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Vice President

Susannah Haan  
Financial Reporting Council  
Fifth Floor  
Aldwych House  
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London WC2B 4HN

14<sup>th</sup> April, 2010

Dear Susannah,

**Consultation on a Stewardship Code for Institutional Investors**

J.P. Morgan Asset Management (“JPMAM”) is a large fund management company with assets under management in excess of one trillion dollars globally. JPMAM views seriously its stewardship obligations to its clients. We vote at over 10,000 AGMs each year in 63 markets worldwide and engage actively on corporate governance issues at companies in which we invest, in order to promote our clients’ best interests.

JPMAM is a member of the National Association of Pension Funds (NAPF) and the Association of British Insurers (ABI) and we generally take their guidance into account when commenting on public policy. In this instance, however, it was felt that the issue was of sufficient concern to warrant our own, independent, response.

We would therefore offer the following comments, which we hope will be of assistance to you and the Council in your deliberations. By way of an executive summary, we would stress two over-arching concerns:-

- the need for **flexibility**. In order to be successful and to gain widespread acceptance, the Code must be reasonable and flexible in its approach and must at all costs avoid a ‘box ticking’ mentality, where quality of engagement is subordinated to perceived quantity of activity.
- the pre-requisite of **materiality**. Resources for engagement should be allocated in a way which is most effective for our clients, which may entail applying a materiality test in reference to the amount of equity held in a given company, such that engagement is taken seriously by the board(s) in question.

With these two priorities in mind, we would offer the following detailed observations:-

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## Section 1: Introduction

*The FRC would welcome views on the policy objectives against which the FRC should judge its approach to a Stewardship Code.*

**JPMAM response:** We agree with the views of the National Association of Pension Funds (NAPF), that the objectives should be the following:

- Set standards of stewardship to which institutional investors should aspire;
- Promote a sense of ownership of the Code amongst institutional investors in order to encourage UK and foreign shareholders to apply and report against it;
- Contribute and facilitate improved communication between shareholders and the boards of the companies in which they invest;
- Ensure that engagement is closely linked to the investment process within the investment firm;
- Secure sufficient and appropriate disclosure to enable institutional shareholders' clients and prospective clients to assess how those managers are acting in relation to the Code, so that this can be taken into account when awarding and monitoring fund management mandates.

We also agree that the industry would benefit from standards being set independently of asset managers, in order to ensure an objective assessment of those standards and encourage greater consistency in their application. We therefore welcome the involvement of the FRC in overseeing the Code.

*The FRC is seeking views on whether it should accept oversight of the Code in its current form, or whether amendments should be made before the FRC does so.*

**JPMAM response:** Whilst, in our view, the format of the Code is arguably less clear than the original ISC Statement of Principles 2005, we believe that the content is fundamentally sound and do not favour major amendments at this stage, although it would be sensible to undertake periodic reviews from time to time.

*Views are also sought on which institutional investors and agents should be encouraged to apply the code on a "comply or explain" basis, what they should be asked to disclose and to whom, and the monitoring arrangements that should be put in place (paragraph 1.17).*

**JPMAM response:** We agree with the view of the NAPF, that the Code should be applied by all in the investment chain, including proxy agents and investment consultants. Pension fund trustees, as principals, should set out clearly how they deal with the Code, or how they delegate the function to their asset. They should also consider inserting clear guidance in their investment mandates. We also foresee trustees and consultants taking asset managers' approach to the Code into account when reviewing current and prospective managers.

Our greatest concern in relation to the implementation of the Code is that disclosure becomes a 'box-ticking' exercise, with too much focus on voting activity and quantity, rather than quality, of engagement. We are also concerned that over-specification may result in engagement becoming over-prescribed, and that such a regime may actually stifle engagement in all its different forms. The need for flexibility must be preserved at all costs.

We believe that asset managers should disclose, and be prepared to justify, any contentious issues which may have arisen during a reporting period. Pension funds should require regular updates from their asset managers. A starting point would be to include corporate governance updates as a routine agenda item in trustee meetings with managers.

