



## SOUTH YORKSHIRE PENSIONS AUTHORITY

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Date: 15 April 2010

This matter is being dealt with by: J N Hattersley

Dear Sirs,

### Investments Division CONSULTATION ON A STEWARDSHIP CODE FOR INSTITUTIONAL INVESTORS

The Authority is pleased to offer its comments on the above consultation document.

The Authority is an administering authority of the Local Government Pension Scheme and manages a Fund that is valued at roughly £4bn. It is, therefore, one of the UK's top fifty pension funds. It is also a rarity in that the Fund is largely internally managed and that the internal team also manages money for another local authority : that pension fund is valued at roughly £160m.

The Authority is sure that you will be receiving many detailed responses from organisations which will offer comment on a line by line basis. The Authority does not wish to replicate such detail but would like to make some general observations upon the document.

Firstly, might I begin by welcoming the initiative. In the Authority's opinion the current ISC Code of Practice is too narrowly focussed and does not match the FRC's wider purpose. Secondly, may I draw your attention to the rather prescribed interpretation of the phrase "institutional investors" in the ISC Code and suggest that the investment chain is made up of at least three different groups of entities : pension funds and insurance companies, advisors and agents and finally asset managers. Each of these has a different role to play in the governance process and serves different constituencies with often differing reporting requirements ( and resources ). These differences need to be recognised under whatever structure is finally agreed upon. The Authority generally approves of the idea of a "comply or explain" approach as it can be flexible enough to encompass these differences.

One of the difficulties involved in any consultation process which is looking to develop a written framework of conduct is that by definition it tends to focus upon quantities and compliance with targets rather emphasising the quality of the underlying tasks. Greater engagement alone is unlikely to achieve the broader goals the FRC has set itself as the outcome of this consultation. There is a danger that by requiring more engagement the result is a reduction in quality given the limited resources that the parties are likely to have access to.

This Authority regards itself as a relatively pro-active investor ( it currently publishes its voting outcomes and policies, for example ) but despite the size of assets under management has very

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limited resources to devote to governance matters. The Authority does engage directly with companies ( usually those where it has a declarable interest or with where it has a long term relationship ) but recognises that it is often more effective to combine with other like-minded investors to achieve its aims. Therefore, the Authority urges the FRC to recognise that there are undoubtedly costs associated with extending governance further and that these might dissuade smaller funds from engaging with the revised Code. The FRC needs to bear in mind that there are a myriad of other codes of practice which funds are being urged to comply with ( Myners Principles, UN Principles etc ) each of which involve lengthy consultation and care and maintenance ( including reporting ) once adopted. At a time when costs are under scrutiny, particularly in the public sector, this is a major consideration.

It also has to be remembered that the primary duty of pension funds is a fiduciary one : it is to ensure that the fund has sufficient assets to meet the pension liabilities. Whilst there is growing evidence, albeit largely anecdotal, to support the view that better governance and greater shareholder engagement contributes to meeting that objective it has to be demonstrated that the costs of doing so do not outweigh the benefits. Because each pension fund will be aiming to achieve own targets peculiar to its own contributor and beneficiary profile it should be expected that the level of engagement reflects those specific wishes as well. In that context the FRC might consider that classifying shareholder engagement as a primary responsibility might be overemphasising the issue somewhat. That is not to say that the Authority isn't fully supportive of the aims behind the Code but it is aware of the practical constraints compliance imposes.

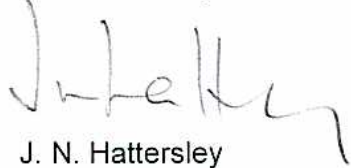
Whilst the Authority welcomes the thinking behind the view that institutional shareholders have responsibilities to the UK companies in which they invest it would caution the FRC to remember that despite ranking in the top fifty of UK funds the Fund controls an insignificant amount of the UK stockmarket. This is particularly pertinent to the ISC exhortation regarding attendance at AGMs etc. It is unrealistic to expect generalised attendance at such meetings. This is one reason why the Authority chooses to combine its weight with those of other like-minded investors. It is necessary for even the largest investors to identify engagement targets in order to be effective. No fund can be expected to engage with all the listed companies in which it invests. Again, in the Authority's opinion, this reinforces the view that the FRC needs to recognise that the different parties in the investment chain have different inputs and influences.

There are two other minor points which the Authority wishes to make. Many funds, especially smaller ones, use pooled vehicles to gain exposure to companies but exercising voting rights through such vehicles is fraught with difficulties. The FRC could consider devising a mechanism whereby managers of pooled vehicles have to exercise their votes in a way which reflects the wishes of the underlying beneficial owners. The consultation document also seems to concentrate upon the need for shareholders to combat underperformance without giving due consideration to the equally important matter of shareholders recognising best practice and encouraging further added value performance.

To try and sum up the Authority understands and approves of the broad policy objectives that the FRC is trying to achieve through the Code but would urge the Council to recognise the practical constraints that investors face. A "comply and explain" approach best suits the broad spectrum of organisations involved in the investment chain and allows the flexibility necessary to satisfy very different objectives. A mandatory regime is likely to lead to a more quantity but lower quality result with a gravitation towards a box-ticking mentality. Finally, the FRC needs to place greater emphasis upon the fiduciary aspects of governance and recognise that enhanced engagement must be achieved in a cost-effective manner.

I hope that you find these comments helpful.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'J. N. Hattersley'. The signature is written in a cursive style with a long, sweeping tail on the final letter.

J. N. Hattersley  
Fund Manager