European Commission's Proposals for a Revised Shareholder Rights Directive
Position Paper by the Investment Management Association

EXECUTIVE SUMMARY

- The Investment Management Association (IMA) represents the asset management industry in the UK. IMA members are responsible for the management of approximately £4.5 trillion (€5.6 trillion) of assets, which are invested on behalf of clients globally and manage holdings amounting to 30% of the domestic equity market.

- IMA supports the objectives of the revised Shareholder Rights Directive (SHRD) in seeking to contribute to the long-term sustainability of EU companies, create an attractive environment for shareholders and improve the efficiency of the equity investment chain. These objectives mirror those in the EU Green Paper on Long Term Financing.

- We strongly support harmonised shareholder rights in relation to related party transactions (paragraphs 6.1 to 6.2 of this paper) and directors' remuneration (paragraphs 5.1 to 5.8). These are important areas of corporate governance and consistent rights and disclosures should improve investors' confidence and the attractiveness of the European capital markets internationally. There are other matters that could be helpfully looked at in order to improve ownership rights on a pan- European basis such as: ***the class test provisions; the impediments to voting; the right of pre-emption; access to boards; 'one share one vote'; and concert party rules.*** We would welcome these matters being clarified/ addressed (paragraphs 1.16 to 1.27).

- We also support measures to improve engagement through a requirement for Institutional Investors (IIs) and Asset Managers (AMs) to disclose their engagement policy publicly or explain why they do not have one (paragraphs 1.1 to 1.3). Whilst we consider the detail of the policy would be best addressed in a voluntary code, IIs and AMs approach to engagement should have a legislative underpin. AMs have a fiduciary duty to protect and enhance the value of the assets entrusted to them and constructive engagement is an important means of achieving that.

- Enhanced ownership rights, together with more engaged shareholders, will help ensure the proposed SHRD's objectives are met. A pan-European approach to these measures is important to our members in that they hold €420 billion of equities on behalf of clients in European companies outside the UK. We would be concerned if these measures were to be diluted in any way.

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- Many of the proposals focus on improving transparency. IMA fully supports transparency and indeed has undertaken a number of its own initiatives to enhance disclosures by the asset management industry, such as in the IMA SORP and the Pension Fund Disclosure Code (see Annex 1). To be effective in raising standards, transparency needs to be meaningful and we have concerns about certain of the disclosures proposed for IIs and AMs in the revised SHRD.

- The transparency required of IIs and AMs in Articles 3g and 3h aim to address a perceived misalignment of incentives and focus on short term performance.

  In this context, AMs are fiduciaries acting on behalf of their clients, IIs. The II sets the terms of the AM's mandate specifying how it wants its money managed and how the AM should report. Costs are negotiated between the II and the AM, and the AM reports to the II on the implementation of the strategies, costs, trading and the extent to which it engages with investee companies as agreed between the parties. The AM must adhere to the terms of the mandate and be transparent to its clients. ***AMs already have extensive obligations to report to their clients/ beneficiaries*** many of which are prescribed in EU legislation (see last bullet below). ***We do not consider the SHRD needs to include such requirements for AMs.***

- Nor is it clear what the public interest is in requiring IIs to make their "equity investment strategy" and their "arrangements with their AMs" public (Article 3g). As regards the latter, an II appoints an AM on the basis of the AM's investment strategy. That strategy is the AM's main service to its client and it is unlikely to want it made public – particularly to its competitors. A requirement to do so could potentially impact the EU's competitiveness as compared to third countries (paragraphs 3.1 to 3.6). At the most, in the interests of reinforcing IIs' fiduciary obligations to their beneficiaries***, IIs could be required to disclose their policy on asset allocation, and include in this their approach to risk as well as their stewardship policy, if any.*** Such a requirement should not be in the SHRD but incorporated into the Life Assurance Directive and the Directive for Institutions for Occupational Retirement Provision in the interests of ensuring a coherent framework.

- Specifically, Article 3f requires the ***results of IIs' and AMs' engagement*** to be disclosed publicly. We welcome the flexibility in the Article in that it does not prescribe the detail to be given. However, in requiring the disclosure to be annual, there are concerns that disclosing an engagement with a particular company too early could undermine the process due to the sensitivity of the issues and the confidentiality necessary (paragraphs 1.9 to 1.12). We would welcome more ***flexibility as to when the disclosure has to be made.***

- Lastly, AMs are regulated entities subject to EU financial services legislation such as MiFID, AIFMD and UCITS. These Directives contain similar disclosure requirements to those now proposed in the SHRD. At a minimum, the proposed ***disclosures in the SHRD should be aligned and be consistent with existing legislation***. Alternatively, where disclosures are not addressed in existing legislation, or where there are differences, then in the interests of ensuring a coherent framework, ***any new proposals should be incorporated into existing legislation as opposed to creating new legislation*** (paragraphs 1.6 and 1.7, 2.2 to 2.5).

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1. TRANSPARENCY – ENGAGEMENT POLICY, IMPLEMENTATION AND RESULTS (ART. 3F)

AMs and IIs to have an engagement policy

IMA supports IIs and AMs being required to develop a policy on shareholder engagement which is public or explain why they do not have one. Whilst we consider the detail of the policy would be best addressed in a voluntary code, IIs and AMs approach to engagement should have a legislative underpin.

In many instances the proposed disclosures are already addressed in EU financial services legislation. Where this is the case, at a minimum the disclosures proposed in the SHRD should be aligned and be consistent with existing legislation. Where they are not, or where there are differences, then any new proposals should be incorporated into existing legislation in the interests of ensuring a coherent framework.

1.1 IMA supports the objective of the revised SHRD in seeking to increase the level and quality of engagement. More engaged shareholders, together with companies that operate with high standards of governance and transparency, should enhance the attractiveness of the EU market and drive economic growth. AMs have an important role to play in this and we welcome them being required in Article 3f to disclose publicly their engagement policy. This means that an AM's clients and prospective clients will be clear as to the AM's approach.

1.2 It is important that, as proposed, this should be on a comply or explain basis and where IIs or AMs do not have an engagement policy, they should be able to explain why not. AMs act as fiduciaries on behalf of their clients and as such have a duty to operate in the best interests of, and deliver value to, those clients. In terms of engagement, some actively engage with investee companies to achieve better returns, whereas others believe their interests are upheld by selling their holding. This is not, however, to say there is a simple division of views – rather there is a spectrum. How an AM manages its clients' money is between the manager and its clients and a diversity of approaches is an important part of the functioning of an efficient market.

1.3 It should also be noted that, as acknowledged in the Impact Assessment, whilst some IIs may conduct engagement in house, the majority outsource it to AMs[1]. This is often to more than one AM in the interests of ensuring diversification. As each AM may have a different approach, it could be difficult for an II to disclose the information expected - albeit it is open to it to give a reasoned explanation. Similarly, an AM can have a number of II clients, each of which can mandate that the AM adopts a different approach such that an AM can have the same problem.

