

## Achieving good governance

### ISS policy review 2021

The Association of Investment Companies (AIC) is a trade body for the closed-ended investment company sector. We represent 358 investment companies, holding assets of over £193 billion as at 30 September 2020. The AIC's members are predominantly listed on the Main Market of the London Stock Exchange, under Chapter 15 of the Listing Rules. Some have shares admitted to trading on the Specialist Fund Segment (SFS); others are quoted on the Alternative Investments Market (AIM).

The AIC's members include investment trusts, Venture Capital Trusts (VCTs), Real Estate Investment Trusts operating as funds (REITs) and non-UK investment companies. Our non-UK members are usually incorporated in Guernsey and Jersey.

The AIC welcomes the opportunity to respond to [ISS's consultation on its benchmark policy changes for 2021](#).

### Share issuance authority for investment companies

ISS is proposing to amend its share issuance authority guidelines for investment companies. It proposes to state that it will:

*“Generally vote for a resolution to authorise the issuance of equity if there is a firm commitment from the board that shares would only be issued at a price at or above net asset value. Otherwise, generally vote for a resolution to authorise the issuance of equity, unless:*

- *The general issuance authority exceeds one-third (33 percent) of the issued share capital. Assuming it is no more than one-third, a further one-third of the issued share capital may also be applied to a fully pre-emptive rights issue taking the acceptable aggregate authority to two-thirds (66 percent); or*
- *The routine authority to disapply pre-emption rights exceeds 5 percent of the issued share capital in any one year.*

*Share issuance proposals which involve the issue of C shares will be considered using the above guidance”.*

These changes recognise Listing Rule 15.4.11. They also recognise that where an investment company issues shares at a premium to net asset value (NAV) there is no value dilution for existing shareholders.

Increasing the size of the company is likely to bring benefits for existing shareholders, such as reducing ongoing charges as the fixed costs of running the company will be spread over a wider shareholder base.

All shareholders will also benefit from being invested in a larger fund as larger funds provide managers with more capital to support a successful investment policy. This can be particularly relevant for companies invested in assets such as private equity, infrastructure or property, which can require large sums to exploit new investment opportunities.

Expanding the company also improves the liquidity of the company's shares. Larger investment companies are better able to attract demand from discretionary fund managers who often do not purchase shares in companies below a certain size. This issue is particularly significant for the investment company sector as a relatively high proportion of companies have smaller market caps when compared to other listed companies.

The AIC supports the proposed changes and **recommends** these are adopted.

### References to investment trusts

Although it is used colloquially, the term 'investment trust' does not cover the full breath of the investment company sector. Instead the term 'investment company' should be used for closed-ended collective investment vehicles which pool their shareholders' capital and hold a portfolio of assets to spread risk and generate an investment return. The term investment companies includes:

- Investment trusts – these are the most common type of investment company. They are usually incorporated in the UK and meet certain conditions set out in tax regulations;
- Non-UK investment companies – these are based outside the UK, predominantly in the Channel Islands, but are often listed on the London Stock Exchange, they are similar to UK investment trusts;
- VCTs – these are investment companies that invest in small, growing businesses; and
- REITs operating as funds – many investment companies that invest in property are structured as UK REITs. Under the UK REIT regime, companies must meet certain requirements and in return the REIT is exempt from UK corporation tax on profits and gains relating to its qualifying property. This prevents double taxation, similar to the rules in place for other collective investment funds. REITs can be funds which operate in a similar way to investment trusts in that they have similar governance arrangements i.e. a board of non-executive directors which outsource the day-to-day running of the investment portfolio to an investment manager.

N.B. REITs can also be trading companies which do not operate as funds. If they are trading companies, they will be likely to undertake property development activities, have employees and executive directors etc.

The term investment company only covers REITs which operate as funds. However, these two types of REIT can be distinguished in a variety of ways (see below for details).

