19 April 2010

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Dear Susannah

Consultation on a Stewardship Code for Institutional Investors

Thank you for the opportunity to comment on your proposals.

Summary and Rationale

Stewardship Matters
UKSIF strongly supports the introduction of a Stewardship Code for institutional investors.

High quality stewardship is essential for long-term wealth creation and protection as well as to meet the broader interests of society and so protect the continuing "licence to operate" of asset owners and their agents.

We believe that the Stewardship Code should have more challenging policy objectives that are focused specifically on delivering this outcome.

Key Drivers for Success
The implementation of the Stewardship Code must not be just an initiative to regulate institutional investors. It must also harness the power of asset owners and change investment industry culture, ie. it must combine regulatory power with the "remunerative" power of asset owners and the "normative" power created by market commentators and civil society.

In particular, the success of the Code will depend on genuine demand from pension funds and other asset owners which create commercial drivers for high quality implementation. In support of this, The Pensions Regulator (TPR) should demand greater transparency from pension funds on how their responsible ownership policies are implemented.

In addition, leadership, transparency, independent monitoring, a market in assessment using ranking / awards and the involvement of a broader range of stakeholders are needed to create an investment industry culture that values and rewards success in stewardship.

UKSIF therefore sees the following as essential to the success of the Stewardship Code:
- Commercial incentives for high quality implementation
- A culture of "pride in commitment" and "leadership not compliance" among senior industry executives
- Meaningful transparency, robust implementation measurement and effective external scrutiny.

Because institutional investment is now a global industry, the engagement of non-UK investors is essential. This can be facilitated by alignment between Stewardship codes as they develop across the world together with compatible requirements for reporting on stewardship both at the global level and between different jurisdications. Initially, to facilitate support from leading responsible asset owners and their agents, it is particularly important to secure compatibility between reporting using the Stewardship Code and using the UN-backed Principles for Responsible Investment (PRI).

A range of improvements should be made to the Institutional Shareholders' Committee Code before it is adopted as the Stewardship Code. This submission gives our proposals for improvements below. For example, to support a robust market in stewardship solutions, the Code should make it clear that stewardship can be implemented using a range of institutional investment services, including independent engagement services.

Role of the Sustainable and Responsible Investment Community
UKSIF believes that the sustainable and responsible investment community has an important role to play in the effective implementation of the Stewardship Code, alongside bodies such as the Association of British Insurers (ABI), Investment Management Association (IMA) and National Association of Pension Funds (NAPF) and civil society.

Sustainable and responsible investment practitioners take a pro-active approach to sustainability governance as well as other forms of corporate governance, they have a clear vision of a future in which there are additional opportunities and challenges for responsible owners resulting from climate change, resource management and social sustainability drivers and, collectively, they represent a wide range of asset owners including insurance companies, pension funds, church, charity and both strictly financially motivated and more values-based individual investors. As representatives of asset owners and their agents, their role is grounded in the business case for long-term responsible investment approaches, ie. they are investment practitioners rather than civil society representatives.

Terminology
We note that your consultation document uses the terms "institutional investors" and "institutional shareholders" to refer to the agents of asset owners rather than to the asset owners themselves. We have followed this practice in our response. We have referred to asset owners, both institutional and individual, as "clients".

Section 1: Introduction

Policy Objectives to be addressed by the Stewardship Code
Paragraph 1.14

We support the objectives proposed (on your Page 5). However, we believe that the Stewardship Code needs to be defined and implemented in such a way that there is a "race to the top" in implementation not a compliance-driven approach.

As a result, we would like to see the following changes to the first and final policy objective to ensure a clearer focus on an outcome of changed institutional investor behaviours driven by meaningful client demand:

Objective 1: Set **high** standards of stewardship to which mainstream institutional investors **and their clients** ~~should~~ aspire, and maintain the credibility and quality of these standards through independent input on the content and monitoring of the Code;

Objective 5: Secure ~~sufficient~~ **high quality** disclosure ~~to~~ **that** enable**s** institutional shareholders' prospective clients to assess how those managers are acting in relation to the Code **and is** ~~so that this can be~~ taken into account when awarding and monitoring fund management mandates.

Amendment of the ISC Code to become the Stewardship Code
Paragraph 1.16

In our view, the ISC code should be amended by the Financial Reporting Council to address the issues identified in this submission before it is adopted as the Stewardship Code.

Scope of the Stewardship Code: Institutional Investors, Agents, Disclosure Requirements, Monitoring Arrangements
Paragraph 1.17

Which Institutional Investors and Agents should be encouraged to apply the Stewardship Code
We see a need to approach this issue from two perspectives.

First of all, all significant medium and long term institutional investors in UK companies (listed and unlisted) should be encouraged to apply the code, This includes the agents of insurance companies, pension funds, sovereign wealth funds, churches and charities and those investing collectively or in segregated portfolios for high net worth individuals and/or the general public. In particular, this encouragement should not be restricted to institutional investors based in the UK and subject to the oversight of the Financial Services Authority.

