

**Collective Investment Schemes as Shareholders:  
Responsibilities and Disclosure**



**OICV-IOSCO**

**Report of the Technical Committee of the  
International Organization of Securities Commissions**

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# Collective Investment Schemes as Shareholders: Responsibilities and Disclosure

## The purpose of this paper: furthering the discussion

1. Collective investment schemes (CIS or mutual funds) are substantial participants in global and national securities market places. Consequently, the role of CIS as institutional investors active in those markets is significant. With increased corporate ownership by CIS, the manner in which CIS deal with the voting and other shareholder rights attached to the securities of those corporations becomes an important issue—for market places, for CIS investors and for CIS regulators.

2. In recent years, CIS industry participants and CIS regulators have considered the implications of CIS participation, as shareholders, in the governance of corporations and the relative importance and value of disclosure to CIS investors of that participation.

3. At the XXIVth Annual Conference of IOSCO held in May 1999, IOSCO members addressed issues relating to CIS and corporate governance. Participants discussed, among other things:<sup>1</sup>

- The available research on the impact CIS operators have on corporate operations when they vote—or refrain from voting—CIS portfolio securities.
- The assumption that most CIS investors invest for the long-term and therefore CIS hold portfolio securities on a largely passive basis without influencing the short-term prices of those securities.
- The potential for increased costs to CIS when CIS operators vote portfolio securities or otherwise seek to influence corporate actions.
- The alternatives to CIS participation in corporate governance, including CIS selling portfolio securities.

4. In a paper published in May 2000, members of the Technical Committee described how CIS make decisions to exercise shareholder rights in each of their jurisdictions.<sup>2</sup> The infrastructure paper summarizes the responses:<sup>3</sup>

CIS rights as shareholders are exercised by the CIS's Board of Directors or the Management Company in the best interests of CIS investors. Although they can, in some cases, be delegated, the delegatee must exercise those rights in the

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<sup>1</sup> Panel 6, "Sound Management in Collective Investment Schemes," at the XXIVth Annual Conference of IOSCO held in Lisbon on May 28, 1999. Greg Tanzer of the Australian Securities and Investments Commission and chair of the Technical Committee's Standing Committee on Investment Management presented the paper "The Role of Collective Investment Schemes as an Institutional Investor in the Management of Listed & Other Public Companies."

<sup>2</sup> "Summary of Responses to the Questionnaire on Principles and Best Practice Standards on Infrastructure for Decision Making for CIS Operators," Report of the Technical Committee of the International Organization of Securities Commissions. May 2000 (the "infrastructure paper").

best interests of CIS investors. Generally, there is no requirement to disclose the criteria followed for the exercise of CIS's shareholder rights.

5. Given the potential significance of CIS involvement in corporate governance, the Technical Committee would like to elaborate on the summary it provided in the infrastructure paper. The Technical Committee poses three questions in this paper:

- (i) Is a CIS required to exercise voting and other shareholder rights or otherwise become involved in the governance of corporations in its portfolio?
- (ii) Who can make decisions about voting and other shareholder rights attached to CIS portfolio securities and how should these decisions be made?
- (iii) Should a CIS provide information to CIS investors about how its rights as a shareholder will be exercised?

The Technical Committee canvasses the current industry and regulatory responses to these questions and concludes with its views on appropriate regulatory responses.

Finally, the Technical Committee asks for industry comment on the answers it suggests and the issues discussed in this paper. **Interested parties are requested to comment by 30 September 2002 in the manner described at the end of this paper.**

### **Institutional investors' participation in corporate governance**

6. The role of pension plans and investment managers as institutional investors in the governance of the corporations whose securities they hold has been well reviewed.

The United States Department of Labor maintains that a plan sponsor's fiduciary duty in managing plan assets includes a duty to vote proxies in the interests of plan beneficiaries and a positive duty to actually vote on issues that may affect the value of the plan's investments. Pension plans are also urged to develop written voting guidelines. The Department of Labor also advocates that pension plan sponsors undertake activities designed to monitor or influence corporate management where warranted to enhance the value of the plan's investments.<sup>3</sup>

The March 2001 Myners Report reviewed institutional investment in the United Kingdom.<sup>4</sup> That report recommended that pension funds in the UK adopt the principles of the U.S. Department of Labor into their mandates and that the government work to enshrine these principles into UK law:<sup>5</sup>

The review does not believe that the Department of Labor principle means compulsory voting in all cases; nor is it the review's intention that managers should invariably exercise votes on all their shares, however unthinkingly. But voting is one of the central means by which shareholders can influence the

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<sup>3</sup> Department of Labor Pensions and Welfare Benefits Administration, Interpretative Bulletin 94-2, July 29, 1994.

