funds europe

A Funds Europe survey in partnership with CACEIS

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Fund governance

WHAT THIS SURVEY REVEALS

Highlights

Fund governance encompasses many issues including boardroom effectivity and outsourcing, and it has numerous touchpoints within ESG. This report visits many of these issues.

With the current Covid-19 pandemic, the action of fund boards has reached a high point of complexity and importance – but even before the outbreak, boardrooms were being called on to step up their level of fund governance under the FCA Assessment of Value regime in the UK.

In this survey, *Funds Europe*, in partnership with CACEIS, gauges perceptions on the value that independent directors bring to fund boards and how well fund infrastructures, such as delegated authorised corporate directors and third-party management companies – which play a vital role in investors' protection – are understood.

We also explore diversity and executive pay.

Among our key findings are that:

- 50% of respondents highlighted people from technology roles as having one of the most desirable backgrounds for directorships
- 36% felt the asset management industry was responding poorly to the diversity challenge
- Many feel educational diversity is important for the future of the industry
- 45% feel asset managers should adhere to the ESG standards they set for other companies they invest in
- Over a quarter feel executive pay should be linked to average company pay
- 41% felt the role of the authorised corporate director was not well understood
- 50% felt the concept of the 'ManCo' was understood, but not the detail
- There needs to be more disclosure on the relationship between fund manager and distributor

The survey's respondents are based in major fund domiciles across Europe. A clear message is that fund professionals feel there needs to be a more level regulatory approach to fund governance across the EU and the UK.

Nick Fitzpatrick
Editor

Introduction

AVOIDING PITFALLS

The purpose of this report

CACEIS PROVIDES HIGH-QUALITY support for clients' day-to-day business needs. We also have a responsibility to leverage our market knowledge and resources to help our clients understand and prepare for the future environment in which they do business. It is for this reason that we have partnered with *Funds Europe* to publish new research into the objectives and effectiveness of governance within the investment industry.

Our research is based on an in-depth survey of how industry professionals perceive current governance structures and what they believe needs to change. Diverse viewpoints on governance are taken into consideration to obtain a detailed picture of the forces shaping regulations and the new opportunities that present themselves, such as communication on ESG factors. From the results, we can identify clear trends which will serve as an important element when defining a future business strategy.

The decision to focus our research on governance was driven by the need to be aware of the pitfalls and issues that can impact investor confidence, security and transparency within the industry. We believe that the insight this report brings will help industry practitioners like CACEIS define a governance policy that is both realistic in its ambitions and effective in its purpose.

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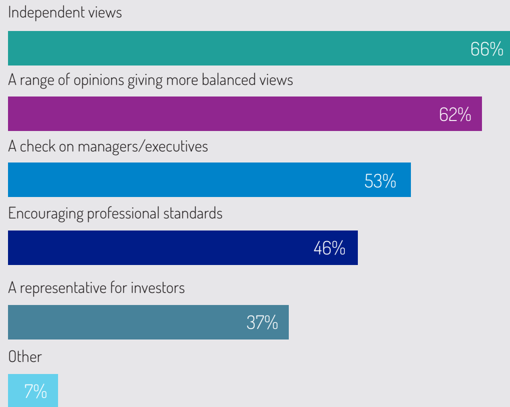
The heated debate on governance

GOVERNANCE MANIFESTS IN SEVERAL WAYS WITHIN ASSET MANAGEMENT – BUT HOWEVER IT MANIFESTS, GOVERNANCE IS A CRUCIAL ISSUE IF THE INDUSTRY'S ECONOMIC USEFULNESS IS TO BE REALISED AND RESPECTED.

IN FEBRUARY, AVIVA Investors said it would lower the fees on five investment funds – and the move gave UK regulators reason to celebrate. The price change, which saw a several percentage-point drop in fees on certain passive and active products, is evidence that the latest regulatory measure on governance in the asset management industry will work to the advantage of customers.

However, if the firm sees higher inflows or simply gets a good press over its higher standard of fund governance, there's no reason why Aviva Investors wouldn't celebrate, too.

The firm's decision to lower fees came about as a result of the Financial Conduct Authority's (FCA) 'Assessment of Value' regime, which is centred on the governance of investment funds by fund boards. Assessment of Value requires boards to take a view on whether the funds they govern are providing value for end-clients based on criteria such as whether advantages from economies of scale are being shared with fund investors, whether the fund's performance is delivering what it ought to – and, of course, whether the fee is appropriate.



Aviva Investors was one of the first asset management companies to produce an Assessment of Value report, which it published as part of the firm's wider annual reporting on its UK fund range.

If a word cloud of asset management keywords was produced, 'governance' would be written large. Quite possibly governance is the most pertinent topic for the industry, certainly within the ambit of regulation and business operations. A series of failures of governance was one of the fundamental reasons for the financial crisis and although regulators focused their governance regimes primarily on the banks, other financial firms have been swept up in the regulatory wake.

Governance affects asset managers on multiple fronts. As well as fund governance – a topic that has manifested at the European level within the likes of MiFID II and PRIIPS over the past decade, and now in the FCA's Assessment of Value initiative in the UK – the governance issue also speaks to how asset managers themselves play a corporate governance role in the companies they invest in.

The *Funds Europe*/CACEIS governance survey aims to deliver a snapshot of fund professionals' attitudes towards both fund governance and

› SOMETHING TO THINK ABOUT – Governance affects asset managers on multiple fronts.

corporate governance. We begin with questions about fund governance, broaden into topics of diversity within wider asset management organisations (a very zeitgeisty governance topic), and also consider shareholder governance.

Above all, it's about investors

It is perfectly reasonable to criticise the framework for investment fund governance by their boards. So many boards of European-domiciled, cross-border funds are comprised of members from the sponsoring fund management company – often entirely so. This leaves boards exposed to criticism of decision-making processes. Whose interests is it that are being served? The investors' or the asset management company's?

> *"Quite possibly governance is the most pertinent topic for the industry. A series of failures of governance was one of the reasons for the financial crisis and although regulators focused primarily on the banks, other financial firms have been swept up."*

Even where cross-border funds do have independent directors, these directors are sometimes sourced from a fund's service providers.

