THE INVESTMENT ASSOCIATION

IMPLEMENTATION UPDATE

Supporting UK Productivity with Long-Term Investment

The Investment Association's Productivity Action Plan

August 2017

The Investment Association
Camomile Court, 23 Camomile Street, London, EC3A 7LL

www.theinvestmentassociation.org
productivity@theia.org

@InvAssoc

August 2017

FOREWORD

WHEN HOUSEHOLDS, PENSION FUNDS, INSURERS, AND OTHER INVESTORS CHOOSE THE INVESTMENT ASSOCIATION'S MEMBERS TO INVEST THEIR MONEY, THEY DO SO IN ORDER TO DELIVER THE RETURNS NECESSARY TO PLAN FOR THE LONG-TERM. MAKING SOUND INVESTMENT DECISIONS WHICH DELIVER THOSE RETURNS IS OUR INDUSTRY'S MOST IMPORTANT RESPONSIBILITY.

The long-term and productive supply of capital throughout the economy is ultimately in the best interests of our customers. Our members already fund 60% of all new capital market fundraisings in the UK. In turn, this investment helps to drive wealth creation across the country, and lifts living standards for all.

However, we are conscious that the UK is experiencing a 'productivity puzzle' with little to no growth in the rate of productivity since the financial crisis of 2008/09. Solving this puzzle is critical if the UK is to close the gap with its major international competitors, deliver higher wages, better living standards, and be more competitive on the global stage.

For our members, the imperative to boost the UK's performance on productivity is clear. Stronger, more productive businesses are more likely to deliver the exceptional long-term investment returns that the many millions of people, whose savings and investments are managed by our industry, both demand and deserve.

We agree with the Government that now is the time to act. For productivity to improve across the UK, our members recognise that the investment industry has a pivotal role to play ensuring companies are able to access the patient capital that they need to fund growth and development plans. In turn, this needs to be supported by the right conditions that encourage both investors and companies to act for the long-term.

But expanding the productive capacity of the UK economy also requires long-term investment in infrastructure, research and development, and physical assets. From the asset allocation, to the incentives and governance of the investment strategies deployed, down to individual portfolio decisions and engagement with company boards, it is clear that more attention needs to be paid to aligning market incentives with the long-term investment needs of the UK economy.

This is why, in March 2016, the Investment Association launched its Productivity Action Plan, aiming to boost UK productivity through long-term investment and enhanced investor stewardship. The Plan sets out targeted reforms to the way different parts of the economy should interact with each other, and aims to give companies the confidence they need to invest in productivity improvements. Most importantly, it seeks to deliver ambitious remedies to the ills of some of the most serious causes of short-term thinking in the British economy.

Over 15 months on, I am pleased to reaffirm our commitment to the Productivity Action Plan. Initiatives launched in the past year like our Long Term Reporting Guidance, backing for a UK municipal bond market, and the publication of Governance and Disclosure Guidelines for Housing Associations show the progress we have made.

We are keen to see more done to open up the supply of long-term finance in the UK. Although much has changed in the past year following the UK's decision to exit the European Union, solving the 'productivity puzzle' continues to represent the challenge of a generation. It is imperative, therefore, that we do not lose sight of the important work that we still have to do. Our priority must now be delivering the remaining recommendations of the Plan.

Chris Cummings
Chief Executive

EXECUTIVE SUMMARY

THERE HAS BEEN A GREAT DEAL OF DEBATE OVER THE CAUSES OF THE UK'S SO CALLED 'PRODUCTIVITY PUZZLE'. IT IS CLEAR THAT WIDE-RANGING AND MULTI-DIMENSIONAL FACTORS CONTRIBUTE TO PRODUCTIVITY, AND IT HAS NOT BEEN OUR INTENTION TO PROVIDE DEFINITIVE ANSWERS TO THIS BROADER DEBATE. RATHER, OUR FOCUS IS HOW THE INVESTMENT INDUSTRY CAN PLAY ITS PART, AND USE ITS UNIQUE POSITION TO HELP CREATE A THRIVING, MORE PRODUCTIVE ECONOMY THROUGH INCREASING LONG TERM INVESTMENT.

Earlier this year we updated the Chancellor on progress made in implementing the Plan. This document lays out in greater detail the actions we have taken since March 2016 to help boost productivity, and our ambitions moving forward.

Over 15 months on, we are pleased to report that we have made significant progress implementing the Plan. **Of the 29 actions we committed to take between 2016 and 2019, half are already complete**. Two other projects will be concluding shortly. In summary, the key achievements of the past year include:

- Publishing our Long Term Reporting Guidance setting out members' expectations for company reporting on the drivers of productivity, capital allocation, human capital, and culture;
- Calling on companies to stop quarterly reporting and issuing short-term earnings guidance, and instead refocus their reporting on the long-term strategic drivers of value creation in their businesses;
- Publicly backing the development of a UK municipal bond market setting out the benefits of municipal bonds to the wider economy, and how they could fund new infrastructure spending;
- Publishing a Stewardship Reporting Framework to assist members in reporting on their stewardship activities;
- Revising our Annual Stewardship Survey in partnership with the PLSA and ICSA to provide a snapshot of stewardship across the investment chain by pension funds and companies;
- Issuing Governance and Disclosure Guidelines for Housing Associations providing advice for those seeking to raise capital on the public market;

2016

MARCH	APRIL	MAY	JUNE	JULY	AUGUST	SEPTEMBER	OCTOBER	NOVEMBER
The IA launches the Productivity Action Plan.	The Executive Remuneration Working Group issues its interim report.	Stewardship Reporting Framework published to assist members in publicly reporting about their stewardship activities. The IA endorses the Pre-emption Group Statement of Principles.	Template resolutions developed to support the Pre-Emption Group Statement of Principles.	The Executive Remuneration Working Group releases its final report. The IA welcomes the FRC's 'Corporate Culture and the role of the Board' report.	Three member working groups begin to develop the Long Term Reporting Guidance.	Member working group established to consider the barriers to greater long-term investment by DC pension schemes.	Position paper issued calling for companies to stop quarterly reporting. The IA's Principles of Executive Remuneration revised to incorporate working group's findings.	Position paper issued encouraging the development of a UK municipal bond market.