<sup>4</sup> HM Treasury, "*Institutional Investment in the United Kingdom: A Review*," Paul Myners, 6 March 2001.

<sup>5</sup> *Id.* at page 93.

companies in which they have holdings, and the review believes that a culture in which *informed* voting was more universal is very much to be desired.

The authors recognize that "effective intervention, when appropriate, is in the best financial interests of beneficiaries" and recommend that "[fund] managers should routinely consider the possibility of intervening in investee companies as one of the means of adding value for their clients"<sup>6</sup>

Investment managers managing assets for institutional investors generally acknowledge the increased significance of the role of investment managers in corporate governance. In a recent topical study on corporate governance, the Association for Investment Management and Research (AIMR) asserts:<sup>7</sup>

Actively exercising [voting] rights through corporate governance may be an effective way of enhancing portfolio value. Not exercising these rights ignores a valuable ownership right that could be managed for the benefit of the portfolio and, in certain accounts, may constitute a dereliction of legal and fiduciary responsibilities to clients.

AIMR identifies issues that may arise for investment managers in proxy voting and outlines approaches to deal with the issues. Guidance is also given on recommended contents of a written proxy policy.

7. Many pension plans have published written proxy voting guidelines, including the California Public Employees' Retirement System (CalPERS), the largest public retirement system in the United States.<sup>8</sup> In Canada, the Ontario Municipal Employees Retirement System (OMERS), which is one of the largest pension plans in Canada, has also released its proxy voting guidelines.<sup>9</sup>

8. Pension plans generally seek to influence the governance of investee companies where such activity will add value to plan assets. It is accepted within the pension industry that good governance is linked to the long-term investment returns necessary for plan beneficiaries. Pension plan sponsors believe the voting rights attached to securities held by the plan are valuable assets belonging to the plan and, therefore, must be exercised in the best interests of plan beneficiaries. As fiduciaries, plan sponsors must exercise their ownership rights in order to optimize the long-term value of their investments. CalPERS takes this approach one step further when it states:<sup>10</sup>

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<sup>6</sup> *Id.* at pages 92 and 93.

<sup>7</sup> "Standards of Practice Handbook - the Code of Ethics and The Standards of Professional Conduct with commentary and interpretation," 8th edition. Association for Investment Management and Research. See Topical Study: Corporate Governance at page 161.

<sup>8</sup> "Global Proxy Voting Principles," California Public Employees' Retirement System dated March 19, 2001 available at the CalPERS Internet website, [www.calpers-governance.org](http://www.calpers-governance.org).

<sup>9</sup> "OMERS Proxy Voting Guidelines," Ontario Municipal Employees Retirement System available at the OMERS Internet website [www.omers.com](http://www.omers.com).

<sup>10</sup> *Supra* note 9.

CalPERS is not simply a passive holder of stock. We are a “shareowner”, and take seriously the responsibility that comes with company ownership.... The twin duties of loyalty and care prohibit CalPERS fiduciaries from placing non-financial considerations over risk/return considerations in the evaluation of investment decisions, including proxy voting. However, actions taken by CalPERS as a shareholder can be instrumental in encouraging action as a responsible corporate citizen by the companies in which the Fund invests. Moreover, through its Economically Targeted Investment (ETI) policy, the Board has recognized that the interests of CalPERS’ beneficiaries can be served by considering - in addition to maximizing investment returns to the Fund - collateral benefits to the national, regional and state economies.

## **CIS and corporate governance**

### ***CIS industry guidelines:***

9. In recent years, CIS industry associations in a number of countries have recognized the important role of CIS and CIS operators as institutional investors and have prepared guidelines for their members.<sup>11</sup> Appendix A to this paper describes the guidelines prepared by the trade associations in Australia, Sweden, the United Kingdom, Italy, Switzerland and France.

