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ICMA

ASSET MANAGEMENT AND INVESTORS COUNCIL

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Sent by email

Dear Claire,

EC Green Paper – The EU corporate governance framework

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 EU corporate governance framework consultation. The AMIC has been very interested and engaged in the issue of shareholder participation. We believe that there is a need for an effective corporate governance framework, particularly one based on the premise of 'comply or explain'. 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 engaging with the management of companies. The need for the industry to improve in this area has been recognised by the AMIC. We believe 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.

However, whilst 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 have a fiduciary role and 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.

We believe that the continued evolution of corporate governance practices across Europe, informed by the consultations done at EU and Member State level, presents a strong argument for the use of best practice guidance rather than law, which once set is much more difficult to revise. Business, and therefore corporate governance, practices are not static and a flexible framework enables adaptation as circumstances dictate.

AMIC responses to the Questionnaire.

1. **Should EU corporate governance measures take into account the size of listed companies? How? Should a differentiated and proportionate regime for small and medium-sized listed companies be established? If so, are there any appropriate definitions or thresholds? If so, please suggest ways of adapting them for SMEs where appropriate when answering the questions below.**

The AMIC understands that small and medium sized firms face problems of governance that are different from those encountered by large listed companies. Remuneration, for instance, may not be as relevant a topic when the leader is a major shareholder, if not the main shareholder. In addition, these companies would be more aware of problems that can cause the isolation of the leader and the protection of minority shareholders. However the AMIC believes that good governance is essential whatever the company's size in order to promote competitiveness and sustainable growth. The AMIC believes that corporate governance frameworks should be adapted to the specific needs and structures of SMEs. Good governance can play a major role in gaining the respect of key external stakeholders. Corporate reputation may also benefit from a gradually increasing transparency and accountability in both private and public transactions.

2. **Should any corporate governance measures be taken at EU level for unlisted companies? Should the EU focus on promoting development and application of voluntary codes for non-listed companies?**

Unlisted companies are key to a country's economy and future growth. And the survival of these companies is in part linked to the implementation of strong and professional governance structures. Non-listed companies, which rely heavily on bank financing and venture capital, should look at governance structure – albeit not one derived mainly from a framework designed for listed companies. The real amount of regulation needed for non-listed companies is a crucial issue that needs careful analysis.

3. **Should the EU seek to ensure that the functions and duties of the chairperson of the board of directors and the chief executive officers are clearly divided?**

The AMIC understands that board leadership structures vary greatly among countries, primarily due to applicable laws and regulations within each jurisdiction. However studies have yet to implicate any particular leadership model in the market failure of 2008. Many investors are choosing to emphasise the need for an independent judgement at the head of a corporate board. Today 40% of S&P 500 corporations separate the Chair from the CEO.

The AMIC would prefer a separation of the functions of the Chairman of the Board of

Directors and of the CEO for listed companies as this separation contributes to greater legal certainty and effective monitoring of the general management by the Board. However we believe that the UK model is appropriate. Although the UK calls for the separation of the roles, the 'comply or explain' provisions of its governance code allow companies to consider their unique circumstances and make the most appropriate determination.

4. **Should recruitment policies be more specific about the profile of directors, including the chairman, to ensure that they have the right skills and that the board is suitably diverse? If so, how could that be best achieved and at what level of governance, i.e. at national, EU, international level?**

From a corporate governance perspective, including more individuals with different backgrounds on Boards of Directors could improve boards' functioning. A diversity of backgrounds, experiences and perspectives should allow boards to bring a more diverse perspective to problems. However the AMIC believes that the chief objective of the recruitment of Boards' members is getting the right mix of skills and knowledge.

Indeed the primary responsibility of a Board is to increase shareholder value. When it comes to the selection of a new board member, companies should ensure that the best qualified person available is selected to fill the defined vacancy. Boards need to identify leaders who can help increase shareholder value, particularly in challenging times. Companies should balance between seeking out a specific skill sets and expertise to fit the needs of a company and ensuring the building of a diverse board.

The AMIC believes that boardroom diversity should be a natural evolution of corporate governance and best practice, and not driven by regulatory intervention.