1.4 However, whilst we support the objective behind Article 3f, we have concerns about certain of the detail.

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1. Transparency – engagement policy, implementation and results (Art. 3f)

1.5 First, the Article specifies the matters to be disclosed in the engagement policy. These include the policy on: integration into the investment process; monitoring investee companies; entering into a dialogue; exercising voting rights; cooperating with other shareholders; and using proxy advisors. These matters are already addressed in existing codes on engagement such as: the EFAMA Code for External Governance of 2011; and the Financial Reporting Council's UK Stewardship Code of 2010[2]. Specifying disclosures in a Directive does not afford the flexibility that there is with a non-statutory code. Thus whilst we support a legislative underpin for an II's or AM's approach to engagement, we believe the details of any such policy should be set out in a code, such as the EFAMA Code, that can be more readily changed to reflect developments over time.

1.6 Secondly, aspects of the proposals overlap with duties under existing EU Directives. For example, for assets managed in funds, both the AIFM Regulation and the UCITS Implementation Directive include requirements to develop strategies for monitoring corporate actions, and to ensure the exercise of voting rights is in accordance with investment objectives and AIF policy (Article 37 of the AIFM Regulation and Article 21 of the UCITS Implementation Directive). There are also detailed requirements relating to conflicts of interest (Article 23 of MiFID; Article 14 of the AIFMD; Article 30 et seq. of the AIFM Regulation; and Article 17 et seq. of the UCITS Implementation Directive). Moreover, AMs under MiFID are required to exercise voting rights if there is a specific agreement to do so.

1.7 Thus in many instances the proposed disclosures in the draft SHRD are already addressed in EU financial services legislation. Where this is the case, at a minimum the disclosures proposed in the SHRD should be aligned and be consistent with existing legislation. Where they are not, or where there are differences, then any new proposals should be incorporated into existing legislation in the interests of ensuring a coherent framework. Indeed, including similar requirements that apply to the same types of entity in different Directives runs contrary to the Parliament's stated aim of improving the coherence of EU financial services legislation.

IIs and AMs to disclose implementation of engagement policy and results

IMA supports IIs and AMs being required to disclose how they have implemented their engagement policy. As regards the requirement to disclose the results, we welcome the flexibility as to what is disclosed in that the proposed SHRD does not prescribe the detail. However, it does require that the disclosures are annual and we are concerned that public disclosure of an engagement with a particular company too early could undermine the process due to the sensitivity of the issues. To address this, there needs to be flexibility as to the timing of the disclosure.

1.8 IMA supports IIs and AMs disclosing how they have implemented their engagement policy. Over the last four years IMA has reported on the activities that underlie IIs'

[2] It is a requirement of the UK's Financial Conduct Authority that UK authorised asset managers disclose their commitment to the Stewardship Code or their alternative investment strategy (FCA COBS Rule 2.2.3R).

and AMs' commitment to the UK's Stewardship Code (IMA's Stewardship Survey). The first report looked at the position as at 30 September 2010, the second as at 30 September 2011, the third as at 30 September 2012 and the fourth as at 30 September 2013. These reports analyse how respondents have implemented the Code and have clearly demonstrated progress, for example, respondents are increasingly transparent and better resourced. We are currently undertaking a fifth exercise in respect of 2014.

1.9 Article 3f goes further than this and requires IIs and AMs to disclose publicly the results of their engagement annually. IIs and AMs that follow the EFAMA Code for external governance and/or the UK's Stewardship Code are already expected to report to their clients and/or beneficiaries on their engagement and voting activities. IMA's Stewardship Survey demonstrates that all but one respondent report to their clients/beneficiaries. The one that does not is quite specialist and makes the information available to clients on request.

1.10 It should also be noted that it can be difficult to determine and attribute the results of shareholder engagement. Company share prices and performance are driven by many factors of which shareholder engagement is only one.

1.11 We welcome the flexibility in the proposed SHRD as to what is disclosed in that it does not prescribe the detail. Much of the engagement process is carried on in private as certain of these issues can be confidential. (IMA's Survey anonymises individual respondents in the collation of results.)

1.12 However, the proposals require the disclosure to be annual. We are concerned that public disclosure of an engagement with a particular company too early could undermine the process due to the sensitivity of the issues. Moreover, public knowledge of a disagreement with investee company management may have an adverse effect on shareholder value without solving the disagreement. To address this concern there also needs to be flexibility as to the timing of the disclosure.

IIs and AMs to disclose how votes were cast

IMA considers that requiring IIs and AMs to disclose publicly if and how they cast their votes in each company in which shares are held risks an II or AM that may not be inclined to vote, doing so without necessarily giving due consideration to the issues in order to be seen to be voting. It would also be onerous for IIs and AMs to have to explain each vote cast and we believe it should be sufficient for the II or AM to refer to its voting policy and explain contentious votes such as those against or abstained.

Moreover, there are other matters that could be helpfully looked at in order to improve ownership rights on a pan- European basis such as: the class test provisions; the impediments to voting; the right of pre-emption; access to boards; 'one share one vote'; and concert party rules. We would welcome these matters being clarified/ addressed.

1. TRANSPARENCY – ENGAGEMENT POLICY, IMPLEMENTATION AND RESULTS (ART. 3F)

1.13 The UK Stewardship Code is applied on a comply or explain basis and expects signatories to have a clear policy on public disclosure of voting activity.

1.14 IMA's Stewardship Survey shows that the Code is effective in that the number of AMs and IIs that disclose publicly voting information is increasing and where respondents do not disclose, they increasingly give a reason as to why not. Specifically, the Code allows situations where votes are not disclosed because of an active decision not to disclose in a particular instance to be distinguished from those where no disclosure is made because of a general policy to refrain from voting.

1.15 It is important that when IIs and AMs vote their shares they do so in an informed manner. The proposed SHRD requires IIs and AMs to disclose votes cast in relation to each company in which shares are held. Whilst it allows an explanation where IIs and AMs decide not to disclose how particular holdings were voted, we consider there is a risk that requiring vote disclosure could drive an II or AM that may not be inclined to vote, to do so without necessarily giving due consideration to the issues in order to be seen to be voting. This could dilute the impact of those votes that have been exercised in a considered manner. This was the experience in the US in that since mutual funds were required to disclose their votes, all but a notable minority tended to outsource their voting decisions to proxy voting advisors. Other points to consider are:

- *Disclosure could result in mechanistic reporting.* The requirement could result in pages of statistics and tables.

- *A particular block of shares may be voted different ways*. AMs act for different clients, and can, therefore, vote a particular block of shares different ways. For example, some beneficial owners give AMs discretion to vote, some give specific instructions and some ask that the recommendations of a particular voting service are followed. An AM could thus end up disclosing that "some shares were voted against, some were voted for and some were consciously withheld". IIs may also appoint a number of AMs to manage their investments each of which is given discretion to vote. Thus, a particular block of shares owned by the II may be voted different ways by different AMs.

