Investment Management Association

Adherence to the FRC's Stewardship Code

At 30 September 2010

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Contents

Key Findings

This report on adherence to the FRC's Stewardship Code (the Code) looks at the activities that support institutional investors' commitment to the Code. It summarises the responses of 41 Asset Managers, seven Asset Owners and two Service Providers to a questionnaire developed under the direction and oversight of a Steering Group chaired by the FRC's Chief Executive. The questionnaire covered the period to 30 September 2010 at which point, the Managers that responded managed £590 billion of UK equities representing 31 per cent of the UK market, and the Owners owned £15 billion. (Service Providers do not hold equities.)

The findings in this report are intended to establish a benchmark for any future surveys.

Policies (Section 3)

The FSA introduced a new requirement from 6 December 2010 requiring UK-authorised Asset Managers to produce a statement of their commitment to the Code or to explain their alternative investment strategy. 43 of the 50 respondents had a finalised policy statement on adherence to the Code on their websites before this date. Six stated publicly that they were developing a statement and were committed to the Code. These six statements have now been finalised and are public[1].

The main driver of stewardship and whether Asset Managers and Owners commit to the Code is the expectation of an Asset Manager's clients and an Asset Owner's beneficiaries and the terms of their mandates. In this context, the majority of respondents confirmed that their stewardship policy is referred to in at least some of their mandates and for six respondents it is in all mandates. 12 of the respondents do not refer to it in any mandates.

Resources (Section 4)

Resource levels are an important indication of an institutional investor's commitment to the Code. 43 respondents provided details and have a total headcount of over 1,300 involved in stewardship. In the main, matters relating to strategy and performance are handled by the portfolio managers/analysts but, due to the specialist knowledge required, dedicated stewardship specialists handle aspects such as corporate governance and socially responsible investment.

This dual approach has given rise to questions as to how Asset Managers and Owners integrate stewardship into the investment process. However, every respondent that adopts such an approach integrates stewardship in one or more ways. For example, those involved in the investment process may set and/or approve the stewardship policy, make the final voting decision in a controversial situation, attend meetings with investee companies with the stewardship specialists and/or simply meet the stewardship specialists in house.

Respondents' resources are often supplemented by Service Providers and the majority of Managers and Owners (39) use a Provider to process voting instructions. They also subscribe to one or more Providers to provide research but tend to make the final voting decision. In only one instance is the Provider's recommendation always followed in that respondents will make the final decision or where they may follow a Provider's recommendation, it is done in a considered way.

Monitoring and escalating (Section 5)

Although on average, the Asset Managers have a holding in just over 450 UK companies and the Asset Owners, 440, two thirds of respondents monitor and just less than half engage with all their investee companies as part of their research and investment process. When respondents do prioritise, the main criteria are when there is a sizeable holding and/or there are material issues of concern.

Each of the Asset Managers and Service Providers, and four of the Asset Owners have an in-house team that analyses company news and results. The majority of respondents (30) also contact management proactively for most or all of their investee companies. To a lesser extent, they contact investor relations and/or the company secretariat and are only likely to contact the Chairman and Non-Executive Directors (NEDs) proactively in exceptional circumstances or when raising concerns.

[1] One Asset Owner's statement has still not been finalised.

When asked about the main obstacles to stewardship, the most commonly quoted were the resources needed to be effective and the fact that the small size of holdings can mean that there is insufficient leverage/ influence over the companies concerned.

A number of respondents commented that attendance at AGMs is not always necessary and may not be an effective method of engagement and just less than 50 per cent only attend AGMs where they have a major holding or where appropriate.

Practical examples (Section 6)

To look at what actually happens in practice, respondents were asked how they escalated matters and engaged with certain companies on particular issues as set out below.

Marks & Spencer Group plc. The appointment of Sir Stuart Rose as both Chairman and Chief Executive and shareholder Resolution 16 at the 2009 AGM calling for the appointment of an independent Chairman.

This issue generated many meetings between respondents and representatives from Marks & Spencer, a number meeting company representatives on several occasions. Some also attended investor meetings and three respondents met with the proponents of the Resolution.

Respondents were divided on the matter with slightly more voting in support (14), than against (10), with four abstentions. Although the Resolution was not passed, almost 38 per cent voted in support of it at the AGM. The Board subsequently brought forward the appointment of an independent Chairman and Sir Stuart handed over his role as Chief Executive to Marc Bolland at the end of July 2010.

Tesco plc. The remuneration of executives in the US (the US business trading at a loss) and Resolution 2 at the 2010 AGM, approval of the Remuneration Report.

Although it appears to have been less intense than that at Marks & Spencer, respondents engaged on this issue. Again views were mixed as to whether the remuneration policy was excessive, with 19 voting against, 15 in support and five abstaining. In the event at the July 2010 AGM, 48 per cent voted against or abstained on Resolution 2.

Of the seven respondents that gave further details, six considered they achieved their objective, and the one that did not commented that the company now planned to consult investors on its remuneration policy.

Barclays plc. Concerns about refinancing and Resolutions 3 to 17 at the 2009 AGM where the entire Board stood for re-election.

There was much engagement over the issue, in particular because of concerns that the capital-raising was unconventional and bypassed normal pre-emption guidelines. Nevertheless, despite concerns about the refinancing, respondents delivered a consistent message with the majority supporting the Board on the basis that it was in the long term interest of the shareholders, although some voted against particular directors. All directors were re-elected.

Lloyds Banking Group plc. Voting on the acquisition of HBOS at the November 2008 EGM.

Again this issue generated a lot of activity and one respondent disposed of its entire holding as a consequence. However, the action was supported on the basis that there were few alternatives and there would be consequences in not supporting the deal. One commented that this was a reluctant vote in favour. Following the merger, five respondents subsequently engaged with Lloyds on the recovery.

Royal Dutch Shell plc. Shareholder Resolution 23 at the 2010 AGM for a report on the viability and risks of the Canadian oil sands projects on the basis they were an environmental and economic liability.

The majority of respondents met with the company on the issue – a number on several occasions. Seven visited the sites in Canada to look at the operations first hand and nine also met with the proponents of the Resolution to understand it better. A clear majority (35) voted against the Resolution generally on the basis that Shell had responded positively to the proposal. At the 2010 AGM, 94 per cent of votes were cast against the Resolution. One respondent publicly commented that it would continue to monitor developments but was satisfied that this had given powerful momentum to investors' engagement on this important issue.

Prudential plc. The proposed acquisition of AIG's Asian operation.

This deal raised widespread concern among investors on the basis they considered the price was too high. Respondents held numerous meetings where they sought to understand the rationale behind and the price of the acquisition. Two expressed concerns publicly. A large number collaborated with other shareholders. The majority achieved their objective in that the deal was withdrawn. Five respondents engaged with the company following these events to discuss the lessons learnt with three wanting changes to the Board to ensure that those responsible were held accountable.

Other examples. Respondents volunteered 21 additional examples. For example, one Asset Owner cited a seven month engagement on a proposed merger outside the UK which it felt did not benefit the company in which it was invested. When the merger was finally announced, following sustained pressure from minority shareholders, it was on significantly better terms than initially indicated.

18 of the other 20 respondents believed that they achieved the objective behind their engagement, either receiving assurance from the companies concerned or changes to the respective boards. Only two were not satisfied: one as the company went ahead with the deal and the other that its request to engage was refused.

Voting (Section 7)

The highest level of voting is in the UK. Close to 80 per cent of respondents vote 100 per cent of their UK holdings and a further 12.5 per cent vote between 75 and 100 per cent. Voting levels are less in overseas markets, with the highest being in the US, Canada and Japan. The most common obstacle to voting is share blocking which occurs in a number of markets with others being the need to re-register holdings and/or obtain powers of attorney.

22 respondents contact companies when voting against or abstaining and 13 write to the company if its explanation for departing from the UK Corporate Governance Code is not accepted.

Nearly two thirds of respondents publicly publish their voting records, with 21 of the 31 providing details of how each individual resolution is voted. Of the 16 that currently do not publish voting records, two are committed to do so in the future and the remaining 14 publicly state that they do not publish for reasons of confidentiality and that records are made available to clients.

Reporting (Section 8)

The majority of respondents report to their clients or beneficiaries, most commonly quarterly, though for 15 respondents, the frequency varies for individual clients and there is "no general trend". The majority provide both voting information and details of stewardship.

Few respondents have obtained an independent audit opinion on their engagement and voting processes having regard to the standards in AAF 01/06[2] and SAS 70[3]. While 40 per cent have obtained an independent audit opinion of their voting processes, few cover stewardship as well.

[2] The Audit and Assurance Faculty of the Institute of Chartered Accountants in England and Wales periodically issues guidance to its members. One such guidance note is AAF 01/06: Assurance reports on internal controls of service organisations made available to third parties, which provides guidance to reporting accountants.

[3] SAS 70: Service Organizations, is an auditing standard developed by the American Institute of Certified Public Accountants. It gives guidance to auditors in issuing an opinion on a service organisation's description of its controls.

1. Introduction

The FRC issued the Code in July 2010[4]. The Code is voluntary and aims to enhance the quality of engagement between institutional investors and companies to help improve long-term returns to shareholders and the efficient exercise of governance responsibilities. It sets out good practice on engagement with investee companies, including monitoring companies, dialogue with company boards and voting at general meetings.

The Code is addressed in the first instance to firms who manage assets on behalf of institutional shareholders, such as pension funds, insurance companies, investment trusts and other collective investment vehicles. From 6 December 2010, the FSA required all UK-authorised Asset Managers to produce a statement of their commitment to the Code or explain why it is not appropriate to their business model. The Code is set out in Appendix 1.

The FRC is considering how the application of the Code will be monitored and by whom in the future, but in the meantime, the implementation guidance stated: "*as an interim measure, the IMA is continuing with its regular engagement survey which is being tailored to cover adherence to the Code*".

IMA has worked closely with the FRC in developing the survey to monitor adherence to the Code and established a Steering Group, chaired by the FRC's Chief Executive, to direct and provide independent oversight. The members of the Steering Group are set out in Appendix 2. The survey aims to establish a benchmark for future surveys.

First, the FRC and IMA jointly reviewed the statements on adherence to the Code published by those institutions that had confirmed to the FRC their commitment and that responded to the questionnaire. Each policy statement was reviewed for its accessibility on the institution's website and completeness, i.e. the ease with which all relevant information could be accessed.

Secondly, it was important not only to look at the policy statements but also whether they are supported by activities in practice. Thus the IMA developed a questionnaire which was agreed by the Steering Group that sought to capture the various activities under the Code. The questionnaire covered the position as at 30 September 2010 on the basis the FRC's implementation guidance stated: "*the FRC would strongly encourage all institutional investors to publish by the end of September 2010 a statement on their website of the extent to which they have complied with the Code, and to notify the FRC when they have done so*".

The questionnaire was sent to all 80 institutions that had committed to the Code by 26 November, with a final date for responses of 8 December 2010. In summary, it requested details of:

- the public policy statement;
- the level of resources employed and the use, if any, made of proxy voting agencies;
- the integration of stewardship into the investment process;
- how monitoring is undertaken and prioritised;
- practical examples and activities in relation to particular case studies;
- general information about voting; and
- the frequency of reports to clients, the information reported and whether voting records are publicly disclosed.

This report is a summary of the results. The collation of the individual submissions that support the report has been reviewed by Ernst & Young.

IMA would like to thank all respondents for their contributions and for the members of the Steering Group who gave their time.

[4] http://www.frc.org.uk/corporate/investorgovernance.cfm

2. Profile of respondents

80 institutions that had committed to the Code were invited to take part in the survey which aimed to determine the activities that support their commitment in practice as at 30 September 2010. 41 Asset Managers, seven Asset Owners and two Service Providers responded (a response rate of just over 60 per cent). As at 30 September 2010, these 41 Asset Managers managed £590 billion[5] of UK equities representing 31 per cent of the UK market (excluding two managers that were unable to provide this information). The seven Asset Owners owned £15 billion.

Each category of respondent has a distinct role in relation to stewardship/engagement which impacts the extent of their commitment to the Code and the responses received.

For example, the majority of Asset Owners appoint an Asset Manager to manage their investments and undertake stewardship activities on their behalf. Thus fewer Asset Owners committed to the Code and responded to the survey than Asset Managers. For the Asset Owners that did respond, the details reported may relate to the same holdings covered by the Asset Managers and thus are double counted. In addition, the majority of the Asset Owners are Occupational Pension Schemes and/or may manage their own assets and undertake stewardship for themselves[6].

Service Providers, on the other hand, have a distinct role in that they provide research and advice to both Asset Owners and Asset Managers on corporate governance and socially responsible investment issues, and may provide electronic voting capabilities. As they do not generally manage or own equities, a number of questions were not applicable to them, or where questions were, they were approached from a different viewpoint. Thus the two Service Providers' responses are presented separately in this report.

Nor are these distinctions clear cut. For example one of the Asset Managers manages its owner's assets and also provides corporate governance services to others (an overlay service)[7].

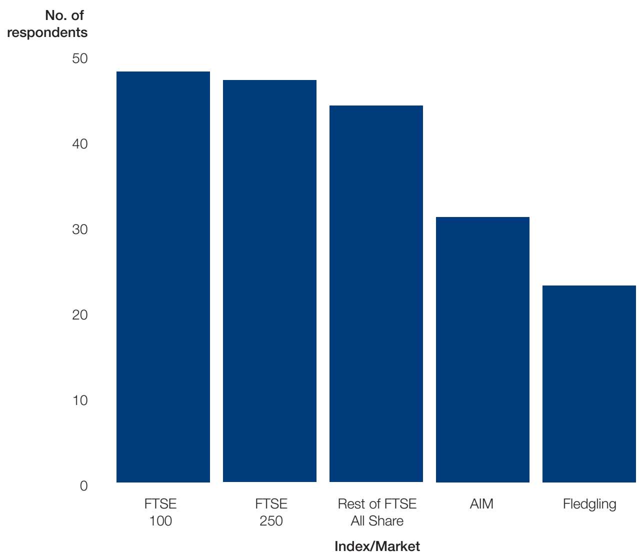
These distinctions should be borne in mind when reading this report.

Stewardship activities and investment strategy

Respondents were asked in which UK index/market the companies relevant to their stewardship activities are listed. The results for Asset Managers/Owners are shown in Chart 1.

All the Asset Managers/Owners engage with companies in the FTSE 100 index and the majority with those in the All Share. Fewer engage with smaller companies, such as those listed on AIM, and fewer again, with companies in the Fledgling index.

