Investment Management Association

Adherence to the FRC's Stewardship Code

At 30 September 2013

May 2014

Investment Management Association
65 Kingsway
London WC2B 6TD
United Kingdom

Tel: +44 (0)20 7831 0898
Fax: +44 (0)20 7831 9975

www.investmentuk.org

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Key findings

This fourth report on the adherence to the Financial Reporting Council's (FRC) Stewardship Code looks at the activities that support institutional investors' commitment in practice. It summarises the responses to a questionnaire sent to 274 signatories as at 30 September 2013, an increase from 241 as at 30 September 2012 and from 172 as at 30 September 2011.

The total number of respondents was 114 in 2013 up from 103 in 2012 and from 83 in 2011. Asset Managers still make up the majority of respondents and managed £708 billion of UK equities (2012: £702 billion; and 2011: £668 billion) representing 32 per cent of the UK equity market. The Asset Owner respondents owned £38 billion (2012: £31 billion; and 2011: £31 billion).

Against this, the overall response rate reduced slightly to 42 per cent in 2013 from 43 per cent in 2012 and 48 per cent in 2011. This mirrors the steady decrease in the average size of respondent in terms of assets managed/owned over the three years. However, it is encouraging that the rate of decline is diminishing and the response rate is stabilising.

The sample of respondents changes from year to year which may impact the comparability of the results. Nevertheless, there are a number of institutional investors that respond year on year: 38 institutional investors responded in all four years since 2010; 58 in the three years to 2013; and 77 in the last two years.

As Service Providers have a distinct role and do not hold equities for investment purposes, they are presented separately in this report. Thus, unless otherwise stated, references to "respondents" are to Asset Manager and Asset Owner respondents only.

Policies (section 3)

All 2013 respondents have a public policy statement on how they discharge their stewardship responsibilities under the Code (Code statement), consistent with 2012. Almost two thirds refer to or include their conflicts of interest policy within their Code statement and an increasing percentage disclose it as a standalone document – 19 per cent as compared to 12 per cent in 2012 and 6 per cent in 2011. Where respondents do not make their conflicts of interest policy public, it tends to be made available to clients and/or on request.

Encouragingly, the proportion of Asset Managers where "all" or "some" mandates refer to stewardship increased to 83 per cent from 71 per cent in 2012 and 65 per cent in 2011. In particular, for 44 per cent of Asset Managers stewardship is referred to in the mandates of all their clients – as compared to 30 per cent in 2012 and 29 per cent in 2011.

The FRC encourages signatories to review their Code statements annually. Almost all, i.e. 90 per cent, of the respondents reviewed their Code statements in 2013 and 67 per cent of respondents updated them. This is a large increase from the 77 per cent and 29 per cent of respondents that reviewed and updated their Code statements, respectively, in 2012.

Eighty-eight per cent of respondents specify the circumstances when they would participate in collective engagement, and 58 per cent disclose their policy on stock lending and recalling lent stock. When the latter is not disclosed it is mainly due to respondents not conducting stock lending.

For almost three quarters of respondents the final Code statement is approved by either the Board or Executive Committee.

Structure and resources (section 4)

Stewardship can be conducted in-house or outsourced. This year 24 per cent of respondents outsourced all of their voting, and 22 per cent all of their engagement. This is a slight increase compared to 17 per cent that outsourced stewardship in 2012. However, where voting and/or engagement are outsourced, respondents monitor their external provider mainly through regular meetings and/or periodic reports.

The total headcount responsible for engagement when it is either all or partly in-house increased significantly by almost 400 to reach 1,703 in 2013 (2012: 1,311 and 2011:1,268). Thus each respondent has an average headcount of 20 – an increase from 17 in 2012. Over 80 per cent of this resource is made up of portfolio managers/analysts and for 65 per cent of respondents, specialists and others also have a role.

Commentators have questioned whether the involvement of specialists means that stewardship is not integrated into the investment process. It is clear that this is not the case, and where specialists are involved, almost 90 per cent of respondents have formal integration arrangements. For example, 67 per cent of respondents involve portfolio managers in either all or controversial voting decisions – an increase from 60 per cent in both 2012 and 2011. Moreover, for 36 per cent of respondents, dedicated specialists often or always attend investee company meetings with portfolio managers/analysts.

Specialists have a wide range of qualifications, for example, a Master's degree or official qualifications from the CFA Institute. Additionally, it is common for specialists to undergo training either in-house or by attending external workshops and conferences.

