



## Response to FRC Consultation Document Appendix

### Suggested Amendments to the Stewardship Code

July 2012



**Note: the first three introductory sections of the draft revised code ('Stewardship and the Code', 'Application of the Code' and 'Comply or Explain') have been completely overhauled. For that reason changes to those sections have not been marked. Changes to the Principles and guidance are, however, marked in bold and underlined text.**

Manifest suggested amendments to the below document have been marked in underlined colour text as illustrated. Please read these suggested changes in conjunction with our Supplementary Explanation Document.

## STEWARDSHIP AND THE CODE

1. Stewardship activities aim to promote the long-term success and preservation of investments so that the ultimate providers of capital also prosper. Effective stewardship benefits investments, investors and the economy as a whole, and pertains to the practical application of fiduciary responsibility which forms the cornerstone of protecting the prosperity of beneficial owners.
2. In publicly listed companies responsibility for stewardship is shared. The primary responsibility rests with the board of the company, which oversees the actions of its management. Through their ownership rights, investors can also play an important role in holding the board and auditors to account for the fulfilment of their responsibilities.
3. The UK Corporate Governance Code identifies the principles that underlie an effective board. This Stewardship Code sets out the principles of effective stewardship by investors. In so doing, the Code assists institutional investors better to exercise their stewardship responsibilities, which in turn gives force to the 'comply or explain' system.
4. For investors, stewardship activities include monitoring and engaging with companies on matters such as strategy, performance, capital structures, risk, remuneration, corporate governance and sustainability. Engagement is purposeful dialogue with companies on those matters as well as on issues that are the immediate subject of votes at general meetings.
5. Institutional investors' activities include decision-making on matters such as allocating assets, awarding investment mandates, designing investment strategies, and buying or selling a specific security. The division of duties within and between institutions may span a spectrum, such that some may be considered more asset owners' and others asset managers'. Each institution will wish to consider where on the spectrum they reside, which is determined by the clients' Statement of Investment Principles or investment mandate (or equivalent).

6. Broadly speaking, asset owners include pension funds, [Sovereign Wealth Funds](#), insurance companies, investment trusts and other collective investment vehicles [and retail investors](#). As the providers of capital, they set the tone for stewardship and may influence behavioural changes that lead to better stewardship. At the other end of the spectrum, asset managers with day-to-day responsibility for managing investments are well positioned to influence companies' long-term performance through [their](#) stewardship [role](#).
7. [The Stewardship](#) Code does not constitute an invitation to manage the affairs of a company or preclude a decision to sell a holding, where this is considered in the best interest of clients or beneficiaries.

## APPLICATION OF THE CODE

1. This Stewardship Code traces its origins to 'The Responsibilities of Institutional Shareholders and Agents: Statement of Principles', first published in 2005 by the Institutional Shareholders Committee (ISC), and which the ISC converted to a code in 2009. Following the 2009 Walker Review of governance in financial institutions, the FRC was invited to take responsibility for the Code. In 2010, the FRC published the first version of the Stewardship Code, which closely mirrored the ISC code. This edition of the Code does not change the spirit of the 2010 Code.
2. The Code is directed in the first instance to institutional investors, by which is meant firms that may be considered asset owners and/or asset managers. The Code also applies, by extension, to service providers [who contribute to the stewardship processes that institutional investors employ, through the provision of research, analysis or opinion](#).
3. The FRC expects signatories of the Code to publish on their website, or if they do not have a website in another accessible form, a statement that:
  - describes how the signatory has applied each of the principles of the Code; and
  - discloses the specific information requested in the guidance to the principles; or
  - if one or more of the principles have not been applied or the specific information requested in the guidance has not been disclosed, explains why the signatory has not complied with any elements of the Code.
4. Disclosures under the Code should improve the functioning of the market for investment mandates: asset owners should be better equipped to evaluate asset managers, and asset managers should be better informed to tailor their services to meet [clients'](#) requirements.
5. In particular, the disclosures should, with respect to conflicts of interest, address the priority given to client interests in decision-making; with respect to [stewardship-driven](#) engagement, describe the circumstances under which the signatory would join forces with other institutional investors to ensure that boards acknowledge and respond to their concerns on critical issues and at critical times; and, with respect to [service providers](#), how the signatory [makes use of their services](#).
6. The statement of how the Code has been applied should be aligned with the signatory's role in the investment chain.
7. Asset owners' adherence to the spirit of the Code may include engaging directly with companies or indirectly through their [Statements of Investment Principles or mandates given to asset managers](#). They should clearly communicate their policies on stewardship to their managers. Since asset owners are the primary audience of asset managers' public statements as well

as client reports on stewardship, asset owners should seek to hold their managers to account for their stewardship activities. In so doing, asset owners better fulfil their duty to their beneficiaries to exercise stewardship over their assets.

