

# **The importance of voting and engagement with companies: An institutional investor's perspective**

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## **International Symposium on Corporate Governance**

Co-hosts: Korea Corporate Governance Services (KCGS) and Korea Securities Depository (KSD)

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For professional investors only

# Introduction to Hermes Fund Managers and Hermes Equity Ownership Services (EOS)

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**Independent fund manager based in London, wholly owned by the British Telecom Pension Scheme (BTPS), one of the largest UK pension funds**

**Heritage and ownership align Hermes with long-term orientated investors**

**Responsible or active ownership activities since the early 1990s**

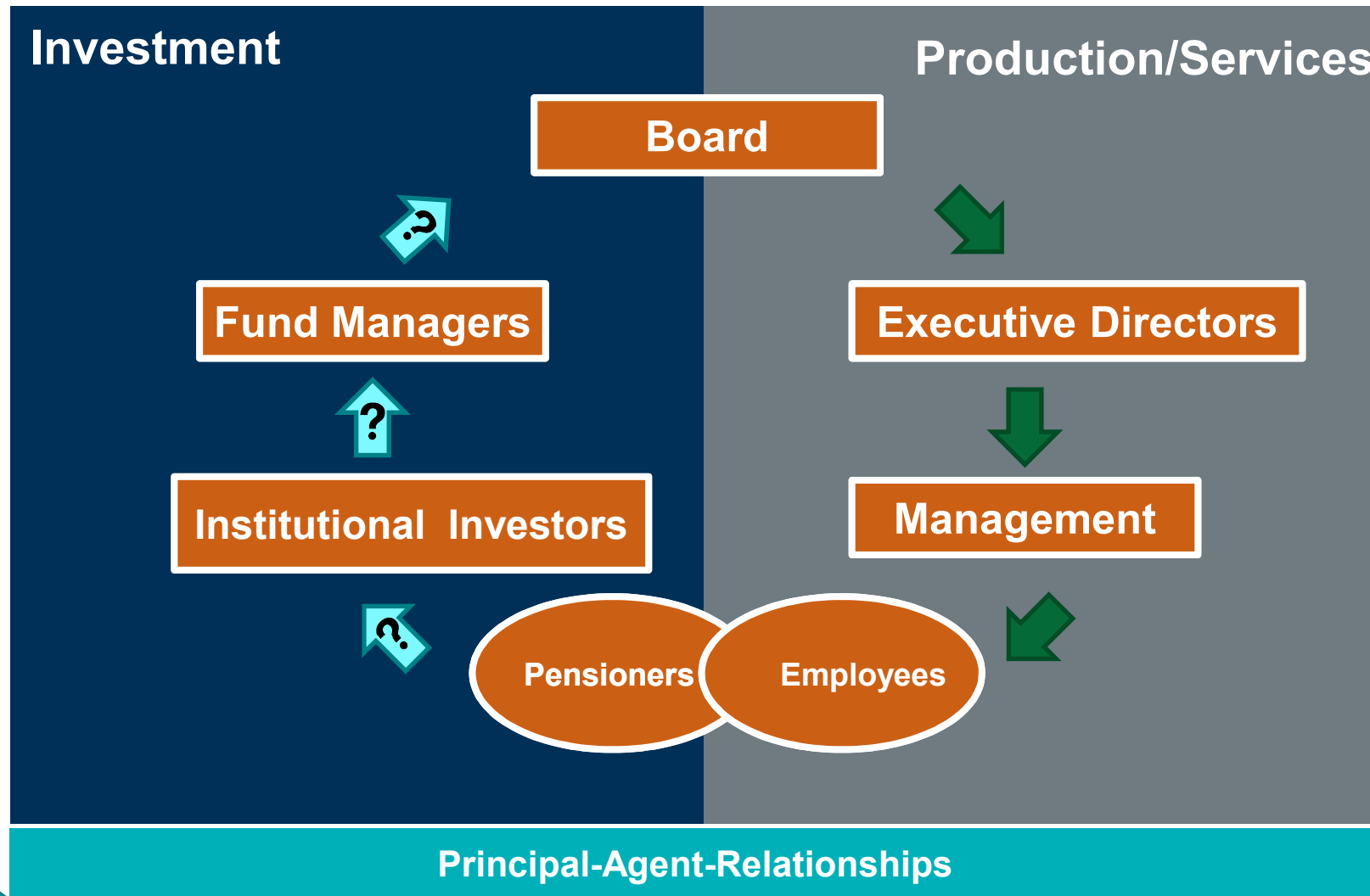
**Hermes Equity Ownership Services (EOS) was established in 2004:**

