THE
INVESTMENT
ASSOCIATION

Rt Hon Philip Hammond MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
London, SW1A 2HQ

The Investment Association
Camomile Court, 23 Camomile Street,
London, EC3A 7LL

T +44 20 7831 0898
E enquiries@theia.org
W theinvestmentassociation.org
Twitter @InvAssoc

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Dear Chancellor,

The Investment Association's Productivity Action Plan – One year on

In March 2016, the Investment Association set out its vision of how the investment industry could help to reverse the UK's productivity problem. The Productivity Action Plan, which aims to boost productivity through long-term investment and enhanced investor stewardship, was welcomed by your predecessor and referenced in the Budget 2016. This letter serves to fulfil our commitment made at the launch to provide an update on the Plan's implementation after the first year. It also outlines the significant actions that we will be taking over the coming months to implement the remainder of the Productivity Action Plan.

Although much has changed in the past year, solving the UK's productivity puzzle continues to represent the challenge of a generation. I am delighted to see that the Government has made boosting productivity such a central plank of its long-term economic strategy for the UK. I believe that the Productivity Action Plan aligns closely with Treasury's Patient Capital Review, as well as the Industrial Strategy and Corporate Governance reforms led by BEIS.

Raising productivity is essential for generating higher wages, better living standards, and in building a more competitive economy. Critically, stronger and more sustainable businesses will help to deliver the exceptional long-term investment returns that the millions of people whose savings and investments our members manage both demand and deserve.

The provision of long-term capital is one of the investment industry's most valuable roles in society. For productivity to improve, businesses across the UK must be able to access the finance they need to grow, and the right conditions need to exist to encourage companies and investors to act for the long-term. Our industry is committed to playing its part in helping businesses adopt a longer-term approach by initiatives such as financing Housing Associations and major infrastructure projects, to helping savers secure good returns.

Across five objectives, the Productivity Action Plan lays down twelve recommendations and twenty-nine specific actions that the asset management industry has committed to undertake in the three years to 2019. I am glad to report that one year in, significant progress has been made in implementing the Plan. Over half of the actions are already completed, and a further two projects are due to issue their final reports in the next quarter of this year. The key achievements of our first year include:

- Publication later this week of our Long Term Reporting Guidance setting out members' expectations for company reporting on the drivers of productivity, capital management, human capital, and culture;

- Publication of our position paper calling on companies to stop reporting quarterly and issuing short-term earnings guidance, and instead refocus their reporting on the longer-term strategic drivers of productive growth and value creation in their business;

- Publicly backing the development of a UK municipal bond market through a position statement setting out the benefits of municipal bonds to the wider economy, borrowers, and investors, and how they could fund new infrastructure spending through direct access to public markets, the use of the aggregator model, and private placements;

- Issuing Governance and Disclosure Guidelines for Housing Associations providing advice for those seeking to raise capital on the public market, focusing on why investors value greater transparency, the information that should be publicly disclosed by Housing Associations, and how this information can be more effectively distributed to investors.

- Establishing and acting as secretariat to the Executive Remuneration Working Group and revising, after extensive consultation, our Principles of Remuneration ahead of company remuneration policy votes during this year's AGM season;

- Establishing a member working group to consider the key regulatory and market barriers to creating an investment environment more conducive to long-term investment by defined contribution pension schemes – its final report is due later this year;

Our priority for the next twelve months will be to focus on delivering the outstanding recommendations with particular emphasis on:

- Developing best-practice guidance on how stewardship and long-term investment can be better incorporated into Statement of Investment Principles and Pension Mandates, and examining methodologies for calculating average holding periods with a view to developing a standard approach across the investment industry;

- Developing joint guidance with the Quoted Companies Alliance to promote better information flows between institutional investors and small and medium-size early stage pre-IPO companies;

- Promoting a more effective new issuance process in the sterling fixed income markets, and allowing the investment industry to efficiently assess if fixed income instruments are suitable for portfolios utilising Solvency II matching adjustment requirements;

- Review the extent to which current accounting standards, solvency and prudential regulatory requirements may be causing excessive de-risking and impeding the provision of longer-term forms of finance.

