Investor Responsibility Briefing

Insight INVESTMENT

HBOS plc

The voting debate: is mandatory or voluntary disclosure best?

The debate on voting disclosure hangs on two key questions. First, should the disclosure of institutional votes should be mandatory or voluntary? Secondly, who should be responsible for disclosure – asset owners or asset managers?

Initial pressure for disclosure

Pressure for disclosure has principally come from the Trades Union Congress (TUC) who believe that compelling asset managers to publicly disclose how they have voted their clients' holdings will lead to better informed voting and, ultimately, better governance. Since 2003, the TUC have asked leading UK asset managers how they have voted on certain 'controversial' resolutions, as part of a survey on voting that is carried out annually.

Initially, Insight was reluctant to participate, believing that assessing voting decisions in isolation is a poor way of judging the quality of an asset manager's activism. However, in 2004, we decided to publish on our website our voting recommendations for the FTSE 350, together with our record of engagement with those companies – providing a complete picture of our activism on governance issues.

A unified survey emerges

In 2004, we participated in the TUC voting survey and in a similar Investment Management Association (IMA) survey designed to demonstrate to the Treasury the level and nature of shareholder activism in the UK. In 2005, the TUC's questions were integrated into the IMA's annual survey of institutional activism, in order to avoid duplication. In 2005, 11 UK asset management firms were publicly disclosing their vote recommendations.

Pressure mounts for mandatory disclosure

We believed that this progress towards voluntary reporting by the asset management industry had persuaded the Department of Trade and Industry (DTI) that there was no need to compel voting disclosure through the Company Law Review – the route suggested by supporters such as the TUC. Insight – and other investment managers – were therefore very surprised by the inclusion of clause 866 in the draft Company Law Reform Bill, giving reserve powers to compel institutional investors to publicly reveal how they had voted. Interestingly, the implication of the drafting is that responsibility for disclosure falls to the asset owners, rather than asset managers.

Given the complexity of institutional ownership structures, it is not clear how this would work in practice. For example, in the case of the Trust, the Trust, itself, would shoulder responsibility for disclosure. For the Trust and most asset owners, this would involve added cost. (The draft Bill gives a potential exemption to disclosure for small pension funds.)

The Regulatory Impact Assessment statement estimates the costs of implementing this clause, but provides no clarification as to how the figure was calculated. Further, it is not clear exactly what the benefits of compulsory voting would be. In the US, we understand that the Securities and Exchange Commission (SEC) is questioning whether the introduction of compulsory voting disclosure for US mutual funds has had the desired effect of better informing voting decisions, or had the unintended consequence of leading asset managers who previously were not actively voting to simply tick boxes and/or delegate decisions to disengaged third parties, diluting the votes of genuinely engaged shareholders.

EU proposals for disclosure

Alongside the review of UK Company Law, the EU is consulting on an action plan, within which one set of proposals is entitled 'Modernising Company Law and Enhancing Corporate Governance in EU.' The action plan contains the more limited proposal that institutional investors be required to disclose their investment policies and their policies with respect to the voting rights in companies in which they invest and should also disclose to their beneficial holders, on request, how these rights have been exercised in a particular case.

Conclusion

From a UK perspective, it appears that the Treasury (which inserted the clause on disclosure into the DTI's Bill) hopes that it will remain as enabling legislation only and that institutional investors will voluntarily comply with disclosure. The Bill is currently going to the Lords and may be passed this year. At that point, we will be able to review the implications for our policy and approach to disclosure.

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