Secondly, where these institutional investors are based in the UK, they should be encouraged to apply the Stewardship Code to their management of all relevant investments, not just companies incorporated or listed in the UK.

Disclosure Requirements – What and to Whom
Please see our comments in Sections 3-5 below.

Monitoring Arrangements
Please see our comments in Section 5 below.

Section 2: Background and Recent Developments

Lessons from experience outside the UK
Paragraph 2.18

In our view, the UN-backed Principles for Responsible Investment (PRI) offer an example of successful implementation of a Stewardship Code outside the UK. Critical success factors that have driven its success include:

- A global standard that is applicable to both asset owners and their agents, rather than a standard applicable only in one jurisdiction
- Strong drive and demand from clients, ie. major asset owners, individually and collectively
- Robust and independently funded monitoring

In Denmark, investors can use their PRI progress reports to implement the Danish legal requirement for disclosure of corporate responsibility information. This has minimised duplication of information provision and encouraged commitment to the Principles.

In the United States, mutual funds are required to disclose their voting records. This has enabled the provision online of information for consumers, eg. at www.socialinvest.org/resources/mfpc/proxy.cfm. However, while it has resulted in useful data, the value of this data has been limited by a lack of associated explanation for voting decisions made. The Stewardship Code should therefore support the disclosure of explanations for key voting decisions.

Section 3: The Coverage of the Code

Barriers to use of the Stewardship Code by UK institutional investors
Paragraph 3.6

As with any other investment activity, institutional investors will need to deploy resources to apply and report on the Stewardship Code. Use of the Code therefore needs to be justified by client demand. In our view, regulator demand alone is unlikely to drive effective implementation.

Effective client demand follows from

- Recognition of the benefits of the Code from both the practitioner community and from civil society
- A robust practitioner and civil society debate about performance standards against it.

Civil society understanding depends in part on transparent and easily accessible information. In our view, it is therefore essential that institutional investor reporting against the Stewardship Code is put into the public domain on a web site or similarly accessible medium rather than being available only to clients or on request.

We would also like to see further implementation support measures to address this barrier, including:

- Encouragement of stronger client demand, including by The Pensions Regulator and via the Investment Governance Group. For example, The Pensions Regulator (TPR) should demand greater transparency from pension funds on how their responsible ownership policies are implemented.
- Encouragement of "soft regulation" measures such as awards or logos based on independent assessment against a minimum standard ("quality mark") and/or a published ranking ("gold / silver / bronze" standard).

Commitment from Research & Voting Agencies & Investment Consultants
Paragraph 3.9

We strongly support measures to encourage Investment Consultants to commit to the spirit of the Code. This is because they normally act as agents of investment clients rather than of institutional investors. For this reason, the active support of Investment Consultants could have a material impact on the successful implementation of the Code by encouraging and support client demand.

We support measures to encourage agents of institutional investors to commit to the spirit of the Code. However, we see this as a significantly lower priority than client support for the Code.

Institutional investors use not only proxy voting agencies but also environmental, social and governance (ESG) research agencies in support of their stewardship activities. Processes to support commitment by voting agencies and investment consultants to the Stewardship Code should therefore include these research agencies within their scope.

The Principles for Responsible Investment (PRI) allows and encourages such agencies and consultants to become signatories. Its experience may provide useful pointers to how best to manage support for the Code from these groups. Details are available at www.unpri.org.

Foreign and Cross-Border Shareholders
Paragraphs 3.13 & 3.14

Because institutional investment is now a global industry, the engagement of non-UK investors is essential. This can be facilitated by alignment between Stewardship codes as they develop across the world together with compatible requirements for reporting on stewardship both at the global level and between different jurisdications.

The Principles for Responsible Investment (PRI) are supported by a strong and growing range on international institutional investors and their clients. To facilitate support from leading responsible asset owners and their investment managers,it is essential to ensure compatibility between reporting using the Stewardship Code and using the UN-backed Principles for Responsible Investment (PRI). Any requirement to report differently between the two could act as an unnecessary duplication of effort for all PRI signatories engaging with UK companies.

Please see also our comment on your Paragraph 2.18 above about the Danish approach.

Section 4: The Content of the Code

Comments on the current ISC Code
Paragraph 4.2, Appendix B

Use of terminology
The use of the term "institutional investor" appears to vary between the ISC Code on the one hand and your Stewardship Code consultation document on the other, In our view, this inconsistency reflects a wider issue about where responsibility sits for effective delegation and management of ownership responsibility within the investment chain. More clarity and consistency of terminology is needed.

Introduction and Scope
The ISC code fails to highlight or arguably recognize the "universal owner" and "license to operate" arguments for taking a strategic approach to fiduciary responsibility. We propose that, in the paragraph which starts "Fulfilling fiduciary obligations …"), the final sentence (The duty of ..) should be deleted and replaced with:

These benefits include both the direct value of well-managed investments and the value to current and future portfolios of economies, societies and environments that enable sustainable wealth creation.