The CIS industry guidelines generally do not dictate whether a CIS or a CIS operator should always exercise voting or other shareholder rights. Rather the guidelines reinforce the need for CIS operators to act exclusively in the best interests of the CIS in deciding how and when to exercise the rights associated with CIS portfolio securities. CIS operators are encouraged to consider whether and how they can or should influence the governance of corporations the CIS invest in for the best interests of the CIS. CIS operators are also encouraged to establish written policies, particularly to deal with situations in which the CIS operators may have conflicts of interest. Disclosure to CIS investors is also a feature of the trade association guidelines, with annual disclosure of voting practices often recommended.

The pension industry’s focus on influencing corporate governance as one way to ensure protection of the long-term value of pension plan assets may not be as relevant to the CIS industry where CIS investors are not all long-term investors. However, the CIS industry generally echoes the pension industry’s emphasis on the requirement for CIS operators to act only in the best interests of the CIS in making decisions whether, and how, to exercise the

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<sup>11</sup> The Investment and Financial Services Association Ltd. (Australia), “*Corporate Governance - A Guide for Investment Managers and Corporations*,” July 1999 and “*Shareholder Activism Among Fund Managers: Policy and Practice*,” March 2001. Fondbolagens Forening (The Swedish Mutual Fund Association) issued guidelines on corporate governance on February 13, 2002. See also the Swedish Association’s report “*Mutual Funds and Corporate Governance*,” May 22, 2001. Association of Unit Trusts and Investment Funds (UK) “*Code of Good Practice: Institutional Investors and Corporate Governance*,” January 2001. Assogestioni (the Italian Asset Management Association) “*The Independent Protocol for Asset Management Companies*,” January 2001. Swiss Funds Association SFA “*Code of conduct for the Swiss fund Industry*,” 30 August 2000. Association Française de la Gestion Financière (AFG-ASFFI, the French professional association) “*UCITS Professional Ethics*,” as modified on June 24, 1999 and “*Mandated Individualised Portfolio Management Professional Ethics*,” April 3, 1997. See also AFG-ASFFI’s “*Recommendations on Corporate Governance*,” adopted June 9, 1998 and amended in 2001.

rights the CIS has as a shareholder of the corporations in its portfolio. The CIS industry also emphasizes disclosure in recognition of the principle that CIS investors can better understand their investment with information about voting and other practices relating to corporate governance.

***Emerging CIS practices:***

10. In North America, there are CIS that take their responsibilities vis a vis shareholder rights beyond CIS industry association guidelines. These CIS have stated investment objectives and strategies to follow socially responsible investing principles and establish and publicize their guidelines for exercising shareholder rights.<sup>12</sup> These CIS also disclose to investors how they intend to exercise voting rights and take other corporate action relating to the companies whose securities they hold. Domini Social Investments was the first fund group in the United States to provide this information at their Internet website and the Ethical Funds were the first in Canada to publish their voting and social activism guidelines and their actual voting practices. These fund companies acknowledge their fiduciary obligations to consider every proxy vote and vote only in the best interests of investors, taking into account financial considerations and social objectives of those investors and the funds. These fund companies also advocate for the right of investors to know how their mutual fund influences corporate governance to allow investors to monitor whether this activity is consistent with their own financial and social objectives.

11. At least one other major North American fund company publicizes a summary of its voting practices. The Vanguard Group's Proxy Voting Policies are a short summary designed to provide information to investors, without the detail provided by the socially responsible mutual funds.<sup>13</sup> Vanguard notes its fiduciary obligations and states that in determining how to vote proxies for the corporations whose securities are held by the funds, its primary consideration will be to maximize shareholder value. Vanguard also gives a brief description of its policies regarding election of directors, corporate social and policy issues, issues of corporate structure and shareholder rights and executive and director compensation.

12. Shareholder activist groups in the United States have lobbied for disclosure of mutual funds' voting practices. Recently, three such groups filed rule-making petitions with the U.S. Securities and Exchange Commission (SEC) asking the SEC to require a mutual fund to tell investors more information about the fund's portfolio and how the fund intends to vote those securities. These shareholder groups assert that this information is necessary to ensure investors are better able to make informed investment decisions and purchase mutual funds whose investment philosophy is aligned with their own.