- Lending our support to the Pre-emption Group Statement of Principles, and driving forward the development of template resolutions to protect the rights of minority shareholders on pre-emption;
- Establishing and acting as secretariat to the Executive Remuneration Working Group and revising, after extensive consultation, our Principles of Remuneration ahead of company remuneration policy votes during this year's AGM season;
- Establishing a member working group to consider the key regulatory and market barriers to creating an investment environment more conducive to long-term investment by defined contribution pension schemes. The final report is due later this year; and
- Advocating at the European Commission for new Prospectus Regulation to make it easier for companies to access equity capital both at IPO and on the secondary markets whilst, at the same time, maintaining important investor protections.

Our priority is now on delivering the remaining recommendations of the Plan. In particular, we will concentrate our efforts over the next 12 months on:

- Developing best-practice guidance as to how long-term investment principles can be better incorporated into mandate design;
- Examining the methodologies for calculating average holding periods with a view to developing a standard approach across the industry;
- Developing joint guidance with the Quoted Companies Alliance to promote better information flows between institutional investors and small and medium-sized, early stage, pre-IPO companies;
- Promoting a more effective new issuance process in the sterling fixed income markets with a particular focus on insurers as institutional investors; and allowing the investment industry to efficiently assess if fixed income instruments are suitable for portfolios utilising Solvency-II matching adjustment requirements;
- Reviewing the extent to which accounting standards and prudential regulatory requirements may be resulting in excessive de-risking and impeding the provision of longer-term forms of finance; and
- Undertaking a comprehensive review of the causes of debt-bias in the UK market, and the limiting effect this may be having on the provision of long-term finance.

2017

Month	Events
DECEMBER	The IA attends European workshop on addressing barriers to listing of SMEs. The IA engaged in advocacy on the Prospectus Regulation in Brussels.
JANUARY	Joint discussion group held with the QCA on pre-IPO engagement. Roundtable with the FCA on the European Banking Authority's review of the prudential regime for investment firms.
FEBRUARY	The IA submits its formal response to the Government's Corporate Governance Reform Green Paper.
MARCH	Guidance issued for Housing Associations seeking to raise capital on the public markets. The IA formally updates the Chancellor regarding progress in implementing the Productivity Action Plan.
APRIL	The IA submits its formal response to the Government's Industrial Strategy Green Paper.
MAY	Long Term Reporting Guidance published.
JUNE	The IA undertakes a review of quarterly reporting in the UK. The IA welcomes the establishment of the Productivity Leadership Group and its 'Be the Business' initiative. The IA welcomes FCA's proposals on reforming the availability of information during the IPO process.
JULY	Review of companies adopting Pre-emption Group Statement of Principles.

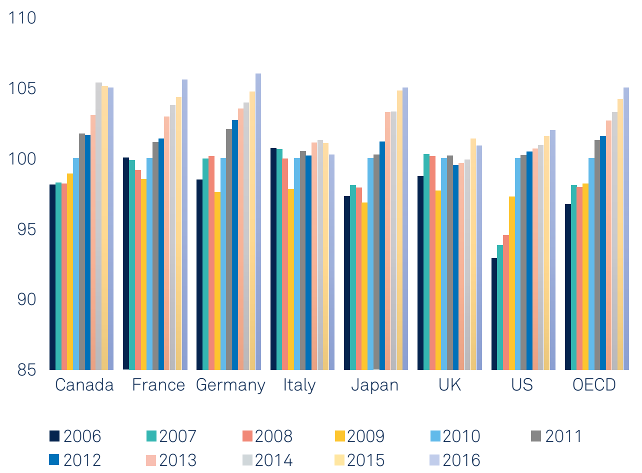
THE PRODUCTIVITY CHALLENGE

Economists agree that a country's ability to improve its living standards depends largely on raising productivity. Productivity is about how well people combine resources to produce goods and services. It is about creating more from less, and through the process of renewing physical and intangible capital, it provides the essential ingredients of wealth creation and economic prosperity.

Gains in productivity are what have made Britain one of the wealthiest nations in the world. Yet despite the lowest rate of unemployment since comparable records began in 1975, productivity growth has remained stubbornly flat since the financial crisis of 2008/09.

Today, the UK ranks fifth in the G7 on productivity, with Germany top, and Canada and Japan below the UK. UK productivity is some 19% below the G7 average, and the productivity gap between today and the pre-2008/09 trend is 15.2% – the largest of any other nation in the G7 and over half the G7 average of 7.5%. Since the financial crisis of 2008/09, only Italy has seen weaker rates of productivity growth than the UK among the G7.[1]

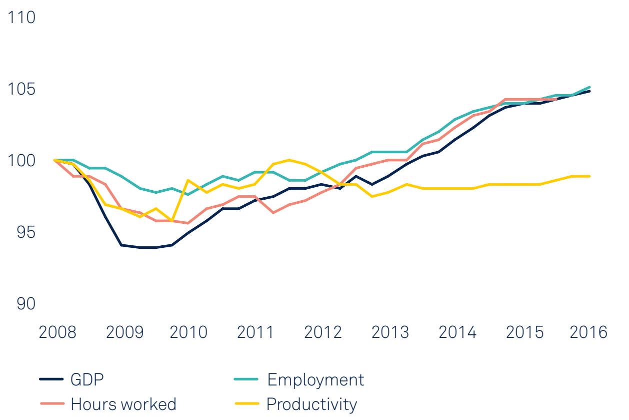
CHART 1: GDP PER HOUR WORKED



Source: OECD. Compendium of Productivity Drivers 2017, 18 May 2017.

Recently the IMF noted that GDP in advanced economies would be 5% higher today if the pre-2008/09 trend had continued for total factor productivity growth.[2] While a broad measure of what goes into production, including research and development, and equipment spending, this would be the equivalent of adding another Japan to the global economy.

CHART 2: THE UK'S PRODUCTIVITY PUZZLE



Source: Office of National Statistics. Statistical Bulletin: Labour Productivity (Oct – Dec 2016).

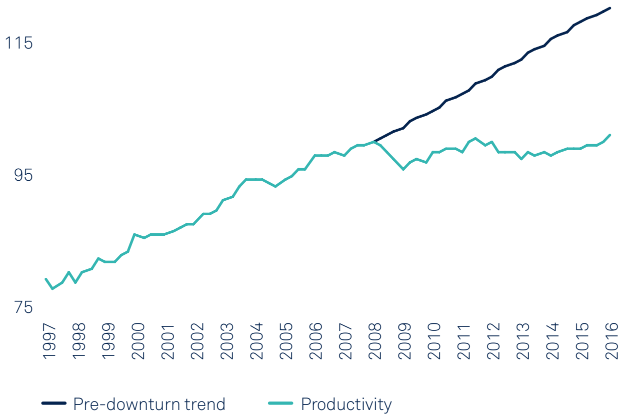
Critically, it is important to note that the recent period of economic growth enjoyed by the UK may be attributed to an increase in the number of hours being worked in the economy, rather than any meaningful improvements in productivity. For the UK, the potential rewards from solving the productivity puzzle could therefore be significant.

