

**Material for “The Council of Experts Concerning the Japanese  
Version of the Stewardship Code” of the Financial Services Agency**

# **UK Stewardship Code**

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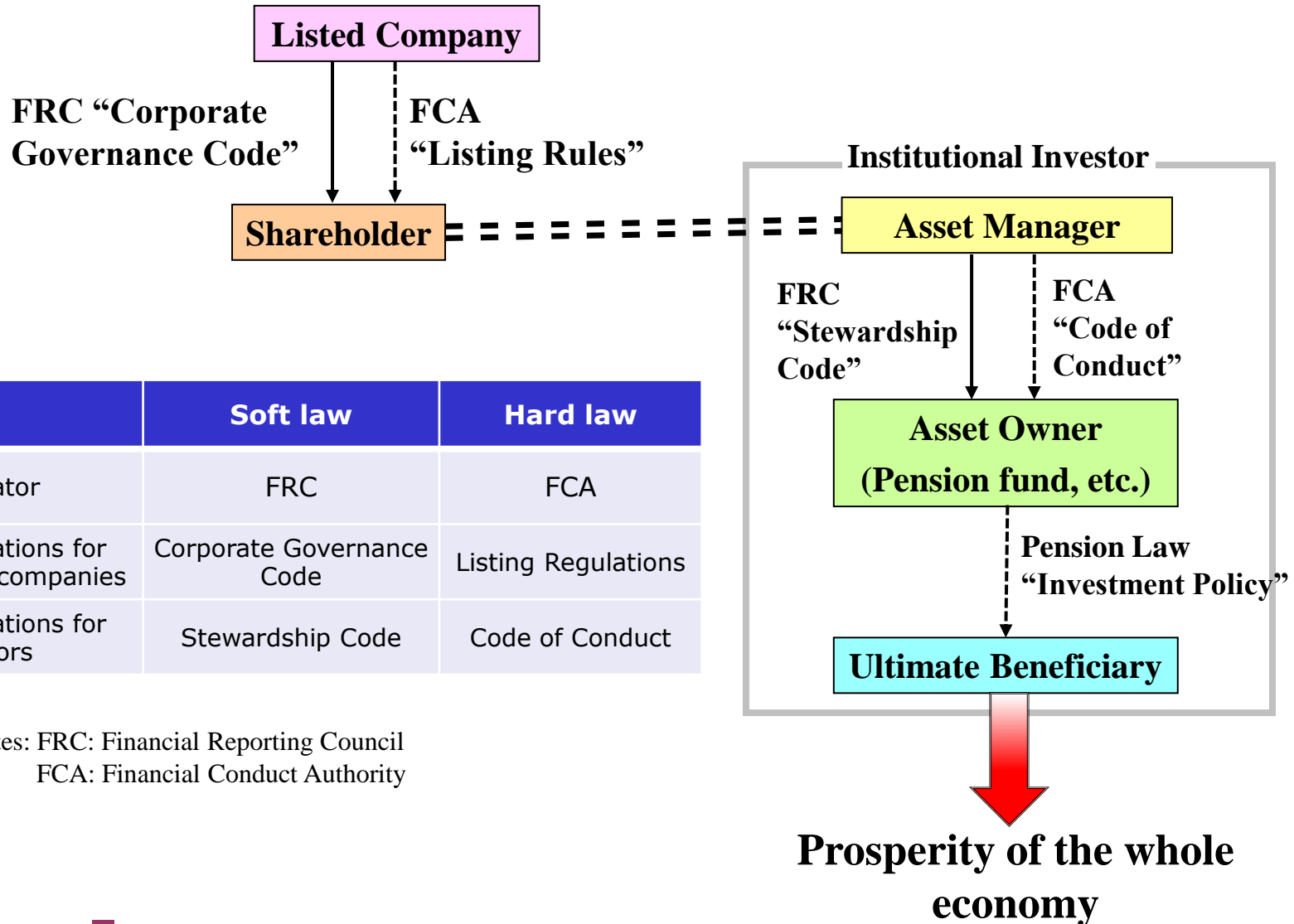
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# 1. Background of the U.K. Stewardship Code

# Framework of Value Improvement Systems in the U.K.



	Soft law	Hard law
Regulator	FRC	FCA
Regulations for listed companies	Corporate Governance Code	Listing Regulations
Regulations for investors	Stewardship Code	Code of Conduct

Notes: FRC: Financial Reporting Council  
FCA: Financial Conduct Authority

# History of the Stewardship Code and the Corporate Governance Code

(Institutional Investor) Stewardship Code		(Listed Company) Corporate Governance Code	
1991 ISC	The Responsibilities of Institutional Shareholders in the UK	1992 The Cadbury Committee	The Committee on the Financial Aspects of Corporate Governance
		1995 The Greenbury Committee	Remuneration of directors
		1998 The Hampel Committee	Final Report by the Corporate Governance Committee
		1998 The Hampel Committee	Combined Code
2001 MOF	The Myners Report on Institutional Investment		
2002 ISC	The Responsibilities of Institutional Shareholders and Agents - Statement of Principles		~ Revision to the Combined Code ~
2009 MOF	The Walker Review		
2009 ISC	Code on the Responsibilities of Institutional Investors		
2010 FRC	Stewardship Code	2010 FRC	Corporate Governance Code
2012 FRC	Revised Stewardship Code	2012 FRC	Revised Corporate Governance Code

Note:

ISC: Institutional Shareholders Committee. (Currently, the name has been changed to IIC (Institutional Investor Council). The main members include ABI (Association of British Insurers), AIC (Association of Investment Companies), IMA (Investment Management Association), and NAPF (National Association of Pension Funds).

