



By email: codereview@frc.org.uk

Chris Hodge
Financial Reporting Council
Fifth Floor
Aldwych House
71 – 91 Aldwych
London WC2B 4HN

11 July 2012

Dear Mr Hodge

Revisions to the UK Stewardship Code – Consultation Document, April 2012

We appreciate the opportunity to respond to this consultation document issued by the Financial Reporting Council ('FRC').

We welcome the revision to the UK Stewardship Code (the 'Code') at this time and agree with the spirit and overall direction of the FRC's proposed revisions. We are supportive of the FRC's decision that, as the Code is still in its infancy, amendments should build on a promising start, but not fundamentally change it. We also welcome the statement that the Code is expected to be stable until 2014 at the earliest as this will enable asset owners and asset managers to improve their existing stewardship policies at a time when they are experiencing significant regulatory change.

Our specific responses to each of the areas covered by the consultation document are set out in the accompanying Appendix.

We would be pleased to discuss our views further with you. If you have any questions in the meantime regarding this letter, please contact Sean O'Hare (Tel 020 7804 9264) or Karen Sharpe (Tel 0207 804 7473).

Yours sincerely

A handwritten signature in cursive script that reads "PricewaterhouseCoopers".

PricewaterhouseCoopers LLP

*PricewaterhouseCoopers LLP, 7 More London Riverside, London SE1 2RT
T: +44 (0) 20 7583 5000, F: +44 (0) 20 7212 4652, www.pwc.co.uk*

PricewaterhouseCoopers LLP is a limited liability partnership registered in England with registered number OC303525. The registered office of PricewaterhouseCoopers LLP is 1 Embankment Place, London WC2N 6RH. PricewaterhouseCoopers LLP is authorised and regulated by the Financial Services Authority for designated investment business.



Appendix – Detailed PwC response to Stewardship Code Consultation

The FRC is conscious of the need, when revising codes and standards, to resist the temptation continually to extend their scope and add unnecessarily to the level of detail. For this reason, in considering whether to propose changes to the Code, the FRC applied two tests:

- When considering additions to the introductory sections of the Code: will the text assist signatories to the Code to understand better what stewardship is, the aim of stewardship, the purpose of the Code and how the Code is implemented?
- When considering adding new guidance to the principles of the Code: does the matter fundamentally impact an institutional investor's stewardship activity and, if so, can it be dealt with without undue prescription?

As well as commenting on the detail of the individual changes summarised in the remainder of this consultation document, views are invited on whether those changes meet these tests, and whether the Code as a whole is well structured, balanced and clear.

PwC response:

Overall, in our view, the changes have met the tests specified by the FRC and are sensible and well balanced. Where we have specific comments, we have included them in our covering letter and/or in the detailed sections below.

Views are invited on whether the proposed revisions correctly describe stewardship and its purpose.

PwC response:

We consider that the revised Code provides greater clarity on the aim of stewardship and the activities that should be undertaken to exercise stewardship for both asset owners and asset managers.

However, we suggest that the definition of stewardship in paragraph 3 of the “Stewardship and the Code” section could be improved by including the additional principles of commitment to the companies in which investors hold stock and readiness to engage in constructive criticism included in paragraph 2.20 of the February 2012 interim report of the Kay review, which we have reproduced below:

“Stewardship extends more widely than the set of issues commonly discussed as corporate governance. Asset managers concerned with stewardship would be expected to engage with, and be committed to, the companies in which they held stock. They would normally be supportive of company management, but would be ready to engage in constructive criticism and, in the extreme cases, to act themselves or in conjunction with others to effect change.”

Views are invited on whether the respective responsibilities of asset owners and asset managers have been correctly described.

PwC response:

The definition of asset owners and asset managers in the “Stewardship and the Code” section is helpful in removing ambiguity, as are the changes to the text throughout the revised Code. The respective responsibilities set out are clear and seem sensible.



Conflict of interest policies

PwC response:

Improvement in this area is welcome as conflicts of interest issues are gaining more and more prominence and the FRC's December 2011 report on the implementation of the Code found the disclosures of conflict of interest policies to be generally weak.

