

Institutional Investors as Owners

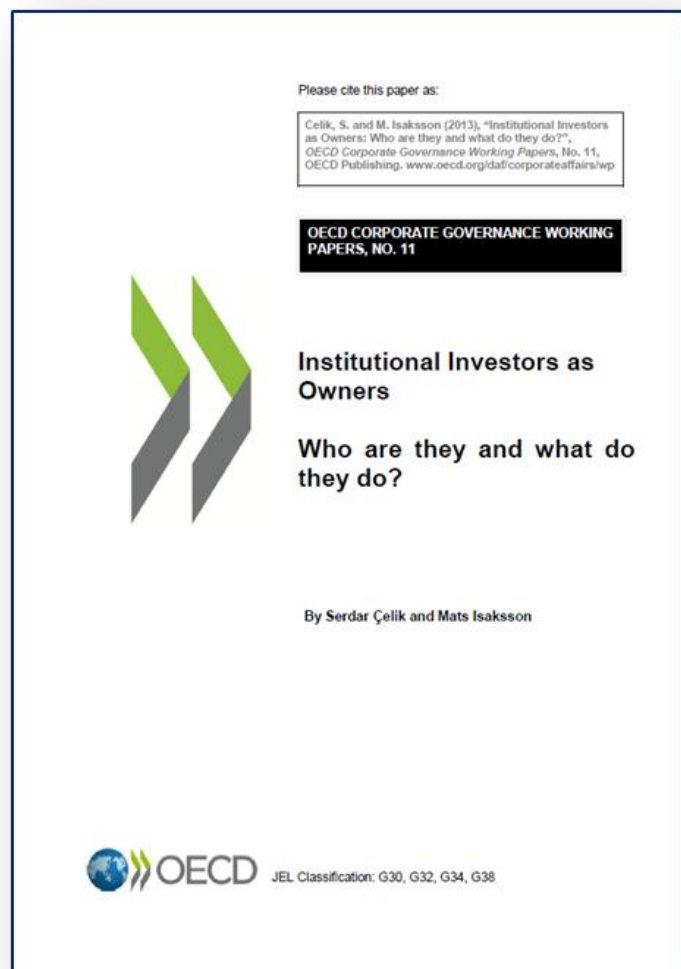
Who are they and what do they do?

**Task Force of Middle East and North African Stock
Exchanges for Corporate Governance**

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Serdar Çelik, OECD

Institutional Investors as Owners



Institutional Investors as Owners - Who are they and what do they do?

By Serdar Çelik and Mats Isaksson

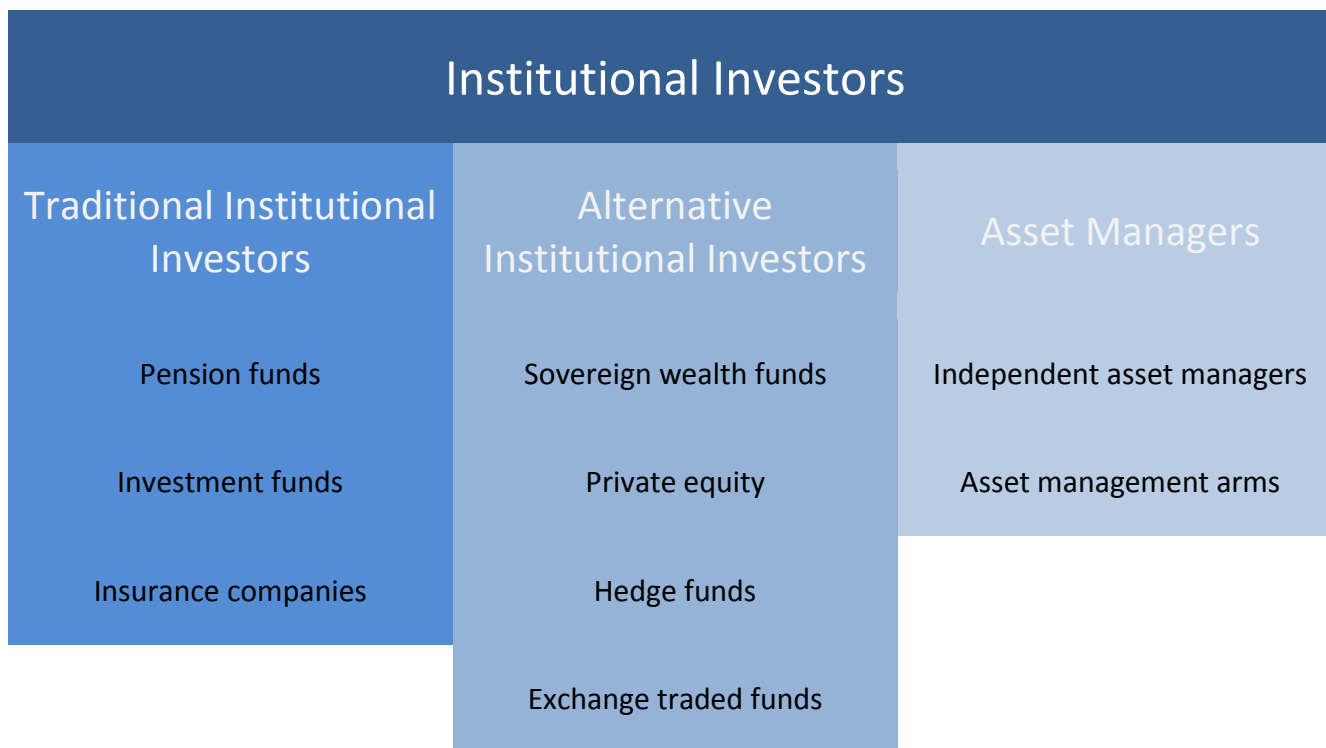
OECD Corporate Governance Working Papers

<http://www.oecd.org/corporate>

Increase in institutional ownership

- In the mid-1960s, physical persons held as much as 84% of all publicly listed stocks in the United States. Today they hold less than 40%.
- In Japan only 18% of all public equity was held by physical persons in 2011.
- In the UK, the portion of public equity held by physical persons has decreased from 54% to only 11% over the last fifty years.
- Today, about 70% of all listed equity in the UK is held by institutional investors.