I am personally committed to ensuring that the investment industry does everything it can to address the UK's productivity challenge, and I look forward to working with the Government to help achieve this.

Yours sincerely,

Chris Cummings
Chief Executive

CC: Rt Hon Greg Clark MP – Secretary of State for Business, Energy and Industrial Strategy
Baroness Neville-Rolfe – Commercial Secretary to the Treasury
Enc: Productivity Action Plan

ANNEX ONE – IMPLEMENTATION UPDATE

BACKGROUND

In March 2016, the Investment Association launched its Productivity Action Plan to help boost UK productivity through long-term investment and enhanced investor stewardship. The result of extensive engagement across the investment community, it outlines a series of targeted reforms to the way different parts of the economy should interact with each other, and aims to give companies the confidence they need to invest in productive enterprises. Most of all, it seeks to deliver ambitious and achievable remedies to the ills of some of the most serious causes of short-term thinking in the British economy.

In part a response to the Government's 2015 'Fixing the Foundations' report, the Productivity Action Plan is the result of an exchange of letters between leading members of the asset management industry and your predecessor. It comprises a package of five Investor Productivity Principles aimed at improving productivity from a systemic, macro perspective, in terms of the functioning of regulatory regimes and capital markets, and from a micro, bottom-up perspective in terms of the reporting of companies and the stewardship of investors. These include:

- **Enhance company reporting for efficient capital allocation** – through investment and analytical expertise the industry will identify and finance those companies contributing productive growth in the economy;
- **Enhance investor stewardship and engagement** – the investment industry will engage with companies to help them achieve sustainable value creation over the long term and support investments in improved productivity;
- **Simplify behavioural incentives and the investment chain** – the industry will work to ensure that the agreed incentives and governance of the investment chain ensure a clear alignment with clients' long term investment objectives;
- **Develop efficient and diverse capital markets** – as key capital market participants, the investment industry has a key role in the development of asset classes and the efficient functioning of capital markets; and
- **Overcome tax and regulatory impediments to the provision of long-term finance** – the investment industry should contribute to the debate on tax and regulatory impediments to investment so as to ensure the right long-term outcomes for clients.

These five objectives are underpinned by 12 recommendations and 29 specific actions the Investment Association is taking, or intends to take, between 2016 and 2019 to help solve the productivity puzzle. Each represents a particular work programme in its own right, including a series of policy initiatives, consultations, and subsequent reviews all targeted at encouraging greater long-term investment and boosting productivity across in the UK.

A copy of the Productivity Action Plan is enclosed for your reference.

UPDATE ON IMPLEMENTATION

Objective one:	**Enhance company reporting for efficient capital allocation.**
Recommendation one:	Improve reporting and research on productivity and re-focus on longer-term strategic drivers.
Recommendation two:	Improve reporting on capital management and clarify investor expectations of capital management.
Recommendation three:	Improve reporting on culture, human capital and accounting for intangibles.

In November 2016, the Investment Association issued its public position statement calling on companies to stop issuing **quarterly reports and short-term earnings guidance**, and instead to refocus their reporting on the strategic drivers of productive growth and value creation in their business. We have since met with a number of company representatives to discuss the challenges and benefits associated with ending quarterly reporting. Our corporate governance research service, the Institutional Voting Information Service (IVIS), is now highlighting those companies that continue to report on a quarterly basis, with companies that continue do so asked to explain how it is relevant to their long-term strategy. Our analysis showed in October 2016, 30 FTSE 100 and 139 FTSE 250 companies had ceased quarterly reporting. Later this year, we will review the progress made in ending the practice of quarterly reporting and will consider issuing an additional guidance statement if required.

Later this week, the Investment Association will publish its **Long Term Reporting Guidance.** Its publication represents the culmination of a significant body of work by three member working groups first established in July 2016. Members were tasked with identifying specific areas of improvement in company reporting which would most usefully aid investors' understanding of an investee company's long-term risks, liabilities, and prospects, and promote a sharper focus by companies on the importance of productivity more generally to their investment proposition.