- In the 1990s, the United Kingdom witnessed a significant development in debate on corporate governance centering on companies.
  - On the back of corporate scandals (BCCI Bank, Maxwell, etc.) having become social problems in the 1980s, the British business community established a committee, chaired by Sir Adrian Cadbury, with the aim of eliminating corporate misconduct and improving the management environment. The Cadbury Committee included the chairman of the Institutional Shareholders Committee as a member. → In the U.K., institutional investors have been involved from the initial stage of the development of corporate governance.
  - “The Report on the Financial Aspects of Corporate Governance” (Cadbury Report) issued by the Cadbury Committee in 1992 served as the foundation for British corporate governance, and is recognised as the world’s pioneering corporate governance code.
  - The Combined Code was announced in 1998 by integrating the reports produced by the Cadbury Committee, the subsequent Greenbury Committee and the Hampel Committee. The Code was under the jurisdiction of the FRC, and was also introduced into the listing rules.
- Into the 2000s, debates from the shareholders’ point of view developed toward improvement of the quality of corporate governance.
  - The Myners Report issued in 2001 provided detailed analyses on the nature and roles of institutional investors, along with which ISC revised the code, requiring its members to issue statements on the shareholders’ behavior. However, the debate remained static thereafter.
  - Following the financial crisis, the importance of the roles and responsibilities of institutional investors in corporate governance was reaffirmed.
    - The Walker Review recommended that a code for institutional investors be formulated.
    - ISC formulated the “Code on the Responsibilities of Institutional Investors.”
    - FRC formulated the “Stewardship Code” in reference to the Code produced by ISC.

# Walker Review Recommendations

- The Walker Review was produced by Sir David Walker after being commissioned by the Prime Minister to review the corporate governance of banks and other financial institutions. It was published in November 2009.
- The recommendations of the Walker Review were considered as suitable not only for financial institutions but also for listed companies, and became the foundation for the formulation of the Stewardship Code.

## Recommendation 16:

The remit of the FRC should be explicitly extended to cover the development and encouragement of adherence to principles of best practice in stewardship by institutional investors and fund managers. This new role should be clarified by separating the content of the present Combined Code, which might be described as the Corporate Governance Code, from what might most appropriately be described as the Stewardship Code.

## Recommendation 17:

The Code on the Responsibilities of Institutional Investors, prepared by the Institutional Shareholders' Committee, should be ratified by the FRC and become the Stewardship Code. By virtue of the independence and authority of the FRC, this transition to sponsorship by the FRC should give materially greater weight to the Stewardship Code. Its status should be akin to that of the Combined Code as a statement of best practice, with observance on a similar "comply or explain" basis.

## Recommendation 18:

The FRC should oversee a review of the Stewardship Code on a regular basis, in close consultation with institutional shareholders, fund managers and other interested parties, to ensure its continuing fitness for purpose in the light of experience and make proposals for any appropriate adaptation.

The Walker Review recommendations led to the enhancement of the foundation of the Stewardship Code.

- Specify best practices in relation to the stewardship responsibilities of institutional investors.
- As to the Combined Code, specify individual code separately about the corporate governance of companies and the stewardship of shareholders.
- Supervision by FRC
- Adopt the ISC's "Code on the Responsibilities of Institutional Investors" as the "Stewardship Code."
- Adopt the "Comply or Explain" approach as a soft law.
- Revise the code periodically (every two years).

# Institutional Investors and Other Organisations That Announced Adoption of the Stewardship Code

	As of October 2010	As of March 2013
Asset Managers	48	101
Asset Owners	12	60
Service Providers	8	14
Public Letters of Support (foreign pension funds, etc.)	6	10
<b>Total</b>	74	185

- Responses of institutional investors to the Stewardship Code:
  - In anticipation of the formulation of the Stewardship Code in 2010, major institutional investors enhanced their organisational structures including expanding administrative department responsible for the disclosure obligation by integrating departments relating to the exercise of voting rights and departments relating to ESG (environment, society, governance) in charge of sustainability.
  - Many of the asset management firms that accepted the Stewardship Code from an initial stage were major institutional investors. Smaller-sized institutional investors seem to have faced excessive administrative burden, etc.
  - Due partly to the background in which asset owners requested the adoption of the Stewardship Code together with the UN Principles of Responsible Investment as a condition for conclusion of asset management agreement, the number of institutions that adopted the Code increased.
- Challenges arising from an increase in the organisations that adopted the Stewardship Code:
  - While the number of the organisations that have adopted the Stewardship Code has increased, the difference of the contents of the statement explaining the responses to, and the policy of, the Stewardship Code expanded.

# Significance of Stewardship

## What is “Stewardship”?

- The term “steward” originate from “steward or administrator of property (for a manor house),” and has a long history in the United Kingdom.
- Stewardship is the concept of acting in the interest of an individual if a relationship of “managing their assets” exists. The relationship of stewardship arises in diverse situations including financial management by a public administration, management of an individual’s assets, corporate management by directors based on capital contribution from shareholders, etc.
- With respect to asset management by institutional investors, stewardship means careful management of assets, and monitoring and communication with the investee companies for the best interest of customers or final beneficiaries.

## Why “Stewardship” rather than “fiduciary duty”?

- Environmental change
  - Responsibilities of institutional investors used to be discussed within the scope of fiduciary duty. However, as the investment chain has become complicated with more and more related parties, the concept of fiduciary duty alone may not be sufficient to cover all the responsibilities of institutional investors.
- Limitation of “fiduciary duty”
  - Although the concept of fiduciary duty is established on a specific contractual, legal or factual relationship of trust, there are some cases in which this concept is not sufficient in the investment chain or its surroundings.
  - It is clearly understood that an asset manager assumes fiduciary duty to an asset owner, whereas the asset owner (e.g. pension fund) assumes fiduciary duty to a beneficiary (e.g. pensioner).
  - If an asset manager uses a proxy advisor, the asset owner has no direct contact. Even in the relationship with the final beneficiaries on the back of the asset owner, the asset manager and the proxy advisor have no direct contact. Therefore, it is ambiguous as to where the responsibility for the beneficiaries lies.
- Understanding the wide-ranging relationships of “Stewardship”
  - By adopting the concept of stewardship which may, in some way, be vague in defining the relationships, we will be able to capture the wider and more complicated relationships in the investment chain, and aim to achieve the ultimate purpose of safeguarding the interests of asset owners and final beneficiaries through improvement of values of listed companies.

