

INVESTMENT ASSOCIATION RESPONSE

FCA CONSULTATION ON PROPOSALS TO IMPROVE SHAREHOLDER ENGAGEMENT

MARCH 2019



ABOUT THE INVESTMENT ASSOCIATION

The Investment Association (IA) is the trade body that represents UK investment managers. Our 250 members collectively manage over £7.7 trillion on behalf of clients in the UK and around the world.

EXECUTIVE SUMMARY

The IA welcomes the opportunity to respond to CP 19/7, the FCA's Consultation on proposals to improve shareholder engagement. The consultation sets out the FCA's proposed approach to implementing parts of the Revised Shareholder Rights Directive ('SRD II' or the 'Directive') in the UK.

The IA is broadly supportive of the FCA's proposals. We support the FCA's proposed "copy-out" approach to implementation of the Directive.

However, there are two areas where we have concerns with the FCA's proposed approach.

Firstly, extending the Directive's scope to investee companies admitted to trading on "comparable markets" outside the EEA. Stewardship practices and approaches are constantly evolving across the world, as has been demonstrated by the growth in the number of Stewardship Codes. This proliferation has led to a healthy diversity in stewardship expectations and reporting requirements in different markets. Our concern is that these evolving global practices could come into conflict with the requirements set out in the FCA's proposed rules. We believe that the implementation of SRD II should focus on the investee companies listed in EEA markets.

Secondly, we do not support the FCA's proposed related party transaction materiality threshold of 25% of profits, assets, market capitalisation or gross capital tests. We would support the FCA employing the 5% materiality threshold currently used in the premium-listed regime. We would also support the requirement to have a shareholder vote on any related party transactions. This would set similarly high standards for both standard- and premium-listed companies and preserve the integrity of the UK regime.

IA members consider that further clarity or guidance would be helpful on a number of issues to provide consistency of approach and understanding across those reporting on the new requirements. These include:

- How "most significant votes" should be defined
- The methodologies used to calculate the following:
 - Turnover and turnover costs
 - Portfolio composition

At our recent FCA: IA member roundtable, the FCA were able to provide information on their expectations on these disclosures. It would be helpful if this information could be reiterated in the FCA's response to this consultation. Based on this further information, the IA will consider if it would be helpful to have industry guidance to develop a consistent approach to these definitions so that reporting is consistent across the industry.

In addition, there may be a need for further guidance on the expectations on reporting against the Directive. The IA previously produced a [Stewardship Reporting Framework](#) to help members report publicly on their Stewardship activities. Our members have already asked us to continue to develop this guidance to help report against the new SRD requirements and Stewardship Code.





RESPONSES TO QUESTIONS

1. Do you agree that the territorial scope of the rules framework should extend beyond that envisaged by the Directive?

The IA does not support the FCA extending the territorial scope of the rules framework to “comparable markets”. The new requirements should apply to shares with a primary or secondary listing on an EEA market only, as in the Directive.

Firms and investee companies operating in EEA markets and following the implementation of the SRD will be subject to similar regulatory approach to stewardship. It makes sense to apply SRD II’s requirements to these parties: because of this convergence, the new requirements can raise standards across the EEA consistently.

Outside the EEA, we are seeing a growing number of jurisdictions consider stewardship and implement Stewardship Codes, which include requirements on reporting of signatories. At the moment, there is no consistent approach to investor stewardship globally, with individual markets setting approaches which are consistent with their market practices and norms.

While in the long-run international comparability of standards might be seen as beneficial, actors in these different markets should ultimately be free to take the approach to investor stewardship that makes sense for them. Further extending the Directive’s scope to “comparable markets” could bring SRD II’s stewardship reporting standards into conflict with these different approaches to stewardship. Local managers operating on behalf of UK firms would be required to report on their stewardship activities in line with UK standards. They should instead be reporting in line with best practice principles for their jurisdiction.

Members have also noted that the proposed approach to extend the scope to comparable markets could lead to confusion with the implementation and territorial scope of the FRC’s Stewardship Code. Given that the UK Stewardship Code is established best practice for stewardship in the UK, asset managers might expect that they need to follow the UK Stewardship Code in fulfilling these new rules for all holdings in comparable markets. This is likely to run at odds with stewardship practices in other markets. As the FCA has stated it is important that asset managers are able to choose the right approach to stewardship for their business and clients, and to be able to sign up to different Stewardship Codes such as EFAMA or the Japanese Code.

