16 April 2019

Via email to dp19-01@fca.org.uk

Mark Manning
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Re: DP19/1 Financial Conduct Authority/Financial Reporting Council Discussion Paper-Building a regulatory framework for effective stewardship

Dear Mark,

This is a joint response from UKSA and ShareSoc on behalf of individual investors.

UKSA and ShareSoc represent the interests of private shareholders. In addition to our own members, there are 5 million people who own shares and have investment accounts with platforms in the UK. The Office for National Statistics estimates that individual investors own 12% of the UK stock market by value. In addition to this there are many more who have money invested in shares via funds, pensions and savings products such as employee share ownership schemes.

In our response we make the following key points:

1. Investor stewardship must not let boards off the hook for their own stewardship. **The Stewardship Code should be renamed the Investor Stewardship Code** to better reflect what investors do and to better acknowledge the role of management and Boards in the stewardship of their shareholders' capital.
2. **The role of individual investors in engaging with companies and stewardship should be given more weight in the FCA/FRC considerations. There are reasons why** individuals are particularly good stewards (they have a long-term focus, their own money is at risk, among other things).
3. **We do not agree that retail shareholders rights should be outside the scope of this consultation.**[1] Retail investors own, on average, 29% of AIM companies and 12% of main market companies. They are a non-trivial constituent to the stewardship issue. At present only 6% of retail shareholders' shares are voted at AGMs. The terms and conditions of legal agreements between retail investors and platforms mean that the rights to vote shares are held by the nominee. Platforms are therefore entitled to vote retail shareholders' shares (to be specific, interests in shares). To date, we know of no platform nominee who has chosen to exercise this right, but this issue and platforms terms and conditions need to be reviewed. **We very much welcome the reference to The Law Commission Review of Intermediated**

[1] Para 4.12 of DP19/1 says: While also outside the scope of this DP, it is worth noting that questions have periodically been raised about how retail shareholders' rights are exercised, where they have a direct investment and shares are held on the share register via a nominee company. Nominees hold securities on behalf of individual shareholders as a cost-effective method of electronic shareholding and to facilitate transactions. In doing so, the nominee becomes the legal owner, while the individual shareholder is the beneficial owner.

Securities (in para 4.13 on page 17 of the FCA/FRC DP19/1). **The Law Commission Review must be given a much higher priority** so that retail investors can exercise their role as stewards of the companies in which they invest.

4. Investor Engagement and Stewardship should not be looked at in isolation from fund performance and fund fees. The proposed requirements for fund managers to report annually to asset owners should be enhanced by performance data and tracking error statistics. It is important that these high-level reports contain information that will highlight closet indexing. (see our answer to question 3 of CP19/7).
5. **Fund managers can be particularly bad stewards** – i.e. quite the wrong people to be voting shareholders. Reasons include Index-following, short-termism, free-riding, need not to upset.

Below we make a number of points. We think this is important context to our response to your consultation as there are broad issues that impact on stewardship and to only respond in a narrow way to your specific questions might mean you missed the bigger picture. After these more general points we then give our answers to your specific questions.

What do we mean by Stewardship?

It is appropriate to suggest that the primary purpose of stewardship is one of looking after the assets of beneficiaries that have been entrusted to the care of others. It is also appropriate in our view to claim that this also broadens the scope of the Stewardship Code to be applicable beyond UK listed equity assets.

However, we have concerns about the definition of stewardship in the draft Code. Section 1 of the Code, 'Defining Stewardship,' states that:

> *'Stewardship is the responsible allocation and management of capital across the institutional investment community to create sustainable value for beneficiaries, the economy and society'.*

The 2012 Stewardship Code defines Stewardship in its first two paragraphs:

1. *Stewardship aims to promote the long term success of companies in such a way that the ultimate providers of capital also prosper. Effective stewardship benefits companies, investors and the economy as a whole.*
2. *In publicly listed companies responsibility for stewardship is shared. The primary responsibility rests with the board of the company, which oversees the actions of its management. Investors in the company also play an important role in holding the board to account for the fulfilment of its responsibilities.*

The 2012 Code identified the aim of investor stewardship as delivering long-term value for beneficiaries while recognising that this also benefited the economy as a whole.