Resources are often supplemented by service providers that are widely used to process the voting instructions and provide research. Eighty-three per cent of respondents use at least one provider to process voting instructions (2012: 86 per cent; and 2011: 77 per cent). For 89 per cent of these, providers that supply research also issue voting recommendations. Although 95 per cent of respondents do not necessarily or only sometimes follow these recommendations, 5 per cent always follow them (2012: 0 per cent; and 2011: 4 per cent).

Monitoring and engagement, together with practical examples (section 5)

Respondents have a variety of approaches to monitoring their UK investee companies such as communicating regularly with company representatives, analysing company news and reports, and undertaking in-house research or employing third party research services.

These monitoring processes help identify companies where further engagement may be needed.
Whilst 34 per cent of respondents engage with all of their holdings, other respondents use a range of criteria to prioritise engagement. Twenty-six per cent engage when there are significant issues and 13 per cent prioritise either their largest or actively managed holdings. Others take into account factors such as whether they have a large enough holding to influence the outcome or how responsive a company was to previous engagement.

Consistent with previous years, most engagement is around board remuneration issues, followed by strategy and objectives and then board leadership. In this context, remuneration is subject to an annual vote and it may be that in the interests of ensuring that the directors' remuneration report is approved, companies initiate the engagement as opposed to the respondents.

This year respondents were also asked to rank the issues that they consider the most important. In this instance, strategy and objectives were considered the most important, followed by board leadership and then board and committee composition and succession. Remuneration was ranked fourth – an indication that engagement on remuneration may be initiated by companies.

Issues such as pre-emption rights, audit and audit tendering were considered to be the least important and were the least frequently addressed. The fact that pre-emption rights do not rank highly reflects the fact that there were few rights issues in 2013.

Overall there is a slight increase in the proportion of respondents that have a policy to attend Annual General Meetings whenever possible or when they have a major holding at 31 per cent as compared to 28 per cent in 2012 and 30 per cent in 2011. However, 37 per cent of respondents have a policy not to attend any AGMs (2012: 37 per cent; 2011: 33 per cent). (This is different from the 38 per cent of respondents that did not attend any AGMs in the year under review.)

As regards engagement with equities listed outside the UK, 94 per cent engage with at least some of these holdings compared to 89 per cent in 2012. Engagement with asset classes other than equity also increased particularly for fixed income (41 per cent as compared to 36 per cent in 2012) and other types of holdings such as commodities (13 per cent as compared to 6 per cent in 2012).

To see what happens in practice, respondents were invited to set out how they engaged with certain companies in the period to 30 September 2013. Respondents were invited to select examples from the following:

- Afren plc
- AngloAmerican plc
- Barclays plc
- Bumi plc
- Carnival plc
- First Group plc
- Glencore Xstrata plc
- Lonmin plc
- Redrow plc
- RSA Insurance Group plc.

Overall, fifty respondents selected at least one company and gave details of their engagement.

More respondents, 31 in total, gave details of their engagement with Barclays than with any other company. As described in previous reports, remuneration had been a main concern at Barclays in the past. However, following the changes in its board structure in the aftermath of the LIBOR scandal, the main focus in 2013 (besides remuneration) was ensuring the overall culture at the bank was changed.

There were similar levels of engagement with Glencore Xstrata where 27 respondents raised concerns relating to the merger, the composition of the board and the strategy of the merged entity.

Between 11 and 13 respondents engaged with AngloAmerican, Carnival, RSA and First Group and fewer than ten with the remaining four companies, Lonmin, Bumi, Afren and Redrow. What distinguished 2013 from previous years was that although remuneration continued to be a concern, respondents tended to focus on a wider range of issues specific to each company. For example, health and safety was the main concern regarding Carnival after a number of shipping incidents. At Redrow, respondents wanted to oppose (successfully) the proposed takeover by a consortium initiated by its Executive Chairman. The main focus relating to Bumi was the ensuing battle between its co-founders, Nat Rothschild and the Bakrie family, whereas leadership, and particularly a change in the Chief Executive, was the principal issue at AngloAmerican.

Broadly, respondents considered they achieved their objectives. On average, 76 per cent of the respondents that engaged considered their engagement partly or fully successful. However, they stressed that engagement with several companies is on-going in that respondents want for example, to ensure cultural change at Barclays, a permanent Chairman at Glencore Xstrata and more independent non-executive directors at Redrow.

There were several instances of collaborative engagement, particularly with Barclays, Glencore Xstrata, Redrow and RSA. The most common form of collaboration was attending joint meetings with the company and in almost all cases, the collaboration was considered effective.

