

FTIM's response to the FRC's Consultation Report on the revised Stewardship Code (April 2012)

Introduction

This response starts with a brief introduction to FTIM and our attempts at compliance with the Code. There follows a point-by-point discussion of the key issues highlighted by the Consultation Report followed by a brief summary of our views.

We have read both the above document and the earlier "Developments in Corporate Governance Report (December 2011)". For simplicity the comments follow the numbering of paragraphs in the Consultation Report.

Fundamental Tracker Investment Management

FTIM is a small investment management firm based in Scotland and manages only the one fund – the Munro Fund, a UK equity OIEC which is based on a model that ensures all stock selection remains completely objective. The fund is not a pure index tracker as weightings are dictated by market consensus dividend forecasts, not market weights. As such it is by nature a long term investor in UK companies, with low stock turnover. The managers cannot sell a holding if they disagree with the company board over corporate governance issues. We believe we have, alongside other index managers, all the more reason to focus on good corporate governance, given that this is the only course of action we can take.

FTIM and the Stewardship Code

FTIM introduced a formal corporate governance policy last autumn alongside signing up to the Stewardship Code. Our application of the Code is clearly stated on our website, and the reasons for limiting our voting to controversial issues (due to cost). We demonstrate how we have written to the company chairman in advance of any AGM where we intended to vote against a resolution. These letters have been published on our website. We have also sought the views of our investors through the same website pages.

http://www.themunrofund.com/0701_corporate_governance.html

We perceive corporate governance to go beyond merely remuneration policy, though this has tended to be our main focus to date. We have issued letters to Barclays, Cookson and WPP on executive pay in recent months, but have also voted against G4S and RBoS on other issues.

Comments on the Consultation Document (numbers refer to the paragraphs in the document)

5. *Definition of stewardship in the proposed revisions* – FTIM agrees that the scope of the Code needs to be restricted to those areas covered by the Corporate Governance Code. There is a danger that it becomes all-encompassing. We have seen how “responsible investment” (or CSR/ESG) has developed into fields covering everything from social policy to climate change – issues on which the average asset manager has limited professional knowledge.

6. *Clarifying the distinct role of asset owner and asset manager* – FTIM agree this is a useful step and is well explained in the revised Code. Delineation should encourage both to take more interest in their duties. It should also ensure asset owners who subcontract the management of these assets to an asset manager agree whose responsibility it is to set voting policy and take an interest in corporate governance. For most asset managers it represents a cost to the business with no immediate benefit. If asset owners are keen for their assets to be managed in a “responsible” way, they must be aware of the costs involved and take an interest in the way their managers have carried out and recorded their adherence to the Code.

It is unusual for asset owners to take on the voting rights themselves from their asset managers. Whilst researching corporate governance with a firm of consultants called ERM last year I interviewed the RailPen investment manager, who, as an asset owner, is a Code signatory. They seem fairly unique in taking control of their own voting in their indexed portfolios and they paid close attention to the voting record of their other asset managers. It is up to other asset owners to follow this example and put more pressure on their asset managers to sign up to the Code or implement its guidelines.

Asset owners have a “stewardship obligation to their beneficiaries” but it must be recognised how difficult it is to assess the views of these beneficiaries. At FTIM we have encouraged feedback on our website, with little response so far. We have also emailed as many of our investors as possible copies of any letters we have sent to company chairmen. The response, though limited, has been supportive.

With only the one fund, the Munro Fund, we have limited conflicts of interest. Having experience of working in a larger institution with a wide spread of funds, it is hard to see how all fund managers will willingly follow the company line on stewardship issues. There will always be a clash between those funds run on a short term view, against those taking a longer term view. So it is imperative for asset managers to state which funds adhere strictly to any agreed Stewardship Code policy.

