

Response April 2010

CBI response to the Investor Code

FRC consultation on a stewardship code for institutional investors

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The CBI supports the proposed stewardship code for institutional investors, which could promote better engagement between investors and companies.

The CBI welcomes the Financial Reporting Council (FRC) consultation on a stewardship code for institutional investors. We support efforts to enhance engagement between investors and companies, and think the proposed Code can help this effort.

In addition to the policy objectives set out by the FRC in the consultation paper, we believe there are a number of other important reasons for the proposed Investor Code:

- The changing demographics of the UK share register, with the steady decline in long-term UK based shareholders meaning it is important to ensure a critical mass of long-term holders in UK companies – not least to ensure the sustainability of the UK’s “comply or explain” corporate governance model.
- To help address the current political spotlight on corporate governance and takeover rules, where we believe enhanced investor engagement should be part of the policy response to ensure investor and company interests are aligned to promote long-term economic growth.
- Ensuring that the UK’s model of corporate governance continues to be one of the most respected internationally, which continues to be one of the key attractions for investing and doing business in the UK.

If the Stewardship Code is to be successful in promoting effective engagement between companies and institutional investors it will require both parties to commit time and resource to ensure high calibre, senior level engagement.

Comments on specific areas of the proposed Investor Code

Section 1: Introduction and policy objectives

The CBI supports the FRC policy objectives as set out in the consultation paper against which to judge a Stewardship Code.

The Stewardship Code should be principles-based, in-keeping with the approach taken with the UK Corporate Governance Code, in order to maximise its prospects for success.

The CBI also supports the proposal to formalise the Code and bring it under the auspices of the FRC, which we believe will add to its gravitas and broaden its appeal to investors to subscribe to the Code.

Section 2: Background and recent developments

We do not have any specific comments to add on experiences from outside the UK.

Section 3: The coverage of the Code

The CBI believes the Code should have the widest possible application, although we recognise that this may have to build incrementally as the Code gains in stature and recognition.

The Code should seek to address whole market behaviour, so it needs to carry the support of a broad church of the investment community. Specifically, the CBI supports:

- The notion that all UK institutional investors should sign up to the Code; and
- The idea that agents such as voting service agencies and investment consultants should be encouraged to commit to the spirit of the Code and make a public statement of the approach that they adopt.

The CBI also encourages the FRC to ensure that the Code is accessible and relevant to foreign investors, to ensure they are active participants. This is particularly important given the trend towards internationalisation of the UK share register.

Section 4: The content of the Code

The CBI is supportive of the proposal that the Institutional Shareholder Committee code issued last year should form the basis of the proposed FRC Stewardship Code.

The CBI believes that Principle 5, “institutional investors should be willing to act collectively with other investors where appropriate” is one of the most significant proposals, and could lead to broader and deeper engagement.

It does pose inevitable questions about how far investors can collaborate in this way, without arousing suspicion that they are acting in concert. We note the guidance on acting in concert issued by the FSA and the Takeover Panel last year. The FRC should consider whether it would be helpful to endorse this guidance for the purpose of the Stewardship Code, and if any other FRC guidance would be appropriate in connection with Principle 5.

We also suggest that the FRC considers whether any further additions to the Code to cover confidentiality of discussions between company management and investors would be beneficial, to help provide assurances to the corporate community that discussions on strategy and performance issues will remain confidential as appropriate.

Section 5: Reporting, monitoring and review

The CBI is broadly supportive of the approach envisaged by the FRC on reporting, monitoring and review.

How institutional investors choose to report to their clients is ultimately a matter for them to mutually agree. We do though support greater transparency and disclosure around how this is done, which should ultimately result in better informed decisions by existing and prospective clients in awarding fund management mandates as recommended in the Walker Review.

Principle 1 in the ISC Code provides for public disclosure of institutional investors’ policy on how they will discharge their stewardship responsibilities, and Principle 5 provides that Institutional investors should disclose their policy on collective engagement, both of which we support.

We also support the other public disclosure obligations contained in the Principles set out in the ISC Code.

We note the FRC consultation sets out three possible approaches on comply or explain:

- A statement as to whether the firm follows the Stewardship Code or an explanation of its alternative ownership or trading strategy if not.
- A statement of how the firm has applied the principles within the Code, in a manner that would enable their clients to evaluate how the principles have been applied, with an explanation of non-compliance against each of the principles where applicable.
- A statement as to whether the firm has complied with all the relevant principles and guidance within the Code or, where it has not, an explanation of non-compliance.

The CBI believes that the minimum requirement clearly has to be for investor firms to make a declaration as to whether or not it is following the Stewardship Code or provide an explanation of its alternative approach, as set out in option one above. This should be clearly stated on the investor’s website, and those investors who subscribe to the Code should be listed collectively, for example on the ISC or FRC websites.

Whilst more detailed explanation along the lines proposed in option two or three above would be desirable, the CBI would encourage the FRC to leave a degree of flexibility to investors to decide which of them they consider most appropriate, at least in the initial period following launch of the Stewardship Code, in order to encourage take-up of the Code.

This could then be subject to review as part of the proposed regular reviews of the operation of the Code. We suggest these regular reviews should generally be not more frequent than every three years, so as to provide periods of stability and time for any changes made to be given proper effect and tested over at least two reporting cycles. Nevertheless, we acknowledge that the first review might need to be sooner, if particular issues or problems have arisen, or in the event of any unintended or unforeseen consequences.

The CBI understands dialogue is ongoing between investors and audit firms concerning auditor verification of certain aspects of investors' compliance statements. We understand that a high level of consensus has been reached on those aspects of the Code that can be objectively measured and thus capable of being subject to an assurance report by the audit firm.



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