

The **co-operative** asset management

Chris Hodge
Financial Reporting Council
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Via e-mail to: codereview@frc.org.uk

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Dear Chris,

Revisions to the UK Stewardship Code

The Co-operative Asset Management ("TCAM") welcomes the opportunity to respond to the FRC's consultation on revisions to the Stewardship Code ("the Code"). We have assets under management of around £20 billion as at July 2012 and specialise in active management of equities and bonds.

We consider that sound corporate governance in the companies in which we invest is of central importance to create and sustain long-term shareholder value. We consider that it is the responsibility of institutional investors, such as ourselves, to act as owners of the companies in which they invest.

We were very supportive of the introduction of the Code and were widely considered to be the first institutional investor to make a comprehensive statement of compliance with the Code. We raise compliance with the Code in our engagement with our investee asset managers as well as contributing to the methodology and participating in the annual IMA survey on the topic.

TCAM's comments on specific matters on which views are invited

The definition of stewardship

We believe a definition, as well as a broad description, of stewardship would be beneficial to the Code and its signatories. The consultation document expresses the intention to make good the demand from signatories for a clearer definition of stewardship, then fails to deliver it by offering a description that falls short of the clarity required for the topic.

Furthermore, in our opinion the Code places an over-emphasis on voting when compared to the other pillars of stewardship, such as engagement and other matters pertinent to corporate strategy, behaviour and performance. Voting, and the disclosure of such voting activity, should certainly form an important part of stewardship but alongside engagement and not as the be-all and end-all.

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Disclosure of voting activities

As the remuneration report vote is to be made binding in the UK, there is a corresponding moral obligation on those who can exercise this power to disclose how they use it. Looking at the Stewardship Code compliance statements on the Financial Reporting Council's website it would appear the majority of smaller asset managers and asset owners, whose combined clout is significant, still do not publically disclose their voting records.

Disclosure of voting activities will at least allow the beneficiaries, ordinary people with pensions and investments, to discover whether those who are supposed to be looking out for their long-term financial health, fiduciaries, are voting with those interests in mind. By and large the response of the investor community on the merit of requiring mandatory vote disclosure, among other innovations, has been to assert that change is not needed because investors have the tools they need and are doing a good job. Despite the so-called shareholder spring, the pitifully low number of successful challenges to bad corporate governance in the form of defeated resolutions while remuneration awarded has increased steadily means that at least part of that assertion cannot be true.

The roles of asset owners and asset managers

We would like to see the FRC ask for disclosure on the nature of what a signatory does, its moving parts, relationships and the stewardship responsibilities that do or do not flow from them, and the constraints it is working under. It seems sensible to include this request for signatories to draw this picture in the signatory's pre-amble to their principle-by-principle disclosures or the landing page of their micro site dedicated to Code compliance. Understanding the profile of the signatory right at the beginning will surely make comprehending (and challenging) their responses to the principles easier as well as aiding the comply or explain principle.

Whether the asset class is a collective, an equity, a corporate bond or a family office or other asset owner, the essence of the stewardship imperative does not change. We consider this should be reflected in the final definition.

To this end, the spectrum concept of having asset owners at one end and asset managers at the other may be worth revision. Rather than the FRC set definitions it should be for each signatory to disclose their role and position in the investment chain. Looking to the Principles of Responsible Investment definitions of asset owners and asset managers we see a rigid definition often leads to unintended obliquity in disclosure.

On the topic of asset owners we believe that stewardship could be enhanced by detailing the methods available to asset owners to pursue their stewardship of their assets e.g. making reference to drafting or revision of the Statements of Investment Principles and how to encompass stewardship in the asset manager selection process.

Conflict of Interest

We consider the institutional investor's duty to act in the interests of their clients is a fiduciary one that should be enshrined in the Code and commend the work of FairPensions on the topic of fiduciary duty to you in this context¹.

¹ <http://www.fairpensions.org.uk/fiduciaryduty>

Sustainability

Corporate governance often dovetails with consideration of wider environmental, social and sustainability factors for instance longer term strategic thinking and the inclusion of sustainability factors in executive remuneration. Sustainability is a relevant factor for the Code and brings with it the ability to widen the scope of the concept of stewardship from the Code's beginnings in pure governance to the holistic evolution that aims to encourage a robust present and future economy that can withstand the impact of climate change and natural resource scarcity. As such, the current revisions are a missed opportunity to address the environmental, social and governance risks present in the current and future climate and that form part of being a good steward. Principle 1 and 4 could both benefit from the insertion of reference to environmental, social and governance risks.

Collaborative Engagement

Point 13 on page 6 of the FRC consultation document, seeks "...an indication of the sorts of circumstances in which the investor might participate in collective engagement." In the interests of clarity, it would be more helpful if the signatory were to provide suitable examples of actual collaboration, albeit strictly anonymised if necessary, rather than provide a policy document that speculates rather sterilely on theoretical circumstances where it *might* collaborate.

Asset Owners

We believe that the Code has a vital role to play in stimulating asset owners into acting as stewards, thus driving forward asset managers by default. The current revisions fall short of the catalyst required to make this critical change in culture come about and we urge the FRC to take action in this regard. We concur with UKSIF's view that The Pensions Regulator (TPR) should encourage adoption of the Stewardship Code by pension funds.

Concluding Thoughts

We expect that the two innovations in the consultation that will face the most resistance are:

- 1) the inclusion of 'service providers' among those who should produce a statement of compliance and/or explain why not
- 2) The requirement for Asset Managers to produce an independently verified report on their compliance statements.

In respect of the first point we consider this to be relevant to the current European Securities and Market Association investigation into the regulation of ESG service providers. In our capacity as service providers to our responsible investment overlay clients TCAM would not have any concerns if called to produce an additional stewardship code statement in that capacity.

However, the FRC has not set out the case for why the application of the Code to service providers passes their own tests of necessity, proportionality etc.

Furthermore, the FRC does not appear to provide a definition of what is a service provider and even includes 'investment consultants' along with proxy advisors and engagement overlay providers. This could become a distraction from the task of primary importance, holding Asset Managers and Asset Owners to account for their stewardship responsibilities.

On the second point many asset managers are likely to object that getting independent assurance on their Stewardship Code will incur unreasonable costs. We see similar push back from companies when we discussing the topic of independent verification of carbon emissions and sustainability data. While this may be true, in part, for the small ones it remains the case that we are very supportive of independent assurance where its expectation is reasonable.

May we suggest the FRC consult with The Institute of Chartered Accountants on whether it would be appropriate to apply an AUM threshold to the requirement to gain independent assurance. This would pre-empt the inevitable cost objection and retain the "comply or explain" spirit of the Code.

In addition, given the aspiration for the Code to become an internationally recognised standard we suggest that the FRC should be mindful of the restrictions a specific standard may place on international reporting conventions.

Prima facia, we see no good reason why asset owners should not be expected to seek their own independent verification of their Code statements. This will act as a catalyst for asset owners to hold their appointed asset managers to account on the implementation of stewardship on their behalf.

We remain at your disposal to discuss any or all of the above.

Yours sincerely,



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