

“Be Careful What You Wish For”

Money managers of the world listen up: the UK Government has identified the best way to manage money – a feat which has eluded the best brains in academia and the entire population of pensions advisors. This will come as news to most of you. Like me, you probably believed that there were many legitimate approaches to achieving client returns. You were convinced that your particular approach was distinctive and correct. You may even have assumed that you work for your client – who is empowered to decide how his shares should be managed. Silly souls. We were all mistaken.

For the *best* approach of all turn to Chapter 5 page 73 of Sir David Walker’s “A review of corporate Governance in UK banks and other financial industry entities.” In his recommendations you will find both the Holy Grail of absolute return enhancement (engagement) and the necessary guiding hand to ensure that you drink from the cup (the FSA). The logic goes like this: 1. Engagement by shareholders and their money managers will contribute to better corporate governance. 2. Better governance will contribute to better company performance. 3. Better company performance will contribute to better investor returns. 4. Therefore selling a company’s shares should become a last rather than first resort. 5. Had engagement been more widespread and effective, the excesses of banks would not have been carried to such excess. 6. To ensure that the industry moves in this direction sooner rather than later, the engagement approach to investing will henceforth be defined as best practice by the FRC and enforced as such by the FSA. Should you “choose” not to comply you will have to publicly “explain” why you are not adhering to best practice and by implication the best way of managing money.

Now that I have your attention, let me be a bit more generous to Sir David. His report is excellent. It is well written. I would endorse most of his many thoughtful recommendations. Even the section on shareholder engagement is rich in insights and careful in its wording. But I part company with his conclusions because they do not flow from his statements. Thus he says, quite rightly, that: “some form of ...stewardship or engagement activity *may* increase absolute returns...;” that engagement offers “*potential* benefits;” that engagement related returns are “*difficult to measure*” and that selling shares instead of holding and engaging is an “*uncertain influence* on decision-taking by the board and a relatively blunt instrument.” How then, do we go from the uncertainties of different money management styles to the certainty implied by a government enforced approach?

And now that I have Sir David’s attention, let me make clear the following:

1. Engagement with governance matters is usually part and parcel of holding shares. The industry has produced excellent guidance on how to do it. But it is not the only way to hold company boards to account. And no amount of investor engagement will fill the vacuum of regulatory failure.
2. The investment management industry works for the client, not for the Government. If it begins to work for the Government it will lose clients.

3. Many members of my profession did fail and failed spectacularly. But the failure was not primarily a lack of engagement. The failure was not to sell bank shares earlier and dismiss bank directors later.

4. We should be careful what we wish for. If one failing of our profession is that too few sold banking shares, another is that too many egged on bank management to produce higher returns with higher risk. Hopeful buyers met cynical sellers. Thus are markets born and maintained. Do you really want money managers to have greater influence on corporate Britain? We are not insiders nor do we want to be.

5. If the Government requires the investment management community to behave in a way that neither client nor manager is convinced as being in the best interests of the beneficial owner, then the clients will seek money management services abroad and the UK money management industry will follow. This is the opposite of current government aims.

No regulator should waste a good crisis and this one offers ample opportunity to improve the marketplace. Many of Sir David's recommendations can make the practice of engagement more effective – but engagement should not be presumed to be best practice. It would be a brave and lonely government who enshrines a particular method of managing money.

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