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By email: codereview@frc.org.uk

Dear Chris

Revisions to the UK Stewardship Code

I am writing to respond to the above consultation paper on behalf of RPMI Railpen, the investment monitoring arm of the Railways Pension Trustee Company Limited, the corporate trustee of various UK railway pension funds with approximately £18 billion in assets under management and 350,000 beneficiaries.

As a major asset owner signatory to the Stewardship Code since its inception in 2010, we consider stewardship to be part of our fiduciary duty to our beneficiaries and that the Code has the potential to enhance engagement between investors and portfolio companies and ultimately to improve long term returns. It follows that we share the FRC's aim to enhance the Code over time and welcome the opportunity to comment on this consultation. We make some general comments below followed by more detailed comments on some of the specific proposals in appendix A to this letter.

We generally support the proposed revisions to the Code which represent significant enhancements and we think it is useful to clarify and define the aim of stewardship. We consider that the introductory section on Stewardship and the Code is very helpful in this respect and we welcome the stronger distinction between asset managers and asset owners. The increased focus on conflicts of interest addresses an area of weakness that is often apparent in public compliance statements. We also welcome the extension of the Code to overseas equities and other asset classes and we welcome the proposed improved disclosure on this and also on the specific extent to which the Code is applied across the house and to other products which we consider will be helpful to asset owners in assessing the commitment of their asset managers to the Code.

However, we also wish to make clear our view that the FRC has missed an opportunity to return to arrangements for voting pooled funds. This was specifically identified as an area of unfinished business in the FRC's paper on the "Implementation of the UK Stewardship Code" in July 2010 as one of various significant issues which are not addressed in the Code and which merited further consideration.

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Whilst we welcome the expanded guidance to Principle 6 on disclosure of stock lending and the use of proxy voting services, we are disappointed that no reference is made anywhere in the consultation document or in the draft revised code to pooled fund voting.

This is of great interest to asset owners and can sometimes be a major obstacle to good stewardship. If an asset manager is unwilling to entertain any dialogue on voting in relation to the wishes of the client in advance of a specific vote or company meeting and is only prepared to report on a post hoc basis long after the vote in question, this can effectively disenfranchise even large asset owner clients. In our own case, where we do not have segregated portfolios, we seek and have sometimes succeeded in obtaining pro rata voting rights over our notional exposure but not in all cases.

We urge the FRC to return to this unfinished piece of business in relation to pooled fund voting arrangements which is essential in our view in promoting good stewardship. We propose that there should be a presumption in favour of pro rata voting with a comply or explain obligation on the part of asset managers. We believe that this step is necessary in order to stimulate proper debate and also to encourage service providers to gear up to overcome the alleged technical issues in implementing pro rata voting.

I hope that these comments are helpful and I would like to acknowledge the openness of the FRC in its willingness to engage with investors and other stakeholders. Please contact me if you need clarification on any aspect of our response or you feel that we can otherwise be of assistance.

Yours sincerely

A handwritten signature in blue ink that reads "Frank Curtiss".

Frank Curtiss
Head of Corporate Governance

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Appendix A

Revisions to the UK Stewardship Code

RPMI Railpen's comments on the detailed questions raised are set out below.

The definition of stewardship

We generally support the revised definition of "stewardship" as set out in the introductory section and in more detail in the guidance to Principle 1. We believe that these changes represent significant enhancements and consider that it is useful to clarify and define the aim of stewardship.

We acknowledge that some non-signatories and overseas asset managers confuse stewardship with socially responsible investment and we have certainly come across this misconception in the course of due diligence in our selection of fund managers. We welcome the explicit clarification both in the introduction and in Principle 1 and we hope that the true nature of stewardship will be understood by potential signatories as a result.

However, we recommend a drafting change to the first sentence in the first paragraph in the guidance to Principle 1 by moving remuneration to the end of the clause as follows:

"...such as strategy, performance, risk and corporate governance including remuneration".

Although only an issue of emphasis, we believe that remuneration is a subset of governance and should follow rather than lead.

The roles of asset owners and asset managers

We observed in our response to the FRC's original consultation in 2010 that the Code did not provide sufficient clarity on the respective responsibilities of the different parties in the investment chain, particularly between asset owners and asset managers. We are pleased to see that this has now been addressed.

We believe it is helpful to identify more clearly the differing responsibilities of asset owners and asset managers. This is very much in keeping with the observations of the recently published Kay Report which stresses the existence of the investment chain and reiterates that markets exist primarily for end users rather than for market participants.