8. An asset manager should [describe](#) how it delivers stewardship responsibilities on behalf of its clients [in enough detail to enable a practical understanding of the stewardship processes employed](#).
9. Asset managers [should](#) have the policies described in their stewardship statements independently verified. [Stewardship related](#) assurance reports on internal controls of service organisations made available to third parties [are available](#). The FRC encourages all managers to adopt [such](#) standards, or an equivalent, if they have not already done so. Where appropriate, asset owners should also consider having their policy statements independently verified.
10. Overseas investors who follow other national or international codes that have similar objectives should not feel the application of the Code duplicates or confuses their responsibilities. Disclosures made in respect of those standards can also be used to demonstrate the extent to which they have complied with the Code. In a similar spirit, UK institutions that apply the Code should use their best efforts to apply its principles to overseas equity holdings.
11. Institutional investors with several types of funds or products need to make only one statement, but are encouraged to explain which of their funds or products are covered by the approach described in their statements. Institutions are also encouraged to disclose whether they adopt a stewardship approach with regard to [all](#) other asset classes in which they invest, including, [for example](#), corporate debt, [property or infrastructure](#).
12. The FRC encourages service providers to disclose how they carry out the wishes of their clients with respect to each principle of the Code that is relevant to their activities.
13. Signatories are expected to review their policy statements annually, and update them where necessary to reflect changes in actual practice.
14. The statement should be easy to find on the signatory's website, or if it does not have a website in another accessible form, and should indicate when the statement was last reviewed. It should include contact details of an individual who can be contacted for further information and by those interested in collective engagement. The FRC hosts on its website the statements of signatories without their own website.
15. The FRC retains on its website a list of asset owners, asset managers and service providers that have published a statement on their compliance or otherwise with the Code, and requests that they notify the FRC when they have done so, and when the statement is updated.

16. The FRC regularly monitors the take-up and application of the Code. It expects the content of the Code to evolve over time to reflect developments in good stewardship practice, the structure and operation of the market, and the broader regulatory framework. Unless circumstances change, the FRC does not envisage proposing further changes to the Code until 2014 at the earliest.

**COMPLY OR EXPLAIN**

1. As with the UK Corporate Governance Code, the Code should be applied on a “comply or explain” basis.
2. The Code is not a rigid set of rules. It consists of principles and guidance. The principles are the core of the Code and the way in which they are applied should be the central question for the institutional investor as it determines how it is to operate according to the Code; the guidance recommends how the principle might be applied.
3. Those signatories that choose not to comply with one of the principles, or not to follow the guidance, should deliver meaningful explanations that enable the reader to understand their approach to stewardship. In providing an explanation, the signatory should aim to illustrate how its actual practices contribute to good stewardship and promote the delivery of the institution’s or its clients’ investment objectives. They should provide a clear rationale for their approach.
4. While the Code operates on a “comply or explain” basis for all signatories, the Financial Services Authority requires all firms authorised to manage funds on behalf of others to disclose “the nature of its commitment” to the Code or “where it does not commit to the Code, its alternative investment strategy” (under Conduct of Business Rule 2.2.3)<sup>1</sup>. The Code thus remains voluntary, but the FSA rule encourages investment managers to consider their stewardship responsibilities and sign up to the Code.
5. The FRC recognises that not all parts of the Code are relevant to all signatories. For example, smaller institutions may judge that some of its principles and guidance are disproportionate in their case. In these circumstances, they should take advantage of the “comply or explain” approach and set out why this is the case.
6. In their responses to explanations, clients and beneficiaries should pay due regard to the signatory’s individual circumstances and bear in mind in particular the size and complexity of the signatory, the nature of the risks and challenges it faces, and the investment objectives of the signatory or its clients.
7. Whilst clients and beneficiaries have every right to challenge a signatory’s explanations if they are unconvincing, clients and beneficiaries should not evaluate explanations in a mechanistic way. Departures from the Code should not be automatically treated as breaches. A signatory’s clients and beneficiaries should be careful to respond to the statements from the signatory in a manner that supports the “comply or explain” process and bears in mind the purpose of good stewardship. They should put their views to the signatory and both parties should be prepared to discuss the position.