Principle 1: Public disclosure of stewardship policy
We would propose the addition of the following bullets:

- *The policy in relation to long-term responsible investment [or "sustainable investment" or "environmental, social and ethical issues"] including key initiatives supported, eg. the United Nations-backed Principles for Responsible Investment (PRI)*

- *The policy in relation to market failures that impact the ability to engage; and the strategy on public policy engagement in support of sustainable financial and commercial markets*

In addition, to support a robust market in stewardship solutions, the Code should make it clearer that stewardship can be implemented using a range of institutional investment services, including independent engagement services. In particular, in the guidance accompanying Principle 1, it should not be assumed that the integration of stewardship with other aspects of the investment process necessarily takes place within a single institutional investor as clients may have placed mandates for different parts of the process with different investment service providers, It should also be made clearer that stewardship can be combined with passive management.

Principle 4: Intervention
This principle should be rewritten to address continuing positive engagement with companies to improve their performance, as well as in response to issues of concern.

Principle 7: Reporting
We would propose replacement of current paragraph 2 (starting "Transparency is ..") by

Transparency to stakeholders is an important feature of effective shareholder engagement. Institutional shareholders and agents should make public disclosures at least annually on the implementation of their engagement policy at a level which enables effective civil society scrutiny. They should not make disclosures where confidentiality might reasonably be crucial to achieving a positive outcome, but should implement trustworthy processes to keep such areas under critical review.

Please see also our comments on your Paragraph 5.3 below.

ISC Code's coverage of <u>Section E of the Combined Code</u>
Paragraph 4.4, Appendix C

We broadly agree with the comments made in the submission of Hermes Equity Ownership Services Ltd, an UKSIF member, on this aspect of the Code.

<u>Section 5: Reporting, Monitoring and Review</u>

Information Disclosed Publicly and Reported to Clients, (b) Monitoring and (c) Reviewing the Operation and Content of the Stewardship Code
Paragraph 5.2

Please see comments below.

Specific <u>information disclosed</u> and level of detail of "comply or explain"
Paragraph 5.3

We recommend that the Financial Reporting Council should work with institutional investors to develop best practice guidance on client reporting and public disclosure. This guidance should allow information users to compare relative performance accurately and with confidence.

Public disclosure
Paragraph 5.6

Please see our comments on the ISC Code's Principle 7 and on your Paragraph 5.3 above.

ISC Code: Structure
Paragraph 5.10

We have no specific comments on this.

ISC Code: Client Reporting and Independent Audit
Paragraph 5.14

Please see our comments on your Paragraph 5.3 above.

Monitoring the Application of the Stewardship Code
Paragraph 5.21

We hope that the results of monitoring will result in high trust from clients and civil society in the quality of reporting by institutional investors and will encourage this reporting to drive investment manager selection.

To ensure this level of trust, it is essential that monitoring of the code takes place in a way in which conflicts of interest are both minimised and managed. Those monitoring the code should be visibly independent of those being monitored.

In our view, this requires that monitoring takes place under the management of the Financial Reporting Council, at full commercial cost and with selection using an open and competitive tender process. In addition, there needs to be a robust approach to those conflicts of interest which remain. Consideration should be given to requiring that those undertaking the monitoring do not, at the same time, provide services to institutional investors monitored (ie. to agents rather than to clients).

Reviewing the Stewardship Code
Paragraph 5.22

We support the approach proposed; however, we would recommend the appointment of a broad-based consultative stakeholder group to support the review process. This could be based on the model of the Financial Reporting Council's actuarial user group which was set up jointly by the Board for Actuarial Standards and the Professional Oversight Board.

The following key stakeholders should be represented:
- Direct clients of investment institutions, such as occupational pension funds, insurance companies and charities
- Beneficiaries of these clients
- Investment consultants and financial advisers
- Investment industry professional associations
- Investment institution executives
- Publicly listed companies, particularly those recognised as having a sustainable and responsible long-term approach to wealth creation
- Media
- Consumers, civil society and the broader public interest ("the common good")
- Regulators and government.

UKSIF – the Sustainable Investment and Finance Association
UKSIF, the sustainable investment and finance association, promotes responsible investment and other forms of finance that support sustainable economic development, enhance quality of life and safeguard the environment. We also seek to ensure that individual and institutional investors can reflect their values in their investments. We aim to support the UK finance sector to be the world leader in advancing sustainable development through financial services.

UKSIF was created in 1991 to bring together the different strands of sustainable and responsible finance nationally and to act as a focus and a voice for the industry. UKSIF's 200+ members and affiliates include pension funds, institutional and retail fund managers, investment banks, financial advisers, research providers, consultants, trade unions, banks, building societies and non-governmental organisations. For more information about UKSIF, please visit www.uksif.org.

UKSIF supports long-term responsible investment and ownership. It focuses its corporate governance support on the interface between governance on the one hand and social, environmental and ethical issues on the other.

With best wishes

Penny Shepherd

Penny Shepherd MBE
Chief Executive
UKSIF – the sustainable investment and finance association