Respondents were asked how they voted on specific resolutions at the AGM of each company. In around a third of cases, the proportion of respondents that voted in support of management was similar to the overall AGM result, particularly for resolutions at RSA's and First Group's AGM. However, for a number of resolutions the AGM results differed considerably from the way respondents voted.

In some instances respondents took a stronger stance against management. For example, Redrow's resolution to re-appoint the non-executive deputy chairman, Alan Jackson, was supported by 76 per cent of votes at the AGM, but none of the five respondents voted in support. Similarly, the resolution to adopt Bumi's accounts received 65 per cent of votes in support at the AGM, but the six respondents that engaged either abstained or voted against. More than 90 per cent of the votes were in support of the re-election of Carnival's Chief Executive, Micky Arison, and Executive Director, Arnold Donald, whereas over a half of the 12 respondents voted against or abstained on both resolutions.

On the other hand, AngloAmerican's resolutions to allot shares and disapply pre-emption rights received 30 per cent and more than 25 per cent of votes against at the

AGM, respectively, but were supported by all 13 respondents that engaged.

Few conflicts of interest were reported and these concerned Barclays, First Group, Glencore Xstrata and RSA. All conflicts were addressed by respondents.

Voting (section 6)

Although the proportion of respondents that vote all their equity holdings remains high, it is lower compared to previous years for all markets. For example, 78 per cent of respondents vote all UK shares down from 86 per cent in 2012. Similarly, 59 per cent vote all shares in the rest of Western Europe compared to 70 per cent in 2012.

Nevertheless, consistent with previous years, 66 per cent of respondents disclose publicly their voting records and 60 per cent of those that do not, disclose the reason why not – an increase from a half in 2012. When voting records are disclosed, 16 per cent of respondents provide the rationale for exceptional votes and votes abstained or against, whereas only 5 per cent provide the rationale for all votes (2012: 6 per cent; 2011: 9 per cent). Thirty-eight per cent of respondents disclose their voting records as a summary report (2012: 32 per cent; 2011: 30 per cent).

An increasing number of respondents give advance notice to management when they intend to abstain or vote against a resolution. Forty-seven per cent always or in the majority of instances give advance notice as compared to 35 per cent in 2012 and 39 per cent in 2011.

Reporting (section 7)

Almost all respondents report to clients and beneficiaries on their stewardship activities. Over one half report quarterly (2012: 50 per cent and 2011: 61 per cent) and the frequency of reporting varies according to client for 27 per cent of respondents (2012: 23 per cent; 2011: 20 per cent).

Most commonly, reports contain details of both voting and engagement (48 per cent) or only voting (21 per cent). A number of respondents include more details such as Environmental, Social and Governance (ESG) assessments, engagement in public policy and details of thematic research.

The proportion of respondents that obtained an independent opinion on both their voting and stewardship processes continued to increase reaching 17 per cent in 2013 (2012: 14 per cent; 2011: 10 per cent). At the same time, the proportion that did not and have no plans to do so fell from 51 per cent in 2012 to 45 per cent in 2013. The external assurance report is made public by 60 per cent of respondents and most of those that do not, keep it internally or make it available to clients.

The main reason why respondents did not obtain an independent opinion is that it was not considered cost effective. However, 59 per cent carry out an internal audit of these processes or intend to in the next 12 months. The respondents that have no plans to do so explained that this is due to lack of an internal audit function but there is also a small number that do not consider it necessary.

1. Introduction

The Financial Reporting Council first issued the Stewardship Code (the Code) in July 2010 and a revised version in September 2012[1]. The Code operates on a 'comply or explain' basis 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, which includes monitoring companies, entering into a dialogue with boards and voting at general meetings.

The Code is directed in the first instance to institutional investors, asset owners and asset managers, with equity holdings in UK listed companies. In particular, the 2012 version of the Code clarified further the asset owners' role in stewardship.

The Investment Management Association (IMA) has worked with the FRC in developing an exercise to monitor adherence to the Code. There have been four such exercises, covering the periods to 30 September 2010, 2011, 2012 and 2013, respectively.

A Steering Group, chaired by the FRC's Chief Executive, provides direction and independent oversight. The members of the Steering Group are set out in Appendix 1.

Institutional investors that had signed up to the Code were invited to complete a questionnaire. The questionnaire was agreed with the Steering Group and sent to the 274 institutional investors that had signed up as at 30 September 2013. In summary, the questionnaire requested details of:

- the public policy statement.
- the level of resources employed and the use, if any, of proxy voting agencies.
- the integration of stewardship into the investment process.
- how monitoring is prioritised, markets and issues respondents engaged with, together with practical examples.
- voting, and whether voting records are publicly disclosed.
- the frequency of reporting to clients, the information reported, and whether an independent opinion on voting and stewardship processes is obtained.

