Institutional Investors as Owners

- Who are they and what do they do?

By Serdar Celik and Mats Isaksson

OECD Corporate Governance Working Papers

http://www.oecd.org/corporate
• Institutional Investors have more than doubled their assets under management in the last decade.

• 85 trillion in AUM

• 32 trillion in public equity
## MANY DIFFERENT ANIMALS

### Institutional Investors

<table>
<thead>
<tr>
<th>Traditional Institutional Investors</th>
<th>Alternative Institutional Investors</th>
<th>Asset Managers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension funds</td>
<td>Sovereign wealth funds</td>
<td>Independent asset managers</td>
</tr>
<tr>
<td>Investment funds</td>
<td>Private equity</td>
<td>Asset management arms</td>
</tr>
<tr>
<td>Insurance companies</td>
<td>Hedge funds</td>
<td></td>
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<tr>
<td></td>
<td>Exchange traded funds</td>
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</tr>
</tbody>
</table>

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

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

- 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).
Complexity – The CalPERS Case

1,102,440 members
CalPERS- Public Employees’ Retirement Fund
Total assets: USD 237 billion
551,627 retirees, beneficiaries, and survivors

Brokerage firms
296 firms

US equities
4658 companies
Non-US equities
5066 companies
Asset-backed / mortgage-backed / derivatives
2579 securities
Corporate bonds
1300 securities
Debt securities
360 securities
Real Estate / REITs
426 securities / funds
Private equity funds
249 funds
Venture capital funds
50 funds

Brokerage firms
296 firms

Internal management
Domestic equity managers
20 firms
Global equity managers
18 firms
Fixed income asset managers
4 firms
Real asset managers
124 firms
Private equity firms
134 firms

Proxy advisory firms
3 firms
Custodians/Portfolio management/data providers
124 firms
Consultancy firms
39 firms
Legal firms
14 firms
Auditor firms
6 firms
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 management arms of insurance companies.
The discussion about ownership engagement has two main sources of origin

- 1. **Legal** (to meet fiduciary duties)

- 2. **Economic** (to improve capital allocation and monitor corporate performance)
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• 1. Legal (to meet fiduciary duties)

• 2. Economic (to improve capital allocation and monitor corporate performance)
• A market economy relies on the self-interest of shareholders for efficient capital allocation and monitoring of corporate performance.

• That is why the equity instrument carries certain rights, for example to vote on major changes and the board.

• And in public markets – are transferable (exit).
Ownership Engagement is Expensive

• Some shareholders are willing to carry these costs.

• Others are not.

• Why?
### Determinants of ownership engagement

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<tr>
<th>Purpose</th>
<th>Not for profit</th>
<th>For profit</th>
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<td>Liability structure</td>
<td>Long-term</td>
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<tr>
<td>Investment strategy</td>
<td>Passive Index</td>
<td>Passive Fundamental</td>
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<td></td>
<td></td>
<td>Active fundamental</td>
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<td>Portfolio structure</td>
<td>Concentrated</td>
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<td>Performance fee</td>
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<td>Zero fee</td>
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<td>Political / social objectives</td>
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<td>Regulatory framework</td>
<td>Engagement requirements</td>
<td>Engagement limitations</td>
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*Not applicable for not-for-profit institutional investors.*
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 capture 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

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<td>No engagement - Hedge fund (HFT)</td>
<td>Alpha engagement - Hedge fund</td>
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Source: OECD
• Incentives for ownership engagement is not a function of share ownership itself. They result from the business model and are beyond the reach of public policy.

• No use talking about institutional investors as one group

• Legal and regulatory requirements to engage may have little – or perhaps even negative effect – on capital allocation and corporate performance.

• Owners with the highest degree of engagement typically have no regulatory obligations to “engage”.

• The public policy question is: How do we make sure that they are compensated?
Thank you for your attention!