STUDY

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Responsible Investing

Shareholder engagement in Europe: a review

Zineb Bennani
Head of Governance and Engagement

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EXECUTIVE SUMMARY

Shareholder dispersion and the extreme liquidity of shares made possible by listing on the stock market may result in weakening links between companies' management and their shareholders. After all, what point is there in trying to get involved in a company's governance for someone who owns only a tiny fraction of the capital of a large multinational? Why bother trying to influence management decisions when a share can be unloaded in a split second should disagreement or disappointment occur? When majority shareholders are in a position to dismiss a company's management at will, minority shareholders can be tempted to head for the door instead of the ballot box. Yet, as Pierre-Yves Gomez[1] forcefully and appropriately recalls, one of the key functions of shareholders is to inspire trust in the company's long-term strategy. When shareholder engagement disappears, this trust vanishes as well, and with it the vision and purpose of the corporate mission, which may be supplanted by short-term profit imperatives or strategies on the part of management to exact more wealth or power.

While they cannot be called new, various forms of shareholder engagement have independently been taking shape in different areas of the world. Today, this issue is gaining ground: investors seem to be taking a stand more often and, what is new, regulatory measures have increased. The purpose of this study is to provide an overview of the issues, actors and current trends affecting shareholder engagement in Europe and the United States that explains the objective basis for Mirova's choices within its own engagement policy.

[1] Economist and Director of the French Corporate Governance Institute (Institut français de gouvernement des entreprises ou IFGE), Pierre-Yves GOMEZ teaches strategy and corporate governance. He also gives courses on the role of businesses in society and the economic and social responsibility of managers. His research work focuses on the political dimension of corporate governance and its link to strategy.

I. The history of shareholder engagement

Definition of shareholder engagement

Engagement is a fairly recent concept, which first emerged in the United States in the 1960s, driven by radical movements and religious congregations seeking to pressure companies to change their behaviour on ethical or moral grounds. The extreme dispersion of capital in Anglo-Saxon countries was favourable to the rise of engagement, especially initiatives designed to ensure that management ran companies in the best interests of shareholders.

With the rise of institutional investors as the holders of companies' capital and the recent development of responsible investment, what is known as "shareholder" engagement has progressively moved toward questions of corporate social responsibility, a trend that has significantly accelerated since the Great Financial Crisis began in 2008 due to pressures from both regulatory agencies and groups of institutional investors. Engagement strategies vary from one country to the next and from one category of investors to the next according to a number of criteria. These include the legal context, prevailing regulations, capital structure and types of shareholders involved as well as the organization of actors in the financial markets.

Much like SRI (Socially Responsible Investment), shareholder engagement suffers from the lack of a 'legal' definition. Nonetheless, there is a broad consensus within the investment community as to what constitutes engagement. According to the definition proposed by Novethic, engagement is '*the act, on the part of an investor, of taking a stand on ESG issues and demanding of the companies it targets that they meaningfully improve their practices. These demands are made by means of a structured process that includes direct dialogue with the company and ongoing monitoring. Investors may use any or all of several levers at their disposal should dialogue prove insufficient to induce change. These include public declarations regarding the engagement process and its progress or lack thereof and the inadequacies of companies' extra-financial practices, management actions ranging from a freeze on the position to full divestment, and, naturally, the exercise of shareholder rights: raising questions at general assemblies, voting against proposals, supporting or submitting external resolutions.*'

This definition highlights the two primary approaches to shareholder engagement that coexist on both sides of the Atlantic and serve to distinguish two categories of investors.

The two principal approaches to shareholder engagement

The first approach, commonly known as 'activist', is often associated with the 'aggressive' practices that seek to directly affect a target company's governance and influence the management strategy. American hedge funds are notorious for using this method to try and maximize short term shareholder return. For some, 'activism' may also refer to the mediatisation of engagement actions; some pension funds, particularly in the United States, tend to use the media as a means of pressuring companies, employing reputational threats to wrest them into changing their positions. Shareholder dispersion and portfolio diversification particularly favoured the emergence and development of this approach in the United States, largely because the capital holdings of pension funds remain relatively small and consequently offer little leverage for influencing company management.

'Active' engagement, on the other hand, is associated with a more constructive process whose aim is to employ shareholders' rights to influence a company's behavior and encourage its management to progressively shift towards more responsible practices. Such engagement takes the form of face to face dialogue, or discussions between the company and a group of investors that share a set of values and collaborate to reach a common goal with respect to influencing a company's policies. While the content of such exchanges usually remains confidential, investors are tending more and more to make the outcome of their activities public. This approach first emerged in Europe in the Netherlands, with the 1997 creation of the 'Dutch Association of Investors for Sustainable Development' (VBDO); the institutional investors of the United Kingdom soon followed suit, goaded into action by the scandals and financial crises of the 2000s.

What makes shareholder engagement desirable for investors?

The growing interest of investors for shareholder engagement can be attributed to several factors. Seen first and foremost as part of the fiduciary duty of investors vis-à-vis the final capital owners, shareholder engagement aims to optimize the company's creation of long-term value by encouraging management to pay heed to the full range of risks associated with their activities, whether these be of a financial or extra-financial (environmental, social, governance) nature. Thus construed, engagement is the ultimate risk management tool.

In the case of passive investment strategies or Responsible Investment approaches that do not have a negative screening process, engagement can be a desirable alternative to divesting of an asset. In this way, engagement helps to anticipate and manage reputational threats arising from holding the securities of companies with highly controversial activities.

Collaborative engagement furthermore makes it possible to share associated costs, while increasing the leverage available to insist that company management address the demands involved; these advantages help to explain the considerable interest expressed by pension funds in this form of engagement.

The various mechanisms for shareholder engagement

Several methods can be employed in conducting engagement according to the strategy selected by participating investors. These include:

- → actively exercising voting rights;
- → Initiating dialogue with management and/or Board in writing or in person;
- → external communications such as press releases ;
- → submitting resolutions or counterproposals;
- → organizing 'vote no' campaigns among shareholders;
- → initiating dialogue with national and supranational regulators;
- → participating in coalitions with other shareholders.

Impediments to the development of shareholder engagement

Nonetheless, there remain a number of obstacles that impede the spread of shareholder engagement, something the OECD noted in its 2011 report on the role of institutional investors in corporate governance. The report points specifically to the following:

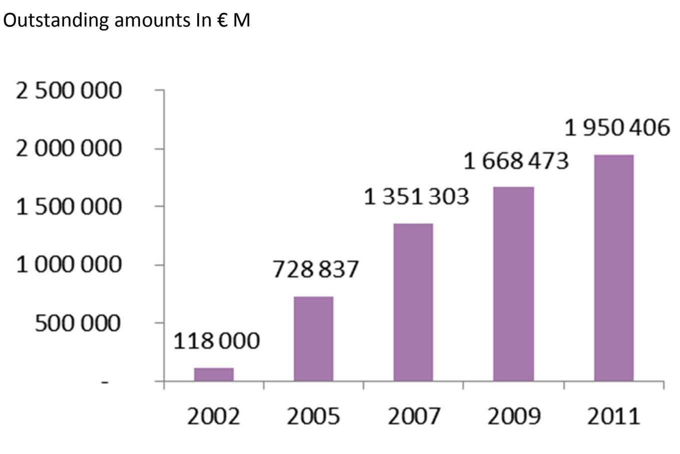
- → a low level of encouragement at the European level as concerns the exercise of voting rights and engagement;
- → a high level of portfolio diversification dictated by prudential statutes which limits the portion of a company's capital that can be held;
- → A strong tendency for assets to be funneled into passive management strategies;
- → the significant economic costs associated with implementing voting and engagement strategies;
- → an ever greater lengthening of the investment chain;
- → a model of executive compensation that fails to reward attempts to achieve outstanding extra-financial performance.