## Issue of understanding “Stewardship”

- The term “Stewardship” became the main point of controversy, and triggered calls for revision, due to the assertion that the definition and the concept is vague, and the explanation was insufficient in the first Code formulated in 2010.
- ICGN’s statement of “Principle of institutional Investor Responsibilities” (2013) uses the expression “Responsibilities of institutional investors” and “fiduciary duty” rather than “Stewardship,” to avoid unnecessary confusion as the term is not fully understood outside the United Kingdom.

Note: This is based on a hearing survey conducted in March 2013 with government officials, experts and researchers.



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## 2. Overview of the Stewardship Code

# The Principles of the Stewardship Code

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So as to protect and enhance the value that accrues to the ultimate beneficiary, institutional investors should:

1. publicly disclose their policy on how they will discharge their stewardship responsibilities.
2. have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.
3. monitor their investee companies.
4. establish clear guidelines on when and how they will escalate their stewardship activities.
5. be willing to act collectively with other investors where appropriate.
6. have a clear policy on voting and disclosure of voting activity.
7. report periodically on their stewardship and voting activities.

# Introduction

## Stewardship and Code

- Significance and Purpose of Stewardship
  - 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.
  - For institutional investors, stewardship is not limited to voting rights. Stewardship activities include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, corporate governance, etc., including corporate culture and remuneration.
- Functions of Corporate Governance and Stewardship Code
  - Corporate governance code: Principles fundamental to effective board of directors
  - Stewardship code: Principles concerning effective stewardship activities by investors
- Definitions of Asset Owner and Asset Manager
  - Asset owner: Pension funds, insurance companies, investment trusts, etc.
  - Asset manager: Those responsible for managing assets on a daily basis; entrusted by asset owners.

## Application of the Code

- Those to whom the code is applicable: Institutional investors registered in the United Kingdom holding shares in companies listed in the U.K. (i.e. Asset owners and asset managers)
- Disclosure of statements by signatory organisations of the code
  - Method of disclosure: On the company's website, or if there is none, other accessible means shall be used.
  - Disclosure: (1) Statement on how the organisation applies the seven principles of the code, and the information required by guidances (attached to each principle)  
(2) If any of the principles are not applied, or if there is information required by the guidances but not disclosed, the reason for non-observance shall be provided.

## Compliance or Explanation?

- Signatory organisations shall provide an easy-to-follow and detailed explanation together with clear reasoning regarding their approach to stewardship if they do not comply with any principles or guidances.
- FRC does not believe that all the codes can be complied with by all the signatory organisations.
- Customers and beneficiaries shall respect the status of the individual signatory organisations, and in particular, pay close attention to the scale and complexity, risks and their nature facing the organisation as well as the investment purposes of these signatory organisations and customers. Further, discreet considerations are required not to assess the explanations of the signatory organisations or handle their non-compliance immediately as violation of the code.

# Principle 1: Disclosure of Statement Concerning Stewardship

## Principle 1:

**Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.**

- Stewardship responsibilities
  - The purpose of stewardship is 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.
  - For institutional investors, stewardship is not limited to voting rights. Stewardship activities include monitoring and engaging (having a visionary dialogue) with companies on matters such as strategy, performance, risk, capital structure, corporate governance, etc. including corporate culture and remuneration.
- Disclosure of the policy for stewardship responsibilities
  - Institutional investors shall be required to publicly disclose their policy on discharging their stewardship responsibilities to increase and preserve the value held by final beneficiaries and customers.
  - The content to be disclosed in the statement shall reflect the differences dependent on position in the investment chain. In particular, the stewardship responsibilities of asset owners are significantly different from the those of asset managers or service providers.
- Disclosure of information in the case of partial outsourcing of stewardship responsibilities
  - If any actions concerning stewardship are outsourced to the service providers, the following points must be explained in the statement.
    - How such service providers to the appropriate implementation of stewardship responsibilities by institutional investors?
    - What measures were taken to get the outsourced work implemented in a manner corresponding to the approach toward stewardship by institutional investors as set forth in the statement?

## Principle 2: Management of Conflicts of Interest

### Principle 2:

**Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.**

- Stipulation of the duty of institutional investors
  - An institutional investor's duty is to act in the interests of its clients and/or beneficiaries.
- Inevitable conflicts of interest and required countermeasures
  - Based on the recognition that conflicts of interest between the group company to which the institutional investor belongs and customers is inevitable, countermeasures should be considered.
  - Institutional investors should put in place, maintain and publicly disclose a policy for identifying and managing conflicts of interest with the aim of taking all reasonable steps to put the interests of their client or beneficiary first. The policy should also address how matters are handled when the interests of clients or beneficiaries diverge from each other.

# Principle 3: Monitoring Investee Companies

## Principle 3:

### **Institutional investors should monitor their investee companies.**

- Effective monitoring is an essential component of stewardship. It should take place regularly and be checked periodically for effectiveness.
- Monitoring of investee companies by institutional investors
  - keep abreast of the company's performance;
  - keep abreast of developments, both internal and external to the company, that drive the company's value and risks;
  - satisfy themselves that the company's leadership is effective;
  - satisfy themselves that the company's board and committees adhere to the spirit of the UK Corporate Governance Code, including through meetings with the chairman and other board members;
  - consider the quality of the company's reporting; and
  - attend the General Meetings of companies in which they have a major holding, where appropriate and practicable.
- Acts relating to monitoring by institutional investors
  - Institutional investors should consider carefully explanations given for departure from the UK Corporate Governance Code and make reasoned judgements in each case. They should give a timely explanation to the company, in writing where appropriate, and be prepared to enter a dialogue if they do not accept the company's position.
  - Institutional investors should endeavour to identify at an early stage issues that may result in a significant loss in investment value. If they have concerns, they should seek to ensure that the appropriate members of the investee company's board or management are made aware.
  - An institutional investor who may be willing to become an insider should indicate in its stewardship statement the willingness to do so, and the mechanism by which this could be done.
  - Institutional investors will expect investee companies and their advisers to ensure that information that could affect their ability to deal in the shares of the company concerned is not conveyed to them without their prior agreement.