Chart 1: Index/market companies engaged with are listed – Asset Managers/Owners



[5] One Asset Manager provided the figure by email, two verbally, and for another, the value of UK equities was taken from the IMA Asset Management Survey for 2009/10 adjusted for the movement in the FTSE All Share - http://www.investmentfunds.org.uk/research/ima-annual-industry-survey

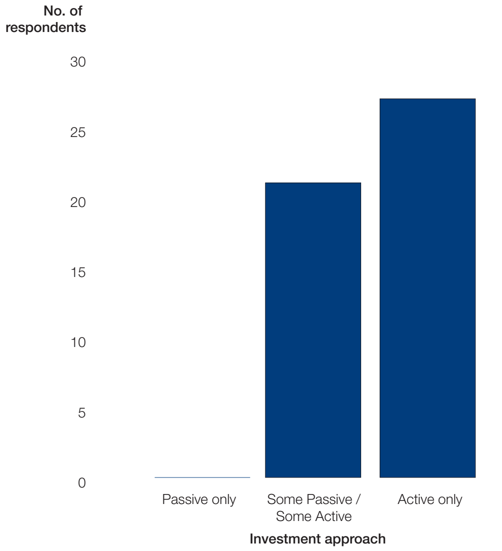
[6] Two Asset Owners have portfolio managers and undertake stewardship for themselves.

[7] Another Asset Manager highlighted that it is mandated to hold a very small number of specific equities, so some of the questions may not be applicable.

Having a distinct role, as noted above, the two Service Providers both provide research for companies in the FTSE All Share Index, and one for companies listed on AIM and in the Fledgling index.

Respondents also take different approaches to investment in these companies – Chart 2. No respondent only undertook passive investment with the majority of holdings being actively managed.

Chart 2: Approaches to investment – Asset Managers/Owners



Neither of the Service Providers held equities for investment purposes.

3. Policies

One of the requirements of committing to the Code is to have a public statement on how stewardship responsibilities are to be discharged. **Principle 1** states that: *"institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities".* The Guidance sets out the matters that should be included.

As stated in the preface to the Code: *"disclosures made by institutions under the Code should assist companies to understand the approach and expectations of their major shareholders. They should also assist those issuing mandates to institutional fund managers to make a better informed choice, thereby improving the functioning of the market and facilitating the exercise of responsibility to end-investors.*
"As with the UK Corporate Governance Code, the Code should be applied on a "comply or explain" basis. In reporting terms this entails providing a statement on the institution's website that contains:

- *a description of how the principles of the Code have been applied, and*
- *disclosure of the specific information listed under Principles 1, 5, 6 and 7; or*
- *an explanation if these elements of the Code have not been complied with".*

To quote a report by Fair Pensions: "*transparency, through public disclosure, is imperative for demonstrating and exercising accountability*[8]".

The majority of respondents adhered to this in that 35 of the Asset Managers and six of the Asset Owners had a final policy statement on their websites. The remaining six Asset Managers were still developing their statements but in each instance provided a public statement to this effect and that it was committed to the Code - Table 1. These six statements have now been finalised. One Asset Owner had not yet committed to the Code and did not have a policy statement, but as it completed the questionnaire, it is included in the other sections of this report. It commented: *"[It] is yet to publish a statement of compliance against the stewardship code. This is not because we are unsure, but rather that we prefer to produce a meaningful statement and will do so as soon as possible. The important thing is that [it] supports what the Code is trying to achieve i.e. more engaged investors and more resilient businesses".*

Table 1: Public policy on stewardship

	Asset Managers	Asset Owners
Final policy statement	35	6
Statement of commitment	6	–
No statement	–	1
Total	**41**	**7**

Each of the two Service Providers had a final policy statement on their websites.

Accessibility and completeness

The survey also looked at how readily someone could determine an institution's approach to stewardship and locate its policy statement on its website - Table 2.

It is encouraging that the vast majority of policies were located immediately. There was some difficulty in locating 11 and only two institution's policy statements were very difficult to locate.

Table 2: Accessibility of public statement

	Asset Managers	Asset Owners
Located immediately	22	4
Some difficulty in locating	11	2
Very difficult to locate	2	–
Total	**35**	**6**

As regards the two Service Providers, although one's policy statement was located immediately, the other's was located with some difficulty.

Moreover, in the majority of instances policies were set out in one document on the web and where this was not the case, there were links to other documents – Table 3. However, in seven instances there was some difficulty in locating the complete statement and in three cases, it was very difficult.

[8] Stewardship in the Spotlight, UK asset managers' public disclosure practices on voting and engagement - http://www.fairpensions.org.uk/sites/default/files/uploaded_files/whatwedo/StewardshipintheSpotlightReport.pdf

Table 3: Locating policies

	Asset Managers	Asset Owners
In one document and/or hyperlinked	25	6
Mainly in one document but some difficulty in locating other parts	7	–
Mainly in one document but very difficult to locate other parts	3	–
Total	**35**	**6**

The two Service Providers' policy statements were in one document.

Conflicts of interest

An institutional investor's duty is to act in the interests of all clients and/or beneficiaries when considering matters such as engagement and voting. But conflicts of interest will inevitably arise from time to time, which may include when voting on matters affecting a parent company or client. **Principle 2** requires that: "*institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship which is publicly disclosed*".

In the majority of cases, respondents cover their policy on managing conflicts of interest within their main policy statement on adherence to the Code, though in a few cases it is addressed in a general stewardship or voting policy statement. One Asset Manager summarises the policy on its website, noting that the full document is a confidential internal document. Only one Asset Owner does not have a statement against this Principle and the Principle is not relevant to the Service Providers that responded.

General observation

This review of policy statements established a benchmark for any future exercises that measure adherence to the Code. Whilst the majority of respondents had clearly given much consideration to the production and presentation of their policy statements, a small minority merely restated the text in the Code for a particular Principle and a few did not address every Principle.

Client mandates

The preface to the Code states: "*institutional shareholders are free to choose whether or not to engage but their choice should be a considered one based on their investment approach. Their managers or agents are then responsible for ensuring that they comply with the terms of the mandate as agreed*".

A key driver for an Asset Manager's stewardship is its clients' expectations and for an Asset Owner, that of its beneficiaries, and in general clients or beneficiaries determine the terms of their mandates.

Respondents were asked to what extent clients'/beneficiaries' investment mandates include a reference to their stewardship policy – Table 4.

All the mandates of four Asset Managers and two Asset Owners refer to their stewardship policy, with the majority, 23 Asset Managers and three Asset Owners, referring to it in some mandates. 12 Asset Managers do not refer to it in any mandates.

Table 4: Number of mandates that refer to the stewardship policy

	Asset Managers	Asset Owners
All	4	2
Some	23	3
None	12	–
No response	2	2
Total	**41**	**7**

The Service Providers, by the nature of their business, are mandated to conduct stewardship.

4. Resources

Structure and headcount

Fulfilling obligations under the Code is likely to have implications for resources and the level of resources employed can be an indication of an institution's commitment. However, this can be affected by the way the institution is structured Table 5[9].

For 11 Asset Managers the portfolio managers/analysts handle all engagement with investee companies with three employing stewardship specialists to look at overall policy[10]. For the majority of Managers (25) and two Owners, matters relating to strategy and performance are handled by the portfolio managers/analysts but, due to the specialist knowledge required, stewardship specialists handle aspects such as corporate governance and socially responsible investment.

For another Manager, the core of its investments is passively managed but it has an overlay of specialist active portfolios where dedicated stewardship specialists handle all engagement. In addition, it has a portfolio of specialist funds where it invests in under-performing companies with the aim of encouraging change where it has a large team dedicated to stewardship. In total it has 34 stewardship specialists.

A further three Asset Owners outsource investment to Asset Managers but have in-house stewardship specialists to look at overall policy which in two cases also undertake voting.

Table 5: Primary resource responsible for stewardship

		Asset Managers	Asset Owners
		Headcount (Number of respondents)	
Portfolio managers/analysts	Portfolio managers	108	–
		(8)	
Portfolio managers/analysts with stewardship specialists looking at policy	Portfolio managers	157	–
	Stewardship specialists	11	–
		(3)	–
Portfolio managers/analysts and stewardship specialists	Portfolio managers	850	22
	Stewardship specialists	114.5	6
		(25)	(2)
Stewardship specialists	Stewardship specialists	34	4.5
		(1)	(3)
Total	**Portfolio managers**	**1,115**	**22**
	Stewardship specialists	**159.5**	**10.5**
		(37)	**(5)**
Average headcount per respondent	Portfolio managers	30.1	4.4
	Stewardship specialists	4.3	2.1

9 The following are not included in the table: three Asset Managers that were unable to provide figures for the UK operations or for those overseas, the resource employed in the stewardship of UK companies; one Asset Owner that outsources stewardship to an overlay service provider; and one Asset Manager and one Asset Owner that did not respond to this question.

10 This is the resource of the UK operations in relation to UK companies and for overseas respondents, the resource employed in the stewardship of UK companies.

One Service Provider reported that it has 27 stewardship specialists, the other did not respond to this question.

Integration into the investment process

As noted, engagement on strategy and performance is often handled by the portfolio managers/analysts but stewardship specialists handle particular aspects such as corporate governance and socially responsible investment. At times this dual approach can give rise to questions as to whether those responsible for stewardship represent the views of the portfolio managers responsible for the investment. It can also be important to have an integrated approach – according to one Asset Owner: "*in our experience, stewardship is most effective when integrated into the investment process - where strategic, operational and financial issues are considered alongside ESG [Environmental, Social and Governance] factors*".

The Guidance to **Principle 1** addresses this and states that the stewardship policy should disclose: *"internal arrangements, including how stewardship is integrated with the wider investment process".*

To determine what happens in practice, the 31 respondents (26 Asset Managers and five Asset Owners) where stewardship specialists have a key role were asked how they ensure integration into the investment process from a range of options - Table 6.

Each Asset Manager selected at least one option and integrates stewardship into the investment process in some way. For more than 88 per cent (23 out of 26 Managers), those involved in the investment process, portfolio managers/analysts, set and/or approve the stewardship policy and for 76 per cent (20), they make the final voting decision in a controversial situation. Around 88 per cent indicated that stewardship specialists attend meetings with investee companies with portfolio managers/analysts, with the same percentage simply meeting in-house with portfolio managers/analysts.

Of the five Asset Owners, two have in-house investment teams that make the final voting decision on controversial issues and one of these teams also sets and approves the stewardship policy. For these two Owners, the stewardship specialists also attend meetings with investee companies with the portfolio managers/analysts. Another Owner retains stewardship in-house and meets with companies but delegates investment to external Asset Managers sometimes discussing stewardship with them. Two Owners outsource both investment and stewardship to external Asset Managers though one retains discretion over voting.

It is clear from the comments received from Managers that the approach to integration varies.

- *"Portfolio managers meet regularly with the executive management of the companies that we invest in and the stewardship specialists often attend such meetings. In addition, the stewardship specialists arrange separate meetings to discuss governance issues, often with non-executive directors or with the Company Secretary. We liaise with the portfolio managers ahead of these meetings and often the portfolio managers will attend."*
- *"Stewardship specialists sit with the portfolio managers to facilitate formal and informal dialogue on stewardship issues. Whenever possible, portfolio managers attend [our] meetings with Chairman together with the stewardship specialists."*
- *"Provides a full ESG overlay service on its clients' investments and does not in itself undertake any investment. However, [it] is pleased to interact with its' clients' fund managers and to provide input on ESG issues into their own company analysis as required."*
- One formally combines its research and ESG teams and uses the joint analysis to rank stocks which is reflected in investment decisions.
- Another has a committee of ten portfolio managers/analysts and three stewardship specialists that make decisions. For contentious issues, the portfolio managers/analysts are consulted, and the issue may be escalated to the committee.

Table 6: Integration into the investment process

	Asset Managers	Asset Owners
Portfolio managers/analysts set and/or approve stewardship policy	23	1
N/A	3	4
Portfolio managers/analysts make final decision on a controversial vote	20	2
N/A	6	3
Stewardship specialists attend meetings with portfolio managers/analysts[11]		
Always	2	–
Often	5	1
Sometimes	16	2
N/A	3	2
Stewardship specialists regularly meet portfolio managers/analysts	23	3
N/A	3	2

Certain respondents not included in Tables 5 and 6, chose to comment.

- *"[Our] responsible investment specialist sets the high level stewardship policies. Detailed policies are set by [an overlay service provider] in consultation with [us]."*
- "*Stewardship activities are the responsibility of the portfolio managers/analysts ("Investment Professionals") and are therefore fully integrated into our investment processes, rather than being delegated to stewardship specialists."*
- *"[It] is a shareholder body with an explicit mandate to sell the investments it has in the banks. . . . our overall success will be dependent on how we discharge our stewardship role and on how we dispose of the investments. Stewardship is therefore integral to everything that [it] does and so there is not a distinction between an investment team and a stewardship team. It is the responsibility of everyone within the team including, crucially, [its] Board of Directors which takes all strategic decisions."*

In addition, one Service Provider commented: "*we do not invest client assets and therefore do not employ investment staff. . . .Where there are particularly high-profile or controversial issues, or cases that fall outside our existing guidelines, we call an internal policy forum to discuss the issues and decide the voting position to adopt".*

Service providers

An Asset Manager's and Owner's resources are often supplemented by Service Providers which can process voting instructions, provide research and recommendations, and other customised services. The Guidance to **Principle 1** states that the stewardship policy should disclose: *"the use made of, if any, proxy voting or other voting advisory service, including information on how they are used".*

When asked for details of the number of Service Providers used and how, the majority of respondents (39) highlighted that they use a Provider (in seven cases more than one) to process voting instructions. A number (18) also subscribe to one or more Service Providers to provide research but the respondent *always* makes the final voting decision. In only one instance is the Provider's recommendation *always* followed, with 19 *sometimes* following the recommendation - Table 7.

A number of Asset Managers elaborated on how recommendations are used in that they may only be followed for straightforward issues, or are only one element in making a decision in that a Manager is likely to take its own view on contentious issues.

- *"[Manager] uses one proxy voting research firm to provide recommendations based on [its] guidelines. [Its] voting team will use these recommendations as a consideration in individual company votes, but does not blindly accept these recommendations . . . and frequently changes the recommended votes or adds customised comments in cases where [it] does not support management."*
- *"We are aware of the recommendations of the voting agencies but arrive at our own decisions independently which may at times coincide with the agency recommendations*."

[11] Where respondents indicated more than one option, they were allocated to the least frequent category.