In the UK, an hour's work would be worth 17.9% more than it is today as a contribution to GDP if the rates of productivity growth remained at pre-2008/09 levels. Put another way, the economy would be in the region of £250bn bigger – or approximately £9,000 for every household in Britain - had productivity growth not stalled in 2008/09.[3]

"THE ECONOMY WOULD BE IN THE REGION OF £250BN BIGGER – OR APPROXIMATELY £9,000 FOR EVERY HOUSEHOLD IN BRITAIN."

[1] House of Commons Library: Briefing Paper. Productivity in the UK, 28 April 2017.
[2] International Monetary Fund. Reinvigorating Productivity Growth, Speech delivered to the American Enterprise Institute, 3 April 2017.
[3] House of Commons Library: Briefing Paper. Productivity in the UK, 28 April 2017.

CHART 3: THE UK'S PRODUCTIVITY GAP



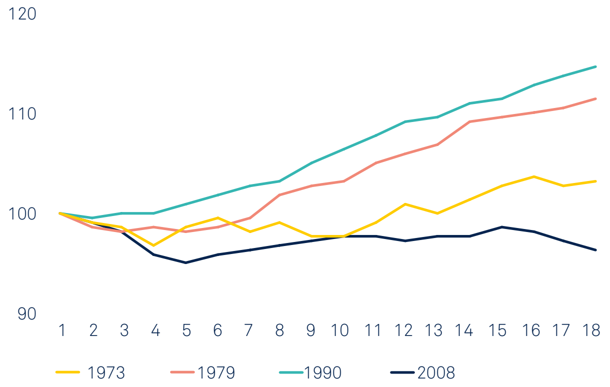
Source: Office of National Statistics. Statistical Bulletin: Labour Productivity (Oct – Dec 2016).

There are reasons to be optimistic about productivity growth in UK. According to the Office for National Statistics (ONS), quarterly productivity growth ranged between 0.2% and 0.4% during 2016. In Q4 2016, productivity increased by 0.4% on a quarterly basis, and 1.2% on an annual one.[4]

However, when taken together with other modest increases in productivity since 2008/09, there is little evidence to suggest this is the end of the UK's productivity challenge. In fact, in Q1 2017, the productivity rate fell again by 0.50%. The UK Office for Budget Responsibility (OBR) also recently warned that productivity growth is likely to be lower than it had previously forecast, and only return to its long-term trend of over 2% per annum in 2020.[5]

This OBR forecast contrasts with the patterns following previous UK economic downturns in which the initial drop in productivity was typically short-lived. In the previous two recessions, productivity began to rise again after only a few quarters, and regained its peak level quite quickly as employment fell while output began to recover.

CHART 4: PRODUCTIVITY RATES FOLLOWING AN ECONOMIC DOWNTURN



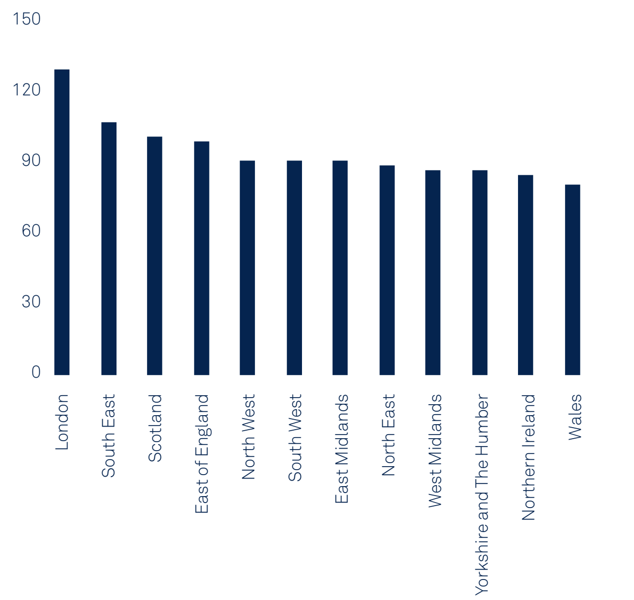
Source: OECD. Compendium of Productivity Drivers 2017, 18 May 2017.

Overall, productivity only exceeded its pre-2008/09 peak for the first time in the second quarter of 2016 by 1.1%,[6] before falling back below the peak again in Q1 2017. It is clear that there is still much to do if the UK is to return to pre 2008/09 rates of growth of over 2%. While the services (+.8%) and manufacturing (+1.7%) sectors have both contributed to recent productivity growth, more effort will be required to close the productivity gap between the least and most productive sectors of the UK economy.

Professional services firms, for example, accounted for almost a third of the UK's most productive firms during 2015/16.[7] On a regional basis, a significant disparity still exists in the rates of productivity with London experiencing the highest levels at some 32% higher than the national average. The only other region with productivity higher than the national average was the South East at 9% above the UK average.

[4] Office of National Statistics. Statistical Bulletin: Labour Productivity (Oct – Dec 2016), 5 April 2017.
[5] Office for Budget Responsibility. Overview of the November 2016 Economic and fiscal outlook, 23 November 2016.
[6] Office of National Statistics. Statistical Bulletin: Labour Productivity (Oct – Dec 2016), 5 April 2017.
[7] Office of National Statistics. Statistical Bulletin: Labour Productivity (Oct – Dec 2016), 5 April 2017.

CHART 5: PRODUCTIVITY BY REGION



Source: Office of National Statistics. Statistical Bulletin: Labour Productivity (Oct – Dec 2016).