In a *Funds Europe* article looking at governance of Luxembourg UCITS funds, we found a number of lawyers sitting as independent directors on funds to which the lawyers' firms provided legal services ('High moral fibre', *Funds Europe Luxembourg Report*, 2016). It is not to say such individuals cannot manage this conflict of interest, of course. In fact one lawyer, in reference to the comprehensive knowledge of a fund that an independent director needs (and may have to spend many hours gaining), pointedly said: "We could be seen as less independent than, for example, a retired auditor for whom the directorship is their main occupation. But I would not accept the mandate of a board where I am not also the legal adviser, because I would want to know the fund well that I am sitting on."

Another lawyer said he would pass the duty of legal advice for the fund whose board he sat on to another lawyer within the firm, to provide some separation of interests.

The direction of travel within the funds industry is for more independent directors; board members sourced from service providers are probably not what regulators have in mind, even if this conflict can be managed.

A widely held notion of the

role of the independent director is that they will better represent client interests than in-house directors and therefore balance out the power of the fund board's corporate members with those of the end-clients.

In the words of America's Securities & Exchange Commission, the fundamental role of the independent fund director is expressed in these questions: Are independent directors really effective? Do they – and can they – really act as a check on management? And thirdly, are they serving the shareholders' interests above all else?

The Assessment of Value regime does emphasise the role of independent non-executive directors - yet our survey results suggest doubts among investment professionals that the hoped-for worthy aims will be achieved.

Value? What value?

We asked the question: What value do you believe independent directors bring to the industry? Respondents were allowed to tick as many answers from the six provided as they liked (fig 1).

About half of respondents ranked the duty to keep a check on fund managers and executives as the third-best example of how independent directors offer value. More specifically, the idea that directors represent client interests came almost lowest – albeit at 37%, the score was not extremely poor.

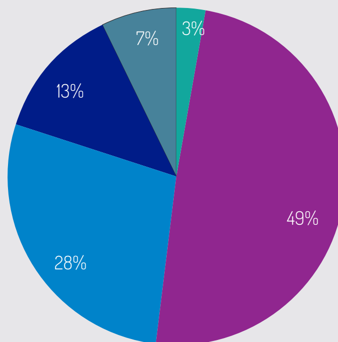
> *"We could be seen as less independent that a retired auditor for whom the directorship is their main occupation. But I would not accept the mandate of a board where I am not also the legal adviser... I would want to know the fund well."*
>
> *LAWYER*

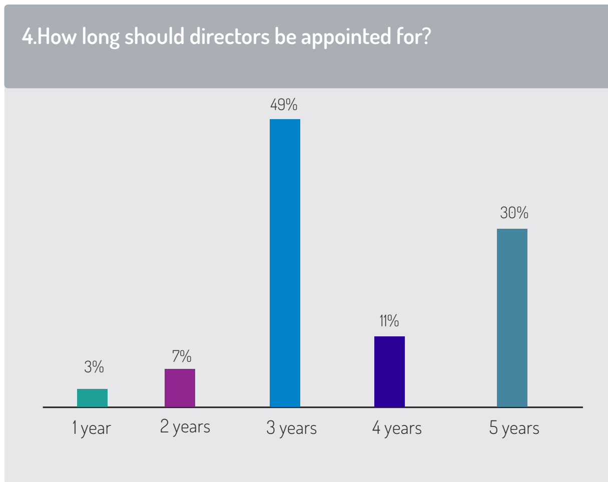
If this reveals some scepticism about the role of independent directors acting as customer representatives, then further scepticism is seen when we look at some specific comments given by respondents.

"Honestly, I believe it's a way to represent the power of certain lobbies," said one respondent. Another merely said independent directors offer "no value" and another commented: "In France, nothing!" And note that 19% of our respondents work in France!

We can speculate about which lobbies our respondent is talking about. Perhaps the ESG lobby using the new regime of fund governance as an additional channel to exert greater levels of shareholder activism. On the other hand, might lobbyists

3. How many independent directors should there be? What is the correct ratio?





be the oil majors and tobacco industry, equally attempting to influence voting or investment flows? Or perhaps it refers to the larger, more powerful institutional investors in a fund who could push for favourable treatment when a fund is gated. Far-fetched you may say, but it's food for thought.

"It is widely accepted that to get a greater range of opinions at board level, there needs to be more diversity – people from wider backgrounds than the traditionally male, middle-aged demographic."

Respondents to our survey believe independent directors' main value comes from the airing of independent views and a wider range of opinions at fund board meetings, and their encouragement of a more balanced discussion.

But let's consider this point: It is now widely accepted that to get a greater range of opinions at board level – whether in a corporation or a fund – there needs to be more 'diversity'. Diversity – surely another prominent word in our word cloud – refers to people from wider backgrounds than the traditionally male, middle-aged demographic that historically characterises management in financial services.

We'll come back to the diversity topic in governance shortly, but now consider this. We asked our respondents about the qualifications that a typical independent director would need (fig 2). (To emphasise, this is not a question of gender or other diversity issues, but of career backgrounds.)

Most (65%) said independent directors should have at least ten years' experience. After this, 15% opted for them having a professional non-executive director qualification and only 10% said legal or accountancy qualifications were desired backgrounds.

Time pressures

Aviva Investors has two independent non-executive directors on its investment funds board.

Alexa Coates was appointed to Aviva Investors Holdings Limited Board and the Aviva Investors Global Services Limited Board in November 2019, just ahead of the introduction of the Assessment of Value regime that is expected to increase the demand for independent directors.

Coates also sits on the Oriental Income fund of asset manager Schroders.

Mark White is the other independent director. White was appointed as an independent non-executive to Aviva Investors in 2015 and to the funds in October 2019 – again, a timely appointment given the new FCA regime.

As for their backgrounds, Coates is a chartered accountant and Oxford-educated White has spent his career at several asset management firms.

The expectation is that independent directors will become successful protagonists in pressuring firms to lower their fund fees where necessary. Doing this could lead to steely glares and frosty conversations around the boardroom table. Therfore, can we imagine what the atmosphere in the boardroom might be like as the independents square up to corporate directors over matters of fund value?

This is a non-trivial question. The number of independent directors on a fund board is important. Independent directors, invariably in the minority if they even exist at all on a fund board, have to deal with highly knowledgeable internal directors whose agenda might not always be about the customers.