- *Disclosure could be costly.* There would be costs of: setting up systems; determining whether votes have been cast; vetting the information; and monitoring compliance with legal requirements. These costs are likely to be significant. We understand from one AM that it takes 16 man weeks (four people working full-time for four weeks) to verify voting information that is required to be disclosed in respect of its US mutual funds. The proposal also requires an explanation of voting behaviour. To disclose an explanation for each vote cast would be onerous and we believe it should be sufficient for the II or AM to refer to its voting policy and explain contentious votes such as those against or abstained.

- *Difficulties in disclosing whether votes have been cast.* Resolutions can be decided on a show of hands with the result that unless a poll is called, an instruction to vote may not be cast. In addition, voting instructions go through a chain – the beneficial owner, an AM, a custodian, the custodian's nominee, a registrar and possibly a proxy voting service – which makes it difficult for those initiating instructions to determine whether the instruction has been received let alone cast. The most an II or AM could disclose is their voting instruction. In addition, these matters need to be addressed in order to enable votes to be confirmed as proposed in Article 3c.

- *Votes "against" can be an indication that engagement has not been effective.* The statement in the Impact Assessment that "the low level of dissent in shareholder meetings may be an indication of sub-optimal shareholder engagement[3]" seems to imply that votes against are indicative of better engagement. In fact often the reverse is true. A vote against is more likely to be an indication that the engagement has not been successful in that, in spite of entering into dialogue with company management, the position was not resolved and the shareholder had to lodge a vote against.

- *Disclosure of voting records means that holdings are disclosed.* The disclosure of holdings could result in IIs, AMs or their clients facing the risk of inappropriate pressure by special interest groups.

- *Whose information is it?* There are questions over who owns the voting information concerned and the rights of AMs as agents to disclose that information to third parties. Nor is it clear what the public interest is in requiring IIs and AMs to disclose their votes publicly.

Other measures to enhance engagement

1.16 Whilst we support the objective behind Article 3f, we are concerned that when addressing shareholder engagement there is too much focus on the 'softer' aspects, such as transparency and proxy voting, rather than the 'harder' aspects, such as rights in relation to the issue of capital and making of/accepting offers/partial offers. The matters that we consider could be addressed/clarified on a pan-European basis to facilitate engagement and long term value creation are set out below.

1.17 First, the ***class test provisions*** which safeguard shareholders' rights when they could potentially be diluted. In the UK under this regime, major transactions are graded into four classes depending on their size. For example, for class 1 transactions, which include major acquisitions or disposals and reverse takeovers, shareholder approval must be obtained and the matter voted on. We strongly support this regime as it gives shareholders the opportunity to exercise, through voting, an active influence over a company on a matter which could significantly affect the value of their investment. We would welcome its introduction throughout the EU.

1.18 Secondly, there are a number of ***barriers to voting*** as set out below:

- *Share blocking.* Share blocking is an obstacle to voting as few want to be 'locked-out' of the market for any period of time. Although the 2007 SHRD was

[3] Page 18 Impact Assessment

largely effective in prohibiting share blocking, it still continues in certain markets such as Iceland, Luxembourg, Norway and Switzerland (although Iceland, Norway and Switzerland are not in the EU).

Germany also operates a practice called 'settlement restriction'. This allows a trade to be executed that does not settle until after the vote has been registered. This increases the risk of a failed settlement which can carry penalties and auto buy-in in some markets. To reduce this risk, some custodians do not satisfy delivery obligations until after the AGM - essentially blocking the trade.

- *Record date*. In effect share blocking was to be replaced with a record date. Although not an obstacle as such, practices around when the record date is set vary. There are concerns that a date far in advance of the meeting date runs the risk that the right to vote remains with someone who has no continuing economic interest in the shares - a person may vote but then dispose of his shares and not have an economic interest in the company when the vote is registered. It also disenfranchises new shareholders when a purchase settles between the record and meeting date.

- *Re-registration and powers of attorney*. Certain countries still require shares to be re-registered before they can be voted. For example, in Denmark voting rights cannot be exercised if the shares are held in an omnibus accounts until the shares are registered and a power of attorney is in place. Although in Finland and Sweden, the voting instruction itself serves to re-register the shares, complex deadlines and requirements for a power of attorney in Sweden make it difficult for overseas shareholders to vote.

1.19 These impediments should be addressed.

1.20 We also believe it is important that the objective of a further shareholder right is retained throughout the EU - the ***right of pre-emption***. In Europe, continental companies tend to have a more concentrated ownership model. But regardless of whether a shareholder is a minority or majority shareholder there is a need to protect their interest and avoid dilution. The right of pre-emption should be enforced throughout the EU.

1.21 As regards, shareholders' engagement with companies, boards of EU companies are often reticent to enter into a dialogue with shareholders whose concerns can be directed via investor relations. It would be helpful if there was guidance that directors, either individually or collectively, should be open to meet with shareholders and enter into a dialogue and that ***shareholders have access to directors***.

1.22 In addition, the right to '***one share, one vote***' is not followed throughout the EU. In the interests of promoting shareholder democracy, we believe that shareholders should be given rights in proportion to their capital investment, i.e. there should be 'one share, one vote'. This is important to achieving good governance and the effectiveness of the "comply or explain" regime.

1. TRANSPARENCY – ENGAGEMENT POLICY, IMPLEMENTATION AND RESULTS (ART. 3F)

1.23 Lastly, a matter which needs to be addressed to enable shareholders to carry out their role across borders is the ***concert party rules***. The rules in some Member States are uncertain or indeed actively hostile to cooperation between shareholders and the recent ESMA guidance on shareholder co-operation and acting in concert and the directive on takeover bids is welcome. However, there are still concerns about collective shareholder action in relation to banks and other financial institutions being impacted by the Acquisitions Directive which was implemented across the EU on 21 March 2009.

1.24 The Acquisitions Directive reformed the provisions of the EU sectoral directives requiring regulatory approval before a shareholder acquires a direct or indirect "qualifying holding" in a bank, investment firm or insurance company (broadly speaking a holding of 10 per cent or more of the shares or voting rights - the UK transposition uses the term "control" instead of qualifying holding but is otherwise substantially the same). The amended sectoral Directive provisions state: *"Member States shall require any natural or legal person or such persons acting in concert (hereinafter referred to as the proposed acquirer), who have taken a decision either to acquire, directly or indirectly, a qualifying holding in [an insurance undertaking, credit institution, etc.]...first to notify the competent authorities..."*

1.25 The Directive does not seek to define when a person is "acting in concert" for these purposes. However, the EU Level 3 Committees have given guidance on this issue. Appendix 1 states: *"In the particular context of Directive 2007/44/EC, persons are 'acting in concert' when each of them decides to exercise his rights linked to the shares he acquires in accordance with an explicit or implicit agreement made between them. Notification of the voting rights held collectively by these persons will have to be made to the competent authorities by each of the parties concerned or by one of these parties on behalf of the group of persons acting in concert."*

1.26 This definition can affect s' ability to cooperate, as even an ad hoc agreement or understanding to vote together on any issue could result in the parties being treated as "acting in concert". They would, therefore, need prior regulatory approval to enter into that agreement or understanding if their holdings together exceed 10 per cent (or if, while the agreement or understanding subsists, either of them acquires additional shares that takes their aggregate holding over this threshold).