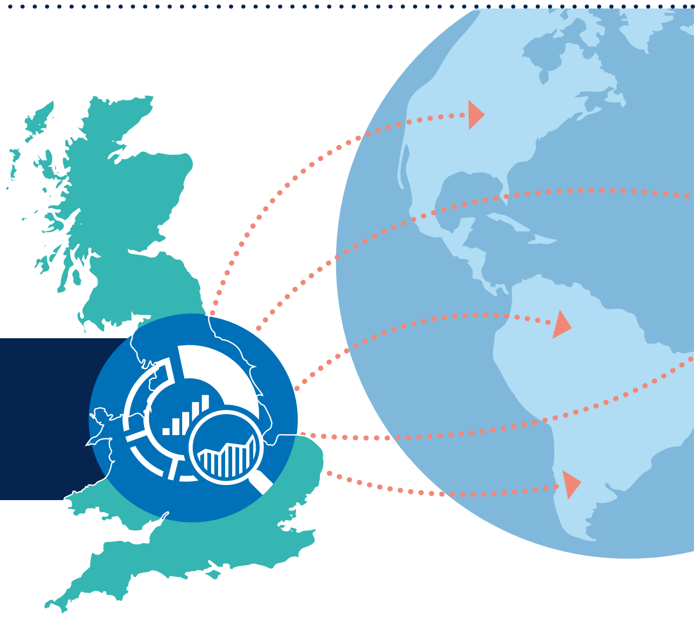
The recent period of productivity stagnation raises important questions about the long-term economic future of the UK. The Investment Association is therefore pleased to see that productivity has been placed at the heart of the Government's long-term economic strategy for the UK, and is a core priority of the Government's Industrial Strategy.

Through our Productivity Action Plan, the Investment Association is committed to supporting the Government in delivering on its aspirations for a more prosperous UK, not only to provide businesses with the capital they need to grow, but to help drive economic growth across the entire country and raise living standards for all.

UK asset managers invest

£5.7 trillion

of savers' money around the world



THE PRODUCTIVITY ACTION PLAN

In July 2015, the Government published its "Fixing the Foundations: Creating a more prosperous nation" strategy, a comprehensive fifteen-point plan setting the agenda for the whole of Government to reverse the UK's long term productivity problem and address the persistently low rates of productivity growth in the UK.

The Investment Association welcomed this, and in an exchange of letters between our members and the Chancellor, we committed to developing our own Action Plan setting out how the investment industry could play its part in improving productivity through long-term investment and enhanced investor stewardship.

The resulting Productivity Action Plan seeks to address the challenge from a systemic, macro perspective, in terms of the functioning of regulatory regime and capital markets, and from a micro, bottom-up perspective, in terms of the reporting of companies and the stewardship of investors. Each principle is underpinned by a series of recommendations, as well as tangible actions we have committed to take, each representing a specific work programme in its own right.

PRODUCTIVITY PRINCIPLES

By articulating a set of fundamental principles that seek to define an ideal framework for how investors can contribute to productivity improvements with long-term investment, we can diagnose the current system's short-comings and begin to identify solutions that can address these challenges.

The following set of Principles were developed as a way to examine the appropriate role and responsibilities of asset managers in contributing to productivity and, in turn, to analyse the challenges presented in fulfilling them.

PRINCIPLE 1

Enhance company reporting for efficient capital allocation: *through investment and analytical expertise, the investment industry will seek to identify and finance those companies contributing productive growth in the economy.*

PRINCIPLE 2

Enhance investor stewardship and engagement: *the investment industry will engage with companies to help them achieve sustainable value creation over the long term and support investments in improved productivity.*

PRINCIPLE 3

Simplify behavioural incentives and the investment chain: *the investment industry will work to ensure that the agreed incentives and governance of the investment chain ensure a clear alignment with clients' long-term investment objectives.*

PRINCIPLE 4

Develop efficient and diverse capital markets: *as key capital market participants, the investment industry has a key role in the development of asset classes and the efficient functioning of capital markets.*

PRINCIPLE 5

Overcome tax and regulatory impediments to the provision of long-term finance: *the investment industry should contribute to the debate on the tax and regulatory impediments to investment so as to ensure the right long-term outcomes for clients.*

UPDATE ON PROGRESS

This section provides a detailed update against each recommendation of the Productivity Action Plan as at 1 August 2017. For more information on current developments, please go to **www.investmentassociation.org**

1 ENHANCE COMPANY REPORTING FOR EFFICIENT CAPITAL ALLOCATION

RECOMMENDATION ONE: IMPROVE REPORTING AND RESEARCH ON PRODUCTIVITY AND RE-FOCUS ON LONGER-TERM STRATEGIC DRIVERS.

RECOMMENDATION TWO: IMPROVE REPORTING ON CAPITAL MANAGEMENT AND CLARIFY INVESTOR EXPECTATIONS OF CAPITAL MANAGEMENT.

RECOMMENDATION THREE: IMPROVE REPORTING ON CULTURE, HUMAN CAPITAL AND ACCOUNTING FOR INTANGIBLES.

CALLING FOR AN END TO QUARTERLY REPORTING

In November 2016, the Investment Association called on companies to stop issuing quarterly reports and short-term earnings guidance, and instead refocus their reporting on the strategic drivers of productive growth and value creation.

Since publishing this paper, the Investment Association has met company representatives to discuss the challenges and benefits associated with ending quarterly reporting. Our corporate governance research arm, the Institutional Voting Information Service (IVIS), is highlighting those companies that continue to report on a quarterly basis, asking those that do how it is relevant to their long-term strategy.

Our analysis in October 2016 showed that 30 FTSE 100 and 139 FTSE 250 companies had ceased quarterly reporting. Now, those companies that have stopped reporting on a quarterly basis number 43 and 167 respectively – an increase of 13 FTSE 100 companies and 28 FTSE 250 companies who have decided to stop updating the market on a quarterly basis.

Over 40% of FTSE 100 companies, and over 60% of FTSE 250 companies, no longer issue quarterly reports

LONG TERM REPORTING GUIDANCE

In May 2017, The Investment Association published its Long Term Reporting Guidance. Its publication represents the culmination of a significant body of work by three member working groups first established in July 2016.

Members were tasked with identifying specific areas of improvement in company reporting which would most usefully aid investors' understanding of an investee company's long-term risks, liabilities, and prospects, and promote a sharper focus by companies on the importance of productivity to their investment proposition.

Understanding the drivers of productivity

The Long Term Reporting Guidance requires that companies conduct an assessment of the levels of productivity within their business; explain the key drivers of productive growth and value creation; and identify the key investments that it is planning on making to improve productivity.

This builds on the work undertaken by the business-led initiative, the Productivity Leadership Group, which the Investment Association will continue to support . This will include working together to help companies establish Key Performance Indicators appropriate to their business in order to measure and report more clearly on productivity.

Explaining capital allocation strategies

Capital allocation decisions play a vital role in determining a company's long-term success, and are viewed by our members as some of the most important responsibilities of company management.

As key providers of capital, through the Guidance our members acknowledge that they have a duty to provide investee companies with clarity regarding their expectations of how capital should be managed, and expected returns. The Investment Association's members are keen to support well-reasoned and articulated capital expenditures which are consistent with a company's long-term strategy, and which lead to productivity improvements.

