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Submitted by email to

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Dear Susannah

ICSA response to the FRC's Consultation on a Stewardship Code for Institutional Investors

Thank you for the opportunity to comment on this important issue.

In framing ICSA's response, we wish to make some observations of a strategic nature. The Stewardship Code for Institutional Investors ("the Code") will have greater impact if investors and companies alike take their duties seriously. ICSA is currently reviewing the Higgs Guidance and it is clear from the various comments made that companies are thinking seriously about changes in their governance arrangements to address the issues raised by the recent cases of value destruction, particularly in the financial services sector. Whilst not underestimating the difficulty of the challenge involved, we would hope that, as a result of the focus on the Code, the subsequent actions of parts of the investor community will match the efforts being made by companies, and advance the overall aim of making the UK one of the premier investment locations in the world.

ICSA also wishes to stress the importance of the role of disclosure in the overall process of strengthening governance arrangements. In the current climate of accountability, increased levels of engagement around the disclosure process are required for mutual trust and confidence to develop. Again, there is evidence, from the work carried out in relation to the ICSA Hermes Transparency in Governance Awards, that companies are making efforts, on their part, to improve their performance. We hope increasing numbers of investors will acknowledge these developments and reciprocate accordingly, including by providing feedback on how informative they have found companies' disclosure, and what more can be done to strengthen the dialogue which high-quality disclosure makes possible.

In the following sections we make some general comments on the Code, and then some specific points on the content.

1. General points

1.1 We are supportive of the FRC's policy objectives as set out on page 5 of the consultation.

1.2 There has been much debate recently about the diversity of share ownership and what that means for engagement. In our view, the market is as it is, and even though the longer

term shareholder is in the minority, we take the view that the Code is worth developing for these shareholders which can sensibly engage.

1.3 We would caution against any requirement for independent audit opinion on investor compliance with the Code, certainly at this early stage. It seems heavy handed for a voluntary code, and the cost could deter investors from signing up to the Code.

1.4 The Code should be drawn to the attention of foreign investors (and overseas proxy voting and voting advisory agencies) and we would welcome foreign investors and their agents following the spirit of the Code. Once the Code is finalised, companies could be encouraged to send the Code to their largest overseas investors/related agencies. We would however welcome clarity on the definition of a foreign investor such that it was clear whether if, for example, a key investor had a US parent company, but operated out of London, and other European cities, the London office investments (only) would be caught by the Code.

2. The draft Code content

2.1 Broadly speaking, subject to the specific comments below, we are supportive of the principles in the draft Code.

Introduction & Scope

2.2 While we consider that compliance with the Code by institutional investors (and those that invest as their agents) should be strongly encouraged, we support the statement in paragraph three that the Code be voluntary. This is a realistic approach considering the diversity of investor type in the market. We further agree that those institutional investors that choose not to engage should disclose that fact and state the reasons why, as required by paragraph seven.

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

2.3 Where the Code states that the institutional investor's disclosed policy should include the detail of the use made of proxy voting or other voting advisory services, we think that it should be made explicit in the Code that the proxy voting and voting advisory agencies should be named. This would allow companies to be clearer about who the influential agencies are, thereby assisting companies to prioritise their engagement with these agencies, to ensure that the investee companies' views are known at the time when the agencies are formulating their voting policies (against which the reports and accounts and notices of meetings of these investee companies will later be judged.) Please also see our later paragraph 2.12.

Principle 3 – Institutional investors should monitor their investee companies

2.4 We consider that the section covering the aspects of the company which the institutional investors should monitor should be expanded. The Code should state that institutional investors are expected to satisfy themselves, to the extent possible, that, (additional text is in bold):

- ❖ the investee company's board and sub-committee structures are effective **and that meaningful board and committee evaluations are undertaken**
- ❖ the independent directors provide adequate oversight
- ❖ **the investee company has an appropriate strategy and has adequately explained the risks specific to the sector and individual company**
- ❖ **the investee company has appropriate strategic, operational and reputational risk policies and procedures in place**

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

2.5 The examples of ways in which institutional investors can escalate their actions should be expanded to include the power of members to 'include other matters in the business dealt with at an AGM' – see s338A of the Companies Act 2006. This is an important additional power, available to members since the implementation of the Shareholder Rights Directive on 3 August 2009, and is in addition to their power to add a resolution to the agenda. It means that with the requisite level of support, a topic that investors consider merits discussion, even if there is no formal resolution associated with it, can be added to the formal business of the AGM.