The Long Term Reporting Guidance requires that companies conduct an assessment of the levels of productivity within their business, explain the key drivers of productive growth and value creation, and identify the key investments that it is planning on making to improve productivity. This builds on the work undertaken by the Productivity Leadership Group during 2016 and its 'How Good is Your Business Really' report. Together with the **UK Productivity Council**, we look forward to helping companies establish productivity Key Performance Indicators appropriate to their business to help them measure and report more clearly on productivity within their company.

On **capital management**, the Long Term Reporting Guidance requests that companies more clearly articulate to shareholders their approach to making capital allocation decisions, how they link to the achievement of the business' long-term strategy, and explain to investors how the long-term performance of past capital allocation decisions are being measured and assessed by the Board. The Long Term Reporting Guidance also discusses how investor engagement can support and challenge a company's capital allocation decisions, and encourage greater investment by companies in fixed capital assets, R&D, and other productive activities. Specifically, it notes that investors have a close interest in understanding how clients' capital is being allocated efficiently, and are keen to support well-articulated and reasoned investments that lead to productivity improvements, and increased shareholder returns over the long-term.

The Long Term Reporting Guidance notes that a key driver of productivity is how well a company manages its **workforce,** and whether it is being deployed efficiently. A well-engaged, stable, and trained workforce is more likely to be more productive and, in turn, more likely to drive long-term business success. These issues are deserving of more transparency by companies through enhanced annual disclosures. We request that companies identify the significant investments that they have made over the past year, and are planning to make in the next, to improve the productivity of their workforce. We also ask that companies outline the significant opportunities, and principal risks, relating to its approach to human capital management, the manner by which the workforce is incentivised to be more productive, and how this approach to motivating the workforce is compatible with its long-term strategy.

The Long Term Reporting Guidance also reaffirms our view that a healthy corporate culture is a valuable asset, a source of competitive advantage, and vital to the creation and protection of long-term value. In July 2016, we welcomed the publication of the **FRC's Culture Project**, and we subsequently incorporated its key findings into our Long Term Reporting Guidance. We continue to seek additional opportunities to raise the profile of human capital management as a material investment consideration, and promote better company reporting to facilitate enhanced investor analysis on culture through our Long Term Reporting Guidance.

Our Long Term Reporting Guidance also acknowledges that an increase in long-term investment decisions will need to be supported by a greater provision of **long term and thematic research**. Within the context of regulatory changes under MiFID-II, we are meeting with our members to identify the barriers to the provision of greater long-term and thematic research, and will consider whether a statement setting out investor expectations to research providers will help improve the long-term and thematic research offering.

We are encouraging companies to adopt our Long Term Reporting Guidance at the earliest opportunity. IVIS will be responsible for monitoring implementation of this guidance through analysis of Annual Reports reporting on year-ends on or after 30 September 2017.

During 2016, the Investment Association engaged with the IASB in an attempt to expedite its research on **accounting for intangibles**. The IASB's approach to research on intangibles, and their impairment and amortisation, however has remained dispersed and fragmented. We recently submitted a response to a Financial Reporting Council consultation paper seeking views on its future research activities, advocating for it to undertake a comprehensive research project to examine the inconsistencies between the treatments of acquired and internally generated intangibles, their recognition and measurement, and the accounting for R&D costs.

Objective two: **Enhance investor stewardship and engagement.**

Recommendation four: More formally incorporate a focus on long-term value creation and productivity into engagement practices.

While the primary responsibility for promoting the success of a company rests with the Board and its oversight of management, investors play a crucial role in holding the Board to account for the fulfilment of its responsibilities. In doing so, shareholder stewardship should promote the long-term success of companies in such a way that the ultimate providers of capital – our members' clients - will also prosper. In this sense, we believe that there should be a natural alignment of interests: effective stewardship should benefit companies, investors, stakeholders, and the economy as a whole.