- ▶ Representation of over 40 pension funds and other long-term investors
- ▶ Screening, voting and private engagement (stewardship activities)
- ▶ Multi-skilled, multi-national team of 25 full-time staff complemented by part-time advisors
- ▶ Assets under stewardship of around \$195bn (as at 30 Sept 2014)

**Hermes EOS works closely with ISS with regard to voting but implements the policies of its clients and has robust, independent decision-making processes**

# The investment and corporate governance chain

## Legal Framework and Self-Regulation



# Problem: Shareholders (fund managers) do not (or not adequately) exercise ownership rights

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## ► What is the result?

The board of directors of many of the world's largest companies are not subject to adequate monitoring and ultimately accountability to shareholders which gives rise to significant agency costs.

- **Even worse, the experience pre-global financial crisis suggests that fund managers may encourage excessive risk taking and short-termism!**
- **What is the underlying issue that needs resolving?**

# More recent focus: Potential conflicts of interest between institutional investors and fund managers

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- ▶ **Timescales over which investment risk and opportunity are considered**
- ▶ **Integration of relevant environmental, social and governance (ESG) factors into investment decision-making**
- ▶ **Risks across investment strategies and asset classes (systemic risk of investment portfolio)**
- ▶ **Alignment of interests: Fees and pay structures**
- ▶ **Stewardship (active ownership) activities on investments:**
  - Fundamental interests and tasks of institutional investors and fund managers differ significantly
  - Fund managers have conflicts, different time horizons and their main concern is buying/selling
  - Experience and skills of fund managers not relevant

Source: ICGN Model Mandate Initiative, Model Contract Terms Between Asset Owners and Their Fund Managers (ICGN), 2012

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# Growing body of empirical evidence showing that active ownership has an impact on financial performance

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Recent research includes:

- ▶ E. Dimson, O. Karakas and X. Li:

*Active Ownership* (unpublished working paper, 2013)

- ▶ R. Bauer, G.L. Clark and M. Viehs

*The Geography of Shareholder Engagement: Evidence from a British Institutional Investor* (ECCE Working Paper, 2013)

- ▶ Most recently: Meta-study by G.L. Clark, A. Feiner and M. Viehs

*From the Stockholder to the Stakeholder – How Sustainability Can Drive Financial Outperformance* (September 2014)

Source: ICGN Model Mandate Initiative, Model Contract Terms Between Asset Owners and Their Fund Managers (ICGN), 2012

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# Active Ownership

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## Existing and developing guidelines

**Self-regulation:** Signing up is voluntary; annual, compulsory self-assessment

► **Principles for Responsible Investment (PRI)** launched in 2006

► Today: 1260 signatories with Assets under Management (AUM) of \$45tn

**Self-regulation:** In UK, disclosure requirement for regulated fund managers

► **UK Stewardship Code (2010); this year introduction of codes for institutional investors in Japan and Malaysia**

**Self-regulation:** Guidance; no obligations

► **International Corporate Governance Network (ICGN): Model Mandate Initiative (2012); Statement of principles for Institutional Investor Responsibilities (2013)**

**Legal framework:** Implementation through law at national level

► **Proposed revised EU Shareholder Rights Directive (April 2014)**

# Voting related issues in Korea

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- ▶ Availability of audited financial statements
- ▶ Information about board candidates
- ▶ Bundled resolutions
- ▶ Concentration of AGMs



# Summary and Conclusions

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1. Regulators believe that active ownership of shareholders can contribute to sustainable corporate value creation or at least reduce the risk of corporate disasters. There is a growing body of empirical evidence to support that belief.
2. Voting is an important aspect of active ownership. Ideally it forms part of a wider engagement programme involving a range of stewardship activities.
3. The investment and corporate governance chain is key in understanding the important role of institutional investors in corporate governance.
4. There are a number of potential conflicts of interest between institutional investors and fund managers: Active ownership is one of the areas where interests are not aligned.
5. The development of corporate governance requires addressing of these conflicts. This is vital where “comply or explain” self-regulation is used.

# Thank you very much for your attention!

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Please get in touch if you have feedback or would like to discuss this presentation:

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