholder's right to direct their company's management into an obligation to do so, for the common good. This would make common equity less attractive to many holders (and to some SWFs in particular, much less attractive). This would be reflected in the market, firstly by a lower price for common equity, and secondly by a reorganisation of the capital structure of public companies. In effect, if regulators demand that holders of common equity take on certain responsibilities, then companies will inevitably find a way of issuing equity which does not carry these burdens, so as to attract investors who for their own legitimate reasons do not wish to actively engage.

Asset managers have clients worldwide, all subject to different sets of rules. The AMIC believes that it is good practice to be transparent (and publish voting records for instance) and to ensure that clients are made aware of certain issues to be voted on.

Moreover, no asset manager has the resources to vote on all issues of every company its clients hold a stake in. Therefore it is important to emphasise the costs active engagement entails – costs that would inevitably be passed onto the ultimate asset owners in the form of higher fees, raising again the question of whether some principals would accept the extra charges, especially if they did not intend to exercise their rights to vote.

REMUNERATION POLICY

The industry represented by the AMIC has a fiduciary duty towards its clients. The way asset managers are compensated therefore is aligned with clients' interests and their longer-term time-horizons: asset management is a multi-year business rather than a transactional business and remuneration arrangements already reflect this, with variable pay being based on a multi-year performance rather than a one-year record of transaction-driven profits. As a result, the time period on which an asset manager's performance is based is more likely to be of 2 - 3 years.

The aim for asset managers is to achieve repeat business and this is done by achieving

good performance over longer time. The AMIC therefore calls for a principle-based approach to remuneration policies targeted at asset managers to ensure adequate flexibility. Many asset managers' response to recent market events has entailed variable pay that varied downward, in some cases quite sharply, to protect core staff resources over the years of lower revenues: this ensured that the long-term structure of asset managers (necessary to align asset managers with clients' long term performance requirements) was not put at risk by short-term revenue dips.

The AMIC would be happy to discuss further with you the points made in this letter.

Yours sincerely,

Robert Parker
AMIC Chairman