To these we would add the following:

- → a lack of expertise and resources necessary to successfully conduct engagement;
- → considerable uncertainty surrounding regulations at both the national and European levels, as well as confusion over the meaning of 'acting in concert';
- → the lack of a clear definition for the notion of 'fiduciary responsibility'.

These obstacles notwithstanding, we have seen a noticeable increase of interest on the part of investors in the exercise of their shareholder responsibilities and engagement; this interest is manifest in a proliferation of voting and engagement strategies in Europe over the last 10 years (as visible in Figure 1).

Figure 1. Progression of voting and engagement strategies in Europe



Source: Mirova/Eurosif, 2012.

This enthusiasm can be explained in a number of ways. First of all, the European Commission, national regulators and the primary professional associations of the financial industry, as well as national and international investor organizations have been applying increasing pressure to encourage more responsible investment policies geared toward the long term. Meanwhile, the gradual evolution of CSR (corporate social responsibility) toward greater standardization has tended to resituate extra-financial risks as factors at the heart of asset managers' and institutional investors' fiduciary duty, and thus to be taken into account by investment policies, as witness the case of POSCO.

II. The European framework for promoting shareholder engagement: between 'hard' and 'soft' law

The regulatory framework that handles questions of corporate governance and shareholder engagement involves a combination of binding legislative measures, or hard law, and codes of good practice, which are not binding, and hence 'soft law'. These various rules are generally established at the local level, thus explaining the heterogeneous practices and differing levels of maturity among the European markets.

At the European Commission level

The Directives related to shareholder rights were intended primarily to address issues related to the exercise of voting rights, in order to eliminate barriers to transnational voting. For instance, the 'shareholder rights' directive of 11 July 2007 put an end to lock-up provisions, which had previously been a major impediment to voting by foreign asset holders, and standardized certain mechanisms to facilitate the exercise of voting rights. These include:

→ the right to submit a question and have it appear on the agenda of the general assembly;

→ the right to submit resolutions for the agenda of the general assembly.

The transposition of the directive into national law by European countries has led to an increase in shareholder participation rates at general assemblies. In Germany, for example, this number rose from 46% to 60% for DAX 30 companies between 2005 and 2011. However, the rules governing the exercise of voting rights continue exhibit considerable variance among European Union member States, and the actual impact of the directive on shareholder rights is in fact very limited, given the complexity of the procedures involved and the heavy requirements for submitting shareholder resolutions at general assemblies.

In truth, the European Commission only began to pay serious attention to the issue of shareholder engagement after the 2008 financial crisis. Analyses of the underlying causes that brought about the catastrophe brought to light considerable failings in terms of governance practices among all types of companies, but especially in the financial sector, leading the Commission to raise questions about the role of shareholders in this crisis, in particular with respect to their strong tendency to privilege short-term returns and maintain a passive attitude towards management and boards.

In view of these findings, shareholder engagement has taken on a very different cast, and has been identified as lying at the heart of debates over corporate governance.

In 2010, the European Commission published its first Green Paper on the governance compensation policies of financial institutions. This was followed by the publication of a second Green Paper on the topic in April of 2011. Needless to say, long-term investment and shareholder engagement were at the heart of both the issues identified and the process of reflection, which coalesced, in 2012, as a plan for action to modernize the legal framework governing European companies based on three broad principles, long term shareholder engagement first among them.

This action plan will likely give rise to a revision of the Directive on the rights of shareholders evoked earlier (directive 2007/36/CE); an initial proposal was, in fact, published by the European Commission in April 2014. The draft in question emphasizes the need for transparency on the part of institutional investors and asset managers regarding their investment and engagement policies, as well the importance of 'Say on Pay.'

If adopted, the directive will provide significant leverage for increasing shareholder engagement in Europe.

At the national level within Europe

Shareholder engagement is a relatively recent phenomenon in Europe, compared to the US, and regulatory frameworks are not designed to encourage it. Its development has been largely due to institutional investors with long-term horizons, such as pension funds, which, because of the broad diversification of their portfolios, find themselves in the position of 'universal' investors and therefore must carefully monitor the companies they invest in and effects such corporations may have on the development of the world economy.

The relative weight of pension funds in the make-up of financial markets for different European countries goes a long way toward explaining the varying levels of development as concerns shareholder engagement in Europe. The countries where institutional investors are dominant, such as the United Kingdom, the Netherlands, Switzerland and Denmark, are also those in which engagement practices are most developed. In 2010, more than 44% of all securities in the UK were held by pension funds, whereas the average proportion was around 27%, according to an OECD report.

It is also worth noting that the regulatory frameworks of the United Kingdom and Netherlands are particularly favorable to the development of shareholder engagement.

The **UK Pension Fund Disclosure Regulation** (2000), which was an amendment of the 1995 Pension Act, had a significant impact on the Responsible Investment strategies employed to invest in securities managed by pension funds due to the obligation to integrate ethical, social and environmental considerations in their investments. This law inaugurated shareholder engagement on the part of British pension funds. Today, thanks to the establishment of the 'UK Stewardship Code,'[2] overseen by the UK's regulatory body for financial markets, the Financial Reporting Council, the British market has the most structured regulations for shareholder engagement in Europe. The stewardship code had garnered over 260 signatories by the end of 2012.

In the Netherlands, the Ministry of Finance played a decisive role in driving the development of shareholder engagement; the agency created a supervisory committee for governance, whose task it was to ensure companies' proper application of codes.

Meanwhile, institutional investors play a crucial role in monitoring respect for the provisions relating to the code of governance. They have organized an association, known as 'Eumedion', whose function is to represent the interests of institutional investors. In 2011, Eumedion published its own code, the **Eumedion Best practices for engaged share-ownership,**[3] aimed at encouraging shareholder engagement among institutional investors in the Netherlands and Europe, and supports the incorporation of ESG issues in shareholder policies.

Both these systems introduce considerable flexibility through their adoption of the 'comply or explain' principle, which lightens the burden of binding regulations, which can prove very expensive to implement and whose efficacy has yet to be demonstrated.

[2] *See the UK inset for further information.*

[3] *See the Netherlands inset for further information.*

In Switzerland, the rise of shareholder engagement is largely attributable to the Ethos Foundation,[4] created in 1997 by two pension funds, one public, the other privately owned, managed equitably by employees and employer. These two funds wished to create a management tool for their assets that would help support sustainable development. Ethos currently brings together 139 institutional investors to promote the inclusion of sustainable development and good governance principles as part of investment activities as well as the long term interests of society. Ethos is very active in Switzerland via its overlay services division, which conducts engagement actions with Swiss companies on behalf of the pension funds that support the foundation. Given the significant holdings of these funds in Swiss companies, Ethos has considerable influence over CSR practices and corporate governance.

In France, the legal framework does not appear particularly favourable to the development of shareholder engagement. What obligations there are with respect to voting rights are applicable only to asset managers, who, alongside insurers, control the market. Despite this lack, we observe a distinct positive tendency, buoyed in part by a few large public retirement funds, such as the ERAFP (*Établissement de Retraite Additionnelle de la Fonction Publique*) that have adopted responsible investment as their investment strategy, and also by the larger asset managers whether general or more specifically oriented toward Responsible Investment, and in part by the larger asset managers, whether generalist or specifically oriented toward Responsible Investment. This said, the lack of structure in the market does not encourage shareholder engagement on the part of French players, despite the fact that France has the most developed regulatory framework as concerns responsible investment and CSR.