## Principle 4: Engagement with Investee Company

### Principle 4:

**Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities.**

- Consider active intervention in management by institutional investors
  - Institutional investors should set out the circumstances in which they will actively intervene and regularly assess the outcomes of doing so.
  - Intervention should be considered regardless of whether an active or passive investment policy is followed.
  - Instances when institutional investors may want to intervene include, but are not limited to, when they have concerns about the company's strategy, performance, governance, remuneration or approach to risks, including those that may arise from social and environmental matters.
  
- Method and degree of involvement in management
  - Initial discussions should take place on a confidential basis.
  - If companies do not respond constructively when institutional investors intervene, then institutional investors should consider whether to escalate their action, for example, by:
    - holding additional meetings with management specifically to discuss concerns;
    - expressing concerns through the company's advisers;
    - meeting with the chairman or other board members;
    - intervening jointly with other institutions on particular issues;
    - making a public statement in advance of General Meetings;
    - submitting resolutions and speaking at General Meetings; and
    - requisitioning a General Meeting, in some cases proposing to change board membership.

# Principle 5: Collective Engagement

## Principle 5:

**Institutional investors should be willing to act collectively with other investors where appropriate.**

- Effectiveness of collective engagement
  - At times collaboration with other investors may be the most effective manner in which to engage.
  - Collective engagement may be most appropriate at times of significant corporate or wider economic stress, or when the risks posed threaten to destroy significant value.
- Disclosure of policy on collective engagement
  - Institutional investors should disclose their policy on collective engagement, which should indicate their readiness to work with other investors through formal and informal groups when this is necessary to achieve their objectives and ensure companies are aware of concerns.
  - The disclosure should also indicate the kinds of circumstances in which the institutional investor would consider participating in collective engagement.



## Principle 6: Disclosure of Exercise of Voting Rights

### Principle 6:

**Institutional investors should have a clear policy on voting and disclosure of voting activity.**

- Exercise of voting rights
  - Institutional investors should seek to vote all shares held.
  - They should not automatically support the board.
- Voting rights as the outcome of engagement
  - If they have been unable to reach a satisfactory outcome through active dialogue then they should register an abstention or vote against the resolution.
  - In both instances, it is good practice to inform the company in advance of their intention and the reasons why.
- Disclosure of voting records
  - Institutional investors should disclose publicly voting records.
- Disclosure of how the institutional investor uses a proxy advisor
  - Institutional investors should disclose the use made, if any, of proxy voting or other voting advisory services.
  - They should describe the scope of such services, identify the providers and disclose the extent to which they follow, rely upon or use recommendations made by such services.

# Principle 6: Disclosure of Exercise of Voting Rights – Status Survey –

## 1. Disclosure of voting results

(%)	2012	2011	2010
Disclose voting information	65	73	65
Do not disclosed	33	27	33
Reason disclosed	15	14	-
Reason not disclosed	15	11	-
Commit to publish	3	2	-
No response	2	-	2
Sample size	80	64	48

## 2. All votes publicly disclosed

(%)	2012	2011	2010
All votes	68	68	68
Rationale for all	6	9	-
Rationale for against or abstained, and exceptional	10	6	-
Rationale for against or abstained	8	4	-
No rationale	44	49	-
Summary report	32	30	32
No response	-	2	-
Sample size	52	47	31

## 3. Disclosure of voting information in arrears

(%)	2012	2011
Quarterly or less	60	57
Six months	13	13
One year	25	28
More than one year	2	2
Sample size	52	47

Notes 1. Source: Investment Management Association, “Adherence to the FRC’s Stewardship”(June 2013).

2. In the survey 1, “Disclosed” included cases in which the results of the exercise of voting rights were publicly disclosed in any form.

3. Respondents to the surveys 2 and 3 are those who answered “Disclosed” in the survey 1.

### 1. Disclosure of voting results

- Large-scale asset management firms tend to disclose the results. More than 90% of the assets of all the respondents are held by 65% of the asset managing firms that responded “Disclosed.”
- Reasons for not disclosed are diverse.
  - Disclosed only to customers (nine firms)
  - Disclosed if requested. (one firm)

### 2. Disclosure of individual proposals

- Asset managers that disclose the rationale for all the proposals account for 68%, whereas those disclosing the reasons for all the proposals represent only 6%.
- 32% of asset managers disclose only the summary report of voting records, such as the ratio of approval and objection.

### 3. Disclosure of voting information in arrears

- While 60% of asset manager disclose quarterly or less, 25% disclose approximately once a year.

# Principle 7: Report on Stewardship Activities

## Principle 7:

**Institutional investors should report periodically on their stewardship and voting activities.**

- Periodical report on stewardship activities by institutional investors
  - Institutional investors should maintain a clear record of their stewardship activities.
  - In the case of asset managers
    - Asset managers should regularly account to their clients or beneficiaries as to how they have discharged their responsibilities. Such reports will be likely to comprise qualitative as well as quantitative information. The particular information reported and the format used, should be a matter for agreement between agents and their principals.
  - In the case of asset owners
    - Asset owners should report at least annually to those to whom they are accountable on their stewardship policy and its execution.
- Nondisclosure of information, if appropriate
  - Transparency is an important feature of effective stewardship. Institutional investors should not, however, be expected to make disclosures that might be counterproductive. Confidentiality in specific situations may well be crucial to achieving a positive outcome.
- Assurance reports on engagement and voting processes under AAF01/06
  - Asset managers that sign up to this Code should obtain an independent opinion on their engagement and voting processes having regard to an international standard or a UK framework such as AAF 01/062.
  - The existence of such assurance reporting should be publicly disclosed.
  - If requested, clients should be provided access to such assurance reports.

