

Taiwan Stock Exchange

Corporate Governance Center

Submitted electronically: 1211@twse.com.tw

Subject: Stewardship Principles for Institutional Investors – Draft for Public Comment

London, 4 February 2016

Dear Sir/Madam,

Hermes EOS welcomes the opportunity to provide our comments on the Stewardship Principles for Institutional Investors (“the Stewardship Principles”).

By way of background, Hermes is a large asset manager in the City of London, and is wholly owned by the BTPS, the UK’s largest corporate pension scheme. As part of our Equity Ownership Service (Hermes EOS), we also respond to consultations on behalf of many clients from around Europe and the world, including Environment Agency Pension Fund, Mineworkers Pension Scheme (MPS) and the British Coal Staff Superannuation Scheme (BCSSS). In all, Hermes EOS advises over 40 clients, including with regard to assets worth a total of over \$225 billion (as at 31 December 2015).

We commend the Taiwan Stock Exchange, which acts under instructions by the Financial Supervisory Commission and co-ordinates with other regulators in the market, for its work on corporate governance and stewardship over the last few years. We very much welcome the publication of the Stewardship Principles which over time can make an important contribution to the development of corporate governance and stewardship in Taiwan. We believe that the proposed principles are well drafted and comprehensively cover most of the important issues. Moreover, the guidance presented provides a good starting point to build on. We also think that as in other markets it is right to adopt the “comply or explain” approach for the implementation of the Stewardship Principles.

However, we would strongly encourage the introduction of a principle encouraging collaboration between institutional investors. In our experience, collaboration between local and foreign investors can be crucial in making stewardship effective. This is particularly the case when ownership is dispersed and no single institutional investor holds a significant stake

or investors are dealing with a block or majority holder. We would note that collaboration is encouraged by the UK Stewardship Code and importantly the UN-supported Principles for Responsible Investment. In fact, in the UK following a government review, a dedicated body to facilitate collaboration, the UK Investor Forum (<http://www.investorforum.org.uk/>), was set up. Clearly, any collaboration or collective action needs to be within the local regulatory framework.

We would also note that the suggestion in Guideline 5.3 that “the institutional investor shall judge on its own about how it should exercise its voting rights even in the case where a voting recommendation report has been obtained from a proxy advisory agency, so as to avoid mechanically voting for or against proposals or abstain” may need to be reviewed and adjusted. While we are fully supportive of the underlying concern and support the intention of the proposed guideline, it should probably differentiate situations where a widely diversified institutional investor obtains recommendations that are based on its own policies for parts of its portfolio. The crucial point is that voting recommendations should be based on the investor’s views and policies and - where appropriate - allow pragmatic exercise of judgment based on a company’s individual circumstances. We agree that institutional investors should not just apply a proxy advisor’s policy. The requirement under Principle 5 to disclose a voting policy and resulting votes should address the underlying issue.

As we explained during the public hearing on the Stewardship Principles at the Taiwan Stock Exchange on 12 January 2016, we have some more fundamental concerns and suggestions about the development of stewardship in Taiwan.

Firstly, we believe it is very important to recognise that there are very different legal and cultural frameworks and environments and most significantly different models of corporate finance and ownership of listed companies in markets around the world. In particular, there is an important question about the main focus of stewardship activities in family or state-controlled companies often found in Asia or Continental Europe – as opposed to the widely dispersed ownership typically found in the UK. Unfortunately, these are issues that may not have been given adequate consideration in the development of stewardship codes in some markets, including Taiwan (for more discussion of this topic, see Dr Hans-Christoph Hirt, *The implications of stewardship codes for institutional investors*, Governance, November 2015, pages 9-12).