2. Do you agree with our proposed amendments to the Handbook to implement the Directive requirements around engagement policies? If not, please explain what alternative approach you would like us to take.

The IA supports the FCA’s proposed approach to implementing the Directive requirements around engagement policies.

We welcome the FCA’s approach of allowing firms to determine the appropriate organisational level at which they will produce their engagement policy and implementation report.

To effectively report in line with the new requirements, IA members have asked for further guidance from the FCA on a number of issues:



- **Most significant votes:** The IA would appreciate further clarification on how asset managers should define and report on 'most significant votes'. At our recent roundtable with members, the FCA set out their expectation that this would be a very limited number of examples based on the profile of the issue, company or size of holdings by the asset manager. It would be helpful if the FCA could clarify its expectations in the policy statement in response to the consultation. This would help achieve market consistency and avoid the potential for conflicting definitions.
- **Implementation report:** Members would like more clarity on the required level of detail expected in the implementation report. This would be especially useful on issues such as the monitoring of companies and reporting on significant votes, and how the report ties in with the revised Stewardship Code and the requirement to produce an Activities and Outcomes Report.
The IA is producing an updated version of our [Stewardship Reporting Framework](#) to help asset managers report on their stewardship activities in line with best practice. Our members have already asked the IA to update this guidance to include guidance on the implementation report.
- **Voting disclosure:** Many UK-based asset managers already provide full disclosure of all votes cast at general meetings of investee companies, in line with market best practice. The IA considers that where this information is already produced in a dedicated section of the asset manager's website, it would not have to be replicated in the implementation report, which could instead link to this information. Clarity on whether this would be acceptable, or whether existing disclosures would have to be enhanced with narrative reporting against all votes (or just the most significant votes), would be helpful. It would also be helpful for the FCA to confirm in its response to the consultation that it does not expect asset managers to disaggregate existing voting disclosure for individual clients, as confirmed at our recent roundtable.

We welcome the FCA's statements that existing disclosures produced to meet other requirements can be used by asset managers to meet the new rules. The IA would be willing to help produce guidance on these points if the FCA does not intend to publish further material. Following this guidance it would be helpful for the FCA to review these disclosures after one year and determine if the guidance is appropriate.


3. Do you agree with our proposed approach to implementing article 3h of the Directive? If not, please explain what alternative approach you would like us to take?

The IA supports the FCA's proposed approach to implementing Article 3h of the Directive.

While this Article does not directly set new requirements for asset managers, in order to facilitate these new disclosures our members will need to communicate some of the required information to clients. We welcome the FCA reaffirming that it does not expect the institutional investor to disclose commercially sensitive information and that the expectation is that high-level information will be provided.

However, IA members request further clarity from the FCA on the following issues:

- **Portfolio turnover costs:** Providing a standardized definition of portfolio turnover costs would help promote a consistent approach. In particular, guidance on those members that have index tracking strategies and how such strategies should calculate portfolio turnover costs would be welcomed.

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- **Timing:** Members would like clarity on whether there is an expectation in terms of how quickly firms should respond to client requests for information, including from asset owners investing in funds.
 - **Portfolio composition:** Clarity on the level of information required for this disclosure would be helpful, as this could be interpreted in a number of ways.
 - **Public disclosure of the arrangement with asset managers and how this is incentivised:** it would be helpful to understand the FCA's expectations regarding these disclosures given that the consultation confirms that firms are not required to disclose commercially sensitive information.

The IA would be willing to help produce guidance on these points if the FCA does not intend to publish further material.

4. Do you agree with our proposed amendments to implement the Directive requirements on asset managers reporting to asset owners? If not, please explain what alternative approach you would like us to take.

The IA broadly supports the FCA's proposed amendments to implement the Directive requirements on asset managers reporting to asset owners.

Reporting flexibility

The IA agrees with the FCA's proposal that asset managers should have the option to provide some or all of the information to be disclosed in the fund annual report. The new requirements should allow for flexibility of reporting approaches rather than prescriptive methods.

Timing

Members have asked for greater flexibility over when and where they should report the required information. Some members want to start including some or all of this information in the quarterly reports that they make to clients, while others would prefer to make separate annual disclosures.

Those members who report on a quarterly basis would like to understand the FCA's expected timescale for compliance. The new disclosures are expected to be made on "at least an annual basis". This will leave members planning to report on an annual basis with a sufficiently long preparatory period before they must make their first sets of disclosures. For quarterly reporters, this period will be significantly shorter should they be required to start including the additional information from the first report due after the implementation deadline.