5. **Should listed companies be required to disclose whether they have a diversity policy and, if so, describe its objectives and main content and regularly report on progress?**

The AMIC agrees that it would be helpful to understand a company's approach to diversity as a factor in the overall approach to employees and developing the people who are essential to the success of the business. In relation to the board specifically, the report of the Chairman or the nominating committee should discuss the board's policy on diversity in the context its own composition and objectives. From a diversity perspective as a shareholder, expertise, relevant business and industry experience and an ability to contribute to the work of the board ought to be the key considerations in appointing a director for the reasons laid out in question 4.

6. **Should listed companies be required to ensure a better gender balance on boards? If so, how?**

The AMIC would welcome more discussion by boards of their own objectives in relation to the blend of the appropriate blend of knowledge and skills on boards, as how gender diversity was considered. This should cover why those objectives were chosen, progress towards them and any obstacles faced. Another concern in relation to quotas is that the level set becomes the maximum rather than a target.

7. **Do you believe there should be a measure at EU level limiting the number of**

mandates a non-executive director may hold? If so, how should it be formulated?

The AMIC believes that to ensure the effectiveness of the Board, members should have professional skills and experience and time to prepare meetings and decisions. However limiting in law the number of mandates served by a non-executive director does not necessarily mean that directors will allocate more time, on average, to board work, nor that they would be better directors. Limiting board mandates would also have the effect of reducing the supply of directors and would probably lead to higher directors' fees, potentially for the same contribution. It may also be worth considering the impact of a limit at a time when the policy direction is to encourage more women into board rooms.

The chairman of the board, and where relevant the nominating committee, is best placed to determine whether a director is able to commit sufficient time to his or her duties at a company, both during normal times and times of crisis. In making that assessment, the specificities of a company, the role of the board and the precise role should be considered as will executive roles, other commitments outside business, such as charity work, and the number of board sub-committees on which a director serves.

8. **Should listed companies be encouraged to conduct an external evaluation regularly (e.g. every three years)? If so, how could this be done?**

In the current environment the AMIC believes all businesses need to ensure that their board is fully performing, not only in its role of overseeing and directing the affairs of the organisation, but also ensuring that it meets the appropriate interests of its shareholders. External evaluation by experienced practitioner is thought to be useful.

Traditionally the corporate governance debate has emphasised structural aspects of governance frameworks. Although the AMIC understands that such governance features have the advantage of being easy to measure and monitor from the outside company, other less tangible behavioural factors such as standards of chairmanship, the style of the boardroom conversation, and the attitudes of individual directors which define the board's contribution to business success and good governance. The AMIC believes that the complementary advantage of board evaluation as a governance tool is its potential ability to engage directly with the inner dynamics of the boardroom.

However the AMIC believes that in-house board evaluation may be useful in addressing some of the more straightforward areas of boardroom functioning e.g. relating to board processes and procedures. They may also be an adequate means of undertaking an interim review of progress between more rigorous board evaluations.

9. **Should disclosure of remuneration policy, the annual remuneration report (a report on how the remuneration policy was implemented in the past year) and individual remuneration of executive and non-executive directors be mandatory?**

The AMIC believes that transparency in remuneration policies is helpful as well as an explanation on how they have been implemented. The underlying philosophy and the rationale for these policies must be clearly explained especially in regard to the link between remuneration, performance and performance targets, and that risk has been taken into account. In addition the report should indicate the alignment of the interests

of management and shareholders. This should help shareholders to understand the behaviours that are being encouraged through incentives and to assess whether these seem appropriate given the company's stated strategy and peer group.

10. Should it be mandatory to put the remuneration policy and the remuneration report to a vote by shareholders?

The AMIC believes that the remuneration report should be put to a vote by shareholders. Shareholders should vote on new incentives plans and remuneration policies and on existing policies if they have been materially revised or if the board or a remuneration sub-committee has used discretion outside the bounds of the policy. However AMIC members are concerned that an annual vote on remuneration will pose the risk of crowding out discussion of governance issues that have a much closer link to long-term performance.

11. Do you agree that the board should approve and take responsibility for the company's 'risk appetite' and report it meaningfully to shareholders? Should these disclosure arrangements also include relevant key societal risks?

