

Siobhan McKeering
Law Commission
1st Floor, Tower
52 Queen Anne's Gate
London, SW1H 9AG

Dear Ms McKeering,

I am writing to respond to the Law Commission's *Intermediated securities: Call for evidence* on behalf of ShareAction, a registered charity established to promote transparency and responsible investment practices by institutional investors. We are a member organisation and count amongst our members well-known NGOs and charitable foundations, as well as over 26,000 individual supporters.¹ Our response highlights key issues in the current system of intermediated finance. We would welcome the Law Commission undertaking a fuller examination of this topic over the coming months.

Despite the advantages outlined in the consultation paper, the current system of financial intermediation can result in significant difficulties for individual and institutional investors to exercise their voting rights. In all but exceptional cases, ultimate investors are forced to invest through a chain of intermediaries, often due to liquidity considerations, safety concerns or economies of scale. ShareAction works with a range of asset owners, including through our own Charity Responsible Investors Network, and we have heard of the difficulties faced by some owners in having their voting policies implemented by their managers.

Through our work with the Association of Member Nominated Trustees (AMNT), we have become aware of some of the problems faced by smaller schemes in relation to their Red Lines Voting (RLV) initiative. One issue in particular is where intermediaries have obstructed owners' voting rights for shares in which they have a beneficial interest. Some trustee bodies that have adopted a policy aligned with the RLV initiative have been told that their fund manager will not accept the voting instructions. This has occurred even where such instructions explicitly permit the manager to vote differently where it believes to do so is aligned with the client's interest, provided this is explained to the trustee board, making it harder for such schemes to meet their fiduciary duties.

Individual investors also face substantial difficulties, and to a large extent the intermediated system contributes to their disenfranchisement both in law and practice. There is a strong public policy case for improving corporate governance by encouraging individual investors to participate in delivering effective stewardship. The role of individual investors in improving corporate governance is particularly clear for AIM and small cap companies². ONS figures show UK individual investors held 9.5% of FTSE 100 shares, 19.4% of other quoted shares and 29.7% of AIM shares, demonstrating a clear need address the issue for individual investors.³

For both institutional and retail investors, we believe the new Stewardship Code will go some way to addressing these issues. In particular the new Principle 6, '*Signatories take account of client and*

¹ <http://www.shareaction.org>

² ShareSoc and UKSA Briefing note, *Intermediated Securities and Individual Shareholders*, July 2019

³ Office of National Statistics, *Ownership of UK quoted shares: 2016*, available at <https://www.ons.gov.uk/economy/investmentpensionsandtrusts/bulletins/ownershipofukquotedshares/2016>

beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them'. This requires signatories to take a number of actions, including explaining:

- How they have sought and received clients' and beneficiaries views, and the reason for their chosen approach.
- How the needs of beneficiaries have been reflected in stewardship and investment aligned with an appropriate investment time horizon.
- How assets have been managed in alignment with clients' stewardship and investment policies
- What they have communicated to clients and beneficiaries about their stewardship and investment activities and outcomes to meet their needs, including the type of information provided, methods and frequency of communication to enable them to fulfil their stewardship reporting requirements.
- Where they have not managed assets in alignment with their clients' stewardship and investment policies, and the reason for this.

The Stewardship Code operates on voluntary basis and the first tranche of signatories will not be published until March 2021, however this represents a positive step forward in an attempt to boost transparency in the investment chain. We remain concerned, however, that difficulties in the intermediated system may be used as the "explanation" in the final action listed above. We are keen to move on from the tacit acceptance that the current system of intermediated finance is too convoluted for stewardship to be undertaken by all investors, particularly now it has widely been accepted as a core tenet of fiduciary duty.

It remains difficult for ultimate investors to obtain confirmation that a vote on a security in which they have a beneficial interest has been received and/or counted. For investors, the right to vote at an AGM is the only time to express a formal opinion on the management, direction and governance of the business they own. Despite this, only 70% of capital is voted at FTSE 100 and FTSE 250 listed businesses. The level of voting at smaller companies is far worse, with only 50% of capital voted by shareholders.⁴ One clear impact of difficulties around obtaining vote confirmation is that it can actively dissuade some investors to try to exercise their vote. For individual investors, who are more likely to be invested in smaller companies the problem is even more acute. It is therefore essential our system does more to encourage shareholders to exercise their voting rights.

Another more general issue about the current system around shareholder votes is that the UK still has no inclination to make the disclosure of votes mandatory. The Government has the necessary powers reserved to put this into place under s.1277 of the Companies Act 2005, but has failed to do so on a number of occasions. Most recently, the FCA had the opportunity to introduce mandatory voting disclosure through the transposition of the Shareholder Rights Directive II but decided against it. There is a concerning lack of transparency and agency in the relationship between fund managers and ultimate investors which is unlikely to be in the long-term interest of clients and beneficiaries.⁵

⁴ ShareAction, *Assessing and engaging asset managers on proxy voting*, 2018 available at <https://shareaction.org/wp-content/uploads/2018/12/InvestorReport-CRIN-ProxyVoting-2018.pdf>

⁵ ShareAction, *Response to FCA consultation on proposals to improve shareholder engagement*, 2019 available at <https://shareaction.org/wp-content/uploads/2019/04/ShareAction-FCA-stewardship-consultation-final.pdf>

Publishing records and rationales for votes would help to increase the emphasis placed on these votes by investors and increase transparency for the media, civil society and individual investors.

Voting decisions by investors may also be a matter of public interest. Over recent years, there have been several examples large companies whose failures have led to substantial job losses or economic collapse. Investors' voting decisions are one of their most powerful tools in holding companies to account but we have seen a poor level of accountability in cases such as the collapse of Carillion. In October, new investment regulations came into force that require pension schemes to develop and maintain policies on ESG and stewardship in their Statement of Investment Principles.⁶ This was a key recommendation of the Law Commissions 2014 and 2017 reports into the fiduciary duties of investment intermediaries. In addition, the Pensions Minister has recently spoken of the need for assets to drive investment 'to deliver the sustainable employment, communities and environment which all of us wish to enjoy'.⁷ As investors begin to play an increasingly important role in society as long-term stewards of capital – in line with their fiduciary duties – it is essential that the legal and regulatory problems in our intermediated system are overcome, so that it acts as a driver of good stewardship, rather than an obstacle.

I hope the above comments are clear. If you have any questions or comments please do not hesitate to contact me at Fergus.moffatt@shareaction.org.

Yours sincerely

Fergus Moffatt
Head of UK Policy

⁶ *Amendments to the Occupational Pension Schemes (Investment) Regulations 2005*, available at <http://www.legislation.gov.uk/ukxi/2018/988/regulation/4/made>

⁷ DWP, *Investment Innovation and Future Consolidation*, 2019 available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/776181/consultation-investment-innovation-and-future-consolidation.pdf