



# New UK Stewardship Code for institutional investors

The Financial Reporting Council (FRC) has published the UK Stewardship Code (the Code), setting out good practice for institutional investors when engaging with the UK listed companies in which they invest. It hopes this will be a catalyst for better engagement between shareholders and companies. The FRC has adopted the Institutional Shareholders' Committee (ISC) Code with only limited changes – in particular, the ISC Code's seven principles and related guidance. The FRC encourages all institutional investors to report on the extent to which they follow the Code; it will list those who have done so on its website from October 2010.

## Background – the ISC Code

The UK Stewardship Code (the Code) is based on the code that covers the responsibilities of institutional investors, published by the Institutional Shareholders' Committee (ISC) Code in November 2009. The ISC's members are the Association of British Insurers, the Association of Investment Companies, the Investment Management Association and the National Association of Pension Funds. The Financial Reporting Council (FRC) has taken responsibility for the Code, as recommended by Sir David Walker's report on the governance of banks and other financial institutions.

## Who does the Code apply to?

### Asset managers

The Code applies primarily to firms that manage assets for institutional shareholders such as pension funds, insurance companies, investment trusts and other collective investment vehicles. The FRC expects those firms to disclose on their websites how they have applied the Code. Institutions that manage several types of fund only need to make one statement.

### Institutional investors

The FRC strongly encourages all institutional investors to report if and how they have complied with the Code. The FRC points out that pension funds and other owners who may not wish to engage directly can contribute by, for example, mandating their fund managers to

do so on their behalf and scrutinising their reports on engagement.

### Service providers

The FRC encourages service providers (such as proxy voting agencies) that engage with companies on behalf of investors to disclose how they apply the principles of the Code that are relevant to their activities.

### Overseas investors

The FRC encourages investors based outside the UK to engage with the Code. The FRC points out that overseas investors who follow their own national or international standards 'should not feel application of the Code duplicates or confuses their responsibilities' – in particular, by using the 'explain' option in the website report. They might use disclosures made about non-UK standards to demonstrate the extent to which they have complied with the Code.

UK institutions that apply the Code should use their best efforts to apply its principles to overseas holdings.

## How the Code applies

### Comply or explain

Institutional shareholders are free to choose whether or not to engage but the FRC advises that 'their choice should be a considered one based on their investment approach'. Those who choose to engage should apply the Code on a 'comply or explain' basis – as with the

## Summary of the main points

### Better engagement

- The FRC believes the Code is an opportunity to build a critical mass of investors committed to high-quality dialogue with companies. This should support the 'comply or explain' approach of the UK Corporate Governance Code.
- The fact that the FRC is now responsible for the Code brings welcome renewed emphasis to the shareholders' role in corporate governance. It is also likely to mean that the Code will receive increasing prominence in shaping the expectations placed on those who invest on behalf of others.

### The Code's principles

- The Code comprises seven principles, with guidance for each principle, in largely the same form as the ISC Code. The principles require institutional investors to:
  - publicly disclose their policy on how they will discharge their stewardship responsibilities;
  - have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed;
  - monitor their investee companies;
  - establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value;
  - be willing to act collectively with other investors where appropriate;
  - have a clear policy on voting and disclosure of voting activity; and
  - report periodically on their stewardship and voting activities.

### 'Comply or explain'

- The FRC expects those who manage assets for institutional shareholders to report on their website how they apply the Code by the end of September 2010 – and to notify the FRC when they have done so. The FRC strongly encourages all institutional investors, including overseas investors, to report.
- The website report should:
  - describe how the Code's principles have been applied and disclose the specific information listed under principles 1, 5, 6 and 7; or
  - explain why these parts of the Code have not been complied with.
- The FRC urges those who provide proxy voting and other advisory services to make appropriate disclosures.
- The FRC will list those investors that have published a statement on their compliance, or otherwise, with the Code on its website from October 2010.
- The Financial Services Authority (FSA) will consult shortly on proposals to introduce a compulsory 'comply or explain' requirement for authorised asset managers.
- UK institutions that apply the Code should use their best efforts to apply its principles to overseas holdings.

### Further review

- The FRC will monitor the take-up and application of the Code and is planning regular reviews. The EU is also considering using stewardship codes and other ways to motivate shareholders to engage with companies, and this may have implications for the Code. The FRC has already identified areas for further consideration, including whether investors should disclose their policies on stock lending.

UK Corporate Governance Code for listed companies.

The institution's website should:

- describe how the principles of the Code have been applied and disclose the information listed under principles 1, 5, 6 and 7; or
- explain why these elements of the Code have not been complied with.

The statement should name an individual who can be contacted for further information and by those interested in collective engagement.

