

## **EFAMA Code for external governance**

**Principles for the exercise of ownership rights in investee companies**

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## INTRODUCTION

EFAMA<sup>1</sup> believes that good standards of governance are critical to ensuring confidence in the European capital markets and has already produced guidance in this area. In 2002, the then FEFSI issued a position paper “Investment Fund Managers as Shareholders” on asset managers’ duty to act as fiduciaries for clients in the exercise of shareholder rights and their expectations of their investee companies. In 2006, EFAMA published a Discussion Paper on “A Code of Conduct for the European Investment Management Industry” which set out high level principles and best practice recommendations for the asset management industry. The 2006 EFAMA Code of Conduct already encouraged investment managers in accordance with Principle 13 to use shareholder rights “in a considered way, in the best interest of investors and to enhance the portfolio value” and to have a policy on their use of shareholder and creditor rights which should be disclosed to investors.

## PURPOSE OF THE CODE

The purpose of the EFAMA Code on External Governance is to provide a framework of high-level principles and best practice recommendations which should act as a catalyst for engagement between Investment Management Companies (IMC) and the companies in which they invest. Adherence to this code should support interaction between the IMC and companies and ensure a strong link between governance and the investment process.

The code is “principles” based in that it relies upon good judgement rather than prescription. As such, the recommendations recognise that the “best” approach for many issues depends on the circumstances.

The Code is not designed to supersede applicable law and regulations.

To improve transparency and demonstrate commitment to high standards of external corporate governance, IMC should, where applicable, publicly confirm adherence to the Code, e.g. on their website or in their annual financial statements. Such confirmation will demonstrate to investors explicit commitment by the IMC to good external governance.

## DEFINITIONS

**Investment Management Companies (IMC):** provide investment management services such as collective portfolio management and/or segregated account management on a discretionary basis as a main business. Where the IMC provides services other than investment management, only

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<sup>1</sup> EFAMA is the representative association for the European investment management industry. It represents through its 26 member associations and 51 corporate members approximately EUR 13.5 trillion in assets under management, of which EUR 8 trillion was managed by approximately 53,000 funds at the end of 2010. Just under 36,000 of these funds were UCITS (Undertakings for Collective Investments in Transferable Securities) funds. For more information about EFAMA, please visit [www.efama.org](http://www.efama.org).

investment management will be subject to these Principles and no other services will be affected. In the case of self-managed SICAV or like structures, the fund itself is to be deemed the IMC.

***Institutional holders:*** include various (legal) entities such as pension funds, insurance companies, and investment trusts and other collective investment vehicles which are not themselves the IMC. They are normally the Clients/Investors of the IMC.

***Client/Investor:*** any natural or legal person to whom an IMC provides investment management services, no matter what legal form the investment takes.

## SCOPE

The principles below set out best practice for IMC when they choose to engage with the companies in which they invest. In this context, IMC have a fiduciary duty to their Clients/Investors. This fiduciary duty comprises the IMC's obligation to align the investment strategy with long-term performance goals when indicated by the Client/Investor or when reflected in the investment policies of the collective investment schemes.

The principles are relevant whenever IMC seek to engage with investee companies and can be applied to any investee company regardless of market capitalisation, although a proportionate approach may be applied for practical reasons, e.g. according to the percentage of ownership in the relevant investee company. They are relevant insofar as the IMC themselves are endowed with ownership rights on behalf of their Clients/Investors. They cover engagement in relation to an investee company's

- strategy and performance;
- conventional corporate governance issues such as board construction, election, succession and remuneration;
- approach to corporate social responsibility;
- risk management.

The principles are designed to enhance the quality of the communication with companies and to foster that IMC create value for their Clients/Investors by dealing effectively with concerns over the companies' performance. They do not constitute an obligation to micro-manage the affairs of investee companies or preclude a decision to sell a holding where that is the most effective response to such concerns.

## PRINCIPLES

**PRINCIPLE 1: IMC should have a documented policy available to the public on whether, and if so how, they exercise their ownership responsibilities.**

### **Best Practice Recommendation**

This policy should take into consideration the widely differing cultures, legal frameworks and company structures amongst EU Member States.