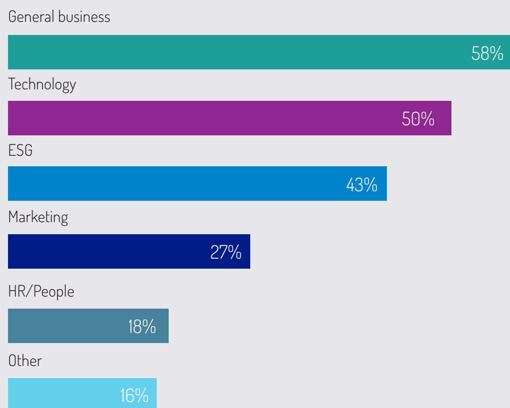
The *Funds Europe*/CACEIS survey asked respondents what they felt was the correct ratio of independent directors to corporate members on fund boards (fig 3). Most (49%) felt boards needed 25% of independents, which is the standard guideline. But 41% of respondents in total voted for boards having either 50% or more.

“You need a few independent directors to have the comfort of not being alone. If you are on your own, then there is the chance that many topics will have already been discussed [internally] by the time of the meeting,” one independent director told *Funds Europe*.

“You need a few independent directors to have the comfort of not being alone. If you are on your own, there is the chance that many topics will have been discussed [internally] by the time of the meeting.”

INDEPENDENT DIRECTOR

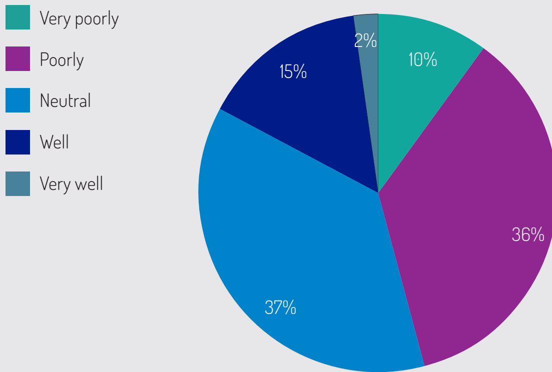
5. Traditionally the industry has tended to recruit directors from a skills base of accountants and lawyers. What other skills bases should we look for?



Interesting backgrounds

Our survey ranged beyond fund directors to consider independent directors more generally in the asset management industry. Traditionally the industry has

6. At present there is a great drive to increase gender diversity within the funds industry. How do you believe that the industry is responding to this?



tended to recruit independent directors from a skills base of accountants and lawyers. What other skills bases did survey respondents think firms should look for (fig 5)?

'General business' ranked top in our survey. We might interpret this in a number of ways. Sales roles may feature strongly in our respondents' minds. But although 58% rated 'general business' as the number-one area from which to recruit directors, 50% said that technology backgrounds were important – a reflection, perhaps, of the sometimes glacial speed at which asset management firms are bringing themselves into the digital age and a reflection also of the generational shift toward millennial clients.

People working in ESG – everyone's favourite topic and written very large in our word cloud – could provide a good source of directors for asset management firms, too. This was ranked third-highest in the survey behind 'general business' and 'technology'.

Again, the comments section suggested this list could be much longer. Compliance & risk, along with fund administration backgrounds, could have ranked highly as desirable, had our survey offered those categories.

The legal and accountancy professions are historically male-dominated, although there are many women working in these professional sectors today and increasingly gaining seniority. We may extrapolate that fund boards and fund management firms generally will see more women board members with these professional backgrounds in future.

With this in mind, how did our respondents feel about the asset management industry's handling of diversity (fig 6)? ESG investing could see asset management firms pushing for gender diversity at corporations in which they invest. What happens when asset management holds a mirror up to itself?

Neutral to poor is how many participants in our survey see the industry's response to gender diversity within their

"The legal and accountancy professions are historically male-dominated, but fund boards and fund management firms generally will see more women board members with these professional qualifications in future."

organisations. Just 15% think the industry is doing well on this issue.

On average, the 177 respondents felt that the industry should do more to encourage diversity generally (fig 7). Only 11% said "Do nothing" when asked about what could be done. The rest would argue some form of encouragement should be given, for example setting mandatory targets. Ten per cent even voted for positive discrimination.

And beyond gender diversity, what other sort of 'inclusion' would respondents like to see (fig 8)?

Educational diversity triumphed, with 32% opting for this from the options our survey presented to them. This result chimes with the diversity debate taking place among fund professionals.

Last year, for example, Chris Cummings, who heads the UK's Investment Association (IA), called for wider recruitment by asset management firms across the class spectrum, and as part of this it was recommended that firms expand the talent pool by broadening their outreach to schools, adult education colleges and to universities outside the range of standard elite institutions.

The IA feels firms should end their bias in recruitment by moving away from only considering degree qualifications and look at other qualifications and life experiences that "paint a fuller picture of applicants' qualities and capabilities".

Additionally, a survey last year by CFA UK also showed that socio-economic inclusion, of which education is a part, is at the forefront of investment professionals' minds. Seven in ten of those surveyed said the industry should employ people from a wider socio-economic background.

So, if educational diversity scored highest and social-background diversity came third in the *Funds Europe*/CACEIS survey with 17% of the score, what came second?

'Age diversity' was the second preferred inclusion factor for asset management firms. This got 28% of the vote – just behind education.

> *"The Investment Association feels firms should end their bias in recruitment by moving away from considering degrees only and look at other qualifications and life experiences that paint a fuller picture of applicants' qualities and capabilities."*

Respondents to our question about which diversity topics were most important were allowed to vote for one choice only and a good number of comments to the survey said they would have voted for all the options – and more, such as disability.

The results clearly show fund professionals would like to see higher standards of diversity and a wide breadth of inclusion groups in the asset management industry.

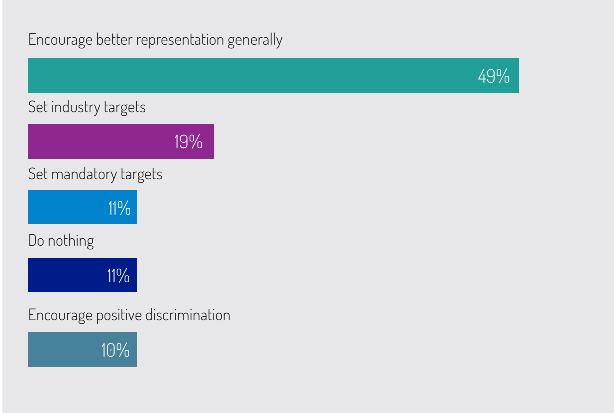
Further, in ESG generally, fund professionals feel the asset management industry should itself raise the bar for the rest of the corporate world.