The revised wording of Principle 2 is much more explicit about disclosing how institutions put the interests of clients or beneficiaries first. However, as noted in the appendix to the revised Code, the change from the requirement to have a "robust" policy to an "effective" one remains ambiguous. Given that the intent of the use of the word "effective" is to mirror the FSA's requirements in this respect, clarity would be improved if the wording from SYSC 10.1.4 in the FSA's handbook was reproduced in the guidance to Principle 2 to indicate the types of risks that an effective policy would typically be expected to cover:

SYSC 10.1.4 Types of conflicts

For the purposes of identifying the types of conflict of interest that arise, or may arise, in the course of providing a service and whose existence may entail a material risk of damage to the interests of a client, a common platform firm and a management company must take into account, as a minimum, whether the firm or a relevant person, or a person directly or indirectly linked by control to the firm:

- (1) Is likely to make a financial gain, or avoid a financial loss, at the expense of the client;
- (2) Has an interest in the outcome of a service provided to the client or of a transaction carried out on behalf of the client, which is distinct from the client's interest in that outcome;
(2A) in the case of a management company providing collective portfolio management services for a UCITS scheme, (2) also applies where the service is provided to, or the transaction is carried out on behalf of, a client other than the UCITS scheme;
- (3) Has a financial or other incentive to favour the interest of another client or group of clients over the interests of the client;
- (4) Carries on the same business as the client, or in the case of a management company, carries on the same activities for the UCITS scheme and for another client or clients which are not UCITS schemes; or
- (5) Receives or will receive from a person other than the client and inducement in relation to a service provided to the client, in the form of monies, goods or services, other than the standard commission or fee for that service.



Collective engagement

PwC response:

We are supportive of the principle of asset managers and owners acting collaboratively for the benefit of their beneficiaries and agree that active shareholder engagement is a core element of effective corporate governance. However, we are aware that some investors have expressed concern that compliance with Principle 5 “Institutional investors should be willing to act collectively with other investors where appropriate” could result in their “acting in concert” under the Takeover Code. We recognise that not every form of collective action creates a concert party but these concerns could give rise to a reticence to comply with this principle and thereby detract from the effectiveness of the Stewardship Code.

Rule 9 of the Takeover Code specifies the circumstances in which shareholder collective action can constitute “board controlling behaviour” and create a concert party. We recommend that the FRC and the Takeover Panel provide greater guidance on the interaction between the Stewardship Code and the Takeover Code.

In addition, the Disclosure Rules and Transparency Rules require shareholders to aggregate their share holdings in listed companies where they adopt, by concerted exercise of their combined voting rights, a “lasting common policy” towards the management of share issuers. Institutions may therefore limit their collaboration with other investors to avoid triggering this requirement and the additional disclosures that may result, which could be difficult to manage: for instance they would need adequate data on their aggregate holdings to establish whether a disclosure needs to be made.

We therefore suggest that the wording of Principle 5 should be re-written to focus on the institution’s policy, rather than its willingness to act. In our view, the wording should be changed from “Institutional investors should be willing to act collectively with other investors where appropriate” to “Institutional investors should have a clear policy on collective engagement”. This change of wording would also make Principle 5 more objective and therefore verifiable (see our discussion on providing assurance under Principle 7 below).

The use of proxy voting or other voting advisory services

PwC response:

We welcome the revised wording to Principle 6 on this matter and consider it will clarify the extent of the disclosures required for signatories without turning it into a “tick-box” exercise.

Stock lending

PwC response:

Principle 6 also provides clarification for signatories on disclosure requirements for stock lending, which has been an issue of interest in the UK market since 2008. We believe that such disclosures should provide transparency and investors are unlikely to see this as an area of difficulty, even where they have not previously included such disclosures.

Other asset classes

PwC response:

Mention of the application of the code to other asset classes in the introductory section is welcome and we don’t believe that investors who manage portfolios extending beyond UK equities will find this difficult.

Assurance reports



PwC response:

In principle, independent assurance that asset managers' disclosures describe fairly their application of the Code should increase the value of, and confidence in, the effectiveness of the Code among its signatories and their clients. This is also in line with the increase we have seen in the number of industry bodies with established codes of conduct that are mandating independent third party reviews of their members, to confirm that what is being done in practice is in line with what has been stated in disclosures.

