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Dear Sirs

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Consultation on a Stewardship Code for Institutional Investors

We welcome the opportunity to comment on the Financial Reporting Council's (FRC) consultation on a Stewardship Code for Institutional Investors.

1 We support the principle of the Code

Good governance starts with a holistic approach driven by the behaviours of executive management and effective internal challenge by non-executive directors, all of whom have the appropriate skills, experience and ethical approach. This is under-pinned by external challenge from: investors who actively monitor the decisions, results and strategy of the board and executive management; and a robust and independent audit process. There are various codes and standards which cover board practices and the external audit and so the proposed Stewardship Code should fill a vacuum concerning investor engagement.

We support the fact that the proposed Code builds upon best practice proposals from the investment industry itself and commend the work done by the ISC in this regard. We believe the FRC's policy objectives will best be served in the early years by building on such best practice following which a further review of the effectiveness of these can be conducted at some future point.

We believe it is important that if the Code is to be applied effectively it is important that the institutional investor group feels properly consulted on implementation of the Code, especially in the initial years.

2 The Code is balanced

We believe that a significant number of institutional investors are already meeting the principles set out within the Code, albeit with varying degrees of transparency and reporting, and therefore its adoption should not be onerous for institutional investors. However, experience elsewhere (eg of the UK Corporate Governance code) clearly demonstrates that codification and transparency of good practice is an effective means of bringing about long-term improvements in the effectiveness of good practice intentions.

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Striking the right balance between the need to avoid over-specification that might discourage application and the need for it to be effective is vital in a new Code and we commend the FRC and the ISC for achieving this.

3 Comply or explain allows investors to exercise judgement

Comply or explain has been a proportionate and effective mechanism used in the Governance Code and we support the same model being adopted for the Code, as it allows institutional investors to use their judgement on the nature and extent of compliance and disclosure.

4 There should be clear responsibility for monitoring the Code

We believe that experience elsewhere shows that if the Code is to be effective in achieving the desired policy objectives, there should be clear ownership for monitoring compliance with and the effectiveness of the Code.

We support the proposal for the IMA to monitor application via its survey as this builds on an existing mechanism. The use of surveys such as those of the IMA is an effective use of resources.

Ultimately an authoritative body outside the industry, eg the FSA or FRC, should be responsible for drawing these findings together and reporting on and reviewing the effectiveness of the Code.

5 Independent public audit opinions should be voluntary

We do not believe that mandating an independent public opinion from an audit firm is consistent with the comply or explain basis for the Code.

The need for an independent public opinion from an audit firm should be on a case by case basis and a decision for beneficial owners. Such an approach recognises that the risks from the reporting will vary depending upon the particular circumstances of the investment firm, agent or beneficial owner.

We do recognise that for some beneficial owners, an independent public opinion by an audit firm will be of great benefit and we welcome the review of AAF 01/06 by the Institute of Chartered Accountants in England and Wales. This review will enable audit firms to have an appropriate framework in place to opine on the objectively verifiable elements of the Code.

6 The Code should apply to all institutional investors and their agents who have a role in good corporate governance either through stewardship or stewardship advice

We encourage all UK institutional investors to adopt the Code and believe that voting services agencies and investment consultants should adopt the Code as they also have a role in corporate governance through good stewardship advice.

We also think there could be merit in a more fundamental review of the practice of use of agencies, since if the approach of the agent is not aligned with the interests of the beneficial owner, application of the Code is unlikely to be relevant.

That said, it is important that the Code does not create a commercial disadvantage to UK institutional investors as more than 40% of share ownership within the UK is from foreign investors. Therefore the FRC should carry out a comprehensive and independent impact assessment.

7 We encourage the Code to be extended to take account of the new Audit Firm Governance Code

There is a good deal of evidence that suggests improved communication between institutional investors and audit firms would assist the goal of ensuring that companies are well managed.

We believe that as currently drafted the Code has missed an important and timely opportunity to include a section on effective engagement with audit firms within the Code and thereby link effective investor engagement with corporates through the UK Corporate Governance Code and audit firms through the Audit Firm Governance Code.

We believe that including a section in the Code on audit firm engagement would assist both investors and audit firms to improve communications.