The Guidance therefore also requests that companies more clearly articulate to shareholders their approach to making capital allocation decisions; how this links to the achievement of the business' long-term strategy; and explain to investors how the long-term performance of past capital allocations are measured and assessed by the Board.

The Guidance also discusses how investor engagement can support and challenge a company's capital allocation decisions, and encourage greater investment by companies in fixed capital assets, R&D, and other productive activities.

Improved workforce disclosures

A key driver of productivity is how well a company manages its workforce, and whether it is being deployed efficiently. A well-engaged, stable, and trained workforce is more likely to be more productive and, in turn, more likely to drive long-term business success. These issues are deserving of more transparency by companies through enhanced annual disclosures.

Through our Long Term Reporting Guidance we request that companies identify the significant investments that they have made over the past year, and are planning to make in the next, to improve the productivity of their workforce. The Investment Association also asks that companies outline the significant opportunities, and principal risks, relating to its approach to human capital management, the manner by which the workforce is incentivised to be more productive, and how this approach to motivating the workforce is compatible with its long-term strategy.

“A WELL-ENGAGED, STABLE, AND TRAINED WORKFORCE IS MORE LIKELY TO BE MORE PRODUCTIVE AND, IN TURN, MORE LIKELY TO DRIVE LONG-TERM BUSINESS SUCCESS.”

Culture as a central driver of value creation

The Long Term Reporting Guidance reaffirms our view that a healthy corporate culture is a valuable asset, a source of competitive advantage, and vital to the creation and protection of long-term value.

In July 2016, the Investment Association welcomed the publication of the FRC's Culture Project which provided a useful framework for Boards to engage on culture, and we subsequently incorporated its key findings into our Long Term Reporting Guidance.

We continue to seek additional opportunities to raise the profile of human capital management as a material investment consideration, and promote better company reporting to facilitate enhanced investor analysis on culture through our Long Term Reporting Guidance.

Long term and thematic research

The Investment Association's Long Term Reporting Guidance acknowledges that an increase in long-term investment decisions will need to be supported by a greater provision of long term and thematic research.

Within the context of regulatory changes under MiFID-II, we are still exploring the principle barriers to the provision of greater long-term and thematic research within the UK, and will consider whether a statement setting out investor expectations to research providers will help improve the research offering.

We are encouraging companies to adopt our Long Term Reporting Guidance at the earliest opportunity. IVIS will be responsible for monitoring implementation of this guidance through analysis of Annual Reports reporting on year-ends on, or after, 30 September 2017.

ACCOUNTING TREATMENT FOR INTANGIBLE ASSETS

Our members are keen to support growing or emerging industries. But as businesses move into new high-tech fields, intangible factors, including the long-term viability of the business model that have become core drivers of value creation, are not necessarily being captured by current accounting practices.

During 2016, the Investment Association engaged with the International Accounting Standards Board (IASB) in an attempt to expedite its research on accounting for intangible assets. The IASB's approach to research on intangibles, and their impairment and amortisation, however has remained dispersed and fragmented.

The Investment Association submitted a response to a Financial Reporting Council consultation paper seeking views on its future research activities, advocating for it to undertake a comprehensive research project to examine the inconsistencies between the treatments of acquired and internally generated intangibles, their recognition and measurement, and the accounting for R&D costs.

“IVIS WILL BE RESPONSIBLE FOR MONITORING IMPLEMENTATION OF THIS GUIDANCE THROUGH ANALYSIS OF ANNUAL REPORTS REPORTING ON YEAR-ENDS ON, OR AFTER, 30 SEPTEMBER 2017.”

2 ENHANCE INVESTOR STEWARDSHIP AND ENGAGEMENT

RECOMMENDATION FOUR: MORE FORMALLY INCORPORATE A FOCUS ON LONG-TERM VALUE CREATION AND PRODUCTIVITY INTO ENGAGEMENT PRACTICES.

While the primary responsibility for promoting the success of a company rests with the Board and its oversight of management, investors play a crucial role in holding the Board to account for the fulfilment of its responsibilities.

In doing so, shareholder stewardship should promote the long-term success of companies in such a way that the ultimate providers of capital – our members' clients - will also prosper. In this sense, there should be a natural alignment of interests: effective stewardship should benefit companies, investors, stakeholders, and the economy as a whole.

STEWARDSHIP REPORTING FRAMEWORK

The Investment Association is committed to working with its members to enhance their public disclosures on their stewardship activities. In 2016, the Investment Association developed its Stewardship Reporting Framework to assist members when they publicly report on their stewardship activities. The Investment Association will assess the framework's uptake later this year.

ANNUAL STEWARDSHIP SURVEY

In partnership with the Pension and Lifetime Savings Association (PLSA) and ICSA: The Governance Institute, the Investment Association also revised its Annual Stewardship Survey to create a single view of stewardship across the investment chain from companies, asset managers, and asset owners. The Investment Association's stewardship survey now also includes questions on the extent to which companies are engaged on productivity and capital management issues.

PLEASE INDICATE WHETHER, IN THE YEAR TO 30 SEPTEMBER 2016, YOU ENGAGED WITH UK COMPANIES ON THE ISSUES IDENTIFIED IN THE IA PRODUCTIVITY ACTION PLAN. (TICK ALL THAT APPLY)

	% of respondents
Long-term drivers of productivity	58%
Reporting on capital management strategy	57%
Reporting on culture, human capital and intangibles	54%
Quarterly reporting	21%

DO YOU INTEND TO ENGAGE WITH UK COMPANIES ON THESE ISSUES IN THE FUTURE? (TICK ALL THAT APPLY)

	% of respondents
Reporting on capital management strategy	69%
Reporting on culture, human capital and intangibles	69%
Long-term drivers of productivity	68%
Quarterly reporting	26%
No	13%

THE INVESTOR FORUM

The Investor Forum now has 34 members with more than £715bn invested in UK equities, representing around 35% of the FTSE 350 market capitalisation, and is now self-funding through an independent membership fee.

Seven significant engagements were completed by the Investor Forum during late 2015 and 2016, and it published its first annual review of activities in January 2017. This outlined the contributions shareholders were making through their stewardship activities, and highlighted the progress made in establishing a new tool for shareholder collective engagement.