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<sup>12</sup> See, for example, the following Internet websites [www.domini.com](http://www.domini.com) (Domini Social Investments LLC), [www.ethicalfunds.com](http://www.ethicalfunds.com) (Ethical Funds Inc.), [www.paxfund.com](http://www.paxfund.com) (Pax World Funds) and [www.calvert.com](http://www.calvert.com) (Calvert Asset Management Company).

<sup>13</sup> The Vanguard Group "A Summary of The Vanguard Group's Corporate Proxy Voting Policies" available at the Internet site of The Vanguard Group [www.vanguard.com](http://www.vanguard.com).

## **CIS regulators focus on general responsibilities of CIS operators**

### ***General CIS regulation:***

13. Specific regulatory pronouncements on CIS voting and other governance practices and disclosure to CIS investors are not common, although CIS regulators may review, and sometimes approve, industry developed codes or guidelines.

Under most regulatory regimes, a CIS operator manages the assets of a CIS, subject to a general duty to manage the assets of the CIS in the best interests of the CIS, honestly and in good faith. At the present time, most CIS regulators do not prescribe any specific requirements for best practices or disclosure to investors concerning voting or other practices relating to governance of CIS portfolio holdings.

14. CIS regulation in many countries requires disclosure of CIS portfolio holdings and imposes limits on the amounts a CIS can invest in any one company. These requirements are designed to ensure transparency and informed decision making by investors, diversification of fund assets and limits on the control that a fund organization can have on any one corporation. Regulatory techniques include:

- requirements for regular disclosure of individual holdings of CIS (at least annually and semi annually sent with the financial statements of the CIS);
- prospectus disclosure of the top holdings of a CIS;
- limits on CIS investing more than a stated percentage in a particular company;
- prohibitions on CIS investing with a view to exercising control or management over a particular company; and
- limits on the maximum amount that can be invested by a group of related CIS in any one company.

The last two regulatory restrictions noted above are related to the risk that a fund complex could exercise undue influence in a particular corporation's affairs. However, CIS regulators that prescribe such restrictions generally do not consider that they limit how a CIS operator can vote or otherwise exercise the rights associated with the securities held by the CIS.<sup>14</sup>

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<sup>14</sup> A Canadian government committee that reviewed Canadian mutual fund regulation in the late 1960's had this to say about the "no control or management" restriction that was then, as now, imposed on Canadian CIS; "It is desirable for mutual funds to act as responsible shareholders, but it is not desirable for them to take control of public companies... we think that serious harm could result if a mutual fund were to assume control over a public company, with all that implies in terms of disruption of the normal routine of a company, only to sell it as a result of a changed investment policy, perhaps dictated by factors completely unrelated to the company concerned." The Canadian committee agreed that mutual funds were not prohibited by this regulatory restriction to exercise their rights as shareholders in the corporations whose securities they hold. Indeed, the Canadian committee urged Canadian mutual funds "to take more seriously their roles as shareholders. Responsibly exercised, the authority conferred by their shareholdings could enable them to make a significant contribution to corporate management." *Report of the Canadian Committee on Mutual Funds and Investment Contracts*, A Provincial and Federal Study, Queen's Printer, Ottawa, 1969 at page 438.

***CIS regulation governing CIS voting and other practices:***

15. Some regulators or legislators have chosen to provide guidance to CIS on voting practices and exercising other shareholder rights.

***United States:***

The SEC has proposed a rule that would require registered investment advisers (fund managers are registered investment advisers) to disclose their proxy voting practices in a publicly available registration form (the substance of which must be provided to clients)<sup>15</sup> The SEC notes that an adviser's clients should be fully informed about who is responsible for voting and how clients' interests in such voting are protected. The SEC is considering comments on this proposed rule, many of which are from industry commentators concerned about and who suggest that such policies should merely be made available to clients on request or simply that proxies should be voted in accordance with applicable law. The SEC has not made a final decision on this proposal.