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## **3. Key Points of the Amendment to the Code in 2012**

# Specification of the Significance of “Stewardship”

## 1. Background

- In response to the criticism that the significance of “Stewardship” is unclear, concerted efforts were made to clarify the definition during revision of the code.
- In the 2010 version of the Stewardship Code, the definition of the term “Stewardship” was insufficient. In the consultative document prepared prior to revision, FRC admitted that confusion was spreading over the meaning of the term “Stewardship” in and out of the U.K. markets, pointing out that the purpose of the Stewardship Code was sometimes recognised only as relating to so-called “relational investments.”
- In the background is the fact that the term “Stewardship” itself is hard to understand. The Principle for Responsible Investment (June 2013) compiled by ICGN (International Corporate Governance Network) describes that “Stewardship is not fully understood outside the U.K.” and does not adopt stewardship.

## 2. Overview of the revision

- The 2012 Revised Code established a new chapter “Stewardship and the Code” in the introduction.
- In paragraphs 1 and 2 of “Stewardship and the Code,” the definition and meaning of stewardship was clarified.
- The guidance of Paragraph 1 indicates the embodied stewardship activities, giving an explicit account about the meaning of the term “Stewardship,” the purpose, and how it relates to corporate governance.
- FRC’s proposed revision won broad support with the opinion that the term “Stewardship” is a useful and appropriate expression.
- While the 2012 Revised Code added descriptions about the purposes of stewardship and the outline of the stewardship activities, the explanation of the concept itself is still far from satisfactory.

# Specification of the Roles and Responsibilities of Asset Owners and Asset Managers

## 1. Background

- With respect to the Stewardship Code 2010, it was pointed out that the difference of roles and responsibilities between asset owners and asset managers was unclear, and the divisions and the scopes thereof were ambiguous.
- There existed some cases in which the term “institutional investors” was ambiguous about if it referred only to the asset managers, or if it also included asset owners in the investment chain.

## 2. Outline of the revisions

- The revised code 2012 clarified the roles and responsibilities of asset owners and asset managers, requiring the interested parties to recognise them expressly.
- Stewardship activities vary depending on the positions of the parties. It is expressly provided that asset owners continue to assume stewardship responsibilities to beneficiaries even in the case where the management of assets is commissioned to asset managers.
- In the revised Code, the term “institutional investors” as used in the previous Code has been clarified as “asset manager” or “asset owner” depending on the meanings of the term if it referred to either asset owner or asset manager. To include both meanings of asset manager and asset owner, the term “institutional investor” has been used. To avoid debate and confusion regarding whether or not asset managers and asset owners are recognised as shareholders from a legal point of view in a strict sense, the term “shareholder” has been replaced with “investor.”
- Asset managers and asset owners are required to clearly recognise the scope of their roles and responsibilities in the statements for the Stewardship Code.

# Enhanced Management of Conflict of Interest by Institutional Investors

## 1. Background

- The handling of problems of conflict of interest is considered a top priority issue while the institutional investors' role in corporate governance has become more and more important.
- In particular, conflict of interest for asset managers is an inevitable issue, and it is required that disciplinary rules are introduced.
- For example, when an asset manager belongs to a financial group company, there will be a risk of conflict of interest between the customer and the investee companies in relation to the group company, or a conflict of interest may occur among the customers if the interests of the customers are diverse.
- According to a survey report published in December 2011, the explanations provided in the statements of signatory institutions concerning the methods to manage conflict of interest are often insufficient, and there are not many signatory institutions that make an assertion of a customer-first policy.

## 2. Outline of the revisions

- Revisions to encourage enhanced management of conflict of interest and to make further disclosure of information in response to the criticisms of insufficient management and explanations on the conflict of interest inside institutional investors.
- In the revised version 2012, no change was made to Principle 2. However, significant revisions made to the guidance will have profound effects on the management practice of conflict of interest
- The guidance of Principle 2 of the revised Code specifies that institutional investors shall assume an obligation to act primarily in the interest of customers and beneficiaries. Also, it requires them to act in a rational manner placing the highest priority on the interests of customers and beneficiaries while recognising that issues of conflict of interest may occur inevitably. For such purposes, institutional investors are required to prepare and disclose publicly their policy of conflict of interest management.

# Enhanced Disclosure regarding Collective Engagement

## 1. Background

- Disclosure regarding collective engagement is made mainly with respect to the organisational structures of groups that conduct business activities, and there was criticism that explanations regarding the timing and conditions in which collective engagement is commenced were insufficient.
- In the U.K., collective engagement is becoming practically common as it can be used as a measure of communications between investee companies and investors when a serious management problem occurs. In particular, some pointed out that collective engagement contributed to certain aspects of the problems of the remuneration of management, such as amounts and structure of remuneration, and transparency.
- The intent of Principle 5 of the Stewardship Code in which disclosure relating to collective engagement is required is to clarify whether or not the signatory institutions wish to address problems in cooperation with other investors in case of a serious problem facing an investee company, and whether or not such cooperation can be established. The purpose is to clarify the attitude of individual institutional investors toward the collective engagement to cooperate with other investors, which is one of the central engagement activities of stewardship, in line with monitoring activities toward investee companies.
- A survey report published in December 2011 pointed out a problem that many of the statements produced by the signatory institutes to the Code focused on explanation only of the structure of the investor groups that conducted collective engagement. The challenge was revealed that the disclosure of information was insufficient in terms of the attitudes and philosophy toward collective engagement which is considered necessary to secure the quality of stewardship.