This report is a summary of the results. The collation of the individual submissions that support the report has been reviewed by Ernst & Young LLP. The IMA would like to thank all respondents for their contributions and the members of the Steering Group who gave their time.

[1] See here for more details.

2. Profile of respondents

Types of respondent

274 institutional investors that had signed up to the Code as at 30 September 2013 were sent a questionnaire, which aimed to determine the activities that support the signatories' commitment in practice. Overall, 114 responded and three institutional investors – two Asset Managers and one Asset Owner – asked to be removed as signatories.

Whilst there were more respondents in 2013 than in any of the previous three years, as shown in Table 1, the response rate declined to 42 per cent in 2013 from 43 per cent in 2012, 48 per cent in 2011 and 67 per cent in 2010. However, it is clear that the rate of decline is reducing and the response rate is beginning to stabilise.

As at 30 September 2013, respondents' UK equity holdings amounted to an aggregate of £746 billion[3] (Table 2). Of this, Asset Managers held £708 billion accounting for 32 per cent of the UK equity market – an average of £10.1 billion per Manager compared to an average of £10.8 billion in 2012. £38 billion were owned by Asset Owners accounting for 1.7 per cent of the UK equity market and making an average of £1.5 billion per owner compared to £1.3 billion in 2012.

Given that Asset Managers may be managing Asset Owners' holdings, the details reported by the Owners and Managers may relate to the same holdings and be double-counted. Service Providers do not hold equities for investment purposes.

Table 1: Types of respondent and response rate

	No. of questionnaires sent				Per cent response rate			
	2013	2012	2011	2010	2013	2012	2011	2010
Asset Managers	198	177	128	58	41	41	45	71
Asset Owners	64	52	34	12	42	44	59	58
Service Providers	12	12	10	5	42	58	50	40
Total/overall rate	**274[2]**	**241**	**172**	**75**	**42**	**43**	**48**	**67**

Table 2: Type of respondent and UK equity assets managed/owned

	No. of respondents				UK equity assets managed/owned (£billion)			
	2013	2012	2011	2010	2013	2012	2011	2010
Asset Manager	82	73	58	41	708[4]	702	668	590
Asset Owner	27	23	20	7	38	31	31	15
Service Provider	5	7	5	2	n/a	n/a	n/a	n/a
Total	**114**	**103**	**83**	**50**	**746**	**733**	**699**	**605**

[2] As at 30 September 2013 there were 284 signatories to the Stewardship Code of which ten did not receive a questionnaire either because they had two entities that were signatories or had indicated that they did not wish to participate.

[3] Excludes twelve Asset Managers and one Asset Owner that did not provide this figure.

[4] For two Asset Managers the value of UK equities was taken from the IMA Asset Management Survey 2012, adjusted for movements in the FTSE All Share index.

The sample of institutional investors that respond each year varies to some degree and, hence, the results may not be entirely comparable year on year. However, there are a number of institutional investors that respond consistently year to year (see Table 3). Exactly one third of the 114 respondents in 2013 responded in all four years since 2010; and 77 respondents – just over 67 per cent – in both 2012 and 2013.

Table 3: Recurring respondents

	No. of respondents		
	2013-2012	2013-2011	2013-2010
Asset Managers	56	47	32
Asset Owners	18	9	5
Service Providers	3	2	1
Total	**77**	**58**	**38**

Stewardship can be impacted by the type of respondent and its structure. For example: whether an asset manager manages its parent's assets or is independent and only manages those of a third party; whether an asset owner is a pension fund, charity or other type of owner; and the type of service a service provider offers. Thus Asset Managers were asked for details of their parent (Table 4); Asset Owners, the type of assets (Table 5); and Service Providers, the type of service provided (Table 6).

These distinctions should be borne in mind when reading this report but are not necessarily clear-cut. For example, one respondent that classified as an Asset Owner manages its own and third party assets, and provides corporate governance services to others (an overlay service).

Asset Managers

Similar to previous years, a little over half of the Asset Managers are independent, while 18 per cent are owned by an insurer, and 13 per cent by an Asset Owner (see Table 4). All other types of ownership account for just 16 per cent.