## Section 2: Background and Recent Developments

*The FRC would welcome any insights on lessons which may be learned from experience outside the UK (paragraph 2.18).*

**JPMAM response:** As has been stated previously, we remain concerned that there is a real danger that disclosure versus the Code becomes reduced to a 'box-ticking' exercise, focussing on quantity of disclosure rather than quality of engagement. Our experience in the United States, where Mutual Fund regulations require exhaustive public disclosure of voting records publicly on dedicated websites, is that managers are obliged to prepare, verify and disclose hundreds of thousands of lines of reporting on proxy voting pursuant to Regulation N-PX, on a website that receives only a negligible number of hits.

JPMAM has always disclosed its proxy voting and engagement activity to its clients and now discloses summary proxy voting statistics, as well as selected retrospective voting and engagement activity, publicly on its website. We remain concerned, however, that public disclosure of ongoing engagement with companies may be prejudicial to that engagement activity and would not be in the best interests of our clients. In our view, resources diverted to checking and maintaining exhaustive public vote disclosure would be better employed on valuable engagement.

## Section 3: The Coverage of the Code

*The FRC would encourage all UK institutional investors to apply and report on the Code regardless of whether or not they are subject to mandatory requirements, and would welcome views on whether there are any barriers or other reasons that would prevent or discourage them from doing so (paragraph 3.6).*

**JPMAM response:** We see no real barriers or impediments that prevent UK institutional investors, who are not subject to mandatory requirements, from applying and reporting under the Code on a voluntary basis, providing the Code is reasonable and flexible in its approach. If resources at smaller asset managers are constrained, or if their investments or investment processes do not, in their view, immediately lend themselves to voting or engagement, then they should explain this both publicly and to their clients.

*Views are invited on whether agents such as voting services agencies and investment consultants should be encouraged to commit to the spirit of the Code, and if so how this could be done (paragraph 3.8).*

**JPMAM response:** We believe that voting agents and investment consultants should commit to the Code. We agree with the view of the NAPF, that both have an integral role to play in facilitating effective stewardship, as well as setting the agenda for trustee meetings and advising on manager selection.

*The FRC is keen to hear from foreign investors in response to this consultation, and would in particular welcome comments on:*

- *Whether foreign investors would be willing voluntarily to commit to a Code sponsored by a UK regulator such as the FRC or a UK industry body like the ISC in respect of their holdings in UK companies;*
- *Their current practice on disclosing information on their engagement policy, including any national or international standards they follow; and*
- *Any barriers or other potential difficulties for foreign shareholders seeking to engage with UK companies (paragraph 3.13).*

**JPMAM response:** We see no real barriers or impediments for foreign shareholders seeking to vote at UK shareholder meetings, and no barriers to engaging with UK companies, other than the obvious logistical or language issues, again, providing the Code is reasonable and flexible in its approach. Overseas

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investors should be invited to commit voluntarily to the Code if they wish. The FRC may consider establishing contact with similar bodies overseas to explore bipartisan equivalency or passporting arrangements with other countries and Codes as they emerge (e.g. Netherlands).

*The FRC would also be interested to hear from investors who operate on a cross-border basis about any potential conflicts which might arise between requirements or codes in place in other countries and the proposed Stewardship Code (paragraph 3.14).*

**JPMAM response:** We see no obvious conflicts with codes or market practice in other countries, although there have been high-profile examples of companies ruling unilaterally groups of shareholders to be ‘acting in concert’ and removing arbitrarily their voting rights, in order to entrench management. There are other jurisdictions where engaging collectively with other shareholders may be unworkable due to existing regulation. Shareholders need to be mindful of this when engaging overseas.

In our view, it is in our clients’ interests to pursue higher standards of corporate governance for all their investments, regardless of market, and indeed issues at foreign companies may often take precedence over UK ones. We would in fact welcome further clarity as to the exact scope of the Code as it relates to asset managers’ obligations to investments overseas.

