

September 2012

Feedback Statement

Revisions to the UK Stewardship Code

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Introduction and Conclusions

In April 2012 the Financial Reporting Council issued a consultation document setting out a series of proposals to amend the UK Stewardship Code, which were intended to:

- Clarify the aim and definition of stewardship;
- Delineate more clearly the varying responsibilities of different types of institutional investors;
- Address issues identified in the FRC's December 2011 report on the impact and implementation of the Stewardship and UK Corporate Governance Codes;
- Address a small number of other issues fundamental to stewardship that previously had not been dealt with in the Code;
- Edit the previous text where needed to create greater consistency across the Code; and
- Provide more information, where needed, on how the Code is expected to be implemented.

Consultation closed on 13 July 2012. This paper summarises the main points from the responses, the decisions taken by the FRC and their rationale. These are set out in more detail later in this report, but the main points are summarised below.

Comments received were generally supportive, and the majority of changes on which the FRC consulted will be implemented, notably:

- The proposed definition of stewardship (paragraph 5 of the consultation document) will be incorporated into the Code, as will the wording around the roles of asset owners and asset managers (paragraphs 6 to 9);
- The revisions around collective engagement (paragraphs 12 and 13) will be included, as will the requirement to disclose an organisation's approach to stock lending (paragraphs 17 to 19);
- Signatories to the Code are encouraged to identify to which of the products under management the statement is applied (paragraph 21);
- The proposal to strengthen Principle 7 to state that asset managers "should obtain" an assurance report has been included (paragraphs 22 to 24). Some managers argued against this change but, as with all the Code's other principles, they retain the ability to explain rather than comply; and
- The introductory section of the Code has been amended to request that signatories review their policy statements annually, update them as necessary, and indicate the date of their last review (paragraph 25).

The proposal that investors should indicate whether or not they were willing to be made insiders (paragraphs 26 to 28) has been adopted, but expanded to suggest that, where they are, they should also indicate the mechanism by which this could be done.

The proposed additional wording in the introductory section of the Code to clarify the role of service providers (paragraph 30) has been incorporated, but extended to emphasise that while investors may choose to outsource some of their stewardship activities to service providers, they cannot delegate their responsibility for stewardship. This point has also been reflected in the guidance to Principle 1.

The FRC has also implemented the proposal to require further disclosure on the use made of proxy voting or other voting advisory services (paragraphs 14 to 16). In addition, signatories will be expected to identify the providers of proxy voting or other voting advisory services, in the same way as changes being made to the UK Corporate Governance Code will require companies to identify external advisors to the board and committees.

Several respondents felt strongly that this section of the Code needs to be extended to address directly the way in which proxy voting agencies carry out their activities. The FRC has not introduced any such changes to this edition of the Code, but will review the need to do so in the light of market and regulatory developments.

Proposed references to overseas equities and other asset classes in the introductory sections of the Code (paragraphs 20 to 21) had been interpreted by some respondents as extending the scope of the Code. To address this misperception, it is now explicitly stated in the introductory section that the Code is directed in the first instance to institutional investors with equity holdings in UK listed companies. The wording on other asset classes has been revised to clarify that, where signatories apply a stewardship approach to assets other than equities, they are encouraged but not required to disclose that they do so.

The proposed change to Principle 2 which would have required an “effective” conflicts of interest policy (paragraphs 10 and 11), will now not be implemented, as respondents considered that this would have presented a significant challenge to independent assurance reporting as envisaged by a framework such as the Stewardship Supplement to AAF 01/06. Instead, Principle 2 will continue to refer to the need for a “robust” policy.

The other proposed changes set out in the consultation document and shown in the draft revised Code have been incorporated, in some cases with minor amendments.

Summary of responses

The consultation on changes to the UK Stewardship Code attracted 51 responses. 12 responses were from asset managers, seven from asset owners and two from listed companies. In addition, nine respondents were from service providers, 17 from representative bodies, three from membership organisations and one from an academic institute. Copies of all responses, with the exception of those that respondents asked to be kept confidential, are available on the FRC website.

Responses on the specific questions asked in the consultation document are summarised below.