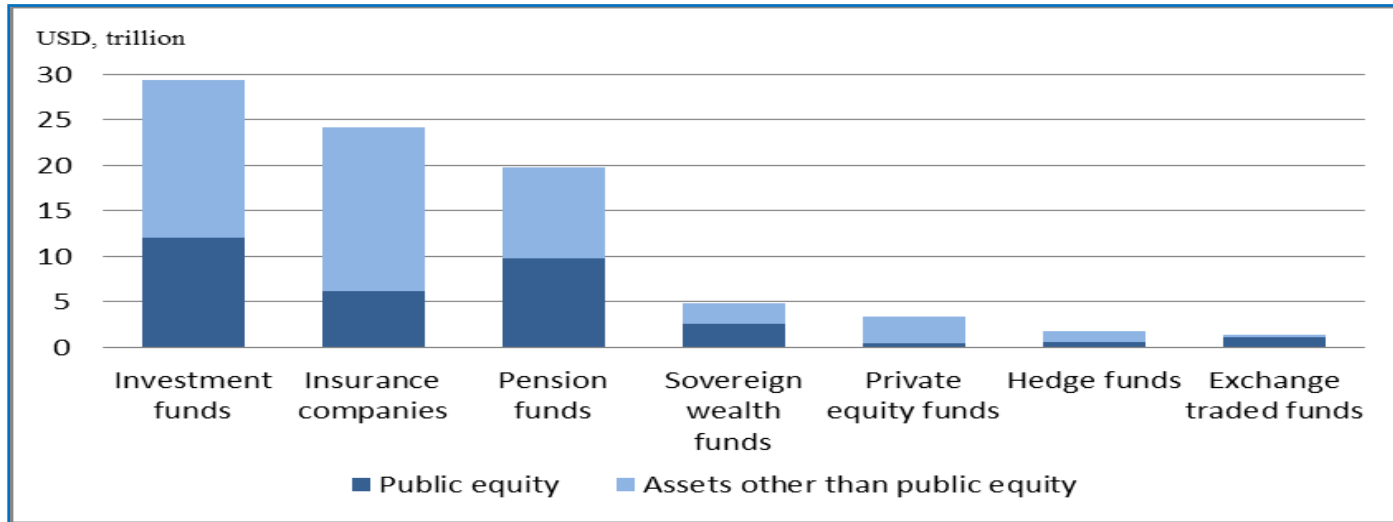
Wide diversity -1



- Other categories, like closed-end investment companies, proprietary trading desks of investment banks, foundations and endowments could be added.

Wide diversity - 2

Total assets under management and allocation to public equity by different types of institutional investors

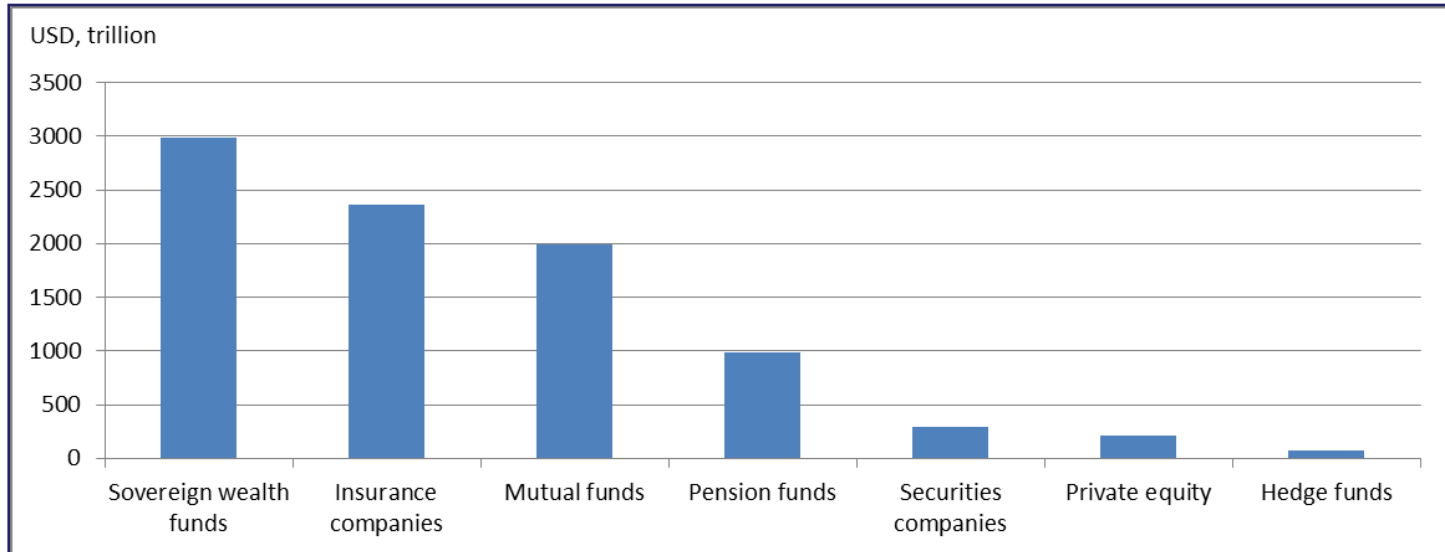


Source: OECD Institutional Investors Database, SWF Institute, IMF, Preqin, BlackRock, McKinsey Global Institute

- Concerns about the accuracy of estimations in the data.
- The combined holdings of all institutional investors; USD 84.8 trillion in 2011.
- Traditional institutional investors; USD 73.4 trillion (USD 28 trillion in public equity).
- Alternative institutional investors; USD 11.4 trillion (USD 4.6 trillion in public equity).

