Investor Stewardship

PARLIAMENTARY BRIEFING

The Financial Reporting Council (FRC)'s recently-published 'Stewardship Code'[1] is a response to the glaring failures of responsible share-ownership seen prior to the financial crisis. Major banks' risky business models and poor decision-making went unchallenged by their investors, with devastating consequences for the economy – including for pension savers, whose funds lost an average of 17% of their value.[2] In his 2008 Review, Sir David Walker recommended that the FRC extend its remit to promoting better investor oversight of major companies.[3]

THE STEWARDSHIP CODE: IN BRIEF

Institutional investors should:

1. Publicly disclose their policy on discharging their stewardship responsibilities
2. Have a robust, publicly disclosed policy on managing conflicts of interest
3. Monitor their investee companies
4. Establish clear guidelines on when and how they will escalate these activities
5. Be willing to act collectively with other investors where appropriate
6. Have a clear policy on voting and public disclosure of voting activity
7. Report periodically to clients on their stewardship and voting activities.

Source: the UK Stewardship Code

The publication of the Code is a welcome development. But it would be a mistake for government to assume either that it will automatically produce high levels of investor compliance with its principles, or that those principles are strong enough to avoid a repeat of the financial crisis.

The Code's provisions are not mandatory; it seems unlikely that the necessary sea change in investor behaviour will take place without strong government support for the FRC. The degree of political consensus on this point is encouraging: both Labour[4] and the coalition government[5] have publicly declared support for the Code.

Government must also clearly state its support for a strengthened Code. It is somewhat disappointing that the FRC opted to adopt the existing industry-led Code[6] – which many regard as too weak - almost unchanged. The FRC's commitment to an early review of the Code's provisions is therefore particularly welcome. Stewardship Codes being drafted by other jurisdictions – such as South Africa's – are already outstripping the UK Code in scope and ambition.[7]

Shareholder oversight is seen by many as a substitute for regulation of listed companies. If measures to improve shareholder engagement are not themselves robust and properly enforced, we risk a double regulatory failure.

RECOMMENDATION

The government should work with the FRC to set published criteria for assessing the Stewardship Code's success, and should clearly state its willingness to regulate if these criteria are not met by a specified review date.

> *"The UK's Stewardship Code for institutional shareholders should be strengthened..."*
>
> \- Labour Party Manifesto 2010[8]

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Voting disclosure

If responsible ownership is to become the norm, improved transparency is vital. Demand is most likely to come from the ultimate asset owners – i.e. pension savers and insurance policy holders – whose money is at stake. For this market mechanism to work, consumers must have the right to see how their shareholder power is being used – including through the exercise of voting rights. In the aftermath of the financial collapse, there is also a clear public interest in knowing how investors vote on contentious issues such as executive pay.

Yet despite years of voluntary codes, there is little evidence that disclosure of voting records by institutional investors is improving:

- In response to recent parliamentary question, the government stated only that the proportion of investors who disclose "has improved since 2004", without indicating the data on which this was based.[10]
- Between 2008 and 2010, the proportion of pension funds disclosing voting information even to their members stagnated at 24% - with even fewer disclosing their voting records publicly.[11]
- Initiatives like the TUC's annual fund manager voting survey have been left to fill the gap – and the number of investors participating in this survey is actually falling, from 68% in 2005 to under 40% in 2009.[12]

Although we understand that the FRC does expect investors to disclose their voting records, the Code itself is unfortunately ambiguous on this point. Its wording suggests that investors can comply with the Code simply by explaining why they do not disclose their votes. It is far from clear that this provision will elicit the necessary step change in transparency from investors who currently lag behind best practice. FairPensions is currently conducting an early analysis of how the Code is being applied, which will be available towards the end of 2010.

The government has reserve powers[13] to make voting disclosure mandatory if voluntary regimes fail. In the April 2010 Budget,[14] the previous government stated its willingness to use these powers – a commitment reiterated in the Labour Manifesto.[15] The present government has not yet expressed a view.