The Investment Association is committed to working with its members to enhance their public disclosures on their stewardship activities. In 2016, the Investment Association developed its **Stewardship Reporting Framework** to assist members when they publicly report on their stewardship activities. In partnership with the Pension and Lifetime Savings Association (PLSA) and ICSA: The Governance Institute, the Investment Association also revised its **Annual Stewardship Survey** to create a single view of stewardship across the investment chain from companies, asset managers, and asset owners. The Investment Association's stewardship survey now also includes questions on the extent to which companies are engaged on productivity and capital management issues. The results will be available in the second quarter of this year.

Following the Kay Review recommendation to establish a collective engagement vehicle for shareholders in the UK, the **Investor Forum** now has 34 members with more than £715bn invested in UK equities, representing around 35% of the FTSE 350 market capitalisation, and is now self-funding through an independent membership fee. Seven significant engagements were completed during late 2015 and 2016, and it published its first annual review of activities in January 2017. This outlined the important contributions shareholders were making through their stewardship activities, and highlighted the progress made in establishing a new tool for shareholder collective engagement.

Objective three:	**Simplify behavioural incentives and the investment chain**
Recommendation five:	Ensure that the relationship between asset owners and investment managers is governed in way that does not inadvertently embed a short-term focus.
Recommendation six:	Consideration of how greater opportunities for long-term investment can be made available to investors in defined contribution schemes.
Recommendation seven:	Foster improved understanding of the investment horizons of investment managers.
Recommendation eight:	Ensure that executive remuneration structures are aligned to long-term decision making

In October 2016, the Investment Association established a members working group to consider the key regulatory and market barriers to creating an investment environment more conducive to long-term investment by **defined contribution pension schemes**, primarily in illiquid assets and infrastructure. The working group's analysis is well advanced, and it is now seeking additional sector-based evidence to support its final report which will be made available later this year. This will likely focus on the practicalities of the current platform-based approach and the requirement for daily pricing, a discussion on the limitations arising from existing permitted link rules, and associated charge-cap issues.

In 2016, the Investment Association initiated a review of the current approaches to incorporating **stewardship and long-term perspectives in pension mandates and statements of investment principles**. It is our intention to develop best-practice guidance on how stewardship and long-term investment can be better incorporated into the Statement of Investment Principles and Mandate design. As part of this guidance, **investment consultants** will be encouraged to issue public position statements describing how their activities support the provision of long-term investment approaches and stewardship in mandate design and performance evaluation.

To support the development of this guidance, a multi-stakeholder working group will also examine methodologies for calculating **average holding periods** with a view to developing a standard approach across the investment industry. It will also explore how the **investment mandate** can operate better as a mutual mechanism for the alignment of behaviours and objectives, (including key issues such as the time horizons in which performance of managers is to be assessed) rather than principally existing as an expression of legal responsibilities and powers.

The Investment Association established the **Executive Remuneration Working Group** in the Autumn of 2015, with the aim of addressing the complexity in executive pay and making sure that remuneration clearly aligns with the long-term interests of companies and investors. The Working Group comprised representatives from companies, investors, and asset owners to ensure views from across the investment chain were represented. Over a 9 month period, the Working Group held 32 roundtables with over 360 individuals to gather stakeholder views on executive remuneration. Those involved included company chairmen, non-executive directors, HR and reward directors, asset managers, trade associations, think tanks, and representatives from government departments.

The working group published its final report in July 2016. The core recommendation of the working group is that there should be greater flexibility for companies to choose the remuneration structure which is most appropriate for their business and which clearly links pay to the long-term success of the company. The working group then proposed a further nine recommendations to help to rebuild trust in the system, including increased transparency, improved shareholder engagement and the skills on the remuneration committee, and addressing the levels of executive pay.

The Executive Remuneration Working Group's Final Report has gained significant traction in the market since its publication, and in October 2016 the Investment Association updated its Principles of Remuneration to reflect the recommendations of the Group. We are now engaging with listed companies on their Remuneration Policies ahead of the 2017 AGM season.

Objective four:	**Develop efficient and diverse capital markets**
Recommendation nine:	Encourage Equity Investment and Improve the Equity Offering Process.
Recommendation ten:	Ensure the efficient operation of the markets for other asset classes to ensure the provision of diverse capital markets.