Wide diversity - 3

Total assets under management by different types of institutional investors in emerging markets

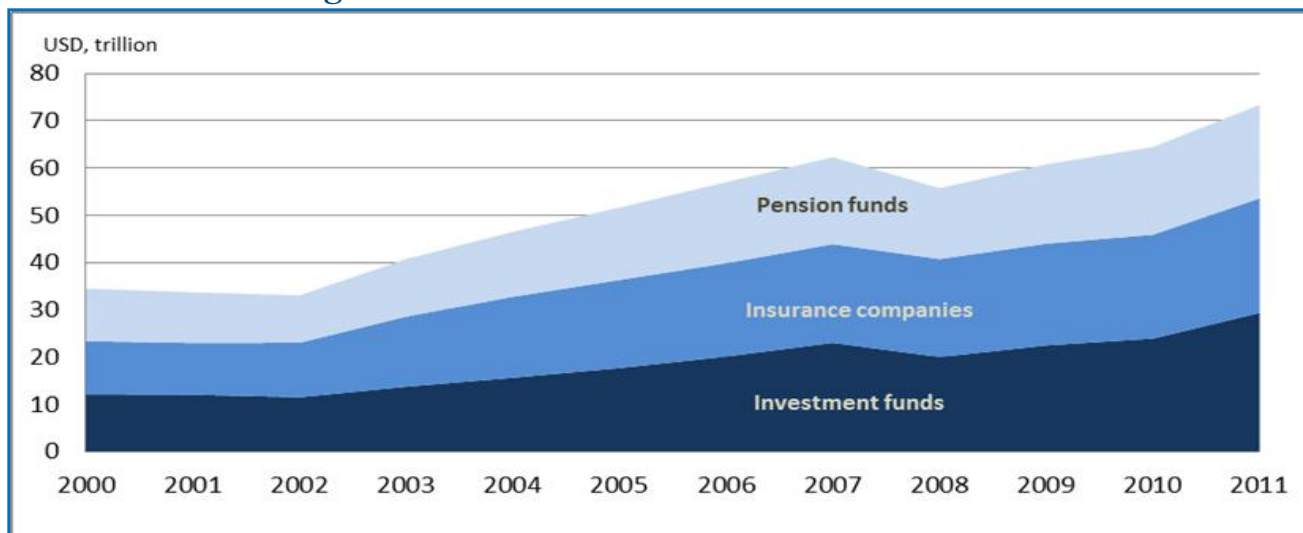


Source: OSCO, Development and Regulation of Institutional Investors in Emerging Markets; SWF Institute

- Unlike developed economies, the largest category in emerging markets is Sovereign Wealth Funds with an estimated USD 3 trillion under management in 2010.

Traditional institutional investors - 1

Assets under management of traditional institutional investors in the OECD

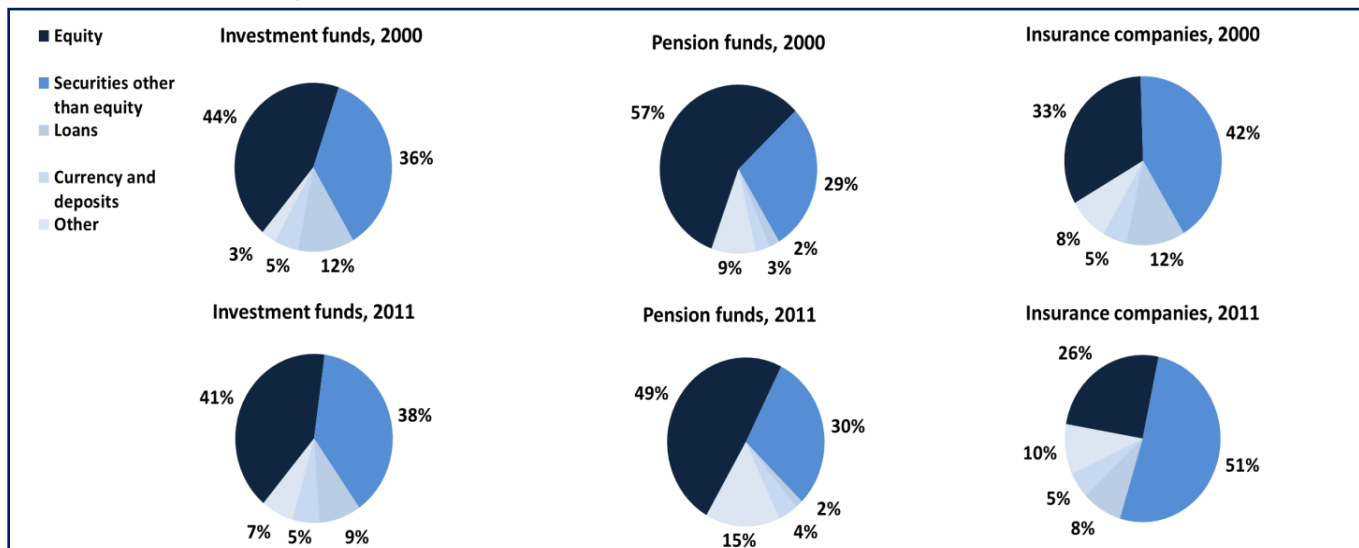


Source: OECD Institutional Investors Database

- In the last decade, traditional institutional investors have more than doubled their total assets; from USD 36 trillion in 2000 to USD 73.4 trillion in 2011.
- The largest increase has been for investment funds; 121%.
- Double counting; pension funds and insurance companies invest in mutual funds which are part of the investment funds category.