We are concerned that the proposed new definition of Stewardship loses this important distinction in the motivations of institutional investors. This might be addressed by, for example, including after "beneficiaries" "and hence" before "the economy and society".

We accept that what is good for the economy is likely to be good for investors and that these two aspects of stewardship ought logically to be aligned. Similarly, it has long been recognised that companies need to achieve and maintain societal consent to operate effectively over the long-term.

However, as described above, we are concerned that the definition does not recognise more clearly the primary motivation of institutional investors of creating value for beneficiaries.

The definition does helpfully encompass both the long-term financial value sought by beneficiaries and the additional benefits to them of a healthy economy, society and environment and the ability to invest, when they wish, in line with their ESG preferences.

In a company, most of the stewardship is undertaken by the executive management. However, the NEDs have a very important role in stewardship, in monitoring performance and ensuring capital is allocated wisely. Capital is provided to companies by investors, including asset owners and asset managers, who are important cogs in this wheel. We must not forget that most of stewardship is done within the company and when companies fail it is the most usually the responsibility of the management, and these are the people the SFO, DPP, FRC and FCA look to persecute/prosecute. If asset owners and asset managers have failed in their stewardship, their role is usually secondary. The primacy of the responsibility of NEDs and management for stewardship must not be overlooked.

Your definition is too narrow as it excludes **individual investors**. Individual investors own 29% of AIM and 12% of the main market by value. They have an important role in stewardship and to ignore them is wrong.

A problem with the definition proposed by the FCA/FRC is that it focusses on processes rather than a **balance of outcomes and processes**. Sir John Kingman has highlighted his concerns in this regard, and we agree with him in this respect.

A useful parallel is with the annual report and accounts. The financial accounts themselves are backward looking, a statement of the balance sheet at the end of the year and an estimate of trading performance in the year. It is a little like driving a car by looking only in the rear-view mirror. The financial accounts tell us about lagging indicators of company performance. This is important but it is only for part of the story.

The KPIs and the narrative reporting give an indication of future performance and some of the KPIs are leading indicators of future performance (customer satisfaction ratings give an insight of future sales: employee satisfaction surveys and staff turnover an insight into employee motivation, incentivisation and future performance and costs; etc).

We approve of the emphasis on "responsible" asset allocation and "sustainable value". In 2000, too much capital was allocated to the dot.com boom/bubble and huge amounts were lost. In the run up to 2008/9 Financial Crisis, too much capital was allocated to banks and huge amounts were lost. At various times, too much capital has been allocated to mining with the result of overcapacity and slumps in commodity prices. Builders have a history of over-expansion, and it was notable that following 2009 a number of new incentive schemes were implemented to incent executives to pass back excess capital to shareholders: these were successful in better asset allocation and produced significant returns for shareholders (and various scandals over excessive pay, e.g. Persimmon, Berkeley Homes). The emphasis on momentum as an investment style has had a history of producing good short-term results (and has been incentivised by remuneration packages – Kay noted this) and has enabled asset managers to win new business.

We note in our response the difference between asset allocation and stock selection and the need to report on both of these aspects of stewardship. The Stewardship Code is not sufficiently specific in this respect.

Code Name

We think calling the Code the Stewardship Code is misleading. **Investor Stewardship Code** would be better and be closer to what the Code tries to do.

Ideally, the Investor Stewardship Code should include reference to individual investors and their role. If it does not, then the Code ought to be called the Institutional Investor Stewardship Code.