In Italy, shareholder engagement is taking its first steps. Like many European countries, Italy was hard hit by the financial crisis, forcing the market to adapt in order to revive the confidence of financial markets and attract foreign investors. In 2011,this led the country to revise its regulations in view of allowing investors to collaborate in the context of engagement issues relating to environmental, social, and governance (ESG) issues. In 2013, Italy published its stewardship code (***Principi italiani di Stewardship***) based on the EFAMA version. It aims to encourage institutional investors and asset managers to publish their voting policies, exercise their voting rights, and collaborate with other investors in opening channels of dialogue with issuers.

[4] *See the inset devoted to Switzerland for additional information.*

At the level of professional associations within the financial sector

The EFAMA, which is the European association for asset management, developed a code in 2011 of best practices geared to European asset managers, the ‘Code for External Governance’ and designed to encourage the proper completion of fiduciary duties and active dialogue with companies. However, it was less far-reaching than the British code. Furthermore, there is no information available regarding the number of European asset managers that adhere to or apply the code.

UNPRI – The United Nations’ Principles for Responsible Investment

A list of Principles for Responsible Investing (PRI) was published in 2006, under the aegis of the Finance Initiative of the United Nations Programme for the Environment and the Foundation for a Global Compact, and with the active participation of a large worldwide network of institutional investors, experts in the investment industry, government representatives, academic researchers and other stakeholders. The ambition of this undertaking was to establish a framework that would make it possible for players in the industry to operate responsibly.

The second of these six principles expressly urges signatories to establish guidelines for actively shouldering their responsibilities as shareholders and exercising their voting rights, or, at the very least, ensuring that voting by proxies conforms to their voting policy. This principle also encourages engagement with issuers, whether directly or through a service provider, not only with regard to governance but also social and environmental issues.

In keeping with these principles, the PRI has established a platform for collaborative engagement (the Clearinghouse), which, in 2011, brought together more than 315 signatories who had conducted engagement actions vis-à-vis more than 782 companies.

By recognizing shareholder engagement as a significant contributor to increasing the creation of long term value, this initiative constitutes acknowledgement from an international organization of the importance of fiduciary duty and the role of institutional investors in promoting CSR among companies. To date, more than 1,200 investors have signed the PRI, representing a total of $34 trillion in assets under management. Among these signatories 61% are asset management companies, 23% are institutional investors, and 16% are providers of specialized services for the investment industry (ratings agencies etc.).

Despite firmer regulations and an increase in shareholders' voluntary engagement in favour of responsible investment practices, shareholder engagement is still in its infancy among European companies.

III. Overview of Shareholder engagement practices by country

Germany

Key Figures

- **Assets under management[5]: €1,185,320 million, or 6% of all AuM worldwide;**
- **Percentage of assets held by pension funds: 13%.**

Legislative and Regulatory Framework

- **Law governing investments (Investmentsgesetz): article 32.**

Principal actors

- **The Federal Financial Supervisory Authority (BAFIN) ;**
- **The Deutsche Schutzveinigung für Wertpapierbesitz (DWS):** one of the oldest shareholder associations, bringing together more than 25,000 shareholders that attent over 850 general assemblies all told.
- **Bundesverband Investment und Asset Management (BVI):** the largest association of institutional investors, with more than 90 members and **€**1.5 trillion in assets under management.

Prevailing governance code

- **Deutscher Corporate Government Kodex**

Principal catalysts

- **N/A**

Active players

- **DWS Investment deka**

[5] *Source : EFAMA_International Statistical Release : Worlwide Investment Funds Assets and Flows (T1 2012).*

Focus on Germany

The German system of governance is heavily coloured by influence of the regulatory state. Shareholders enjoy considerable rights and have the means to support or submit counterproposals at general assemblies. There are no minimum requirements for eligibility to submit a counter-proposal at a general assembly, and there are no legal restrictions on proposals made by shareholders.

Shareholders play rather a large role in German companies. In 2009, investment firms, insurance companies and foreign institutional investors represented over 35% of all listed shares issued in the country, as concerns the 30 companies of the DAX, 70% of shares are held by German and foreign institutional investors. These elevated rates are a direct legacy of the cross ownership that predominated when companies borrowed massively to obtain financing the 1950s and 60s.

The state of affairs presented by the OECD report indicates that German institutional investors are encouraged to exercise their shareholder responsibilities. First of all, seen in terms of the legal framework governing voting, the trend so far in is in the direction of participation. In 1998, the principle of 'one share, one vote' was introduced; from 2003-2005 a series of measures were passed protecting minority shareholders and establishing a mandatory record date, which considerably facilitates the exercise of voting rights. One must recall that in Germany, the holder of a single share can set in motion a legal process to annul a decision made at a general assembly. Shareholders can also act by rejecting items on the general assembly agenda and presenting counter-proposals.

Mutual funds, which are the most common investment vehicle in Germany, are overseen by investment management companies, the largest of which are DWS Investment, Deka and Union Investment. These companies are governed by a law on investing (*Investmentsgesetz*) whose function is to protect investors' rights. Article 32 of this law stipulates that: 'it is appropriate for institutional investors to directly exercise their voting rights as shareholders'. This recommendation has played an important role in the activities of institutional shareholders in the country. Lastly, the German association for asset management publishes a 'voluntary code of conduct' that defines a governance framework for the sector and stipulates that 'an investment company acts always and exclusively in the best interests of investors and market integrity…In keeping with this principle, the investment company exercises shareholder and claimant rights associated with the holdings of each fund independent of any third party interest, particularly custodian banks and affiliated corporations.'

In practice, institutional investors in Germany acquit themselves of their shareholder responsibilities through voting and the option of taking action at general assemblies via the submission of counterproposals, all performed through management companies. As a result they are some of the most active institutional investors in Europe, despite two significant obstacles also seen in France: collaboration as a necessary condition and the risks associated with collective action. German companies are remarkable for their capital structure: in close to 80% of German companies, at least one shareholder possesses more than 25% of the capital. Consequently, thresholds have been established to frame the rights of certain shareholders, which encourages institutional investors to cooperate without resorting to collective action[6]

On the other hand, there is very little transparency with respect to voting policies or reporting of votes cast, due to a lack of disclosure requirements. Transposition of the European Directive on UCITS (Undertakings for the Collective Investment of Transferable Securities), begun in 2001, should help to improve practices in this area. As concerns engagement, German institutional investors are highly focused on the national market and rarely vote abroad, while foreign institutional investors still rarely vote in Germany. Among those who do, 80% merely follow the recommendations of their proxy agency.

Focus on Germany's biggest pension funds: MetallRente

MetallRente is the largest retirement contribution system. It was created in 2001 by German employees in the electrical and metallurgy sectors. It is bundled with a platform for distributing retirement funds that employs three vehicles, the MetallDirektversicherung (an insurance policy), the MetallPensionskasse, and the MetalPensionsfonds. The funds, totaling $780 Million, are managed by third parties.

The pension fund consists of only $33 million. MetallRente has more than 210,000 beneficiaries, having progressively expanded to employees in the textile and steel industries as well as those working in construction materials.

Since 2001, pension funds are under the obligation to disclose to what extent they take into account SRI criteria, and since this date, all of MetallRente's assets are managed in accordance with SRI criteria, with a specific focus on social and human rights issues. The fund employs an exclusionary strategy and boycotts companies with trouble managing their CSR performance and those 5% or more of whose revenues come from activities related to social undesirable sectors such as alcohol, the arms industry, tobacco or pornography.