Traditional institutional investors - 2

Asset allocation by traditional institutional investors in the OECD

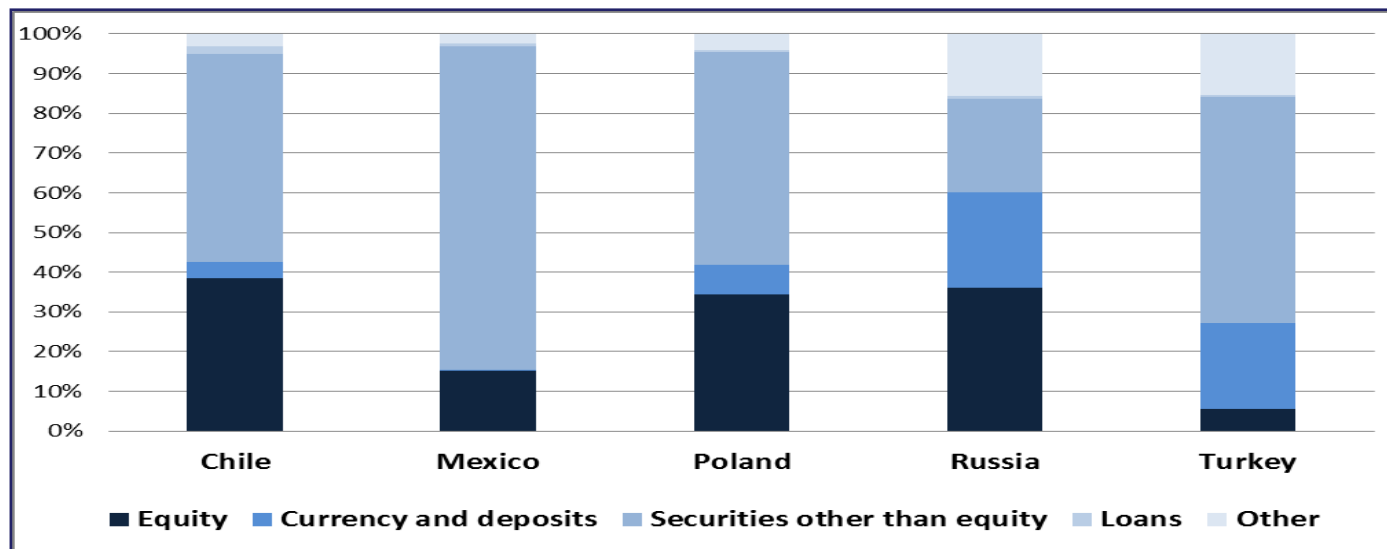


Source: OECD Institutional Investors Database

- For investment funds and pension funds public equity was the single largest asset class both in 2000 and 2011.
- In 2011 public equity represented almost half of the portfolio of pension funds and 41% of the total portfolio of investment funds.
- Insurance companies held 26% of their assets in the form of public equity.

Traditional institutional investors - 3

Asset allocation of traditional institutional investors in emerging markets (2011)

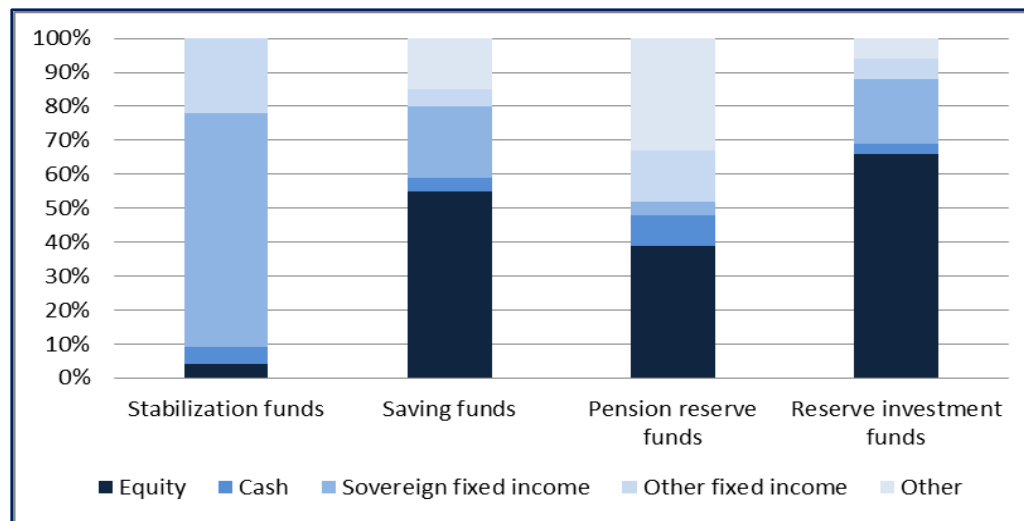


Source: OECD, Institutional Investors Database

- Limited data.
- Only in Russia was public equity the single largest asset class in 2011.

