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Dear Ms Haan

**Financial Reporting Council (FRC) - Consultation on a Stewardship Code for Institutional Investors**

Thank you for the opportunity to comment on the above Code. We appreciate the FRC encouragement to foreign investors to comment. By way of background, Element Investment Managers is an investment manager in South Africa. We incorporate active ownership into our investment process in order to reduce downside risk and add long-term value. We were the first Investment Manager to sign the UN PRI in South Africa (May 2006). We had already incorporated Environmental, Social and Governance (ESG) issues as an integral part of our investment process from 2001 and it was a natural step to align ourselves with a global body setting out common guidelines such as the UN PRI.

The draft Corporate Governance Code for South Africa in 2009 (King III) made no reference to shareholder responsibilities. We were of the opinion that an 'apply or explain' code of governance required the active involvement of institutional shareholders who have a vested interest in an effective system of corporate governance. Element Investment Managers initiated an engagement between the PRI South Network and the

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King Committee to ensure institutional investors were included in the system of governance. The outcome of the engagement was the decision by the King Committee to set up a working group to develop a Code for Responsible Investing in South Africa. The Institute of Directors is the secretariat.

We provide a response to the questions proposed in your consultation paper:

## **1. Views on policy objectives of a Stewardship Code and FRC oversight of the Code**

The policy objectives set out in the consultation document appear to be too broad taking into account our understanding of the current limited global industry practice of stewardship or 'active ownership.' (We are active UN PRI signatories, a member of the ICGN and maintain an Advisory Board that includes Peter Butler of Governance for Owners in the UK).

We would suggest initial focus on the following policy objectives:

- 1) Ensure industry awareness of the fiduciary duties of institutional investors and their agents and that stewardship is firmly within the bounds of these fiduciary duties.
- 2) Institutional investors to disclose their application of the Code. Disclosure to specifically set out how stewardship is integrated into the investment process
- 3) Develop a system to enforce and assess the transparency and accuracy of investment industry reporting
- 4) The promotion of stewardship through the introduction of a well researched reward system.

We concur with Sir David Walker that the FRC should be responsible for the Stewardship Code and welcome the FRC decision to accept this responsibility. Our current experience in South Africa with the development of a similar Code suggests a regulator, independent of the industry, should be allocated this important role. We believe that this will help ensure the whole industry develops the norm of integrating active ownership into mandates and investment processes for enhanced delivery of long-term returns to beneficiaries.

## **2. Coverage of the Code**

We would encourage the application of the code to all UK institutional investors, including their agents and foreign investors.

A number of South African companies are dual listed on the London Stock Exchange and the Johannesburg Stock Exchange. Our active ownership activities incorporate all investee companies. We would be willing to commit to a Code, sponsored by the FRC, covering the dual listed companies and any UK companies that may be included in our portfolios in the future.

Barriers to engagement include distance and cost to meet with executives and board members based in the UK. Some investee companies do not provide an electronic link with South African offices to encourage South African shareholders to follow AGM proceedings and ask questions.

We are not aware of any conflicts that could arise between the proposed Stewardship Code and other Codes. Element investment Managers consults the general guidance of the International Corporate Governance Network (ICGN) – Statement of Principles on Institutional Shareholder Responsibilities

## **3. Content of the Code**

The ISC Code with the principles of stewardship is a useful starting framework.

If the final framework proceeds with detailed practices to complement the principles, great care needs to be taken to ensure these practices are comprehensive. Particular consideration should be given to the recommendations of institutional investors that have long-term track records of professional active ownership.

Some of the issues that require consideration include:

- Securities lending practices require disclosure.
- Disclosure of the reasons for voting against resolutions or abstaining.
- Disclosure of the proportion of holdings voted with reasons why certain holdings were not voted.
- Engagement is a complex process that requires appropriate intervention and

timing. Care should be taken not to give any impression that the interventions are limited to those listed in the current Code or that it is a guide to the sequence of engagement escalation.

- All material risks that influence value should be considered when voting or engaging with an investee company.
- Engagement should be constructive with investee companies to increase mutual understanding and position the company to reduce downside risk and promote value creation.
- Institutional investors should work with regulators to develop guidance that encourages collaborative engagement initiatives.
- Institutional investors must make use of sufficient qualified resources to meet client requirements. Regular reporting should include resources and skills.
- We are aware that the UN PRI is considering compulsory disclosure of certain information for all signatories. We would urge the FRC and the UN PRI to work together to ensure alignment of disclosure requirements.
- Ensure the Code reinforces the asset owner having ultimate responsibility for stewardship. Allocation of mandates by asset owners to agents that require sound ownership practices will ensure active ownership grows and becomes widely practiced in the investment industry.

### **3. Reporting, Monitoring and Review**

As referred to above, we believe it will be beneficial for the FRC and UN PRI to collaborate on disclosure and reporting requirements.

The UN PRI requires signatories to complete a survey every year after the first year of membership. It is recommended that the FRC consider the use of this survey rather than the IMA option. IMA's role is to represent the asset management industry. Any survey should be seen to be independent.

*'The IMA is the trade body for the UK's £3000 billion asset management industry. [Our role is to represent the industry and promote high standards.](http://www.investmentuk.org)' [www.investmentuk.org](http://www.investmentuk.org)*

The UN PRI survey is their only means of monitoring actual compliance with the Principles. It is expected that material resources will be allocated to ensure the PRI survey is developed to meet the needs of the industry and maintain credibility for this rapidly growing movement.

An audit opinion from registered auditors or professional service providers, of the adequacy of the institutional investor's stewardship processes, including reporting, could help promote trust in the investment industry.

Not all institutional shareholders will want to comply with the Stewardship Code. We encourage disclosure by all shareholders on their website of their policy on stewardship. Differentiating institutional shareholders that practice sound ownership practices and highlighting their best practices is important for developing and embedding stewardship.

#### **4. A reward system to encourage stewardship**

Active ownership is not widely practiced. We hear and read comments such as:

'We vote with our feet'

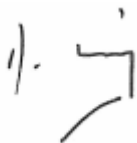
'We don't get paid to be active investors'

Researching and introducing a system of reward for sound ownership practices will be challenging but could meaningfully contribute to embedding stewardship.

In conclusion, we are supportive of a stewardship code and are willing to commit to a well-researched Code sponsored by the FRC. We believe active ownership as a component of Responsible Investment adds long-term value to investment portfolios and reduces downside risk. We suggest a workshop to resolve outstanding contentious issues after you have received and analysed all comment. Investors with a 5 year or greater track record of professional stewardship can be of great assistance to the FRC for this purpose.

We are available to discuss any of the above points or participate in any working group to finalise the Code.

Yours sincerely



David Couldridge  
Investment Analyst