



The International Securities Lending Association
4 Lombard Street
London EC3V 9AA

ISLA's Response to the FRC Proposed Revisions to the Stewardship Code 2012

Dear Sir,

The International Securities Lending Association (ISLA)ⁱ welcomes the opportunity to comment on the proposed changes to the Stewardship Code, but limits its views to the proposals relating to securities lending.

Securities lending involves the temporary transfer of securities from a 'lender' to a 'borrower'. Lenders are generally insurance funds, pension schemes, or collective investment schemes. Borrowers are generally broker dealers or investment banks who are acting as a market maker or as a prime broker. Whilst legal transfer occurs, the lender retains the economic exposure and benefits of ownership of the lent assets.

Existing best practice means that all activity is undertaken using a master agreement which (unless otherwise agreed) obligates the borrower to return borrowed securities on demand and to provide eligible collateral with margin, in shares, bonds or cash, for the duration of the loan. There is estimated to be a little under €10trn of assets available to lend globally with around €1.5trn lent at any one timeⁱⁱ.

Securities lending provides direct benefits to institutional investors such as pension plans, mutual funds and insurance companies, by enabling such investors to generate low risk incremental returns on their investment portfolios. These returns enhance performance over time and may substantially reduce the costs to long term investors of managing their portfolios.

At the same time securities lending also provides substantial benefits to the wider capital markets, enabling higher levels of settlement efficiency and increased liquidity. Without securities lending it would be prohibitively more expensive and risky for investment firms to make markets in a wide range of securities, and more difficult for investors to hedge investment positions or engage in trading strategies such as arbitrage. Securities lending is therefore a very important contributor to the functioning of the secondary markets.

ISLA has actively promoted the production of educational documents to help investors fully understand the risks, rewards, procedures and options within securities lendingⁱⁱⁱ and also has an active Corporate Governance group, which embraces all parties in the securities lending market (institutional investors, lending agents and prime brokers).

Securities Lending is sometimes considered in relation to corporate governance because whilst shares are on loan, the lender temporarily passes title to the shares to another investor. If the lender wishes to vote on the shares, he or she must recall them from loan to do so.

ISLA believes that each institutional investor should decide whether or not to engage in securities lending and if participating, needs to determine its own policy regarding the recalling

of shares for voting. In making this decision and in developing appropriate policies, it is essential that the investor fully understands the risks and rewards involved in the activity (including how lending affects the ability to vote) and ensures that these policies are consistent with its own corporate governance and investment objectives.

In preparing this response, ISLA has engaged with its members, including its members beyond the UK. ISLA supports the proposal to ask signatories of the stewardship code to disclose their policy on the issue, and specifically whether they recall lent stock for voting purposes. ISLA has long supported the need for investors to have clear policies regarding securities lending and corporate governance but recognize that such policies need to be flexible enough to take into account company specific circumstances. We note that disclosure of such codes is consistent with the UK section of the 'Code for External Governance' published in April 2011 by the European Fund and Asset Management Association^{iv}.

We and our respective members again thank you for the opportunity to respond to the proposed revisions. We remain fully at your disposal for further engagement and correspondence.

Yours sincerely,



Kevin McNulty

Chief Executive

ⁱ The International Securities Lending Association (ISLA) represents the common interests of lenders and borrowers of securities internationally. The association has more than 90 members comprising insurance companies, pension funds, asset managers, banks and securities dealers, who in turn represent more than 4,000 clients. ISLA publishes a master legal agreement which is widely used in the market internationally, as well as a series of guides, best practice papers and educational materials. Further details about ISLA can be found on our website: <http://www.isla.co.uk>

ⁱⁱ Estimates provided by DataExplorers, a Markit company

ⁱⁱⁱ <http://www.isla.co.uk/publications>

^{iv} http://www.efama.org/Publications/Public/Responsible_Investment/11-4030_EFAMA%20Report%20on%20RI.pdf