3 SIMPLIFY BEHAVIOURAL INCENTIVES AND THE INVESTMENT CHAIN

RECOMMENDATION FIVE: ENSURE THAT THE RELATIONSHIP BETWEEN ASSET OWNERS AND INVESTMENT MANAGERS IS GOVERNED IN WAY THAT DOES NOT INADVERTENTLY EMBED A SHORT-TERM FOCUS.

RECOMMENDATION SIX: CONSIDERATION OF HOW GREATER OPPORTUNITIES FOR LONG-TERM INVESTMENT CAN BE MADE AVAILABLE TO INVESTORS IN DEFINED CONTRIBUTION SCHEMES.

RECOMMENDATION SEVEN: FOSTER IMPROVED UNDERSTANDING OF THE INVESTMENT HORIZONS OF INVESTMENT MANAGERS.

RECOMMENDATION EIGHT: ENSURE THAT EXECUTIVE REMUNERATION STRUCTURES ARE ALIGNED TO LONG-TERM DECISION MAKING.

DC SCHEMES AND INVESTING IN ILLIQUID ASSETS

In October 2016, the Investment Association established a members' working group to consider the key regulatory and market barriers to creating an investment environment more conducive to long-term investment by defined contribution pension schemes, primarily in illiquid assets and infrastructure.

The working group's analysis is well advanced, and it is now seeking additional sector-based evidence to support its final report that will be available later this year. This is likely to focus on the practicalities of the current platform-based approach, the requirement for daily pricing, a discussion on the limitations arising from existing permitted link rules, and associated charge-cap issues.

INCORPORATING LONG-TERMISM AND STEWARDSHIP INTO MANDATE DESIGN

In 2016, the Investment Association initiated a review of the current approaches to incorporating stewardship practices and long-term investment perspectives into mandate design and statements of investment principles. It is our intention to develop best-practice guidance on how stewardship and long-term investment can be better incorporated into the Statement of Investment Principles and Mandate design.

As part of this guidance, investment consultants will be encouraged to issue public position statements describing how their activities support the provision of long-term investment approaches and stewardship in mandate design and performance evaluation.

To support the development of this guidance, a multi-stakeholder working group will also examine methodologies for calculating average holding periods with a view to developing a standard approach across the investment industry. It will also explore how the investment mandate can operate better as a mutual mechanism for the alignment of behaviours and objectives, (including key issues such as the time horizons in which performance of managers is to be assessed) rather than principally existing as an expression of legal responsibilities and powers.

ALIGNING EXECUTIVE REMUNERATION WITH LONG-TERM PERFORMANCE

The Investment Association established and acted as the secretariat to the Executive Remuneration Working Group in the Autumn of 2015, with the aim of addressing the complexity in executive pay and making sure that remuneration clearly aligns with the long-term interests of companies and investors. The working group comprised representatives from companies, investors, and asset owners to ensure views from across the investment chain were represented.

Following publication of its interim report, the working group held a consultation process involving 32 roundtables with over 360 individuals to gather stakeholder views on executive remuneration. Those involved included company chairmen, non-executive directors, HR and reward directors, asset managers, trade associations, think tanks, and representatives from government departments.

The working group published its final report in July 2016. The core recommendation of the working group is that there should be greater flexibility for companies to choose the remuneration structure which is most appropriate for their business and which clearly links pay to the long-term success of the company.

The working group then proposed a further nine recommendations to help to rebuild trust in the system, including increased transparency, improved shareholder engagement, and better training for members of remuneration committees.

The final report has gained significant traction with companies since its launch, and in October 2016 the Investment Association updated its own Principles of Remuneration to reflect the recommendations of the Group.

There has been a significant level of engagement with companies on their Remuneration Policies ahead of the 2017 AGM season. Since 1 September 2016, the Investment Association has carried out over 200 consultations with companies about their remuneration policies.

> “THE WORKING GROUP HELD A CONSULTATION PROCESS INVOLVING 32 ROUNDTABLES WITH OVER 360 INDIVIDUALS TO GATHER STAKEHOLDER VIEWS ON EXECUTIVE REMUNERATION.”

SINCE 1 SEPTEMBER 2016, THE INVESTMENT ASSOCIATION HAS CARRIED OUT

OVER 200 CONSULTATIONS

WITH COMPANIES ABOUT THEIR REMUNERATION POLICIES.

4 DEVELOP EFFICIENT AND DIVERSE CAPITAL MARKETS

RECOMMENDATION NINE: ENCOURAGE EQUITY INVESTMENT AND IMPROVE THE EQUITY OFFERING PROCESS.

RECOMMENDATION TEN: ENSURE THE EFFICIENT OPERATION OF THE MARKETS FOR OTHER ASSET CLASSES TO ENSURE THE PROVISION OF DIVERSE CAPITAL MARKETS.

The Investment Association agrees with the Government that to catalyse UK productivity improvements, companies must be able to access the finance they need to invest in new technology and sustainable growth.

Providing long-term capital is one of the asset management industry's most valuable roles in society. Our members already fund 60% of all new capital market fundraisings in the UK. Subject to clients' risk and reward requirements, our members are well positioned to help develop other capital markets in the UK, such as private placements, municipal bonds, local authority debt markets, and securitisations.

IMPROVING PRE-IPO ENGAGEMENT

The practice of early engagement should be seen as an integral part of the IPO process. We have been collaborating with the Quoted Companies Alliance to identify the key barriers to more effective pre-IPO engagement between investors and small and medium-sized companies, including holding a joint members' roundtable on the issue in January.

The roundtable concluded that the current model was working and that there was a good supply of pre-IPO companies being brought forward by brokers for consideration by investors, but further effort was required to improve the flow and timing of key information to potential investors.

We have committed to develop joint guidance with the QCA setting out investors' expectations for companies considering listing on the public market. This will aim to improve the timing and quality of information between investors and companies, and prepare companies and management for listing on the public market by introducing consistent, industry-backed guidelines.

PROSPECTUS REGULATION

The Investment Association is committed to lowering the cost of issuing equity capital, and removing the information asymmetry that exists at the expense of investors. During 2016, we engaged with relevant stakeholders on prospectus regulation with a focus on making it easier for companies to access equity capital both at IPO and on the secondary markets, whilst at the same time maintaining important investor protections. We welcome the recent agreement by the European Commission on new prospectus regulation which will ensure that key information and risk factors will be presented in a succinct and clear format, and in a manner consistent with the key priorities of asset managers for non-equity securities.

The Investment Association supports all efforts to facilitate the timely publication and easy access to prospectuses and to ensure that all investors receive all necessary information to make sound and well-informed investment decisions.