## 2. Outline of the revision

- The guidance of Principle 5 was revised, adding words to the effect of enhancing the explanation and disclosure concerning approaches to collective engagement regarding not only information about the structure of the investor groups conducting collective engagement but also in what circumstances investors want to participate in collective engagement.
- In addition to disclosure concerning the organisational structure of the investor groups conducting conventional collective engagement, it is expected that more substantial disclosure will be provided such as the conditions and background for engaging in collective engagement.



# Enhanced Disclosure regarding the Use of Proxy Advisors

## 1. Background

- In response to criticism that information regarding the increased impact of proxy advisors is not disclosed, institutional investors are required to make further disclosure on the use of proxy advisors. This issue is also considered by the European authorities as one of the most important challenges of the investment environment.
- Principle 1 of the 2010 version of the Code had required signatory institutions to explain whether or not they were using a proxy advisor and how they used them. There was, however, criticism that many of the statements submitted by the signatory institutions were insufficient with just simple explanations that they had their own policy for exercising voting rights, or whether they followed the results given by the proxy advisors. Such information was criticized as inadequate for assessing the value of the statements of those signatory institutions.

## 2. Outline of the revisions

### (1) Use of a proxy advisor

- The guidance of Principle 1 of the 2010 version Code had encouraged investors to disclose their policy of exercising voting rights and the use of proxy advisors, etc. Following revision in 2012, this paragraph was transferred to the guidance of Principle 6.
- In the guidance of Principle 6 of the 2012 revised Code, the range of matters required to be disclosed was expanded. Signatory institutions are required not only to state whether or not they use a proxy advisor but also explicitly disclose the name of the proxy advisor they use, and what kind of services they receive from such proxy advisor, to what degree they consider, rely on, and use their recommendations for voting activities.

### (2) Stewardship responsibilities of institutional investors when a proxy advisor is used

- It was explicitly stated that the stewardship responsibilities will not be alleviated even if an institutional investor uses a proxy advisor to outsource its work.
- In the 2012 revised version, a paragraph was added to the Introduction: “Application of the Code,” clarifying that institutional investors continue to assume the obligation to guarantee that the activities of a service provider (such as a proxy advisor, etc.) are executed in a manner corresponding to the approach of the stewardship of the relevant institutional investors even if the institutional investors outsource the operations relating to stewardship activities to the service provider.
- The guidance of Principle 1 of the revised Code requires that statements produced by signatory institutions reflect the responsibilities and the positioning in the investment chain of the institutional investors, and if the stewardship activities are outsourced, they should explain how such outsourcing corresponds to the appropriate implementation of the stewardship of the institutional investors, and what actions should be taken by the investors so that these activities are implemented in a manner corresponding to the approach to the stewardship as set forth in the statement of the signatory institutions.

# Reconfirmation of the Scope of Application of the Code (1)

## 1. Background

### (1) Scope of application of the Stewardship Code:

- The main purpose of the establishment of the Stewardship Code is to expand the engagement between institutional investors and listed companies toward the improvement of corporate governance in U.K. listed companies.  
⇒ The primary scope of application of the Code is **institutional investors registered in the U.K. that manage U.K. equities**.

### (2) Diversification of U.K. market participants

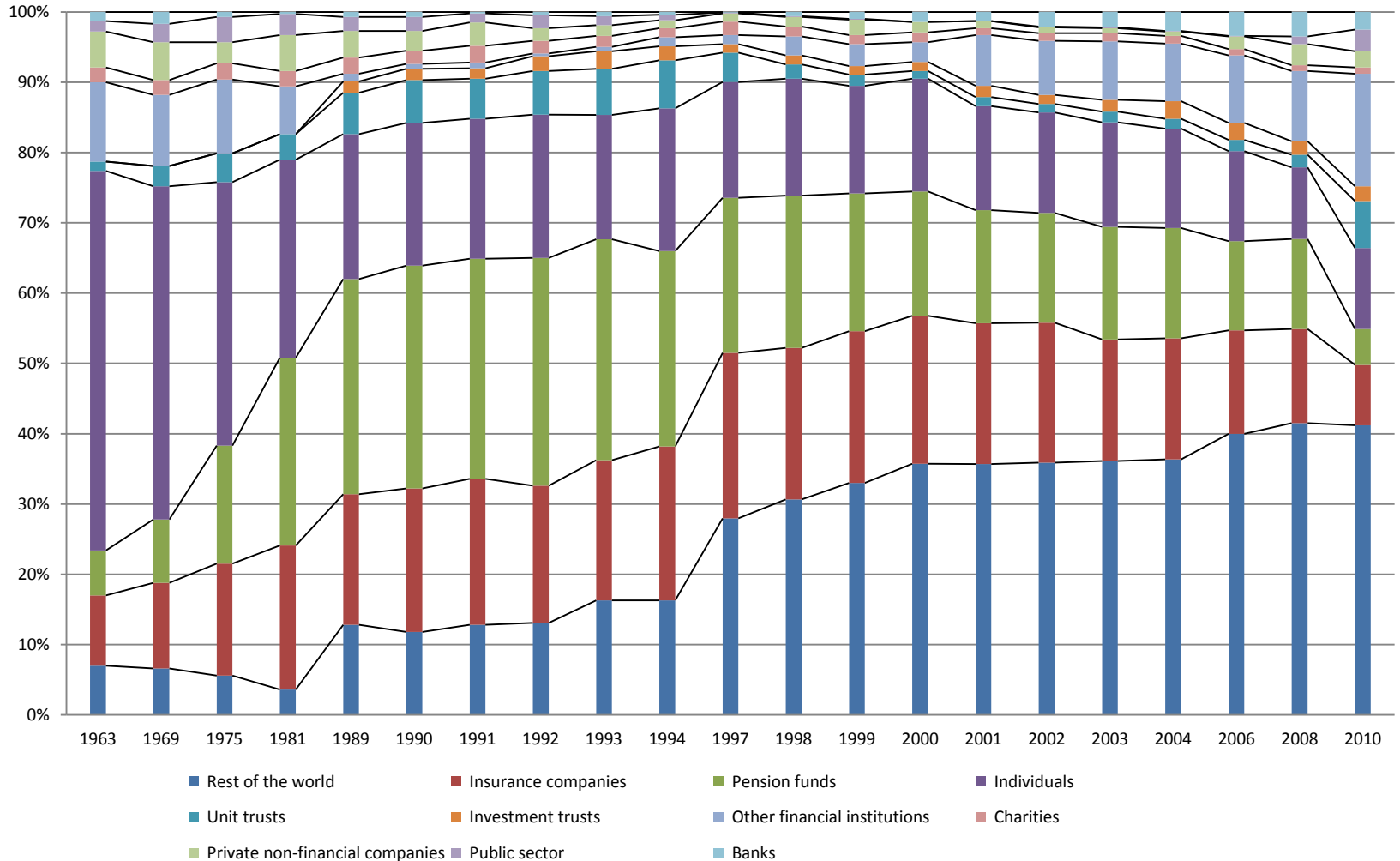
- The shareholding ratio of foreign institutional investors is higher than U.K. institutional investors in U.K. stock markets.
- The shareholding ratio of foreign investors in U.K. stock markets exceeded 40% in 2006 and thereafter, rising to 41.2% in 2010. In contrast to this, the total shareholding ratio of U.K. institutional investors (insurance companies, pension funds, unit trusts and investment trusts) remained at 22.5%.