- *"Voting agencies follow a custom policy in most major markets although we use their standard policy in some markets. However note that where the vote recommendation is a vote against, we will review this to ensure it is appropriate."*
- *"We receive the voting recommendations as a by-product of subscribing to the electronic voting service; however we consider the recommendations as one of a number of inputs."*

One Asset Owner commented that it: *"commits considerable resources to ensuring we vote in an informed manner for all our UK equity holdings. All voting decisions are made in house. The RI team liaises closely with the fund's portfolio managers where applicable to ensure we vote in alignment with our investment objectives. For companies in the FTSE All Share, [it] works with another Asset Owner, particularly in the area of voting and in some follow-up engagements. Based on our joint voting policy we appointed a proxy service provider to provide bespoke recommendations and a follow-up letter writing service. Voting decisions are, however, made independently as described above. Where we have not supported management, a bespoke letter is sent in advance of the meeting where practicable".*

One Asset Manager did not use a Service Provider and stated: *"the decision on how to vote shares is made by the Board of [Manager]. [It] does not make use of a voting advisory service – any recommendations on voting made to the [its] Board come from analysis conducted by [its] staff members".*

One Asset Owner that delegates stewardship to its Asset Manager commented: "*our fund managers use proxy research and services but we don't use it internally . . . It is difficult to comment on how closely they follow voting recommendations but our general experience of the industry is that many (if not most) managers robotically follow recommendations from the likes of Risk Metrics".*

Table 7: Service Providers used in the UK[12]

	To process instructions		**To provide research, but respondent always makes final decision**		**To provide research and recommendation sometimes followed**		**To provide research and recommendation always followed**	
	Asset Managers	Asset Owners	Asset Managers	Asset Owners	Asset Managers	Asset Owners	Asset Managers	Asset Owners
>Four	–	–	3	–	–	–	–	–
Four	–	–	–	–	–	1	–	–
Three	1	1	3	–	–	–	–	–
Two	5	–	4	1	6	–	–	–
One	30	2	7	–	11	1	1	–
Total	**36**	**3**	**17**	**1**	**17**	**2**	**1**	**–**

[12] Some respondents reported that they both always make the final voting decision and sometimes follow the Service Provider's recommendation. The latter answer is recorded in the Table.

5. Monitoring and escalating

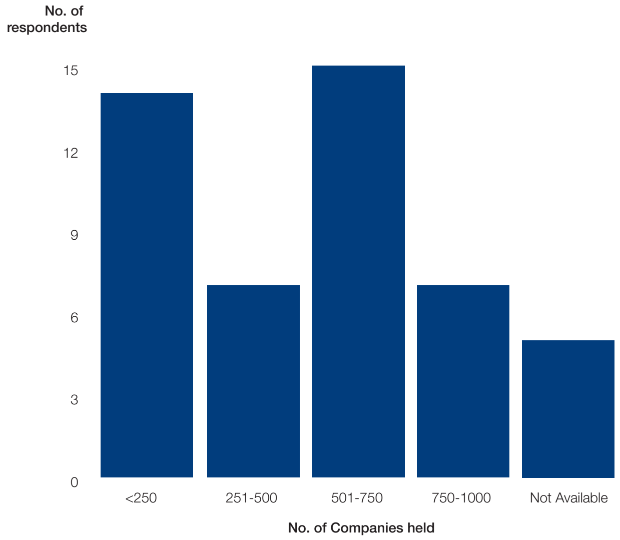
Principle 3 states that: "*institutional investors should monitor investee companies"* and the guidance that: *"investee companies should be monitored to determine when it is necessary to enter into an active dialogue with their boards. This monitoring should be regular and the process clearly communicable and checked periodically for its effectiveness. Institutional investors should endeavour to identify problems at an early stage to minimise any loss of shareholder value".*

Principle 4 is that: *"institutional investors should establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value".*

Prioritisation

The survey mainly focused on engagement with UK companies. As at 30 September 2010, respondents held from under 250 to around 1,000 UK companies – Chart 3, and on average the Asset Managers held just over 450 UK companies and the Asset Owners, 440[13].

Chart 3: Number of UK Companies held Asset Managers/Owners



In view of this, it was considered that respondents were likely to have to prioritise the companies they monitor and engage with and were asked to set out the criteria used – Table 8[14].

However, two thirds do not prioritise monitoring and just less than half engagement in that they cover all investee companies as part of their research and investment process, or simply stated that they cover all. For example:

- *"Monitoring and engagement are a function of our research and investment process. All investee companies are monitored and engagement will be a function of the issues that arise as part of our investment."*
- *"As a research driven organisation, [our] analysts continually monitor companies within their investment coverage held for our clients or potentially of interest to them."*
- *"We monitor our investee companies through periodic reviews. Stock reviews form a holistic assessment of business, drivers, financials, corporate governance and social and environmental drivers and is a primary starting point for raising issues for further engagement. Similarly, sector and thematic analysis are tools for identifying potential concerns. The corporate governance structure is reviewed separately on an annual basis, during analysis of proxy documentation for Annual General Meetings."*
- "*The CG [Corporate Governance] Team undertakes 'base case' analyses of governance architecture versus our CG guidelines. This is then overlaid with our analysts' views, and evolves over time as we meet with companies and understand issues, creating a proprietary database containing detailed governance models for over 700 Pan-European companies, including all FTSE100 and selected FTSE250 and smaller companies. For our analyst-driven investment processes, these models are used to generate proprietary ESG rankings and ratings, which are incorporated into analysts' models and stock rankings."*
- "*Portfolio managers spend a large proportion of their time meeting company management and a close relationship with investee companies is enhanced by engaging in private meetings with management. Based on our monitoring, discussions on governance issues are considered when appropriate."*

[13] Those unable to provide this data are not included in the average calculations.

[14] As the responses varied and a number of the answers were quite lengthy, the table is an interpretation of the results in order to highlight the main issues raised.

In two cases monitoring is periodic: "*monitoring is naturally periodic. Typically, it will occur around financial reporting, general meetings, in connection with news and announcements and when, for whatever reason, we might be conducting research into investment ideas*".

The main criteria of those that do prioritise, particular in relation to engagement, are when they have a sizeable holding and/or there are material issues of concern:

- *"Stewardship activities are prioritised according to a combination of the size of our position (in terms of value and as a percentage of the share capital), the extent to which we have already identified material issues of concern and on a thematic/sector based approach."*
- *"Portfolio managers, their assistants and the research team use their discretion . . . depending on the relative position size with [in] the specific portfolio and the perceived risks associated with the company in question."*
- *"[It] is likely to invest in a wide range of companies. Some of these holdings may be modest in scale or as a proportion of the equity of the company and the cost of intervening may be greater than the potential value to clients. In these cases, [we] may decide not to intervene or to act only in co-operation with other shareholders. The current policy is that, where holdings across all clients are less than 3% of the equity, intervention will be limited to proxy voting."*
- *"Monitoring and engagement will be carried out on a proportional basis (considering materiality and liquidity of holding) . . ."*

Other themes are breaches of good practice or specific concerns/client requests.

Moreover, engagement can be reactive or proactive: *"reactive engagement refers to instances where we respond to a corporate action, AGM/EGM, or are approached by a company to discuss executive remuneration or board and management changes. . . We also engage proactively . . . where we have particular concerns about issues such as performance, strategy, and/or risk and reputation management particularly where these are material to clients' long term investment returns. Our aim is to develop a better understanding of any governance and investment risks, communicate our views, and where appropriate seek change".*

One Asset Manager does not attempt to engage: "*our process is to sell our holding if we believe the company's strategy is contrary to our interests as an investor*".

Another committed to do more going forward: "*in future will endeavour to meet with company management where possible. We will also consider stepping up our activities where we have an important position and this is considered important in protecting shareholder value for clients*".

Two Asset Owners delegate monitoring and engagement to their Asset Managers and one to an overlay service provider. The latter stating: "*our [provider] monitors companies on the Fund's behalf, based on its own direct analysis and external research from a variety of sources such as EIRIS or the Corporate Library. The monitoring also includes the voting of the Fund's holdings, and engagement, through correspondence, face-to-face meetings, attending AGMs or other means, with portfolio companies*".

However, for one Asset Manager: *"the relatively small number of companies in which we invest means that prioritisation is not a material issue".*

Table 8: Prioritisation criteria – Asset Managers/Owners

	Monitoring	Engagement
Part of the research/ investment process	22	21
All companies/companies in the All Share	10	3
By size of holding/ material issue of concern	9	18
Periodic monitoring	2	–
Specific concerns and breach of good practice	–	4
When vote against	–	2
Sell not engage	–	1
Will aim to do so going forward	–	1
Delegated to manager/ overlay service	3	3
No response	2	2

One Service Provider responded and monitors all companies as requested by its clients and, as well as monitoring the press and RNS announcements, uses an in-house system that automatically collects company information. It also engages with: "*all the companies we monitor. We will contact all companies to provide them with our draft analysis and voting recommendations for comment and also send a final version of the advice given to clients*".

Activities

The Code does not set out how monitoring should be undertaken. To determine what happens in practice, respondents were asked how they monitor from a list of options.

Each of the Asset Managers has an in-house team that analyses company news and results, as do four of the Asset Owners. 29 Asset Managers and two Asset Owners do this for all investee companies and 12 and one, respectively, for major companies, actively managed holdings or when there are issues[15].

With regards to contact with companies, the majority of respondents (30) contact management proactively for most or all of their investee companies. To a lesser extent, they contact investor relations and/or the company secretariat and are only likely to contact the Chairman and NEDs proactively in exceptional circumstances or when reacting to concerns - Table 9[16].

Both Service Providers have an in-house team that analyses news and results for all companies. One contacts companies where they have specific concerns and the other is pro-active in contacting the company secretariat mainly to clarify disclosures.

Just less than 50 per cent of respondents attend Annual General Meetings (AGMs) where they have a major holding or where appropriate. A number of Managers commented that attendance at AGMs is not always necessary and may not be an effective method of engagement.

- *"We attend AGMs on occasion, particularly when we have a major concern that has not been resolved through more private engagement initiatives. Normally we do not find this to be the most effective form of engagement as an institutional shareholder."*
- *"Due to the concentration of AGMs during the voting season and sometimes many meetings are held on the same day, it is difficult to attend AGMs due to time and location constraints as well as analysing and engaging on other meetings."*

Ten Managers never attend AGMs.

Of the Asset Owners, one attends the AGM when they have a major holding, two do so if there is a major issue or where it might add to their engagement, two never attend as they outsource to their manager and one outsources to an overlay service. One did not

Table 9: Contact with companies – Asset Managers/Owners

	Investor relations and/or company secretariat	The Chairman and/or NEDs	Management	Financial advisers, brokers and/or PR advisers
Proactive – all or most	18	7	30	17
Proactive – exceptionally	6	14	2	3
Reactive – for concerns	18	19	9	19
Other	4	7	6	6
Never	1	–	–	2
No response	1	1	1	1
Total	**48**	**48**	**48**	**48**

[15] Two Owners delegate monitoring to their managers and one to an overlay service provider. One Asset Owner did not respond to this question.

[16] A number of respondents gave more than one response in each category. For the purposes of this report, only one response (the less frequent) has been included in the table.

respond. One of the two Service Providers may attend following a specific request from clients and the other when there are specific concerns.

Other monitoring activities reported were:

- six Asset Managers participate in a number of industry forums where they engage and collaborate on issues – such forums help them to keep abreast of, and further, responsible share ownership; and
- two Asset Owners collaborate, each noting an alliance with another Asset Owner to engage collectively.

Barriers to stewardship

A wide variety of issues were raised when respondents were asked for any barriers to stewardship, which are summarised in Table 10.

The main barriers are the resources required to monitor and engage effectively and then the size of holding (i.e. those with small holdings not having enough leverage/influence with the companies concerned).

- *"Committing significant additional resource to governance increases the costs of investment management companies but has yet to prove to add additional value in terms of returns generated for investors."*
- *"The only barriers to engagement are resource-driven."*
- *"Volume of companies to cover relative to size of internal resources."*
- *"Resources are a clear barrier, there is no limit to how much engagement could be done but not all can be done."*
- *"Resources and the long-term nature of engagement. It is often difficult to internally justify protracted engagement when outcomes, by their very nature, are not immediate. Attribution is also a problem when you have several investors asking for similar things: who really had the most influence? The requirement to cover so many issues for so many companies means we cannot pursue every case we'd like to and have to make hard choices about which ones are most serious and likely to yield results."*

Another common issue is that the clients' authority may limit the Manager's ability to vote and there are concerns that: *"the "acting in concert" rules may in some cases be a potential barrier that can prevent or inhibit collaboration with other investors, particularly across borders, as rules vary in different markets*".

Table 10: Barriers to stewardship

	No. of Respondents
Resources	12
Size of holding – limits ability to influence company	9
Concerns over acting in concert and insider information	5
No authority to vote or clients choose not to vote	4
Differing opinions amongst portfolio managers/shareholders	3
Lack of client demand	3
Difficulty in monitoring and quantifying output	2
Lack of receptiveness from corporates	2
Regulation	2
Other	6
No response	9
None	3

6. Practical examples

To assess what actually happens in practice, respondents were asked in relation to particular issues at six companies how they escalated matters and engaged with the companies in question.

Each respondent was asked to confirm if it had a holding in the company concerned, if and how that interest changed as a consequence of the issue, and how it engaged and voted on the resolution and its rationale.

The companies and issues were:

- Marks & Spencer Group plc – following the appointment of Sir Stuart Rose as Chairman and Chief Executive, shareholder Resolution 16 at the 2009 AGM calling for the appointment of an independent Chairman.
- Tesco plc – following concerns about rewarding executives of the US business (the US subsidiary trading at a loss) Resolution 2 at the 2010 AGM, approval of the Remuneration Report.
- Barclays plc – following concerns about the refinancing, Resolutions 3 to 17 at the 2009 AGM where the entire Board stood for re-election.
- Lloyds Banking Group plc – voting on the acquisition of HBOS at the November 2008 EGM.
- Royal Dutch Shell plc - shareholder Resolution 23 at the 2010 AGM for a report on the viability and risks of the Canadian oil sands projects on the basis they were an environmental and economic liability.
- Prudential plc - the acquisition of the AIG's Asian operation.

Each respondent was also invited to select three of the above as "case studies" and give further details as set out below.

- What it wanted to achieve through engagement.
- Whether there were any conflicts of interest, what they were and how they were addressed.
- How it sought to achieve its objectives. In this context, the Guidance to **Principle 4** sets out examples of how escalation can be achieved:
  - *"holding additional meetings with management specifically to discuss concerns;*
  - *expressing concerns through the company's advisers;*
  - *meeting with the Chairman, SID, or with all independent directors;*
  - *intervening jointly with other institutions on particular issues;*
  - *making a public statement in advance of the AGM or an EGM;*
  - *submitting resolutions at shareholders' meetings; and*
  - *requisitioning an EGM, in some cases proposing to change the board".*
- Whether there was collaboration - **Principle 5** states that: "*institutional investors should be willing to act collectively with other investors, where appropriate".*
- Whether it achieved what it wanted.

