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Securities and Futures Commission
35/F, Cheung Kong Center
2 Queen's Road Central
Hong Kong

By email to: ResponsibleOwnership@sfc.hk

28 May 2015

Dear Sir/Madam,

Please find attached the response by F&C Investments to the Securities and Futures Commission's Consultation on the Principles of Responsible Ownership that was published in March 2015.

We are pleased to contribute to this important review, and hope that our comments are useful in your deliberations. Please feel free to contact me if you have further questions or comments. We would be happy to meet with you, as required, to discuss our views in further details.

With best wishes,

F&C Investments



May 2015

**Consultation on the Principles of Responsible Ownership, published March 2015
Response by F&C Investments**

F&C Management Limited is a global asset management firm with assets under management of EUR 107.9bn. As well as acting for our own portfolios, we also represent the interests of over 25 major third-party investment institutions with EUR 76.9bn of assets. F&C has long been an active voice in support of robust corporate governance standards for companies in jurisdictions where F&C invests. In this context we welcome the opportunity to comment on the Consultation Paper on the Principles of Responsible Ownership.

F&C is supportive of the development of the Principles of Responsible Ownership in Hong Kong. As an active investor for many years, F&C believes that robust engagement and voting by institutional investors is critical to the health of financial markets and long-term value creation. This is particularly so in Hong Kong's principles-based, "comply or explain" regulatory regime, whose effectiveness requires active involvement by investors to engage with companies and monitor their compliance with the Hong Kong Corporate Governance Code.

We present below our responses outlined in the consultation paper.



Please see below our view on Securities and Futures Commission' consultation on responsible ownership:

Scope and Expectations

- F&C supports the proposed policy objectives, and believes that robust stewardship and company engagement should be encouraged throughout the institutional investment universe, including asset owners and asset managers of all sizes. For this initiative to be effective it must have a broad reach, and this speaks to the need to reach out to both local and foreign institutional investors, including sovereign wealth funds and statutory asset owners.
- All Hong Kong-based institutional investors should be required to consider whether they should apply the Principles in order to establish a clear fiduciary obligation with the providers of capital. If an institutional investor believes that the Principles are not relevant to their investment strategy and do not wish to sign up to the Principles, it should explain the reasons to the SFC.
- Individual and retail shareholders should be encouraged to sign up to the Principles, but the Hong Kong market currently lacks suitable means for engaging smaller retail investors in the stewardship process envisioned by the Principles. In this regard, it may be appropriate to encourage the development of retail shareholders' groups to provide greater participation in and awareness of stewardship issues.

Oversight

- The most appropriate regulator will be the one who regulates the investment industry as the Principles are intended for the investment industry. In the case of Hong Kong, this will likely be the SFC.

Comply or Explain

- We agree that both asset managers and asset owners should report on a "comply or explain" basis with regard to their application of the Principles. We believe that this is relevant for all institutional investors.
- Asset owners should be able to delegate stewardship activities to asset managers but should actively monitor the implementation of the Principles by their managers.
- Investors should report whether and how they use specialist service providers to help them undertake stewardship activities.

Reporting

- F&C believes that reporting is an important dimension of the Principles, and institutional investors should at the very least disclose their policies on engagement and voting.
- Public disclosure of votes cast at shareholder meetings adds transparency to investors' stewardship activities, which can be useful for both issuers and beneficiaries.
- More detailed reporting can be provided to clients on a bespoke basis, which can include reporting on engagements undertaken and their outcomes.



Please find below our comments on the SFC's specific questions (in italics):

- *Do you agree with the approach (paragraphs 49 to 50) to aim the Principles at all investors and not just institutional investors? If the scope of the Principles is too broad which investors should be excluded or, alternatively, which investors should be included?*

We agree that the Principles should aim at all investors as the owners of companies they invest in.

All Hong Kong-based institutional investors should be required to report to the SFC whether they apply the Principles. If an institutional investor applies the Principles, it should report its implementation of the Principles on a "comply or explain" basis. Retail investor bodies could be setup to help individual and retail shareholders to carry out their stewardship activities.