In a letter dated February 12, 2002, Mr. Harvey L. Pitt, the Chairman of the SEC confirmed the SEC's long-standing views that an investment adviser (including a fund manager) must exercise its responsibility to vote shares of its clients in a manner consistent with securities legislation and its fiduciary duties to act in the best interests of its clients.<sup>16</sup>

***Germany:***

German CIS legislation requires investment managers to act exclusively in the best interests of investors and specifically notes the exercise of voting rights in this context. As a rule, an investment company must itself exercise the voting rights attached to shares. The investment company may empower a third person to exercise the voting rights only for an isolated instance. In this case it must give instructions for the exercise of voting rights. According to a recent government bill, mandating a third person to act for an unlimited period of time is allowed if the third person acts independently. The German Banking Supervisor is empowered to enact guidelines in this context.

***France:***

The French Commission des Opérations de Bourse (COB) regulates CIS involvement in corporate governance. CIS operators must be in a position to freely exercise the rights attached to the shares held by CIS. These rights include the right to attend shareholder meetings, to exercise voting rights, to participate on shareholder rights defence associations and to start legal proceedings. These rights must be exercised in the sole

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<sup>15</sup> See "Proposed Rule: Electronic Filing by Investment Advisers; Proposed Amendments to Form ADV under the Investment Advisers Act of 1940," Securities and Exchange Commission, Release No. IA-1862, April 5, 2000 [Part 2A Item 16 Proxy Voting Policies] and "Summary of Comments on Electronic Filing by Investment Advisers; Proposed Amendments to Form ADV under the Investment Advisers Act of 1940" Securities and Exchange Commission, July 27, 2000.

<sup>16</sup> "Proxy Voting is a Fiduciary Duty, SEC Chief Says in Letter to Group," Wall Street Journal. March 21, 2002.

interest of CIS investors and CIS operators are required to account for their exercise of voting rights in the annual reports of the CIS.

***Italy:***

The general principles of Italian CIS legislation provide that asset management companies must exercise, in the interests of unitholders, the voting rights attached to the CIS portfolio securities. The stated general principle is not supported by specific rules imposing fund managers to attend meetings and exercise their shareholder franchise, or to disclose to investors voting practices. However the Commissione Nazionale per le Società e la Borsa (the CONSOB) has welcomed the trade association guidelines developed for members of Assogestioni and has asked to be informed on an annual basis of investment companies voting policies. In order to enforce corporate governance good practice, the CONSOB is considering setting rules for CIS operators that would:

- make binding voting instructions given to appointees of asset management companies;
- require CIS operators to give information to unit-holders on voting practices; and
- allow the exercise of votes by proxy only in exceptional circumstances.

***Japan:***

Japanese CIS legislation requires CIS operators to exercise voting rights, on behalf of CIS investors, as well as other shareholder rights attached to the shares held by CIS. CIS operators are required to fulfil duties of loyalty and care and accordingly must exercise voting rights in the best interest of CIS investors. The Japanese CIS regulators have published for comment a draft inspection manual for CIS operators and investment advisors. This inspection manual is expected to be finalized in May 2002 and will set out the minimum standard expected of CIS operators in exercising voting rights on behalf of CIS investors. This standard is intended to ensure CIS operators act in accordance with their duties at law.

## **CIS participation in corporate governance raises regulatory issues**

16. Among other factors, the extent of CIS investment in national and global markets means that it may not necessarily be in the best interests of a CIS for a CIS operator to sell securities held by the CIS when the CIS operator is dissatisfied with the company's performance. CIS trade associations have recognized the importance of CIS operators considering how they can influence the governance of corporations, through the exercise of shareholder rights, in the best interests of the CIS. The Technical Committee acknowledge that CIS operators may take an active stance vis a vis their funds' portfolio holdings, including exercising voting rights, particularly on contentious matters. CIS operators' options are not limited to disposing of non-performing securities.

17. Two principles are important for the Technical Committee:

- shareholder rights attaching to CIS portfolio securities belong to the CIS—these rights should be considered by CIS operators and any exercise of those rights must be carried out in the best interests of the CIS; and
- public disclosure of CIS practices relating to corporate governance both encourages proper exercise of rights and allows CIS investors to make informed investment decisions.

18. CIS operators must be aware of their obligations to the CIS and the potential for conflicts of interest when they exercise shareholder rights or otherwise become involved in corporate governance on behalf of a CIS. In a 1999 speech, the late SEC Commissioner Paul R. Carey noted potential pressures on fund managers in making these decisions:<sup>17</sup>

Fund advisers could have an economic interest to vote the fund's shares to please company management, even if such a vote might not be in the best interests of the fund. This could be because a fund adviser might manage - or hope to manage - the retirement plan of a company whose stock is owned by the fund. If the fund adviser wants the pension business of XYZ Company, or it wants to continue to manage XYZ's pension business, it might think twice before voting against the recommendation of XYZ's management - even if voting against the recommendation could increase the value of the fund's investment. Clearly, this result is contrary to a fund adviser's fiduciary duty to the fund and its shareholders.