The full analysis is set out in Appendix 4 and summarised below.

Marks & Spencer Group Plc Chairman and Chief Executive

March 2008 to September 2010

In March 2008, Marks & Spencer announced that, contrary to the provisions of the Combined Code, its Chief Executive, Sir Stuart Rose, would be appointed combined Chairman/Chief Executive when Lord Burns stepped down in June. The LAPFF[17] put forward Resolution 16 at the July 2009 AGM for the appointment of an independent Chairman.

This generated many meetings between respondents and representatives from the company, such as the outgoing Chairman, the deputy/acting Chairman, the Senior Independent Director, and the Company Secretary. A number met the company more than once. Some also attended investor meetings and three respondents met with the proponents of the Resolution. Although the Resolution was not passed, almost 38 per cent voted in support of it at the AGM. Respondents were also divided on the matter with slightly more voting in support (14), reasons including:

[17] The Local Authority Pension Fund Forum (LAPFF), set up in 1991, is a voluntary association of 48 public sector pension funds based in the UK. It exists 'to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders to promote corporate social responsibility and high standards of corporate governance'.

"The Board had not acted appropriately in relation to shareholder concerns about concentration of power."

"The company's arguments from the outset lacked weight and relied to a great extent on the threat that if shareholders don't let the CEO have this to manage [his own succession] he may leave."

Reasons cited by those that voted against (10 respondents):

"We had already met with Sir Stuart and understood the plan for the appointment of a new CEO, with him moving to Chairman after a period of transition. With this clear plan in place we felt there was no value in supporting the shareholder proposal, particularly as we did not want to see a 'rudderless ship' with both a new CEO and a new Chairman in such a short period of time."

"Our stewardship specialists met with the company 3 times between March 2008 and July 2008 and also wrote to the company. We received sufficient reassurances regarding the Board's intentions on succession planning that we did not feel a vote for the shareholder resolution was warranted."

Of the four respondents that abstained, reasons included:

"We disapproved of Sir Stuart Rose's appointment as Chairman but we did not want him to leave the company."

"We believed that the resolution was overly prescriptive, and the company should not be forced to work under an external deadline for this critical appointment."

"The wording of the resolution was framed sensibly. However from our engagement with the board we were of the view that succession planning was underway and we did not want to impose a specific deadline on the process."

The Board subsequently brought forward the appointment of an independent Chairman and Sir Stuart handed over his role as Chief Executive to Marc Bolland at the end of July 2010.

Tesco plc
Remuneration
July 2010 to September 2010

In the run up to the 2010 AGM, several corporate governance groups were concerned about the remuneration of Tesco's board. The key issue was the generosity of remuneration notwithstanding the poor performance of the US business.

Although it appears to have been less intense than that at Marks & Spencer, there was much engagement on this issue. To quote one respondent: "*in addition to our conversation with the company before our vote; we requested a meeting with the incoming remuneration committee chair. Subsequent to the AGM we have met the SID and the chair to discuss a variety of matters including succession, strategy and pay. Recently we have discussed the company's pay policy with a number of other investors prior to a round of meetings between investors and the remuneration committee chair. We had also had discussions with the company around our vote in 2009 and 2008".*

In the event at the July 2010 AGM, 48 per cent voted against or abstained on Resolution 2, approval of the Remuneration Report. Respondents' views were mixed as to whether the remuneration policy was excessive/in line with the US business performance but were weighted more heavily towards against/ abstaining. Of the 15 respondents that voted in support, the reasons included:

"CEO Terry Leahy announced his retirement on 8 June 2010, largely foregoing his Fresh & Easy bonus as a result making the protest vote about his compensation largely irrelevant."

"Given the stage of development of the US business we considered that the focus on it was appropriate. Thus while we were mindful of the concerns being highlighted on this issue and more generally, we were on balance supportive."

Reasons cited by those that voted against (19 respondents):

"The performance of Tesco's Fresh & Easy was a long-standing issue of discussion with the Board. We were particularly concerned that the remuneration outcomes

did not take particular account of the underperformance at this division."

"Concerns identified in areas such as the US director, Tim Mason's salary and bonus awards; discrepancy in the calculation of performance metrics; consistent application of discretion to advantage the directors; underwhelming degree of stretch incorporated into performance targets; and executive contracts that have reward for failure provisions."

And of those that abstained (five), one wanted to engage further on the issue:

"We were uncomfortable with some aspects of remuneration policy but were aware that the Chairman of the Remuneration Committee would be standing down so we decided not to vote against and to engage further on remuneration matters over the coming year."

Seven respondents selected this as a "case study" of which six considered they achieved their objective. The one that did not, stated: *"remuneration was one aspect of the engagement. While the Company has taken steps to address the performance concerns, the Company was not as proactive in relation to the remuneration concerns. Please note that following the AGM, the Company now has plans to consult investors on the review of its remuneration policy".*

Barclays plc
Strategy and director re-election
November 2008 to April 2009

In November 2008, shortly after the collapse of Lehman Brothers, Barclays declined financial assistance from the UK Government and announced it was to raise £7.3 billion, primarily from Middle East investors. Barclays was criticised for the terms it offered the foreign investors on the basis that they were more costly than the Government scheme. Responding to these concerns, the entire Barclays' board put itself up for re-election at the April 2009 AGM (Resolutions 3 to 17).

There was much engagement over the issue. To quote: "*the capital raising was unconventional, and bypassed 'normal' pre-emption guidelines. This was also a far from normal situation which warranted increased focus from shareholders*".

Other comments included:

"We met with members of the board: the Chairman, executive and non executive directors. Engagement was a mix of conference calls, and face-to-face meetings which were held both at our office and at the bank. Engagement took place over a prolonged period."

"We met with management on three occasions in the weeks following the announcement of the issue in addition to which we held a meeting with the Chairman and one of the non-executive directors to discuss the group's wider approach to corporate governance."

Respondents delivered a consistent message with the majority supporting the Board (the Board was re-elected) although there were concerns.

"While we would have preferred that the Company choose a financing route better aligned with the interest of existing shareholders, we did not believe that it was in the long-term interests of the Company and its shareholders to remove the board at that time."

"Notwithstanding concerns . . . in the circumstances the re-election of the Board was in the best interests of shareholders."

"Accepted Barclays' view that they were not able to raise money in any conventional way given the market conditions . . . supported the re-election of the entire board."

"We didn't believe that a Government holding in Barclays would be in our long term interests."

"Barclays have performed well relative to their peers in running the business. Voting against the directors would be counter-productive at this stage, but the company will be monitored carefully."

Three voted against the re-election of Chairman, Marcus Agius: *"we reluctantly supported [the capital raising] because of the macro-economic conditions at the time; the bank would have been put under intolerable pressure if the capital raising had not proceeded.......Having recently had a meeting with the chair, we concluded that we had lost our confidence in him, we therefore after considerable deliberation, voted against him".*

One voted against the re-election of Bob Diamond as his contractual terms allowed for a notional bonus element. Another voted against the re-election of Sir Richard Broadbent as Senior Independent Director on the basis: *"he is primarily responsible for appropriate communication and consultation with shareholders. We remain concerned that last year's capital raising, despite the extraordinary market conditions, eroded shareholder pre-emption rights. While we welcome subsequent disclosure about the bank's rationale, we wish to avoid such precedents being set, regardless of market conditions".*

Lloyds Banking Group plc HBOS acquisition

September 2008 to September 2010

In September 2008, Lloyds Banking Group announced plans to acquire HBOS after HBOS's shares fell amid concerns over its future. The Government lent HBOS £25.4 billion in October/November 2008 which according to Reuters, shareholders were unaware of when voting on the acquisition in November 2008 (Resolution 1). Both the subsequent capital raising by Lloyds Banking Group and the eventual buyback of shares were approved with large majorities. In February 2010, Lloyds Banking Group announced a charge of £24 billion in respect of bad debts for 2009, mainly a legacy of lending by the corporate banking division of HBOS.

Again this issue generated a lot of activity. To quote one Manager: *"April 2009 – CIO, fund managers and Corporate Governance Manager met with UKFI to discuss Lloyds' acquisition of HBOS, November 2009 – fund managers met with CEO and FD, fund manager teleconference with Chairman, March 2010 – fund managers met with CEO, April 2010 – fund managers met with Chairman, September 2010 – fund manager teleconference with Chairman and CEO".*

The majority of respondents supported the acquisition (it received 96 per cent support at the EGM). A number believed there were few alternatives and that there would be consequences in not supporting the deal.

"In view of the deterioration of the markets in the preceding weeks it was too risky to rely on the market to raise new capital and the uncertainty was likely to de-stabilise Lloyds. Therefore the risks of not supporting the acquisition were too great. This was a reluctant vote in favour."

"In uncertain times the acquisition appeared to eliminate capital uncertainties, especially for HBOS shareholders [we] held shares in both companies."

"The Lloyds takeover of HBOS was a political decision. We would have voted against had we felt that client investments were at risk."

"There was clearly significant risk in Lloyds acquiring ownership of HBOS. However, our concerns were somewhat assuaged by the assurances we obtained relating to due diligence. However, as a representative of universal owners we were also concerned about the failure of a major financial institution and the effect that that would have had on our clients' portfolios."

"The Company explained that this was a window of opportunity to gain a significant market position without the Competition Commission rejecting the transaction and this was in the national interest following the collapse of other UK banks. There were cost savings of £1.5 billion expected from the merger."

"While we had some concerns regarding the proposed acquisition we believed that there would be long term benefits as a shareholder."

One of the Managers that abstained did so as there was *"a lack of transparency in the deal to acquire HBOS".*

Royal Dutch Shell plc Oil sands and safety

March 2010 to September 2010

Fair Pensions, supported by a number of institutional shareholders, put forward a resolution at Shell's May 2010 AGM for a review of the viability of the Canadian oil sands projects on the basis they were an environmental and economic liability. Resolution 23 directed that a report on the projects' viability and the legal and reputational risks arising from damage to the environment and livelihoods be in the Annual Report presented to the 2011 AGM.

Although there was little support for Resolution 23 (at the 2010 AGM, 94 per cent voted against it), the majority of respondents met with the company on the issue – a number on several occasions. One noted: *"we have had more than 6 meetings with different representatives from Shell in 2010 where we discussed climate change, oil sands and safety".* Seven respondents visited the sites in Canada to look at the operations first hand and nine also met with the proponents of the Resolution to understand it better.

A clear majority (35) voted against the Resolution generally on the basis that Shell had responded positively to the proposal. One respondent: "*considered the increased disclosures made by the company in response to the issues raised by the proponents to be satisfactory*". Others commented:

"Oil sands earnings are typically higher than the company's downstream averages, the assets are politically secure and have a long life span."

"The resolution focused on disclosure and we believed that the Company had provided sufficient information to enable shareholders take an informed position on the issue."

"This was in recognition of the extensive dialogue we had with the company on [these] issues. . . . There are still a number of areas where we would like to see further improvements in disclosure, but we believe that these are best pursued through continued dialogue rather than by commissioning a report . . ."

"Shell impressed us with its stakeholder engagement . . . provided information on its assumptions around carbon regulation and environmental risks and also highlighted a wide range of measures it had introduced to improve sustainability performance, ranging from improved energy efficiency to employee safety."

One that supported the Resolution stated: *"shareholder resolutions in the UK are rare and contentious but [we] will use them on occasion . . . as a means of encouraging other shareholders to be more 'hands on' where we believe a company's strategy or practices are not in shareholders' long-term interests".*

Another abstained: *"we believe dialogue must continue on these issues and have abstained . . . to encourage further positive and open dialogue whilst supporting the steps already taken by both parties".*

One respondent that published details on their website concluded: *"will continue to monitor developments in the oil sands debate but is satisfied that our activities in the resolutions and the oil sands letter of 2009, which was backed by $3 trillion of investment, has given powerful momentum to investor engagement on this most important of issues".*

Prudential plc
Acquisition of AIG's operations
March 2010 to June 2010

On 1 March 2010 Prudential announced an agreement with AIG to acquire AIG's Asian operations, AIA, for a consideration of US$ 35.5 billion, the cash component to be financed through a rights issue. Critics argued that the price was too high. Prudential subsequently tried to renegotiate the deal after it became clear that it would not be supported at the original price but was unsuccessful and the deal was pulled just ahead of the date of the EGM when it was to be voted on.

This deal concerned shareholders. Respondents evidenced a lot of activity and numerous meetings with company management, either with the Chief Financial Officer, Chief Executive Officer, Chairman or other representatives and many on several occasions. A large number collaborated with other shareholders.

"Our view was that at US$35 billion the acquisition was likely too expensive but at a slightly lower price would have offered strategic opportunities. We had two meetings with management leading up to the EGM. We also had informal discussions with other major UK institutional investors via the ABI investment committee. We have subsequently met with the Senior Non-Exec."

"We first met management in March and told them we had reservations about the deal and also informed the advisers. We held numerous conversations with other shareholders to express our concerns. In May we confirmed our opposition to the transaction and voted our shares accordingly. When the acquisition was abandoned we told the company and its advisers that we expected the Board to take responsibility for a misjudged and poorly executed transaction and pushed for certain resignations. We informed the advisers of our views and held separate meetings with both the Chairman and Senior Independent Director. We have continued to have contact with other shareholders and

we remain unreconciled to the lack of senior Board change. This engagement attracted some media attention but it was never our intention to involve the media."

For some the collaboration was not always helpful: *"the amount of anonymous press comment through which some of [our] views were made public - not by [us] - were not helpful",* and "*we did not achieve a change of management because other shareholders are too supportive of management or, in some cases, wanted change but were unwilling to take any steps to achieve change".*

The majority achieved their objective as the deal was withdrawn although one noted: *"we were very disappointed that the company's advisers failed to communicate our views to the board in July. We raised our concerns about the poor communication with the SID in October. We are pleased that the board has strengthened its IR and is reviewing its advisers"*.

A few, however, did not achieve their objective, two of whom wanted the deal to go ahead: *"[our] preference was for the deal to go ahead at the renegotiated price. Post this we believed that there should be some change to the main Board in order to help restore shareholder confidence".*

Another is keeping the situation under review: "*we note the change of board members announced this month at PRU. The board are aware of our concerns regarding the directors' roles in overseeing the strategy related to the aborted acquisition. We will keep monitoring the impact of the new board members, and open up further engagement with the company if necessary".*

Further examples

Respondents were invited to highlight additional examples of engagement that they felt were effective. 21 examples were given relating to a variety of issues:

- social or environmental issues (three respondents);
- concerns over management strategy/board membership/forcing changes to the board (seven);
- remuneration issues (three);
- merger and acquisition activity (three);
- concerns over capital raising and pre-emption rights (two);
- issues with a company holding a virtual AGM (one);
- wanting to understand board structure, environmental performance and relations with indigenous communities (one); and
- concerns over Remuneration, Board Structure, Succession Planning (one).