1.27 The procedures and processes and time taken for such approval can be an impediment to collective engagement. To address these concerns, it would be necessary to revise the guidance to clarify that the Directive's provisions are not triggered by an ad hoc agreement or understanding to vote together on a particular issue.

2. Transparency – AMs to IIs (Art. 3h)

AMs to disclose to IIs half yearly

IMA fully supports transparency. The transparency required of AMs in Articles 3g and 3h aim to address a perceived misalignment of incentives and focus on short term performance.

AMs are fiduciaries acting on behalf of their clients, IIs, and must adhere to the terms of the mandate set and be transparent to their clients. AMs already have extensive obligations to report to clients/ beneficiaries many of which are prescribed in EU legislation. As such, we do not consider the proposed SHRD needs to require AMs to report to their clients/ beneficiaries.

In the event that the proposed SHRD is to include such disclosures then, at a minimum, they should be aligned and be consistent with existing legislation. Alternatively, where disclosures are not addressed in existing legislation, or where there are differences, then in the interests of ensuring a coherent framework, any new proposals should be incorporated into existing legislation as opposed to creating new legislation.

AMs are already required to make detailed disclosures

2.1 IMA supports the principle behind Article 3h in that AMs should, and indeed do, report to their clients on how they have discharged their responsibilities under the II's mandate.

2.2 The proposed SHRD defines an AM as an investment firm within meaning of Article 4 of MiFID, an alternative investment fund manager as defined by Article 4 of AIFMD, a management company as defined by Article 2(1) of the UCITS Implementation Directive, or investment company authorised pursuant to, and provided it has not designated a management company for its management, the UCITS Implementing Directive.

2.3 These Directives already contain extensive obligations for AMs to report to clients/ beneficiaries. Funds also have to make certain information public. As such we do not consider the proposed SHRD needs to require AMs to report to their clients/ beneficiaries. For example, in relation to the specific disclosures proposed:

- *Investment strategy and its implementation and portfolio composition* (paragraphs 1 and 2b). AMs are already required under MiFID (Article 25), AIFM Regulation (Article 105) and UCITS Implementation Directive (Article 69) to report to their II clients on their investment activities and on the portfolio composition.

- *Portfolio turnover costs (*paragraph 2d). Article 24 of MiFID, Article of 23 1(i) of AIFMD and Annex 1 of the UCITS Implementation Directive already requires the disclosure of fees, charges and expenses. Moreover, in accordance with the

2. TRANSPARENCY – AMS TO IIS (ART. 3H)

UCITS Directive[4] the simplified prospectus which is required for funds with a UCITS passport has to set out portfolio turnover rate.

- *Conflicts of interest that have arisen in connection with engagement activities and how dealt with* (paragraph 2f). As noted in paragraph 1.6, there are already detailed requirements in MiFID, AFMD, the AIFM Regulation and the UCITS Implementation Directive on conflicts of interest.

2.4 Moreover, the UK industry has drafted its own guidelines to further improve transparency: the IMA SORP and the Pension Fund Disclosure Code. We set out in Annex 1 the requirements/guidelines for AMs to report to clients/underlying beneficiaries in respect of both segregated mandates, where assets are managed on a discretionary basis, and funds.

2.5 In the event that the proposed SHRD is to include such disclosures at a minimum, they should be aligned and be consistent with existing legislation. Alternatively, where disclosures are not addressed in existing legislation, or where there are differences, then in the interests of ensuring a coherent framework, any new proposals should be incorporated into existing legislation as opposed to creating new legislation.

2.6 Our observations on other of the disclosure requirements are set out below.

- *Targeted portfolio turnover or turnover range and the method used to calculate (paragraph 2c).* We understand that the aim in requiring targeted portfolio turnover to be disclosed is to encourage AMs to be less short term5. As noted below, we do not consider AMs are necessarily short term. Moreover, setting targeted portfolio turnover could give rise to an incentive to sell holdings to ensure that the target is achieved when the investments may be performing well. In the event targeted turnover is to be disclosed then it will be important to have a single methodology so that clients can compare the disclosures.

- *Policy on securities lending and implementation thereof (paragraph 2e).* The UK's Stewardship Code requires that those that adhere to it disclose their policy on securities lending in their stewardship policy. We consider that this is a more appropriate location for a policy - policies do not tend to change much over time and do not need to be reported six monthly unless there has been a change.

- *Whether or not and if so how, the AM uses proxy advisors for their engagement activities (paragraph 2g).* This largely repeats the disclosure in the engagement policy in Article 3f. As for the policy on securities lending, we consider the use of proxy advisors is not likely to change over time and as such, it does not need to be reported six monthly.

2.7 Lastly, the proposed SHRD states that it applies to IIs and AMs to the extent that they invest, directly, or through a fund - a UCITS or AIF - in shares. It is not clear how the disclosures will work when an AM with a segregated mandate invests in a

[4] As amplified by Commission Recommendation 2004/384/EC
[5] Page 23, Impact Assessment

fund run by another manager or where that second manager operates a fund of funds, given the detailed reporting requirements outlined.

The agency nature of asset management

2.8 From the Commission's Impact Assessment, we understand that the increased transparency proposed seeks to address what is described as "the agency problem[6]" when IIs delegate to AMs in that the misalignment of incentives results in short–termism. In this context, we believe it may be helpful to explain how the asset management industry operates.

2.9 AMs have a broad set of roles and responsilbities in terms of the transmission of capital. However, their primary responsibility is to their clients, be they individuals or institutions. In pooling their clients' funds, AMs reduce clients' risk exposures by diversifying their savings into multiple asset classes, provide them with liquidity in otherwise illiquid assets, and reduce costs by trading in large blocks of securities.

2.10 An AM invests on behalf of its clients in corporates which in turn seek to generate value that exceeds the cost of capital. The AM, in both the retail and institutional markets, is generally remunerated on the basis of an *ad valorem* fee, representing a fixed percentage of assets managed. The AM's incentives are, first, to retain the business long-term and, secondly, to increase the value of the client's assets over time either as the client gives it more money to manage or if the value of the portfolio increases. Thus the better the companies perform; the better returns clients achieve which in turn means that the AMs are better remunerated. Particularly in the institutional market, these *ad valorem* fees may be supplemented by performance fees. Typically these are based on rolling three-year performance figures; in some cases any period of underperformance must be followed by making up the "lost" return before any performance fee is payable.