### (3) Diversification of assets by asset allocation of U.K. institutional investors

- In the asset allocation of U.K. institutional investors, the shareholding ratio of non-U.K. shares is higher.
- Regarding the asset allocation of U.K. institutional investors, U.K. shares applicable to the Stewardship Code account for no more than 20%, and the shareholding ratio of foreign shares is higher than U.K. shares in the assets under management in 2010 and thereafter.
- Among the major institutional investors, some conduct engagement with not only U.K. shares but also foreign shares, exercising the voting rights of the foreign shares by publishing the guidelines for foreign shares and the results of their voting activities.
- Asset owners expect that asset managers will apply a similar stewardship approach toward Non-U.K. shares. Some asset owners point out that the statements of signatory institutions are unclear whether or not the principles of the Code are applied partially or entirely to the assets under management.

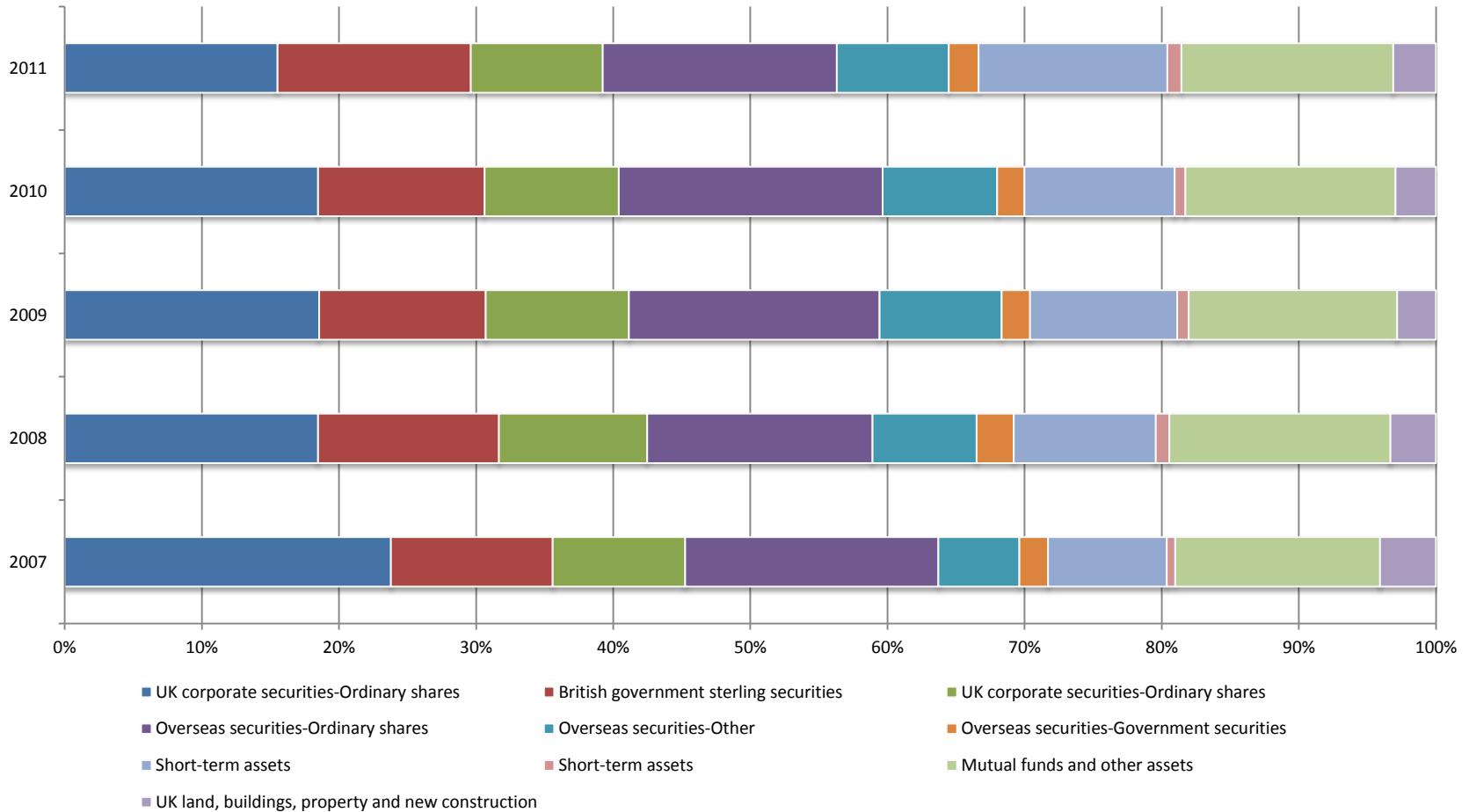
# Reconfirmation of the Scope of Application of the Code (2)

