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Dear Chris

2009 Review of the Effectiveness of the Combined Code

Thank you for the opportunity to contribute to this review. Our comments aim to complement those of others by focusing on why and how the Combined Code should address long-term responsible investment and sustainable development concerns[1].

Supporting a Sustainable Economy

Today, we face an urgent need for the efficient and effective re-allocation of capital to build a low-carbon, resource efficient, socially sustainable economy. UK listed companies, as users of capital, play an essential role in achieving this transition. Financial institutions among them have additional key powers and responsibilities.

It is in the interests of the long-term owners of UK companies and in the wider public interest that financial institutions and other UK listed companies are managed in such a way that this capital re-allocation takes place effectively. This is particularly relevant for major asset owners who own a broad swathe of the economy and therefore have interests as "universal investors"[2].

The Combined Code must support and encourage this by laying down relevant standards of good practice for companies, their owners (ie. institutional shareholders) and the investment institutions that act as agents for their owners.

In our view, many companies are still not providing responsible investors and other stakeholders with the information that they need to integrate sustainability issues into their analysis. There is often limited forward-looking guidance on the company's sustainability strategy. More generally, when information is not disclosed freely, executives can influence ratings and investment analysis and so prevent an efficient market by withholding key insights from those who draw unflattering conclusions.

In addition, Financial Services Secretary Paul Myners has described current City behaviour as "an entirely rational response to commercial incentives" that results in "a failure to take account of the longer-term consequences of investment activity, including impact on the broader economy and society"[3]. This suggests that major asset owners (institutional shareholders) are failing to incentivise and measure their agents appropriately.

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[1] We have covered more general corporate governance concerns only where we feel that we may have something material to add to the submissions of others.
[2] See definition on Page 4 of "Universal ownership: Exploring opportunities and Challenges" (Conference Report, April 2006) at http://www.mercer.com/attachment.dyn?idContent=1241115&filePath=/attachments/English/MIC_UO_Report.pdf
[3] Speech by Lord Myners, Financial Services Secretary, to Investment Management Association (IMA) Annual Dinner on 19 May 2009. See hm-treasury.gov.uk/speech_fsst_190509.htm.

In our view, key features of a sustainable investment system include:

- **Pension schemes, insurance companies and other major asset owners** that believe that they must ensure the health of the economy and environment so that they can achieve sustainable income and capital growth.
- **Investment managers**, incentivised to deliver effective ownership and long-term returns, that vote to unseat company management that seek short-term profits at the expense of either the company's long-term health or the wealth-generating capability of the economy as a whole.
- **Companies** that report publicly on a range of relevant ESG information. They disclose their sustainability strategy and all information used for financial ratings. Their non-executive directors have the time and resources for effective scrutiny. Directors refuse additional roles that may introduce conflicts of interest into the institutional investment chain. Remuneration encourages long-term thinking and concern for ESG issues. Major financial institutions and other key companies may have directors appointed to represent the public interest.

During its periodic reviews, the Combined Code should be assessed on its achievements in supporting these outcomes.

One key indicator of success would be that UK listed companies routinely and systematically seek to improve rather than degrade ecosystems, confident that investors value superior performance on this as well as on conventional financial metrics. For example, oil companies would never seek to exploit Canadian tar sands – corporate remuneration policies would discourage it and any carbon intensive business strategy would be rejected decisively by investor vote.

Recommendations

In support of this, we recommend the following improvements to the Combined Code:

Part 1: Companies

1. Management of environmental, social and governance (ESG) risks and opportunities and corporate performance and disclosure on ESG issues should be improved by incorporating the Association of British Insurers (ABI) guidelines on responsible investment disclosure[4], redrafted into a "comply or explain" format, into the Combined Code. This includes requiring ESG matters to be addressed in risk management, board training and access to information, and executive remuneration.

   If it was not felt appropriate to address management of ESG matters on a "comply or explain" basis then a meaningful improvement to address corporate disclosure would be to incorporate the ABI guidelines unchanged.

2. Greater emphasis should be given in the Combined Code to the importance of integrity and values.

3. Company boards should publish a robust audit of the potential conflicts of interests of its directors and how these are managed and mitigated. More robust guidance may also be needed on when directors should refuse additional roles that may introduce conflicts of interest into the institutional investment chain.

4. Investors should be offered the ability to comment directly on sustainability disclosures and strategies by a separate vote on the enhanced business review, including on a forward looking corporate sustainability strategy.

5. For major financial institutions and other companies with significant impact on society and the environment, consideration should be given to encouraging the appointment of non-executive directors specifically to represent the public interest.

[4] Available at www.abi.org.uk/Members/circulars/viewAttachment.asp?EID=15636&DID=14121

Part 2: Institutional shareholders

6. The Combined Code should distinguish more clearly between asset owners (eg. pension funds, insurance companies) and their agents, the investment managers.

7. To support responsible ownership of assets, a broader approach is needed to the responsibilities of asset owners such as pension funds, insurance companies and sovereign wealth funds. This needs to address governance of the asset owners themselves (where not already addressed elsewhere) and good practice in their contractual relationships with their agents. The Combined Code should include reference to the work of the Investment Governance Group[5] and add its weight to encouraging “comply or explain” reporting against the revised Myners principles. It should also encourage major asset owners to sign and implement the internationally accepted and UN-backed “Principles for Responsible Investment”[6].

8. UKSIF’s recent report “Responsible Business: Sustainable Pension 2009”[7] and its earlier report “Local Government: Responsible Pension” highlight good practice by occupational pension funds and make associated recommendations. These recommendations should be considered for inclusion in the Combined Code. The 2009 report assesses the responsible investment practices of the corporate pension funds of UK listed companies that are Corporate Responsibility leaders, while the 2007 report considers Local Government Pension Scheme (LGPS) funds.

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. Our overall strategic objective is to ensure that the UK finance sector is 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, please visit www.uksif.org.

With best wishes

Penny Shepherd

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

[5] Details at www.thepensionsregulator.gov.uk/igg/index.aspx.
[6] Available at www.unpri.org.
[7] Available at www.uksif.org/sustainablepensions.