2.11 Thus rather than there being a misalignment of interests, an AM's interests are in fact aligned with those of its clients.

2.12 Nor do we believe the case has been made that there is a problem of short-termism. We note the reference to holding periods of 8 months[7]. The source cited provides no analysis in support of this conclusion, and in any case, turnover figures can be a misleading indicator of how long an AM holds particular stocks, and may be distorted by the inclusion of trading by other investors with explicit short term strategies. In recent years, there has been a growth of alternative investment strategies, for example, hedge funds and other investors pursuing "quantitative" strategies which may involve turning over portfolios more rapidly. These strategies shorten average holding periods across the market even if the behaviour of most AMs is unchanged.

2.13 In different circumstances AMs may be long or short term, both in terms of the average holding period of individual securities and the techniques used to gain

[6] Page 22 Impact Assessment
[7] Page 22 Impact Assessment

2. TRANSPARENCY – AMS TO IIS (ART. 3H)

economic exposure to securities. Where AMs are long term is in the nature of the agency relationship and their ultimate goal of achieving a track record of delivering returns for their clients. Thus whilst strategies vary widely, the majority of IMA members use approaches that are characterised by long term holdings as a core part of their portfolio management process. Indeed this is the essence of "active" fund management – the AM seeks to identify stocks which are under-priced by the market and buys them in the expectation that over time the return will be greater than that of the market as a whole. An AM does not have an incentive to over-trade portfolios in that the associated costs can reduce investment performance (and hence a firm's competitiveness in attracting clients) and its revenues, because of the *ad valorem* nature of fees.

2.14 In summary, the majority of AMs investing in equities continue to manage their clients' money in ways that seek to build value over the long term, whether those clients are institutional investors like pension funds or investors in retail funds. They do so because it is in their interests to keep their clients by delivering sound performance over the longer term. Thus AMs are not necessarily short term and we do not believe measures are needed to address this. We set out in Annex 2 our further evidence to that effect.

3. TRANSPARENCY – IIS' INVESTMENT STRATEGY AND ARRANGEMENTS WITH AMS (ART. 3G)

Public disclosure of IIs' investment strategy

As regards requiring IIs to disclose publicly how their equity investment strategy is aligned with the profile and duration of their liabilities, an II will allocate investments into various asset classes, for example, fixed income or equity. Whilst fixed income/cash-flow generating investments may match the cash flows and/or the duration of an II's liabilities, equity investments do not have durations per se, and thus do not form part of an II's matching strategy. Regulation has also tended to drive IIs into fixed income investments at the expense of equities.

Moreover, an II's equity investment strategy is proprietary information which the II is likely to be reticent to make public. At the most, in the interests of reinforcing IIs' fiduciary obligations to beneficiaries, IIs could be required to disclose their policy on asset allocation, and include in this their approach to risk as well as their stewardship policy, if any. In the interests of ensuring a coherent framework, IMA does not consider such requirements should be in the SHRD but should be incorporated into the Life Assurance Directive and the Directive for Institutions for Occupational Retirement Provision.

3.1 As noted, IMA supports transparency but we do not believe that IIs should be required to disclose publicly how their "equity investment strategy is aligned with the profile and duration of their liabilities and contributes to the medium to long term performance of their assets".

3.2 Depending on the profile of their liabilities an II will allocate investments into various asset classes (asset allocation). Whilst an II will buy fixed income/cash-flow generating investments to match the cash flows and/or the duration of its liabilities, equity investments do not have durations per se, and thus do not form part of an II's matching strategy. Regulation has also tended to drive IIs into fixed income investments at the expense of equities. For example:

- Solvency requirements have particularly impacted insurers obliging them to shift from holding shares to bonds and other assets.
- Pension fund accounting requires pension scheme assets to be marked to market, whilst liabilities are discounted using AA-rated bond yields. This caused pension schemes to move out of equities into bonds to better match their liabilities.
- Tax systems can act as a disincentive to invest in shares. Thus with an investment in shares there can be a stamp tax on purchase, the dividend income can be taxed and paid out of profits that have been subject to corporation tax, and there can be tax on any gain on sale. Bonds and cash on the other hand are only subject to income tax.

The proposal would, therefore, be an artificial construct of little value.

3. TRANSPARENCY – IIS' INVESTMENT STRATEGY AND ARRANGEMENTS WITH AMS (ART. 3G)

3.3 Moreover, an II's equity investment strategy is proprietary information which the II is likely to be reticent to make public. As such, this requirement could result in standardised disclosures. At the most, in the interests of reinforcing IIs' fiduciary obligations to their beneficiaries, IIs could be required to disclose their policy on asset allocation, and include in this their approach to risk as well as their stewardship policy, if any. However, such requirements should not be in the SHRD but incorporated into the Life Assurance Directive and the Directive for Institutions for Occupational Retirement Provision in the interests of ensuring a coherent framework.

Public disclosure of IIs' arrangements with AMs

It is not clear what the public interest is in requiring an II to disclose publicly details of its arrangement with its AMs. An II appoints an AM on the basis of the latter's investment strategy. That strategy is the AM's main service to its client and it is unlikely to want to make it public – particularly to its competitors. IMA considers that requiring an II to publish such information runs the risk of impacting the EU's competitiveness as compared to third countries.

3.4 We do not believe that an II should have to disclose publicly details of its arrangement with its AMs. This is a private contractual arrangement. Whilst, in accordance with existing EU legislation, the AM is required to report to its II clients, it is not clear what the public interest is in requiring such details to be public. An II appoints an AM on the basis of the latter's investment strategy. That strategy is the AM's main service to its client and it is unlikely to want to make it public – particularly to its competitors. A requirement for it to do so could impact the EU's competitiveness as compared to third countries.

3.5 We agree that the incentive structures that operate in the equity markets are key in encouraging long-term behaviour and better engagement[8]. However, as set out in Section 2, an AM's interest tends to be aligned with those of its clients/ beneficiaries and tends to be long term. Thus we do not see any benefit in IIs having to disclose publicly the details of their arrangements with their AMs.

3.5 Our observations on certain of the specific disclosure requirements are set out below.

- *Incentivise AM to align its investment strategy and decision with the profile and duration of II's liabilities.* AMs act as fiduciaries on behalf of their clients. They have a duty to operate in the best interests of those clients and act in accordance with the client's mandate. AMs may adopt varying strategies to do so but the mandate is rarely to manage the client's liabilities.

- *Incentivise the AM to make decisions on medium to long-term company performance and engage to improve investment returns.* We set out in Section

[8] Page 21 Impact Assessment

3. TRANSPARENCY – IIS' INVESTMENT STRATEGY AND ARRANGEMENTS WITH AMS (ART. 3G)

2 our comments on AMs' incentives. Rather than requiring public disclosure of whether and to what extent the II incentivises the AM, we believe the II should consider and discuss with its AMs their policy on engagement, if any, to see if this meets its needs before entering into the mandate. We do not believe this needs to be specified in legislation but should form part of the II's normal due diligence.