Alternative institutional investors - 1

Asset allocation of different types of sovereign wealth funds (2010)



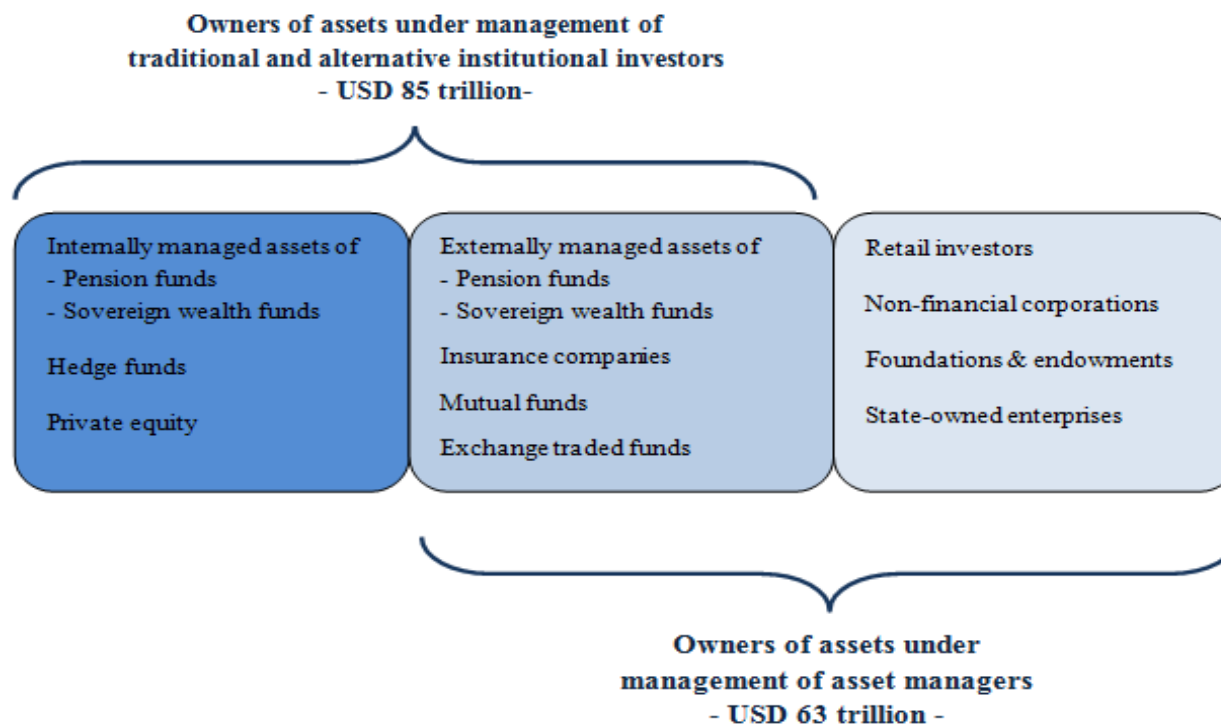
Source: IMF, Global Financial Stability Report, April 2012

- The largest category among alternative institutional investors, measured by total assets under management, is the SWFs.
- SWF is a highly diverse concept in terms of organisational model, governance, purpose and investment strategies.
- Except for stabilization funds, public equity constitutes a significant portion of SWFs total assets.

Alternative institutional investors - 2

- There is no simple unifying principle for private equity and hedge funds.
- Private equity funds held USD 3.4 trillion, of which USD 1 trillion is estimated to be in the form of committed capital. Only a small part of the remaining USD 2 trillion is invested in listed equities.
- Hedge funds' relatively modest holdings of equity do not necessarily reflect their role in equity markets and corporate governance.
- The most recent addition is ETFs, which grew dramatically from USD 74 billion in 2000 to USD 1,35 trillion in 2011.

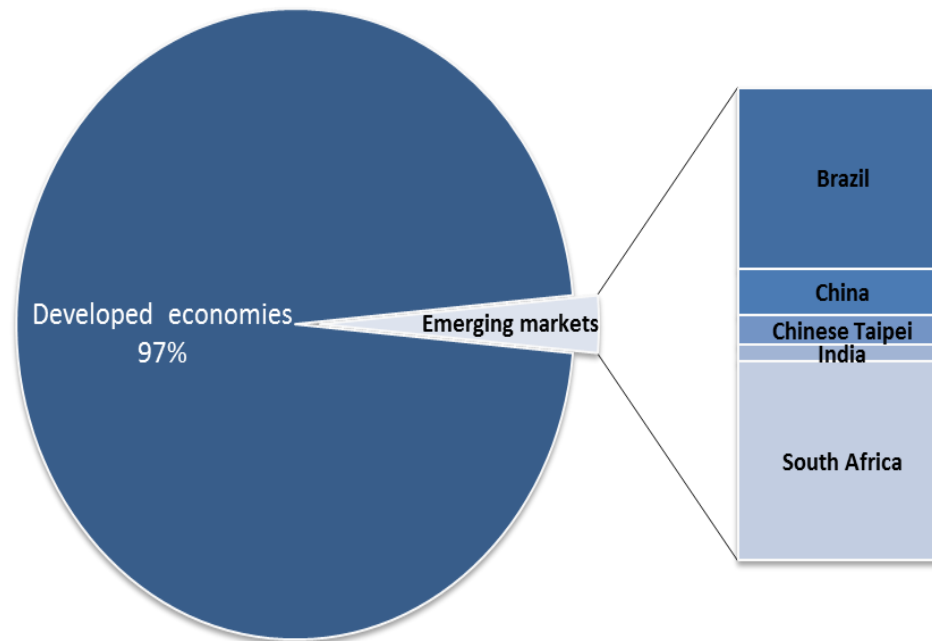
Asset managers



- Asset managers are defined as having the day-to-day responsibility of managing investments.
- Increase in outsourcing of asset management to external asset managers. Globally, asset management firms are estimated to have had about USD 63 trillion in 2011.
- Some of the asset managers are themselves traditional or alternative institutional investors.