RECOMMENDATION

The government should clearly state its willingness to make use of its reserve powers to introduce mandatory voting disclosure, if the Stewardship Code does not prompt a stated minimum level of disclosure by a specified review date.

Nor is raising the quantity of disclosures the only imperative facing policymakers: the quality of those disclosures is a major issue. Among investors who do disclose, there is huge variation in exactly what information is reported - from full details of every vote cast, with reasons for contentious decisions,[16] to aggregate figures which shed no light on the investor's record on specific issues or companies.[17] It seems unlikely that full and comparable information will be disclosed across the board without statutory guidelines.

RECOMMENDATION

The government or the FRC should set out a standard form of disclosure detailing the minimum information to be provided, which should ideally reflect current best practice.

> *"Experience in the recent crisis phase has forcefully illustrated that while shareholders enjoy limited liability in respect of their investee companies, in the case of major banks the taxpayer has been obliged to assume effectively unlimited liability. This further underlines the importance of discharge of the responsibility of shareholders as owners."*
>
> - Sir David Walker [9]

> *"It is important that all institutional investors disclose their voting in order to improve transparency in this area."*
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> - Baroness Wilcox, 16 August 2010, in response to a written parliamentary question[18]

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The campaign for responsible investment

ABOUT FAIRPENSIONS

FairPensions is a registered charity which works to promote Responsible Investment (RI) by 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.

In the case of pension funds, RI most often entails engagement with investee companies i.e. shareholder activism through dialogue, reinforced by the potential exercise of shareholder powers. We advocate a strategy of active ownership to manage environmental, social and corporate governance (ESG) risks with the potential to affect the long-term value of investment portfolios.

FairPensions is a member organisation, supported by a number of leading UK charities including Oxfam, Amnesty International and WWF, as well as organisations representing the beneficial owners of pension schemes, such as the National Federation of Occupational Pensioners, UNITE and Unison.

fairpensions.org.uk

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1. Available online at http://www.tinyurl.com/FRCStewardshipCode
2. OECD: http://www.oecd.org/dataoecd/52/52/42204972.pdf
3. 'A review of corporate governance in UK banks and other financial industry entities', Recommendations 16 & 17 (p17): http://www.hm-treasury.gov.uk/d/walker_review_261109.pdf
4. Labour Party Manifesto 2010, Page 1:9.
5. 'Edward Davey responds to FRC Stewardship Code', 01 July 2010. http://nds.coi.gov.uk/content/Detail.aspx?ReleaseID=414200&NewsAreaID=2
6. The Institutional Shareholders' Committee's Code on the Responsibilities of Institutional Investors
7. The draft South African Stewardship Code can be downloaded at http://www.busrep.co.za/index.php?fSectionId=553&fArticleId=5629780
8. Page 1:9. Available online at http://www2.labour.org.uk/uploads/TheLabourPartyManifesto-2010.pdf
9. The Walker Review: Final Recommendations (November 2009)
10. 16 August 2010, http://www.publications.parliament.uk/pa/ld/ldtoday/writtens/16082010.htm#hdg-InstitutionalInvestorsVotingRecords
11. National Association of Pension Funds, 'Pension funds' engagement with companies' 2008 and 2010. Available online at http://www.napf.org.uk.
12. TUC Fund Manager Voting Survey 2009. http://www.tuc.org.uk/extras/fundmanager2009.pdf
13. Under section 1277 of the Companies Act 2006.
14. Budget 2010, Para 3.25, Page 40. http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/budget2010_chapter3.pdf
15. Page 1:9. Available online at http://www2.labour.org.uk/uploads/TheLabourPartyManifesto-2010.pdf
16. See for example http://www.fandc.com/new/Institutional/Default.aspx?id=94334
17. See for example http://www.assetmanagement.hsbc.com/uk/institutions/corporate_gov.html
18. See http://www.parliament.the-stationery-office.co.uk/pa/ld/ldtoday/writtens/16082010.htm

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