10. *Conflicts of interest* – on the FTIM website we argue that we see no eventuality where we would have any conflicts of interest in relation to the Code (nor with our investors who are aware of our tight, well-defined investment process). Other index funds will use similar process-driven stock selection. We believe we are unique in having no active funds in-house where opportunities for short-term trading might conflict with a longer term approach demanded by the index funds. With this in mind we have been in correspondence in recent months with the chairman of Barclays suggesting a representative from FTIM or a similar “non-conflicted” shareholder should be

appointed to represent shareholders on the board of Barclays. In the light of what has occurred in recent weeks in relation to Libor, this idea has taken on a greater urgency.....

12. *Collective engagement* – we agree that a willingness to participate in collective engagement should be included in investors' statements. As a small institution with a willingness to "stick our heads above the parapet" we would welcome approaches from other investors to assist campaigns against poor corporate governance. We are limited in our efforts as we are unable to afford the research sold by proxy voting firms such as ISS, or the advice available from the ABI and NAPF. We do not have the resources to read all the Report & Accounts of our investee companies and thus to filter out the ones requiring action. An early warning system for smaller institutions like us would be very useful.

14. *Proxy voting* – FTIM agree it would be useful to see to what degree investors rely on the opinion of these advisory services. We do not have access to them, but if we did we would use them as a source of information and an early warning system, rather than a blind guide to voting.

17. *Stock lending* –FTIM backs the introduction of a disclosure on whether lent stock is withdrawn for voting. This is perfectly possible for most institutions to arrange and a failure to do this defeats the whole object of active stewardship.

FTIM does not lend stock. We have other reservations on the practice, as institutions do not make clear to their investors the counterparty risk they accept on behalf of their investors. Does the income from this activity find its way into investors' pockets to compensate them for this hidden risk or does it remain with the asset managers?

20. *Other asset classes* – we agree that it would make sense for institutions to clarify which areas are covered by the Code. We would like to believe overseas equities could be included in time but for now we would expect the FRC to concentrate its efforts on the UK market and to leave it to institutions to decide on their policies for overseas assets. Beneficiaries may wish to see their asset managers extend corporate governance principles to other asset classes such as corporate bonds and overseas equities but they should be aware that this could be expensive and institutions might become even more dependent on proxy advisory services.

22. *Assurance services* – I have just waded through the ICAEW's AAF 01/06 Stewardship Supplement (March 2011). We are a small institution with limited resources. If we were expected to comply with the guidelines suggested here we would never have signed up to the Stewardship Code. One should remember it is a voluntary code that already has cost implications. Asset managers are well known for their unwillingness to pay for outside services, and unless they can arrange for the respective asset owners to pay for these assurance reports, then I suspect only the largest asset managers will be willing to introduce these reports. FTIM would certainly reconsider its position. Whilst we would maintain a strong interest in applying the Code, we might withdraw from being a full signatory.

The cynic would note that the summary report of the consultation on the Amendments to AAF 01/06 Stewardship listed only 5 responses, two of which were accountancy firms. No doubt the auditors would appreciate widening their services to include AAF 01/06 assurance reports.

25. *Annual updates* – FTIM agree an annual review is required. In the process of submitting this response we have become aware of various elements of our policy statement that needs revising. Additions will include a mention of the issues discussed below in 26.

26. *Insider information* – FTIM would agree that it would be useful if institutions stated their willingness to be made insiders, and preferably for them to appoint a named individual who could be the first point of call. Whilst it might not always be practical, it could avoid the confusion that arises when rung up to say you are about to be made an insider. In some cases this effectively makes you an insider, even if the offer is turned down!

FTIM are relatively unique in having no conflicts of interest give the model-driven investment process. We have extensive experience of fund management and stock-broking. We would willingly be taken “inside” and act the role of “sounding board” for listed companies.

Summary

FTIM would agree with the majority of the changes discussed and introduced in the revised draft. As a small but active signatory to the Code we have strived to follow as many of the principles as possible but have made it clear on our website where limited resources restrain our response. The FRC should endeavour to avoid compliance to the Code becoming too much of a bureaucratic exercise, dragging in external reporters (auditors) or taking up too many internal resources. This would discourage small and medium sized asset managers to participate. If asset owners insist on these procedures they should be willing to contribute to the costs. We try to keep costs for our unit-holders as low as possible and we have to balance this against the ideal of full compliance.

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