13 of these respondents met directly with the company, although one noted that a meeting with a company was refused. Others used public forums in order to achieve their objectives, with some making public statements, one posting on a collaborative vehicle, one tabling a resolution and another requesting an EGM. An additional three wrote letters.

Eight mentioned some collaboration with other investors, one had joint meetings with the company, one sent joint letters and another attended an informal meeting with investors only. One Manager noted that in two instances this collaboration was unhelpful in that in one case it received inside information, and in another not all shareholders agreed.

One Asset Owner gave an example of a seven month engagement relating to a proposed merger which did not appear to benefit the company in which it had an interest. The following steps were taken:

- a group of investors, including the Asset Owner, wrote to the board expressing concern about the proposed terms of the merger;
- following which, two more shareholders joined to sign the letter, however the: "*non-executive directors refused to engage with the group of minority shareholders and requested we direct all further communication to the company secretary*";
- the Asset Owner released a press statement detailing concerns to raise awareness of the issue and put further pressure on the board;
- the group of minority shareholders wrote a further letter to the company secretary and to the Spanish regulator and responding to the lack of cooperation from the company, signed a public shareholder agreement which was filed with the Spanish regulator;
- at the AGM, the Asset Owner sent its lawyer to attend on behalf of the group of minority shareholders, however, he/she was refused speaking rights. It later transpired that Asset Owner's votes were miscounted; and
- other shareholders gave their support and a second shareholder agreement was submitted to the Spanish regulator, although due to 'acting in concert' concerns some minority shareholders were unable to sign.

Finally when the merger was announced it was on significantly better terms than initially indicated, which the Owner considered was due to the sustained pressure from the minority shareholders.

18 of the other 20 respondents felt that they achieved their objectives, citing that they received assurance from the companies concerned or changes to the respective boards. Two were not satisfied, one as the company went ahead with the deal and the other as its request to engage had been refused.

7. Voting

The Guidance to **Principle 6** states that: *"institutional investors should seek to vote all shares held. They should not automatically support the board. 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".*

In addition, the Guidance to **Principle 3** states: *"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".*

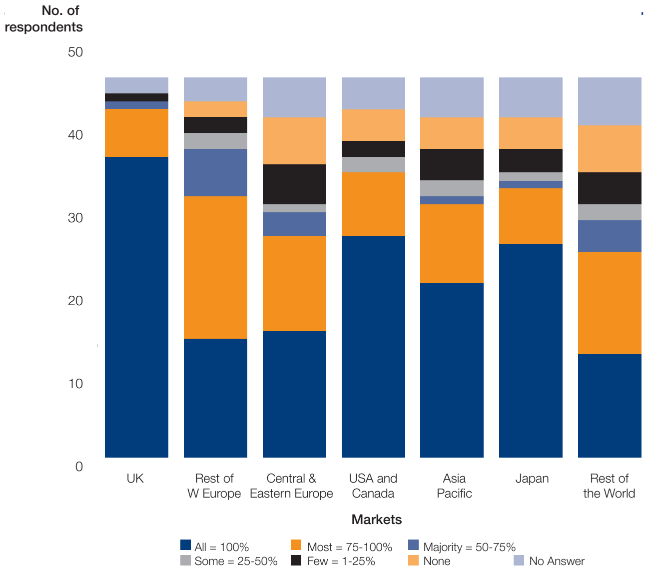
To see what happens in practice, respondents were asked to indicate the proportion of holdings they endeavour to vote in particular markets, and whether they contact management when voting against or abstaining on a resolution.

Holdings voted in particular markets

The highest level of voting is in the UK. Close to 80 per cent of respondents vote 100 per cent of their UK holdings and a further 12.5 per cent vote between 75 and 100 per cent. Voting levels are less in overseas markets with better levels being achieved in the USA, Canada and Japan as compared to other markets - Chart 4.

Of the Service Providers, one votes 100 per cent in all the noted markets, the other did not respond to this question.

Chart 4: Percentage of holdings voted in each market – Asset Owners/Managers



Respondents detailed a number of barriers to voting which are summarised in Table 11. The most common issue is share blocking which was identified as a barrier in Argentina, Austria, Azerbaijan, Belgium, Czech Republic, Egypt, Finland, Greece, Hungary, Italy, Kazakhstan, Latvia, Lebanon, Luxembourg, Mauritius, Morocco, Netherlands, Norway, Portugal, Slovak Republic, Sweden, Switzerland and Turkey. To quote: *"proxy voting in certain countries requires "share blocking." Shareholders wishing to vote their proxies must deposit their shares shortly before the date of the meeting (usually one week) with a designated depositary. During this blocking period, shares that will be voted at the meeting cannot be sold until the meeting has taken place and the shares are returned to the clients' custodian banks. We may determine that the value of exercising the vote does not outweigh the detriment of not being able to transact in the shares during this period. Accordingly, if share blocking is required we may abstain from voting those shares".*

Other key barriers are the need to re-register holdings and obtain powers of attorney: *"markets with barriers to voting such as share blocking, share re-registration and power of attorney requirements among others are becoming less common with the adoption of local legislation facilitating proxy voting by foreign investors. However, in practice not all issuers and/or financial intermediaries have implemented these changes into their internal processes".*

Table 11: Barriers to voting – Asset Owners/Managers

	No. of Respondents
Share blocking (sometimes by custodians)	36
Power of Attorney requirements (standardisation, costs, timeliness)	18
Re – registration practices	8
Country voting practices(China/India/ Taiwan/Japan)	6
Lack of information/transparency (certain markets/language barriers)	5
Short deadlines (in Developing markets)	4
Stock lending issues	4
Inefficiency of voting services/voting chain issues	3
Internal resources	2
Costs	2
Other restrictive voting practices	6
No barriers	1

Inform management/company

Table 12 sets out when management are advised of the reasons when abstaining or voting against a management resolution and the company is notified in writing if its explanation for departing from the UK Corporate Governance Code is not accepted.

22 respondents in most instances contact companies when voting against or abstaining and 13 write to the company if its explanation for departing from the UK Corporate Governance Code is not accepted.

Of the nine that responded "other" to contacting management when voting against or abstaining, three are piloting a process to inform companies or are committed to do so going forward. Two inform the company before the vote, depending on the size of the holding, two provide feedback as part of their routine discussions rather than after the vote. Another does so: *"depending on proportionality, any governance concerns would be raised through the ongoing dialogue with management during the 'held period'. Management would be aware when we are not supportive, so we would not formally notify as a matter of course".*

Another commented: *"following publication of the UK Stewardship code it is our intention to write to all UK Companies where we intend to vote against or abstain indicating the reason for our decision".*

As regards departures from the Corporate Governance Code, one Asset Manager stated: "*we will contact companies to discuss deviations from the code on a case-by-case basis".*

Two Managers prefer to telephone: "*we often call companies to discuss issues as we typically find this is more practical and effective".*

Table 12: Contacting management – Asset Owners/Managers

	Voting against or abstaining on management resolution	Departing from the UK Corporate Governance Code
Always	8	6
Most instances	14	7
Sometimes	8	16
Infrequently	5	8
Never	1	2
Other	9	6
No response	3	3
Total	**48**	**48**

One Service Provider *always* contacts management in these instances; the other provides clients with the facility to contact companies and provides companies with its research.

Disclosure of voting records

The Guidance to **Principle 6** states that: "*institutional investors should disclose publicly voting records and if they do not, explain why".*

Respondents were asked whether they publicly disclose their voting records and to provide a link and if not, whether they disclose the reasons why and again to provide a link - Table 13.

Respondents are clearly adhering to the Guidance in that nearly two thirds or 64 per cent of respondents publically publish their voting records, with 43 per cent providing details of how each individual resolution is voted. Of the 16 that currently do not publish their voting records; two are committed to do so in the future, as stated: *"as soon as we have finalized and published our Stewardship statement, (6 Dec. 2010) we will start disclosing a summary of our proxy voting results, on a quarterly basis"*.

In accordance with the Guidance, the remaining 14 Managers publicly state why they do not publish. The reasons given are that these reports may contain confidential information and that records are made available to clients, who in some instances may publish themselves. Comments included:

- *"We provide clients with their voting records every quarter. [It] does not currently publish aggregated voting records. We view clients' voting records as their property which they may choose to publish if they wish, rather than ours to make public."*
- *"As institutional managers, we disclose our voting to the clients on whose behalf we vote. As fiduciaries, we believe this information is our clients' property, and it is their prerogative to disclose it more publicly should they wish. Moreover, in some cases public disclosure of client proxy voting records would be restricted as confidential information under investment management agreements with our clients."*
- *"[It] is committed to voting on all the UK stocks it holds for its underlying investors and where it has the full discretion to do so. Whilst comprehensive records of [its] voting instructions are maintained, [it] does not report specifically on its voting activity. Whilst being mindful of its fiduciary duty and the interest of all investors, [it] believes that automatic public disclosure of its voting records may have a detrimental effect on its ability to manage its portfolios and ultimately would not be in the best interest of all shareholders. On specific requests from clients, [it] will in good faith provide records of voting instructions given to third parties such as trustees, depositaries and custodians subject to limitations."*

Table 13: Public disclosure of voting records

	Asset Managers	Asset Owners
Individual votes	16	5
Summary of votes	9	1
Commit to publish	2	–
Do not publish but give reasons	14	–
No response	–	1
Total	**41**	**7**

One Service Provider also publishes its votes or voting recommendations.

8. Reporting

Principle 7 states that: *"institutional investors should report periodically on their stewardship and voting activities".*

In accordance with the Guidance: *"those that act as agents should regularly report to their clients details on how they have discharged their responsibilities. Such reports will be likely to comprise both qualitative as well as quantitative information. The particular information reported, including the format in which details of how votes have been cast are to be presented, should be a matter for agreement between agents and their principals".*

All respondents, except one Asset Owner that did not answer this question, report to their clients/beneficiaries. Most commonly this is quarterly, though for 15 respondents, the frequency varies for individual clients and there is "no general trend"- Table 14.

Table 14: Frequency of reporting to clients/beneficiaries

	Asset Managers	Asset Owners
Annually	3	2
Quarterly	26	–
Monthly or more frequently	1	–
No general trend[18]	11	4
No response	–	1
Total	**41**	**7**

The majority provide both voting information and details of stewardship – Table 15.

21 respondents provided additional information about their reports, these include those that publish ESG reports on a regular basis with the majority meeting specific client requests. Certain of the Managers' comments are as follows:

- *"Voting information is the primary content of our reporting. There are some clients who also require reporting on governance and broader stewardship activities and these requests tend to be dealt with on a case by case basis. We are reviewing our stewardship reporting with a mind to broadening the reports to cover both Voting and Engagement and providing such reports on a regular basis."*
- *"We also provide all clients with a global governance 'overview' which highlights our other activities such as engagement with regulators, and updated policies. Some clients also receive bespoke reporting."*
- *"We produce two types of reports: vote summary reports (all voted resolutions or votes against management only) and commentary pieces on regional developments and engagements. The clients choose the type of report(s) they wish to receive."*
- *"Our policy is that we will make voting records available on request to clients and investors in our funds. We are also committed to disclosing our engagement and monitoring activity in publicly available documents and literature i.e. fund reports & accounts."*
- *"Institutional pension fund clients receive voting information quarterly with some clients also receiving engagement activity reports. These clients also receive biannual voting and engagement activity reports. In addition, [it] publishes biannual reports disclosing high level voting activity and governance and sustainability engagement on our website which are also sent out to institutional pension fund clients. [It] is actively considering publishing voting disclosure on its website."*

An Asset Owner commented: *"we report annually in writing via the scheme accounts to members. Voting information is provided monthly on our website. We also report to our Investment Committee at roughly bi-monthly intervals".*

Another: "*to end March 2010 we provided global monthly voting reports on our website. Our voting records from April 2010 are now on-line within a search function. Our half yearly RI Activity Reports cover stewardship activities for all our assets under management and highlight a selection of our more in-depth investee company engagement activities. However, our disclosures are balanced by the need to retain confidentiality with the investee company and protect any proprietary investment strategies. A section on RI activities is included within [its] Annual Report and the Members Annual Report – both of which are available on our website".*

[18] Respondents that selected multiple options have been allocated to the "no general trend" category.

Table 15: Content of reports

	Asset Managers	Asset Owners
Voting information only	8	–
Details of stewardship only	1	–
Both voting information and details of stewardship[19]	28	5
Other	4	1
No response	–	1
Total	**41**	**7**

One Service Provider reports both voting and stewardship activities monthly to their clients, and the other noted that reports vary from client to client.

The Guidance to the Principle also states that: "*those that sign up to this Code should consider obtaining an independent audit opinion on their engagement and voting processes having regard to the standards in AAF 01/06 and SAS 70*".

Respondents were asked if they had obtained such an independent audit opinion the period covered - Table 16. At present this has not yet been widely taken up.

While 40 per cent have obtained an independent audit opinion of their voting processes, few cover stewardship as well. One Manager's reason for not doing so in its public policy was: *"while our voting record is audited as part of the SAS 70, we are not convinced that engagement is something that should be audited. While voting is something that can be measured and compliance can be confirmed, engagement may not always follow a formal process and does not always have tangible outcomes and results that can be quantified".*

Another stated: "*it is our expectation to have external assurance. This has not been done to date, as we have followed the FRC's Stewardship Code guidance to wait for the ICAEW's report on external assurance as it relates to the Code. Now that the ICAEW's guidance was published - after the FRC's 30 September 2010 deadline for signatories - we will be reviewing the ICAEW paper and have already begun to discuss this process with external auditors*".

An Asset Owner commented: "*our voting and stewardship activities are subject to scrutiny from [it's] internal audit department*".

Neither Service Provider noted such an audit.

