



Susannah Haan
Financial Reporting Council
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By email to: stewardshipcode@frc.org.uk

15 April 2010

Dear Susannah,

Please find attached the response by F&C Investments to the Financial Reporting Council's Consultation on a Stewardship Code for Institutional Investors that was published in January 2010.

We are pleased to contribute to this important review, and hope that our comments are useful in your deliberations. Please feel free to contact me if you have further questions or comments. We would be happy to meet with you, as required, to discuss our views in further detail.

With best wishes,

A handwritten signature in black ink, appearing to read 'George S. Dallas'.

George S. Dallas
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April 2010

Consultation on a Stewardship Code for Institutional Investors, published January 2010

Response by F&C Investments

F&C Management Ltd (F&C) is a London-based global asset management firm whose institutional and retail clients collectively represent over £153 billion of assets¹. F&C has long been an active voice in support of robust corporate governance standards for UK companies and for companies in all jurisdictions where F&C invests. In this context we welcome the opportunity to comment on the Financial Reporting Council's (FRC) Consultation on a Stewardship Code for Institutional Investors. This follows our submission on the Revised UK Corporate Governance Code in March 2010 and our submission on the FRC's Progress Report and Second Consultation on the Review of the Effectiveness of the Combined Code, which we submitted to you in October 2009.

F&C is supportive of the development of a Stewardship Code in the UK. As an active investor for many years, F&C believes that robust engagement and voting by institutional investors is critical to the health of financial markets and long-term value creation. This is particularly so in the UK's principles-based, "comply or explain" regulatory regime, whose effectiveness requires active involvement by investors to engage with companies and monitor their compliance with the UK Corporate Governance Code.

As an active member of the Association of British Insurers' (ABI) Investment Committee, F&C also has provided input to the ABI's response to this FRC consultation, and we support the ABI submission as reflective of our own views in most aspects. But we also want to provide direct input to the FRC to underscore our specific positions on particular aspects of the Code. We present below our responses to each of the individual categories outlined in the consultation paper.

Issues for Comment

Section 1: Introduction

Policy objectives

- **Scope and Expectations.** F&C supports the proposed policy objectives, and believes that robust stewardship and company engagement should be encouraged throughout the institutional investment universe, including asset owners and asset managers of all sizes. For this initiative to be effective it must have a broad reach, and we are concerned that expectations about the impact of this Code may be exaggerated unless its principles are adopted by a much wider segment of the investment market than the leading UK institutions. This speaks to the need to reach out to smaller institutional investors in the UK and to foreign investors, including sovereign wealth funds. This is addressed in greater detail in the section on the coverage of the Code.
- **Scaling and Resourcing.** To raise the level of investor stewardship and engagement, the Code points to ways in which collective action amongst investors can create efficiencies. However it should be noted that efficiencies alone may not be sufficient to realise the policy objectives. If a heightened level

¹ As at 31 December 2009, F&C Management directly managed £97.8 billion in assets. In addition, F&C has been mandated to vote and/or engage in dialogue on behalf of over 20 investment institutions whose assets total £55.4 billion. These institutions are identified in our quarterly **reo** reports: www.fandc.com/reopublicreport.

of quality engagement is to be sustainable, then sustainable financing for incremental resources to conduct this engagement will also be an implicit policy objective. In this context it is important for fund management mandates to reflect and value the extent to which stewardship services are included as part of the mandate. Increasing the demand for stewardship services by asset owners will enhance the supply and quality of stewardship services provided by asset managers. It should also be noted that smaller pension funds and asset managers may not operate on a scale so as to be able to devote considerable in-house resources to issues of stewardship and engagement. In this context we believe it is appropriate for smaller institutional investors, and sovereign wealth funds as well, to use third-party services, as long as the investor displays diligence in service provider selection and is transparent to the investor's beneficiaries and trustees with regard to any stewardship services provided.

- **Beyond equities?** One area where the policy objectives potentially could broaden is in the area of bonds and other forms of corporate debt. While shareholders enjoy ultimate ownership and voting rights that creditors do not have, it remains the case that both creditors and shareholders benefit from good corporate governance. Long-term shareholders and long-term creditors both want to see a well-managed and well-governed company that produces sustainable operating earnings and cash flow for debt servicing, dividends and capital appreciation. Moreover, many institutional investors invest in both corporate bonds and equities, and have an interest in stewardship across a broad range of asset classes. In this context, the scope of the Stewardship Code could potentially broaden to take into account the perspective of fixed income investors.

FRC oversight

- We agree that the FRC is well-positioned to assume oversight of the Code. The nature of this oversight should allow for the implementation of the Code to be monitored and for the Code itself to come under periodic review for its effectiveness. The content and development of the Code should continue to be driven by the ISC, as it is critical to have an investor body that is able to adapt the content of the Code to evolving best practices and the realities of the investment management process.

“Comply or Explain”

- We agree that asset managers and asset owners should report on a “comply or explain” basis with regard to their application of the Code. We believe that this is relevant for all institutional investors, and, as noted earlier, smaller investors or sovereign wealth funds without their own dedicated stewardship resources can disclose the extent to which they use other stewardship services providers for purposes of voting or engagement to meet their compliance to the Code.