The current engagement processes

Our analysis of the main problems in the current engagement process is as follows:

- The informal nature of most current shareholder engagement (cosy chats with selected shareholders behind closed doors) does not work well for the broad shareholder base. It is not clear whether investors are each being told the same story, how information is being spun, or whether complete or only partial information is being given out. Investors will ask different questions during engagement meetings and so may develop different interpretations of what the company is trying to achieve. Ad hoc engagements tend to only occur when a problem arises.
- Currently, when a large number of investors are "consulted", it is difficult to have the same conversation with each investor and the proposal often changes over the process of engagement. Currently, the different views of different investors create a very "messy" backcloth in which to engage. For example, in relation to remuneration proposals, there is often no clear trail from the initial proposal though to the final version voted on by shareholders.
- Voting happens too late in the process. Discussion and voting at the AGM is ineffective, as institutions do not like to vote against the directors' recommendations. A more professional and systematic process is required.

There is clear evidence of engagement not working, i.e. surprises, adverse voting results and numerous bad cases of corporate governance. The 20% Naughty register https://www.theinvestmentassociation.org/publicregister.html has many more cases than expected. 152 companies in the FTSE All Share Index were "naughty". The BEIS Committee report on executive pay highlighted the problems. It named and shamed serious offenders, and criticised the investors and remuneration committees for failing to address the problems.

Fund Managers, the Investment Association, the Investor Forum and companies keep repeating the mantra that engagement is getting better. It may be, but it is nowhere near good enough. The arguments they put forward are specious and self-serving.

We are arguing that individual investors have good points to make and need a voice in company-investor engagement. Our arguments/rationale/logic have been fiercely resisted by the fund management industry.

There are reasons why **fund managers are particularly bad stewards** – i.e. quite the wrong people to be voting shareholders. Reasons include Index-following, short-termism, free-riding, need not to upset. There is more evidence in UKSA's Responsible Investing booklet from 2010. http://www.uksa.org.uk/sites/default/files/responsible_investing_2010_members.pdf . It also contains some information on why individuals are particularly good stewards (they have a long-term focus, their own money is at risk, among other things).

Persimmon is the latest UK governance disaster. Others in 2018/19 include Carillion, Conviviality and Patisserie Valerie who all had accounting issues and Aviva and Unilever with awful corporate governance where directors failed to listen to, or understand, what shareholders/investors/ fund managers were saying.

The way most engagements are currently run is probably a breach of several regulations about orderly markets, all shareholders having the same information etc, etc. Part of the reason why we run the RBS Shareholder Committee Campaign is to highlight the very limited information that is shared with individual investors.

AGMs should be the basis of successful engagement, prefaced by analyst type meetings, shareholder meetings and structured discussions on corporate governance issues of concern.

A lot more work needs to be done to make AGMs more effective. Our members attend many AGMs and, in many cases, write excellent writeups which are put on our website for other members to read. This is viewed by our members as a useful service.

How to involve Individual Investors in shareholder engagement

As well as the AGM, we suggest regular meetings between companies and groups of individual investors.

Three examples of good practice are HSBC, BHP Billiton and Marks and Spencer.

BHP Billiton

We (UKSA AND ShareSoc) organise a series of events for individual investors to meet the companies they invest in. Probably the best model for this is BHP Billiton who (in conjunction with UKSA+ShareSoc) have **very successfully** run such investor events for over 10 years. Here is a link to the recent event https://www.sharesoc.org/news/bhp-billiton-retail-shareholder-event-18-sept-2018/

The BHP example is particularly relevant, as BHP suffered very well planned, coordinated actions by various action groups at its AGM which somewhat highjacked it from what many would view as the main purpose of the AGM, to interact with its shareholders and to vote on important resolutions. Cliff Weight was one of those real shareholders at the BHP AGM and found enlightening the degree of concern and the range of issues that were covered. The fact that meetings outside of the AGM had not been able to satisfy employees, labour unions, conservation groups, environmentalists, local communities, etc raised concerns for shareholders about how well the BHP Billiton Board were listening. It was difficult as an observer in what was a highly emotional atmosphere to evaluate the issues. However, having been present at the previous shareholder event (2 months previously) where many of the same issues had also been raised and discussed he felt that the BHP management are doing a pretty good job in very difficult circumstances. One factor that swayed his view was the time that BHP had dedicated to talking to its retail shareholders in Australia and the UK and also the BHP commitment which was reflected in the length of time they had been engaging in this way.

