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Dear Susannah,

Re: Financial Reporting Council – Consultation on a Stewardship Code for Institutional Investors

This is Aviva Investors' response to the consultation. Aviva Investors is a global asset management company wholly owned by Aviva plc, the world's fifth largest insurance group, with assets under management in excess of £250 billion across a range of funds. We are committed responsible investors who believe that good governance and strong, responsible leadership at companies is critical to creating sustainable long term performance at companies and, therefore, for investors.

It follows therefore that we support the introduction of a stewardship code for investors. We agree with the statement in the consultation paper that while shareholders cannot and should not be involved in the management of their company, they can insist on a high standard of corporate governance as a long-term driver of good investment performance.

The Code has the potential to contribute to significant improvement in investment managers' stewardship of clients' ownership interests and rights, promoting the long term health of businesses and create shareholder value. However, this can only be achieved if stewardship is done well.

For the code to be effective there needs to be a critical mass of engaged investors. This means that the Code should be adaptable for use by both UK and non UK investors. Overseas investors in 2008 accounted for more than 41% of shareholdings in UK companies and they should be encouraged to commit to the Code. However, it would be difficult to require the same standard of verification of non UK institutions (as this may prevent them from committing to the code) and it would be difficult to monitor their activities.

Also, everyone needs to be realistic about what the investment community can achieve. The capital markets are dictated by disparate interests that are not all conducive to good engagement for the long term benefit of companies or their ultimate beneficiaries (see attached Appendix). As Sir Christopher suggests, progress will take years not months!

Notwithstanding the above, we believe that the Stewardship Code is an important foundation upon which building blocks can lead to higher standards over time.

However, for this to have a lasting effect, the markets must appreciate and value good stewardship otherwise this current spate of interest will be short lived.

In order to help understanding of our position on the various questions asked, we are responding to the questions in the order they appear in Appendix A :

Section 1: Policy objectives

Whilst the objectives as stated in the consultation document are acceptable we believe there should be more emphasis and clarity around what you (the FRC) are trying to achieve by seeking commitment to the Code and that these aims should also be reflected in the policy objectives. We see the main aims of the Code as being:

- To encourage proper integration of engagement into the investment process so that governance becomes a meaningful part of the investment decision making process;
- To improve two-way communication between companies and their investors with the aim of long term value creation;
- To develop transparent and effective means of monitoring and reporting on the application of the Code by institutional investors so that the public, members of institutional shareholders and clients can assess the stewardship performance of institutional shareholders;
- To improve the understanding between institutional investors and their clients in setting good stewardship standards for the benefit of ultimate beneficiaries;
- To promote awareness and adoption of the Stewardship Code by UK and non UK institutional investors

Section 2: Background and recent developments (experience outside the UK)

The FRC would welcome any insights on lessons which may be learned from experience outside the UK (paragraph 2.18). The FRC is keen to hear from foreign investors in response to this consultation, and would in particular welcome comments on: whether foreign investors would be willing voluntarily to commit to a Code sponsored by a UK regulator such as the FRC or a UK industry body like the ISC in respect of their holdings in UK companies; Their current practice on disclosing information on their engagement policy, including any national or international standards they follow; and any barriers or other potential difficulties for foreign shareholders seeking to engage with UK companies (paragraph 3.13).

We have drawn the consultation document to the attention of counterparts based abroad and understand that some of them will be replying to the consultation. These questions are best answered by investors outside the UK.

The FRC would also be interested to hear from investors who operate on a cross-border basis about any potential conflicts which might arise between requirements or

codes in place in other countries and the proposed Stewardship Code (paragraph 3.14).

There is no question that shareholder registers today are truly global. When so few UK shares are owned by long term UK shareholders (26%) we have no choice but to encourage global institutions to commit to the Code if it is to be effective.

As institutional investors, we collaborate with overseas shareholders regularly and we know there is real interest in the shareholders code. Overseas shareholders are increasingly interested in their role as investors in UK companies.

In March, the new Commissioner of the Internal Market and Services for the European Union, Michel Barnier announced that Europe will be looking into engagement and the roles and responsibilities of shareholders, tackling many of the issues that we have raised in the UK with the Stewardship Code. There is considerable interest in an EU Code as well as individual country codes.

It is likely there will be a proliferation of Codes in Europe and elsewhere and this is concerning from a practical point of view. It would be very difficult for investors investing globally to comply with 20 or 30 different codes. Therefore, it would be helpful for co-ordinated action to “harmonise” or mutually recognise appropriate codes that might emerge.

