Response to the FRC Consultation on the UK Stewardship Code Consultation, July 2012

Local Authority Pension Fund Forum

# LAPFF response to Revisions to the UK Stewardship Code Consultation Document

## 1 Background

LAPFF, which was set up in 1991, is a voluntary association of 55 local authority pension funds based in the UK. LAPFF exists 'to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders to promote corporate social responsibility and high standards of corporate governance amongst the companies in which they invest.' The Forum's members currently have combined assets of about £100 billion.

LAPFF, as a group of UK asset owners, is interested in promoting long-term investment interests of its beneficiaries. The Forum was created as a collaborative body of shareholders who aim to enhance the long-term value of companies in which it invests. It is a body of active owners.

LAPFF is therefore supportive of the aims of the Stewardship Code. The Forum has discussed the Code at a number of meetings, in addition to producing a number of briefing papers to assist members in both applying it, and understanding how their asset managers might seek to apply it. At the time of writing, 14 LAPFF member funds' own Stewardship Code statement are listed on the FRC and more funds are likely to produce statements.

## 2 Responses to proposed Changes

### The definition of stewardship

LAPFF believes that the revised text is generally clearer, and we welcome the emphasis on stewardship being a shared responsibility, rather than something that is done *by* shareholders *to* companies.

The Forum would query the emphasis in paragraph 6 of the 'Stewardship and the Code' section. It is suggested that asset owners are largely restricted to setting the tone for stewardship, and ensuring that asset managers undertake this role effectively. In practice it is clear than some asset managers do not wish to perform this role, and believe that it does not deliver benefits. In contrast, some asset owners are active themselves in stewardship, rather than delegating this to their asset managers. Therefore LAPFF believes that this portrayal does not accurately capture the stewardship landscape in the UK as it stands.

**The roles of asset owners and asset managers**

As stated above, we believe that the FRC should make clear that some asset owners are willing to be proactive in terms of Stewardship.

**Conflict of interest polices**

The proposed text for the guidance to Principle 2 might benefit from slightly more specificity. The most commonly cited potential conflict is how listed asset management companies vote at their own company's AGM, but there are others. For instance, there are some cases of the directors of asset management firms sitting on the boards of other PLCs. However, the Forum has not seen any examples of asset managers describing how this influences voting and engagement decisions if the manager is an investor in the company.

It therefore may be helpful if the FRC sets out in the guidance, the types of issues a conflicts of interest policy should address.

**Collective engagement**

The Forum supports the revised wording and the greater emphasis on the circumstances in which collective engagement might be considered. LAPFF is in an unusual position in that it is in itself an organisation that facilitates collective engagement, and members that have produced Code statements typically refer to the Forum's role. However there are many occasions when LAPFF seeks to work with other investors and investor groups to make engagement more effective, typically because of significant and persistent concerns. Therefore the Forum will work with its members to make Code statements more specific on this particular point.

**The use of proxy voting or other voting advisory services**

The Forum believes that the language in the proposed text is appropriate, if the intention is to elicit more information about how services are used in practice. In addition the operation of a transparent procurement process by asset managers in the hiring of third party providers would be appropriate.

LAPFF also welcomes the minor amendment to the text of the guidance relating to disclosure of voting records.

**Stock lending**

The Forum notes that no view is expressed on the rights and wrongs of securities lending, but is aware that in March 2012, the Bank of England described securities lending as being "essential for any capital market to work efficiently".

The Forum supports the suggestion that the Stewardship Code be modified to request signatories to disclose their policy on securities lending, with particular reference to their policy on voting. In so doing, it should be recognised that it might not be straightforward to define a policy that covers every possible eventuality, as there might be a need to establish the perceived value of registering a vote compared with the associated loss of fee income. It would be for each individual Fund to consider different circumstances and form a view.