Glorianne Stromberg (a former Commissioner of the Ontario Securities Commission) describes her concerns about fund managers participating in corporate governance as follows:<sup>18</sup>

Individuals who have chosen to pool their investments in a collective investment vehicle have given up one of the fundamental rights that flow from the ownership of securities - namely, the right to vote such securities. By pooling their investments, individuals have unwittingly conveyed their voting power and by doing so have placed enormous power in the hands of professional money managers, some of whom are not independent of other financial and commercial interests.

The Myners Report emphasizes that “where managers are failing to take an activist stance because of their wider business interests, they would be illegitimately subordinating the interests of their clients to other aims. Management firms have a responsibility to ensure that the reality as well as the appearance of effective Chinese walls is established, protecting their clients' interests in improving the performance of companies they own, from their wider business interests.”<sup>19</sup>

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<sup>17</sup> Speech by SEC Commissioner: Remarks to the Investment Company Institute Procedures Conference. Paul R. Carey, Commissioner, U.S. Securities & Exchange Commission. December 9, 1999.

<sup>18</sup> “*Investment Funds in Canada and Consumer Protection - Strategies for the Millennium*,” A Review by Glorianne Stromberg prepared for the Office of Consumer Affairs Industry, Canada, October 1998 at page 131.

<sup>19</sup> *Supra* note 5 at page 91.

## How should CIS regulators respond to the regulatory issues?

19. The Technical Committee asks three questions at the beginning of this paper and suggests responses to those questions in this part of the paper.

20. Is a CIS required to exercise voting and other shareholder rights or otherwise become involved in the governance of corporations in its portfolio?

*Answer:*

CIS operators are subject to general responsibilities and obligations at law governing their actions in managing CIS. The Technical Committee believes that a CIS operator should consider these responsibilities in deciding whether or not it will exercise voting and other shareholder rights attached to CIS portfolio securities. In making these decisions, CIS operators should be aware that the shareholder rights associated with securities held by a CIS, including voting rights, are important rights that belong to the CIS and should be considered and exercised in its best interests alone. A CIS operator may conclude that it will not vote or take other action as a shareholder, if it believes this decision is in the best interests of the CIS investors.

21. Who can make decisions about voting and other shareholder rights attached to CIS portfolio securities and how should these decisions be made?

*Answer:*

The Technical Committee's infrastructure paper notes that a CIS board of directors or operator generally makes these decisions.<sup>20</sup> Where a CIS operator is performing this function, it is subject to standards of care and obligations at law that govern its actions in participating in corporate governance on behalf of a CIS. Any actions taken must be taken in the best interests of the CIS and not in the self-interest of the CIS operator. Similarly these obligations would extend to the entity to whom the CIS operator has delegated the function of voting securities or taking other corporate actions for the CIS.

CIS regulators may consider giving guidance to CIS operators on how to deal with conflicts of interest that may arise in exercising shareholder rights. For example, CIS regulators may prohibit a CIS operator from exercising rights in a conflict situation or may require decision making by individuals or entities independent from the CIS operator in such situations.

The Technical Committee notes that all of the industry guidelines referred to earlier in this paper recommend that CIS operators develop written policies and procedures for their governance activities regarding CIS portfolio companies. Among other things, these policies would establish how a CIS operator will decide whether to vote securities the CIS holds and if it decides to vote, how it will vote and how it will handle potential

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<sup>20</sup> *Supra* note 2.

conflicts of interest in the decision making process. The Technical Committee views these policies as important in permitting public understanding of CIS practices in voting or otherwise participating in corporate governance. Established policies and procedures encourage CIS operators to act in the best interests of investors and allow for monitoring by the public and CIS regulators of adherence to that principle.