2.6 Secondly, the term EGM is no longer a defined term in the Companies Act, and the final bullet should read 'requisitioning a general meeting (which is not an annual general meeting) ...'

Principle 6 – Institutional investors should have a clear policy on voting and disclosure of voting activity

2.7 We suggest that the first sentence be expanded by the phrase in bold below: "Institutional investors should seek to vote all shares held, **having given due consideration to the issues to be discussed.**" We appreciate that resource will not necessarily allow this to be the case for every single meeting in which an institution has an interest, but that it is a case of reasonable endeavours.

2.8 The paragraph goes on to state that: "They should not automatically support the board". This should be followed by a statement that where there is a disagreement with management, the institutional investor should engage with the investee company in good time. This will maximise the possibility that issues will be addressed and resolved and that, if not, both institutional investors and the company will have a clear understanding of subsequent voting behaviour.

2.9 We further believe that the second half of the next paragraph should be made stronger such that the paragraph would read: "If they have been unable to reach a satisfactory outcome through active dialogue then they should register an abstention or vote against the resolution. In both instances, they should inform the company in advance of their intention and the reasons why."

2.10 Many institutions outsource the voting process to a proxy voting agency, which actually lodges the proxy cards with the investee companies' registrars. The Code should make clear that where voting is outsourced, responsibility for ensuring that the votes will be properly cast remains with the institution, and that institutional investors should therefore satisfy themselves that the proxy votes are being properly lodged by their agents in advance of the deadlines for submission at the relevant meetings and disclose what steps they have taken to do so.

2.11 As so much of the voting by institutions is actually undertaken by proxy voting agencies we strongly agree with paragraph 3.9 that these agencies should be encouraged to commit to the spirit of the Code.

2.12 Similarly the Code should somehow capture the responsibility of the voting advisory agencies, which give advice to institutional investors on how to vote on the resolutions at investee company AGMs, to find a way to engage with the investee companies on their draft voting policies **before** companies issue their notices of meeting. It is a source of great frustration to companies that they are often only informed about how institutions are likely to vote on general issues once their notice is already published. Clearly if the agencies only update their policies once a year, this should be done well in advance of the AGM season for the majority of companies which takes place in the second quarter of the year. Engagement with companies on these voting policies therefore needs to take place by the end of the preceding October, before notices of meetings/reports and accounts are drafted.

Differences between the Code and Section E of the Combined Code

2.13 We have the following comments on your paragraphs 4.5 to 4.9 which highlighted the key differences between the content of the Code and Section E of the Combined Code:

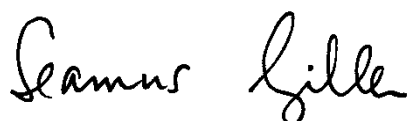
4.5/4.6 – the basis for company/shareholder dialogue: we agree that the ISC wording is clearer.

4.7/4.8 – consideration of investee companies' explanation by shareholders: we think that the Combined Code points in 4.7 should be included in the ISC Code. However, where investors do not accept explanations provided by the company, we believe there should be the freedom initially to deal with the issue by discussion, which can be more constructive than communicating in writing. The Code should state that the final position of the investor should be confirmed in writing if still not accepting of the company's explanation.

4.9 – attendance at AGMs: we agree that it is unrealistic to routinely expect institutional investors to attend AGMs and consider that the key emphasis should be on making sure they cast their votes. If investors are required to ensure that their votes have been properly cast, as we suggest in paragraph 2.10, and they find out that their proxy votes have not been registered or have been registered incorrectly, they should then ensure that they attend the general meeting to rectify the matter by voting in person as a corporate representative at the meeting.

We would be glad to expand on any of these points should you like to discuss any of them further.

Yours sincerely



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