- *Given that the Principles will not achieve their objectives unless listed companies welcome both the Principles and the greater engagement from shareholders that will follow, do listed companies and their representatives have any suggestions for the Principles that are likely to encourage the appropriate level of shareholder engagement?*

Not applicable.

- *What do institutional shareholders active in investing in Hong Kong companies expect will be the likely costs and benefits arising from their compliance with the proposed Principles?*

The likely costs will include:

1. Voting of all shares: an electronic voting system, formulation of voting policies, resources to execute votes in an informed and responsible manner and resources for vote administration (e.g. accounts set up, reconciliation, dealing with custodians and powers of attorney)
2. Company engagement: additional resources dedicated to meeting with boards and management with a view to effect change
3. Reporting

The benefits will include:

1. Protection of investments from downside risks caused by poor corporate governance or poor management of extra-financial risks and impacts
 2. Enhancement of long-term shareholder returns in illiquid investments
 3. Bridging the gap between corporate leadership and institutional investors: ensuring that the boards act in the interests of minority shareholders and holding directors accountable to all shareholders
- *Whilst we do not wish to encourage a close-ended list of the type of institutions which will qualify as "institutional investors" and their agents, we would encourage views from the market as to their understanding of the types of institutions which may well fall within or outside of such a broad characterisation.*

Institutional investors will include asset owners and asset managers. However, the Principles may also be relevant for their advisors (e.g. proxy providers). For the ease of interpretation and local relevance, we recommend that the definition of institutional investors and their agents reflect existing definitions in the Securities and Futures Ordinance for professional investors.

- *Should institutional investors be encouraged or obliged to apply the Principles on a "comply-or-explain" basis and, if so, which institutional investors and what should they be asked to disclose and to whom?*

For the Principles to be taken seriously, Hong Kong-based institutional investors should be obligated to report to the SFC whether they support the Principles and, if yes, should publicly report against each principle on a "comply or explain basis".

Asset owners should be able to delegate stewardship activities to their asset managers. When stewardship activities are delegated, asset owners should report at least annually to those to whom they are accountable and publicly on their stewardship policy and its execution.

- *Will individual or retail investors find the Principles useful? We welcome views on whether there are any particular aspects of the Principles that individual or retail investors would like further guidance on.*

Not applicable.

- *Should certain types of organisations be required to disclose whether or not they comply with the Principles and, if not, why they do not do so (i.e. on a "comply-or-explain" basis)? For example, should the following be required to comply with the Principles on a "comply-or-explain" basis: (i) institutions authorized and regulated by the HKMA, (ii) approved trustees of MPF schemes, trustees of ORSO20 schemes and trustees of pooled investment schemes approved for MPF purposes, (iii) insurers, insurance intermediaries and MPF intermediaries authorized and/or regulated by the OCl and (iv) entities licensed and regulated by the SFC?*

Please see our detailed responses to questions above.

- *Should entities such as voting services agencies and investment consultants be encouraged to commit to the spirit of the Principles, and if so how this should be facilitated?*

We agree that voting services agencies and investment consultants be encouraged to commit to the spirit of the Principles. Voting agencies which provide voting recommendations should be encouraged to commit to the spirit of the Principles as they should engage with companies and take company perspective into account when preparing vote recommendations. Moreover, voting agencies should manage conflicts of interest arising from their business activities and disclose their conflicts of interest policies.

Investment consultants should be encouraged to sign up if they consider the Principles relevant for them. We believe that any entity that considers the Principles helpful in their work should be able to sign up to the Principles.

- *As all Hong Kong institutional investors will be encouraged to apply the Principles, are there any hurdles or other reasons that would prevent or discourage them from doing so?*

Stewardship principles may not be compatible with certain investment strategies (e.g. algorithm trading, quantitative strategies and activist strategies). This is why institutional investors need to be able to explain why they do not apply the Principles.