Proposed definition of stewardship

Most respondents felt the proposed wording on stewardship was useful and appropriate, and it has therefore been incorporated. A small minority did not find the phrase “the division of duties within and between institutions may span a spectrum” in paragraph six of “Stewardship and the Code” helpful. Some respondents felt that the concept of a “spectrum” was confusing compared to the model of the traditional investment chain. However, paragraph five of “Application of the Code” makes it clear that “the statement of how the Code has been applied should be aligned with the signatory’s role in the investment chain.”

The roles of asset owners and asset managers

The majority of respondents welcomed the proposed clarification of the role of asset owners in exercising their stewardship responsibilities, and this has therefore been retained. There was support from respondents for further guidance for asset owners as to how they can carry out their stewardship responsibilities. This is something the FRC would encourage the market to consider developing.

Conflicts of interest

The majority of feedback to the proposed re-wording of Principle 2 from “robust” to “effective” was negative; as a result, the wording from the 2010 Code has been retained with no change. The issue was the impact that the use of “effective” may have on signatories wishing to use the AAF 01/06 framework to obtain an independent opinion on their engagement and voting processes under the revised Principle 7 of the Code. Assurance reporting as envisaged in the Stewardship Supplement to AAF 01/06 is intended to provide an opinion as to whether the policies and processes in relation to the application of specified Principles and related disclosures have been fairly described. However, “effective” would require the design and operational effectiveness of the relevant policies and processes to be tested, which goes beyond what the current Supplement is designed to support.

There was strong support for improved disclosure around conflicts of interest, with some respondents wanting the revisions to the guidance to Principle 2 to be stronger. Some asset owners wished to see their managers describe more fully their organisational context, for example, whether they were part of a wider financial services group, and the reporting lines between the manager and the wider group. The FRC will assess the quality of disclosure under the revised Code before considering whether further changes are needed in future editions.

The use of proxy voting or other voting advisory services

There was strong support for the FRC's proposals to improve disclosure of investors' use of proxy voting agencies within the guidance to Principle 6, with several respondents commenting that the Code needs to be strengthened even further in this area.

The guidance under Principle 1 in the 2010 version of the Code encouraged investors to disclose their policy on voting and the use made of any proxy voting or other voting advisory service. This has been moved to the guidance for Principle 6, and extended to encourage investors also to describe what types of services are provided and disclose the extent to which they follow or rely upon recommendations made by such services. In addition, under the revised Code, signatories will also now be asked to identify the providers of proxy voting or other voting advisory services, in the same way as changes being made to the UK Corporate Governance Code will require companies to identify external advisors to the board and committees.

In addition, wording has been added to "Application of the Code" reminding institutional investors that although they may choose to delegate some of the activities associated with stewardship to service providers (which include, but are not restricted to, voting advisory services), they retain responsibility for ensuring those activities are carried out in a manner consistent with their own approach to stewardship.

A similar sentiment has been added to the Guidance to Principle 1. In addition to the proposed new wording emphasising that the statement of how the Code had been applied should reflect the institutional investor's responsibilities and position in the investment chain – which was supported by respondents - the revised Code says that the statement should also explain what steps the investor has taken to ensure outsourced activities are carried out in a manner consistent with their approach to stewardship.

Representatives from listed companies and their representative bodies submitted a number of additional requests for requirements to be added to the Code addressing the process followed by the proxy voting agencies. The FRC has not introduced any such changes to this edition of the Code, but will review the need to do so in the light of market and regulatory developments. It is still unclear, for example, whether the European Commission intends to regulate or require disclosure of the activities of proxy voting agencies following the recent consultation by the European Securities and Markets Authority.

Extending the Code to other asset classes

The UK Stewardship Code is derived from 'The Responsibilities of Institutional Shareholders and Agents: Statement of Principles,' first published in 2002 by the Institutional Shareholders Committee, and consequently has always been directed primarily towards institutional investors with equity holdings in UK listed companies.

However, the FRC recognises that asset owners may wish to adopt a stewardship approach to other parts of their portfolio, and may therefore wish to know which managers apply stewardship principles to some or all other asset classes. Certain managers and owners have previously informed the FRC that they already apply a common approach to their holdings in global equities and other asset classes.

For this reason, where institutions apply a stewardship approach to other asset classes in addition to their equity holdings in UK listed companies, the FRC proposed that this could be disclosed. Some respondents interpreted the proposed wording as formally extending the scope of the Code to other asset classes. This was not the FRC's intention, and it is now explicitly stated in paragraph two of "Application of the Code" that the Code is directed in the first instance to institutional investors with equity holdings in UK-listed companies. In addition, the wording on other asset classes has been revised to clarify that, where signatories apply a stewardship approach to other assets, they are encouraged but not required to disclose that they do so.