The AIC **recommends** that all references to 'investment trusts' be amended to 'investment companies' throughout ISS's guidelines. This will cover all the types of companies set out above. Although these companies have slightly different tax structures and may operate on different stock exchanges, fundamentally they are similar and operate with the same governance arrangements.

Using the term investment companies would reduce confusion. It would also ensure that ISS's guidelines align with the companies that are able to report against the AIC Code of Corporate Governance (AIC Code) which is endorsed by the UK Financial Reporting Council, the Guernsey Financial Services Commission and supported by the Jersey Financial Services Commission. Companies that report against the AIC Code are able to meet their obligations under the UK Code (and associated disclosure requirements under paragraph 9.8.6 of the

Listing Rules) and as such do not need to report further on issues contained in the UK Code which are irrelevant to them.

For administrative purposes, the AIC **recommends** that ISS includes the following companies as investment companies:

- companies listed on the Main Market of the London Stock Exchange that report against Chapter 15 of the Listing Rules;
- investing companies listed on AIM; and
- companies listed on the SFS of the Main Market of the London Stock Exchange.

Defining investment companies in this way will exclude UK REITS which do not act as funds from scope. They will therefore be (correctly) treated the same as other trading companies.

The AIC would be happy to advise which of our members fall within these categories and provide you with an annual/ad hoc update if you think that would help.

### Overboarding

The AIC proposes that ISS makes a minor amendment to its policy on overboarding to provide more balance to its position.

ISS takes a pragmatic approach to the difficult issue of overboarding. Its policy states that persons holding more than a certain number of mandates may be considered to be overboarded. The explanatory text emphasises that, “*A stricter view may apply for directors who serve on the boards of complex companies, those in highly regulated sectors or directors who chair a number of key committees*”.

This suggests that ISS only deviates from its policy where a stricter interpretation is required. ISS has conveyed to us that it also has the capacity, where justified, to take a less strict view where directors serve on the boards of less complex companies where time commitments will be less onerous providing directors with more time to take on further roles.

Many investment companies are likely to fall into this category as typically they:

- are operationally very simple, with limited or no physical presence. They do not have complex group structures, international divisions or complex accounts;
- have independent boards comprised of non-executive directors. They do not have executive directors or employees and therefore do not have internal audit functions. Instead, they outsource the day-to-day running of the company to third party service providers. This includes appointing an investment manager to make the day-to-day investment decisions, and a custodian to hold assets that can be held in custody, such as equities and bonds. There are contracts in place with each service provider which are reviewed on a regular basis by the board;
- do not provide goods or services and have no trading activity or customers. They are investment vehicles for their shareholders, but do not provide services to those shareholders;
- have suppliers which are typically professional advisers or regulated firms.

The AIC **recommends** that the following sentence (shown in underlined text) is included in ISS's guidelines. This echoes the requirement in the UK and AIC Codes to ensure directors "have sufficient time to meet their board responsibilities".

**"Overboarding**

*Where directors have multiple board appointments, ISS may recommend a vote against directors who appear to hold an excessive number of board roles at publicly-listed companies, defined as follows:*

- *Any person who holds more than five mandates at listed companies will be classified as overboarded. For the purposes of calculating this limit, a non-executive directorship counts as one mandate, a non-executive chair counts as two mandates, and a position as executive director (or a comparable role) is counted as three mandates.*
- *Also, any person who holds the position of executive director (or a comparable role) at one company and a non-executive chair at a different company will be classified as overboarded.*

*When applying this policy, ISS will consider the nature and scope of the various appointments and the companies concerned, and if any exceptional circumstances exist. A stricter view may apply for directors who serve on the boards of complex companies, those in highly regulated sectors, or directors who chair a number of key committees. Likewise, a more lenient view may apply for directors who serve on the boards of less complex companies (for example, externally managed investment companies) provided they have sufficient time to meet their board responsibilities."*

The AIC would be pleased to discuss any of our proposals with you in further detail if you think this would be of help.

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To discuss the issues raised in this paper please contact:

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