8 Other sources of best practice

Some investors are already subject to mandatory requirements on stewardship under UK law. Pension funds for example are required to report under Section 244 of the Pensions Act 2004 and the FRC might consider establishing the usefulness and practicality of this disclosure with their beneficial owners and investee companies.

Our detailed responses to each question within the consultation are set out on the following pages.

If you have any questions on this response, please contact Steve Maslin (phone: 0207 728 2736; email: steve.maslin@gtuk.com) or Giles Mullins (phone: 01908 359 609); email: giles.m.mullins@gtuk.com)

Yours faithfully



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Appendix A: consultation questions

Question one: *The FRC would welcome views on the policy objectives against which the FRC should judge its approach to a Stewardship Code (paragraph 1.14)*

The policy objectives should include effective dialogue between investors and audit firms. This is discussed in Section 7 above.

Question two: *The FRC is seeking views on whether it should accept oversight of the Code in its current form, or whether amendments should be made before the FRC does so (paragraph 1.16)*

Yes the FRC should accept oversight of the Code in its current form, other than in relation to auditor dialogue as set out in Section 7.

Question three: *Views are also sought on which institutional investors and agents should be encouraged to apply the code of a “comply or explain” basis, what they should be asked to disclose and to whom, and the monitoring arrangements that should be put in place (paragraph 1.17)*

We have answered this question within Sections 6.

Question four: *The FRC would welcome any insights on lessons which may be learned from experience outside the UK (paragraph 2.18)*

Whilst some EU countries already place certain disclosure obligations on shareholders, for example Portugal, the Netherlands and France, we believe this Code is likely to become a framework for best practice for many jurisdictions outside of the UK.

Question five: *The FRC would encourage all UK institutional investors to apply and report on the code, regardless of whether or not they are subject to mandatory requirements, and would welcome views on whether there are any barriers or other reasons that would prevent or discourage them from doing so (paragraph 3.6)*

We have answered this question within Section 6.

Question six: *Views are invited on whether agents such as voting services agencies and investment consultants should be encouraged to commit to the spirit of the code, and if so how could this be done (paragraph 3.8)*

We have answered this question within Section 6.

Question seven: *The FRC is keen to hear from foreign investors in response to this consultation, and would in particular welcome comments on:*

- i) 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;*
- ii) Their current practice on disclosing information on their engagement policy, including any national or international standards they follow; and*
- iii) Any barriers or other potential difficulties for foreign shareholders seeking to engage with UK companies (paragraph 3.13)*

We have chosen not to answer this question.

Question eight: *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 code (paragraph 3.14)*

We have chosen not to answer this question.

Question nine: *Respondents are welcome to comment on any aspect of the ISC Code, but in particular views are invited on these questions:*

- i) 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?*
- ii) 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*
- iii) Are the respective responsibilities of the different parts of the investment chain sufficiently clear and appropriate?*
- iv) 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*
- v) Are there any parts of the ISC Code where further guidance is needed, or where the existing guidance should be amended (paragraph 4.2)*

The Code covers all the relevant responsibilities and provides sufficient guidance and clarity.

The Code strikes 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.

Question ten: *Views are invited on whether the ISC Code adequately covers the content of Section E of the Combined Code (paragraph 4.4)*

Yes we believe the ISC Code adequately covers the content of Section E as explained in paragraphs 4.5 to 4.9 of the consultation.

Question eleven: *The FRC would welcome views on;*

- i) The information that institutional shareholders should disclose publicly and that they should report to clients*
- ii) The arrangements that should be put in place to monitor how institutional shareholders apply and report against the Code; and*
- iii) The arrangements for reviewing the operation and content of the Code (paragraph 5.2)*

We have answered this question in our response to question 3.

Question twelve: *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)*

We have answered this question in our response to question 3.

Question thirteen: *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 have answered this question in our response to question 3.

Question fourteen: *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)*

We have answered this question in our responses to questions 2 and 3.

Question fifteen: *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)*

We have answered the relevant part of this question in Section 4.

Question sixteen: *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)*

We have answered this question in our response to question 3.

Question seventeen: *Views are invited on the proposed approach to reviewing the Code (paragraph 5.22)*

We believe the review cycle of the Code should mirror that of the Governance Code and Audit Firm Governance Code.