Table 16: Independent audit of stewardship and voting processes – Asset Owners/Managers

Period covered	**Voting only**	**Stewardship only**	**Both voting and stewardship**
Covered but no period given	1	–	1
2008	1	–	–
2009	7	–	–
2010	6	–	3
Annually	4	–	–
In progress/under review	–	3	5
No	23	39	33
No response	6	6	6
Total	**48**	**48**	**48**

[19] Respondents that selected multiple options have been allocated to the "both" category

9. Other stewardship activities

18 respondents provided additional comments on activities not addressed by the specific questions. Two main themes arose. Six highlighted that stewardship extends further than UK equities, some undertaking it globally and/or for all asset classes. One Manager: "*also actively engages as a bond holder. We believe that long-term creditors and long-term shareholders have many overlapping and complementary interests, and that joint collaboration on different corporate asset classes can add critical mass to the engagement discussion and lead to positive outcomes that can support both creditor and shareholder interests. We believe the FRC missed an important opportunity by not addressing the role of bond holders and other corporate creditors in the Stewardship Code".*

The other main theme was collaboration with other investors on policy issues. Eight respondents highlighted that they are members of corporate governance forums, respond to consultations and work collectively to achieve change. As one Manager stated: *"as a member of various industry bodies, collective engagement is often held which [it] is involved and participates. It aims to maximise shareholder value by promoting integrity in business. This is done by promoting best practice in the UK through the publication of thought pieces. The Head of Corporate Governance gives client presentations on how [it] is performing in this area and how the activities are in shareholders' interests. [It] responds to regulatory/academic consultations on Environmental, Social and Governance issues. [It] responds to remuneration consultations on executive pay put forward by companies. During this process, [it] expresses its views on whether the proposals are appropriate from an investors point of view. [It] is a member of various bodies such as UKSIF, UNPRI and FTSE 4 Good. These groups aim to promote best practice within the industry and raise awareness on ESG issues".*

Another stated: *"we further expect companies to work toward enhancing long term shareholder value and believe that companies should address SEE and governance issues in that context. We also engage actively with regulators and policy makers on areas which affect our clients, with respect to investment and stewardship matters. Additionally, we offer clients a range of services to help them implement their stewardship activities, such as trustee training, portfolio screening, and exclusion strategies".*

Two others commented that their engagement processes are evolving with the focus being on securing long term shareholder value.

One Asset Owner and one Service Provider considered that Asset Managers are in the forefront of stewardship and should take the lead in moving it forward in order to avoid regulation in the future. The Asset Owner noted that its community should also step up in this area and hopes that this Steering Group: "*invites more views from the asset owner side of the fence, as well as other constituents (e.g. advisers) if only for the reason that the FM [fund management] industry - like any other - doesn't not have the monopoly on good ideas".*

Appendix 1
The Financial Reporting Council's Stewardship Code

The UK Stewardship Code

July 2010

Preface

The Stewardship Code aims to enhance the quality of engagement between institutional investors and companies to help improve long-term returns to shareholders and the efficient exercise of governance responsibilities. Engagement includes pursuing purposeful dialogue on strategy, performance and the management of risk, as well as on issues that are the immediate subject of votes at general meetings.

The Code sets out good practice on engagement with investee companies to which the FRC believes institutional investors should aspire. It provides an opportunity to build a critical mass of UK and overseas investors committed to the high quality dialogue with companies needed to underpin good governance. By creating a sound basis of engagement it should create a much needed stronger link between governance and the investment process, and lend greater substance to the concept of "comply or explain" as applied by listed companies. The FRC therefore sees it as complementary to the UK Corporate Governance Code for listed companies, as revised in June 2010.

Institutional shareholders are free to choose whether or not to engage but their choice should be a considered one based on their investment approach. Their managers or agents are then responsible for ensuring that they comply with the terms of the mandate as agreed.

Disclosures made by institutions under the Code should assist companies to understand the approach and expectations of their major shareholders. They should also assist those issuing mandates to institutional fund managers to make a better informed choice, thereby improving the functioning of the market and facilitating the exercise of responsibility to end-investors.

As with the UK Corporate Governance Code, the Code should be applied on a "comply or explain" basis. In reporting terms this entails providing a statement on the institution's website that contains:

- a description of how the principles of the Code have been applied, and
- disclosure of the specific information listed under Principles 1, 5, 6 and 7; or
- an explanation if these elements of the Code have not been complied with.

It should be noted that compliance with the Code does not constitute an invitation to manage the affairs of investee companies or preclude a decision to sell a holding, where this is considered in the best interest of end-investors.

The Code is addressed in the first instance to firms who manage assets on behalf of institutional shareholders such as pension funds, insurance companies, investment trusts and other collective investment vehicles. The FRC expects those firms to disclose on their websites how they have applied the Code. Institutions that manage several types of fund need to make only one statement.

However the responsibility for monitoring company performance does not rest with fund managers alone. Pension fund trustees and other owners can do so either directly or indirectly through the mandates given to fund managers. Their actions can have a significant impact on the quality and quantity of engagement with UK companies. The FRC therefore strongly encourages all institutional investors to report if and how they have complied with the Code.

Principle 1 of the Code states that institutional investors that make use of proxy voting and other advisory services should disclose how they are used. The FRC encourages those service providers in turn to disclose how they carry out the wishes of their clients by applying the principles of the Code that are relevant to their activities.

The FRC recognises that not all parts of the Code will be relevant to all institutional investors, while smaller institutions may judge that some of its principles and guidance are disproportionate in their case. In these circumstances, they should take advantage of the “comply or explain” approach and set out why this is the case.

Specifically, the ”explain” option means that overseas investors who follow other national or international standards that have similar objectives should not feel application of the Code duplicates or confuses their responsibilities. Disclosures made in respect of those standards can also be used to demonstrate the extent to which they have complied with the Code. In a similar spirit, UK institutions that apply the Code should use their best efforts to apply its principles to overseas holdings.

The FRC will retain on its website a list of those investors that have published a statement on their compliance or otherwise with the Code, and requests that they notify the FRC when they have done so. The FRC also considers that it would be good practice for each institution to name in its statement an individual who can be contacted for further information and by those interested in collective engagement.

The FRC will carry out regular monitoring of the take-up and application of the Code.

The FRC expects the content of the Code to evolve over time to reflect developments in good engagement practice, in the structure and operation of the market, and the broader regulatory framework, and it will need to give further consideration to issues raised in response to the consultation on this Code in the same light. A decision on the timing of the first review of the content of the Code will be taken in the second half of 2011.

Financial Reporting Council
July 2010

The Principles of the Code

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 and this policy should be 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.

The UK Stewardship Code

Principle 1

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

Guidance

The disclosure should include:

- how investee companies will be monitored. In order for monitoring to be effective an active dialogue may, where necessary, need to be entered into with the investee company's board;
- the strategy on intervention;
- internal arrangements, including how stewardship is integrated with the wider investment process;
- the policy on voting and the use made of, if any, proxy voting or other voting advisory service, including information on how they are used; and
- the policy on considering explanations made in relation to the UK Corporate Governance Code.

Principle 2

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

Guidance

An institutional investor's duty is to act in the interests of all clients and/or beneficiaries when considering matters such as engagement and voting.

Conflicts of interest will inevitably arise from time to time, which may include when voting on matters affecting a parent company or client.

Institutional investors should put in place and maintain a policy for managing conflicts of interest.

Principle 3

Institutional investors should monitor their investee companies.

Guidance

Investee companies should be monitored to determine when it is necessary to enter into an active dialogue with their boards. This monitoring should be regular, and the process clearly communicable and checked periodically for its effectiveness.

As part of this monitoring, institutional investors should:

- seek to satisfy themselves, to the extent possible, that the investee company's board and committee structures are effective, and that independent directors provide adequate oversight, including by meeting the chairman and, where appropriate, other board members;
- maintain a clear audit trail, for example, records of private meetings held with companies, of votes cast, and of reasons for voting against the investee company's management, for abstaining, or for voting with management in a contentious situation; and
- attend the General Meetings of companies in which they have a major holding, where appropriate and practicable.

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 problems at an early stage to minimise any loss of shareholder value. If they have concerns they should seek to ensure that the appropriate members of the investee company's board are made aware of them.

Institutional investors may not wish to be made insiders. They 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 agreement.

Principle 4

Institutional investors should establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.

Guidance

Institutional investors should set out the circumstances when 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. In addition, being underweight is not, of itself, a reason for not intervening. Instances when institutional investors may want to intervene include when they have concerns about the company's strategy and performance, its governance or its approach to the risks arising from social and environmental matters.

Initial discussions should take place on a confidential basis. However, if boards do not respond constructively when institutional investors intervene, then institutional investors will 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, senior independent director, or with all independent directors;
- intervening jointly with other institutions on particular issues;
- making a public statement in advance of the AGM or an EGM;
- submitting resolutions at shareholders' meetings; and
- requisitioning an EGM, in some cases proposing to change board membership.

Principle 5

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

Guidance

At times collaboration with other investors may be the most effective manner in which to engage.

Collaborative engagement may be most appropriate at times of significant corporate or wider economic stress, or when the risks posed threaten the ability of the company to continue.

Institutional investors should disclose their policy on collective engagement.

When participating in collective engagement, institutional investors should have due regard to their policies on conflicts of interest and insider information.

Principle 6

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

Guidance

Institutional investors should seek to vote all shares held. They should not automatically support the board.

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.

Institutional investors should disclose publicly voting records and if they do not explain why.

Principle 7

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

Guidance

Those that act as agents should regularly report to their clients details of how they have discharged their responsibilities. Such reports will be likely to comprise qualitative as well as quantitative information. The particular information reported, including the format in which details of how votes have been cast are presented, should be a matter for agreement between agents and their principals.

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.

Those that act as principals, or represent the interests of the end-investor, should report at least annually to those to whom they are accountable on their policy and its execution.

Those that sign up to this Code should consider obtaining an independent audit opinion on their engagement and voting processes having regard to the standards in AAF 01/06[1] and SAS 70[2]. The existence of such assurance certification should be publicly disclosed.

[1] Assurance reports on internal controls of service organisations made available to third parties.

[2] Statement on Auditing Standards No.70: Reports on the processing of transactions by service organizations.

Appendix 2
Steering Group Members

Stephen Haddrill (Chair)	Financial Reporting Council
Jocelyn Brown	Financial Reporting Council
Richard Davies	Investor Relations Society
Michelle Edkins	BlackRock Investment Management (UK)
Professor Igor Filatotchev	CASS Business School
David Jackson	British Petroleum plc
Huw Jones	M&G Investments
Yvonne Lenoir	European Fund and Asset Management Association
Liz Murrall	Investment Management Association
Frances Wells	Investment Management Association

Appendix 3
Respondents to the questionnaire

Asset Managers				Asset Owners
Aberdeen Asset Management	Capital International	Lazard Asset Management	Scottish Widows Investment Partnership	BBC Pension Trust
AEGON Asset Management UK	F & C Investments	Legal & General Investment Management	Standard Life Investments	British Airways Pensions
Aerion Fund Management	Fidelity Investment Managers	M&G Investment Management	The Co-operative Asset Management	London Pension Fund Authority
Alliance Bernstein	Gartmore Investment Management	Martin Currie Investment Management	Thomas Miller Investments	NI Local Government Officers' Superannuation Committee
Artemis Investment Management	Henderson Global Investors	Newton Investment Management	Threadneedle Asset Management	Pension Protection Fund
Asset Value Investors	Hermes Fund Managers	Old Mutual Asset Managers	TT International	Railpen Investments
Aviva Investors Global Services	HSBC Global Asset Management (UK)	Pyrford International	UBS Global Asset Management (UK)	Universities Superannuation Scheme
AXA Investment Managers	Impax Asset Management	RC Brown Investment Management	UK Financial Investments (UKFI)	**Service Providers**
Baillie Gifford & Co	Invesco Perpetual	RCM (UK)		Manifest Information Services
BlackRock	J.P. Morgan Asset Management	Royal London Asset Management		Pensions Investment Research Consultants (PIRC)
BP Investment Management	Jupiter Asset Management	Schroder Investment Management		

Appendix 4
Detailed practical examples

Marks & Spencer Group plc
Chairman and Chief executive

The issue

In March 2008, Marks & Spencer announced that its Chief Executive, Sir Stuart Rose, would be appointed combined Chairman/Chief Executive when Lord Burns stepped down in June 2008. This was contrary to the provisions of the Combined Code.

The LAPFF tabled Resolution 16 at the July 2009 AGM for the appointment of an independent Chairman. Although the resolution was not passed, almost 38 per cent voted for it and the Board subsequently brought forward the appointment of an independent Chairman. Sir Stuart handed over his role as Chief Executive to Marc Bolland at the end of July 2010.

Case study

15 respondents that selected this as a case study aimed to:

- clarify succession planning and the dual role (six);
- separate the roles (three);
- ensure there were good governance arrangements to counter the power of Sir Stuart Rose (one);
- improve the management and returns (three);
- achieve additional goals regarding remuneration (two); and
- voice concerns over dual role (one)[1,2].

One stated: "*[we] wanted to understand the reasons behind the appointment of Sir Stuart Rose as Chairman and why the Board felt it was appropriate to deviate from best practice. In addition, [we] wanted to know why a consultation with shareholders was not held as this could have ensured safeguards were in place which alleviated concerns*".

To achieve these objectives, 12 respondents had a number of meetings and telephone conversations with various members of the management team and Board, including the Chairman which, with one exception, included their portfolio managers/analysts. Three followed these meetings with letters, one publicly stated its views on the need for change and another commented in the press.

Of the remaining three, one wrote to the company, another attended corporate events and a meeting with the proponents, and one commented in the press. To quote one Asset Manager: "*the engagement on this specific issue was part of an ongoing engagement with the company . . . We pushed for greater dialogue with shareholders, the creation and maintenance of checks and balances on the chair/CEO including him stepping back to enable the internal candidates to grow. We were pleased to see that the company began to make greater efforts at communicating with us and other investors – and the improved annual report disclosures were a sign of this - during the process and delighted that the new chair has met us prior to taking over the reins*".

Two noted conflicts of interest in that the company or its pension fund was also a client. Both continued to engage on the issue with one respondent keeping its Non-Executive Directors and client account managers informed of developments, and the other managing the conflict through internal challenge and independent director representation on the board and engagement committee.

Ten respondents collaborated with other investors with six participating in joint meetings with the company, two also signing joint letters. Four discussed this issue with other investors; of which one stated they discussed the "*approach taken, the outcome of meetings and in lobbying for another candidate*".

Only two respondents remarked that this collaboration was unhelpful; one noting that the investors involved did not share the same views, and another that the message became diluted in large meetings which tended to "*focus on the softer governance issues and not drill down to how these relate to the financial and operational performance of the company*".

Four respondents attended the AGM.

12 respondents considered that they achieved their objective. Of those that did not: one was disappointed

[1] One did not state its objective.

[2] One Asset Owner had three objectives: to discuss succession planning, to improve management and returns and to achieve additional goals regarding remuneration.

that Stuart Rose had not stepped down and for another it was as the company had been initially unwilling to engage. One did not answer either way and is still having on-going engagement.