HSBC

HBSC are another role model and they tend to schedule their event about a month before their AGM which gives the Chairman a chance to rehearse some of the likely AGM questions. These meetings with UKSA/ShareSoc members have been held for over ten overs.

Meeting agenda and how it is run

The presentation is usually similar (or the same) as that given to institutional investors/fund manager/analyst events. We don't wish to demean issues like branch closures, customer complaints, etc, but investors in shares want to know about and focus the event on factors that are crucial to the share price now and in the future.

M&S Shareholder Panel

M&S ask for volunteers each year to join a panel of shareholders. About 6 meetings are held each year including a Christmas lunch event. These meetings provide an opportunity for M&S directors and senior executives to discuss issues of concern and for shareholders to raise questions and issues that they believe are important. M&S have done this since 2016.

More information is at https://corporate.marksandspencer.com/investors/shareholder-information/faq/shareholder-panel which explains:

> Why is M&S doing this now?
>
> In 2016 we invited a number of shareholders to M&S's Head Office for our very first Shareholder Panel, providing a platform for them to offer their views on the issues that are of most concern to them as investors, and to hear about how the Company is addressing these directly from members of the senior management team. This was hugely successful, and very well received by those who attended, and it was therefore decided to introduce a regular event and for which all registered shareholders can apply to attend.

Shareholder Panels and Shareholder Committees

We see a role for meetings between companies and representatives of shareholders on a more formal and structured basis as part of a successful engagement policy with shareholders. The current ad hoc approach fails to build trust.

We have submitted a shareholder resolution to RBS to include a resolution at the AGM to implement a shareholder committee, for the 2017, 2018 and 2019 AGMs. At the 2018 AGM, 5.5% of votes were in favour of the shareholder committee (the 5.5% figure excludes majority shareholder UKGI who voted against our proposal).

Background re high fees and poor performance of asset managers

We note that the 2016 FCA Asset Management Market Study Interim Report MS15/2.2, noted inter alia:

- *The annual average disclosed fee for actively managed equity funds available to UK investors is 0.90% of the assets under management (AUM) and the average passive fee is 0.15%. Furthermore, transaction costs (charged when asset managers trade on investors' behalf) are normally higher for active funds (as illustrated in Figure 1.2). (p10 para 1.3)*
- *Asset management firms have consistently earned substantial profits across our six-year sample, with an average profit margin of 36%. These margins are even higher if the profit-sharing element of staff remuneration is included. (page 14, para 1.21)*

These were damning criticisms of the industry. There are very relevant to the Stewardship Code as stewardship requires resources and, we argue, excessive profiteering is one of the reasons that asset managers and asset owners under resource stewardship activities and provide a high cost, poor service as a result.

The criticisms are also relevant to this discussion paper as unnecessarily high fund managers' fees are extremely concerning to asset owners and to the ultimate beneficial owners. Costs and performance can be of far more significance than how the fund manager addresses stewardship. We think these issues need to be addressed at the same time, separately but in parallel. We worry that an over focus on stewardship may be a diversion from the bigger problem of fees and performance.

Voting of shares held by Retail Investors

The ability of beneficial shareholders who hold their shares in nominee accounts being able to vote their shares easily and at no additional cost is a critical aspect of shareholder rights and shareholder democracy. **Any regulatory proposals that fail to address this point can only be a partial solution.** The Law Commission Review of Intermediated Securities (see para 4.13 of the DP 19/1) must be given a much higher priority.