The fund is overseen by a joint board consisting of employee representatives and corporate executives. Due to the German governance system, employees are heavily represented within the governing bodies of companies and influence companies' strategic decisions in no small way. In order to limit the possibility of undue influence, the pension fund has promised not to exercise its voting rights, exert influence, or undertake engagement vis-à-vis companies that are part of the fund.

While the fund is not a signatory of the PRI, it has committed to applying the principles.

[6] Since 2009, a law on the limitation of risk offers a more nuanced definition of concerted action: concerted measures that are likely to influence corporate strategy.

United States

Key figures

- Assets under Management [7]: €10,884,509 million, or 57% of all AuM worldwide;
- Percentage of assets held by pension funds: N/A.

Legislative and Regulatory Framework

- Article 14 of the Security and Exchanges Act (1934) ;
- Employee Retirement Income Security Act or ERISA (1974) : law governing the shareholder engagement activities of pension funds;
- Sarbanes-Oxley Act (2002);
- Shareholder Bill of Rights Act and Shareholder Empowerment Act (2009) [currently referred to committee];
- Dodd-Frank Wall Street Reform and Consumer Protection Act (2010).

Principal actors

- Commission on Public Trust and Private Entreprise (2003) ;
- National Association of Corporate Directors (1977);
- Security Exchange Commission.

Prevailing governance code

- Report of New York Stock Exchange Commission on Corporate Governance 2011.

Principal catalysts

- N/A

Active Players

- Pension funds (TIAA-CREF, CalPERS)

Focus on the United States

The Unites States are remarkable for having no national corporate governance code. Despite this lack, however, various texts produced by the Federal governments or by state legislatures have made possible a fairly complete regulatory framework.

Shareholder rights were first guaranteed by the *Security and Exchanges* law of 1934, which in Article 14, assigns responsibility for protecting them to the SEC, already responsible for 'policing' the stock market. As such, the SEC must ensure the quality and transparency of the information circulated, especially within the proxy voting system that is the principal focus of Article 14. This same article also permits shareholders to individually submit resolutions at shareholder assemblies. The prerequisites for submitting a resolution being quite simple, the practice has become quite current in the US. While this mechanism is generally not viewed with great enthusiasm by management, it does nonetheless help move dialogue between a company and its shareholders forward; this is particularly true for subjects like executive compensation, shareholder rights or questions relating to ESG. As for their efficacy—Ernst & Young LLP found that 15% of the 800 proposed resolutions submitted by shareholders were withdrawn following dialogue between shareholders and the company.

In 1974, a piece of legislation known as ERISA (Employee Retirement Income Security Act) was passed. Its role: to oversee shareholder engagement activities and define the obligations of pension funds. Insisting, among other things, on the fiduciary duty of pension funds, this law establishes a requirement for maximized investment return, thanks to management focused on the interests of participants and beneficiaries. This law encouraged many private pension funds to exercise their voting rights, not only for domestic companies, but also for shares held abroad. In practice, ERISA also pushed public funds to exercise their voting rights, even if this was not its original intent.

The Sarbanes-Oxley Act of 2002 marked a turning point of global importance in terms of corporate governance. Coming in the wake of several financial scandals directly linked to the relationships between companies like WorldCom or EnRon and their external auditors, this Act dealt with the reform of corporate accounting practices at publicly listed companies and with investor protection. The various reforms set in motion by this law considerably increased requirements as concerns the transparency of information, a shift that has without a doubt had a positive effect on shareholders' exercise of voting rights.

[7] *Source : EFAMA_International Statistical Release: Worldwide Investment Funds Assets and Flows (T1 2012)*

It is fair to say that the effects of Sarbanes-Oxley have been felt well beyond the frontiers of the United States.

More recently, two bills from 2009 indicate a rising concern with the protection of shareholder rights. The first of these, the 'Shareholder Bill of Rights Act' (S. 1074) was intended to give shareholders a greater say in the process of nominating, electing and compensating the executives of publicly held companies. It would have permitted shareholders to vote on various essential components of these governance topics. A second proposed law, the 'Shareholder Empowerment Act' (H.R. 2861), proposed a modification of the 1934 statutes to specify the rules and criteria governing the election of Board members and, to a lesser extent, the compensation of directors. The proposal was notable for introducing the idea of an advisory shareholder vote on compensation reports.

While not enacted, both bills contributed substantially to the latest major corporate governance development in the United States, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. This legislation contains an entire section dedicated to provisions for investor protection and treats questions of executive compensation, such as an advisory vote for golden parachutes or the curtailing of discretionary voting by brokers on the topic of remuneration. The law also includes measures that touch on more general aspects of corporate governance: proxy voting, separation of Chief Executive Officer and Board chairmanship functions, etc. Since the law went into effect, the SEC has focused primarily on defining more specific measures for implementing these rules.

ERISA's 1974 package constituted a decisive step forward in terms of a framework for governance in the United States, and established several longstanding practices. Subsequent legislation has reinforced protection for minority shareholders and fostered awareness of the central issues of governance and their impact on both asset management and financial performance. Their measures have served to encourage active shareholder, as the growing number of resolutions submitted on the subject of executive compensation, which doubled in 2013 compared to the previous year, illustrates.[8]

[8] *Source:* 2012 Proxy Season Review: US, *ISS.*

Focus on the major US pension funds

<u>CalPERS – California Public Employees' Retirement System</u>

CalPERS can justifiably be described as a pioneer in the area of modern corporate governance, and is well-known for activist shareholders. This US agency, which acts as an institutional fund manager for the state of California, is the largest public pension fund in the US, with close to $233 billion in assets under management in 2012. Created in 1932, the agency became involved in corporate governance only in 1984, under Jesse Unruh, following a financial blackmail incident in which a company it held passively was implicated. That same year, CalPERS adopted a corporate governance policy that stressed the creation of long-term value for shareholders. This shareholder activism played a non-negligible role in the resignation of several major chief executives, including Richard Grasso in 2003 (NYSE), and Michael Eisner in 2005 (The Walt Disney Co.). Through its many initiatives, which strive to be international in scope, the agency has become a major player in terms of corporate governance; these include launching the International Corporate Governance Programme's in 1996 and the UK's 1997 adoption of corporate governance principles, as well as US standards in 1998, and, more recently, establishing a strategic plan for combating abusive compensation among executives in 2003.

The Focus List, originally created in 1987, was completely revised in 2010 in order to make its engagement approach more effective. This formerly public list, which is now confidential, identifies companies within CalPERS' portfolio with particularly poor governance practices and financial results. A thorough engagement process allows the agency to work towards improving these companies' performance. Since 2011, the fund has been particularly involved in supporting shareholder resolutions that address management and director practices. The list has a longstanding reputation of being able to make previously laggard securities outperform their indices, a result known as the 'CalPERS effect'. Another distinctive feature of CalPERS is that the agency has for a long time taken center stage in the theoretical debates on the topic of corporate governance, in particular through its internet portal[9] dedicated to the topic, created in 1999, which compiles no less than 14,000 documents on the subject.

[9] http://www.shareholderforum.com/

CalPERS has also not hesitated to publicly take a stance on major issues, for instance, by calling for a reform of the corporate compensation system in 2004. The agency is deeply implicated in ESG issues, and has invested $1.5 billion in cleantech to date. In addition, the agency pursues on-going engagement with corporations on ESG topics.

TIAA-CREF - Teachers Insurance and Annuity Association, College Retirement Equities Fund

TIAA-CREF is one of the world's largest financial services providers, and the primary supplier of retirement savings plans for teachers, academic researchers, medical professionals and workers inthe cultural sector. The company manages over $406 billion of assets in-house according to a predominately long-term strategy, and describes itself as a universal investor. TIAA also offers Plan Sponsor Services.

