

Catherine Horton
Financial Reporting Council
8th Floor
125 London Wall
London
EC2Y 5AS

By email

1st March 2018

Dear Sir/Madam,

Re. Consultation on Corporate Governance Code

Kames Capital is a global investment company based in the UK with assets under management of €50.6bn. Kames is also a subsidiary of the AEGON Asset Management Group, which has assets under management of €309bn. As an active investment manager, Kames' welcomes the opportunity to respond with comments on the FRC's consultation on proposed changes to the Corporate Governance Code and Stewardship Code.

Please find our response in the proposal attached to this letter.

Yours sincerely,

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Q1. Do you have any concerns in relation to the proposed Code application date?

Our only concern is that many companies could adhere to the revised guidelines earlier than this, so should be encouraged to adopt as soon as possible or the earliest reporting on the new code will not be until early 2020. That would not reflect well when pressure is already mounting on the standards in governance now.

Q2. Do you have any comments on the revised Guidance?

The section on the impact of the commitments of the Chair to be explained in the annual report should be extended to all non-executive directors as it is important that all have the time and ability to fulfil their duties properly.

Q3. Do you agree that the proposed methods in Provision 3 are sufficient to achieve meaningful engagement?

As adherence to the code is still on a comply or explain basis, we believe that each company should select a mechanism that works for its own circumstances. The company should be able to explain why it is the correct mechanism for gathering stakeholder feedback and how such feedback is fed into board discussions.

However, as the UK has a unitary board structure, we are concerned that if such a stakeholder representative was to be appointed to the board, that they would not properly fulfil the directors' duties as outlined in the Companies Act. All directors should have sufficient skills to contribute to the success of the company on behalf of all stakeholders, not one particular subset.

Q4. Do you consider that we should include more specific reference to the UN SDGs or other NGO principles, either in the Code or in the Guidance?

While we consider the UN SDG's in our analysis we do not believe reference should be made in the Corporate Governance Code. We believe it is up to the shareholders to decide what ESG issues are material to companies and engage on them.

Q5. Do you agree that 20 per cent is 'significant' and that an update should be published no later than six months after the vote?

Yes, we support the threshold being set at 20% and appreciate Investment Association Public Register as a useful tool for us to monitor progress made by companies by way of engagement or commitment to change.

A 6 month update would provide plenty of time to enter into meaningful shareholder engagement and to decide on a plan of action, if one is needed. However, details on what is expected from the 6 month update would be useful i.e. the reasons given by shareholders for the voting dissent, how many shareholders were contacted as well as any actions to be taken as a result.

Q6. Do you agree with the removal of the exemption for companies below the FTSE 350 to have an independent board evaluation every three years? If not, please provide information relating to the potential costs and other burdens involved.

Yes, we encourage all companies regardless of size to strive for the best standards of corporate governance. However, we would like emphasis placed on the comply or explain nature of the code, to ensure that smaller companies can decide what suits the particular circumstances and not feel forced into a structure that doesn't suit. Such companies should be able to articulate clearly why the deviations from the code are in the best interests of that company.

Q7. Do you agree that nine years, as applied to non-executive directors and chairs, is an appropriate time period to be considered independent?

While we agree the clarification of independence is appropriate for the role of non-executive director, we do not agree with it being applied to the Chair of the company.

The position of Chair of the company is different to any other non-executive in that the relationship built up with the Chief Executive and the time commitment required to fulfil the role effectively means that once appointed, it is hard to justify calling the Chair independent. In addition, if the company were in a period of change in the executive team, the Chair becomes a steady influence in the company.

So, while we support the premise of being independent on appointment, we do not believe the independence test should apply to the Chair thereafter. If we are unhappy with the performance of the Chair, we can vote against their election at the next Annual General Meeting.

Q8. Do you agree that it is not necessary to provide for a maximum period of tenure?

Yes, while most boards practice frequent refreshment of their members, we believe the company is best placed to decide if someone needs to stay longer than 9 years as long as they are not deemed to be independent.

Q9. Do you agree that the overall changes proposed in Section 3 of revised Code will lead to more action to build diversity in the boardroom, in the executive pipeline and in the company as a whole?

