



26 February 2018

Dear Ms Horton

We are pleased to submit our comments on the FRC's consultation on revisions to the Stewardship Code. We have provided general comments against the relevant specific Principles.

Best regards

Dr Julia Mundy
University of Greenwich

Professor Lisa Jack
University of Portsmouth

Principle 3: Monitoring of investee companies

Several academics studies, including our current report ('Is the Stewardship Code fit for purpose?' available from Dr Mundy at J.Mundy@gre.ac.uk), indicate that the purpose of monitoring is to support investment decisions. Monitoring of a company is more likely to take place when asset managers are unable to divest their shares, but maximising investment returns remains the primary objective. Direct monitoring is determined by a host of factors: recovery stocks or 'problem' firms; shareholdings in which the size of the equity stake is a high absolute value or a high percentage of the overall fund or a high proportion of the investee's share capital; the availability of internal resources; and ready access to investee firms, both in terms of location and cultural acceptance; and the access afforded by the companies. Lack of resources and time creates a mismatch between the top twenty investors of a PLC and the top twenty investments of an asset manager. Thus, smaller PLCs are not able to attract the attention of their major investors and smaller asset managers are unable to obtain access to their major investee companies. Our study indicates that asset managers regard monitoring as both costly and risky; hence, decisions not to monitor companies should not automatically be regarded as a dereliction of duty.

Our study challenges the notion that asset managers engage in 'purposeful dialogue' with their investee companies. The fund managers, analysts, and ESG managers we interviewed estimate that they spend 70-95% of their time in private meetings listening and the remainder asking questions and challenging decisions. Notably, their concerns about the limits of their expertise combined with their desire to conceal their investment intentions makes them wary of offering opinions or seeking to influence. We therefore suggest that the term 'purposeful dialogue' is replaced in the Code with 'constructive challenge'; this is a more specific type of behaviour that can be reported, and it reflects the reality and limits of engagement.

Principle 5: Willingness to act collectively with other investors where appropriate

The findings from our current report ('Is the Stewardship Code fit for purpose?' available from Dr Mundy at J.Mundy@gre.ac.uk) indicate that there are clear limits to collective engagement because asset managers do not wish to reveal their investment plans to competitors. Collective engagement is likely to be reactive and requires that asset managers' interests are perfectly aligned. ESG managers are more inclined to collaborate with their counterparts at other firms, and use the PRI Clearing House to share high-level information about specific ESG issues. In summary, collective engagement is unlikely to have much impact without changes to incentives or market structures.

Principle 7: Periodic reporting on stewardship and voting activities.

The findings from our current report ('Is the Stewardship Code fit for purpose?' available from Dr Mundy at J.Mundy@gre.ac.uk) indicate that it is not easy to obtain demonstrable evidence for the benefits of engagement. The fund managers and ESG managers we interviewed struggled to provide concrete examples beyond specific governance issues such as the removal and appointment of senior executives. Furthermore, such changes were thought to be more likely when aligned with the company's own views. Despite the use of engagement for investment purposes, it does not follow that stewardship is entirely absent from the asset manager-PLC relationship. Prior academic research has found that PLCs internalise the requirements of their investors, and this may also be true of stewardship concerns.

Voting actions should not be regarded a useful proxy for engagement or stewardship. It has a cost attached to it and should therefore be used only when necessary. We find that votes against a company's resolutions are viewed as a last resort by asset managers because they could signal that engagement has failed and can also antagonise a company. In summary, attempts to introduce objective or 'hard' measures of engagement or incentives for 'desired' behaviours are likely to result in 'gaming' behaviours and increased costs, and should therefore be strongly resisted.