Currently only 6% of retail shareholder vote at AGMs. This is because of the difficulties, for those holding shares via nominees, that platforms have created. The platforms are not facilitating shareholders exercising their voting and other rights.

In addition, the shareholder register does not require the name on register of the beneficial owner of shares held via nominees. Currently, HM Government has no plans to change this, despite it being a clear objective of the EU Shareholder Rights Directive. The Law Commission review of Intermediated Securities must (as noted above) be given a much higher priority. FCA/FRC support in this issue would be most welcome. Being able to communicate with shareholders would allow the registrars to offer an alternative service to platforms.

In our response to the Platforms Consultation, UKSA-ShareSoc called upon the FCA also to examine these issues:

1. **A new "name on register" electronic system** needs to be provided if "dematerialisation" is to fully happen so that investors can buy and sell shares through any broker and not be locked into one broker as happens at present.
2. The protection of holdings in nominee accounts by alleged "ring-fencing" of client holding and cash which is totally undermined by the rules in the Special Administration Regime (e.g. the case of Beaufort).
3. The relatively low protection provided by the Financial Services Compensation Scheme in relation to the amounts likely to be invested in platforms, e.g. in pension SIPPs and ISAs.
4. The basic poor legal protection offered by nominee accounts and the failure of almost all stockbrokers to offer personal crest accounts (i.e. where your name is on the share register of the company and your holdings therefore clearly legally your own and not the platform operators).
5. Similarly, the requirement to use nominee accounts for ISAs and SIPPs is deeply uncompetitive because it locks clients into one platform from which they have difficulty withdrawing.

The above issues do not seem to be covered by the FCA / FRC proposals, but are major contributors to the current uncompetitive environment for retail investors in respect of platform operators and hence for retail investors to vote their shares and engage pro-rata to the amount of their investments in companies (on average 29% of AIM companies and 12% of main market companies).

Hence, we call upon the FCA to begin a CMA review of the conduct of platforms and custodian banks, the primary operators of nominee services and the FRC to support such a review. The shareholder voting plumbing is broken and there are many vested interests who are interested in tinkering at the edges than ensuring that the law works as it was intended. This review will look at how retail shareholders rights can be restored. Once implemented, companies will be able to develop more productive relationships with their providers of capital.

In relation to your specific questions, our comments are as follows

Q1: Do you agree with the definition of stewardship set out here? If not, what alternative definition would you suggest?

No.

It is appropriate to suggest that the primary purpose of stewardship is one of looking after the assets of beneficiaries that have been entrusted to the care of others. It is also appropriate in our view to claim that this also broadens the scope of the Stewardship Code to be applicable beyond UK listed equity assets.

However, we have concerns about the definition of stewardship in the Code. Section 1 of the Code, 'Defining Stewardship,' states that:

'Stewardship is the responsible allocation and management of capital across the institutional investment community to create sustainable value for beneficiaries, the economy and society'.

The 2012 Stewardship Code defines Stewardship in its first two paragraphs:

1. *Stewardship aims to promote the long term success of companies in such a way that the ultimate providers of capital also prosper. Effective stewardship benefits companies, investors and the economy as a whole.*
2. *In publicly listed companies responsibility for stewardship is shared. The primary responsibility rests with the board of the company, which oversees the actions of its*

management. Investors in the company also play an important role in holding the board to account for the fulfilment of its responsibilities.

The 2012 Code identified the aim of investor stewardship as delivering long-term value for beneficiaries while recognising that this also benefited the economy as a whole. We are concerned that the proposed new definition of Stewardship loses this important distinction in the motivations of institutional investors. This might be addressed by, for example, including "and hence" between "beneficiaries" and "the economy and society".

We accept that what is good for the economy is likely to be good for investors and that these two aspects of stewardship ought logically to be aligned. Similarly, it has long been recognised that companies need to achieve and maintain societal consent to operate effectively over the long-term.