To achieve this, we issued a formal response to the FCA's Discussion Paper on availability of information in the UK equity IPO process in August 2016. In March 2017, the FCA published its consultation on its policy proposals aimed at reforming the IPO process to restore the primacy of the prospectus document, significantly improve the range and quality of information available to investors, and facilitate the availability of such information early enough in the process to support more balanced investor education and price discovery.

PROTECTING MINORITY SHAREHOLDERS THROUGH SUPPORT FOR PRE-EMPTION PRINCIPLES

The concept of pre-emption, the right of existing shareholders to acquire new shares issued by a company in proportion to their existing holding, is widely recognised as a great strength of raising equity capital in the UK as it protects the rights of minority shareholders from having their holdings diluted.

That is why the Investment Association endorsed the Pre-Emption Group Statement of Principles in May 2016, and drove forward a set of template resolutions to make it easier for companies to enact the provisions contained with the Pre-Emption Group's Statement of Principles. The Investment Association has conducted a review following the 2017 AGM season to identify those companies that are not complying with the Principles, or those that have not adopted the template resolutions. We will now write those companies who disregarded the principles and consider what further education or publicity is required to embed the Principles as market practice, and to ensure that the system works for all stakeholders.

GUIDANCE AND DISCLOSURE GUIDELINES FOR HOUSING ASSOCIATIONS

The Investment Association judges that the private sector and capital markets can play an important part in assisting the public sector in meeting its long-term investment and financing needs.

In March 2017 the Investment Association published Governance and Disclosure Guidelines for Housing Associations seeking to access capital market funding. Housing Associations have raised over £14.4 billion of debt in capital markets since 2012. However, it is clear that our members could potentially provide further funding to the sector if governance and regulatory rules at Housing Associations better responded to the requirements of capital market investors.

For example, transparency is essential as this has an impact on investor confidence, affects pricing in secondary markets, and affects the ability of issuers to attract a broader investor base. In addition, there are complex regulatory requirements that require certain disclosures on a timely basis.

ENCOURAGING THE DEVELOPMENT OF A UK MUNICIPAL BOND MARKET

Municipal bonds are an attractive asset class for institutional investors looking to match their assets to their long-term liabilities. In November 2016, the Investment Association gave its formal backing to the development of a UK municipal bond market by launching a position paper outlining our support, and the benefits of municipal bonds for investors, borrowers, and the wider economy.

We believe that the development of a UK municipal bond market will provide a means for investors currently not investing in infrastructure to gain that exposure to this asset class. Additionally, for local authorities, a municipal bond market will not only diversify their lending sources, they will enable access to a wider range of capital at competitive market rates. They will also reduce their reliance on central government funding.

SECURITISATION

Soundly structured securitisation is an important channel for diversifying funding sources and allocating risk more efficiently within the financial system. We continue to support on-going work to develop European Private Placements and the revival of the securitisation market in the UK and Europe. The Investment Association is now a member of the European Securitisation Co-ordination Group consisting of a wide variety of industry representatives, looking to provide a concerted industry voice to allow for better engagement on securitisation issues, particularly the development of a simple, standard, and transparent European framework for securitisations.

MAKING THE STERLING FIXED INCOME MARKET MORE EFFICIENT

A stable, well-functioning bond market is a critical part of the UK financial market infrastructure, providing capital for issuers and investment opportunities for a broad range of savers and investors. In 2017, we will seek to promote a more effective new issuance process in the sterling fixed income markets and aide secondary market liquidity by setting out investor expectation on necessary disclosure for new issues in order to efficiently assess an instrument's eligibility for portfolios utilising Solvency II Matching Adjustment. Insurers as institutional investors are critical buyers of long-term, sterling debt and efforts should be made to provide all necessary information to make informed and regulatory-compliant investment decisions.

PROMOTING APPROPRIATE BEHAVIOURS IN FIXED INCOME MARKETS

We have also sought to promote appropriate behaviours and investor expectations in fixed income markets. In 2017, The Investment Association will be working with its members to set out investor expectations of companies and their advisers to establish best practice for liability management exercises that have the potential to impact holders of existing debt securities. We will seek to engage more broadly with the fixed income market participants to ensure that best practice continues to develop in this critical aspect of the market.

OUR MEMBERS ALREADY FUND

60%

OF ALL NEW CAPITAL MARKET FUNDRAISINGS IN THE UK.

5 OVERCOME TAX AND REGULATORY IMPEDIMENTS TO THE PROVISION OF LONG-TERM FINANCE

RECOMMENDATION ELEVEN: ENSURE THAT SOLVENCY AND PRUDENTIAL REGULATION DOES NOT INADVERTENTLY IMPEDE INVESTMENT MANAGERS FROM INVESTING IN A MANNER CONSISTENT WITH THEIR CLIENTS' LONG-TERM INTERESTS.

RECOMMENDATION TWELVE: REVIEW THE CAUSES OF "DEBT-BIAS" AND ITS EFFECT ON FINANCIAL STABILITY AND PRO-CYCLICAL DECISION-MAKING.

While investors have different mandates, investment strategies, incentives and knowledge of the markets in which they are investing, regulatory and tax developments remain an important factor in shaping the asset allocation strategies of institutional investors and the funding structures of corporates. Both have important implications for long-term investment and financial stability.

Based on our members' extensive practitioner experience, the Investment Association is keen to contribute to the debate on potential tax and regulatory impediments to investment to ensure the right long term outcomes for our members' clients.

THEMATIC REVIEW OF RISK IN PRUDENTIAL AND CONDUCT REGULATION

We have sought to encourage the FCA to undertake a thematic review of whether the approach to market risk in prudential and conduct regulation is resulting in investment decisions that are consistent with the long-term investment objectives of clients. The Investment Association is contributing to the European Banking Authority's review of the prudential regime for investment firms. To support this work, the Investment Association hosted a roundtable in January 2017 with the FCA to discuss the latest EBA discussion paper.

This year, the Investment Association will also convene a multi-stakeholder working group to review the extent to which current accounting standards, solvency rules, and prudential regulatory requirements may be resulting in excessive de-risking by insurers and pension funds and impeding the provision of longer-term forms of finance.

INVESTIGATING WHY COMPANIES FAVOUR DEBT OVER EQUITY

On the supply side, a growing number of companies are raising capital through debt rather than equity. It is our view that, among other issues, the current tax system continues to incentivise businesses to use debt, rather than equity, and that this 'debt bias' is having an adverse effect on the level of long term investment and financial stability in the UK. We have now begun to undertake a comprehensive review of why companies favour funding through debt rather than equity. We are currently arranging meetings with key stakeholders to obtain their initial views about the scope of the proposed analysis, before commissioning an independent consultant to undertake the analysis.