We also recognise in some cases that the distinction between asset owner and asset manager is a simplification. We note that the observation that there may be a spectrum and agree that it is helpful for institutions to indicate where they believe they sit on the spectrum in the context of the application of the Stewardship Code. We consider at RPMI Railpen ourselves to be an asset owner given that our investment management activities are outsourced.

We support the explicit recognition that asset owners have a stewardship obligation to their beneficiaries and are pleased to see that the Code continues to recognise that specific stewardship activities will vary according to circumstances. In our own case we take a major role in stewardship activities, including direct engagement with portfolio companies, but we recognise that not all pension funds and asset owners are in a position to do so.

We firmly agree that asset owners should seek to hold their asset managers to account for their stewardship activities and this is a major part of the work of our in-house corporate governance team. It follows that we expect asset managers to explain how they deliver their stewardship responsibilities on our behalf.

Application Overseas

There are two aspects to this issue: overseas investors who invest in the UK; and UK investors who invest overseas.

As a global asset owner, we believe it is helpful for UK institutions to apply the Code to their overseas holdings and we seek to do so ourselves.

We also feel it is worthwhile to encourage overseas investors, who in the aggregate now own a very significant proportion of the UK equities market, to take the UK Stewardship Code into account. We welcome the FRC's success in encouraging major North American investors to become signatories and hope others will follow as this will be helpful in sustaining a successful engagement culture.

We recognise that there are potential cross border conflicts arising from the application of the Code but we wonder if some of these are more apparent than real and we suspect that these apparent conflicts are sometimes used as a lazy justification to opt out of stewardship.

So far only a few other jurisdictions, such as South Africa, have actually introduced stewardship codes but we anticipate that other markets will want to consider whether to introduce codes of their own and we would regard this as a very positive development.

It is often asserted that the proliferation of codes could cause confusion and create compliance challenges. Greater international regulatory co-operation may help to reduce this risk. With this in mind, we would encourage some sort of system of mutual recognition between codes in different markets in order to support a network of codes that can cope with local practice rather than a "one size fits all" global code.

Conflict of Interest Policies – Principle 2

We agree with the FRC's observation that reporting in signatories' statements of how conflicts of interest are managed is frequently weak. The increased focus on conflicts of interest in the revised guidance to Principle 2 addresses an area of weakness that is often apparent in public compliance statements. We share the FRC's view that it is helpful to encourage signatories to state explicitly that they put the interests of their clients and beneficiaries first.

We believe that it should become standard practice for asset managers to disclose at least annually to their clients their conflicts of interest with respect to stewardship matters (which are likely to be different from their conflicts in their wider operations).

We have a quibble in replacing "robust" with "effective" in the wording of principle 2. This is not because we consider that "effective" is conceptually wrong but for the practical reason that it has a very specific meaning in audit and assurance parlance and may cause the audit profession significant difficulty in terms of their perceived exposure to liability.

Escalation – Principle 4

We consider the amended wording to be helpful and largely satisfactory. We have a small drafting suggestion in relation to the specific examples outlined in the bullet points which list various actions more or less in order of their severity. We think it may be useful to add “voting against specific directors” between the existing bullet points 4 and 5 as this is a not infrequent subsequent step if the previous actions listed in the previous four bullet points fail to yield results.

Collective Engagement - Principle 5

We agree that greater clarity is helpful and that while disclosure of membership of trade and other collective bodies can be informative, it is not the same as joining forces with other investors at critical moments.

We would observe in passing that our due diligence in relation to external asset managers’ assertions about compliance with this principle sometimes reveals that collective engagement on their part is more hypothetical than real in that they have never actually engaged collectively but might do so in certain (limited) circumstances.

Clear Policy on Voting and Disclosure of Voting Activity – Principle 6

We welcome the new reference to disclosures on the use of proxy voting and other voting advisory services. This is certainly in the interests of clients and beneficiaries but is also helpful to asset managers themselves in that it gives them an opportunity to explain that they make considered rather than uncritical use of these services. This may also be helpful when looking at these issues with interested parties such as the European Commission and ESMA.

We already make such a disclosure in our own statement of stewardship compliance and take the opportunity to stress that proxy voting research is used as an advisory resource and our own policies and judgement take precedence particularly where we have insight from our own engagement activities and our external fund managers.

