FairPensions™
The campaign for **responsible** investment

Fairshare Educational Foundation
Trowbray House
108 Weston Street
London SE1 3QB
020 7403 7800
fairpensions.org.uk

Hayden Johnston
Conduct Policy Division
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

By email to: cp10_15@fsa.gov.uk

1 September 2010

Dear Mr Johnston,

FairPensions welcomes the opportunity to respond to the proposals on *Disclosure of commitment to the Stewardship Code principles* contained in the FSA's Quarterly Consultation No 25. FairPensions is a project of The Fairshare Educational Foundation, a registered charity (no 1117244) established to promote Responsible Investment by UK pension schemes and fund managers, and to ensure that the ultimate beneficiaries are well served by institutional investors and other professional agents in the investment world.

FairPensions is a member organisation. Our members include organisations representing the beneficial owners of pension schemes, such as the Occupational Pensioners Alliance, UNITE and Unison, as well as thousands of individual pension fund members.

We believe that effective corporate governance is essential to the protection of beneficiaries' assets and the long-term health of the wider economy. We have a history of engagement with the post-financial-crisis reviews of this issue, including the Walker Review and the FRC's consultations on the Corporate Governance Code and the Stewardship Code, and we continue to engage actively with the FRC on the implementation and development of the Stewardship Code. We reproduce some relevant passages of our Walker Review submission below where they are relevant. All of our previous submissions can be found on our website at http://www.fairpensions.org.uk.

Introductory remarks

Before answering the specific questions, we would like to make one small point about process. We have previously visited the FSA to discuss ways of reaching out to interested parties beyond regulated entities, as we are concerned that the voice of civil society and consumer groups can sometimes be under-represented in consultation processes.

We only became aware of this consultation document three weeks before the deadline, partly due to its being contained in the Quarterly Consultation rather than published as a stand-alone document. We are aware that many small organisations like ourselves do not have the capacity to exhaustively monitor all consultations carried out by regulatory bodies, and therefore that many organisations representing beneficial owners, who have a strong interest in the content of this consultation, may have been unable to respond to it.

Given the large number of responses to the FRC's consultation on the Stewardship Code from trade unions and civil society organisations, we very much hope that the consultation elicits a full and balanced range of responses, representing the interests of institutional clients and beneficial owners as well as those of the regulated entities affected by the proposals. If this proves not to be the case, we would once again urge the FSA to give fresh consideration to how it might encourage and facilitate a greater range of responses.

Question 13: Do you agree that we should introduce a new rule in COBS, as outlined in Appendix 5?

We welcome the FSA's attention to Recommendation 20 of the Walker Review, which we regard as important to improving transparency and encouraging shareholder engagement. To this extent, we agree with the proposal to introduce a new rule. However, we have some concerns about the content and scope of the proposed rule.

Firstly, the proposed requirement is "restricted to firms that are managing investments on behalf of professional clients that are not natural persons".[1] This would seem to exclude FSA-regulated firms providing personal pensions to individual pension savers. We are unsure why this is felt to be desirable, or indeed consistent with the Walker Review. Recommendation 20 states that the FSA should require "institutions that are *authorised to manage assets for others*" (our emphasis) to disclose information about their commitment to the Stewardship Code. No distinction is made here between natural persons and institutional clients. Neither was such a distinction made in CP10/3, which stated the FSA's intention to "require *investment firms* to disclose publicly the extent to which they comply with the Stewardship Code".[2]

The consultation paper states that the aim of the recommendation is "to secure sufficient disclosure to allow prospective clients of asset managers to make informed decisions".[3] Individual pension savers are also prospective clients, and we are unsure why it is felt unnecessary to provide them with the same level of information. As we understand it, part of the purpose of the transparency regime surrounding the Stewardship Code is to drive client demand for effective shareholder engagement up the investment chain. We believe that such demand is most likely to be driven by the beneficial owners whose money is at stake.

Moreover, as a number of respondents to the FRC's consultation on the Code pointed out, 'stewardship' should refer not just to stewardship of investee companies, but to stewardship of the assets entrusted to institutional investors by beneficial owners. It seems inconsistent in this context to disregard assets entrusted by the increasing number of individual savers who purchase investment products directly rather than through, for instance, trust-based occupational pension schemes.