Resolution 16

32 of the total 48 respondents[3] held an interest in the company in the period March 2008 to September 2010. Six reduced their position as a result of the issue, of which three disposed of their holding, mainly or partly as a result of the issue. The findings are summarised in Table I.

Table I: Marks & Spencer plc

	Asset Managers	Asset Owners
Number of Holders	27	5
Did interest change?	4 reduced	2 reduced
Voting on shareholder resolution 16[4]		
For	12	2
Against	9	1
Abstain	3	1

Prior to the vote and AGM:

- 17 of these holders met with a variety of representatives from the company such as the outgoing Chairman, the deputy/acting Chairman, Senior Independent Directors, Sir Stuart Rose, and the Company Secretary, many on more than one occasion;
- three also met with representatives from the proponents of the resolution to understand their position fully;
- a further three met with other investors to discuss the issue;
- four wrote to the company or contacted it to explain their position;
- one Owner's engagement was through its appointed Manager; and
- six Asset Managers did not engage on this issue with one citing the small size of their holding nor did one Asset Owner as the shares were not held in a segregated fund.

Slightly more respondents voted for the Resolution, the reasons including:

- supporting the proponents;
- reinforcing the message to the board that their position on the combined roles was not supported; and
- that the practice diverged from best practice.

Ten of the holders supported management, specific reasons for voting against were:

- the company had provided assurances for an acceptable solution;
- the plan was understood and not wanting a "rudderless ship" in the meantime; and
- the resolution was weak or flawed as regards information about the directors.

Of those who abstained, two considered the Resolution too prescriptive and that the company should not have to work to external deadlines, but were sympathetic to the underlying intent on succession planning. One "disapproved" of Sir Stuart's election to Chairman, but did not want him to leave, and whilst another considered the Resolution sensible, the plan was already underway.

The Service Provider that responded also recommended a vote for and commented: "*we were disappointed in the voting decisions of some organisations who, in our view, voted against the resolution having gained very meagre 'concessions'. For example, one reported that it opposed the resolution having "received an assurance that our view that the chair's appointment should precede that of the CEO would receive an airing at the next nominations committee". This was despite the fact that company had already publicly committed to appointing a new chief executive first*."

[3] One of the Service Providers responded to this section of the questionnaire but as it does not hold an interest for investment purposes it is not included in this analysis unless specifically stated.

[4] Three Managers sold their holding before the vote, but did not consider that this was as a result of this issue and one Asset Owner did not provide this information.

"*We have subsequently carried out analysis of voting behaviour on shareholder resolutions. We discovered that a certain group of asset managers appear to have opposed all shareholder resolutions on ESG issues from 2006 to 2010. We believe that responses to this survey will confirm this. We therefore consider that this maybe a house policy rather than informed voting and this maybe something that should be explored further".*

Tesco plc
Remuneration

The issue

In the run up to the 2010 AGM, several corporate governance groups expressed concern about the remuneration of Tesco's board. In particular the focus on rewarding executives for the performance of the US business, which comprised a fraction of the turnover, with the Chief Executive of Tesco's American Fresh & Easy chain receiving a package worth £4.3 million, despite the subsidiary consistently trading at a loss.

Tesco had already been warned about mounting shareholder concern the previous year, when 7 per cent failed to support its remuneration report and 41 per cent voted against amendments to the share option plan. Sir Terry Leahy, Tesco's outgoing Chief Executive, received about £10 million in pay and shares, while the US Chief Executive received about £7 million. At the July 2010 AGM, 48 per cent of shareholders voted against or abstained on Resolution 2, approval of the Remuneration Report.

Case study

Seven respondents selected this as a case study where the main points of discussion surrounded remuneration. As one stated, its aim was to seek: "*improvements to the company's remuneration structure such that it is aligned, better, with the business strategy and shareholders' interests*". More specific objectives highlighted were to:

- minimise the cost in event of termination;
- obtain assurance of appropriate oversight of the decision given the performance concerns; and
- clarify technical elements of the plan.

To achieve their objectives, four respondents noted a total of six meetings with key representatives from the company (namely the Chair of the Remuneration Committee, the Chairman or Company Secretary) which in most instances included both stewardship specialists and portfolio managers/analysts. In addition, several calls were made to the company, generally by the stewardship specialists but in some instances by portfolio managers/analysts (one Manager only interacted by telephone).

No conflicts of interest were reported. Four respondents collaborated on this issue, one having joint meetings with the company, three discussions with other investors, including with other members from the "Corporate Governance Forum", although the Forum's members had different views. One sought to set up a joint meeting with other investors and the Chair of Remuneration Committee in the new year, but in the interim held a conference call with other investors to identify a consensus so that a consistent message could be given to the chair of the Remuneration Committee.

None of the seven respondents attended the AGM.

Six achieved their objective with one stating this was only partial as although they were satisfied with "*the use of ROCE in the long term incentive plan*", the US bonus had been paid out in full. The one that did not stated: *"remuneration was one aspect of the engagement. While the Company has taken steps to address the performance concerns, the Company was not as proactive in relation to the remuneration concerns. Please note that following the AGM, the Company now has plans to consult investors on the review of its remuneration policy".*

Resolution 2

40 of the 48 respondents had a holding in the period July 2010 to September 2010. One Manager added to its position as a consequence of this issue commenting: "*we are supportive of the management and are comfortable with the level of remuneration given the success of the overall company*". For all others it remained static. The findings are summarised in Table II.

Table II: Tesco plc

	Asset Managers	Asset Owners
Number of Holders	35	5
Did interest change?	1 added	–
Voting on Resolution 2[5]		
For	15	0
Against	16	3
Abstain	4	1

17 had telephone calls/meetings with the Company Secretary, the Chairman and Chair of the Remuneration Committee to discuss remuneration strategy and performance. A few Asset Managers followed up with letters and a further 10 communicated via joint meetings with other investors, via letter or via clients. One commented: *"in addition to our conversation with the company before our vote; we requested a meeting with the incoming remuneration committee chair. Subsequent to the AGM we have met the SID and the chair to discuss a variety of matters including succession, strategy and pay. Recently we have discussed the company's pay policy with a number of other investors prior to a round of meetings between investors and the remuneration committee chair. We had also had discussions with the company around our vote in 2009 and 2008".* 13 respondents did not engage.

15 respondents voted for Resolution 2, reasons being:

- remuneration was in line with own guidelines (two);
- the remuneration was not excessive, the approach was satisfactory or the plan had significant performance criteria (six);
- the plan seemed acceptable based on the success of the US business (two); and
- support for management and an overall view of the company's good track record and good governance generally (five).

The main concerns of the 19 that voted against were performance issues in the US business and the technical aspects of the executive remuneration relating to the performance metrics and justifications for some of the awards.

Five respondents abstained. One wanted to engage further on the issue, and three had concerns with some parts of the remuneration report but supported others, one was not active in voting.

The Service Provider that responded recommended a vote against and commented: *"combined awards under the annual bonus and long term incentives were considered excessive in the year under review and considered highly excessive on a potential basis, particularly in light of high executive salaries. Last year Sir Terry Leahy was the second-highest paid director within the FTSE 100 consumers services sector in terms of salary and average directors' salaries were within the upper quartile of the comparative group".*

Barclays plc
Strategy and director re-election

The issue

In November 2008, shortly after the collapse of Lehman Brothers, Barclays declined financial assistance from the UK Government and announced it was to raise £7.3 billion, primarily from Middle East investors. It is understood that this was to avoid the restrictive terms attached to a Government bailout, and to enable Barclays to remain 'strong and independent'. However, Barclays was criticised for the terms it offered the foreign investors on the basis that they were more costly than the Government scheme. Responding to these concerns, the entire Barclays board put itself up for re-election at the April 2009 AGM (Resolutions 3 to 17) giving investors the ability to either support the board or dismiss it. All directors were re-elected.

Case study

All 12 respondents that selected this as a case study either aimed to gain a better understanding of, or express concerns over, the capital raising and why this had been chosen over funding from the Government or

[5] One Asset Owner was not able to provide this information.

existing shareholders. Additional reasons were that four considered the capital raising did not respect pre-emption rights. To quote: "*the capital raising was unconventional, and bypassed 'normal' pre-emption guidelines. This was also a far from normal situation which warranted increased focus from shareholders*".

Two also had concerns over remuneration. Two sought to make changes to the board following the share issue, and three wanted to communicate concerns about the outreach to shareholders, one stating its objective was: *"to inform the Company of our discontent and disappointment with the Company's handling of the capital raising. To also seek reassurances that it would consult shareholders/consider shareholder views on any significant changes going forward, given the recent concerns shared by investors".*

Three respondents made their concerns known immediately after the announcement, either by meeting with the executives, Chairman and Senior Independent Director or by a conference call. Ten met with company representatives, mainly the Chairman, of which four also interacted with other investors - either through meetings or conference calls. For two, a joint investor meeting was the main means of engagement. One stated: *"met with Company chairman and company secretary ahead of the 2009 AGM. We then followed up with the Company advising it of our vote decisions, detailing our continuing reservations over remuneration. In summary we said that following our meetings with the Company we were supporting the board in order not to de-stabilise it any further and also because we got the distinct impression the board were wholly chastened by the experience and was well aware of shareholder disappointment. With this said, we made the Board aware that it was 'on trial'".*

Another stated: *"Following the share issue announcement, we met executives and the chairman and SID. Following those discussions, we wrote to the chairman asking that 6 non-executives be replaced, on the grounds that whilst we had some faith in the capabilities of the executive team, we had lost faith in the first line of defence, namely a robust, competent board. We subsequently had meetings with the chairman and SID regarding succession planning on the board. In the light of the board's plan, we were able to accept that it was not necessary to vote against board members".*

Two made public statements: one at the AGM that it was against the capital raising; and the other that boardroom change was necessary.

Two respondents noted conflicts of interest due to client relationships. Both continued to engage, with one keeping its Non-Executive Directors and client account managers informed of developments, and the other ignoring the relationship, engaging robustly with the company and voting against the issue.

Only two respondents attended the AGM.

The majority achieved their objective. One commented: "*whilst the proposed arrangement was a significant breach of pre-emption rights, our principal concern as shareholders was ensuring that the Company continued to trade and that the value of our share-holding would not fall to zero. Due to economic conditions, there existed considerable uncertainty relating to the capacity of current shareholders to subscribe for the total amount of capital required and the extent of the discount required".*

Of the three that did not, one was: "*not happy with the company's dilutive capital raising and with the board's poor outreach to shareholders. However, these engagement initiatives have strengthened the dialogue between Barclays and [ourselves], and we believe they took [our] concerns seriously in a way which we hope will allow for better communication and dialogue going forward".*

Another was disappointed that the Chairman secured a majority and the third did not feel that "*sufficient of its shareholders were requesting the change that we were*".

Resolutions 3 to 17

37 respondents had a holding in the period November 2008 to April 2009. Three reduced their holdings but all three subsequently voted in support of the board. Three reported an increase in that they participated in the capital raising. The findings are summarised in Table III.

Table III: Barclays plc

	Asset Managers	Asset Owners
Number of Holders	31[6]	6
Did interest change?	4 reduced and one increased [7]	1 increased
Voting on resolutions 3 to 17[8]		
For all	23	6
Against some, majority for	4	0
Abstained some, majority for	1	0

In the run up to the AGM, 25 respondents engaged on the issue many with a series of meetings with the board, Chairman and their advisors. Ten did not engage and two did not respond[9].

The majority voted for all the Resolutions; the main reasons being: to avoid Government control; the company's performance relative to its peers; not wanting to de-stabilise board; and that it was in the best interests of shareholders. To quote: *"while we would have preferred that the Company choose a financing route better aligned with the interest of existing shareholders, we did not believe that it was in the long-term interests of the Company and its shareholders to remove the board at that time".*

However, three voted against the re-election of the Chairman, Marcus Agius: *"on balance, whilst concerned about the way in which the capital raising had been handled, we reluctantly supported it because of the macro-economic conditions at the time; the bank would have been put under intolerable pressure if the capital raising had not proceeded; as a universal owner we had little choice but to support the raising. Having recently had a meeting with the chair, we concluded that we had lost our confidence in him, we therefore after considerable deliberation, voted against him".*

One abstained on the re-election of Bob Diamond as his contractual terms allowed for a notional bonus element and in view of his excessive bonus arrangements, a payoff could be expensive for shareholders (Resolution 4). Another voted against the re-election of Sir Richard Broadbent as Senior Independent Director (Resolution 6) on the basis: *"he is primarily responsible for appropriate communication and consultation with shareholders. We remain concerned that last year's capital raising, despite the extraordinary market conditions, eroded shareholder pre-emption rights. While we welcome subsequent disclosure about the bank's rationale, we wish to avoid such precedents being set, regardless of market conditions".*

The Service Provider that responded recommended opposing the re-election of Bob Diamond (Resolution 9), Christopher Lucas (Resolution 11), Frederik Seegers (Resolution 14) and John Varley (Resolution 16) on the basis that the contractual terms for these directors fell short of best practice.

Lloyds Banking Group plc HBOS acquisition

The issue

In September 2008 Lloyds Banking Group announced plans to acquire HBOS. Effectively the buy-out was a rescue deal after HBOS's shares fell amid concerns over its future. The Government lent HBOS £25.4 billion in October/November 2008. According to Reuters, shareholders were not aware of the loan when voting on the acquisition which was supported by 96 per cent of shareholders at the Extraordinary General Meeting on 19 November 2008 (Resolution 1). In addition, both the subsequent capital raising by Lloyds Banking Group and the eventual buyback of the shares were approved with large majorities. In February 2010, Lloyds Banking Group announced a charge of £24

[6] One Asset Manager held shares during this period but disposed of them before the record date and therefore did not vote. The reason for selling was not linked to the issue in question.

[7] In one additional case the economic interest did not change, although its holding was rebalanced from ordinary shares into convertible stock.

[8] Two Managers recorded voting both for and against Resolutions 3 to 17, reflecting different clients' interests, and thus are not shown in the table as it would distort the results.

[9] One Asset Owner outsources to its manager.

billion in respect of bad debts for the financial year ended 2009, mainly a legacy of lending by the corporate banking division of HBOS.

Case study

Four respondents selected this as a case study: the main objective of three of them was to seek further clarification on the acquisition while the main objective of the fourth was to voice concerns over the deal. One commented: "*this [our engagement] not only allows the analyst to seek clarification on their concerns but the PMs [Portfolio Managers] can ask questions relevant to their investment objectives/thesis for the stock. Our deep and thorough understanding of the deal allowed us to position ourselves appropriately ahead of the crisis and for the recovery the following year".*

To achieve this, three had at least two meetings each with company representatives (one with the Chairman and management, another with the Chief Executive Officer and Chief Financial Officer, and the third with the Finance Director and Head of Investor Relations). One telephoned to voice concerns and later to inform the company of the decision to vote against the Resolution - it also significantly reduced its holding. In all cases, respondents were represented by portfolio managers or analysts (in one instance the Head of UK equities) and in one instance the stewardship specialists also attended. No conflicts of interest were noted. None of the respondents collaborated on the issue. All four considered they achieved their objective.