- *Method and time horizon of the evaluation of the AM's performance and duration of the AMs mandate.* As noted in the Impact Assessment, IIs monitor AMs performance regularly – typically quarterly[9]. However, we understand from our members that it is rare for a mandate to be terminated on the basis of short term underperformance in that mandates are generally awarded by clients who look at performance over five years. Thus the majority of AMs continue to manage IIs' money in ways that seek to build value over the long term – see Section 2.

- *Structure of the consideration for the AM's services contributes to the alignment of the AM's investment decisions with the profile and duration of the IIs liabilities.* As noted above, the AM's mandate is rarely to manage the II's liabilities and our observations on the incentive structures are set out in Section 2.

- *Targeted portfolio turnover or turnover range and the method used to calculate.* See 2.5.

[9] Page 21, Impact Assessment

4. TRANSPARENCY – PROXY ADVISORS (ART. 3I)

IMA is not convinced that there has been a market failure or investor protection issue that justifies the disclosures proposed for proxy voting advisors (PVAs). Disclosure should be driven by the markets and the needs of the advisors' clients, investors. In this context, the EU proxy advisory industry has produced Best Practice Principles which expect proxy advisors to make certain disclosures. This should be given time to take effect.

If, however, this voluntary approach does not prove to be effective and concerns still remain, then it may be necessary to pursue an EU measure and a standard for the proxy advisory industry.

4.1 The proposals seek to ensure that advisors are more transparent and take into account local market and regulatory conditions.

4.2 AMs are one of proxy advisors' main client groups in that advisors can process voting instructions, provide research and make voting recommendations. IMA would welcome them being more transparent as to the methodologies and policies used. In particular, we would support advisors disclosing how they manage conflicts of interest, especially if there are conflicts surrounding a particular recommendation.

4.3 However, we are not convinced that there has been a market failure or investor protection issue that justifies the legislative measures proposed. This was the conclusion of ESMA in its feedback statement on the role of the proxy advisory industry.

4.4 Disclosure should be driven by the markets and the needs of the advisors' clients, investors. In this context, the EU proxy advisory industry has produced Best Practice Principles which expect proxy advisors to make certain disclosures. We understand that signatories to the Principles committed to publishing their Statement of Compliance by June 2014 and that there will be a further review by ESMA.

4.5 If, however, this voluntary approach does not prove to be effective and concerns still remain, then it may be necessary to pursue an EU measure and a standard for the proxy advisory industry. In any event, we consider any policy option needs to be applied internationally to non-European proxy advisors and cover their activities in Europe.

4.6 Lastly, paragraph 1 of the Article requires Member States to adopt measures to *guarantee* that the voting recommendations are accurate and reliable. We do not see how Member States can guarantee the recommendations in that they are points of view based on the advisor's research, analysis and their clients' policy preferences. Their clients, investors, make their own final voting decisions based on a variety of in-house and third-party information sources.

5. DIRECTORS REMUNERATION (ART. 9A AND 9B)

Vote on remuneration policy

IMA strongly supports a pan-European approach to a listed company's directors' remuneration policy and a binding vote at least every three years. This mirrors requirements introduced in the UK as from 2013.

Whilst we have comments on the detail of the requirements, as set out below, we support the improved transparency proposed. This should help ensure that a company's future pay policy is clear and easily understood, and that there is a clearer link between pay, and a company's strategic objectives and performance.

5.1 Listed companies have access to capital from the market in turn for which they are subject to a certain amount of scrutiny and oversight. In particular, if executive directors set their own remuneration they are conflicted. Their incentive structures can also be an important driver of company behaviour.

5.2 We strongly support the introduction of a binding vote on a listed company's remuneration policy at least every three years. The proposals mirror requirements that were introduced in the UK as from 2013. IMA members hold € 420 billion of equities in European companies outside the UK, and support such requirements being adopted on a pan-European basis.

5.3 We also support the improved transparency proposed. This should help ensure that a company's future pay policy is clear and easily understood, and that there is a clearer link between pay and a company's strategic objectives and performance.

5.4 The policy report is to look forward and be subject to a binding vote. The implementation report is to look backwards on how the policy was applied in practice and is to be subject to an advisory vote. However, this distinction is not necessarily followed in the detail. For example, requiring a vote on policy and how pay and conditions of employees were taken into account by explaining the ratio of the average remuneration of directors and employees is more of an implementation rather than a policy issue. This should be moved to Article 9b.

5.5 The proposals allow some flexibility in relation to the recruitment of new directors. Thus remuneration can be paid to an individual director outside the approved policy, where the remuneration has received prior approval on the basis of the information in the pay policy. However, the Article states that "the remuneration may be awarded provisionally pending approval by the shareholders[10]". We consider it unlikely that a director would take up a position on the basis of provisional remuneration that is subject to approval. We also question how easily that remuneration could be recovered should it not be approved. We believe there needs to be some limit on the remuneration afforded to newly recruited directors but do not consider this construct would work in practice.

[10] Article 9a, paragraph 1.

5. DIRECTORS REMUNERATION (ART. 9A AND 9B)

5.6 We welcome the main terms of the service contract being set out in the policy report. Such contracts can be long and detailed and it is important that such disclosures are targeted. It would also be helpful if shareholders could access service contracts and that there was a requirement for them to be made available on a company's web site.

Vote on remuneration report and contents of report

> *IMA welcomes the introduction of an advisory vote on how directors' pay policy has been implemented every year and the transparency proposed.*

5.7 As noted, executive directors' remuneration can be an important driver of company behaviour and IMA welcomes the introduction of an advisory vote on how pay policy has been implemented every year. We also support the proposed transparency in that companies need to set out clearly how the remuneration policy has been implemented to help shareholders hold companies to account.

5.8 It would also be helpful if there was more transparency on the relative importance of the spend on remuneration, profit and dividends – directors remuneration is only one component.

6. RELATED PARTY TRANSACTIONS (ART. 9C)

> *IMA strongly supports measures to introduce consistent disclosures and rights in relation to related party transactions throughout the EU. The enhanced transparency and shareholder rights should improve confidence and the attractiveness of European capital markets to international investors. However, to ensure the regime is workable, there may need to be certain exemptions, for example, in addition to the proposed exemption for transactions between wholly owned group companies, we would not expect transactions in the ordinary course of business to be caught.*

6.1 Within the EU there are a diversity of corporate structures and at times investors are concerned that the value of their assets could be eroded by those in positions of dominance, particularly in companies that have significant controlling shareholders. In addition, shareholders' rights in relation to related party transactions vary across the European Union. Thus we strongly support measures to introduce consistent disclosures and rights in this important area of corporate governance. Our members hold €420 billion of equities in European companies outside the UK. The enhanced transparency and shareholder rights should improve confidence and the attractiveness of European capital markets to international investors.