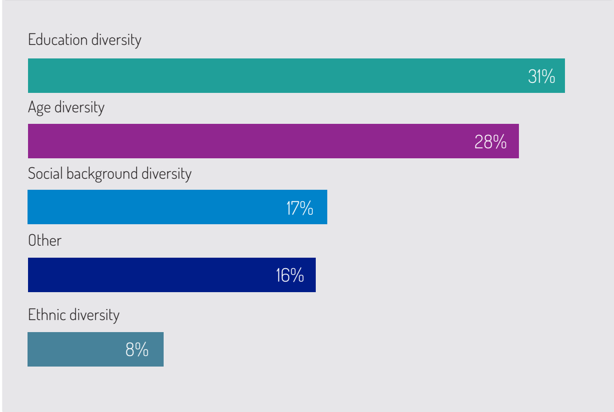
We asked: As ESG standards gain wider adoption, should investors look for these standards also to be deployed in the asset managers' own business (fig 9)?

Forty-five per cent said asset managers should adhere to the ESG standards they set for other companies – but nearly a quarter said firms should do more themselves than meet any other minimum standards.

A total of 26% said managers should set their own standards or at least match their clients' standard policies.

"If shareholder stances take more of a social and environmental tone, asset management firms will not want to be seen as preaching one thing but doing another."





Preaching from the same page?

Asset management firms could face reputational damage and accusations of hypocrisy if the expectations they express for corporate behaviour through votes cast at AGMs are not matched by their own practices. This is important as ESG proliferates and there is now firm evidence that traditional active managers are increasingly using shareholder activism to try to increase returns and protect investments.

Public demands made to companies in the UK by asset management firms that are not historically associated with taking tough shareholder positions as much as some hedge funds increased to 55 last year, from 35 in 2018 and from 13 five years ago, according to research by Headland, a communications consultancy.

Traditional fund managers cited in the research included Columbia Threadneedle and Schroders, which last year supported Coast Capital, a US hedge fund, in demanding the removal of the chairman of transport company First Group.

Over the past five years, traditional asset managers were successful in getting 37% of their demands implemented by the companies targeted.

Activism by traditional asset managers so far appears restricted to pragmatic matters of business. But if shareholder stances do take more of a social and environmental tone, asset management firms will not want to be seen as preaching one thing but doing another.

For example, from the start of 2019, the Investment Association began to issue warnings to investors of companies not on track to meet targets set by the Hampton-Alexander review for 33% of board members to be women by 2020. The independent Hampton-Alexander review was launched by the UK government with the aim of increasing female representation in senior positions in FTSE 350 firms.

In 2018, the trade body highlighted 11 FTSE 250 companies with all-male boards, ten of which have since appointed at least one woman.

But the asset management industry has gender problems of its own – a situation that does not seem to be getting better.

Research by PwC and the Diversity Project showed that the difference between what women and men earn in the investment management sector had worsened.

A disproportionate number of men are working in the highest-paid roles in the asset management industry and the industry has the lowest

9. As ESG standards gain wider adoption, should investors look for these standards also to be deployed in the asset managers' own business?

Response	%
Asset managers should adhere to the standards they demand for ESG	45%
Asset managers should set a better example than the minimum standard	26%
Asset managers should set their own standards	15%
Asset managers should aim to match their clients' standards policies	11%
Other	3%

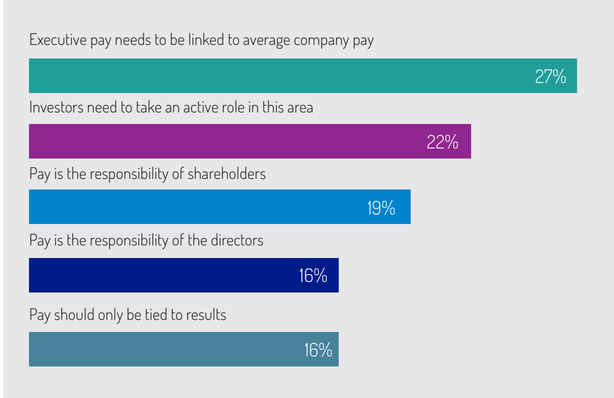
percentage of highly paid women, according to the research, published in October last year.

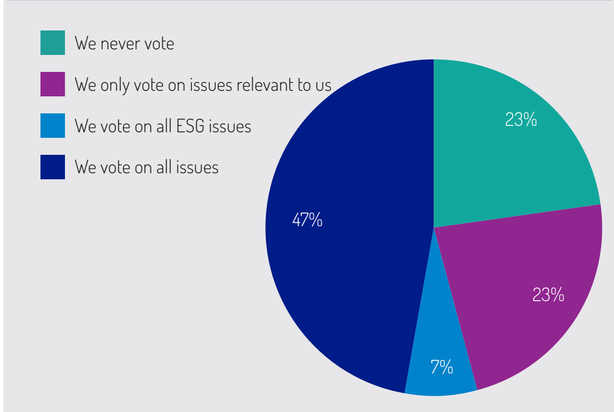
Just 23% of women occupied the upper quartile of the industry. This was even slightly poorer than in other related sectors: the score was 25% for banking, and 32% for insurance. Out of 22 business sectors analysed, the investment management sector came second-last in terms of gender pay performance after recording an increase of 0.6% in the average mean pay gap over a two-year period. And out of the five sectors with the biggest gender pay gaps recorded in 2018 (banking, investment management, insurance, real estate and travel), only the investment management industry failed to record an overall improvement.

Dame Helena Morrissey, who chairs the Diversity Project and has worked within investment management, said: "We still have a problem convincing many mainstream fund managers that diversity is a business issue, rather than political correctness."

Diversity is clearly an issue where asset management needs to be careful of being 'preachy'. Another issue where this could flare up is executive pay.

The corporate pay argument for asset managers – acting as shareholders – is traditionally a business matter centring on the shareholder value a CEO brings to a company. But with executive pay being examined in relation to how much companies pay their employees, pay is increasingly mixed in with the social cause of inequality.