22. Should a CIS provide information to CIS investors about how its rights as a shareholder will be exercised?

*Answer:*

CIS investors should have information about the voting and other corporate governance related policies of CIS operators. For example, CIS prospectuses and annual reports could reference the availability of these policies and summarize their contents. Information also should be provided to CIS investors on how a CIS operator generally exercised these rights over a financial year, for example in CIS annual reports. Significant deviations from the policies would be explained.

The primary goal of disclosure should be to ensure that CIS investors understand generally how a CIS operator will exercise shareholder rights. CIS investors should also have access to additional information, such as the CIS operators' voting and other policies and procedures and summaries of actual voting practices.

Information about the voting or other governance practices of CIS operators concerning the portfolio securities of a CIS could be made publicly available, either on request or electronically. This information may be particularly relevant where the CIS operator is subject to perceived conflicts of interest in its decision making. Similarly, information on voting practices may be important for markets where a group of related mutual funds are large holders of public companies (subject to individual CIS limits).

In specific cases, it may be desirable for a CIS operator to disclose how it voted a particular block of securities held by either one CIS or a group of related CIS (this depends on the size of the block and the importance of the vote and/or the existence of potential conflicts of interest).

Disclosure of voting practices need not be overly complicated or detailed. Electronic media (including a CIS operator's Internet website) or other forms of investor communication (such as newsletters) can be used to disseminate information on voting guidelines and actual practices.

## **Comments**

23. The Technical Committee welcomes comments on the issues outlined in this paper. Information about CIS corporate governance and disclosure policies and practices would be particularly useful. Thoughts on whether the questions and answers outlined above are well-founded questions and answers by CIS regulators in today's global markets are encouraged.

The Technical Committee sees these issues as important ones — and looks forward to a continued dialogue.

24. **All interested parties are requested to comment by 30 September 2002.** Comments in English are invited by post, fax or e-mail, addressed as follows:

General Secretariat  
International Organization of Securities Commissions (IOSCO)  
Plaza de Carlos Trías Bertrán, 7  
Planta 3ª  
28020 Madrid  
España  
Telephone: +34 (91) 417 55 49  
Facsimile: +34 (91) 555 93 68  
E-mail: [Terry@oicv.iosco.org](mailto:Terry@oicv.iosco.org)

Members of the Technical Committee may also ask for comments from members of the CIS trade association in their country. Written comments received will be sent to the IOSCO General Secretariat.

## *Appendix A* *CIS Industry Guidelines*<sup>21</sup>

### *Australia*

The Investment and Financial Services Association Ltd. (IFSA) represents the Australian wholesale and retail investment management, superannuation and life insurance industries. Its two reports on the role of institutional investors and corporate governance stress that:

- Effective governance depends heavily on the willingness of the owners of a company to behave like owners and to exercise their rights of ownership, to express their views to boards of directors and to organize and exercise their shareholder franchise if they do not receive a satisfactory response.
- The relative size of their shareholdings gives investment managers both a particular responsibility and a capacity to exercise that beneficial shareholder influence and franchise.

In its March 2001 report, IFSA notes that:<sup>22</sup>

Fund managers have an overriding responsibility to their unit-holders and clients to manage their investments in accordance with stated investment objectives... The significant increase in funds under management, in particular superannuation funds, has highlighted the importance of ensuring that shareholder interests in funds invested in equities on behalf of investors and superannuation beneficiaries are appropriately exercised.

IFSA points out that in Australia, there is no obligation under applicable law for fund managers or trustees to attend meetings or vote on resolutions. However, it recommends that IFSA members as a matter of good practice should:

- encourage direct contact with companies, including communication with senior management and board members about performance, corporate governance and other matters affecting shareholders' interest;
- vote on all material issues at all Australian company meetings where they have the voting authority and responsibility to do so;
- have a written policy on the exercise of proxy votes; and
- report on voting activities to clients who have delegated the responsibility for exercising proxy votes to the fund manager.

IFSA concludes from its recent survey of practices of fund managers in Australia, that the fund industry in Australia is actively involved, through proxy voting or other direct action, on behalf of their investors. IFSA also concludes that Australian fund managers are strongly in compliance with its guidelines noted above. It comments that there is no need in Australia for

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<sup>21</sup> *Supra* note 12.