A number of respondents also raised concerns about the existing wording (now in paragraph nine of "Application of the Code") which encourages UK investors, on a best efforts basis, to apply the principles of the Code to their overseas equity holdings, and welcomes overseas investors who might seek to apply the Code to their holdings of UK equities. This was interpreted by some respondents as an attempt to apply the Code extraterritorially.

This was not the intention. Rather, the wording addressed to overseas investors is intended to reassure them that, if they are already applying a stewardship approach in accordance with other codes, they do not necessarily need to introduce new processes or practices in order also to sign up to the UK Stewardship Code. The wording addressed to UK investors is simply an encouragement to apply good practice to all their equity investments to the extent possible, recognising that in some markets there are barriers that make it difficult for them to do so. In the event that other national or international codes are introduced, the FRC recognises that some degree of mutual recognition will be required in practice to avoid global investors being required to comply with a large number of codes.

The FRC also proposed that signatories be encouraged to explain which of their UK equity funds or products were covered by the approach described in their statement. This was in response to comments from asset owners that it is unclear from some signatories' statements whether they apply the Code's principles to some or all of their funds under management. The majority of respondents were strongly supportive, but a minority were concerned that such a disclosure would be impractical. The FRC has retained the wording, and would encourage signatories to provide this information where it is practical for them to do so.

Assurance

The amendments to Principle 7 state that managers "should obtain" an assurance report rather than "should consider obtaining" as in the 2010 Code. Some asset managers were opposed to the change on the grounds of additional bureaucracy and cost. However, since signatories retain the option to explain against this Principle if they wish, the revision was supported by a majority of respondents, including most of the major institutions. The proposed wording has been retained, as has the statement that assurance reports should be made available to clients on request.

One question raised by some respondents was whether asset owners are also expected to apply the AAF 01/06 framework to their own stewardship disclosures, particularly where stewardship activities are undertaken in-house or through a service provider. The framework is primarily designed to assure reporting on activities carried out by asset managers on behalf of their clients. However, the FRC has sought to address this point in paragraph 8 of "Application of the Code", which invites asset owners to consider having their policy statements independently verified. As this is only in the introductory section of the Code, it is not a formal requirement.

Frequency of review

The FRC proposed that signatories be encouraged to review their policy statements annually, update them as necessary, and indicate the date of their last review. This was supported by the majority of respondents and has therefore been incorporated, although a minority felt it could be onerous.

The FRC has noted from its own monitoring that there have been a few cases where policy statements have not been updated, even when there are known to have been changes in the signatory's approach or processes. In practice, signatories may have decided to wait until the launch of the 2012 Code before reviewing their policy statement.

Inside Information

There was widespread support for the proposal to revise the reference to inside information in Principle 3 to remove the implicit assumption that investors were unlikely to wish to be made insiders. The reference now reads: "Institutional investors may or may not wish to be made insiders. An institutional investor who may be willing to become an insider should indicate in its stewardship statement the willingness to do so, and the mechanism by which this could be done."

Other topics raised by respondents

A number of minor editorial changes have also been included to reflect points made by respondents. They include, for example, the addition of capital structure and culture as suitable topics for engagement within the guidance to Principle 1. Following a suggestion from a respondent, the FSA disclosure requirements for asset managers are now explained in paragraph 4 of "Comply or Explain", with a link in a footnote to the FSA's Conduct of Business Rules, to aid international investors who are unfamiliar with the UK regulatory framework.

Pro rata voting within pooled funds was highlighted in responses received from both asset owners' representative bodies and a number of the larger owners. In their responses, some pension funds called on the FRC to introduce a "comply or explain" expectation that fund managers should allow their clients to vote the shares attributable to them within pooled funds. One also commented that "it might be helpful if the FRC and other regulators looked at whether there is a regulatory or other legal barrier to pro rata voting." The FRC has not made any addition to this edition of the Code but intends to facilitate a roundtable of market participants in 2013 to help encourage debate on this issue.



The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries; and oversee the regulatory activities of the accountancy and actuarial professional bodies.

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