If the UK Code is to become the benchmark for such a Code (similar to the way the Cadbury Code was adopted in other jurisdictions) then it has to be easily adapted or adopted by global shareholders. We believe the principles and content of the Code as currently drafted are reflective of good practice and should be applicable globally. However, some of the arrangements around the operation of the code such as independent verification of processes may need further consideration in the context of some overseas jurisdictions as this may hinder investors from other jurisdictions from committing to the Code. The potential interest from overseas shareholders should be encouraged.

Section 3: The coverage of the Code

We agree with the FRC’s view that all UK institutional investors should apply and report on the Code regardless of whether or not they are subject to mandatory requirements. However, it should be recognised that it is acceptable for some investors to explain why they consider the Code to be inapplicable (see our response under Section 5) Also, it should be recognised that there may be differences in approach and differences on what type of engagement is most suitable. For example, an activist fund with few companies would be able to engage in all the escalation options available whilst an index fund holding small positions in hundreds of companies may find being active in public policy issues more effective. (paragraph 3.6)

The principles apply primarily to institutional investors and do not translate easily to the roles of investment consultants and corporate governance agencies. However, they should be encouraged to commit to the code by making appropriate disclosures relevant to their specific roles within the accountability chain. Each different

constituent should commit to the Code in different ways because their roles are different. The agents' focus would be on (1) a statement on whether they believe in the objectives of the Stewardship Code (2) if so, how they promote the adherence to the Code by their clients.

There should be separate categories on the ISC website for different types of constituent e.g. UK asset managers, UK institutional investors (pension funds, life funds etc), investment consultants, corporate governance agencies and a separate section for overseas institutional investor. (paragraph 3.8)

Section 4: The content of the Code

What are the responsibilities for engagement of institutional investors to the beneficial owners whose interests they represent? Does the ISC Code cover all the relevant responsibilities?

Yes.

What are the responsibilities for engagement of institutional shareholders to the UK listed companies in which they invest? Does the ISC Code cover all the relevant responsibilities?

Yes.

Are the respective responsibilities of the different parts of the investment chain sufficiently clear and appropriate?

This code is primarily for institutional investors (asset managers and asset owners) and the responsibilities for these investors, in terms of complying with the code, are clear. Responsibilities for others in the investment chain, such as investment consultants and proxy advisers, are confined to reporting responsibilities which we believe is appropriate. It is hoped that best practice for agents will develop simultaneously.

Does the Code strike the right balance between the need to avoid over-specification that might discourage the application of the Code and the need for it to be effective with an appropriate degree of transparency?

Yes, except that expectations on overseas investors should be flexible to allow them to commit to the Code without too much bureaucracy.

Are there any parts of the ISC Code where further guidance is needed, or where the existing guidance should be amended? (paragraph 4.2) Views are invited on whether the ISC Code adequately covers the content of Section E of the Combined Code (paragraph 4.4)

Whilst there is always room for improvement, we believe the Code as currently formulated sets appropriate standards for institutional investors. However, we believe the Code could benefit from some minor amendments as follows:

There are aspects of Section E of the Combined Code and the old ISC Code which are useful but which have been removed in the proposed Code. We believe that the

proposed ISC Code focuses too much on process and not enough on the quality of engagement. For example, Section E of the Combined Code refers to institutional shareholders entering into a dialogue with companies "based on the mutual understanding of objectives" and when evaluating companies' governance, institutional shareholders "should give due weight to all relevant factors drawn to their attention". They should make "reasoned judgements" and avoid "box-ticking". They should bear in mind the "size and complexity" of the company and the nature of the risks and challenges it faces. All these references have been removed and replaced by procedural requirements.

Other suggested amendments include:

Principle 1: Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

Institutional investors should also disclose their policy on lending and recalling stock.

Principle 2: Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed

There is no guidance under this section. Therefore it would be helpful if the Code gave an indication of what information it would expect to see under this section. For example institutional investors should reveal all material conflicts of interest in client reports and disclose processes in place to mitigate their effects on the website.

Principle 4: Institutional investors should establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.

We would amend the last sentence of the first paragraph under this section to "Instances when institutional investors may want to intervene include when they have concerns about the company's strategy and performance, its governance or its approach to **all** risks arising including from social and environmental matters."

Principle 7: Institutional investors should report periodically on their stewardship and voting activities.

We welcome the suggestion that disclosures on meeting the code should be independently verified. We recognise that an audit cannot cover all aspects of the code but where it is undertaken, the areas audited should be disclosed. Where it is NOT independently verified, this should be disclosed

Section 5: Reporting, monitoring and review

Publicly available reporting:

The FRC would welcome views on the specific information that should be disclosed by institutional shareholders and their agents, and at what level of detail the "comply or explain" principle should apply (paragraph 5.3). Views are invited on whether public disclosure of the information summarised is appropriate and useful, and whether other information might also usefully be disclosed (paragraph 5.6).