- *The Principles are aimed at investors of Hong Kong listed companies and are not intended to apply extraterritorially. Should investors based in Hong Kong be encouraged to abide by the codes or principles of other jurisdictions relating to their foreign investment?*

Yes. Investors and their ultimate beneficiaries will benefit from stewardship activities which seek to protect their interests and promote healthy financial markets globally.

- *How can foreign investors in Hong Kong listed companies be encouraged to commit to the spirit of the Principles in respect of their holdings in Hong Kong companies? Do foreign investors foresee any barriers or difficulties in doing so?*

Many foreign investors who will choose to commit to Hong Kong's Principles will also be signatories to similar Stewardship Codes in their home countries. The SFC may wish to consider a mechanism where a foreign investor would be deemed as a signatory to Hong Kong's Principles, if they are a signatory to a Stewardship Code in their home market and specify in their Stewardship Code statements that they apply corresponding stewardship principles in jurisdictions outside their home market, including Hong Kong.

The SFC may also want to work with other national regulators overseeing the implementation of stewardship principles to ensure that all national principles encourage investors to either apply national principles extraterritorially or abide by the codes/principles of other jurisdictions relating to their foreign investments.

- *Do investors who operate on a cross-border basis envisage any potential conflicts which might arise between requirements or codes in place in other countries and the proposed Principles?*

Although the focus of this consultation is responsible ownership and stewardship, we would note that effective implementation of the Principles will naturally draw investors in more active dialogue with listed companies. As a result, it would be appropriate to use this process as a catalyst for review of the Corporate Governance Code. Indeed, as the primary stewards of a company are its directors, there may be merit in reviewing responsibilities of directors as regards active dialogue with investors, and defining examples of good practice relevant to the Hong Kong market.

- *What are institutional investors' current practices on disclosing information on their engagement policy, including any national or international standards they follow?*

Institutional investors who are signatories to the UK Stewardship Code typically publish their responsible investments policies outlining their approach to voting, engagement with investee companies and integration of ESG factors in investment decisions. Some asset managers also publish annual responsible investment reports, providing summary voting statistics and examples of key ESG issues they engaged on in the prior year.

Many asset managers and asset owners use the UK Stewardship Code compliance statement to outline their approach to engagement. Some of these compliance statements are extremely informative and detailed.

Depending on client demand, asset managers may provide full disclosure of votes cast and engagement activities undertaken to their clients. Increasingly, asset managers also disclose these information publicly to improve transparency of their ownership activities.

- *We would also welcome views on the policy objectives against which the SFC should judge its approach to the Principles. The proposed objectives are to:*
 - *promote a sense of ownership amongst institutional investors in order to encourage Hong Kong and foreign shareholders to voluntarily apply and report against the Principles;*
 - *ensure that engagement is closely linked to the investment process;*
 - *contribute towards improved communication between shareholders and the boards of the companies in which they invest;*
 - *secure sufficient disclosure to enable institutional shareholders' prospective clients to assess how those managers are acting in relation to the Principles so that this can be taken into account when awarding and monitoring management mandates.*

We support the proposed policy objectives, and believe that robust stewardship and company engagement should be encouraged throughout the institutional investment universe, including asset owners and asset managers of all sizes. For this initiative to be effective it must have a broad reach, and this speaks to the need to reach out to both local and foreign institutional investors, including sovereign wealth funds and statutory asset owners.

Shareholders should have opportunities to discuss material issues related to strategy, governance, performance and risk management with executive and non-executive directors on a regular basis and outside the normal AGM environment. Such discussions should be elevated from a management-mediated process, often lead by IR personnel, to a dialogue with the board directors who hold fiduciary responsibilities and are directly accountable to shareholders.

- *Should compliance with the Principles be monitored? If so, which regulator should be responsible for doing so? For example, should it be the SFC or should it be the primary regulator in each respective industry?*

We agree that compliance with the Principles should be monitored in order for the Principles to be taken and implemented seriously. In the case of Hong Kong, responsibilities for the Principles should sit with the SFC as the primary regulator of the investment industry.