Asset managers in emerging markets

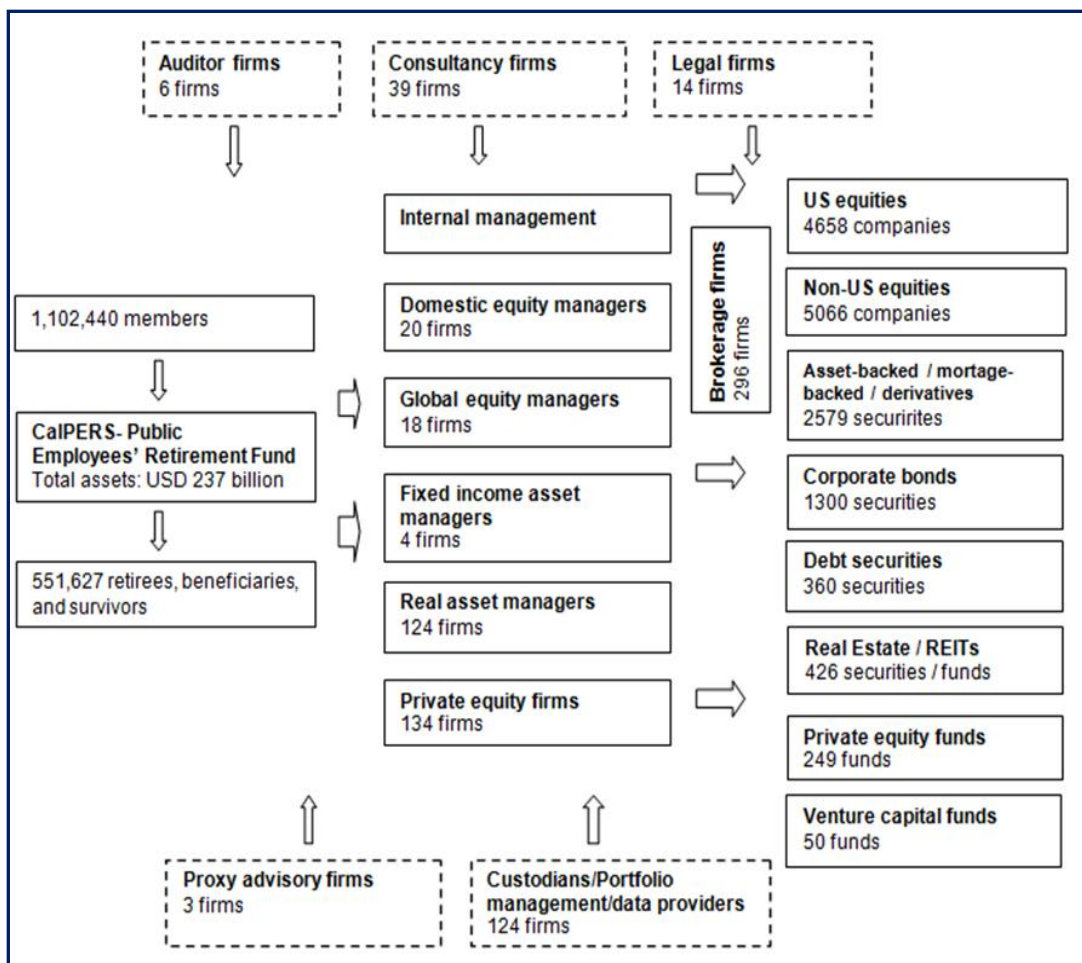
The share of asset managers from emerging markets in global industry



Source: Towers Watson (2012), the World's 500 Largest Asset Managers, based on joint research by Towers Watson and Pensions & Investments

The complexity of the investment chain

CalPERS case (June 2012)



Source: CalPERS Comprehensive Annual Financial Report, Financial Year Ended June 30, 2012 and CalPERS Annual Investment Report, Financial Year Ended June 30, 2012,

The role of institutional investors as owners

- New impetus to the discussion about the role of institutional investors as owners of publicly listed companies.
- Particularly, how they carry out the corporate governance functions that are associated with share ownership.
- Regulatory and voluntary initiatives aiming at increasing their level of ownership engagement. Such as;
 - The 1994 interpretation of the US Employee Retirement Income Security Act.
 - The UK Stewardship Code.

Determinants of ownership engagement

Purpose	Not for profit		For profit	
Liability structure	Long-term		Short-term	
Investment strategy	Passive Index	Passive Fundamental	Active fundamental	Active Quantitative
Portfolio structure	Concentrated		Diversified	
Fee structure	NA*	Performance fee	Flat fee	Zero fee
Political / social objectives	Political/social incentives		No political/social incentives	
Regulatory framework	Engagement requirements	Engagement limitations	No legal requirements/limitations	