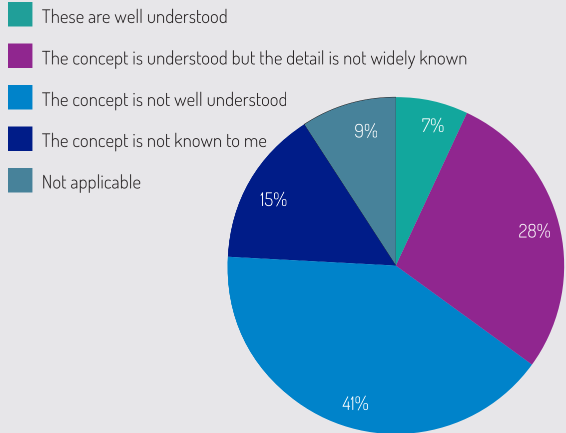
> *"We still have a problem convincing many mainstream fund managers that diversity is a business issue, rather than political correctness."*
>
> *DAME HELENA MORRISSEY*

Amundi, Europe's largest asset manager, is getting serious about ESG investing. The firm told *Funds Europe* in December 2019 that it planned to name and shame ESG laggards from the universe of companies it invests in.

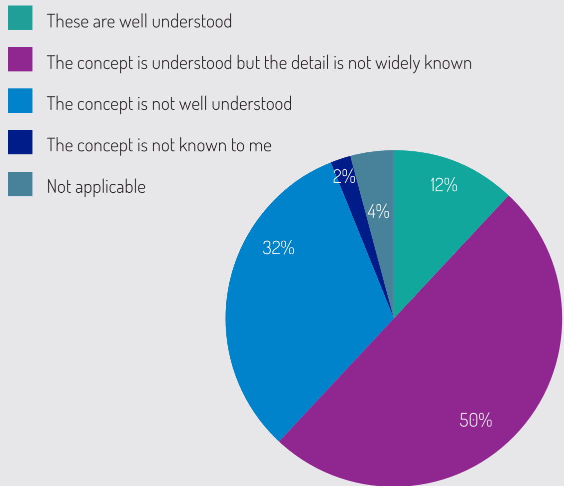
Part of its ESG exercise is to ask each company in which it holds shares to release the ratio of the CEO's pay to that of its average employee. What is this exercise, if not an exercise in social commentary?

At least Amundi's CEO Yves Perrier may avoid flack over his own pay; he's apparently one of the lowest-paid asset management CEOs, relatively speaking. In 2018, he earned €3m, including basic pay and bonus. In 2017, when he earned €2.58m, a McLagan survey showed his pay was at the low end of the market, compared with a 24-strong peer-group

12. How well does the industry understand the role of an ACD (Authorised Corporate Director)?



13. How well do you believe both the funds industry and investors understand 'ManCos'?



median of €8.16m.

Our respondents clearly felt strongly about pay (fig 10). Many (27%) feel senior executive pay should be linked to average company pay and 22% said investors do need to play an active role in this area.

ManCo proliferation

Back to the topic of fund governance – this time with a focus on fund services and compliance. In the cross-border European world of UCITS funds, third-party management companies (known as outsourced ManCos) play a crucial role in regulatory compliance and governance. In the UK, Authorised Corporate Directors (ACDs) - which can also be 'hosted' (outsourced) - have full regulatory and governance obligations for day-to-day fund operations.

Scrutiny of ACDs has become intense since the turmoil surrounding fund manager Neil Woodford. The FCA is now investigating them.

Shiv Taneja, founder and chief executive of the Fund Boards Council, which promotes good governance on fund boards, said the Woodford debacle had thrown open serious issues around the governance of funds.

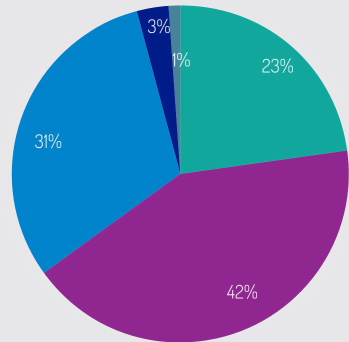
Taneja believes there was "a complete breakdown of multiple sets of actors", with failures at four levels: the regulator (the FCA), the external outsourced governance team, otherwise known as the ACD (Link Asset Services), a distributor (the online broker Hargreaves Lansdown, which recommended the fund to its clients who, in turn, held 31% of the gated Woodford fund at the end of 2018) and Woodford Investment Management itself.

"I think each one of them has got to take responsibility for certain things that they ought to have done and didn't do that could have mitigated risks," says Taneja.

We asked the question: How well does the industry

14. Do you believe responsibilities are clear between all participants in the industry, i.e. depositaries, asset servicers, management companies and investment managers?

- These are well understood
- The responsibilities are understood but the detail is not widely known
- The responsibilities are not well understood
- The exact responsibilities are not known to me
- Not applicable



"Our respondents clearly felt strongly about pay: 27% feel senior executive pay should be linked to average company pay and 22% said investors do need to play an active role in this area."

understand the role of the ACD (fig 12)?

Forty-one per cent said the concept was not well understood and 28% said the concept was understood but the detail was not widely known.

The ACD is a UK concept. Given that 12% of our respondents were from the UK, the higher level of non-UK respondents could have influenced the less-than-favourable result.

Just over 20% of respondents were from Luxembourg, where the ManCo – which is broadly comparable in nature to the UK's ACD – is firmly established.

Asset managers are keen outsourcers of their middle offices, which is largely the operational area of regulation and compliance. Third-party ManCos are specifically set up to capture this area of outsourcing.

Asset management firms are – or should be – aware that whereas they can outsource the function, they cannot outsource the responsibility.

However, outsourcing this area has become rampant. There has been a highly accelerated growth of the ManCo market. In Luxembourg alone, there were 429 ManCos employing a total of 5,700 people at the end of 2018, according to PwC's 'Observatory for Management Companies' 2019 report.

"There has been a highly accelerated growth of the ManCo market. In Luxembourg alone, there were 429 ManCos employing a total of 5,700 people at the end of 2018, according to a PwC report."

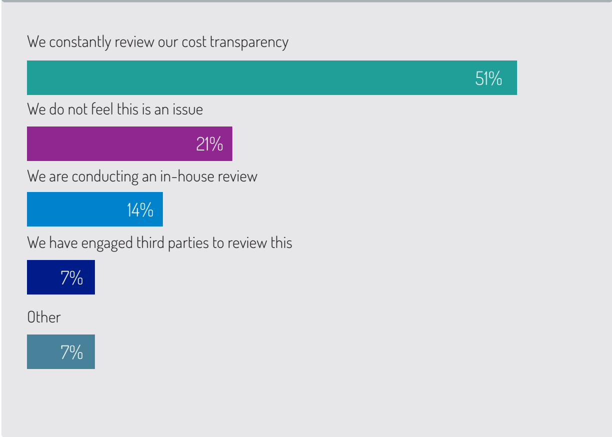
Furthermore, figures from the Association of the Luxembourg Fund Industry published in March 2019 showed that half of these firms had less than €1 billion of assets under management, which represented just 12% of the total assets in Luxembourg's ManCo market. Just six ManCos in Luxembourg had more than €25 billion in assets under management.