Secondly, it is inevitable and, we would argue, justified that institutional investors prioritise certain markets and, as such, generally approach stewardship activities very differently in their home and major capital markets as opposed to relatively smaller markets on different continents. This should not come as a surprise, as some of the principles in stewardship codes are difficult to comply with, particularly for widely diversified institutional investors without a presence in a particular market or simply because they appear too expensive in light of the funds invested in the market or individual companies. We would expect that in turn the expectations of asset owners and regulators need to be adjusted, for example with regard to the role of non-domestic investors in the governance of companies in smaller markets. This is an issue that has not been given adequate consideration in the development and discussion of stewardship codes to date (for more discussion on this topic, see Hirt above).

Thirdly, in its recently proposed Global Stewardship Code, the International Corporate Governance Network (ICGN) tries to address some of the root causes of why stewardship activities of investors - even in the UK - remain limited or superficial through the inclusion of a dedicated principle (for a recent discussion of these fundamental issues, see Simon Wong, *Is institutional investor stewardship still elusive?*, Butterworths Journal of International Banking and Financial Law, September 2015, pages 508-512). Principle 1 of the ICGN’s code deals with internal governance, conflicts of interest and obstacles to effective stewardship. Drawing on the ICGN’s *Model Contract Terms Between Asset Owners and Their Managers* (2012) and the *Global Governance Principles* (2014), it covers a range of issues that are not addressed in existing national stewardship codes which tend to focus on policies, processes and reporting.

In our consultation response dated 15 January 2016, we applauded the ICGN for trying to place issues such as investment horizons, performance periods, fee and remuneration structures and conflicts of interest, firmly within the stewardship code debate. Having said this, we also noted that some of these underlying problems and resulting questions, which extend far beyond narrowly defined stewardship activities, such as monitoring, voting and engagement, may overwhelm investors in markets where they historically have played a more limited role. Nevertheless we believe it is right to start the debate on these issues as soon as possible so as to create a framework in which a stewardship culture can develop over time. We suggested, however, that Principle 1 is renamed and reworded, so as to make it clear that it deals with the framework and the prerequisites of effective stewardship.

Last but not least, the experience with the UK stewardship code is somewhat mixed and demonstrates the importance of quality disclosures and reporting on stewardship by fund managers. We would encourage the Taiwan Stock Exchange to start considering the stewardship experience in the UK, where the Financial Reporting Council (FRC) has now taken the view that it must take a more active role in assessing the disclosure of signatories of the UK Stewardship Code (see FRC, *Developments in Corporate Governance and Stewardship 2015*, published 14 January 2016). We would emphasise, however, that ultimately it should not be the regulator but asset owners passing judgment on fund managers' stewardship activities. But in order to do so, they will require adequate and up to date disclosures.

In summary, we very much welcome the Stewardship Principles but we believe that there should be more reflection on four key issues:

1. How should stewardship activities - or at least their main focus and techniques - differ in Taiwan, a market with characteristics that are very different from the UK, for example in terms of ownership structures?
2. What are the implications of investors prioritising certain markets, for example, how do the expectations of asset owners and a local regulator need to be adjusted with regard to the role of non-domestic investors in the governance of companies in Taiwan?
3. Should the Stewardship Principles address some of the root causes of why stewardship activities of investors - even in the UK - remain limited or superficial, such as investment horizons, performance periods, fee and remuneration structures and conflicts of interest?
4. What is the appropriate role of regulators in the assessment of stewardship disclosures by signatories to codes?

We would encourage the Taiwan Stock Exchange to consider all of these points together with companies, institutional investors and other market participants, as they will be crucial in the successful implementation of the Stewardship Principles. This is particularly important in defining what best practice in stewardship activities will look like in Taiwan. We would be very pleased to assist in exploring these questions, help to launch the Stewardship Principles and to share our thoughts on the most effective way to implement it.

We hope that our comments and suggestions are of assistance. If you would like to discuss our views in further detail, please do not hesitate to contact Dr Hans-Christoph Hirt (Hans-Christoph.Hirt@hermes-investment.com).

Yours sincerely,



Dr Hans-Christoph Hirt