

# The Stewardship Code in UK

## ~How it works~

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# Engagement in UK

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- The departments responsible for engagement in pension funds and investment management companies are usually the Corporate Governance Department or the Responsible Investment Department.
  - Those in charge of the proxy voting are normally responsible for engagement.
  - Meetings with listed companies include IR meetings, but these are not part of engagement. Usually only fund managers participate in IR meetings.
- Asset owners such as pension funds do not usually implement engagement directly.
  - However, whether or not they implement engagement in a positive manner can be one of the key criteria for selecting asset managers.
- As is often the case with investment management companies, fund managers attend engagement meetings.
  - It is highly likely that a listed company wants to exchange opinions with the investment managers on strategic issues.
- Top management and the CFO of a listed company will attend such meetings. In some cases, outside independent directors may also be present at the meeting.
  - From the viewpoint of the enhancement of corporate governance, it is encouraged in the U.K. that outside directors have a positive dialogue with shareholders.

# Selection of Investees for Engagement

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- In some cases, concentrated investment is followed by engagement with investee companies at least once a year.
  - There is a case in which communication with investees similar to engagement is conducted before determining the initial investment.
- In many cases, such communication is conducted when a doubt about the proposed agenda for a general shareholders' meeting arises (“before”), an opposition vote is cast at the general shareholders' meeting (“after”), and when the relevant investee company requests to conduct communication.
- There are many cases in which investee companies are selected based on a judgment that encouraging such communication will produce positive results reflecting the facts that the shareholding ratio is high, or the company is facing a serious problem.
  - Given that the purpose of engagement is to improve the performance of asset management, it is considered inappropriate to make it a routine matter.
- It is controversial on whether or not a passive investment manager should conduct engagement.

# Significance of “Comply or Explain” Approach

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- In the United Kingdom, the Combined Code concerning corporate governance has adopted the “Comply or Explain” approach, as has the Stewardship Code.
  - While it is highly regarded as a flexible regulatory method, it is recognized in Japan and some other countries as a provisional measure until blanket regulations are established.
- The Stewardship Code will be applied only to the signatory parties. However, the FCA’s Conduct of Business Sourcebook (COBS) requires authorized investment management firms to provide explanations on the status of their commitment to the Stewardship Code, or to disclose their investment strategies if they do not follow the Code.
- For example, in the case of a hedge fund, there may be an investment strategy of seeking returns using short-term trading. Therefore, depending on the contents of the strategy, it is not rational to expect stewardship through engagement, etc., to be conducted.
  - It must be understood that the “Comply or Explain” approach is adopted because blanket application is irrational, not because there is huge resistance against blanket application.
- It should be noted that an asset owner’s commissioning asset management to an investment management firm which does not follow the Stewardship Code does not automatically signify a violation of stewardship responsibilities.

# Collective Engagement

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- The Stewardship Code encourages collective engagement. (Principle 5)
- Collective engagement is recognized as highly effective particularly in the case of corporate management crisis, economic crisis and occurrence of other serious situations that could significantly damage corporate value.
- Collective engagement is also recommended from the perspective of preventing free ride.
- On the other hand, negative views against collective engagement are also provided as interests and opinions are diverse even among major institutional investors.
- The Kay Review proposed the establishment of an investor forum, to which Schroders, L&G, etc., responded in June 2013 by starting movements to set one up.

# Engagement-related Legal Issues

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- It is required not to transmit without prior consent undisclosed material facts which may affect the transactions conducted by asset managers in order to prevent violation of insider trading regulations from occurring.
  - In the Greenlight case in 2012, transactions conducted by a hedge fund which had obtained an undisclosed material information without prior consent were considered as insider trading.
  - It was pointed out, however, that such transactions would not have been judged as a violation against fiduciary duty according to U.S. case law.
- There is a risk that collective engagement can be regarded as “acting in concert” based on the TOB regulations.
  - The Takeover Panel has specified in its guidance that “acting in concert” is not applicable unless, for example, the representative of a business group requests to be appointed director in order to prevent institutional investors from taking negative attitudes.
- It is said that U.S. asset managers wishing to remain “passive investors” are cautious about engagement, taking into consideration U.S. regulations on reporting for large shareholders.
  - U.S. regulations require passive investors to report only once a year.