Meanwhile, the Central Bank of Ireland has received more than 100 applications from UK-based firms wanting to set up ManCos to ensure Brexit does not affect their ability to operate cross-border funds.

So, how well understood is the ManCo? We asked this question (fig 13) and perhaps the most significant score was the 50% who said the ManCo concept was understood but the detail

15. In the UK recently, concern has been raised about the closeness of fund distributors and fund companies, at times questioning their independence in assessing fund companies for buy lists. How much do you believe this is a problem?

Response	%
Fund managers need to disclose the exact relationship between them and their distributors	44%
Fund managers need to demonstrate clear transparency	37%
There is no need for additional disclosure	10%
Fund managers should not invest in their own distributors	5%
Only investment recommendations need to disclose the type of relationship	3%
Other	1%



not widely known.

We further found that 32% of respondents who answered the question said the ManCo concept was not well understood. However, 12% did consider the idea of the ManCo to be well understood.

> *"The Woodford situation is an extreme example of how desperately wrong things can go when there is either an absence of governance or when organisations don't do what they are supposed to do."*
>
> *SHIV TANEJA*

Digesting these results, it may be reasonable to ask if there is a significant lack of knowledge about the role in governance that the ACD and ManCo entities have – and given the lack of clarity that some respondents believe exists, whether this affects the quality of fund governance, particularly as outsourcing has proliferated. The question is acute for hosted ACDs, given that Woodford – and more pertinently his investors – relied on one.

"The Woodford situation is an extreme example of how desperately wrong things can go when there is either an absence of governance or when organisations don't do what they are supposed to do," Taneja says.

Partly triggered by Brexit, but very much with the emphasis on investor protection, regulators in the main cross-border fund domiciles of Luxembourg and Ireland have brought more scrutiny on ManCos. Questions are being asked of their balance sheets, operating models and human resources, in other words that they have genuine substance in terms of staff and expertise.

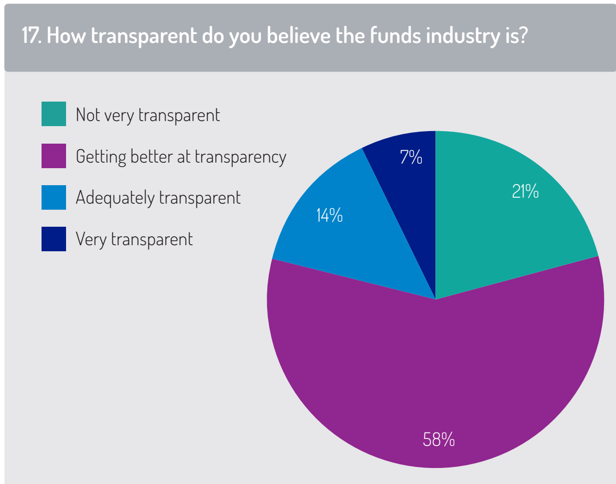
At the height of Brexit uncertainty two years ago, a number of asset managers, such as M&G Investments, set up their own ManCos, mainly because they were uncomfortable with the lack of choice in the third-party market. Keeping this area of fund governance in-house may be seen as a tougher form of fund governance for an asset manager to take. However, increased standards for expertise set by the regulators, coupled with the fact that ManCos have an extra two years of track record since regulatory scrutiny began, suggest the evolved outsourced ManCo model is set to thrive.

The role of the distributor (namely Hargreaves Lansdown) in the Woodford blow-up has also caused a good deal of scrutiny, so we asked our

respondents if they felt the closeness of fund distributors and fund manufacturers was a problem (fig 15).

Again, this was a multiple-choice question and the answer with the highest rating (44%) showed respondents felt fund management companies needed to disclose the exact relationship between them and their distributors. Some 37% said fund managers needed to demonstrate clear transparency. A paltry 10% were comfortable with the current level of disclosure.

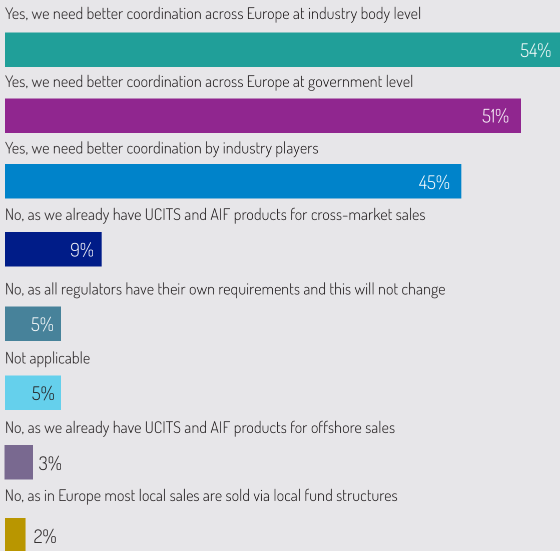
A related question here, although not necessarily relevant to all respondents (150 of the 177 in total answered it), was: What measures are you currently taking to assess



cost transparency within your business (fig 16)?

Just over half said cost transparency was constantly reviewed; 21% said they did not feel it to be an issue; and a total of 21% said they were conducting a review in-house or had engaged a third party.

On the whole, it appears that fund professionals do not consider the industry to be adequately transparent (fig 17). Nearly 60% said the



industry was getting better at transparency but 21% described the industry as "not very transparent". Twenty-one per cent said transparency was adequate or very good.

Get joined up

All the above topics, and others covered by our survey, are being steered by regulators. ESG, for example, is barely an option any longer. Investors are under increasing policy pressure to enact ESG investing and to take action over climate change.

As regulators have increasingly implemented and devised new rules for the funds industry over the past decade and continue a granular level of scrutiny, fund professionals in our survey voice a well-known frustration within the sector: a lack of 'joined-upness'. They want to see better coordination across Europe (fig 18), primarily at the industry-body level (54%), then at the government level (51%), and also between various industry players themselves (45%).