#### **Section 4: The Content of the Code**

*Respondents are welcome to comment on any aspect of the ISC Code, but in particular views are invited on these questions:*

- *What are the responsibilities for engagement of institutional investors to the beneficial owners whose interests they represent? Does the ISC Code cover all the relevant responsibilities?*
- *What are the responsibilities for engagement of institutional shareholders to the UK listed companies in which they invest? Does the ISC Code cover all the relevant responsibilities?*
- *Are the respective responsibilities of the different parts of the investment chain sufficiently clear and appropriate?*
- *Does the Code strike the right balance between the need to avoid overspecification that might discourage the application of the Code and the need for it to be effective with an appropriate degree of transparency?*
- *Are there any parts of the ISC Code where further guidance is needed, or where the existing guidance should be amended? (paragraph 4.2)*

*Views are invited on whether the ISC Code adequately covers the content of Section E of the Combined Code (paragraph 4.4)*

**JPMAM response:** No view, other than our already highlighted concerns regarding over-specification, whereby reporting in relation to the Code becomes reduced to a ‘box-ticking’ exercise, focussing on quantity of disclosure rather than quality of engagement. We must not lose sight of the primary objective, which is to promote meaningful engagement, in all its forms, that is effective for our clients. It is also worth stating that resources for engagement should be channelled to where they might be the most effective for our clients, which may entail applying a materiality test in reference to the amount of equity held in a given company.

## **Section 5: Reporting, Monitoring and Review**

*The FRC would welcome views on:*

- *The information that institutional shareholders should disclose publicly and that they should report to clients;*
- *The arrangements that should be put in place to monitor how institutional shareholders apply and report against the Code; and*
- *The arrangements for reviewing the operation and content of the Code (paragraph 5.2).*

*The FRC would welcome views on the specific information that should be disclosed by institutional shareholders and their agents, and at what level of detail the “comply or explain” principle should apply (paragraph 5.3).*

*Views are invited on whether public disclosure of the information summarised is appropriate and useful, and whether other information might also usefully be disclosed (paragraph 5.6).*

**JPMAM response:** It is fair to say that this is the area which has proved the most contentious and caused the most debate amongst practitioners. We believe that an asset manager’s duty, first and foremost, is to its clients and it should be for the end client, with the help of their advisers, to assess the standards of stewardship achieved by asset managers on their behalf. That being said, asset managers should, as a matter of best practice, publish a statement on their websites as to how, in their view, they have complied with the Code. They should also justify any exceptions, or explain why sections of the Code, if any, are not applicable to them. They should also make available their written policy on voting and engagement, as well as how they deal with other matters, such as social and environmental issues, publicly on their websites. Their approach to conflicts of interest should also be disclosed.

We would point to the existing IMA Survey as an effective transitional arrangement to assess levels of engagement and stewardship activity in the interim.

Asset managers wishing to demonstrate compliance with the Code should also be required to make publicly available summary voting reports, detailing issues of particular interest or deviations from normal voting policy. We agree with the NAPF that this should be on an exceptions basis, in order to avoid exhaustive reporting which does not add value.

Asset managers should also publish summary engagement statistics for the period under review and include details of engagement highlights, subject to the sensitivities of any ongoing engagement, or where detailed disclosure would be prejudicial to that engagement, or detrimental to the best interests of their clients.

JPMAM does not believe that public disclosure of our entire proxy voting record is necessarily in the best interest of our clients, whose objectives may not be aligned with those of the general public and certain special interest groups. As has been stated previously, diverting already-constrained resources to the checking and maintenance of exhaustive public vote disclosure could, in our view, actually result in the unintended consequence of less stewardship for our clients, where those resources would be better employed undertaking meaningful engagement activity and generating real value.

We believe there is a very real concern that a SAS70-type verification risks giving rise to an approach whereby the quality of engagement is subordinated to perceived quantity of activity, with those tasked with

verifying the process resorting to the expedient of simply counting the number of engagements conducted. This risk of 'box-ticking' would be exacerbated if the oversight function were to be taken on by a regulatory body, or outsourced to a third party, rather than assessed by practitioners. Ultimately, it should be for the end client, with the help of their advisers, to assess the standards of stewardship achieved by asset managers on their behalf. The evidence-based approach taken by the UN PRI might also be a model for consideration.

I hope the above is helpful. Should you wish to respond on any of the above points, or discuss corporate governance further, please do not hesitate to contact me. Alternatively, we would be happy either to arrange a meeting with members of the corporate governance team, or to discuss the issues at your next scheduled one-to-one meeting.

Yours sincerely

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