6.2 To ensure the regime is workable, there may need to be certain exemptions, for example, in addition to the proposed exemption for transactions between wholly owned group companies, we would not expect transactions in the ordinary course of business to be caught. In this context, ordinary course of business should be clearly defined such that the size and incidence of the transaction and whether its terms are unusual in the circumstances are considered. In addition, the proposed definition of related party is as per international accounting standards. This should be revisited in that reporting seeks to ensure transparency to the markets whereas the requirements on listed companies are to provide investor protection.

7. IDENTIFICATION OF SHAREHOLDERS AND CROSS BORDER VOTING (ARTS. 3A, 3B, 3C, 3D AND 3E)

IMA welcomes a consistent approach to the identification of shareholders across the EU. However, we have some concerns about some of the details in this Article concerning the definition of shareholder, the difficulties in determining whether votes have been cast and that it could operate to give intermediaries a commercial advantage.

7.1 IMA welcomes a consistent approach to the identification of shareholders across the EU. However, we have some concerns about some of the details in this Article.

7.2 Article 2b of the 2007 SHRD states that 'shareholder' means the natural or legal person that is recognised as a shareholder under the applicable law. The proposed SHRD requires intermediaries to communicate contact details of the 'shareholder' but it is not clear which entity would be identified as such. For example, it could be the entity that has voting authority, the legal owner or the ultimate beneficial owner/asset owner. The definition of "shareholder" needs to be clarified. On the basis the Article aims to facilitate the exercise of shareholder rights, we consider that this should be the person that controls those rights, i.e., controls the voting rights, and not necessarily the ultimate beneficiary.

7.3 Article 3c of the proposed SHRD requires companies to confirm the votes cast in general meeting and where an intermediary casts the vote, the intermediary is to transmit the voting confirmation to the shareholder. However, as noted in paragraph 1.15, there are difficulties in disclosing whether votes have been cast.

7.4 First, resolutions can be decided on a show of hands with the result that unless a poll is called, an instruction to vote may not be cast. Secondly, as regards an intermediary transmitting a vote confirmation to the shareholder, this can be complex in that voting instructions go through a chain. There is the beneficial owner, a fund manager, a custodian, the custodian's nominee, a registrar and possibly a proxy voting service. These factors make it difficult for intermediaries to confirm whether the instruction has cast and send a confirmation to the shareholder.

7.5 IMA would welcome EU measures that would address this and improve the efficiency and transparency of the voting chain. We also believe consideration should be given to requiring all votes to be taken on a poll.

7.6 Article 3c requires that where there is more than one intermediary in the chain, the confirmation should be transmitted between intermediaries without delay. We are concerned that this may preclude a confirmation being transmitted directly to the shareholder and bypassing intermediaries in the chain. Moreover, this information is already transmitted at no extra cost. Article 3d allows "intermediaries to charge prices or fees" for this service. This runs the risk that the proposals operate to give intermediaries a commercial advantage at a cost to companies and their shareholders. We believe this Article should be deleted. In the event it is retained, there need to be safeguards to prevent intermediaries levying excessive charges.

ANNEX 1

AMS REPORTING IN RESPECT OF SEGREGATED MANDATES AND FUNDS

SEGREGATED MANDATES

Requirements for segregated mandates are generally derived from MiFID, implemented from 1 November 2007.

Thus for MiFID and equivalent third country regulated business "clients" must receive adequate reports on the services provided by the firm. The reports must include, where applicable, the costs associated with the transactions and services undertaken by the firm on behalf of the client.

Also derived from MiFID an AM must act honestly, fairly and professionally in accordance with the best interests of its clients.

Other rules are more specific in particular areas. For example, as regards ensuring that "investment strategy and its implementation are in accordance with the arrangement ", suitability requirements seek to ensure an asset manager obtains information to understand the essential facts about their client and has a reasonable basis for believing that transactions in the course of managing that client's assets meets the client's objectives.

Specifically, the information on a client's objectives must include, where relevant, the length of time the client wishes to hold the investment, their attitude to risk and risk profile, and the purpose of the investment.

A client's, i.e. the asset owner's, time horizons, investment objectives and strategy may vary. Thus an asset manager may not necessarily be able to make decisions that ensure the II's assets contribute to "long-term performance". It is not a given, for example, that an asset owner wants an absolute return investment objective.

Disclosure to one of the most significant client groups using segregated mandates, occupational pension schemes, is covered by a Code that was prepared by the IMA - the IMA's Pension Fund Disclosure Code. This was first produced in 2002 by a group of investment managers, pension fund trustees and investment consultants, and has been endorsed by the FCA.

The Code's objective is to promote investment managers' accountability to clients through increased transparency and to assist pension fund trustees' understanding of the fund's assets for which they are responsible. It provides a comprehensive, clear and standardised form of disclosure. The Code has been updated twice, in 2005 and 2007, to accommodate disclosure requirements under the FSA's Use of Dealing Commission regime, and also to bring it into compliance with the execution provisions of MiFID. It operates on two levels:

- Level 1 is a description of house policies, processes and procedures in relation to the management of costs incurred on behalf of clients and, in respect of new provisions brought in by MiFID, appropriate information on the investment manager's execution policy.
- Level 2 is client specific information. This requires disaggregation of transactions by counterparties and disclosure of commissions on those transactions and services

received in exchange for those commissions. Additional commentary is provided where this helps put numerical disclosure into context. It also requires managers to disclose, in percentage terms, the firm-wide pattern of trading, and the sources and uses of commissions overall in the relevant asset class and to compare that to the specific client

In addition, Level 2 requires disclosure of other costs e.g. fund management fees and other income derived by the manager and associates, underwriting/sub-underwriting commissions, stock-lending income to the fund and the associated fees, VAT, stamp duty and any other transaction taxes and levies.

The latest version of the Code is at: Pension Fund Disclosure Code - September 2007.

FUNDS

For AMs of European funds Directives and Regulations specify the AMs transparency obligations. The obligations are in two main forms – pre-sale obligations fulfilled by the prospectus (or equivalent documents) and after-sale obligations fulfilled by periodic reports. In addition, the Directives impose a requirement for AIFs and UCITS to have depositaries in order to oversee the operation and management of the AIF or UCITS.

AIFMD regulates managers (AIFMs) of any collective investment undertaking – of whatever legal structure: whether open-ended or closed-ended; whether authorised, listed or unregulated - which is not a UCITS. However, the majority (around 85 per cent of total funds under management) of UK authorized funds are regulated under the UCITS Directives.

Prospectus/ Disclosure to investors

Article 69 of the UCITS Directive requires the prospectus to include the information necessary for investors to be able to make an informed judgement of the investment proposed to them, and, in particular, of the risks attached thereto.