As a highly engaged investor, TIAA-CREF has been addressing social questions for close to 30 years. As early as the 1970s, the company began dialogue with management and boards of directors to promote change, for instance, in Apartheid South Africa. Since then, TIAA has acquired the distinction of being the first US company to adopt and implement, on a voluntary basis, an advisory vote by beneficiaries on its executive compensation policy.

TIAA also does not hesitate to make its position known on social topics that have an impact on shareholder value. In the last few years, TIAA has exercised its vote in support of greater transparency as regards activities related to environmental issues, human rights, and workers' rights. The fund also takes part in lobbying activities, particularly those aimed at improving global standards of governance, and participates in collaborative engagement initiatives alongside other investors within the context of the ICGN, the Council of Institutional investors, or the Asian Corporate Governance Association.

TIAA makes an effort to vote as often as possible at general meetings. Well-versed in voting procedures all over the world, the fund is deeply committed to exercising its voting rights. The company's engagement policy, which was updated in 2007, is anchored in the principle of 'quiet diplomacy', which eschews public confrontation in order to ensure that dialogue takes place under the best possible conditions.

France

Key Figures

- Assets under Management[10]: €1,447,385 million, or 5.4% of all AuM worldwide
- Percentage of assets held by pension funds: 5%.

Legislative and Regulatory Framework

- 2001: law concerning new economic regulations: *nouvelles régulations économiques* (NRE)
- 2003: law concerning banking security *loi sur la sécurité financière* (LSF)

Article L 533-22 of the Monetary and Financial Code presents voting obligations for portfolio management companies on a 'comply or explain' basis

- 2003: AMF General Rules

Articles 314-100 à 314-102 require that financial management companies possess a voting policy and compile a report on the exercise of voting rights

Principal Actors

- AMF : *autorité des marchés financiers*
- AFEP and ANSA: associations of issuers
- AFG : Association Française de Gestion
- French government.

Prevailing governance code

- AFEP-MEDEF Code
- AFG Governance Code
- MiddleNext Code

Principal catalysts

- 'Say on Pay' introduced in 2013
- Rapport de l'AMF sur les assemblées générales

Active players

- Large national asset management companies
- Pension funds and insurers: ERAFP, FRR, Ircantec, CNP assurances
- FIR : Cordial.

[10] *Source : EFAMA_International Statistical Release : Worlwide Investment Funds Assets and Flows (T1 2012).*

Focus on France

The legal context for questions of shareholder voting and corporate governance is based on national legislation as well as the relevant European directives.

As early as 1997, the code of ethics for the AFG (Association Française de Gestion) encouraged members to exercise their rights in the interest of their clients. This code had a broad impact, fuelled, on the one hand, by laws associated with the 2001 NRE (nouvelles régulations économiques)[11] and 2003 LSF (lois sur la sécurité financière), and on the other by the general rules of the French market regulator, the AMF (Autorités des marchés financiers).

In France, the voting requirement applies only to asset management companies and is a provision of Article L533-22 of the Monetary and Financial Code governed by the 'comply or explain' principle. The general rules of the AMF (articles 314-100 to 314-102), however, require that financial management companies establish a voting policy that, among other things, specifies procedures for the exercise of voting rights, and that they draft a report on said exercise of voting rights.

Despite a lack of regulatory goads, most institutional investors (insurers and retirement funds) exercise their voting rights, generally through mandates delegating the task to their asset management companies.

The AMF, which is the regulating authority for financial markets in France, plays a leading role in improving practices where the exercise of voting rights and protection of shareholder rights are concerned. It provides oversight and control over how the AFEP-MEDEF's governance code (a code published by issuer organizations that is the primary reference point in terms of governance for French companies) is applied by CAC 40 companies.

Additionally, the AMF frequently sponsors working groups that bring together various stakeholders in order to produce recommendations for enhancing corporate governance in France. In 2012, the AMF published recommendations for the improvement of general assembly procedures for listed companies. The first of these entails the establishment of on-

[11] *Loi NRE, n° 2001-420 du 15 mai 2001 relative aux nouvelles régulations économiques.*

going dialogue between companies and their shareholders on the topic of voting policy.

Although the obligation to exercise voting rights currently only applies to asset managers at this juncture, the AMF encourages French and international institutional investors to define their own voting policies and vote at general assemblies (per recommendation AMF n°2011-06 regarding voting consulting firms) and adds that by voting, such investors contribute positively to the development of good governance practices at publicly listed companies by ensuring respect for rules promulgated by professional bodies.

Focus on the most prominent professional initiative: FIR

The Forum for Responsible Investment, commonly known as the FIR (Forum de l'investissement Responsible) is a multilateral association that brings together various actors from the value chain of Responsible Investing in France which, in 2010, launched an initiative dubbed 'Cordial' (short for Corporate Dialogue), whose goal is to establish dialogue with companies from the SBF120 (*Société des Bourses Françaises 120 Index*) on environmental, social or governance topics. The singularity of this engagement initiative lies in its constitution of a workgroup that includes not only asset managers, but brokers, ratings agencies and consultants, which makes it the first initiative of its kind in Europe. However, it is not an attempt to directly influence company behaviour. The engagement process takes the form of a predefined questionnaire that is distributed to companies at face to face meetings; results are then summarized in a report that offers recommendations as to good practices to implement with respect to the particular topic of engagement.

The first two themes, launched in 2010, were, first, the submission of executive compensation policies and ESG criteria to voting by the general assembly (meetings with 22 companies) and second, Human Resources policies in the context of the financial crisis (meetings with 31 companies). A final report on each engagement process is published on the FIR website.

Focus on France's major pension funds

<u>The ERAFP: supplementary retirement plan for public servants</u>

The ERAFP is a public administration body created in 2005 following a reform of the law governing retirement benefits (article 76 of law 2003-775 of 21 August 2003) in order to manage supplementary retirement benefits due to public servants, local authorities and employees of public hospitals. The entity is placed under the authority of the State and administered by a joint board of directors consisting of employer representatives and representatives of contributing beneficiaries.

With 4.6 million contributing beneficiaries, the ERAFP is one of the largest public pension funds in the world. It controls close to €12 billion in assets, which are entirely invested according to an approach that is 100% socially responsible.

As a long-term institutional investor and signatory of the PRI, the ERAFP was a pioneer, establishing an SRI charter as early as 2006 to reflect its values and vision of responsible investing. This charter remains a reference for the ERAFP's asset managers, guiding their investment selection, portfolio construction process, and dialogue with companies as well as their exercise of shareholder rights (voting, submission of resolutions, questions at general meetings etc.) and their collaborative undertakings or participation in shareholder coalitions.

In 2012, at the initiative of its board, the ERAFP established guidelines for shareholder engagement that would become the first building blocks of the engagement policy that the institution is currently proposing alongside several other pension funds and long-term investors. One of the fund's first efforts in this direction was a press release published 2 October 2012, in which the ERAFP took a clear stand on Arcelor Mittal's proposed closure of the Florange blast furnace and expressed its concern regarding the need to balance the interests of all stakeholders.

This initiative heralds the emergence of a genuine desire on the part of the pension fund to develop an active and unapologetic engagement policy to address concerns that draw on the values of the establishment.

<u>FRR: Reserve Retirement Fund (*Fonds de réserve pour les retraites)*</u>

The FRR is a public entity created in 2000 to manage the country's collective resources for the purpose of ensuring the financing needed by the social security retirement schemes for employees in the private sector, artisans and business owners.

The FRR, which had €35.1 billion dollars in assets in December 2011, is overseen by a supervisory board that includes representatives of public authorities (parliament and ministers), representatives of social partners and qualified individuals.