Section 2: Background and Recent Developments

- The consultation document summarises well the development of the ISC Code in the UK. While the ISC Code itself was not formed until June 2009, it should be noted that many investors have been active in applying the underlying principles of the Code, both individually and collectively, for a longer period. Collective engagement has been reflected in the activities of the ABI, the Investment Management Association (IMA) and other investor representative bodies, as well as in other voluntary associations of leading UK institutions.
- Outside the UK, in addition to what was noted in the consultation document, we would like to make reference to the International Corporate Governance Network's (ICGN) Statement of Principles of Institutional Shareholder Responsibilities, which was published in 2007 as a global framework for investor stewardship. As a member of other global investor networks including the Global International Governance Network (GIGN), the Council of Institutional Investors (CII) in the US and Eumedion in the Netherlands, F&C also would like to highlight that a number of prominent investors outside the UK

demonstrate strong stewardship programmes that complement the objectives of the Stewardship Code that is being developed in the UK.

Section 3: Coverage of the Code

- As noted earlier, we believe this Code is relevant to all institutional asset managers and owners active in the UK. While larger UK investors may be in a better position to meet the Code's requirements through their own resources, smaller investors or foreign investors with limited internal resources should be encouraged to demonstrate how Code requirements may be met through the use of third party stewardship services. However the Code and the nature of its provisions are not such that proxy voting agencies or investment consultants could commit to the Code itself. To the extent it may be appropriate to encourage such service providers to commit to the "spirit" of the Code, there may be more guidance required as to what this means in practice.
- As was noted in the consultation document, the role of foreign investors in the UK is substantial. While foreign investors should be encouraged to adopt the Code, we expect that many non-UK institutions may be reluctant to commit voluntarily to a Code sponsored by a UK regulator. Nevertheless it might be the case that one of the greatest impacts of the Code will be the extent to which it stimulates more prominent non-UK investors to take a more proactive approach to stewardship in the UK market – whether or not such institutions formally commit to the Code. Those foreign investors that do not wish to commit to the UK Stewardship Code formally should be encouraged to disclose their own policies and practices on stewardship. To the extent that the development of investor stewardship codes continues in other jurisdictions, both the FRC and ISC should monitor international trends, with a view towards developing a system of mutual stewardship code recognition. This could involve the ISC listing on its website those overseas investors that have provided some basic disclosures as to their engagement practices and policies—in addition to listing those UK institutions that have committed formally to the Code.

Section 4: Content of the Code

- As a member of the ABI and the IMA, F&C has contributed to and supported the development of the ISC Statement of Principles in 2007 and the ISC Code in 2009. In this context we are supportive of the content of the Code, and believe that it covers the content of Section E of the Combined Code.
- We note that aspects of the Code may be aspirational, and that resource/scaling constraints might prevent all investee companies receiving equal levels of engagement by UK institutional investors. For example, for those investors with hundreds or thousands of companies to monitor, it may not always be practical to have an advance dialogue with the investee company with regard to the voting intentions on individual resolutions. Unless incremental resources allow for a greater scaling of company dialogue, investors will have to prioritise engagement initiatives. Consequently, while voting, analysis, and monitoring can be applied across an investment portfolio, more detailed engagement outreach motivated by the Code might not be consistently applied among investee companies.

Section 5: Reporting, Monitoring and Review

- **Public disclosure.** F&C believes that reporting is an important dimension of the Code, and we are supportive of the disclosure items recommended by the Principle 1 of the ISC Code that are reflected in paragraph 5.4 of the consultation document. More detailed reporting can be provided to clients on a bespoke basis, which can include reporting on engagement cases and outcomes.

- **Reporting to companies.** As a related point to reporting on stewardship policies, it is also important for investors to reach out proactively to investee companies with regard to engagement and voting policies. As a service to F&C's own engagement overlay clients, our company outreach includes alerting each investee company to F&C's Corporate Governance Guidelines, which include its voting policies. F&C also sends companies a letter in cases where we do not support management in the voting process, to ensure that our voting activities are understood by company managers and boards.
- **External assurance.** F&C is comfortable with the Code's encouragement of voluntary external assurance. If such assurance is to employ an AAF or SAS framework there will need to be developed a clear and workable set of standards to guide both auditing firms and institutional investors. In this regard we note the initial analysis of the Institute of Chartered Accountants of England and Wales (ICAEW) that only Principles 1, 6 and 7 are fully capable of independent external assurance, and that the other Principles in their current form require too much subjective judgement for an assurance model.
- **IMA survey.** We are supportive of the use of the IMA survey as means to monitor the application of the Code. However to capture as wide a UK investor base as possible, this survey should extend beyond IMA members. We would specifically suggest that overseas investors active in the UK market be encouraged to take part in the survey. The usefulness of the IMA survey as a monitoring mechanism can be reviewed in accordance with the periodic review of the Code itself.