SUMMARY ACTION PLAN

1 ENHANCE COMPANY REPORTING FOR EFFICIENT CAPITAL ALLOCATION

RECOMMENDATION 1: Improve reporting and research on productivity and re-focus on longer-term strategic drivers

COMPLETED:

- ✓ Seek clearer articulation and measurement of the long-term drivers of productivity.
- ✓ Issue a Position Statement calling for listed companies to cease reporting quarterly.

ACTIONS TO BE COMPLETED:

- Call for the provision of Longer-Term and Thematic Investment Research.
- Work with the Productivity Leadership Group and companies to develop appropriate Key Performance Indicators.

RECOMMENDATION 2: Improve reporting on capital management and clarify investor expectations of capital management

COMPLETED:

- ✓ Work with companies to improve how they articulate their capital management strategy and reporting of outcomes.
- ✓ Set out how investor engagement can support and challenge company capital management decisions.

ACTIONS TO BE COMPLETED:

- Following the call for companies to disclose their cost of capital in our Long Term Reporting Guidance, reassess the demand for the FRC Reporting Lab to undertake a project on cost of capital.

RECOMMENDATION 3: Improve reporting on culture, human capital and accounting for intangibles

COMPLETED:

- ✓ Raise the profile of Human Capital Management as a material investment consideration.
- ✓ Promote better company reporting to facilitate enhanced investor analysis.
- ✓ Support the work of the FRC's Culture Project.

ACTIONS TO BE COMPLETED:

- Continue to engage with the IASB to expedite its research on accounting for intangibles.

2 ENHANCE INVESTOR STEWARDSHIP AND ENGAGEMENT

RECOMMENDATION 4: More formally incorporate a focus on long-term value creation and productivity into engagement practices

COMPLETED:

- ✓ Seek wider support and financing for the work of the Investor Forum by launching an independent membership fee.
- ✓ Issue a Stewardship Reporting Framework to assist members in reporting on their stewardship activities.

ACTIONS TO BE COMPLETED:

- 2017 Annual Stewardship Survey (final results expected summer 2017).
- Continue to support asset managers in the public reporting of stewardship activities.

3 SIMPLIFY BEHAVIOURAL INCENTIVES AND THE INVESTMENT CHAIN

RECOMMENDATION 5: Ensure that the relationship between asset owners and investment managers is governed in way that does not inadvertently embed a short-term focus

ACTIONS TO BE COMPLETED:

- Work with the Pensions Regulator, the PLSA, and investment consultants to develop best-practice guidance on how stewardship and long-term incentives can be better incorporated into the Statement of Investment Principles and Mandate design.
- Investment consultants encouraged to issue public position statements describing how their activities support the provision of long-term investment approaches and stewardship in mandate design and performance evaluation.

RECOMMENDATION 6: Consideration of how greater opportunities for long-term investment can be made available to investors in defined contribution schemes

COMPLETED:

- ✓ Establish a Working Group of key stakeholders to consider the key regulatory and market barriers to creating a DC investment environment more suited to long-term investment.

ACTIONS TO BE COMPLETED:

- Consider the findings from the Working Group on dc scheme investment in illiquid assets and issue a final report.

RECOMMENDATION 7: Foster improved understanding of the investment horizons of investment managers

ACTIONS TO BE COMPLETED:

- Examine methodologies for calculating average holding periods with a view to developing a standard approach across the industry.

RECOMMENDATION 8: Ensure that executive remuneration structures are aligned to long-term decision making

COMPLETED:

- ✓ Consider the findings of the Executive Remuneration Working Group's review of executive remuneration structures.

4 DEVELOP EFFICIENT AND DIVERSE CAPITAL MARKETS

RECOMMENDATION 9: Encourage Equity Investment and Improve the Equity Offering Process

COMPLETED:

- ✓ Engage with the European Commissions on the proposed Prospectus Regulation.

ACTIONS IN PROGRESS:

- Lower the cost of issuing equity capital and removing the information asymmetry that exists at the expense of investors.
- Engage with key stakeholders to improve and support the efficiency of the secondary market capital raising process whilst maintaining investor protections.

ACTIONS TO BE COMPLETED:

- Develop joint guidance with the Quoted Companies Alliance to improve information flows between institutional investors and small and mid-size early stage pre-IPO companies.

RECOMMENDATION 10: Ensure the efficient operation of the markets for other asset classes to ensure the provision of diverse capital markets

COMPLETED:

- ✓ Develop and promote guidelines for Housing Associations raising capital in public markets.
- ✓ Work with the UK Municipal Agency to promote the development of a UK municipal bond market and highlight the interest of investors in this sector.
- ✓ Support the work of the Financial Markets Standards Board and the FCA Debt Markets Forum.
- ✓ Promote appropriate behaviours and investor expectations in fixed income markets.
- ✓ Engage with the European Commission on the proposed Prospectus Regulation to promote the key priorities of asset managers for non-equity securities.

ACTIONS TO BE COMPLETED:

- Promote a more efficient new issuance process in fixed income markets and aide secondary market liquidity through the use of clear terminology and standard definitions in covenants for sterling and euro bond issues.
- Support on-going work to develop European Private Placements and the revival of the securitisation market in UK and Europe.

5 OVERCOME TAX AND REGULATORY IMPEDIMENTS TO THE PROVISION OF LONG-TERM FINANCE.

RECOMMENDATION 11: Ensure that solvency and prudential regulation does not inadvertently impede investment managers from investing in a manner consistent with their clients' long-term interests

ACTIONS TO BE COMPLETED:

- Encourage the FCA to undertake a thematic review of whether the approach to market risk in prudential and conduct regulation is resulting in investment decisions that are consistent with the long-term investment objectives of clients.
- Convene a multi-stakeholder Working Group to review the extent to which current accounting standards and solvency and prudential regulatory requirements may be resulting in excessive de-risking by insurers and pension funds and impeding the provision of longer-term forms of finance.

RECOMMENDATION 12: Review the causes of "debt-bias" and its effect on financial stability and pro-cyclical decision-making

ACTIONS TO BE COMPLETED:

- Undertake a comprehensive review of why companies favour funding through debt rather than equity.

The Investment Association
Camomile Court, 23 Camomile Street, London, EC3A 7LL

www.theinvestmentassociation.org

@InvAssoc

August 2017