The Investment Association agrees with the Government that to catalyse UK productivity improvements, companies must be able to access the finance they need to invest in new technology and sustainable growth. Providing long-term capital is one of the asset management industry's most valuable roles in society. Our members already fund 60% of all new capital market fundraisings in the UK. Subject to clients' risk and reward requirements, our members are well positioned to help support the emergence of new capital markets in the UK, such as private placements, municipal bonds, local authority debt markets, and securitisations.

The practice of early engagement should be seen as an integral part of the IPO process. We have been collaborating with the Quoted Companies Alliance to identify the key barriers to more effective **pre-IPO engagement** between investors and small and medium-sized companies, including holding a joint members' roundtable on the issue in January 2017. The roundtable concluded that the current model was working and that there was a good supply of pre-IPO companies being brought forward by brokers for consideration by investors. However, further effort was required to improve the flow and timing of key information to potential investors. We have therefore committed to develop joint guidance with the QCA setting out investors' expectations for companies considering listing on the public market. This will aim to improve the timing and quality of information between investors and companies, and prepare companies and management for listing on the public market by introducing consistent, industry-backed guidelines.

The Investment Association is committed to lowering the cost of issuing equity capital, and removing the information asymmetry that exists at the expense of investors. During 2016, we lobbied relevant stakeholders on **prospectus regulation** with a focus on making it easier for companies to access equity capital both at IPO and on the secondary markets, whilst at the same time maintaining important investor protections. We welcome the recent agreement by the European Commission on new prospectus regulation which will ensure that key information and risk factors will be presented in a succinct and clear format, and in a manner consistent with the key priorities of asset managers for non-equity securities.

The Investment Association supports all efforts to facilitate the **timely publication and easy access to prospectuses** to ensure that all investors receive all necessary information to make sound and well-informed investment decisions. To achieve this, we issued a formal response to the FCA's Discussion Paper on availability of information in the UK equity IPO process in August 2016. In March 2017, the FCA published its consultation on its policy proposals aimed at reforming the IPO process to restore the primacy of the prospectus document, significantly improve the range and quality of information available to investors, and facilitate the availability of such information early enough in the process to support more balanced investor education and price discovery. The Investment Association will be responding to the consultation and engaging with the FCA and other market participants to ensure that these aims are met.

The concept of **pre-emption** is widely recognised as a great strength of raising equity capital in the UK. That is why the Investment Association endorsed the Pre-Emption Group Statement of Principles in May 2016, and drove forward a set of template resolutions to make it easier for companies to enact the provisions contained therein. The Investment Association will conduct a review following the 2017 AGM season to identify those companies that are not complying with the Principles, or those that have not adopted the template resolutions. We will then consider whether any further clarification or education is needed to embed the Principles as market practice, and to ensure that the system works for all stakeholders.

The Investment Association judges that the private sector and capital markets can play an important part in assisting the public sector in meeting its long-term investment and financing needs. For example, in March 2017 the Investment Association published **Governance and Disclosure Guidelines for Housing Associations** seeking to access capital market funding. Housing Associations have raised over £14.4 billion of debt in capital markets since 2012. However, it is clear that our members could potentially provide further funding to the sector if governance and regulatory rules at Housing Associations better responded to the requirements of capital market investors. For example, transparency is essential as this has an impact on investor confidence, affects pricing in secondary markets, and affects the ability of issuers to attract a broader investor base. In addition, there are complex regulatory requirements that require certain disclosures on a timely basis.

Municipal bonds are an attractive asset class for institutional investors looking to match their assets to their long-term liabilities. This is why in November 2016, the Investment Association gave its formal backing to the development of a UK municipal bond market by launching a position paper outlining our support, and the benefits of municipal bonds for investors, borrowers, and the wider economy. We believe that the development of a UK municipal bond market will provide a means for investors currently not investing in infrastructure to gain that exposure to this asset class. Additionally, for local authorities, a municipal bond market will not only diversify their lending sources, they will enable access to a wider range of capital at competitive market rates. They will also reduce their reliance on central government funding.