However, as described above, we are concerned that the definition does not recognise more clearly the primary motivation of institutional investors of creating value for beneficiaries.

The definition does helpfully encompass both the long-term financial value sought by beneficiaries and the additional benefits to them of a healthy economy, society and environment and the ability to invest, when they wish, in line with their ESG preferences.

In a company, most of the stewardship is undertaken by the executive management. However, the NEDs have a very important role in stewardship, in monitoring performance and ensuring capital is allocated wisely. Capital is provided to companies by investors, including asset owners and asset managers, who are important cogs in this wheel. We must not forget that most of stewardship is done within the company and when companies fail it is the most usually the responsibility of the management, and these are the people the SFO, DPP, FRC and FCA look to persecute/prosecute. If asset owners and asset managers have failed in their stewardship, their role is usually secondary. The primacy of the responsibility of NEDs and management for stewardship must not be overlooked.

Your definition is too narrow as it excludes **individual investors**. Individual investors own 29% of AIM and 12% of the main market by value. They have an important role in stewardship and to ignore them is wrong.

We have explained in our introductory comments how the engagement process fails and how it could work better. The definition of stewardship should be compatible with the way engagement should work.

Q2: Are there any particular areas which you consider that investors' effective stewardship should focus on to help improve outcomes for the benefit of beneficiaries, the economy and society (e.g. ESG outcomes, innovative R&D, sustainability in operations, executive pay)?

No. You should let market competitive pressures dictate priorities.

Q3: To what extent do the proposed key attributes capture what constitutes effective stewardship? Which attributes do you consider to be most important? Are there other attributes that we should consider? If so, please describe.

Currently many fund managers produce reports on their stewardship with detailed data in pdf format. This makes it very difficult for external people to analyse. It is a sign that such a fund manager only wishes to comply with the letter of the law/regulation rather than the spirit of the guidance. Our point is that the Table 1 looks OK, but it needs to be monitored and reported on to check that the desired outcome of transparency is being achieved.

Some of these fund managers have a history and culture of being as opaque as possible.

Q4: What do you think is the appropriate institutional, geographical and asset class scope of stewardship? How can challenges associated with issues such as the coordination of stewardship activities across asset classes, or the exercise of effective stewardship across borders, be overcome?

This exercise should focus on investors in the UK stock market and the stewardship of companies quoted on the UK market and AIM.

We do not agree that retail shareholders rights should be outside the scope of this consultation.[2] Retail investors own, on average, 29% of AIM companies and 12% of main market companies. They are a non-trivial constituent to the stewardship issue. At present only 6% of retail shareholders' shares are voted at AGMs. The terms and conditions of legal agreements, between retail investors and platforms, mean that the rights to vote shares are held by the nominee. Platforms are therefore entitled to vote retail shareholders' shares (to be specific, interests in shares). To date, we know of no platform nominee who has chosen to exercise this right, but this issue and platforms terms and conditions need to be reviewed. **We very much welcome the reference to The Law Commission Review of Intermediated Securities** (in para 4.13 on page 17 of the FCA/FRC DP19/1). **The Law Commission Review must be given a much higher priority** so that retail investors can exercise their role as stewards of the companies in which they invest.

Q5: We welcome examples of how firms with different objectives and investment strategies approach stewardship. In particular, we welcome input on how stewardship practices differ across active and index-tracker funds, in the following areas:

i: how firms prioritise and conduct stewardship engagements

ii: what investments firms have made in stewardship resources

iii: how stewardship activity is integrated with investment decisions.

We have no comments in response to this question.

Q6: To what extent do you agree with the key barriers to achieving effective stewardship identified in this DP? What do you believe are the most significant challenges in achieving effective stewardship? We would particularly welcome views on the investment required to embed effective stewardship in investment decision-making.

