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Karen Northey
Asset Management and Funds Policy
Financial Conduct Authority
25 The North Colonnade
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29 September 2017

Dear Ms Northey,

Asset management market study remedies

Hermes Investment Management provides active investment strategies and stewardship. Our goal is to help people invest better, retire better and create a better society for all. We have been doing this since 1983, initially to manage the assets of our owner, the BT Pension Scheme, and more recently for a growing range of external clients comprising £30.1 billion of assets under management and £264.2 billion of assets under advice (relating to our stewardship service)

Executive summary

Our fundamental belief is that the investment industry should operate in the interests of its' ultimate beneficiaries, to that end we have welcomed the attention given to it by the FCA.

Asset management performs a vital role channelling savers' money into the real economy and financing the investment opportunities that create the employment and prosperity upon which we all rely. We are very cognisant however, that market practices have not always been aligned with this noble purpose. If the financial system is seen to be working in its own interests then it is both damaging its own legitimacy and more pertinently weakening long-term individual and aggregate returns to savers. To that end, we welcome the FCA's detailed analysis and proposed remedies, in particular those around enhancing the levels of fund governance.

Holistic value

At Hermes we have long held the belief that the financial system should operate in the interests of its ultimate asset owners, not its various agents. We also recognise that the decisions we as financial practitioners make on how to invest the money entrusted to us by savers shapes the society they will live in. Recognising this, we believe that the investment industry should be rethinking the purpose of investment and importantly, how it is that we measure value. Critically, we would contend that value should not be assessed in purely monetary terms.

We have argued that serving the interest of savers requires us as investors to be pursuing the delivery of what we describe as holistic returns (see the Why Question, March 2017). This means taking account of the secondary and tertiary effects of an investment as these can be as, if not more, relevant to the vast majority of savers as the nominal financial return. It means shifting from a focus on short-term relative returns towards long-run absolute returns. Fundamentally, it means, being mindful of the societal impact of a company's activities, products and services and balancing this against the narrow potential financial returns. Applying this holistic return approach can reconnect the industry with its underlying purpose, that being to help citizens fund their retirement and shape the society they live in today and will retire in to tomorrow.

Good governance

We are welcoming of the proposed enhancements to fund governance. There is a wealth of evidence to demonstrate that diversity and independence are two criteria which contribute significantly to better and more effective boards. Indeed, reflecting on this evidence base as well as existing practice elsewhere we suggest the FCA views the step towards 25% independence as a stepping stone and encourages fund boards to aim in the medium-term towards having a majority of independent non-executive directors.

Value for money

Similarly, we support the introduction of a requirement for the authorised fund manager board to assess whether value for money has been provided to investors. We agree with the FCA's suggestion that this ongoing assessment will help to focus minds. We are concerned however, that without sufficient and appropriate guidance being provided by the FCA this new test may inadvertently resolve one problem, that related to unreasonable costs and charges (by some fund managers), while exacerbating another, namely the myopic focus on nominal financial returns.

If too narrowly interpreted, a value for money test risks disincentivising fund managers from investing the time and resources necessary to fulfil their duty to be responsible stewards of their investee companies. This would be to the detriment of aggregate wealth-creation and to the legitimacy of the industry.

Too narrow a view of risk and investment performance fails to fully capture more holistic elements and perversely rewards those active managers who do least worst on an historical short-term basis and make least effort understanding the impacts of a company's operations on the environment and wider society. Similarly, an assessment of both a passive or active fund's value for money which omits consideration of the fund manager's stewardship resources and activity undermines the increasing global recognition that investors have responsibilities towards companies which extend beyond the decision to buy or sell the stock.

We therefore encourage the FCA to give this matter careful consideration and suggest that fund managers be required to give ongoing consideration to and subsequently explain how their funds are delivering holistic value to savers.

Fund boards should be expected to question what impact their fund's investment decisions are having on society and the environment, how it is they are supporting aggregate wealth creation, and satisfy themselves that beneficiaries holistic best interests are being positively served. These considerations should supplement those considerations set out by the FCA in relation to for example economies of scale.

We would be very happy to discuss this and any other matter further.

Yours sincerely,

Saker Nusseibeh

CEO, Hermes Investment Management