We also support the recommended disclosure on stock lending policy and recalling stock. We will also adopt this when we conduct the annual review of our own statement.

Assurance Reports – Principle 7

We support the proposed stronger invocation that asset managers “should obtain” an assurance report over the existing wording which merely encourages managers to consider obtaining such a report. As the consultation paper notes, it will still be open to asset managers to continue to explain rather than comply. We encourage our asset managers to look at this and we have voluntarily submitted to an AAF 01/06 review by our external auditor on an annual basis in order to lead by example.

RPMI Railpen serves on the ICAEW’s AAF 01/06 Stakeholder Panel and we seek to contribute to the debate on how the Stewardship Supplement can be strengthened. We welcome the ICAEW’s intention to seek to introduce conformance changes to the Supplement to coincide with the implementation of the revised Stewardship Code and we will participate in the ensuing formal consultation with interested parties.

We acknowledge that there is some criticism of the limited scope of the Supplement and that it confines itself to what can be objectively verifiable and excludes Principles 3, 4 and 5 of the Code which are considered to be inherently uncertain. We share these concerns but note that these limitations are in part driven by the audit profession's perceived exposure to liability. We observe, however, that consideration is being given to extending the scope to one or more of the principles currently excluded as part of the review of the Supplement.

We support the FRC's proposal that clients of asset managers should be given free access to assurance reports. In our view the whole point of the exercise is to provide reassurance to clients that stewardship activities have been independently reviewed and we entirely agree with the FRC that to deny access undermines the purpose and credibility of assurance reports. However, we note that this is not necessarily the fault of asset managers and may well be the result of disclosure restrictions placed on them by their own auditors. As noted above, this reflects in part the audit profession's concerns about liability.

We note the ICAEW's helpful recognition that access to assurance reports can be difficult and that this also extends to other types of internal control reports prepared under the AAF 01/06 Guidance and welcome the ICAEW's commitment to look at this further.

Other Issues - Arrangements for Voting Pooled Funds

We wish to make clear our view that the FRC has missed an opportunity to revisit the issue of arrangements for voting pooled funds. This was specifically identified as an area of unfinished business in the FRC's paper on the "Implementation of the UK Stewardship Code" in July 2010 as one of various significant issues which were not addressed in the Code and which merited further consideration. Most of these have been satisfactorily considered in the current consultation exercise but we are profoundly disappointed there is no reference in the consultation document or in the draft to pooled fund voting.

This is of great interest to asset owners and can sometimes be a major obstacle to good stewardship, given that some pooled funds do not allow clients to issue pro rata voting instructions. This means that the asset owners whose assets are held within such vehicles are unable to vote all their shares in accordance with their wishes and may have to wait some time to find out how their proportionate exposure was voted. If an asset manager is unwilling to entertain any dialogue on voting in relation to the wishes of the client in advance of a specific vote or company meeting and is only prepared to report on a post hoc basis long after the vote in question, this can effectively disenfranchise even large asset owner clients.

In our own case, where we do not have segregated portfolios, we seek and have sometimes succeeded in obtaining pro rata voting rights over our notional exposure but not in all cases. We would stress that our UK passive index manager has permitted us to issue pro rata voting instructions in respect of UK equities for something like 15 years and that the arrangement works well and has not caused either party any significant operational, regulatory or other difficulty.

This suggests that this particular manager has no major regulatory or technical issues in facilitating pooled fund voting which are sometimes used by other asset managers to refuse requests for pro rata voting. We are not aware of any UK regulatory requirements that prevent this and we are sceptical that it is a major barrier in other markets. We suspect that it is more a case of an unwillingness to take on what might be perceived as administratively complex.

This restricts meaningful involvement and engagement on the part of end-clients and can be a significant barrier to effective stewardship. We consider that it should be a best practice requirement, on a comply or explain basis, for pooled funds to enable voting decisions to be made by the underlying asset owners and to be reflected in the votes cast. We feel that pooled funds should be encouraged to facilitate pro rata voting and to explain publicly if and why they do not.

We urge the FRC to return to this unfinished piece of business in relation to pooled fund voting arrangements which is essential in our view in promoting good stewardship. We propose that there should be a presumption in favour of pro rata voting on a comply or explain basis. We believe that this step is necessary in order to stimulate proper debate and also to encourage service providers to gear up to overcome the alleged technical issues in implementing pro rata voting. It might also be helpful if the FRC and other regulators look at whether there is a regulatory or other legal barrier to pro rata voting.