Index funds are in a special position as they cannot choose to sell shares in a company (other than to rebalance their weightings to match the index). Therefore, they have to engage with companies to ensure they are managed well for the long term. Providers of index funds recognise that their customers expect them to engage with companies, with a view to ensuring good corporate governance, sustainable business performance, high quality business management, proper risk management, and the avoidance of avoidable rows over executive compensation, etc. BlackRock, Vanguard, LGIM are leading index fund providers and all have large corporate governance teams. Their size creates barriers to entry for others.

We have noted elsewhere in our letter the difference between asset allocation and stock picking. Effective stewardship requires both to be managed and reported on.

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[2] Para 4.12 of DP19/1 says: While also outside the scope of this DP, it is worth noting that questions have periodically been raised about how retail shareholders' rights are exercised, where they have a direct investment and shares are held on the share register via a nominee company. Nominees hold securities on behalf of individual shareholders as a cost-effective method of electronic shareholding and to facilitate transactions. In doing so, the nominee becomes the legal owner, while the individual shareholder is the beneficial owner.

The decision to buy/sell/reduce/increase or over/underweight shares is different to the decision about engaging with a company about corporate governance. Many firms split the roles of fund manager and corporate governance executive/analyst. If the company gives out useful corporate governance information that may impact the share price, then those attending the meeting will need to have effective Chinese walls or rules about agreeing not to trade in such circumstances (trades to balance funds such as index weighting funds being excepted).

It may be better to have the majority of engagement undertaken by the corporate governance team. For example, participation in a shareholder panel or shareholder committee could be done by members of the corporate governance team rather than the buy/sell fund managers.

1 to 1 meetings between management and fund managers should be banned. Any information that is given out should be available to all fund managers, analysts and shareholders at the same time. Analyst meetings should be broadcast on the web, so that all receive information at the same time (CA 2006 S172 has the obligation to act fairly between members and this should require information given out to be available to all at the same time). Trading on the basis of privileged information is insider trading, illegal and should be prosecuted vigorously.

When companies give out information that may affect the share price, this must to all shareholders at the same time. We prefer this is done at 5pm after the market has closed, not at 7am. 5pm allows more time for thoughtful analysis before the market opens the next day..

We have no other comments in response to this question, although we suggest that you read our response to the Question 1 of the FRC's consultation on the revisions to the Stewardship Code.

Q7: To what extent do you consider that the proposed balance between regulatory rules and the Stewardship Code will raise stewardship standards and encourage a market for effective stewardship?

In general, we prefer light touch regulation where that is sufficient, but not where it is not sufficient. It is difficult to argue with relatively benign and light-touch regulatory proposals set out in Table 2 of the Discussion Paper.

All we would say is that, if basic compliance with the revised Stewardship Code is to become mandatory, there will need to be very clear guidance on what is expected by way of reporting by asset managers. As has so often proved to be the case when regulation is applied, the outputs from businesses degenerate into meaningless boiler plate which is designed purely to put a tick in the compliance box. One of the things we like about the FRC's voluntary approach to the Code is that it largely avoids this pitfall. The FRC will score and 'tier' the responses in the Outcomes and Activities reports. Asset managers will not have to sign up to the Code and those that don't will not appear on any list of responsible stewards. Others can pay lip-service and will get a low rating from the FRC. Others that provide well-considered and meaningful responses (in their Outcomes and Activities reports) will get a high rating. We like this approach and believe that it works better than applying the 'dead hand' of regulation.

Q8: To what extent are there are issues with proxy advisers that are not adequately addressed by SRD II and proposed revisions to the Stewardship Code?

We have no comment to make in response to this question.