The prospectus must include, independently of the instruments invested in, a clear and easily understandable explanation of the fund's risk profile. In particular, it must include a description of the fund's investment objectives, including its financial objectives (e.g. capital growth or income), investment policy (e.g. specialisation in geographical or industrial sectors), any limitations on that investment policy and an indication of any techniques and instruments or borrowing powers which may be used in the management of the fund.
The Key Investor Information Document must include appropriate information about the essential characteristics of the UCITS concerned, which is to be provided to investors so that they are reasonably able to understand the nature and the risks of the investment product that is being offered to them and, consequently, to take investment decisions on an informed basis.

Under Article 23 of AIFMD, AIFMs are required to make available to investors, the following information (amongst other items) before they invest in the AIF, as well as any material changes thereof:

AMS REPORTING IN RESPECT OF SEGREGATED MANDATES AND FUNDS

- a description of the investment strategy and objectives of the AIF;
- a description of the types of assets in which the AIF may invest, the techniques it may employ and all associated risks, any applicable investment restrictions;
- the circumstances in which the AIF may use leverage, the types and sources of leverage permitted and the associated risks, any restrictions on the use of leverage and any collateral and asset reuse arrangements, and the maximum level of leverage which the AIFM are entitled to employ on behalf of the AIF;
- a description of the procedures by which the AIF may change its investment strategy or investment policy, or both.

Periodic reports

AIFMs and UCITS Managers are required to make available to investors annual reports that contain, in respect of each AIF or UCITS, audited accounts prepared in accordance with the accounting standards applicable in the home Member State and a report on the activities of the financial year.

An annual report of an AIF shall include at least:

(a) an overview of investment activities during the year or period, and an overview of the AIF's portfolio at year-end or period-end;
(b) an overview of AIF performance over the year or period;
(c) material changes as defined below in the information listed in Article 23 of Directive 2011/61/EU not already present in the financial statements.

The report shall include a fair and balanced review of the activities and performance of the AIF, containing also a description of the principal risks and investment or economic uncertainties that the AIF might face.

The annual report of a UCITS shall include a period-end portfolio statement, a statement of changes in the composition of the portfolio during the period and sufficient information to enable investors to make an informed judgement on the development of the activities of the UCITS and its results.

UCITS Managers are also required to make available to investors half-yearly reports that contain, in respect of each UCITS, summary accounts (unaudited), a period-end portfolio statement and a statement of changes in the composition of the portfolio during the period.

As part of the UK's commitment to full and meaningful transparency, IMA recently revised and reissued its "Statement of Recommended Practice (SORP)" which provides the funds industry with a consistent interpretation of UK accounting standards. Its production and content is overseen by the UK's national accounting standard setter (the Financial Reporting Council) and compliance is mandated by the UK competent authority, the Financial Conduct Authority.

The reissued SORP includes a new, simple way of informing investors how much it cost them to own units in a fund each year. The new measure tells investors, in pounds and pence per unit, how much profit (or loss) they have made and how much it has cost them. This goes beyond any disclosure required by regulators and because it is drawn from the independently verified information assembled for the audited Annual Report & Accounts of a fund, it gives consumers confidence that it is both accurate and comprehensive.

Depositary obligations

In the UK, the depositary of a UCITS or AIF that is an authorised fund must be independent of its manager. The depositary of an AIF that is not an authorised fund, may be from within the same group as the manager, but only if conflicts of interest are avoided and there is sufficient organizational separation between the two entities. The depositary, when acting in its capacity as depositary, must act solely in the interests of the unit holders and must take reasonable care to ensure that the scheme is managed by the authorised fund manager in accordance with its investment and borrowing powers, dealing requirements, provisions on valuation and pricing and allocation and distribution of income. The depositary of an authorised fund is responsible for the safekeeping of all of the scheme property (other than tangible movable property) entrusted to it.

ANNEX 2

LONG TERM STRATEGIES EXERCISED BY AMS

The implication from the Impact Assessment appears to be that there is a concern that AMs are holding shares short-term. We believe this is incorrect.

There are many participants in capital markets. They include a number with high portfolio turnover, such as "high frequency traders" and some hedge funds. Such activity has been increasing in recent years and the observed increase in market turnover is likely to be the result of this. The capital markets research consultancy Tabb Group produced the following breakdown of turnover in the UK equity market:

Hedge funds	37%
High frequency traders	28%
Investment bank proprietary trading	7%
Retail investors	4%
Long-only funds	24%

Source: Tabb Group "Breaking Down the UK Equity Market", January 2011[11]

This shows that the quoted high turnover rates are largely the result of activities by players other than institutional asset managers. This group however manages the overwhelming bulk of institutional assets: in the UK the "traditional" asset management industry is about twenty times the size of the hedge fund industry. Nor can we find evidence of investment managers holding the shares of individual companies for shorter periods. We have asked our members for data about portfolio turnover within their funds. Most have reported typical holding periods for stocks of at least four years and no secular rise in turnover over time, though turnover does increase temporarily during periods of market turmoil, such as 2008-09.

We have further corroborated this by examining receipts from stamp duty reserve tax in the UK. This is a 0.5% tax payable when shares are bought, although banks enjoy an exemption as market makers. Total receipts from this tax are published by Her Majesty's Revenue & Customs. We have grossed-up these figures to reach implied total turnover and then compared them with average total market capitalisation for the relevant tax year. This gives what we believe to be a reasonable proxy for average turnover across the market. The results are as follows:

[11] This research is proprietary.

ANNEX 2

LONG TERM STRATEGIES EXERCISED BY AMS

Tax year	Turnover as % of market cap	Notional average holding period (months)
2001-2	36%	33
2002-3	42%	29
2003-4	40%	30
2004-5	36%	33
2005-6	30%	40
2006-7	26%	46
2007-8	26%	46
2008-9	35%	34
2009-10	27%	44

Source: UK National Statistics, London Stock Exchange and IMA calculations

It is clear from this table that there has not been any trend over the last ten years towards higher turnover, although it was unsurprisingly raised in the wake of the bursting of the dot.com bubble in the early years of the last decade and during the credit crisis in 2008-09.

To the extent that these calculations include trading entities which pay stamp duty, they may overstate turnover by asset managers. Moreover much turnover may be the result of factors such as managers having to change their holdings in response clients' inflows and outflows, or decisions to increase or reduce exposure to a stock while remaining a shareholder. It follows that the periods for which even active managers are likely to remain shareholders in individual companies are likely to be significantly longer than the notional holding periods in the table.

We conclude that we have yet to see evidence of short-term behaviour by AMs generally. Many managers of retail funds and of institutional money continue to pursue classic "buy and hold" strategies. Indeed this is the essence of "active" fund management – the manager seeks to identify stocks which are under-priced by the market and buys them in the expectation that over time the return will be greater than that of the market as a whole. This is wholly consistent with what one would expect to find given the incentives against high turnover in terms of the costs involved.