Yes, we strongly believe that diverse boards leads to better decision making and our focus is on diversity in its broadest sense. So taking account of all elements of diversity in the recruitment process and monitoring the board regularly will contribute to the board reaching its potential

Q10. Do you agree with extending the Hampton-Alexander recommendation beyond the FTSE 350? If not, please provide information relating to the potential costs and other burdens involved.

As mentioned in Q6, we encourage all companies to strive for the best standards of corporate governance and we would expect smaller companies to be able to explain if they cannot meet the Hampton Alexander recommendations.

Q11. What are your views on encouraging companies to report on levels of ethnicity in executive pipelines? Please provide information relating to the practical implications, potential costs and other burdens involved, and to which companies it should apply.

As mentioned earlier, we are strong believers in diversity in its broadest sense, however, ethnicity is harder to categorise and is largely defined on an individual basis, and therefore it would be challenging to implement disclosure in the same manner as gender diversity.

Q12. Do you agree with retaining the requirements included in the current Code, even though there is some duplication with the Listing Rules, the Disclosure and Transparency Rules or Companies Act?

We have no objections to these overlapping.

Q13. Do you support the removal to the Guidance of the requirement currently retained in C.3.3 of the current Code? If not, please give reasons.

Yes

Q14. Do you agree with the wider remit for the remuneration committee and what are your views on the most effective way to discharge this new responsibility, and how might this operate in practice?

We are supportive of the remuneration committee understanding the remuneration of the workforce as the executives should not be remunerated in an inconsistent manner to the rest of the staff. However, we are a little concerned that the wording as it stands could be misunderstood and lead to a pseudo executive function being carried out by the remuneration committee thus impacting their independence. We encourage this role to be carefully defined in the code to prevent such a misunderstanding.

Q15. Can you suggest other ways in which the Code could support executive remuneration that drives long-term sustainable performance?

We do not believe particular structure of remuneration should be codified, we encourage companies to set remuneration appropriate for the circumstances of the business and closely linked to strategy.

However, we believe the members of the remuneration committee, and in particular the Chair of the remuneration committee should have served on the board for more than 12 months to ensure they have a thorough understanding of the personnel, operations and strategy of the company.

We support the inclusion of Provision 36, we believe best practice is for plans to last 5 years and it is useful for this to be reflected in the code

Q16. Do you think the changes proposed will give meaningful impetus to boards in exercising discretion?

While we are in favour of a level of discretion to be built into the remuneration framework, we would not want unlimited discretion to be included as it renders the whole framework meaningless.

We would rather the code focussed more on encouraging the use of discretion in a responsible manner. Formulaic outcomes should be assessed in light of overall company performance and experience of the shareholders and other stakeholders over the measured period, if there is a discrepancy then the discretion written into the policy should be used in an appropriate way.

UK Stewardship Code Questions

Q17. Should the Stewardship Code be more explicit about the expectations of those investing directly or indirectly and those advising them? Would separate codes or enhanced separate guidance for different categories of the investment chain help drive best practice?

We agree that there should be more specific roles for the different parts of the investment chain, in particular, the asset owners. We believe that Stewardship will only progress if all parts of the investment chain are engaged in the responsibilities.

We would not be in favour of different codes for the different participants as we believe that would only lead to confusion.

Q18. Should the Stewardship Code focus on best practice expectations using a more traditional ‘comply or explain’ format? If so, are there any areas in which this would not be appropriate? How might we go about determining what best practice is?

Stewardship is part of the Investment process that varies across different firms and largely dependent on client expectations. We would therefore not support explicit roles and procedures for stewardship.

It would be useful for the FRC to highlight a variety of different “best practice” stewardship so that clients can better understand the difference of approach and quality between different investment managers.

Q19. Are there alternative ways in which the FRC could highlight best practice reporting other than the tiering exercise as it was undertaken in 2016?

While the Stewardship Code Statements are an important part of the process, it would be useful if the FRC looked at how those statements were applied and what the stewardship activities are reported.