A long-term investor and founding member of the PRI, the FRR launched a strategy of responsible investment in 2003. To this effect the FRR defined general guidelines defining a policy of responsible investing, and in 2004 incorporated SRI criteria in its specifications for traditional mandates. In 2005, the supervisory board adopted and implemented guidelines for the exercise of voting rights, then, in 2009, began its efforts at engagement, starting with the 10 companies it considered highest in priority. The FRR's engagement approach takes the form of dialogue with companies and maintains continuity with the exercise of voting rights. Also worth noting, a certain number of mandates are already implementing an engagement strategy alongside their SRI strategy that governs the funds. Lastly, the FRR plays a very active role in the development of PRI and lend support to a variety of collaborative engagement initiatives.

Italy

Key Figures

- **Assets under Management: N/A ;**
- **Percentage of all assets in pension funds worldwide: N/A**

Legislative and Regulatory Framework

- **Principi italiani di Stewardship**

Principal Actors

- **Comitato per la Corporate Governance**
- **Assonime**
- **Assogestioni.**

Prevailing governance code

- **Codice di Autodisciplina delle società quotate**

Principal catalysts

- **N/A**

Active players

- **Etica SGR**
- **Fondazione culturale Banca Etica**
- **Fonds de pension du groupe Banca Intesa San Paolo**
- **Fonds de pension Cometa**

Focus on Italy

In 2011, a meeting between the Italian stock exchange, Abi, Ania, Assogestioni Assonime and Confindustria created a new 24 member Committee on Corporate Governance, charged with updating Italy's code of governance, the *Codice di Autodisciplina*. The changes to this code, which was first published in 1999 and overseen since 2001 by Assonime, the Association of the Italian joint stock companies, include the integration of d.lgs 6/2003 regarding reforms affecting private equity firms and d.lgs 262/2005 on economic protection. The new Code also addresses executive compensation policies from the perspective of the European provisions in article 123-ter of the *Testo Unico della Finanza*. The committee revised the standards for good governance as concerns the composition and functions of the Board. Member entities are encouraged to publish their criteria for nominating and evaluating independent board members. These guidelines are applied in keeping with the European principle of 'comply or explain'.

The exercise of voting rights by Italian pension funds is governed by the legislative decree 252/2005, issued from the deliberations of Covip (Commission for oversight of pension funds) on 7 January 1998. More specifically, articles 6 and 7 of d.lgs 252/2005 define rules for voting, maximum holding thresholds to limit shareholder lobbying and reporting requirements on the inclusion of ESG requirements. Furthermore the Covip decisions of 31 October 2006 and 16 March 2012 require that funds explain to what extent ESG criteria have been included in their investment strategies, and to provide detailed information as to criteria employed in voting decisions. These provisions are designed to guarantee a transparent relationship between asset managers and pension funds.

Focus on the major Italian pension funds

The Cometa pension fund was created for the benefit of employers in the metalworking and plant operations industries. It is the largest pension fund in Italy, and covers employees in the goldsmith trades as per an agreement signed 1 February 1999. The fund was created by an agreement among industry organizations such as Federmeccanica, Assistal and Intersind, and employee organisations, including Fim, Fiom, Uilm and Fismic. The fund is designed around a responsible management of resources in order to ensure employees a more attractive retirement package than the legally mandated system.

In 2010, Cometa signed the PRI with the intent of progressively incorporating extra-financial considerations into its investment approach. In order to consolidate this process, Cometa first published a document covering the fundamental principles of its engagement policy and then implemented an analysis of investments already held in its portfolios in order to ensure that ESG criteria were respected. The fund exercises its voting rights to insist on greater transparency of dialogue on the part of companies it invests in. Cometa is one of Italy's most active members in the PRI, and participates in for a as well as in the activities of various working groups and collective engagement projects alongside other actors.

The pension fund of the Groupe Intesa Sanpaolo, created in 1999 on behalf of employees at the Banque Sanpaolo has assets under management of €1.465 trillion. The fund incorporates criteria measuring good conduct in the area of governance and corporate social responsibility. The fund launched its first engagement initiatives focused on human rights and environmental themes in 2011, ultimately becoming signatories of the PRI two years later. Additionally, the fund devotes an entire section of its annual report to principles of engagement and corporate responsibility.

But the most important efforts in the area of SRI and engagement in Italy can all be traced back to three entities: the Gruppo Banca Etica, Etica SGR and the Fondazione Culturale Responsibilità Etica.

Etica SGR is the only firm that manages savings assets to have committed to maintaining only socially responsible investment funds. Etica SGR also uses ESG criteria to select listed companies that are targeted for engagement, largely consisting of dialogue with companies regarding ESG criteria and encouraging CSR initiatives. Through the platform 'Linee Guida sull'Azionariato Attivo', Etica SGR contributes to improving corporate governance practices (compensation, composition of controlling bodies, etc.).

Norway

Key Figures

- Assets under Management[12]: €67,499 million, or 0.35% of all assets worldwide
- Percentage of assets held by pension funds: N/A

Legislative and Regulatory Context

Public Company Act: Article 45

Principal Actors

- Norwegian regulator

Prevailing Governance Code

- The *Norwegian Code of Practice for Corporate Governance*

Principal Catalysts

- N/A

Active Players

- The Norwegian Pension Fund
- The Norwegian Shareholders Association
- Financial institutions, Insurance Companies, Trusts

Focus on Norway

While not a member of the European Union, Norway transposed the European directive on shareholder rights in 2009. The Norwegian system of corporate governance has traditionally been fairly restrictive and protective of management and large shareholders. In order to bolster the attractiveness of its financial market, Norway has adapted to better take into account the interests of minority shareholders and foreign investors.

Adherence to the Norwegian code of governance is based on the 'comply or explain' principle.

Focus on the major Norwegian pension fund

Government Pension Fund Global

This entity was founded in 1990 to ensure the long-term oversight of national oil revenues. In 1998, the Ministry of Finance delegated the Norwegian sovereign fund's management to an arm of the country's central bank: Norges Bank Investment Management (NBIM). The fund is invested internationally and in October 2012 represented assets of NOK 3.740 trillion, equivalent to €505 billion, distributed as follows: two-thirds equities, one third fixed income, with a marginal fraction in real estate. It is thus one of the world's largest funds. While the fund has always clearly presented itself as committed to long-term investment, these principles and commitment have crystalized and deepened since 2008, when the government requested a review of the Government Pension Fund's ethical guidelines. Following the publication of the commission's conclusions, the Finance Minister emphasized that the fund had an obligation to behave responsibly as an investor by promoting better market functioning and sustainable development. To this effect, the fund introduced new investment and governance policies; these included a broader adoption of ESG criteria, adherence to the PRI and active participation in transnational initiatives.

In terms of voting, NBIM actively exercises delegated rights on behalf of the sovereign wealth fund, according to a policy that is transparent and incorporates social and environmental concerns. Each vote cast is reported on and published on their website. NBIM also takes an active stance when it comes to engaging with companies it holds, when their practices diverge from its voting policy or can negatively affect the market or the sector. Little information is available, however, regarding these activities. It is also the fund's policy to participate in shareholder group litigation, and NBIM (or its parent Norges Bank) has participated in several suits, in particular against Vivendi, Merk, Citigroup (still pending), Porsche and Countrywide Financial Corp. (amicable resolution). Norges Bank is also a stakeholder in many collaborative actions, having signed on to 43 new class action suits since 2001 and collected over $16 million as a result of previous cases. NBIM is also represented in several professional bodies (IIRC etc.).

The fund's investment strategies also take into account ESG issues and have established specific themes from children's

[12] *Source : EFAMA_International Statistical Release : Worlwide Investment Funds Assets and Flows (T1 2012)*

rights and climate change to shareholder rights and water management questions.