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<sup>1</sup> <http://www.fsa.gov.uk/pubs/hb-releases/rel108/rel08COBS.pdf>

## THE PRINCIPLES OF THE CODE

**So as to protect and enhance the value to the ultimate beneficiary,** institutional investors should:

- publicly disclose their policy on how they will discharge their stewardship responsibilities.
- have ~~a robust~~ an effective policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.
- monitor their investments.
- establish clear guidelines on when and how they will escalate their activities in ensuring they meet their policy on discharging their stewardship responsibilities. as a method of protecting and enhancing investor value
- have a clear policy on individual and collective engagement and disclosure of general engagement activity, including, but not limited to, voting.
- report periodically on their stewardship, engagement and voting activities.



## THE UK STEWARDSHIP CODE

### Principle 1

Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.

#### Guidance

Stewardship activities include monitoring and engaging with [investments](#) on matters such as strategy, performance, risk, [capital structure](#), remuneration, [corporate governance](#) and [sustainability](#). Engagement is purposeful dialogue with companies on those matters as well as on issues that are the immediate subject of votes at general meetings and the formal activity of voting itself.

Institutional investors' policy on stewardship should disclose how the institutional investor applies stewardship towards the aim of enhancing and protecting the value for the ultimate beneficiary or client.

The statement should reflect the institutional investor's activities within the investment chain as well as the responsibilities that arise from those activities. In particular, the stewardship responsibilities of those whose primary activities are related to asset ownership may be different from those whose primary activities are related to asset management or other investment-related services.

[This disclosure should be made available on the institutional investor's website, or if it does not have a website in another accessible form.](#)

The disclosure should also describe the institutional investor's include:

- ~~• how investee companies will be monitored. In order for monitoring to be effective an active dialogue may, where necessary, need to be entered into with the investee company's board;~~
- ~~• the strategy on intervention;~~  
internal arrangements, including how stewardship is integrated with the wider investment process; -
- ~~• the policy on voting and the use made of, if any, proxy voting or other voting advisory service, including information on how they are used; and~~
- ~~• the policy on considering explanations made in relation to the UK Corporate Governance Code.~~

## Principle 2

Institutional investors should have ~~a robust~~ an effective policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.

### Guidance

An institutional investor's fiduciary duty is to act in the interests of ~~all its~~ clients and/or beneficiaries ~~when considering matters such as engagement and voting.~~

Conflicts of interest will inevitably arise from time to time, which may include when voting on matters affecting a parent company or client.

Institutional investors should put in place, ~~and~~ maintain, and publicly disclose an effective a policy for identifying and managing conflicts of interest, with the aim of taking all reasonable steps to put the interests of their client or beneficiary first. The policy should also address how matters are handled when the interests of clients or beneficiaries differ.

## Principle 3

Institutional investors should monitor their investments.

### Guidance

An essential component of stewardship is effective monitoring. Investee companies should be monitored to determine when it is necessary to enter into an active dialogue with their boards. This mMonitoring should be regular, ~~and the process clearly communicable~~ and checked periodically for its effectiveness.

As part of this monitoring, institutional investors should seek to:

- keep abreast of the investee's performance;
- keep abreast of developments within and external to the investee that drive the investee's risks, values and valuation;
- satisfy themselves that the entity's leadership is effective;
- ~~seek to~~ satisfy themselves, ~~to the extent possible,~~ that the investee entity's board, committees and other relevant institutions adhere to the spirit of relevant Codes, structures are effective, and that independent directors provide adequate oversight, including by meeting the chairman and, where appropriate, other board members or responsible individuals;

- ~~• maintain a clear audit trail, for example, records of private meetings held with companies, of votes cast, and of reasons for voting against the investee company's management, for abstaining, or for voting with management in a contentious situation; and~~
- **consider the quality of the [entity's reporting](#); and**
- attend the General Meetings of companies in which they have a major holding, where appropriate and practicable.

Institutional investors should consider carefully explanations given for departure from the [relevant Governance Code\(s\)](#) and make reasoned judgements in each case. They should give a timely explanation to the [entity](#), in writing where appropriate, and be prepared to enter a dialogue if they do not accept the [entity's](#) position.

Institutional investors should endeavour to identify issues ~~problems~~ at an early stage [both opportunities to enhance investment value and](#) problems that may result in [impairment](#) in investment value. to minimise any loss of shareholder value. If they have [questions](#) they should seek to ensure that the appropriate members of the investee [entity's](#) board or management are made aware of them.

Institutional investors may or may not wish to be made insiders. They An institutional investor who may be willing to become an insider should indicate in its stewardship statement the willingness of the firm to do so.