Table 4: Asset Managers - parent

	No. of respondents			Per cent of respondents		
	2013	2012	2011	2013	2012	2011
Retail bank	3[5]	3	3	4	4	5
Investment bank	4	7	3	5	10	5
Insurer	15[6]	13	14	18	18	24
Independent	43[7]	35	27	53	48	47
Asset Owner	11[8]	9	5	13	12	9
Other	6[9]	6	6	7	8	10
Total	**82**	**73**	**58**	**100**	**100**	**100**

5 One is part of a banking group whose primary business is retail banking.
6 One was acquired by an insurer during 2013 and another did not respond to this question but its ownership was determined from its corporate website.
7 One is owned by partners and nine are owned by an independent public company.
8 Two are Occupational Pension Schemes and one is a Foundation owned by Swiss pension funds.
9 Four are owned by private companies, one by another Asset Manager and one partly by partners and partly by a private banking group.

Asset Owners

Almost 90 per cent of Asset Owners are pension schemes with occupational pension schemes being the most prominent type of owner at 56 per cent (Table 5). Of the two respondents that selected "other", one is an *"occupational pension scheme and stewardship overlay service [provider]"* and the other is an *"independent self-managed investment trust".*

Table 5: Asset Owners - type

	No. of respondents			Per cent of respondents		
	2013	**2012**	**2011**	**2013**	**2012**	**2011**
Occupational pension scheme	15	11	8	56	48	40
Public pension scheme	8	8	7	30	34	35
Private pension scheme	–	–	2	–	–	10
Charity/ foundation	2	2	1	7	9	5
Other	2	2	2	7	9	10
Total	**27**	**23**	**20**	**100**	**100**	**100**

Service Providers

As shown in Table 6, the number of Service Providers that responded decreased to five in 2013 from seven in 2012. Three of these are proxy voting agencies providing research, issuing voting guidance, and carrying out voting instructions. The other two are consultants offering advice on a wide range of issues such as strategy, sustainable investments etc.

Table 6: Service Providers - service

	No. of respondents			Per cent of respondents		
	2013	**2012**	**2011**	**2013**	**2012**	**2011**
Proxy voting agency	3[10]	6	3	60	86	60
Consultant	2	1	2	40	14	40
Total	**5**	**7**	**5**	**100**	**100**	**100**

Since Service Providers do not manage or own equities, a number of questions did not apply to them, or they were approached from a different viewpoint. Thus their responses are presented separately from those of Asset Managers and Asset Owners.

[10] Includes one respondent who is a *"provider of research into corporate environmental, social and governance (ESG) risk management and performance".*

3. Policies

Public policy statement

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".*

Only those that committed to the Code were invited to complete the questionnaire, thus all respondents have a public policy statement on how they discharge their stewardship responsibilities (Code statement). However, for four Asset Managers and two Asset Owners their Code statement is on the FRC's website as opposed to their own.

Conflicts of interest

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

Table 7 shows that although 82 per cent of respondents have a public conflicts of interest policy, an increasing percentage – 15 per cent in 2013 compared to 6 per cent in 2012 – does not. Fourteen out of the 16 respondents explained why they do not have a public conflicts of interest policy:

- nine respondents make it available to clients or when requested.
- three respondents include it within their "*wider fund governance framework".*
- one respondent lists all potential conflicts of interest in the Annual Report.
- one respondent stated that it has *"consciously maintained an independent ownership structure in order to minimise conflicts of interest that may impede our effectiveness in serving our clients"* and developed an internal policy.

Table 7: Public conflicts of interest policy

	Per cent of respondents		
	2013	**2012**	**2011**
Standalone	19	12	6
Within or referenced in Code statement	63	82	90
Not public	15	6	4
No response	3	–	–
Sample size	**109**	**96**	**78**

The Guidance to **Principle 2** was updated in 2012 to state that: *"the conflicts of interest policy should address how matters are handled when the interests of clients or beneficiaries diverge from each other".*

Eighty-two, i.e. three quarters, of respondents address this in their conflicts of interest policy whereas 23 do not[11]. Of the latter, explanations as to why not, included:

- four Asset Owners that did not consider this relevant to their business.
- one that stated *"it was decided not to go into this detail".*
- another that does not provide this at the *"summary level"* but believes that such a case is unlikely to arise *"given that beneficiaries' entitlements are governed by the Scheme Deed and Rules".*
- two Asset Managers where this is unlikely to happen due to their ownership structure – both owned by an Asset Owner – which leaves no room for divergence of interests.
- one Asset Manager that *"vote[s] different clients in accordance with their interests".*
- another Asset Manager that undertakes corporate engagement for its clients *"as a whole".*
- another Asset Manager that applies its stewardship policy across all clients and it is for individual clients to choose a different approach.
- two Asset Managers that found conflicts of interest unlikely to occur, one because it is unlikely to hold shares in public companies and the other because all its clients are related.
- one Asset Manager that includes this in a policy distributed to clients.