The Norwegian sovereign wealth fund has become a recognized leader in responsible institutional investment thanks to its substantial size (among the world's largest) and the direct support it receives from the Ministry of Finance for ESG inclusion and long-term management. NBIM also raises its profile thanks to collaborative actions that entail a high level of public visibility and also make possible real progress.

The Netherlands

Key Figures

- Actif sous gestion [13]: €67,201 million, or 0.35 % of all AUM worldwide
- Percentage of assets held by pension funds: N/A

Legislative and Regulatory Framework

Civil Code of the Netherlands (1992)

Principal Actors

- Government of the Netherlands
- Corporate Governance Code Monitoring Committee (under the auspices of the 2004)
- **AFM** (Autoriteit Financiële Markten)
- **Eumedion:** association of institutional investors

Prevailing Governance Code

- Eumedion Code
- Frijnscode Code

Principal Catalysts

- N/A

Active Players

- Pension Funds: PGGM, ABP
- Eumedion Association of Institutional Investors
- **VEB (Vereniging van Effectenbezitters)** investor association

Focus on the Netherlands

The Dutch market exhibits a high level of transparency where governance is concerned, and companies largely conform closely to the Netherlandish code. Governance rules are contained within the Dutch Civil Code, which is considerably influenced by the laws and directives of the European Union. Following the EU Commission's 2003 call for the implementation of governance codes, the Finance Minister established a committee, chaired by Morris Tabaksbalt, to draft the first Dutch code of governance. The minister then created a 'Corporate Governance Monitoring Committee', whose primary function is to oversee application of the Frijnscode (2009), the official governance code, itself a revision of the Tabaksbalt code of 2004.

The Netherlands are very active as concerns shareholder engagement, and investor submission of resolutions is fairly common, contrary to prevailing practice in the rest of Europe. Institutional investors play a significant role in the governance of companies and in fostering good CSR practices through active voting policies, regular dialogue with companies and participation in collaborative initiatives alongside other engaged players across Europe. This is all the more true since the law governing action taken in concert was recently revised in order to remove barriers to collaborative engagement.

Individual shareholders are also highly active and organized within an investor association called VEB (*Vereniging van Effectenbezitters*), which has nearly 45,000 members and attends more than 150 general assemblies annually.

Dutch shareholders are entitled to initiate legal proceedings against the strategy pursued by management by registering their complaint with the Ondernemingskamer, a distinct entity appended to the court of appeals whose mission is to resolve conflicts related to the application of statutes.

Focus on the Eumedion code

The Foundation for Corporate Governance Research for Pension Funds (SCGOP) was founded in 1998 to provide a means for pension funds to encourage companies in improving their governance practices, and actually published the first two codes in this area. In 2006, the SCGOP was replaced by Eumedion, a foundation dedicated to developing and maintaining good governance practices to serve as a reference point for publicly held companies and institutional investors in the Netherlands and Europe.

Today, Eumedion has close to 70 members, predominately institutional investors, collectively representing over a trillion euros in assets under management. The association is extremely active and undertakes numerous initiatives aimed at improving the governance practices of Dutch companies and encourage discussion among institutional investors, company management and professional associations. Eumedion also participates in consultations initiated by the government of the Netherlands, European Union institutions and other authorities as well as lobbying to influence laws and regulations; other activities include services related to governance issues which it provides to its members in the form of seminars, colloquia, round tables etc. Eumedion participated in 14 consultations in 2012, and has issued six position papers in addition to three governance handbooks since 2008. Finally, the foundation

[13] *Source : EFAMA_International Statistical Release : Worlwide Investment Funds Assets and Flows (T1 2012)*

writes annual letters to each of the 75 largest publicly held Dutch companies in order to increase their awareness of currently prevailing best practices.

Focus on the primary Dutch pension funds

PGGM

With over €125bn[14] in assets under management and 2.5 million beneficiaries, PGGM is the second largest pension fund in the Netherlands, and one of the five largest in Europe. Its role is to manage funds collected by the compulsory defined contribution plan for employees in the healthcare and social services sectors according to the principle of solidarity.

Prior to 2006, PGGM's responsible investment approach relied on the active exercise of voting rights and an engagement policty that was entirely delegated to F&C, a British asset management company specializing in voting and engagement services.

In 2006, PGGM became a signatory of the PRI and established a new responsible investment approach that provides a framework covering its investment strategy and execution, evaluation and reporting of its responsible investing activities. Concurrently, the fund has reinforced its internal resources and decided to conduct part of its engagement actions directly.

For Dutch companies, for instance, PGGM engages directly with companies targeted by its 'focus list' to address governance issues identified by Eumedion that are specific to the Dutch market. For European companies and those in the US, PGGM continues to delegate engagement on environmental and social issues to F&C. PGGM furthermore participates in collaborative engagement actions with other investors belonging to the PRI.

PGGM is also a member of the Institutional Investor Group on Myanmar and a leading member of Eumedion.

ABP

ABP, which administers the pension scheme for government employees, education and public sector employees, has €309 billion in assets under management. The fund exercises its voting rights for over 4,000 companies worldwide, and undertakes engagement activities largely in the voting process. Outside of this context, engagement is limited to specific cases in which ABP conducts dialogue with a company or sends a letter with specific concerns. The fund may sometimes resort to more active engagement, submitting resolutions or participating in class action suits. The fund also participates in collaborative efforts via Eumedion.

[14] *À juin 2012, source : site internet PGGM.nl*

United Kingdom

Key Figures

- **Assets under management[15]:€884,938 million, or 4.6% of all assets worldwide**
- **Percentage of assets held in pension funds: 44%**

Legislative and Regulatory Framework

- **Financial Services and Markets Act 2000 - section 890**
  Funds are required to disclose the environmental social and ethical components of their investment strategies
- **The Occupational Pension Schemes Regulation 2005: British Parliamentary legislation that governs the transparency of pension funds regarding their responsible investment policy**
- **Companies Act 2006: addresses transparency of voting by institutional investors**

Principal actors

- **Institutional Shareholders' Committee (ISC)**
- **Financial Reporting Council**

Prevailing governance code

- **The UK CG Code** (2011) combining the Cadbury Report (1992) the Greenbury Report (1995) and the Hampel report (1998)
- **Myners review of institutional investment (2001)**
- **Walker review (2009):** covers the governance of banks and other financial institutions
- **Stewardship Code** (2010) revised September 2012

Principal Catalysts

- **Rapport Kay review (2012)**
- Binding vote for Say on Pay introduced in 2013
- Binding vote introduced for executive stock options. Measure set to take effect in October 2013

Active Players

- Management companies and consulting firms specialized in engagement overlay services: F&C, Hermes, Governance for Owners
- Pension funds: Environmental Agency Pension Fund (EAPF).

[15] *Source: EFAMA_International Statistical Release: Worldwide Investment Funds Assets and Flows (T1 2012)*

Focus on the United Kingdom

The Institutional Shareholders' Committee (ISC)

The ISC is a consortium of several different institutional investor groups that coordinate their activities in order to defend the interest of British investors. Its key members include the ABI (Association of British Insurers), the IMA (Investment Management Association), the AIC (Association of Investment Companies) and the NAPF (National Association of Pension Funds). The organization's principal objective is the establishment of a discussion forum for approaching important topics through concerted action to achieve greater impact, for formulating recommendations in the context of lobbying activities, and for openly discussing subjects relevant to investor interests.

