SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: **20 SEPTEMBER 2013**

LEAD OFFICER: **SHEILA LITTLE, CHIEF FINANCE OFFICER**

SUBJECT: **THE STEWARDSHIP CODE**

SUMMARY OF ISSUE:

The report sets out the case for adopting The Stewardship Code as a step towards achieving effective corporate governance and acting as a responsible investor with regards to the companies that it owns.

RECOMMENDATIONS:

It is recommended that:

1 The Pension Fund Board adopt The Stewardship Code and approve the Fund's commitment to the Code as set out in Annex 1.

REASON FOR RECOMMENDATIONS:

Given the current importance of responsible investment and stewardship, the adoption of The Stewardship Code is an important move towards the Fund playing a full part in the quest for effective corporate governance. Recent research has also highlighted a link between funds demonstrating a strong environment/ social/ governance stance and the achievement of higher returns.

DETAILS:

Background

1 The Stewardship Code ("The Code") is a set of principles or guidelines released in 2010 by the Financial Reporting Council (FRC), directed at institutional investors who own shares in UK listed companies ("quoted companies"). Its principal aim is to encourage institutional investors, who manage other people's money, to be active owners and engage with their investee companies so as to encourage them to act in the interests of their beneficiaries. In the UK context these are primarily shareholders, but UK company law extends corporate responsibilities to wider stakeholders.

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2 The Code applies to firms who manage assets on behalf of institutional shareholders such as pension funds, insurance companies, investment trusts and other collective investment vehicles. This means fund managers, but the Code also "strongly encourages" asset owners to disclose their own level of compliance with the Code's principles. Since its introduction, all UK-authorised fund managers are required under the Financial Conduct Authority's (FCA's) Conduct of Business Rules to produce a statement of commitment to the Stewardship Code, or explain why it is not appropriate to their business model.

3 The Code adopts the same "comply or explain" approach used in the UK Corporate Governance Code. This means that it does not require compliance with principles. However, if asset owners and managers do not comply with any of the principles, they must explain why. Copies of Stewardship Code statements are also sent to the FRC and are either hosted on their website or show a link to the pension fund's own investment pages.

Origin of The Stewardship Code

4 In the immediate aftermath of the financial crisis, Sir David Walker was asked by the then government to report on the governance of banks and other financial institutions. His final report (The Walker Review) was published in July 2009. Within the report, Sir David made a number of observations about lax investor oversight. He noted that:

"With hindsight, it seems clear that the board and director shortcomings would have been tackled rather more effectively had there been more vigorous scrutiny and persistence by major investors acting as owners." (chapter 5, page 63)

5 In reaction to the criticism levelled at fund managers throughout the Walker Review consultation, the UK's Institutional Shareholders' Committee (ISC) issued a pre-emptive strike against potential legislation with the publication of a set of best practice guidelines: The Responsibilities of Institutional Shareholders And Agents: Statement Of Principles. In response, Sir David advocated that the ISC code be renamed the "Stewardship Code" and be adopted and adapted by the FRC to ensure independent oversight and monitoring.

Principles

6 The overarching purpose of the principles is to "enhance the quality of the dialogue" with companies, "reduce the risk of catastrophic outcomes", and aid "efficient exercise of governance responsibilities." Although the Code sets out a best practice framework for investors that choose to engage with investee companies, the ISC made it clear at the time of its launch that it does not constitute an obligation to micromanage or preclude a decision to sell a holding where this is considered the most effective response to concerns.

7 The seven principles of the Code are that Institutional investors should:

- 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 with this policy being 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.
- Report periodically on their stewardship and voting activities.

Relationship with the Myners Principles

8 The Myners Principles predate the Stewardship Code by some considerable time as they were originally published in 2002. They were introduced following a review of institutional investment, commissioned by HM Treasury and taken on by Lord Myners. His review found shortcomings in the expertise and organisation of investment decision-making by pension fund trustees. As an alternative to possible regulation, the Myners Principles were introduced on a comply and explain basis.

9 In 2004 the Government conducted a review of the operation of the principles. This review concluded that they had contributed to an improvement in trustee performance, albeit with more progress in some areas (e.g., trustee expertise and training) than others (e.g., more detailed consideration of investment time horizons and shareholder engagement). The Principles were revisited again in 2007 when the government asked the National Association of Pension Funds (NAPF) to undertake a review of their operation and propose any relevant changes.

10 In their current form, there are two principles of relevance to stewardship: principles 5 and 6.

Principle 5: Responsible ownership

11 Administering authorities should:

- Adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents;

- Include a statement of their policy on responsible ownership in the Statement of Investment Principles; and

- Report periodically to scheme members on the discharge of such responsibilities.

Principle 6: Transparency and reporting

12 Administering authorities should:

- Act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives; and

- Provide regular communication to scheme members in the form they consider most appropriate.

13 Principle 5 contains anachronistic wording due to the fact the ISC Principles have now been subsumed into the Stewardship Code and the ISC no longer exists. However, compliance with the Myners's Principles can be achieved by adopting the Stewardship Code and referencing to that fact in the Statement of Investment Principles.

14 A draft Stewardship Code statement for approval by the Pension Fund Board is shown as Annex 1.

CONSULTATION:

15 The Chairman of the Pension Fund has been consulted on the proposed change and has offered full support for the proposals.

RISK MANAGEMENT AND IMPLICATIONS:

16 There are no risk related issues contained within the report's proposals.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

17 There are no financial and value for money implications.

CHIEF FINANCE OFFICER COMMENTARY

18 The Chief Finance Officer is satisfied that all material, financial and business issues and possibility of risks have been considered and addressed and that the Stewardship Code will assist in the quest for responsible investment and stewardship strategies.

LEGAL IMPLICATIONS – MONITORING OFFICER

19 There are no legal implications or legislative requirements associated with this report.

EQUALITIES AND DIVERSITY

20 The adoption of the Stewardship Code will not require an equality analysis, as the initiative is not a major policy, project or function being created or changed.

OTHER IMPLICATIONS

21 There are no potential implications for council priorities and policy areas.

WHAT HAPPENS NEXT

22 The following next steps are planned:

- Adoption of the Stewardship Code
- Compliance with the Code is kept under regular review and progress reported to the Board where appropriate.

Contact Officer:
Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)

Consulted:
Pension Fund Board Chairman

Annexes:
Stewardship Code Statement

Sources/background papers:
None

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