Regarding Service Providers, three publish their conflicts of interest policy as a standalone document but do not describe how they address a divergence between the interests of clients. Two of these do not consider this issue to be applicable or relevant to them and the other explained that clients decide their voting policy themselves and they *"are not 'telling' them how to vote"*, and that their research is *"produced to standards of objectivity which address issues such as issuer influence etc."*

Reviewing and updating policy statements

The FRC's 2013 Report on Developments in Corporate Governance noted: *"more than one year on from the 2012 Code coming in to force, nearly half of the signatories have not yet updated their policy statements. While recognising that failure to update the statement does not necessarily indicate a lack of activity, especially where the signatory has limited resources, such a high percentage suggests that at least some investors have signed up to the Code in name only[12]".*

In this context, whilst only 42 per cent of signatories responded to the questionnaire, almost all of these, 90 per cent, had reviewed their Code statement in 2013 and 67 per cent – or 73 respondents – made changes (see Table 8).

Table 8: Statement reviewed

	Per cent of respondents			
		2013		2012
Reviewed				
Changes made	67		29	
No changes made	22		48	
		90[13]		77
Not reviewed		9		23
No response		1		–
Sample size		**109**		**96**

Regarding Service Providers, only one did not review its Code statement. The other four carried out reviews – two of which introduced changes.

In the main, any changes made by respondents were to

[11] Four respondents did not reply to this question.

[12] FRC's 2013 Report on Developments in Corporate Governance, Page 26.

[13] Includes one respondent that stated it reviewed the statement but did not provide any further details.

reflect the revised 2012 Code. Code revisions are addressed throughout this report where relevant. The following are addressed here:

- **Principle 5** was amended to include: *"The disclosure should also indicate the kinds of circumstances in which the institutional investor would consider participating in collective engagement".*
- **Principle 6** was amended so that institutional investors *"disclose their approach to stock lending and recalling lent stock".*

The majority of respondents disclose when they would participate in collective engagement (see Table 9). Only 10 per cent do not address this, and almost all explained why not:

- an Asset Manager and an Asset Owner participate in collective engagement but do not disclose details.
- another Asset Manager and Asset Owner support collective engagement but the decision to participate is taken on a case-by-case basis.
- one Asset Owner does not consider this and two delegate to asset managers or engage collectively through membership of the NAPF.
- finally, one Asset Manager has a policy of addressing issues directly with companies and does not commit its clients to vote with other parties on governance issues.

On stock lending and recalling lent stock, 38 per cent of respondents do not disclose their approach. However, two thirds of these do not conduct stock lending either due to their investment style[14] or as a general rule. Other respondents that do not disclose their approach to stock lending provided various explanations:

- five include details in a separate statement e.g. in their voting policy or in their statement of investment principles.
- one *"may recall securities from loan for proxy voting purposes"* but it *"do[es] not disclose details of [its] process to recall stock on loan for voting purposes".*
- one has decided *"not to go into this detail".*
- three delegate this to investment managers.

Table 9: Additional disclosures

	When participate in collective engagement	**Policies on stock lending and recalling lent stock**
	Per cent of respondents	**Per cent of respondents**
	2013	**2013**
Yes	88	58
No	10	38
No response	2	4
Sample size	**109**	**109**

Four Service Providers responded to this part, all of which disclose the circumstances when they would participate in collective engagement but none disclose their approach to stock lending as they do not consider it to be applicable to their business model. However, one clarified that although it does not participate in stock lending, it will *"offer stock lending flagging services for voting clients to alert them to votes for stock on loan".*

Other changes to Code statements included:

- many that added more details on the engagement process, revised their conflicts of interest policy, changed legal text, updated their voting policy, referred to the independent report on processes, updated contact details, and addressed enhancements to their ESG policy.
- three that updated their statements to reflect changes in internal organisation structure.

Other changes made by the Service Providers included providing context about overall sustainable investment, giving more details on how stewardship is integrated into the global research process, updating research services used and the relationship with a proxy voting agency.

[14] For example, one respondent stated that stocks are not lent due to the high turnover of their investment style which involves short-term arbitrage.

Approval of policy statements

Respondents were asked for the first time who approves the final policy statement (see Table 10). For nearly three quarters of respondents the statement was approved by either the Board or the Executive Committee. Fewer policy statements were approved by portfolio managers/analysts and legal and compliance – 10 and 11 per cent, respectively. Dedicated specialists approved the statement for only four per cent of respondents.

