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The Association of Investment Companies

Revisions to the UK Stewardship Code

Response from the Association of Investment Companies

The Association of Investment Companies (AIC) welcomes the opportunity to respond to the FRC's consultation on the UK Stewardship Code. The AIC is the trade association representing the closed-ended investment company industry. Its membership comprises some 350 investment companies with £81 billion of assets under management.

The Stewardship Code plays an important role in encouraging better dialogue between companies and their investors. The AIC supports the work of the FRC to improve the scope, structure and content of the Stewardship Code. In particular, the redrafting of the introductory sections creates a clearer framework around the Code's principles and recommendations and provides useful information on how the Code is expected to be implemented. We have made some recommendations below to further improve the effectiveness of the code.

The roles of asset owners and asset managers

The AIC supports the decision to differentiate and clarify the roles of asset owners and asset managers. This helps to focus the principles and recommendations of the Code on the relevant parties. However, we **recommend** that, where reference is made to both asset owners and asset managers, the term 'asset owners and asset managers' is used instead of reverting back to the previous term 'institutional investors'. This will provide greater clarity and consistency. It will also reduce the range of terms which is used.

Service providers

We welcome the statement on page 3 of the revised Stewardship Code that it applies, by extension, to service providers, such as proxy advisors and investment consultants. However, we **recommend** that greater emphasis is given in the introductory sections to explaining that effective governance and stewardship relies upon engagement and co-operation throughout the whole of the investment chain. The FRC should encourage all relevant parties in the investment process to report under the 'comply or explain' framework of the Stewardship Code.

The AIC is aware of a number of problems that investment company boards have encountered when dealing with governance agencies. Investment company boards continue to face these difficulties and there has been little improvement since the publication of the Stewardship Code. We have previously called for a specific principle to be included in the Stewardship Code, with more detailed guidance, which addresses the responsibilities of these service providers. Whilst the proposed changes are welcome, they do not go far enough. We therefore repeat our **recommendation** that the Stewardship Code should include specific provisions relating to the responsibilities of proxy voting and governance agencies.

We welcome the proposed change to principle 6, which recommends that institutional investors disclose the extent to which they follow, rely upon or use recommendations made by proxy voting or other voting advisory services. This statement should be specific, for example it might state that the default policy is to follow the recommendation given with an option to take an alternative approach in certain situations. We **recommend** that principle 6 is extended such that asset owners and asset managers investors explain what internal procedures are followed when a report is received from a proxy voting or other voting advisory service provider. This should include whether it is made available to the individual making the buy/sell decision, the governance team and setting out who makes the final voting decision.

Annual policy statements

The FRC noted that only a small fraction of institutions that became signatories to the Stewardship Code in 2010 updated their policies in 2011. It has therefore proposed that signatories review their policies annually and update them where necessary to reflect changes in actual practice. We would question the need for such policies to be reviewed on an annual basis. The Stewardship Code is designed to cover activities which are carried out with a long term perspective in mind. Indeed, the opening paragraph to the introductory sections notes that *"stewardship activities aim to promote the long-term success of companies"*. For this reason, we would not expect such policies to change much year on year. Instead, we **recommend** that the FRC requests signatories to revisit their policies every three years. This will ensure that sufficient time is given for new systems and procedures to be implemented and adjusted where necessary, before a formal review is undertaken.

Assurance reports

The AIC does **not agree** that asset managers should obtain an independent opinion on their engagement and voting processes. Assurance reports are best suited for compliance-based procedures, and not for making more subjective judgements about whether certain practices achieve a desired outcome. Subjecting engagement processes to a box-ticking exercise undermines the flexibility and value of the Stewardship Code. The proposed change to principle 7, that asset managers 'should obtain', rather than 'should consider obtaining', accentuates this concern. It will lead to a greater emphasis on outsourcing and reduce the likelihood that asset managers take responsibility for their own processes. We **recommend** that this change is not made.

Insider information

The AIC **recommends** that the FRC considers the interaction of the Stewardship Code with the Market Abuse Directive which is currently under review. The European Commission originally put forward a proposal for the definition of insider information to include information which is not generally available to the public, but which, if it were made available to a reasonable investor, would be regarded by that person as relevant to their dealing decision. The precise implications of this proposal are unclear but potentially extend the definition of insider information beyond the scope of price sensitive information in the traditional sense and could include information received as a result of, say, stewardship/engagement activities. If this were the case, then the risk of breaching market abuse regulations could significantly curtail the willingness of parties to engage in stewardship activities.

Monitoring

The FRC proposes additions to principle 3 to set out activities which parties engaged in stewardship activities should undertake as part of their monitoring processes. This includes a recommendation that institutional investors should satisfy themselves that the company's leadership is effective. Confirmation of compliance with the other recommendations on this list is relatively straightforward.

However, seeking comfort on the effectiveness of the company's leadership is subjective and requires a qualitative assessment to be made. Instead, parties engaged in stewardship activities should be able to assume that, where the investee company complies with the best practice recommendations set out in the UK Corporate Governance Code, its leadership is effective. Indeed, it is proposed that a recommendation is added to the Stewardship Code that, as part of its monitoring activities, an institutional investor should seek to satisfy itself that the investee company's board adheres to the spirit of the UK Corporate Governance Code. Additional consideration of the effectiveness of the company's leadership should not be necessary. It is **recommended** that assessing the company's leadership is removed from the list of monitoring activities in principle 3.

Record of stewardship activities

A proposed change is made to principle 7 that institutional investors should have processes in place to maintain a clear record of their stewardship activities. We **recommend** that it is made clear that these records are maintained for internal purposes only and there is no expectation that they will be made available for external distribution. We believe that such records may be useful for supporting discussions between asset owners and asset managers but should not be subject to wider circulation. Any expectation could influence the approach taken to recording information and create barriers to effective engagement.

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