We agree the suggested disclosures in the consultation paper are appropriate. More specifically, voting decisions and the rationale for those decisions should be disclosed. Engagement information should be disclosed without naming the companies involved as this may be counter-productive, reduce the number of engagements and create a barrier to openness at meetings.

The reporting should provide insights into the monitoring, engagement and voting, the issues, aims, outcomes and developments and how this is integrated into the investment process - not just the fact that it was done. Such information might include resources put towards engagement, how they engaged e.g. letters, face to face meetings, AGMs etc. The report should include objectives and initiatives that have taken place and an update on major events and issues without breaching confidentiality obligations.

It would be helpful for reporting to focus on areas of interest rather than spreading the information over all voting and routine engagement activity. Reporting this way, as is current practice, tends to direct inadequate resources towards covering all holdings, in all jurisdictions leaving less time for more focused and purposeful engagement where investors might make a difference. Investment managers should describe how they prioritise where their attention is directed, acknowledging that it is not possible to cover all companies. Unless there is scope for prioritisation and a recognition that asset managers cannot do it all, many will resort to outsourcing governance or box ticking, neither of which is likely to lead to better returns for clients.

Views are invited on the structure of the ISC Code and on the best way to encourage reporting against it on a “comply or explain” basis (paragraph 5.10).

It would be helpful for the Stewardship Code to follow the use of Principles and Provisions as the UK Combined Code (rather than Principles and guidance). The two Codes would then have a symmetry and consistency that would foster linkage between the two UK codes, one for companies and one for investors.

We also preferred the format and structure of the old Code. It was structured more logically and was clearer in its expectation of investors. In particular, we liked the list of concerns on which shareholders may want to intervene. This list has been removed. However, we think the emphasis on conflicts of interest is a helpful addition.

The suggested reporting against the code in 5.9 on a “comply or explain” basis is appropriate. However, we would suggest the first bullet point should not restrict explanation of non compliance of the code to alternative ownership or trading strategies – there may be other reasons why institutional shareholders decide not to commit to the Code and they should say what this is. We would suggest this bullet point reads as follows “A statement as to whether the firm follows the Stewardship Code or an explanation as to why they do not”.

Reporting to clients:

Views are invited on the proposals in ISC Code for reporting to clients and the merits of independent opinions from auditors or other professional accountants. It would be helpful to have estimates of the costs incurred by asset managers in commissioning these opinions and of the benefits to asset owners (paragraph 5.14).

The recommendation that investors who sign up to the Code should obtain an independent opinion from an independent third party on their processes comes under the section reporting to clients. We believe it would be preferable to make this information public. There is significant doubt currently as to whether institutional investors actually do what they say and this will not change unless the external market has more evidence that what institutional investors say they do can be confirmed.

Views are invited on the merits of the current IMA survey and other possible approaches to monitoring the overall application of the Code (paragraph 5.21).

While clients have the primary role of monitoring the performance of their agents, the FRC has a role in monitoring adherence to the Code by signatories e.g. via a survey. As a general comment, the monitoring should recognise that different investment approaches will result in different forms of engagement (for example, between activist funds with few investments and an index tracking fund with thousands) and intervention and that each has its place in good stewardship.

It has been suggested that monitoring should continue (as it has in the past) with the IMA carrying out surveys with the added assurance of independent verification of the data by an independent source. However, we believe such surveys should be carried out under the auspices of the FRC and carried out by an independent organisation. This will give more credibility to the results of the monitoring as many will not see trade bodies monitoring their institutional investor members as suitably independent.

An alternative consideration might be to use a similar process to the UNPRI where institutional investors publicly respond to questions (drafted by the FRC) covering important aspects of stewardship. The accuracy of disclosures should be verified by independent audits arranged by individual firms and disclosed on the ISC website.

Views are invited on the proposed approach to reviewing the Code (paragraph 5.22). We agree there should be a review process similar to that for the Combined Code. There are two types of reviews (1) on adherence to the Code which can be covered by annual surveys and (2) a review of the overall effectiveness of the Code and the “comply or explain” mechanism. We agree that the review should focus on 2.

However, a review of the Code should be undertaken within the first two years of its launch as this is the first investor code and there are bound to be improvements that need to be made in the early days.

It would be helpful to have more clarity on what FRC “oversight” means. For example, does oversight mean the FRC will still have power of veto or the power to insist on changes?

It is also important that the ISC Committee or Committees have significant input from practitioners who have a clearer understanding of how the Code works in practice, its shortfalls and efficiencies and its ability to create long term value for clients.