Our second concern relates to the limited content of the proposed disclosure rule. We understand that "the nature of [a firm's] commitment" is to be interpreted simply as a binary statement of whether or not a firm applies the Stewardship Code. We believe that this would be insufficient. We note that CP10/3 indicated that, for many firms, "a more detailed consideration of how the Code will apply to their business and how they observe or fail to observe it will be

[1] CP10/15, Para 5.10.
[2] CP10/3, Para 6.33.
[3] CP10/15, Para 5.8.

required."[4] We would interpret this as including a breakdown of how the firm applies each individual Principle of the Stewardship Code, rather than a broad brush statement about their application of the Code as a whole.

This more detailed information is particularly crucial at this early stage of the Code's existence, when a settled interpretation of its provisions has yet to be established. For example, the guidance to Principle 6 states that "institutional investors should disclose publicly voting records and if they do not explain why." This explicit comply-or-explain provision within a comply-or-explain Code would seem to suggest that investors can fail to disclose their voting records, and still claim to be in full compliance with the Code, providing they give an explanation. However, the Preface to the Code appears to suggest that compliance does require disclosure of voting records, and we understand that this is indeed the FRC's intention.

Because of such ambiguities, a simple statement of whether or not a particular firm applies the Code will not meet the FSA's objective of securing "sufficient disclosure to allow prospective clients of asset managers to make informed decisions".[5] We do not regard disclosures on commitment to the Code as simply a badge or label that allows clients to see at-a-glance whether an asset manager 'does' stewardship. Rather, it should be a framework that allows clients to judge, on each of the key areas outlined in the Code, the *effectiveness* of that asset manager's stewardship activities.

We would therefore urge the FSA either to redraft the proposed rule, or to provide further guidance about the detailed information that should be disclosed by firms who do express commitment to the Stewardship Code.

Question 14: Is there any reason why other categories of firm should be excluded from the scope of this requirement? Please explain your position.

We do not see any reason to exclude other categories of firm from the scope of this requirement. In particular, we agree with the FSA's proposal not to exclude "asset managers whose business models place greater emphasis on active trading."[6] Part of the purpose both of Recommendation 20 and of the FSA's proposals for implementation is that such asset managers will be required to clearly state that they do not engage. 'Pre-screening' firms so that the disclosure requirements only apply to those whom the FSA might expect to engage would seem to prejudge the operation of the disclosure regime.

Indeed, if anything we would suggest that the scope of the requirement has been drawn too narrowly rather than too broadly: please see our comments on Q13 above.

Question 15: Do you agree that a general disclosure would suffice in cases where asset managers' clients have different expectations or requirements?

No comment.

[4] CP10/3, Para 6.33.
[5] CP10/15, Para 5.8.
[6] CP10/15, Para 5.16.

Question 16: Do you agree that disclosure should be through the firm's website? What other methods of disclosure would be appropriate (e.g. via the prospectus, or periodic reporting) to make the statement accessible?

Yes, we agree that disclosure should be through the firm's website, as suggested in Recommendation 20 of the Walker Review. This is important not only because it is easily accessible for prospective investors, but because it is publicly accessible. It should not be forgotten that the impetus for the Walker Review's Recommendations on investor stewardship was the recognition that inadequate stewardship contributed to the financial crisis, and that there was therefore a strong public interest in more effective stewardship. As Sir David Walker noted,

"The context is a major asymmetry under which, from one standpoint, the liability of shareholders in major listed banks is limited to their equity stakes, while from the other standpoint… the liability of the taxpayer is seen to have been unlimited."[7]

We would therefore urge that any alternative methods of disclosure which are sanctioned as appropriate must be easily accessible to the public, and not only to a narrowly-defined class of prospective institutional clients. However, given the unlikelihood of any asset management firm not having a website, our starting point would be that allowing for alternative (as opposed to additional) methods of disclosure is unnecessary.

Question 17: Do you agree with our assessment that the increase in costs for firms as a consequence of our proposed requirement will be of minimal significance?

Yes. Particularly given that most firms will be publishing detailed information as per the FRC's requirements, the additional costs of the disclosures required by the FSA would seem likely to be negligible, and in some cases non-existent.

We remain at your disposal and would welcome the opportunity to meet with you to discuss any or all of the above.

Yours sincerely,

Louise Rouse

Louise Rouse
Acting Chief Executive, FairPensions

[7] Walker Review: Final Recommendations, Preface (Page 6)