## ● Trend of shareholders of UK-listed companies (1963~2010)



# Reconfirmation of the Scope of Application of the Code (3)

- Investee companies of U.K. institutional investors (insurance companies, pension funds, unit trusts, investment trusts)



(Prepared based on the materials of the Office for National Statistics)

# Reconfirmation of the Scope of Application of the Code (4)

## 2. Outline of the revision

### (1) Scope of application of the Stewardship Code:

- Remained unchanged.

### (2) Scope of applicable investors:

- Introduction “Application of the Code” was newly established, and the 2nd paragraph clarified that the Code shall be applicable primarily to institutional investors who hold U.K.-listed shares.
- The 9th paragraph sets forth the concept of application of the Stewardship Code for international investors in and outside the U.K.
- A cautious stance remains with respect to external application of the Stewardship Code for foreign investors. As to foreign investors holding shares in U.K. companies, if they adopt the rules and principles of other countries or international rules and principles other than the Stewardship Code under the 9th paragraph of “Application of the Code,” they can respect those rules and principles, and shall not be required to adopt the U.K. Code.
- Discussions are continuing regarding foreign asset owners applying the Stewardship Code substantially by, for instance, hiring asset managers on the basis of having signed the Stewardship Code.

### (3) Scope of applicable assets:

- The 9th paragraph of the Introduction “Application of the Code” encourages U.K. investors to apply good business practice in the stewardship approach also to non-U.K. share investments as extensively as possible.
- The 10th paragraph encourages that the signatory institutions explain in the statement on the application of the Stewardship Code about the assets covered by the stewardship approach out of U.K. stock funds and financial instruments. If the Stewardship Code is applied also to assets other than U.K. shares, the disclosure of such fact is encouraged.

# Assurance Report of Asset Managers

## 1. Background

- In March 2011, The Institute of Chartered Accountants in England and Wales (ICAEW) issued a Stewardship Supplement applicable to asset managers with respect to the Stewardship Code, in relation to the guidance AAF01/06 2011 concerning the guarantee report on the internal control of service organisations.
- With respect to the internal control of service organisations, highly independent guarantees will be provided to asset owners and beneficiaries while keeping formal interventions to a minimum.

## 2. Outline of the revision

- Principle 7, was revised from “Asset managers must consider obtaining an assurance report” to “Asset managers must obtain an assurance report”.
- Since there were some asset owners who had concerns over the probability that asset managers may reject the provision of the assurance report, or they may demand additional fees for providing such a report, a paragraph was added to Principle 7 with the aim of eradicating such concerns from asset owners, to the effect that such assurance report must be provided when requested by a customer.
- Addressing the problem of whether or not the guarantee concerning the internal control of an asset manager can be extended to the asset owner:
  - For example, if stewardship activities are conducted in-house by an asset owner, or if the asset owner itself implements stewardship activities using a service provider, etc., a problem arises concerning the necessity of a guarantee of the internal control by the asset owner itself.
  - The primary purpose of the framework of AAF01/06 applicable to asset managers is to provide an assurance concerning the stewardship activities that an asset manager conducts for an asset owner as its customer. As to the extensive applicability of the framework to an asset owner, the 8th Paragraph of the revised “Application of the Code” states that it is desirable that the asset owner consider requesting an independent guarantee of the statement.
  - However, as the above extensive application is stated in the Introduction of the Code, rather than in the main text, it should be interpreted that asset owner is not obliged to obtain an assurance.

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## 4. Stewardship Code Expanding Globally

# Stewardship Code Expanding Globally

Codes by organisations and groups of foreign countries:

- South Africa: Committee on Responsible Investing by Institutional Investors in South Africa  
“The Code for Responsible Investing in South Africa” (2011)
- The Netherlands: EUMEDION  
“BEST PRACTICES FOR ENGAGED SHARE-OWNERSHIP INTENDED FOR EUMEDION PARTICIPANTS” (2011)
- Canada: The Canadian Coalition for Good Governance (CCGG)  
“2010 Principles for Governance Monitoring, Voting and Shareholder Engagement” (2010)
- Switzerland: The Association of Swiss Pension Funds (ASIP), Swiss Federal Social Security Funds, Swiss Business Federation, Swiss Foundation for Sustainable Development, Swiss Bankers Association, Federation of Industrial and Service Groups in Switzerland  
“Guidelines for institutional investors governing the exercising of participation rights in public limited companies” (2013)
- Italia: News Release by Milano Stock Exchange  
“Corporate Governance Committee: new entries; stewardship code and monitoring as planned activities for 2013” (Nov. 29, 2012) (still being formulated)

Codes by international organisations:

- EFAMA (European Fund Management Association)  
“EFAMA Code for external governance, Principles for the exercise of ownership rights in investee companies” (2011)
- ICGN (International Corporate Governance Network)  
“ICGN Statement of Principles for Institutional Investor Responsibilities” (2013)

Recommendations for formulating codes:

- The Securities Commission of Malaysia  
“Corporate Governance Blueprint 2011, Chapter 2: Role of Institutional Investors” (2011)
- ESMA (European Securities and Markets Authority)  
“Feedback statement on the consultation regarding the role of the proxy advisory industry” (2013)