Table 10: Approval of final policy statement

	Per cent of respondents
	2013
Board	37
Executive Committee	37
Portfolio managers/analysts	10
Legal/compliance	11
Dedicated specialists	4
No response	1
Sample size	**109**

For two Service Providers the final statement was approved by legal and compliance and for the other three by the Board, Executive Committee and dedicated specialists, respectively.

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".*

The FRC 2013 report of developments in Corporate Governance noted that *"greater client demand will be the key to increased monitoring and engagement by asset managers and many owners have told the FRC that the biggest merit of the Stewardship Code was that it had normalised their right to ask for stewardship as a routine matter for consideration[15]".*

As shown in Table 11, for 83 per cent of Asset Managers "all" or "some" of their mandates awarded by clients refer to stewardship responsibilities – an increase from 71 per cent in 2012; 65 per cent in 2011; and 66 per cent in 2010. Moreover, 44 per cent stated that all clients expect them to exercise stewardship which is a significant increase compared to the 30 per cent in 2012.

Table 11: Mandates that refer to stewardship responsibility[16]

	Per cent of respondents			
	2013	**2012**	**2011**	**2010**
All clients	44	30	29	10
Some clients				
Three quarters	16	11	3	
Half	11	8	10	
A quarter	12	22	22	
	39	41	36	56
None	11	28	28	29
No response	6	1	7	5
Sample size	**82**	**73**	**58**	**41**

[15] Page 23.

[16] This table corresponds to Table 8 in the 2012 report, page 13, but has been modified to reflect only the responses of Asset Managers.

4. Structure and resources

Structure

In fulfilling obligations under the Code, stewardship can either be conducted in-house or outsourced, fully or partly, to an external party (see Table 12). This is not relevant for Service Providers which are excluded from this section.

This year there has been an increase in the percentage of respondents that outsource all voting (24 per cent) and engagement (22 per cent)[17] as compared to 17 per cent that outsourced all stewardship in 2012. Eleven per cent outsource to an external investment manager and eight per cent to an overlay service provider. The five per cent that answered "other" mainly outsource to both an investment manager and overlay service provider with one relying on its parent to administer these arrangements.

The FRC's guidance on the application of the Code specifies that *"institutional investors may choose to outsource to external service providers some of the activities associated with stewardship. However, they cannot delegate their responsibility for stewardship. They remain responsible for ensuring those activities are carried out in a manner consistent with their own approach to stewardship".*

There were 26 respondents that outsource all voting and 24 that outsource all engagement. In both instances, respondents monitor these external parties (see Table 13). Just over 60 per cent monitor by receiving and reviewing periodic reports, around 10 per cent through meetings with these parties and nearly a third do both. One respondent that outsources voting explained that its external manager advises of its voting intentions prior to the meeting and discusses any deviations from the respondent's own policy. Another respondent that outsources engagement contacts its external managers *"when a situation which needs clarification arises".*

Table 13: Monitoring of external parties

	Per cent of respondents	
	Voting	Engagement
	2013	2013
Periodic reports	62	63
Meetings	11	8
Other	27	29
Sample size	**26**	**24**

Table 12: How stewardship is conducted

	Per cent of respondents			
	Voting	Engagement	Stewardship	Stewardship
	2013	2013	2012	2011
All in-house	63	71	68	82
Partly in-house[18]	13	7	15	n/a
Outsourced	24	22	17	18
External investment manager	11	11	8	12
Overlay service provider	8	6	9	6
Other[19]	5	5	n/a	n/a
Sample size	**109**	**109**	**96**	**78**

[17] This year for the first time respondents were asked separately about voting and engagement.

[18] This option was not available to respondents in 2011.

[19] This option was not available to respondents in 2011 and 2012.

Most commonly, portfolio managers and analysts undertake this monitoring (seven respondents) followed by trustees or those reporting to trustees (five Asset Owners) and investment consultants (three respondents). Four respondents assign this to their in-house investment team. For one respondent both its portfolio managers and trustees monitor and for three it is by, respectively:

- stewardship specialists.
- the Board of Directors.
- the *"in-house pension scheme staff".*

All eight respondents where engagement is part in-house and part outsourced monitor external parties. Three respondents meet with the external parties, two receive and review periodic reports and two use both methods. One respondent monitors *"through meetings and emails".*

For two of these eight respondents, the portfolio managers and analysts undertake the monitoring, for another two it is the stewardship specialists and for the remaining four it is by: the Head of Finance; investment and governance manager; management team; and operations and compliance team, respectively.

With the exception of section 6 on voting, those that outsource all engagement are excluded from the remainder of this report which focuses on the 85 respondents that carry out all or part of their engagement in-house. Section 6 on voting focuses on the 83 respondents that carry out some or all of their voting in-house.