In November 2009, the ISC published a code of responsibilities for institutional investors designed to improve quality of their dialogue with companies, optimize the long-term returns of shareholders, reduce risks associated with poor strategic decisions and help them meet their governance obligations. This code became the template for the first version of the 'UK Stewardship Code,' published by the FRC (Financial Reporting Council) in 2010.

Focus on the UK Stewardship Code

An initiative of the FRC, the UK Stewardship Code was launched in response to the 2008 Great Financial Crisis and based, as mentioned above, on the ISC's code of responsibilities. Its aim is to place shareholder engagement at the core of institutional investors' fiduciary responsibility by encouraging them to actively and effectively exercise their shareholder rights through ongoing dialogue with chairpersons of boards and collaboration with other investors.

Oversight of the code's application devolves to the FRC, which already published a first update to the code in September 2012 that included amendments designed to take into account the principal conclusions of the code's 18 month review.

The code is built around 6 key principles, and speaks both to institutional investors and the asset management companies that act as their agents, assuming the final responsibility for operationalizing these principles.

Now in its 19th month, the UK Stewardship code has garnered 234 signatures, of these, 175 are asset managers, 48 asset owners, and 12 are service providers. However, it is wise to bear in mind that signatories do not necessarily implement the Code's recommendations.

Focus on a pension fund: Environmental Agency Pension Fund (EAFP)

This public-sector regulatory body is invested with the mission of promoting the protection and improvement of the environment. With close to £2.2 billion in assets under management, its pension fund is one of the largest British funds. The investment strategy adopted by the investment fund is in sync with values fostered by the EAFP, as witness the financial strength and environmental responsibility that characterize its investments.

For a number of years, the Agency had to contend with low market returns and criticism from the media as to its investment in highly polluting industries; these led to a revision of its investment strategy to incorporate its vision of exercising shareholder rights. As of 2005, its new responsible investment policy emphasizes criteria that take into account environmental issues and long term risks or opportunities that can have an impact on financial results. Thus, the investment selection process is based on environmental considerations that are justified on financial rather than ethical grounds.

In its 2010-2015 five-year plan, the EAPF reaffirmed its desire to play a leading role in resolving the environmental challenges facing society today. This plan is designed around five priorities, described by the agency as: act to reduce climate change its consequences; protect and improve water, land and air; work with people and communities to create better places; work with businesses and other organizations to use resources wisely; and, be the best we can. More than £1 billion was earmarked for this project for 2012. Most of the fund's engagement activity is delegated to asset management companies that are instructed to address a number of specific topics: climate change, environmental externalities, pollution and soil remediation, natural habitats and questions of flora and fauna. A report on these various engagement topics is then compiled quarterly

Concurrently, the EAPF encourages collaborative engagement, and works hand in hand with other pension funds as a means of amplifying the impact of its engagement with companies.

The fund has won a number of prestigious awards, among these the LCG Corporate Governance Award, and the Professional Pensions "Best use of SRI" award.

Switzerland

Key Figures

- Assets under management[16]: €290.02 trillion or 1.5 % of all AUM worldwide
- Percentage of assets held in pension funds: N/A

Legislative and Regulatory Framework

- Directive issued by the SIX Swiss Exchange
- Swiss Economic Code
- Swiss Code of Obligations (Civil Code Part V)

Principal Actors

- Federal Council

Prevailing Governance Code

- Swiss Code of best practice for corporate governance (2008).

Principal Catalysts

- N/A

Active Players

- Ethos Foundation

Focus on Switzerland: the Ethos Foundation

Ethos is a Swiss foundation created in 1997 by two retirement schemes, one public, one private and both jointly managed by employees and employer, which were seeking to create an asset management tool that would contribute to sustainable development. The foundation is supported by 139 institutional investors and promotes the integration of sustainable development and good governance principles within investment activities, as well as the long term interests of society at large.

Ethos owns the investment and consulting services company, Ethos Service, created in 2000, which specializes in SRI and active shareholding and has current assets under management of CHF1.6 billion, or €1.3 billion. Ethos is a signatory of the PRI and adheres to the UK Stewardship Code. The foundation received the prestigious ICGN award in 2009.

Consistent with the explicit intentions of its founding members, Ethos takes its shareholder responsibilities very seriously.

The company has established a charter, voting guidelines, and principles of governance that are clear, applicable and fully address environmental and social issues. Ethos systematically exercises the voting rights delegated to them, and prepares a detailed report on the topic that includes qualitative analysis and is made publicly available. Ethos first began conducting engagement in 2004, at the behest of the two founding pension schemes, which were looking to improve their governance practices and reinforce their CSR. Originally focused on the 100 largest capitalizations on the Swiss market, the Ethos Engagement Pool now covers all listed companies in Switzerland and brings together 86 Swiss pension plans (total holdings: €96.6 billion).

From the standpoint of active shareholding, Ethos has proposed shareholder resolutions on several occasions: at UBS in 1998 and 2008, Crédit Suisse and Zurich Financial Services in 2002, as well as Nesté in 2008. Resolutions proposed by Ethos garner broad support and lead to a dialogue process with companies that contributes to reviewing practices, increased transparency, replacement of certain directors, and other concrete outcomes. In 2008, Ethos launched a ‘Say on Pay’ initiative alongside eight other pension plans, directed at the five largest publicly held Swiss banks, four of which ended up adopting an advisory vote in 2009. Ethos renewed this initiative the same year, with four other financial institutions. In all, 20 large corporations were convinced to adopt ‘Say on Pay’.

As a service provider, Ethos also publishes thematic research on engagement topics and extra-financial evaluation.

IV. Conclusion

The lack of an engagement policy is at best tantamount to writing management a blank cheque and at worst conceals an agenda of short-term profit maximization that ignores long-term consequences. However, as described above, shareholder engagement in itself is only a tool, and behind this concept are a variety of practices that range from those of religious organizations to activist funds in search of shareholder value maximization in the very short term.

In addition, whether they be institutional investors or asset managers, market players find it difficult to adopt a coherent stance due to the multiplicity of clients on whose behalf they

[16] *Source: EFAMA_International Statistical Release : Worldwide Investment Funds Assets and Flows (T1 2012).*

act, and who may have diverging opinions, when they have an opinion at all.

These very real challenges, we believe, demand that the engagement strategy chosen by investors be clear and transparent in order for end-savers to use them effectively in making investment choices. Mirova's engagement policy is available to everyone (the *Mirova Engagement Policy*) and has a clear strategy: to express the vision of a responsible company whose aim is ensure the sustainability of its long-term economic performance. Any attempt to guarantee this sustainability, or 'license to operate', necessarily involves taking into account the impact the company may have on its stakeholders and on the environment. To this end, Mirova has set out an engagement strategy based on three pillars:

- Promote responsible governance. This primarily entails aligning the interests of company management with those of the company itself, and not with those of a single stakeholder, even shareholders. To this effect, we are committed to supporting and encouraging companies in the attempt to integrate social and environmental objectives in executive compensation criteria.
- Encourage companies to recognize human rights issues that may affect their practices. In a globalized, open and interconnected world, this involves companies taking into account social practices when choosing direct and indirect suppliers. In this area, we have launched active engagement strategies with companies in the textile and Information and Communication Technology industries.
- Support companies' attempts to reduce their carbon footprint. This involves complex, multiple and critical challenges. Because our engagement capacities are inherently limited, we need to make measured choices in order to optimize effectiveness. Because building a low-carbon economy has become a clearly pressing issue, we have decided to engage on the issue of Arctic offshore oil exploitation, which raises the question of whether investment projects will bring satisfactory yields.

Our engagement policy freely available online at:
http://www.mirova.com/Content/Files/Mirova/Recherche/Mirova%20Engagement%20Policy.pdf

STUDY

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Responsible Investing

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