We have provided assurance on Stewardship Code disclosures for a number of our asset management clients on a voluntary basis; however, take-up of this service has been limited. We support the change to Principle 7 strengthening the wording to "should obtain an independent assurance opinion" on the understanding that the flexibility of the comply-or-explain mechanism is available to institutions and their investors. Ultimately, the value of assurance reports will be determined by the market (including whether clients of asset managers or proxy voting agents require such independent assurance as a contribution toward gaining comfort over execution of their own stewardship responsibilities).

The ICAEW's AAF 01/06 supplement on assurance reporting on the UK Stewardship Code is limited to Principles 1, 2, 6 and 7 only, as Principles 3, 4 and 5 were not considered by the AAF 01/06 working group to be 'objectively verifiable'. The value of the independent assurance would be increased if all 7 principles were covered by an assurance opinion and the FRC should encourage the AAF 01/06 Working Group to consider whether the revisions to the Code are sufficient to include Principles 3, 4 and 5 within the remit of the AAF 01/06 supplement.

The AAF 01/06 guidance itself was intended to have deeper application than the stewardship supplement currently covers. The May 2011 supplement is restricted to 'fair description' of the application of the Code (i.e. whether the disclosure is an accurate representation of the policies in place). This falls short of providing an opinion on the suitability of design of controls in place to ensure compliance with the policies (i.e. whether the controls would, if operating effectively, achieve the requirements set out by the policies) or on operating effectiveness (i.e. whether the controls disclosed have been complied with in practice over a period of time).

We consider that the current wording of the guidance to Principle 7 that asset managers should obtain an independent opinion "on their engagement and voting processes" may imply more extensive assurance than is currently envisaged by the AAF 01/06 guidance. Whilst the AAF 01/06 Working Group set out its intention to review the need for these additional elements of assurance, such an extension of scope would increase the cost of providing assurance.

We are surprised to hear that some asset owners have been denied access to assurance reports on their managers, or have been asked to pay an excessive amount for access and welcome the additional statement in Principle 7 that, "if requested, clients should be provided access to such assurance reports". We have not come across this situation when providing services as a service auditor or reporting accountant.

To avoid doubt arising over which parties are entitled to receive a copy of the report, the term "client" should be clearly defined in the engagement letter between the reporting accountant and the asset manager to include the intended recipients of the report (i.e. for an asset manager, its clients). Our view, and our understanding of the current market, is that assurance reports should be shared with

clients without cost.

Technical points

- Whilst the revised Code has correctly stated that the replacement for SAS 70 is SSAE 16, we do not consider this to be a suitable assurance standard to apply over application of the UK Stewardship Code as it is intended only for controls relevant to the financial reporting of clients. Whilst there is a suitable US standard which could be applied to this subject matter (AT 101), we do not believe that the FRC should recommend a US standard to provide assurance over a UK code. Should the aim be to avoid prescribing a particular standard, we believe that the wording in Principle 7 should be amended to say “having regard to frameworks such as AAF 01/06, ISAE 3000 or equivalent”. This would still allow for bespoke assurance reports to be carried out.
- We suggest that where the wording in Principle 7 has been amended from “independent audit opinion” to “independent opinion”, it should have been amended to “independent assurance opinion”.

Relevance of signatories’ statements

PwC response:

The FRC’s observation is consistent with our own experience that reports have not generally been updated in 2011 and we support the requirement for an annual review to be carried out.

Other Substantive Changes to the Code

PwC response:

- ***Insider information, acquisitions and sub-underwriting***
We support the suggested amendment to the guidance to Principle 3.
- ***FSA disclosure requirements***
We support the explanation provided in the introductory statement.
- ***The role of service providers***
We support the clarification provided.

Editorial changes

PwC response:

- ***The Preface***
We consider that the changes improve clarity and support the move to bring consistency with the UK Corporate Governance Code. We suggest one change of wording in paragraph 9 of the “Application of the code” section: “Asset managers are expected to have the policies described in their stewardship statements independently verified” should be amended to read “Asset managers are expected to have the policies described in their stewardship statements independently assured”.
- ***Guidance to Principle 1***
We support the amendments to Principle 1 and the removal of repetition.
- ***Principle 2***
See discussion of our views on amendments to this Principle under “Conflicts of Interest policies” above.



- ***Guidance to Principles 3 and 4***
We are supportive of the changes to the guidance of these Principles.
- ***Guidance to Principle 5***
We are supportive of deletion of the last paragraph of Principle 5 to remove repetition.