AMIC members believe that the board has a role in the governance of the risk management process and should have a full understanding of the risk and return profile of the company in the context of the stated strategy and broader market and industry conditions. The board should ensure that it receives sufficient information from management to be able to fulfil this role. We would prefer that the board explains how it oversees risk management and that management reports on the technical detail of the material risks the company faces and how these are managed. Societal risks that are material to the company's long-term performance should be discussed.

12. Do you agree that the board should ensure that the company's risk management arrangements are effective and commensurate with company's risk profile?

The AMIC agrees on the basis of our responses above.

13. Please point to any existing EU legal rules which, in your view, may contribute to inappropriate short-termism among investors and suggest how these rules could be changed to prevent such behaviour.

AMIC members do not believe that there is excessive short-termism in capital markets. Within the investment management industry there is a spectrum of different investment strategies, with different investment horizons, as dictated by client demand. Even investors with a relatively constant holding will, for instance, buy and sell at the margin for a number of reasons, including changes to client mandates, fund flows, rebalancing of an index or revised views on the prospects for a sector or a company. We believe it would be helpful to have an understanding of how long investors stay on the share register of companies even if their aggregate holding changes over time.

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.

In terms of EU regulatory themes that might be reviewed to encourage a long-term perspective, we would highlight the following: accounting standards, quarterly reporting requirements and tax regulations.

14. **Are there measures to be taken, and if so, which ones, as regards the incentive structures for and performance evaluation of asset managers managing long-term institutional investors' portfolios?**

The industry represented by the AMIC has, as mentioned previously, 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.

15. **Should EU law promote more effective monitoring of asset managers by institutional investors with regard to strategies, costs, trading and the extent to which asset managers engaged with the investee companies? If so, how?**

AMIC members believe that asset managers are generally well monitored by institutional investors. They are in fact assisted in many markets by investment consultants who are generally well informed about a range of asset managers in terms of performance, fees, incentive arrangements and personnel. However the AMIC supports steps to make disclosure requirements more consistent across Member States in relation to reporting to clients dealing and fund management costs, commission allocation and other aspects of managing an investment mandate that might be of interest.

16. **Should EU rules require a certain independence of the asset managers' governing body, for example from its parent company, or are other (legislative) measures needed to enhance disclosure and management of**

conflicts of interest?

The regulatory principle of strict separation between the activities of trading securities and advisory activities within credit institutions already exists. In addition the FRC Stewardship Code includes a principle on this issue, namely *principle 2: Institutional Investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be disclosed.* The AMIC believes that the disclosure requirements as well as the regulatory approach are appropriate measures for the disclosure and management of conflicts of interest.

AMIC members usually maintain a conflicts of interest policy which aims to identify and address all potential conflicts, including those that arise as a result of share ownership and the active engagement with companies. In particular, this policy aims to address the controls surrounding sensitive information obtained as a result of exercising Stewardship responsibilities as well as conflicts that could arise as a result of existing relationships with the parent or an affiliated company. Policies are usually made available to clients on request.

17. What would be the best way for the EU to facilitate shareholder cooperation?

'Acting in concert' is a vague and broad concept which in fact differs from jurisdiction to jurisdiction and is ultimately interpreted by national courts. It requires "sub-group" aggregation, i.e. full aggregation of all holdings amongst all participating entities. If this principle is disregarded, a shareholder faces adverse consequences such as loss of voting rights, claims for damages by other shareholders or the issuer, involuntary takeover bids.

There is a strict EU regulatory framework for 'acting in concert', with the potential consequence to make an obligatory take-over bid over a 30% threshold of ownership. The AMIC believes that the European Commission should clarify the legal situation and constraints in each jurisdiction.

In fact AMIC members would welcome more shareholder cooperation in engagement. In addition to clarification of the EU understanding of how shareholders and companies should conduct themselves; the confidentiality of views exchanged; and the role of various external parties such as regulators and the media, some AMIC members proposed that the EU could also set up a 'Corporate Governance Forum 'on which major European institutional investors and asset managers interested in governance and engagement sit. Under the Forum auspices, experiences could be shared and lessons learned taken back to domestic markets to advance practices across Europe.

18. Should EU law require proxy advisors to be more transparent, e.g. about their analytical methods, conflicts of interest and their policy for managing them and/or whether they apply a code of conduct? If so, how can this best be achieved?