When the IMC have a policy on how they exercise their ownership responsibilities, the policy should include, inter alia:

- How investee companies are monitored. For monitoring to be effective, where necessary, an active dialogue may need to be entered into with the investee company's board (see Principle 2).
- How conflicts of interest are managed. For example, an IMC's duty is to act in the best interests of clients when considering matters such as engagement and voting. Conflicts of interest will inevitably arise from time to time, which may include when voting on matters affecting a parent or related company, or a company related to a client.
- How issues around insider information are handled.
- The approach to stock lending and recalling lent stock.
- The strategy on intervention (see Principle 3).
- The approach to collective engagement (see Principle 4), where appropriate.
- Voting and the use made of, if any, proxy voting or other voting advisory service, including information on how they are used (see Principle 5).

It should be ensured that when institutional holders' mandates are given to IMC, external governance is discussed and the approach agreed with the IMC as part of the mandate. Their IMC are then responsible for ensuring that they comply with the terms of the mandate as agreed.

### **PRINCIPLE 2: IMC should monitor their investee companies.**

#### **Best Practice Recommendation**

Investee companies should be monitored to determine when it is necessary to enter into an active dialogue with their boards. This monitoring should be regular, and the IMC should seek to satisfy themselves, to the extent possible, that the investee company's board and sub-committee structures are effective, and that independent directors provide adequate oversight.

The IMC should endeavour to identify problems at an early stage to potentially minimise any loss of value. If they have concerns they should seek to ensure that the appropriate members of an investee company's board are made aware of them.

IMC may not wish to be made insiders. They will expect investee companies and their advisers to ensure that information that could affect their ability to deal in the shares of the company concerned is not conveyed to them without their agreement.

**PRINCIPLE 3: IMC should establish clear guidelines on when and how they will intervene with investee companies to protect and enhance value.**

#### **Best Practice Recommendation**

Interaction with investee companies on an ongoing basis can help to protect and secure value in the long term. IMC should set out the circumstances when they will actively intervene and periodically assess the outcomes of doing so. Intervention could be considered regardless of investment style. Instances when the IMC may want to intervene include when they have concerns about the company's strategy and performance, its governance or its approach to social and environmental matters. However, disinvestment from the investee company may be an appropriate measure in order to protect investors' interests.

Initial discussions can comprise, if necessary, for example:

- holding meetings with a company's management specifically to discuss concerns;
- expressing concerns through the company's advisers;
- meeting with the Chief Executive Officer, senior independent director or the chairman of the supervisory board, as the case may be, or with other independent directors/board members.

If boards do not respond constructively then the IMC should consider whether to escalate their action, for example, by:

- intervening jointly with other institutions on particular issues;
- making a public statement in advance of or at the AGM or an EGM;
- submitting resolutions at shareholders' meetings; and
- calling an EGM to propose shareholder action, for example to effect changes to the board.

**PRINCIPLE 4: IMC should consider cooperating with other investors, where appropriate, having due regard to applicable rules on acting in concert.**

**Best Practice Recommendation**

At times cooperation with other investors may be the most effective manner in which to engage. It may be appropriate to engage collectively at times of significant corporate or wider economic stress, or when the risks posed threaten the ability of the company to continue having regard to applicable rules on acting in concert.

IMC when participating in collective engagement should have due regard to market regulations and their own policies on conflicts of interest and insider information.

**PRINCIPLE 5: IMC should exercise their voting rights in a considered way.**

**Best Practice Recommendation**

IMC should have an adequate and effective policy on defining how and when voting rights will be exercised to the exclusive benefit of the Clients/Investors. The policy should define procedures and measures for:

- monitoring relevant corporate events;
- ensuring that the exercise of voting rights is in accordance with the relevant investment objectives and policy;
- preventing or managing any conflicts of interest arising from the exercise of voting rights.

Where IMC decide to exercise voting rights in an investee company, they should seek to vote all shares held. They should not automatically vote in favour of resolutions proposed by the board or management. They should register an abstention, if permissible at the relevant market, or vote against the resolution if they deem it to be in the best interests of their Clients/Investors. Before voting against management resolutions which may have significant effects on the investee company, the IMC should, where appropriate and unless prohibited by law or contract, consider to intervene with the investee company in accordance with Principle 3 of this Code and with the best interest of the investors.

**PRINCIPLE 6: IMC should report on their exercise of ownership rights and voting activities and have a policy on external governance disclosure.**

**Best Practice Recommendation**

IMC should report on request to their Clients/Investors details on how they have discharged their responsibilities. Such reports will be likely to comprise both qualitative as well as quantitative information. The particular information reported to institutional holders, including the format in which details of how votes have been cast are be presented, should be a matter for agreement between the holders and the IMC.

Transparency is an important feature of effective external governance. However IMC should not be expected to make disclosures that might be counterproductive. Confidentiality in specific situations may well be crucial to achieving a positive outcome.