Email

29 March 2019

Dear Sirs,

I am responding on behalf of Charles Stanley & Co Limited, a UK-based wealth manager and investment platform that manages and administers approximately £25 billion of portfolios on behalf of predominantly retail investors. In the context of the Code, we are an 'asset manager'.

As a signatory to the UK Stewardship Code, we applaud the efforts of the FRC in continuing to develop the Code. In the interest of brevity, our comments here are narrowly restricted to the issue that is of primary concern to us. We are concerned that aspects of the proposed changes are geared more towards larger asset management groups, and may not be sufficiently flexible to accommodate smaller asset managers or indeed investment managers operating segregated portfolios on their clients' behalf. On our reading of these changes, we fear that if we continue to act in our clients' best interests we may struggle to remain a signatory.

We agree with the core statement on page 1 of Appendix A:

> *This definition identifies the primary purpose of stewardship as looking after the assets of beneficiaries that have been entrusted to the care of others.*

The essence of this statement is that, as managers and administrators of client assets entrusted to our care, the definition of Stewardship means only 'steward of client assets'. Put another way: whilst our firms are stewards of client assets, we are not stewards of investee companies; the only stewards of an investee company will be the management of that company. Nor are we 'stewards of the market', as suggested on page 16 of the paper; again, we are stewards only of our clients' assets. There is the risk of confusion that arises from the increasingly common use of the term 'stewardship' as a synonym for 'engagement', rather than in its normal legal use as implying a duty of care that it is acknowledged that shareholders – and intermediaries acting on their behalf - do not have in law towards investee companies. As stewards of client assets, we have the right to engage with investee companies, but we do not have a legal obligation to do so.

The Law Commission acknowledges in its 2014 report on fiduciary duties that 'stewardship' in the sense of a legal duty towards an investee company may apply where a trustee has a significant or controlling shareholding, however the legal case cited refers to a 99.8% shareholding as triggering the obligation, the implication being that insignificant shareholdings (e.g. 0.2%) won't trigger a stewardship obligation in this sense. Later the Law Commission notes:

> *5.19 We did not think that pension trustees had an enforceable legal obligation to engage in the stewardship of companies. However, for large funds, stewardship was one possible tool. Where a company is in danger of making poor long-term decisions it may be more effective to engage with the company to influence the decision, rather than simply sell the shares. We commented that such direct engagement is expensive and may be beyond the resources of most trustees.*

The Law Commission weighs views before concluding:

> *5.97 Our conclusion is that, at present, there is no duty on pension trustees or other investors to undertake stewardship activities. Nor is there a direct duty on investment*

> *managers, provided that they explain why they are not complying with the Stewardship Code. If the Government wished to go beyond the "comply or explain" approach of the Stewardship Code, this would require a change in the law.*

This acknowledges that investment managers don't presently have a legal obligation to engage in 'stewardship', in the sense of a duty to engage directly with investee companies.

The significance of this goes beyond semantics or legal niceties – in our role as shareholders on behalf of investor clients, depending on circumstances the appropriate course of action may frequently be not to engage, but to sell an investment; 'exit' rather than 'voice'. Conversely, forced engagement may act to the significant detriment of our investors if it involves certain costs to clients without a reasonable prospect of benefit to them, for example where clients' aggregate shareholding is insignificant, something that will be the norm for smaller asset and investment managers.

As a result:

- we would appreciate further guidance on what 'constructive' means in Principle H: *Signatories must undertake constructive engagement to maintain or enhance the value of assets*. Is there a de minimis holding size below which engagement would not be constructive, or is engagement required in all circumstances regardless of likely impact. It is not clear whether a proportionality principle applies.

- we do not see how it will be practical or desirable for smaller managers to adopt an 'Apply and Explain' approach to Principle J: *Signatories must actively exercise their rights and responsibilities*. If this is a blanket requirement, it risks being contrary to the best interests of the clients of smaller managers for the reasons outlined above.

In conversation with our trade association PIMFA, we have been discussing the likely need for all discretionary managers (not just those with professional clients) to adopt an Engagement Policy, as a requirement of the revised Shareholder Rights Directive. Our gut feeling at this stage is that the UK Stewardship Code is probably moving away from being a feasible option for wealth management firms serving a mix of retail and professional investors, and that it may be better aligned with our clients' interests for us to adopt such an SRD Engagement Policy as the 'alternative investment strategy' permitted under COBS 2.2.3(ii).

I hope that this is useful feedback. As mentioned, it is high level rather than detailed. Please do let me know if you have any questions.

Kind regards,

Robert Howard