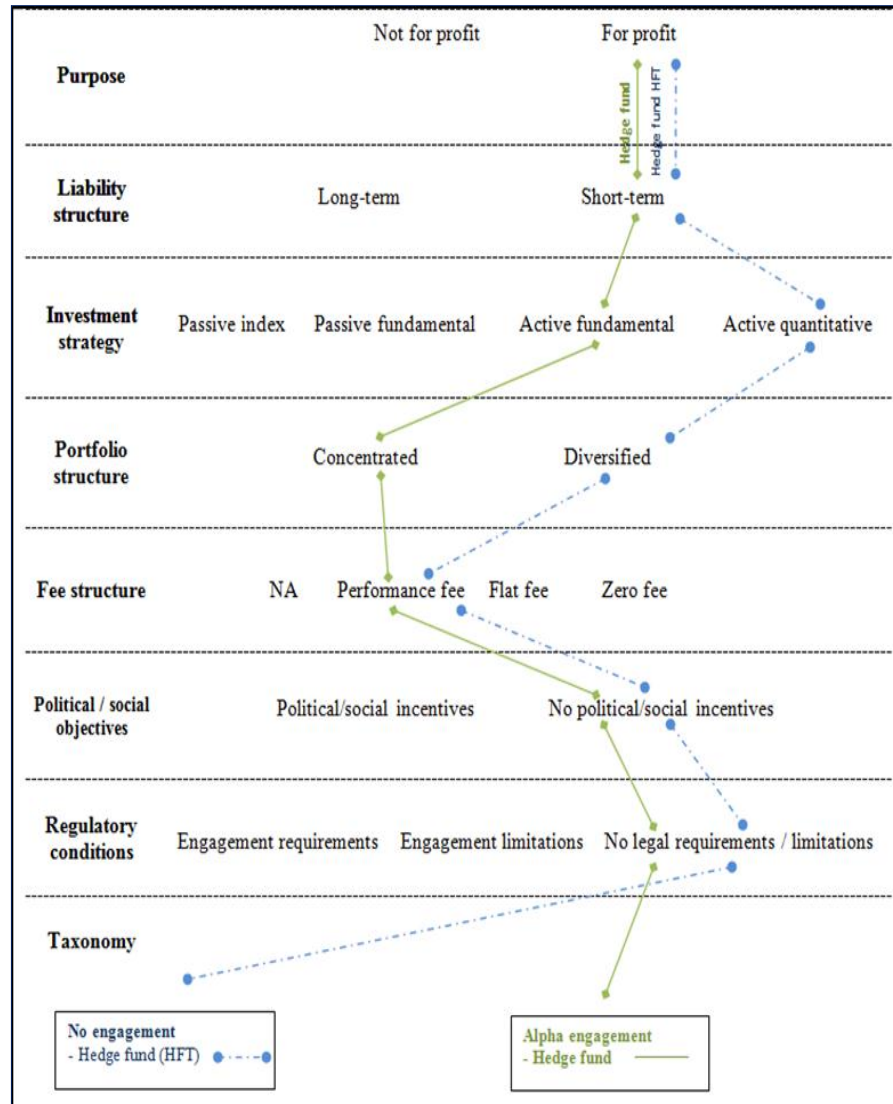
*Not applicable for not-for-profit institutional investors.

- Determinants are the factors that constitute the institution's business model and the regulatory constraint under which this business is carried out.
- Vary not only between different categories of institutions, but also within a given category of institutional investors. For example, between two different hedge funds.
- Suggested determinants can be debated and refined. Some of them may be taken out and others should perhaps be added.