Further guidance

The IA requests further clarity from the FCA on the following issue:

- **Turnover and turnover costs:** The IA would appreciate the FCA providing further guidance on the appropriate methodology to use for reporting on turnover and turnover costs. Members would like to understand if the FCA's preferred methodologies are reflected in existing industry guidance. It would be helpful for the FCA to include guidance on how turnover and turnover costs should be reported in different scenarios, such as where equity represents a small fraction of a multi-asset portfolio. We welcome comments that it is expected that existing reporting requirements can be used to meet this reporting requirement.

The IA would be willing to help produce guidance if the FCA does not intend to publish further material.

IA Members have also asked for the FCA to clarify if Local Authority Pension Funds and Investment Trusts will be covered in scope of the proposed rules.



5. Are there any other points we should address in the Handbook in relation to the SRDII, for example by adding clarificatory rules or providing further guidance?

The IA broadly supports the FCA's proposed approach to implementing the new requirements for asset managers and asset owners under SRD II.

The FCA's proposed SYSC rule 3.4.9R and COBS rule 2.2B.9 refer to a 'collective investment undertaking'. An SRD CIU is not defined within the proposed amendments to the Glossary of definitions. A definition in relation to SRD would be helpful to determine whether close-end vehicles, such as Investment Trusts where asset management firms are appointed as the AIFM, are in scope. If these Trusts are in scope, we recommend that the Statement of Recommended Practice (SORP) for UK Authorised Funds and Investment Trust Companies are updated to include the required SRD information. We believe this is consistent with the intention of the Directive particularly Article 3g(2) where it is stated that the Member States may provide for the information required to be provided by asset managers be disclosed together with the annual report referred to in Article 68 of UCITS Directive or in AIFM Directive.

6. Do you agree with how we are proposing to implement SRD II requirements on related party transactions in the DTRs (including our proposal to replicate existing LR provisions so far as possible i and choosing a threshold of 25%)? If not, please explain what alternative approach you would like us to take.

Approach

The IA broadly supports the FCA's proposals for implementing SRD II's related party transactions requirements for standard- and premium-listed issuers.

The IA agrees with the FCA that the UK's current related party transactions regime for premium-listed companies is robust. Maintaining the regime, which is internationally well-regarded, has the support of market participants, and is significantly more stringent than the proposals under SRD II is a priority for our members. We therefore support the FCA's proposals to replicate existing LR provisions as far as possible while implementing SRD II's provisions for both standard- and premium-listed issuers. We believe that this consistent approach should be extended to include the same materiality threshold and requirement for a shareholder vote as used in the premium regime.

Materiality threshold

The IA does not support the FCA's proposed materiality threshold of 25%.

The UK's current regime for premium-listed companies uses a materiality threshold of 5%. This threshold is a key element of the regime and helps ensure its robustness. By using the same threshold for standard-listed issuers the FCA would encourage similarly high standards for standard-listed issuers while maintaining the integrity of the overall regime.

Third-party report

Some members would support the FCA implementing SRD II's requirement for issuers to produce a third-party report assessing any related party transactions. To these members this does not seem to be an excessive burden on issuers.



7. Do you agree with our proposed amendment to the LRs – in particular that we should extend our rules for related party transactions to all issuers with a premium listing (except those subject to LR 16) or with a standard listing of shares that have their registered office outside of the UK or other EU Member State? Further, do you agree that we should give recognition to compliance with equivalent standards in non-EU jurisdictions and, if so, what are your views on how this could best be achieved?

The IA is broadly supportive of the FCA's proposed amendments to the LRs.

The IA is supportive of the FCA's proposal to extend the rules for related party transactions to all issuers with a premium listing (except those subject to LR 16) or with a standard listing of shares that have their registered office outside of the UK or other EU member state. We agree with the principle that all companies in a given category should meet the same requirements.

We do not support the FCA giving equivalence to non-EU standards. To support such a measure our members would have to be convinced that this would not lead to a drop in standards.

8. Are there any other points we should address in our rules for related party transactions in relation to SRD II?

Aside from the points raised in Q7 and Q8, the IA is supportive of the FCA's proposed approach.

9. Do you agree with the conclusion and analysis set out in our cost benefit analysis?

No comment.