The FRC recognises that not all parts of the Code will be relevant to all institutional investors. In particular, smaller institutions may consider some of the principles and guidance disproportionate; if they do, they should explain why in the 'comply or explain' statement.

## Website statement

The FRC strongly encourages all institutional investors to publish a statement on their website of the extent to which they have complied with the Code by the end of September 2010 – and to notify the FRC when they have done so. Those that have already published a statement of how they have applied the ISC Code 'are encouraged to refresh it in the light of the new Code'.

The FRC will list those investors that have published a statement on their compliance, or otherwise, with the Code on its website from October 2010.

## FSA consultation on mandatory 'comply or explain'

The FSA will consult shortly on proposals to introduce a compulsory 'comply or explain' requirement for authorised asset managers.

## The Code's principles

The Code has seven principles and gives guidance for each principle. They are largely the same as those in the ISC Code. The changes incorporate the guidance for institutional investors previously in Section E of the Combined Code (now replaced by the UK Corporate Governance Code), and align the Code with the guidance on shareholder engagement in the UK Corporate Governance Code.

### Principle 1

'Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.'

- No substantive change to the ISC Code's principle or guidance.

### Principle 2

'Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.'

- No substantive change to the ISC Code's principle or guidance.

### Principle 3

'Institutional investors should monitor their investee companies.'

The guidance on principle 3 has been amended to encourage investors to:

- meet the chair of companies in which they invest – and other board members where appropriate – as part of their monitoring (and not only when they have concerns);
- attend the general meetings of companies in which they have a major holding, where appropriate and practicable; and
- consider carefully companies' explanations for not following the UK Corporate Governance Code, and make reasoned judgements in each case. They should give a timely explanation to the company, in writing where appropriate, and be prepared to discuss it if they do not accept the company's position.

### Principle 4

'Institutional investors should establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.'

- No substantive change to the ISC Code's principle or guidance.

### Principle 5

'Institutional investors should be willing to act collectively with other investors where appropriate.'

- No substantive change to the ISC Code's principle or guidance.

### Principle 6

'Institutional investors should have a clear policy on voting and disclosure of voting activity.'

- No substantive change to the ISC Code's principle or guidance.

### Principle 7

'Institutional investors should report periodically on their stewardship and voting activities.'

- No substantive change to the ISC Code's principle or guidance.
- The guidance to principle 7 continues to state that investors should consider obtaining an independent audit opinion on their engagement and voting processes. An Institute of Chartered Accountants in England and Wales working group is preparing guidance on this issue, with a stakeholder panel including fund managers, pension funds and auditors. The guidance will be issued for consultation later in 2010. The FRC comments that asset managers may wish to wait until the guidance has been finalised before considering whether to comply with this part of the Code. Overseas institutions should take an approach to verification that is consistent with that in their own jurisdiction.

## Monitoring and review

The FRC will begin full annual monitoring of the take-up and application of the Code in the second half of 2011. The Investment Management Association will continue its regular engagement survey, which is being tailored to cover adherence to the Code, and will review adherence in 2010 and provide initial benchmarking data. The FRC will discuss how to promote and develop the Code with the Institutional Investor Council being established by the ISC.

The FRC plans to review the content and impact of the Code regularly to reflect developments in good engagement practice, in market structure and operation, and the broader regulatory framework. It also wishes to reassess some of the issues raised in response to its January 2010 consultation on the Code – for example, whether institutional investors should disclose their policies on stock lending, arrangements for voting pooled funds and the nature of the information to be disclosed on voting records. A decision on the timing of the first review will be made in the second half of 2011.

#### Useful links

- Stewardship Code, FRC consultation document on the Code and responses  
[www.frc.org.uk/press/pub2306.html](http://www.frc.org.uk/press/pub2306.html).
- ISC Code  
[institutionalshareholderscommittee.org.uk/sitebuildercontent/sitebuilderfiles/ISCCode161109.pdf](http://institutionalshareholderscommittee.org.uk/sitebuildercontent/sitebuilderfiles/ISCCode161109.pdf).
- Sir David Walker's recommendations  
[webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/walker\\_review\\_information.htm](http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/walker_review_information.htm).
- UK Corporate Governance Code  
[www.frc.org.uk/documents/pagemanager/CorporateGovernance/UK%20Corp%20Gov%20Code%20June%202010.pdf](http://www.frc.org.uk/documents/pagemanager/CorporateGovernance/UK%20Corp%20Gov%20Code%20June%202010.pdf).
- Freshfields briefing on the UK Corporate Governance Code  
[www.freshfields.com/publications/pdfs/2010/May10/28244.pdf](http://www.freshfields.com/publications/pdfs/2010/May10/28244.pdf).

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