Institutional investors will expect investee [entities](#) and their advisers to ensure that information that could affect their ability to deal in the [asset](#) concerned is not conveyed to them without their prior agreement.

[Institutional investors should disclose the use made, if any, of investment related advisory services, this may include, but should not be limited to, voting advisory services. The statement should disclose the extent to which they follow, rely upon or use recommendations made by such services.](#)

## Principle 4

Institutional investors should establish clear guidelines on when and how they will escalate their activities in ensuring they meet their policy on discharging their stewardship responsibilities ~~as a method of protecting and enhancing shareholder value.~~

### Guidance

Institutional investors should set out the circumstances when they will actively engage and regularly assess the outcomes of doing so. Intervention should be considered regardless of whether an active or passive investment policy is followed. In addition, being underweight is not, of itself, a reason for not contributing. Instances when institutional investors may want to intervene include when they have concerns about the company's strategy, ~~and~~ performance, capital structure, ~~its~~ governance, remuneration or its approach to the risks, including those that may arise ~~arising~~ from social and environmental matters.

Initial discussions may take place on a confidential basis. However, if ~~boards~~ entities do not respond constructively when institutional investors intervene, then institutional investors ~~will~~ **should** consider whether to escalate their action, for example, by:

- holding additional meetings with management specifically to discuss concerns;
- expressing concerns through the entity's advisers;
- meeting with the chairman, senior independent director, committee chairs or with all independent directors (or equivalent individuals);
- contributing jointly with other institutions on particular issues (see Principle 5);
- where they occur, making a public statement in advance of General Meetings ~~the AGM or an EGM;~~
- where relevant, submitting resolutions and speaking at General Meetings ~~shareholders' meetings;~~ and
- requisitioning a GM, in order to enforce consideration of the issue in whatever way is deemed most appropriate.

## Principle 5

**Institutional investors should have a clear policy on individual and collective engagement and disclosure of general engagement activity, including, but not limited to, voting.**

### Guidance

At times collaboration with other investors may be the most effective manner in which to engage.

**Collaborative Collective engagement may be appropriate at times of significant corporate or wider economic stress, or when the risks posed threaten **to destroy significant value the ability of the company to continue.** Equally, it may be the most appropriate tool for realising changes to positively increase investment return.**

Institutional investors should disclose their policy on collective engagement, **indicating their readiness to work with other investors through formal and informal groups when this is necessary to achieve their objectives and ensure investees are aware of concerns. The disclosure should also indicate the kinds of circumstances in which the institutional investor would consider participating in collective engagement.**

**~~When participating in collective engagement, institutional investors should have due regard to their policies on conflicts of interest and insider information.~~**

Institutional investors should carefully consider whether voting all shares held contributes to stewardship aims. They should not automatically support the voting recommendations of the board or those of third parties.

If they have been unable to reach a satisfactory outcome through active dialogue then they may wish to consider using votes to oppose management. In such circumstances, it is good practice to inform the company in advance of their intention and the reasons why.

Institutional investors should disclose publicly voting records, including explanation of whether they have voted and why ~~and if they do not explain why.~~

**Institutional investors should disclose their approach to stock lending and recalling lent stock.**

**Institutional investors should describe their approach to nominee ownership arrangements and shareholder identification to facilitate dialogue.**

## Principle 6

**Institutional investors should report periodically on their stewardship activities.**

### Guidance

**Institutional investors should have processes to maintain a clear record of their stewardship activities.**

**Asset managers and service providers** ~~Those that act as agents~~ should regularly report **account** to their clients **or beneficiaries for details of** how they have discharged their responsibilities. Such reports will be likely to comprise qualitative as well as quantitative information. The particular information reported **and the format used** ~~, including the format in which details of how votes have been cast are presented,~~ should be a matter for agreement between agents and their [clients](#).

Transparency is an important feature of effective stewardship. Institutional investors should not, however, be expected to make disclosures that might be counterproductive. Confidentiality in specific situations may well be crucial to achieving a positive outcome.

**Asset owners** ~~Those that act as principals, or represent the interests of the end-investor,~~ should report at least annually to those to whom they are accountable on their **stewardship** policy and its execution.

Those Asset managers that sign up to this Code should consider obtaining an independent audit opinion on their [stewardship](#) processes [having regard to appropriate assurance frameworks](#). The existence of such assurance certification reporting should be publicly disclosed. [Such assurance reports should be available alongside Stewardship Code statements in order to enable readers to ascertain their relevance and robustness.](#)