Conclusion:

The Stewardship Code is a good start in the journey towards better engagement and stewardship. However, we need to recognise the significant barriers and conflicts of interest that currently exist in the financial markets (see appendix) and be realistic about what we can achieve in the near term.

We expect that a form of good stewardship will emerge with experience and best practice will develop over time. Widespread adoption of the Code will only happen if there is a demand for good stewardship from clients of institutional investors. If this does not happen, then there will be no expansion of good stewardship and no growth in the existing handful of active investors that currently do it because they believe in good stewardship

We believe the role of the FRC in this initial stage, is to present the Code as a template of existing good practice that can be improved upon. This should not be rushed. It is better to get it right and establish a sound footing for the Code to gain momentum over time.

There needs to be independence over monitoring adherence to the Code otherwise there will always be suspicions that institutional investors are not always doing as much as they say they are. Disclosure of practice should be a true reflection of the beliefs and activities of institutional investors

We hope a sufficient number of institutional investors will commit to the Code but most of all we hope that over time everyone will understand the role of good stewardship and good governance in the creation of value and that questioning boards on governance and risk will become as routine for investment managers as analysing their financial and commercial profiles.

Yours sincerely,

Anita Skipper

Corporate Governance Director

Aviva Investors

APPENDIX A: Impediments to good stewardship

1. Many assets managers and sell-side analysts have traditionally focused on financial data. They have little experience in applying unquantifiable metrics such as governance and so they tend not to.
2. Even when they are aware of governance concerns, sell-side analysts do not report this in their reports because they fear they could lose access to those boards, who could just shut them out for being negative.
3. As a result, asset managers do not get the data on governance in their broker reports to inform them when making investment decisions.
4. Asset managers themselves may be concerned about not upsetting boards – for similar access reasons or, perhaps, because they feel they need a good working relationship with boards to benefit most from the relationship.
5. Asset managers may benefit from mandates from companies, for example, to run their pension funds. This may lead to a reluctance to vote against boards and a reluctance to be critical. Commercial conflict versus duty to clients.
6. City culture is similar to the culture at companies. Many asset managers are paid well for short term performance. So there is little incentive to change things and, in fact, it would seem hypocritical to try.
7. Many institutional investors do not consider governance in their investment decisions and, even with the Stewardship Code, there is currently no incentive to change their minds. If pension funds do not believe in governance or good stewardship, why should they change their minds now? Only public pressure, peer pressure, ultimate beneficiary pressure or political pressure is likely to have an effect.
8. If clients don't care, why should the fund managers put time, effort and cost into trying to make the boards better? There is currently no incentive for investment managers to change either unless clients start to demand it or it becomes politically unacceptable not to.
9. Engagement on governance issues is separated from engagement on financial and strategic issues. The people making investment decisions are not working with those that make voting decisions. This will not lead to added value.
10. Short termism. Asset managers are expected to beat competitors each quarter. They feel they can't wait for 2 years for engagement to work – they may as well sell stock now, invest in faster growing company and maybe buy back into it later. The ownership timescale and the corporate timescale are miles apart.
11. The proliferation of quant investing, long/short funds also renders engagement superfluous to requirements. For some it helps if the company fails! The larger this part of the market gets, the weaker shareholder control will be on companies.
12. Free-rider issue. Where one investor bears the cost of engagement to the benefit of other investors. Few asset managers will bear the full cost if the benefits are relatively small and may profit your competitor as much as yourself..

13. Measuring performance against a benchmark focuses on relative not absolute performance and exacerbates the problem. Often asset managers are invested in a stock not because they believe in it but because they do not want to be too far away from the benchmark. If they are underweight, it may be beneficial for the company to underperform.
14. Stock lending is a lucrative business and investors may prefer to loan stock than vote stock. Do institutional investors recall their stock for voting? If the stock is lent, the vote goes with the stock.
15. Globalisation of shareholder registers – different approach to the same issues dilutes effect of shareholder engagement.
16. Shareholders often cannot agree on the same approach or the same solutions. Many times there is lack of consensus on whether there is a problem!
17. Role of voting advisory services. Many institutional investors buy research from voting agencies and outsource voting decisions to them, so much so, that the agencies are probably more powerful than the investors themselves! It is said that RMG can influence up to 30% of the votes that are received.
18. Imperfect voting mechanisms – votes can still get lost.
19. Unclear regulatory rules restricts the dissemination of information and the sharing of information which is necessary for collaboration, afraid that this may lead to insider trading, concert parties or market abuse.
20. Importantly institutional investors are significantly under-resourced to carry out proper engagement on all their stocks in their firm's portfolios.