Q20. Are there elements of the revised UK Corporate Governance Code that we should mirror in the Stewardship Code?

While the spirit of both codes is similar. The Stewardship code is set against a backdrop of commercial relationships between client and investment manager and as such they can vary in the manner they manage these relationships and how they fulfil their stewardship responsibilities. Many of the aspects of the code would not allow the flexibility that is required and therefore we do not believe there should be any mirroring.

Q21. How could an investor’s role in building a company’s long-term success be further encouraged through the Stewardship Code?

n/a

Q22. Would it be appropriate to incorporate ‘wider stakeholders’ into the areas of suggested focus for monitoring and engagement by investors? Should the Stewardship Code more

explicitly refer to ESG factors and broader social impact? If so, how should these be integrated and are there any specific areas of focus that should be addressed?

While investors engage on ESG issues as part of their stewardship activities, these issues need to be material to the companies in question.

It would therefore not be useful to have a specific list of issues ranging across stakeholder and ESG matters to engage on as it may lead to a compliance based approach to engagement rather than a more meaningful materiality based discussion. Consequently, we would not be in favour of additions of this type to the code.

Q23. How can the Stewardship Code encourage reporting on the way in which stewardship activities have been carried out? Are there ways in which the FRC or others could encourage this reporting, even if the encouragement falls outside of the Stewardship Code?

It could encourage adherence to the Investment Association Stewardship Reporting Framework.

Q24. How could the Stewardship Code take account of some investors' wider view of responsible investment?

While we would not want a proliferation of different expectations specified for different asset classes, the Stewardship code could encourage the disclosure of how Investment Managers exercise their responsibilities for all their managed assets.

Q25. Are there elements of international stewardship codes that should be included in the Stewardship Code?

We believe that most of the international codes are largely based on the UK model, so we do not see the need for any more additions.

Q26. What role should independent assurance play in revisions to the Stewardship Code? Are there ways in which independent assurance could be made more useful and effective?

We currently get independent audit assurance conducted once a year, but we do not find it particularly insightful or useful as a reflection of our stewardship activities. Perhaps a review of how these are conducted would be useful.

Q27: Would it be appropriate for the Stewardship Code to support disclosure of the approach to directed voting in pooled funds?

We would not support the Code requiring disclosure on this. We believe there are significant benefits in pooling assets in relation to these activities such as the ability of the Investment manager to use their full weight of holding in engagement with companies without dilution of multiple messages caused by differing policies on behalf of some clients. Furthermore, there are reasons that splitting votes of pooled fund assets is not possible.

- Operational – Pooled fund Clients have willingly given up certain rights such as individual voting policies in order to benefit from reduced fees, benefits of scale of a pooled vehicle. The extra time and cost associated with trying to determine what portion of the fund would need to be voted in a different manner would impact all the clients in the fund and could lead to votes failing to be cast because of the manual nature of splitting votes.
- Legal – In OEIC's, clients do not own the underlying assets in the fund, only units of the entirety. As such, they are not able to direct voting for any of the underlying assets. All of the shares in the funds are voted in accordance with the Kames Capital Responsible Investment Policy.
- TCF - we are responsible for treating all our customers fairly. If we were to adopt the Red Line Policy for one pooled fund client we would risk breaching TCF for other clients.

Q28: Should board and executive pipeline diversity be included as an explicit expectation of investor engagement?

While we are fully supportive of the principle of diversity in companies at all levels, we believe the issues we engage on have to be material to the companies in question. We therefore do not believe the code should be specific on engagement topics and should remain a high level code.

Q29: Should the Stewardship Code explicitly request that investors give consideration to company performance and reporting on adapting to climate change?

As is our response to the question above, the code should not specify engagement topics.

Q30: Should signatories to the Stewardship Code define the purpose of stewardship with respect to the role of their organisation and specific investment or other activities?

This could easily be included in the response to principle 1.

Q31: Should the Stewardship Code require asset managers to disclose a fund's purpose and its specific approach to stewardship, and report against these approaches at a fund level? How might this best be achieved?

No, we believe this would lead to a great deal of complication and complexity in reporting.