 

The broad approach taken by each Fund can be described, such as whether it participates in securities lending, and if so, whether it temporarily suspends lending in a particular share ahead of a forthcoming vote, and whether and when it recalls shares that are out on loan ahead of a vote. Perhaps such broad policies can then be expanded by reference to individual markets (e.g. UK equities, US equities etc), to the size of the investee company (e.g. large caps, small caps or AIM shares), to whether or not a notifiable holding is held, to situations where there are contentious proposals which the Fund does not support, or indeed which the Fund does support, and finally when the Fund supports all the proposals and regards none as contentious.

The above are more straightforward for segregated holdings than for holdings in pooled funds. In the latter case, a Fund can set out its broad arrangements with its asset managers, with regards to their general approach to voting. However, any Fund might use several different managers of pooled funds. Rather than attempting to indicate whether or not each one lends out stock, and if so, in what circumstances they recall the stock to exercise a vote, a Fund would expect each asset manager to be setting this out in its own policy statement.

Finally, it is recognised that there might be complications should the record date for voting entitlement coincide with the record date for dividend entitlement.

**Other asset classes**

The application of the Stewardship Code to other asset classes may require further consideration.

The emphasis on shareholder engagement in the UK and other markets in recent years has been in large part in response to the nature of typical PLC ownership – the classic problem of the separation of ownership and control. With a diversified shareholder base there may be little attempt to ensure that management is playing its part as a steward of the business. The development of the Code, promoted by the Walker Review in 2009, was in response to the concern that institutional shareholders had exercised ineffective oversight in the past, particularly in relation to listed financial institutions. Hence the value of the Code is that it sets out the view that stewardship on the part of shareholders is valuable and should be encouraged. Obviously this holds for other public markets, and as such it would make sense to extend the remit of the Code to cover listed equities in other markets.

However, it is not immediately obvious that similar concerns have been raised in respect of investors' role in other types of assets, or that therefore there is a reasonable consensus that the adoption of a stewardship approach would be beneficial. It is notable, for example, that the Walker Review did not contain a single reference to any sort of oversight role for bondholders in respect of financial institutions.

In addition, in the Forum's experience, the adoption of a stewardship approach to other asset classes by asset managers is relative rare, unless one draws the definition of 'stewardship' rather widely. Encouraging investors to make claims about their activities in this area may lead to reporting that reinterprets existing behaviour as involving 'stewardship', rather than providing useful information.

 

LAPFF believes that in future it will be useful to revisit this. However, currently, with the Code in force for less than two years, it appears more appropriate to keep the focus on ensuring that it is effective in promoting stewardship in respect of listed equities. As such we would recommend removing the reference to "corporate debt" and make clear that the Code's remit is listed equities.

**Assurance reports**

The Forum agrees with the change to the text regarding assurance reports.

**Relevance of signatories' statements**

Whilst the Forum agrees with the proposal that signatories' Code statements should be reviewed and updated as appropriate, an annual review is unlikely to lead to many changes, at least for asset owners.

For example, since July 2000, pension funds have been required to produce a statement in their Statement of Investment Principles setting out their policy (if any) on shareholder voting and social and environmental issues. LAPFF members generally attach more significance to these issues than private sector funds, and as such their SIPs are likely to say more on these points. But, in our experience, these statements are only infrequently updated. In practice, once the fund has set the broad outlines of its policy, the relevant section of the SIP is only likely to be updated if there is a significant change.

We would expect to experience similar results in relation to Stewardship Code statements.

**Further comments**

**Guidance to Principle 4**

In reference to public statements, we would recommend that "in advance of General Meetings" is deleted. In practice shareholders sometimes make public statements when there are no scheduled meetings forthcoming. In addition the Forum believes it would be beneficial to encourage shareholders to consider public comment to be a legitimate aspect of stewardship.

**Pooled funds**

A number of LAPFF members have raised the issue of being able to apply their own voting policy when investing via pooled funds, and we are aware that this has been raised as an issue previous by other asset owners. Asset manager practice on this issue varies significantly, with some allowing asset owners to apply their own policy and others not.

The FRC could assist asset owners by making it clear that asset managers should assist asset owners wishing to adopt and apply their own stewardship policies, including in respect of pooled funds. This could provide a useful spur to encourage asset managers to adopt a constructive approach to this issue.

 