Soundly structured securitisation is an important channel for diversifying funding sources and allocating risk more efficiently within the financial system. We continue to support on-going work to develop European Private Placements and the **revival of the securitisation market** in UK and Europe. The Investment Association is now a member of the European Securitisation Co-ordination Group consisting of a wide variety of industry representatives, looking to provide a concerted industry voice to allow for better engagement on securitisation issues, particularly the development of a simple, standard, and transparent European framework for securitisations.

A stable, well-functioning bond market is a critical part of the UK financial market infrastructure, providing capital for issuers and investment opportunities for a broad range of savers and investors. In 2017, we will seek to promote **a more effective new issuance process** in the sterling fixed income markets, and aide secondary market liquidity by setting out investor expectation on necessary disclosure for new issues in order to efficiently assess an instrument's eligibility for portfolios utilising Solvency II Matching Adjustment. Insurers as institutional investors are critical buyers of long-term, sterling debt and efforts should be made to provide all necessary information to make informed and regulatory-compliant investment decisions.

We have also sought to promote appropriate behaviours and investor expectations in fixed income markets. In 2017, the Investment Association will be working with its members to set out investor expectations of companies and their advisers to establish best practice for liability management exercises that have the potential to impact holders of existing debt securities. We will seek to engage more broadly with the fixed income market participants to ensure that best practice continues to develop in this critical aspect of the market.

Objective five:	**Overcome tax and regulatory impediments to the provision of long-term finance.**
Recommendation eleven:	Ensure that solvency and prudential regulation does not inadvertently impede investment managers from investing in a manner consistent with their clients' long-term interests.
Recommendation twelve:	Review the causes of "debt-bias" and its effect on financial stability and procyclical decision-making

While investors have different mandates, investment strategies, incentives and knowledge of the markets in which they are investing, regulatory and tax developments remain an important factor in shaping the asset allocation strategies of institutional investors and the funding structures of corporates.

Based on our members' extensive practitioner experience, the Investment Association is keen to contribute to the debate on potential tax and regulatory impediments to investment to ensure the right long-term outcomes for our members' clients. We have sought to encourage the FCA to undertake a thematic review of whether the approach to **market risk in prudential and conduct regulation** is resulting in investment decisions that are consistent with the long-term investment objectives of clients. The Investment Association is also contributing to the European Banking Authority's review of the prudential regime for investment firms. To support this work, the Investment Association hosted a roundtable in January 2017 with the FCA to discuss the latest EBA discussion paper.

This year, the Investment Association will also convene a multi-stakeholder working group to review the extent to which current accounting standards, solvency rules, and prudential regulatory requirements may be resulting in **excessive de-risking** by insurers and pension funds and impeding the provision of longer-term forms of finance.

On the supply side, a growing numbers of companies are raising capital through debt rather than equity. It is our view that, among other issues, the current tax system continues to incentivise businesses to use debt, rather than equity, and that this **'debt bias'** is having an adverse effect on the level of long-term investment and financial stability in the UK. We have now begun to undertake a comprehensive review of why companies favour funding through debt rather than equity. We are currently arranging meetings with key stakeholders to obtain their initial views about the scope of the proposed analysis, before commissioning an independent consultant to undertake the analysis.

FURTHER ENGAGEMENT ON PRODUCTIVITY ISSUES

The Investment Association backs the Government's **Patient Capital Review**, and believe that our members' practitioner experience means that they are well placed to help inform this review. We welcome the opportunity to contribute to the Patient Capital Review, and have been meeting with Treasury officials to discuss how we might be able to assist with this important initiative. We have welcomed the opportunity to contribute to the Government's **Industrial Strategy Green Paper**. We consider that there are a number of areas where the work we are carrying out under the Productivity Action Plan can also help inform this important initiative. Finally, we have responded to the consultation on reform to **Corporate Governance** in particular detail, as we believe that this is an area in which rapid and important progress can be made towards solving the productivity puzzle.