Until this happens, then without everyone 'on the same page', there will inevitably be different standards of governance across the EU, including its departing member, the UK. **fe**

Credit for gender diversity

The European Banking Authority (EBA) has called on asset managers, banks and other credit institutions to improve gender diversity at management levels following a finding that more than 40% of firms had not complied with an EU directive requiring them to adopt a diversity policy.

According to the EBA, credit institutions with more women on the board are likely to be more profitable than those with single-gender boards.

Regulatory pressure on European investment firms to improve gender diversity within their management bodies is considered good for their credit ratings, according to rating firm Moody's.

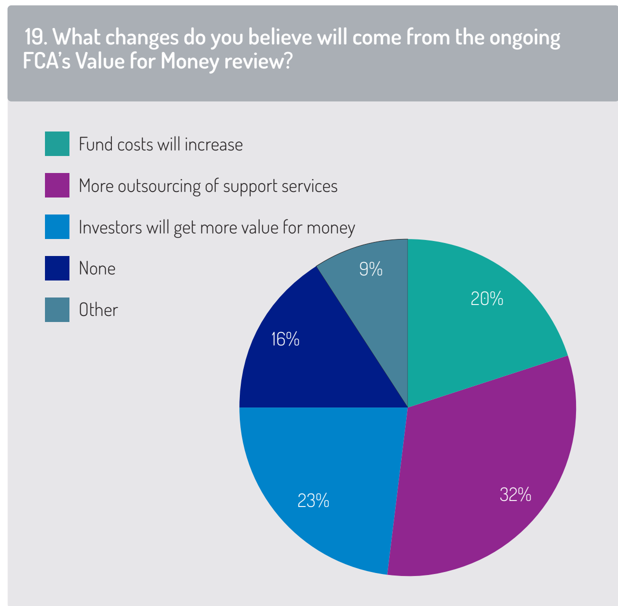
Moody's said a diverse approach to hiring and promotion, coupled with fairness in compensation, are key to attracting and retaining talent and are attributes increasingly becoming indicators of asset management companies' financial strength.

"A more diverse team is also more likely to make better business decisions and foster

greater innovation and better governance, which are essential for companies to retain access to investors," the firm added.

Moody's singled out Standard Life Aberdeen (SLA) as an example of a firm that has set specific targets for the proportion of women employees on its board, executive management team and wider workforce. At the end of 2018, 25% of the 12 SLA board members were women. By the end of 2020, the firm aims to increase this figure to 33%.

Women made up 45% of SLA's total workforce at the end of 2018. It's target for the end of this year is 50%.



Where are all the Kates and Johannas?

Neutral to poor is how many participants in the *Funds Europe*/CACEIS survey see the industry as responding to gender diversity within their organisations. Just 15% think the industry is doing well on this issue.

The finding is supported by other research showing that gender inequality remains rife in the funds industry. There are actually more fund managers named Dave or David in the UK than there are women at the helm.

Out of 1,496 UK-listed open-ended funds, about 108 were run by managers named David or Dave, the equivalent to 7.2% of funds, Morningstar found. There were only 105 women overall managing funds.

The most common women's names in the study were Kate and Johanna – but they accounted for just 11 of all fund managers in total and managed 22 funds between them.

Emma Morgan, portfolio manager at Morningstar, said: "It's a great shame that the industry is missing out on a whole swathe of talented individuals. The more the industry can do to attract and promote women in fund management, the better outcomes we can achieve for everyone."

According to a separate study by campaign group the Diversity Project, less than

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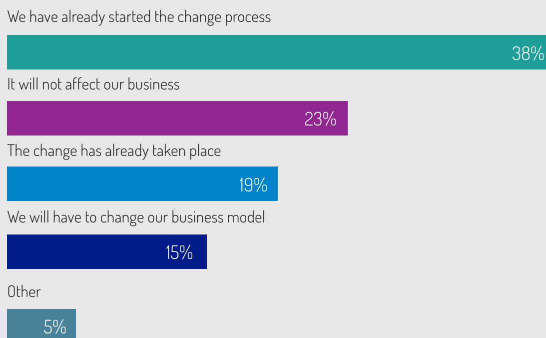
10% of senior managers in the asset management industry are female.



Higher and higher fund costs

Cost pressures from regulation is one of the most difficult challenges for asset management firms. Supporting the increasing demands of regulation comes at a time of unprecedented pressure to reduce fees. It's a difficult balance to get right – and it's no wonder outsourcing of some regulatory and compliance functions is a growth business.

In the UK, the FCA's Value for Money review found that price competition was "weak in a number of areas" of the industry.

Despite a large number of firms operating in the market, there had been high profits over a number of years, suggesting a lack of competition.

Our survey respondents (fig 19) expect the market review by the FCA will lead to higher fund costs and more outsourcing. However, underlying investors could see more value, too.

ESG and transparency

Transparency in the asset management industry could be better. This is highlighted by views in the *Funds Europe/* CACEIS survey where 21% of respondents felt the industry was not transparent enough, though 58% felt the industry was "getting better" (fig 17).

One area where investors wish to see more transparency is within ESG, another topic broached by our survey (fig 20).

In separate research (by fund manager Franklin Templeton), many institutional investors said they were seeking improved ESG transparency and data standardisation. This was seen as important for more meaningful adoption.

The research found a lack of acceptable policy frameworks

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as the main challenge to introducing ESG and a lack of quality data to support decisions.

Janine Guillot, chief executive of The Sustainability Accounting Standards Board (SASB), said: "A collective effort across all market participants – asset owners, asset managers, data providers, standards-setters and policymakers – is needed to ensure investors have the tools and capabilities necessary to achieve their financial goals."

We asked our respondents if they saw any improvement in ESG standardisation as the EU moves towards legislating in this area. Most said they had already started to change. Some said the change had already taken place.

But ESG standardisation is likely to attract more debate. The EU's recent taxonomy is expected to help.

Until the taxonomy – which will cover bonds as well as

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>
> *JANINE GUILLOT*

Location, location, location

What country are you based in?