<sup>22</sup> The Investment and Financial Services Association Ltd., “*Shareholder Activism Among Fund Managers: Policy and Practice*,” *Supra* note 12 at page 7.

regulatory intervention to require fund managers to vote proxies. Compulsory voting will not achieve any “significant regulatory benefit” and may lead to a “tick-a-box” approach for fund managers who are not currently voting.<sup>23</sup>

### ***Sweden***

The Swedish Mutual Fund Association asked Swedish investors for their opinions on CIS and corporate governance. The managing director of the Association concluded in a letter accompanying the Swedish guidelines that:<sup>24</sup>

More than two thirds of the Swedish unit holders are satisfied with the fund company safeguarding their interests in the day-to-day management. Over 50 percent of the unit holders think it is important that the fund company takes an active part in corporate governance issues and it is now important that the Swedish mutual fund companies strive to meet the demand of reliable and transparent information, as one third of the savers requests.

The Swedish Association confirms that the CIS operator has a responsibility for making decisions on corporate governance with a view to generating the best possible return. CIS operators must act only in the best interests of investors and may do so either by taking active steps to bring about changes in a particular corporation or by selling the shares it holds. The decision as to what to do must be left to the CIS and the CIS operator.

In its guidelines of February 2002, the Swedish Association recommends that CIS operators, among other things, establish and publicize policies on corporate governance containing principles for exercising voting rights and for electing members of the board. CIS operators should disclose to investors their standpoints in certain corporate issues and the reasons for their positions.

### ***The United Kingdom***

The UK Association of Unit Trusts and Investment Funds emphasizes in its Code of Good Practice that fund managers should become involved in governance matters and should also report to their investors on their policy on voting and other governance issues. Guidance is given on various topics, including the extent of disclosure to investors on governance issues.

### ***Italy***

The Italian Asset Management Association (Assogestioni) emphasizes and reinforces the general rule requiring CIS operators to act exclusively in the interests of investors in deciding how best to exercise the rights attached to the CIS portfolio securities. The guidelines (rules that should be included in the by-laws of Italian asset management companies (SGR) are designed also to emphasize the role that independent directors can play in protecting fund

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<sup>23</sup> *Id.* at page 12 and 14.

<sup>24</sup> The Swedish Mutual Funds Association, “*Mutual Funds and Corporate Governance*,” supra note 12. See letter of Pia Nilsson/Managing Director dated 2001-05-22 at page 2.

investors, for instance, by monitoring how executive directors deal with voting and other shareholder rights. The guidelines address such matters as:

- the responsibility of independent directors to ensure correct application of the principles and procedures for the exercise of shareholders' rights attached to CIS portfolio securities;
- the prohibition against CIS operators (SGR) exercising voting rights attached to CIS portfolio securities that are issued by companies that directly or indirectly control the SGR;
- the prohibition against SGRs delegating the exercise of voting rights to other group companies or officers thereof unless such companies are also SGRs. If delegation is permitted, the person to whom the proxy is given must be given explicit instructions on how the votes are to be cast, in the best interests of unit-holders; and
- a requirement for SGRs to formalize and keep appropriate records showing the decision-making process followed in exercising the voting and other rights attached to financial instruments under management and the reasons for the decisions where the vote concerns a company belonging to the same group as the SGR. The positions adopted in a shareholders' meeting shall be reported, in relation to their importance, to investors in the CIS annual report or in some other appropriate manner previously established.

### ***Switzerland***

The Swiss Funds Association (SFA) emphasizes the obligation of CIS operators to exercise shareholder rights pertaining to the investments of the CIS “independently and exclusively in the interests of investors.”<sup>25</sup> CIS operators are required to be in a position to provide investors with information on their exercise of these rights. Delegation of the exercise of such rights is permitted to custodian banks or other third parties, except where exercising the right “could have lasting impact on the interests of the investors.”<sup>26</sup> In such cases, the CIS operator is to exercise the rights itself or give explicit directions to its delegatee.

### ***France:***

The French professional association AFG-ASFFI consider it very important for asset management portfolio firms to develop voting guidelines, including voting criteria on resolutions. AFG-ASFFI also strongly encourages CIS operators to exercise voting rights and account for this exercise in CIS annual reports.

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<sup>25</sup> Swiss Funds Association (SFA), “Code of Conduct for the Swiss fund industry.” Supra note 12 at page 38.

<sup>26</sup> *Id.*