Resolution 1

40 respondents had a holding in the period September 2008 to September 2010. One disposed of its entire holding as consequence of this issue, another four reduced their holdings, two increased and of the two that made changes over time one noted that: "*there was considerable buying and selling of Lloyds shares during this time"* and another that "*positions were adjusted due to a range of factors*". The findings are summarised in Table IV.

Table IV: Lloyds Banking Group plc

	Asset Managers	Asset Owners
Number of Holders	35	5
Did interest change?	4 decreased 1 increased 2 changed over time	1 increased 1 decreased
Voting on Resolution 1[10]		
For	26	3
Against	0	1
Abstain	2	–

Ahead of the vote, 23 holders engaged with the company/or other related parties on this issue (two meeting with HBOS and not Lloyds). Some (six) recorded details of several meetings with the boards of one or both companies to discuss the merger, one stated: *"we had a telephone meeting with the CFO in which we discussed the issues with him……and obtained specific assurances about the due diligence and the strategic opportunity. Subsequent to the acquisition we engaged with the chair on the issue to express our concern with the disconnection between what we were told by the bank and the outcome of the acquisition. We continue to engage with the company on a variety of issues, notably its strategy and its pay policy and how the bank will recover from the acquisition".*

The majority supported the acquisition, some believing this was in the best interests of their clients and to protect the investment, whereas others considered there were few alternatives, as one stated: "*although we had concerns over the acquisition, the wording in the prospectus had changed in that it stated that the Government would not lend to Lloyds if they did not acquire HBOS. In view of the deterioration of the markets in the preceding weeks it was too risky to rely on the market to raise new capital and the uncertainty was likely to de-stabilise Lloyds. Therefore the risks of not supporting the acquisition were too great. This was a reluctant vote in favour".*

[10] Two Managers recorded voting both for and against Resolution 1, reflecting different clients' interests, and thus are not shown in the table as it would distort the results. Two Managers did not vote on this resolution and three further Managers did not have entitlement to vote at the time. One Asset Owner did not have access to this information.

The Asset Owner who voted against considered the price too high.

Two Asset Managers abstained; one because of a lack of information on the deal, and the other as it was a passive investment. One Manager that did not vote stated: *"we did not vote on this resolution. Our standard policy is to only vote in the relatively rare instances when we decide that an action proposed by a company is against the best interests of our clients".*

The Service Provider stated*: "[we] considered that the company has provided sufficient information about the acquisition and that the proposal was subject to sufficient independent scrutiny. Given the extraordinary circumstances that the company faces, and the commitments made by the HM Treasury to act as a value-oriented party, we recommended voting in favour of the scheme of arrangement".*

Following the merger, five respondents subsequently engaged with the company about the recovery, with two specifically addressing remuneration. In addition, there was a shareholder action campaign to recoup losses. Although none of the respondents reported participating in this, one stated: *"we were approached by the shareholder action group. Our clients were no longer shareholders and we had sold at a profit, so there was no loss for us to reclaim. We also felt that taking action against the company could have further repercussions for the share price which might disadvantage the current shareholders. We therefore didn't participate in the shareholder action".*

Royal Dutch Shell plc
Oil sands and safety

The issue

Fair Pensions, supported by a number of institutional shareholders, tabled a resolution at Shell's May 2010 AGM for a review of the viability of the Canadian oil sands projects. The investors argued that the projects were too big an environmental and economic liability. The Resolution directed the relevant Committee to commission a report on the projects to cover future carbon prices, oil price volatility, oil demand, anticipated regulation of greenhouse gas emissions, and legal and reputational risks arising from damage to the environment and livelihoods. It directed that the findings be reported in the Annual Report presented to the 2011 AGM.

Shell urged its shareholders to vote against the Resolution on the basis that global demand for energy is expected to rise significantly in the future, and that oil sands represent one of the world's largest sources of crude oil. It also argued that investment in the sector had been profitable and had benefited shareholders. At the AGM, 94 per cent voted against the resolution (Resolution 23).

Case study

19 respondents selected this as a case study, of these 17 Asset Managers and one Asset Owner aimed to:

- better understand the risks and costs involved in the project (six);
- better understand management's approach (three);
- understand the company's stance on the resolution (four);
- increase disclosures on oil sands (two);
- ensure an effective board (one);
- ensure the oil sands projects are in best interests of shareholders (one); and
- question how the pursuit of oil sands fits with the more sustainable energy path they espouse (one).

One other Owner sought to cover wider issues: *"our stewardship activities in relation to RDS, [Royal Dutch Shell] extend beyond the one issue raised in the case study. We have engaged with RDS individually and collaboratively on matters including remuneration, political risk, climate change and their Nigerian operations. In relation to oil sands, we have been engaging with all the major oil companies with interests in Alberta for a number of years, including RDS and BP. The objectives of our on-going oil sands engagement is to:*

- *ensure oil companies were aware of all the risks associated with oil sands;*
- *improve disclosure to shareholders as to how the risks associated with oil sands are being mitigated;*

- *outline some of the key actions companies with oil sands interests should be implementing to maintain their license to operate; and*
- *protect shareholder value."*

The scope of engagement varied. For nine respondents the stewardship specialists attended company meetings, in three cases alongside their portfolio managers/analysts, and for a further two, only the portfolio managers/analysts attended meetings. Seven respondents visited the sites in Canada to look at the operations first hand. Ten also met with the proponents of the Resolution to understand it more fully. One Asset Manager noted: *"alongside the SRI Officer and Responsible Investment Analyst, [our] global sector oils analyst was involved in the one-on-one discussions and meetings with the company. From Royal Dutch Shell we met with investor relations and the Head of Shell's oil sands operations. The oil sands issue was also raised at a meeting [with our] investment team (including fund managers, oils analyst and SRI Officer) that was held with the CFO and Upstream Director. In addition to these meetings, attended an analyst meeting with the Chief Executive Officer, a Non Executive Director and the Chairman of the Corporate Social Responsibility Committee of the Board, an Executive Director Upstream International, the EVP Oil Sands, the EVP Downstream Strategy, Portfolio & Alternative Energy, Shell Nigeria CEO, EVP CO2. Among other issues, this meeting discussed oil sands operations in some depth".*

12 noted collaborative engagement, including some meetings between investors only. Shell also organised a day in London for investors to discuss all aspects of its ESG performance which six respondents attended. A National Association of Pension Funds Case Committee chaired by one of the respondents arranged several meetings with the company and investors, and another respondent signed a joint letter with other investors. None reported collaboration as unhelpful, though one stated it would not normally agree to a collective agreement to vote "*due to acting in concert rules*" but noted that on this occasion, it was useful: "*due to the technical nature . . . broaden the knowledge base . . . enabled us to question to the specific risks*".

Six attended the AGM, one noting: *"we met with Shell multiple times prior to the AGM. The Head of RI and the CG manager met privately with the Chief Executive just prior to the commencement of the AGM where the issues were discussed amicably – though Shell stood by its position. At the AGM we praised Shell for taking a markedly more thorough and open approach to engagement on the issue, though questioned the fact that the pursuit of oil sands appeared to be by their own assessment in direct contradiction to the more sustainable energy path they espoused".*

All but one achieved their objective as the company improved its disclosure and/or respondents were re-assured that it had looked at all areas of risk. The Asset Owner that did not considered there were still outstanding issues with the exploitation of oil sands. One respondent that published details on their website concluded: *"[Asset Manager] will continue to monitor developments in the oil sands debate but is satisfied that our activities in the resolutions and the oil sands letter of 2009, which was backed by $3 trillion of investment, has given powerful momentum to investor engagement on this most important of issues".*

Resolution 23

40 respondents had an interest in the company during the period March 2010 to September 2010; none reduced their holding as a result of the issue[11]. The findings are summarised in Table V.

Table V: Royal Dutch Shell plc

	Asset Managers	Asset Owners
Number of Holders	35	5
Did interest change?	–	–
Voting on Resolution 23[12]		
For	2	–
Against	30	5
Abstain	1	–

[11] One Asset Manager received queries from clients – it did not change its holding.

[12] One Manager split its vote according to the differing views of its portfolio managers, registering some votes for, some against and some abstentions. As these votes skew the results, they are not included in the Table. One Manager did not vote.

Although there was little support for Resolution 23, the majority of respondents engaged with the company on the issue. 25 of the 40 met directly with the company, with eight noting several meetings over a period of time with Board members and/or senior executives, including the Chairman, or with experts in the field. One noted: *"we have had more than 6 meetings with different representatives from Shell in 2010 where we discussed climate change, oil sands and safety".*

Two noted joint engagement on the issue and two engaged via an umbrella organisation for local authority pension funds. Only seven did not engage.

All Asset Managers, except one, voted on Resolution 23. A clear majority (90 per cent) voted against the Resolution, generally (for 22 respondents) on the basis that the company had responded positively to the proposal and to quote one respondent, it: "*considered the increased disclosures made by the company in response to the issues raised by the proponents to be satisfactory*".

Other reasons for not supporting the Resolution, included, in summary:

- support for the oil sands investment and/or management (four);
- a further review would not be additive (one);
- it was in line with their template and the Board had evaluated the risks and set out its approach (one);
- wanted to engage further (one);
- followed a trend of a major client (one);
- did not want to add to the reporting burden and set a precedent (one);
- considered the Resolution too restrictive on activities (one);
- followed the advice of a proxy voting agency due to conflicts (one); and
- did not consider it in the shareholders' interest (two).

Reasons for supporting the Resolution were:

- did not consider the proposal burdensome and the disclosure would benefit shareholders (one); and
- as "co-filers", wanted to encourage others to be "hands on" (one).

One Manager abstained - it considered the request was reasonable and whilst the company had responded positively, it had still not met the proposals in full. The Service Provider that responded recommended an abstention on the basis of the disclosures given but remained concerned about disclosures in relation to Tar Sands.

Prudential plc
Acquisition of AIG's Asian operations

The issue

On 1 March 2010 Prudential announced an agreement with AIG to acquire AIG's Asian operations, AIA, for a total consideration of US$ 35.5 billion, the cash component to be financed through a rights issue. The deal would have made the conglomerate a leading life insurer in seven Asian countries, and a major foreign provider in China and India.

Critics of the acquisition argued that the price was too high. Prudential subsequently tried to renegotiate the deal after it became clear that its shareholders would not support the acquisition at the original price but was unsuccessful and the deal was pulled just ahead of the date of the EGM when it was to be voted on. Prudential had incurred costs of some £284 million post tax on the aborted takeover; including a break fee payable to AIG, underwriting fees, other fees and the cost of hedging currencies.

Case study

17 respondents[13] selected this as a case study and mainly wanted to understand the rationale behind and/or to look at the price of the acquisition (twelve respondents). One had a very detailed agenda for their discussions with management and the Chairman in March, April and May 2010 wanting to understand: *"the rationale for and background of the AIA acquisition including the risks and benefits to shareholders; the integration of the businesses; the price and EV for AIA, including the revenue synergies and cost savings; the sale of licences in India and China, and ongoing discussions with the regulators; our concerns regarding the significant dilution to shareholders from issuing*

[13] One did not give the objective of its engagement.

stock to fund the AIA acquisition; significant fees to the advisers; delays in the deal caused by the FSA concerns re the company's regulatory capital surplus in relation to AIA. Discussion with the SID (October 2010) was: to communicate our views on the Chairman's position post AIA and establish what lessons the board had learned from AIA".

Another wanted clarity on management's capabilities. A further three wanted changes to the Board or to ensure that those responsible for the transaction were held fully accountable after it had been aborted.

All 17 respondents met with company management, either with the Chief Financial Officer, Chief Executive Officer, Chairman or other representatives and many on several occasions. One stated: "*we first met management in March and told them we had reservations about the deal and also informed the advisers. We held numerous conversations with other shareholders to express our concerns. In May we confirmed our opposition to the transaction and voted our shares accordingly. When the acquisition was abandoned we told the company and its advisers that we expected the Board to take responsibility for a misjudged and poorly executed transaction and pushed for certain resignations. We informed the advisers of our views and held separate meetings with both the Chairman and Senior Independent Director. We have continued to have contact with other shareholders and we remain unreconciled to the lack of senior Board change. This engagement attracted some media attention but it was never our intention to involve the media".*

For all but one respondent, meetings were with the portfolio managers/analysts which in seven instances, involved members of the corporate governance team.

Two noted potential conflicts of interest. One Asset Manager's parent was an advisor to the deal. Although there was a Chinese Wall, had the deal come to fruition then the Manager would not have been able to vote on behalf of certain US clients and would have to document how its vote was in the best interests of its clients and not the Manager. The other conflict related to Prudential's distribution of the Manager's funds which was not a conflict in relation to this issue.

75 per cent recorded some form of collaboration, with half (seven) attending joint meetings with the company. An additional six noted informal discussions with other investors (two via ABI, one via NAPF). Two noted that a lack of consensus with other investors meant that this collaboration did not aid their objective.

One expressed scepticism about the deal publicly, and another attended the AGM and made a public statement. Two other respondents attended the AGM.

12 felt that they achieved their objective (two because the acquisition did not proceed), although one noted: *"however, we were very disappointed that the company's advisers failed to communicate our views to the board in July. We raised our concerns about the poor communication with the SID in October. We are pleased that the board has strengthened its IR and is reviewing its advisers"*.

Of those who were not satisfied, one noted "*the company did not agree with our views*", another failed to achieve a consensus in-house, two wanted the deal to go ahead, one of which had an issue with the Board, as did a further Manager. One had concerns over the length of time the FSA can take to interview and approve potential new non-executives.

Acquisition of AIG's Asian operations

36 of the respondents had an interest in the stock in the period March 2010 to June 2001. As a result of this issue, one added to its position, seven reduced and three sold out, though one noted that they subsequently repurchased after the deal collapsed. The findings are summarised in Table VI.

Table VI: Prudential plc

	Asset Managers	Asset Owners
Number of Holders	32	4
Did interest change?	9 reduced/sold 1 added	1 reduced

Five highlighted that they engaged with the company following these events to discuss the lessons learnt.

The Service Provider that responded to this section commented: "*we had prepared research and voting advice for clients ready to issue if the EGM had gone ahead, and had recommended opposition to the scheme of arrangement (resolution 1). The draft report is available if of interest*".

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