	Responses
Albania	1%
Algeria	1%
Andorra	1%
Austria	1%
Belgium	3%
British Virgin Islands	1%
Burma	1%
Cayman Islands	1%
France	19%
France, Metropolitan	2%
Germany	9%
Greece	1%
Hong Kong	1%
Ireland	9%
Italy	3%
Luxembourg	21%
Mauritius	1%
Monaco	1%
Netherlands	3%
Spain	2%
Sweden	1%
Switzerland	3%
Ukraine	1%
United Kingdom	12%
United States	1%

shares – starts coming into force over the next couple of years, the only independent check on firms' claims on how sustainable their funds really are will continue to come from ratings agencies, which have over the past decade cashed in on growing demand for ESG scores.

But, while around $3 trillion (€2.7 trillion) of institutional assets globally now track ESG scores, ratings agencies' role in certifying the green credentials of firms has been criticised for a lack of correlation between the methodologies used to create the ESG scores.

Once the taxonomy becomes mandatory, the principal role of checking the green claims of fund houses is likely to move from ratings agencies to national regulators and will gain more teeth in the process. Retail financial products that reach the highest green standards – likely to include investments in clean energy and renewable technologies, for example – will be awarded an eco-label.

Ama Seery, sustainability specialist at Janus Henderson, which manages $374.8 billion in assets, says that the taxonomy is a "welcome first step", but should have gone further to include not just environmental factors but also social and governance issues.

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Responsibilities

What section of the funds industry do you work in?

	Responses
Administration	31%
Distribution	18%
Fund platform	18%
Manufacturing	21%
Market infrastructure	6%
Technology	6%

"Ama Seery, sustainability specialist at Janus Henderson, said that the taxonomy is a 'welcome first step', but should have gone further to include not just environmental factors but also social and governance issues."

Why good governance has never been so important

NEIL COXHEAD, MATTHEW IVES AND PAT SHARMAN IDENTIFY CHALLENGES FOR DELIVERING GOOD GOVERNANCE SUCH AS POOR-QUALITY DATA.

GOOD GOVERNANCE IS crucial. The Dutch pension fund market, for example, is widely regarded as one of the most sophisticated in the world and is well-known for its rigorous governance processes, particularly in terms of regulatory reporting and cost transparency.

In 2019, Holland's KAS BANK became part of CACEIS and this has enabled us to create a pensions centre of excellence backed by one of the largest financial services companies in the world, Crédit Agricole, which brings us significant balance sheet strength.

What does good governance mean?

Good governance is partly about providing timely, accurate data that's flexible enough to adapt to a pension scheme's changing needs and provides trustees with the tools to help in decision-making. This involves bringing new, often difficult to create, solutions to the market, such as cost transparency.

We've been working with pension schemes on cost collection and reporting for over eight years. It's not easy. The data we receive from investment managers can sometimes be unstructured and there are often big data gaps. Consequently, we've had to be highly flexible in the way we collect the data and rigorous in how we cleanse it, so that we can turn it into something that's easy for a trustee board to view and digest. Getting to this point has required a singular focus on governance and looking at what needs to be delivered through the lens of a pension trustee.

We also believe that good governance involves responsible investing. This is a huge topic that involves numerous touch points and it's not always easy to apply. It can be very difficult, for example, to assess the Environmental, Social & Governance characteristics of a company – and sometimes analysts may disagree on their findings.

Not all custodians provide these value-add services. This is because the barriers to entry are high due to the complexity involved. Moreover, even general services can sometimes be sub-optimal. Indeed, basic functions such as fund accounting can often be quite poor. Pension funds recognise these shortcomings and know that things need to be improved. At CACEIS, we are doing our part to raise the bar, so that trustees can have greater confidence in the data. It's all about bringing added value to the service. Harnessing the power of new technology can help here.

Governance is also a regulatory priority

Since the beginning of October 2019, new regulations in the UK require that pension funds explain their ESG policies in their Statement of Investment Principles. This has been interpreted in several different ways. Many have used standard wording supplied by their consultants. But we suspect the Pensions Regulator would have preferred them to take their own view. This year, pension schemes will also have to report on the chair's statement.

Many trustees articulate their ESG policy through their asset managers. Typically, a trustee will simply ask their asset manager if they've implemented their policy. Others merely adhere to the Stewardship code and its principles. Their asset managers will tell them this is fine, but again we believe the regulator would have preferred something more bespoke. Screening according to industry standards might be useful, or independent ratings on asset managers. Again, custodians can support pension funds with this.

We can also use an independent third-party agent to collect data, including 'look through' services for funds, and then provide a high-level report for the trustees. We think this is where trustees should be moving. It might be subjective, but at least it's an independent report, highlighting positive, negative and neutral areas. In our view, this represents a positive step forward.

Trustees also need to have conversations with the managers they employ about the stocks they own. Why does one manager own BP and the other refuse to hold it, for example. Indeed, the trustees of some of the smaller pension funds in the UK don't necessarily know what funds they hold.

We believe that custodians are 'the honest broker' in all this. We can supply independent rigour, consistency and oversight to the process, becoming a trusted partner from a governance perspective. All other suppliers have something to gain. For example, take cost transparency - we've discovered that transaction fees can make up 25% of a pension scheme's total investment costs and these costs can be three times higher than estimates. From our perspective, highlighting these issues to our pension scheme clients is another example of good governance.

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Putting something back

It's also important that custodians engage with the wider pension industry. In 2019, the situation with Woodford Investment Management highlighted the challenges with liquidity risk through exposure to unquoted, illiquid securities. This illustrated the importance of good governance, which was uppermost in many investors' eyes. We believe this wouldn't have happened in other jurisdictions, such as the Dutch pensions market, where 'look through' reporting is used.

This is all part and parcel of what we do. In short, custody is all about good governance and we like to think that custodians are helping to police the industry.

Neil Coxhead is managing director CACEIS BANK, UK Branch; Matthew Ives is business development director CACEIS BANK, UK Branch; and Pat Sharman is managing director KAS BANK, UK Branch.

Survey methodology

A total of 177 professionals drawn from *Funds Europe*'s readership participated in the survey that was conducted online in early 2020. For some questions, the number of responses was less than this total because of dropouts.

The section of the industry that most respondents work in is fund administration (31%). This was followed by fund manufacturing, which accounted for 21% of respondents.

A total of 18% identified with distribution, and the same percentage with fund platform functions. Market infrastructure and technology each accounted for 6% of respondents.

Most respondents are based in the major fund domiciles of Luxembourg (21%), France (19%) and the UK (12%). Nine per cent of respondents are located in Ireland and the same again in Germany.

Any commentary given about the results or more widely about the industry is that of *Funds Europe* and is not necessarily shared by CACEIS.

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