Q9: We welcome feedback on other specific aspects of the regulatory framework described above. In particular, we are interested in views on:

> i: Whether and to what extent the FCA's proposed rules for asset owners should be extended to SIPP operators?
>
> Yes

ii: The case for regulatory rules to expand the reach of stewardship beyond listed equity

We see no need for regulatory rules. Voluntary disclosures should be adequate driven by market competitive pressures.(see Q7 above)

iii: Whether there is a role for UK regulators in encouraging overseas investors to engage in stewardship for their asset holdings in the UK

Yes.

iv: The extent to which additional rules might be necessary either to improve stewardship quality or prevent behaviours that might not be conducive to effective stewardship

There needs to be a carve out for the concert party rules, when investors wish to discuss stewardship issues. For example, it needs to be made clear that being a member of a Shareholder Panel or Shareholder Committee would not prejudice the members fiduciary duties.

v: For differences between active and index-tracker strategies in the practice of stewardship, whether there are particular regulatory actions we should consider to address any perceived harms.

The FCA should focus on improving the effectiveness of asset owner demand. The FCA/TPR joint regulatory strategy for regulating the pensions and retirement income sector (pub. October 2018) offers a sound framework for this. The FCA could usefully consider developing a similar strategy to address the management of investments for other appropriate Life products.

To avoid "free-riding" by index funds, you might consider whether (say) 0.1bp (basis point) of AUM should be allocated to a stewardship fund. If the index fund does not spend at least this amount, then this amount could go to a central levy who would provide a stewardship service.

vi: Whether the FCA's proposed rules to implement certain provisions of SRD II should apply on a mandatory, rather than 'comply or explain', basis.

SRD II is a minimum threshold. We in the UK should aspire to a much higher standard.

Q10: We welcome feedback on whether, to support effective stewardship, we should consider amendments to other aspects of the regulatory framework that affect how investors and issuers interact (such as the LRs, PRs and DTRs)?

Fund managers should be required to report back to asset owners on their performance stewardship and engagement. This should cover the following information:

– the key material medium to long-term risks associated with the investments – portfolio composition
– turnover
– turnover costs

- Performance in absolute terms and versus benchmark(s)
- Tracking error
- Significant buys and sells of shares in the period under review (e.g. top 5 of each) and performance (absolute and relative to benchmark(s)) of
    - Newly bought shares
    - Sold shares
    - Rest of the portfolio

- The major engagements (e.g. top 5) in the period and the outcomes achieved and any other major activities, e.g. a letter sent to all investee companies.
- Summary of votes in the period (number of votes, number for, against, abstain, withheld), plus trend data to compare with historic practice and explanatory commentary.
- Fees charged in the period, split between management and performance fees if performance fees are charged.

– whether and if so, how the asset manager uses proxy advisors for the purpose of their engagement activities

– their policy on securities lending and how it is applied to fulfil engagement activities, if applicable, particularly at the time of general meetings of companies they invest in

• whether, and if so, how they make investment decisions based on an evaluation of medium to long-term performance, including the non-financial performance, of the companies they invest in

• whether any conflicts of interest have arisen in their engagement activities, and, if so, what they are and how the asset manager has dealt with them

The points highlighted in yellow in red font are additional to those on page 17 para 3.35 and Annex C (COBS) of CP19/7.

We agree that using COBS is a good way for the FCA to regulate this but think that the minimum standard laid down by the SRD II is appropriate for some of the 27/28 EU member states but not for an advanced economy such as the UK.

Much of what is of interest are soft issues, better dealt with via a Code, rather than through regulation. We have laid out in our introductory comments the failings of the current engagement process and have also made these points in our response to the FRC consultation on its proposed Stewardship Code.

The ability of beneficial shareholders who hold their shares in nominee accounts being able to vote their shares easily and at no additional cost is a critical aspect of shareholder rights and shareholder democracy. **Any regulatory proposals that fail to address this point can only be a partial solution.** The Law Commission Review of Intermediated Securities (see para 4.13 of the DP) must be given a much higher priority.

We would of course be happy to meet with you and explain our views in more detail.

Yours faithfully,

Peter Parry – Policy Director – UK Shareholders' Association

Cliff Weight – Policy Director – ShareSoc, UK Individual Shareholder' Society