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Lord Myners  
Financial Services Secretary to the Treasury  
HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

16 FEB 2010

11<sup>th</sup> February 2010

Dear Lord Myners,

Thank you very much for your letter 28th January 2010. As you may be aware, we at Hermes are passionate believers in, and promoters of, responsible asset management.

At the broad level, we believe that responsible asset management is much more than specific engagement on "hot issues". It is about partnering with our clients, aligning our interest with theirs and offering them complete transparency, even when such transparency is unpopular. It is in this context that I believe more should have been done by the asset management industry in pointing out to clients the moral hazards of a credit induced bull market. A responsible asset manager should engage with investors and point out that leverage based high returns, while attractive in the short term, do contain substantial risk; as the events of 2008 clearly demonstrated.

With regards to the much narrower issue of investment bankers' remuneration- which is just one of many unintended consequences of a lack of responsible asset management- we tackle this primarily through our HEOS (Hermes Equity Ownership Services) division. I must say that it has been disappointing to see how little focus has been given to the active voting of passively held shares (which are now a large proportion of pension funds' holdings) by institutional investors. Indeed one could argue that the lack of shareholder engagement was itself an unintended consequence of the move towards indexation.

Our HEOS division (which represents some £50 billion of clients' voting rights) has played an active role in the debate on pay in the financial sector over the past few years. In 2008 it actively engaged with the Institute of International Finance to bolster its work on remuneration, work which has provided the foundation for the development of international best practice. It also engaged with regulators in the UK and elsewhere about the development of regulatory standards, as well as its ongoing work engaging with individual companies.

HEOS has highlighted both privately and publicly the analysis that a significant portion of current banking profits arises not from individual skill but from the effective government

subsidies to the industry and the whole financial system which have helped limit the negative impacts of the credit crisis. Our position in this regard was the basis for a major article in the Financial Times last year.

I attach HEOS's letter sent earlier this week in response to the FSB's call for evidence on pay in the financial sector. We do not believe that it is appropriate to share the details of individual corporate engagements publicly, but you can see from this letter that in the last year alongside its work on this issue around the world, HEOS has engaged with five UK financial institutions on pay issues. Given that the banks tell us that competitive pressures are a significant driver for their desire to pay substantial compensation to their staff, we believe it is vital that shareholders engage not just in a parochial UK context but also on an international basis. In only one occasion has a small portion of one of our UK engagements become a matter of public record but you might expect that HEOS has raised the question of the source of current banking profits and whether these have been earned as a result of staff skill as part of our discussions. These discussions continue, on a global basis.

You raise the question of whether this issue will affect HEOS's voting with regard to remuneration reports at forthcoming AGMs. HEOS will certainly feed into its voting decisions their impressions of the quality of thinking and debate on remuneration committees gleaned from their discussions with financial companies. However, I believe that under the current regulations the remuneration report, and therefore the vote in relation to it, covers the remuneration of Board members and some of the most senior executives. It does not extend to the pay of the staff about whom much of the current controversy revolves.

As well as these backward-looking issues, Hermes and its share voting service HEOS are concerned to help shape the approach of the industry to remuneration issues going forward. To that end I attach the set of principles on banking remuneration developed by HEOS for its clients. We look forward to these forming part of HEOS' discussions with financial institutions around the world.

I would conclude that remuneration is a key issue, but that there is a far wider issue of responsible management by asset managers, investors, regulators, governments and the investment banking industry itself.

I hope this answers your query and I would be delighted to discuss this further with you.

Yours truly,

A handwritten signature in black ink, appearing to read 'Saker Nusseibeh', with a long, sweeping horizontal line extending to the right.

Saker Nusseibeh, PhD  
Head of Investment  
Hermes Fund Managers Ltd.