The AMIC believes that proxy firms perform an inevitable – and often valuable – part of enabling shareholders to optimizing the monitoring role of investors in a more cost efficient way. Proxy advisors are able to monitor the voting rights attached to dispersed portfolios of institutional investors.

AMIC members also believe that proxy advisors could generally do more to explain their approach to policy development and implementation, their level of engagement with clients and with companies, as well as their overall business model. This would best be achieved through enhancing the disclosure on their website. The AMIC would expect proxy advisors to be more transparent about the criteria used to analyse resolutions and issue voting recommendations.

19. **Do you believe that other (legislative) measures are necessary, e.g. restrictions on the ability of proxy advisors to provide consulting services to investee companies?**

AMIC members consider that conflicts of interest should be managed appropriately and the disclosure measures suggested above should be implemented.

20. **Do you see the need for a technical and/or legal European mechanism to help issuers identify their shareholder in order to facilitate dialogue on corporate governance issues? If so, do you believe this would also benefit cooperation between investors? Please provide details (e.g. objective(s) pursued, preferred instrument, frequency, level of detail and cost allocation).**

AMIC members expect that issuers will have good knowledge of their shareholders through reporting obligations of disclosure thresholds and declarations of intent.

However the AMIC would support the introduction of a European-wide mechanism for companies to identify their shareholders below the existing threshold for ownership disclosures. The purpose of this mechanism should be to enable companies to identify those in the ownership chain taking investment decision and decisions on voting at shareholder meetings. If this information were made public, on the company's website for instance, it would also enhance the ability of shareholders to communicate with one another and to engage collectively with companies. We would note that carefully thinking needs to be given to the structure of the mechanism to ensure that it could not be used by companies inappropriately.

21. **Do you think that minority shareholders need additional rights to represent their interests effectively in companies with controlling or dominant shareholders?**

AMIC members agree that the interests of minority shareholders need particular protection in relation to capital management (in particular share issuance such that they are not materially diluted) and governance controls.

However the AMIC would also like to note that the EU landscape offers a fragmented picture as regards the need for further development for protection of minority shareholder. In some countries minority shareholder protection is already well developed. Other countries are still searching for methods to foster more active capital market mechanisms to promote more widely-held shareholdings, whereas other markets are in search of more long-term oriented block-holders. Therefore more could be done to ensure consistent shareholder rights across Europe, in order to reduce unnecessary risks of equity investment and thus make it more attractive and a more effective driver of economic growth.

22. **Do you think that minority shareholders need more protection against related party transactions? If so, what measures could be taken?**

The AMIC agrees that minority shareholders need more protection against related party transactions.

23. **Are the measures to be taken, and if so, which ones, to promote at EU level employee share ownership?**

The AMIC believes this is a question that should be addressed at company level.

24. **Do you agree that companies departing from the recommendations of corporate governance codes should be required to provide detailed explanations for such departures and describe the alternative solutions adopted?**

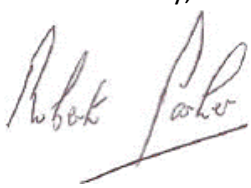
The AMIC has publicly supported the 'comply or explain' approach. The approach allows for sufficient flexibility to accommodate different investment strategies, approaches and models while providing asset owners with relevant information on the investment manager's approach to engagement to make an informed decision when appointing a manager. The success of the 'comply or explain' approach is based on good quality, detailed explanations for not adopting accepted best practice.

25. **Do you agree that monitoring bodies should be authorised to check the informative quality of the explanations in the corporate governance statements and require companies to complete the explanations where necessary? If yes, what exactly should be their role?**

Monitoring bodies could usefully be authorised to check the quality of the explanations given by companies for adopting approaches at variance with accepted best practice. At the same time, it is shareholders who have the vested interest to ensure such disclosure is adequate and to engage to encourage improved reporting. AMIC members suggest that the role of monitoring bodies might best be to investigate referrals of poor disclosure from shareholders and require improvement within a specified period. They do not believe that monitoring bodies are currently well equipped to be the initiator of such actions.

The AMIC would be happy to discuss further with you the points made in this letter. The Secretary of the AMIC, Nathalie Aubry-Stacey, can be reached at Nathalie.aubry-stacey@icmagroup.org should you need further information.

Yours sincerely,



Robert Parker
AMIC Chairman