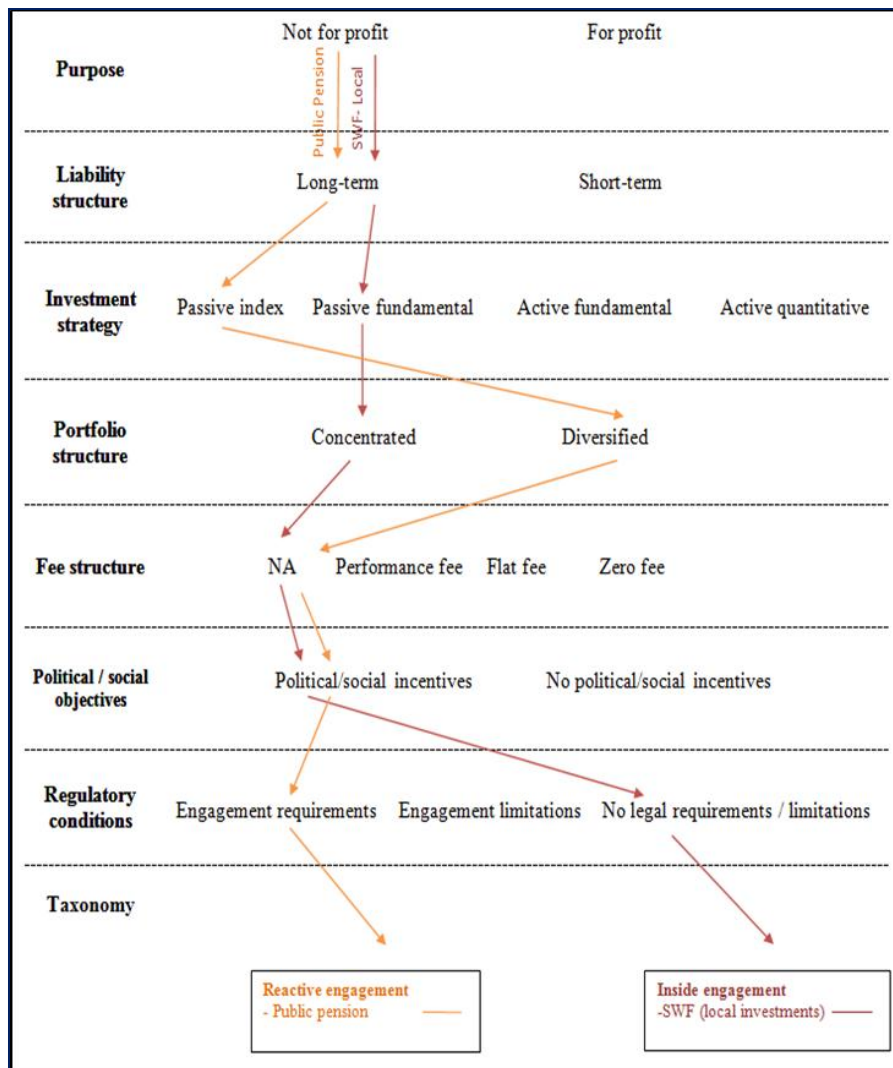
Levels of ownership engagement

- **No engagement:** Do not monitor individual investee companies actively, do not vote their shares and do not engage in any dialogue with the management of investee companies.
- **Reactive engagement:** Voting practices that are primarily based on a set of generic, pre-defined criteria. Relies on buying advice and voting services from external providers such as proxy advisors. Reactions to engagement by other shareholders.
- **Alpha engagement:** To support short or long-term returns above market benchmarks.
- **Inside engagement:** Characterized by fundamental corporate analysis, direct voting of shares and often assuming board responsibilities. Typically hold controlling or large stakes in the company.

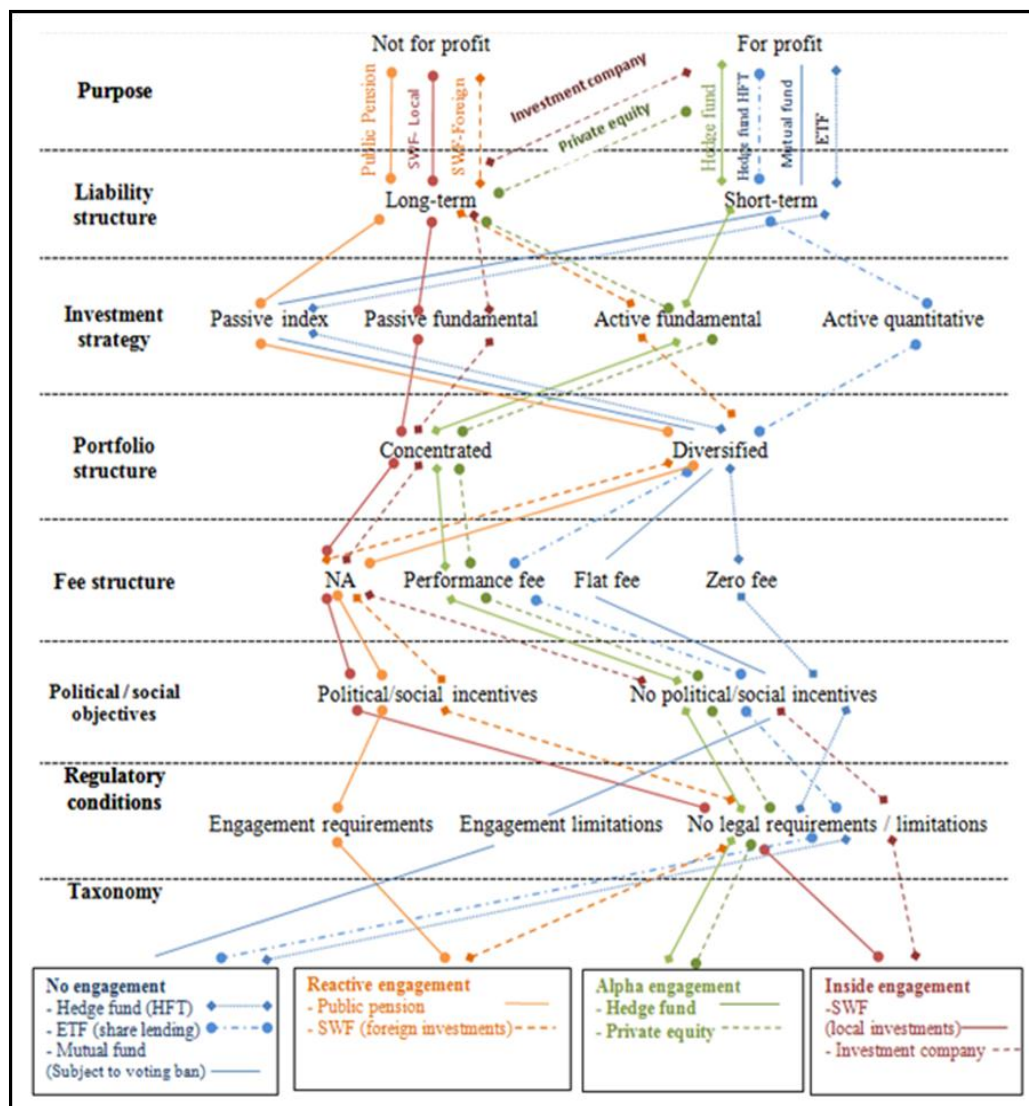
No engagement and alpha engagement



Reactive engagement and inside engagement



Corporate governance taxonomy of institutional investors



Main messages

- Analysis of ownership engagement from public policy perspective.
- Constraints of regulatory intervention
- Ownership engagement is hardly a moral issue or a general fiduciary duty.
- The role of ownership engagement for effective allocation of capital and monitoring of corporate performance

Main messages

- In order to understand the level of ownership engagement we need to identify a whole range of different determinants.
- Legal or regulatory requirements for voting may have little effect on ownership engagement if other and more dominant determinants for ownership engagement remain unchanged.
- Institutions with the highest degree of engagement typically have no regulatory obligation with respect to the degree of their ownership engagement.

Thank you for your attention!