Resources

Overall, the total headcount responsible for stewardship increased year on year and significantly increased in 2013 (see Table 14). There were 392 more individuals involved in stewardship in 2013 compared to 2012 whereas the number of respondents to this question increased by only six. As a result, the average headcount reached 20 per respondent as compared to 17 in 2012. Over 80 per cent of this resource is portfolio managers and analysts and only 12 per cent specialists.

The four respondents where 'others' are responsible included:

- one Asset Owner where this is the Investment Committee via the Head of Finance.
- an Asset Manager where the voting policy is commonly determined by Head of Risk, portfolio managers and the external voting provider.
- one Asset Manager where the portfolio managers do this *"in consultation with the Investment Committee".*
- one Asset Manager where responsibility is with the investment administration.

Table 14: Primary resource responsible

		Headcount			
		No. of respondents			
		2013	**2012**	**2011**	**2010**
Portfolio managers/analysts supported by dedicated specialists looking at policy	Portfolio managers	398	221	81	57
	Specialists	20	22	16	3
	Others	5	7	4	–
	No. of respondents	*7*	*11*	*3*	*2*
Portfolio managers/analysts working alongside dedicated specialists	Portfolio managers	745	547	640	469
	Specialists	173	170	166	94
	Others	23	35	24	–
	No. of respondents	*38*	*37*	*36*	*24*
Dedicated specialists only	Specialists	17	40	29	38
	Others	4	8	6	–
	No. of respondents	*6*	*4*	*3*	*4*
Others		23	10	2	–
	No. of respondents	*4*	*4*	*1*	–
Total headcount where specialists and others have a role		1,408	1,060	968	661
	No. of respondents	*55*	*56*	*43*	*30*
Portfolio managers/analysts only	Portfolio managers	270	224	284	108
	Others	25	27	16	–
	No. of respondents	*30*	*23*	*18*	*8*
Total	Portfolio managers	1,413	992	1,005	634
	Specialists	210	232	211	135
	Others	80	87	52	–
	Overall headcount	**1,703**	**1,311**	**1,268**	**769**
	Overall no. of respondents	***85***	***79***	***61***	***38***
	Average headcount	**20**	**17**	**21**	**20**

Integration into the investment process

Engagement on strategy and performance may often be handled by the portfolio managers/analysts, with specialists handling particular aspects such as corporate governance and Socially Responsible Investment (SRI). At times, this dual approach can give rise to questions as to whether those conducting stewardship represent the views of the portfolio managers responsible for the investment and how stewardship is integrated into the investment process.

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

Forty-nine, i.e. almost 90 per cent, of the 55 respondents that involve specialists and others (Table 14) have formal arrangements in place to ensure integration. Just over three quarters of those describe their arrangements in their Code statement.

A number of respondents gave details, for example:

- *"A member of the Governance and Stewardship team attends our UK Equity team meeting on a weekly basis. There are monthly 'issues' meetings between the Governance and Stewardship team and UK portfolio managers. The Governance and Stewardship team operate a system of identifying companies with Governance 'Health Warnings' which are included in quarterly company investment analysis. …"*

- *"Each ESG analyst is assigned specialist sectors where they provide commentary and score companies on their governance and environmental and social management. Quarterly meetings for each sector are attended by the ESG sector analyst, financial analyst and fund managers where investment ideas, risks and opportunities and portfolio construction is discussed. …"*

- *"Portfolio managers/analysts actively contribute to the development of the overall stewardship policy and make the final voting decisions in a controversial situation. Portfolio managers/analysts frequently meet with in-house dedicated specialists to discuss stewardship. They attend meetings with investee company management alongside dedicated specialists. …"*

- *"[Manager] views Integration as one element of our investment process, which takes into account the potential impacts of Environmental, Social and Governance ("sustainability") issues on investment outcomes. Evaluated as one of many criteria influencing active return and risk, this means that we aim to embed ESG issues within our existing framework, rather than as a separate discipline. …"*

- *"…Our capital allocation decisions seek to reflect the role of governance, as this speaks to the inherent risk of a business and is one component that should be reflected in its cost of capital. We recognise that there are legitimate reasons why material issues of an environmental, social and a governance point of view should form part of fundamental investment analysis. …"*

- *"ESG is integrated into our investment process in various ways but primarily as part of our stock specific and portfolio risk assessment/management construct. [Manager]'s investment process depends heavily on the robustness of our proprietary stock valuation scenarios. …"*

Some Asset Owners clarified that they would select asset managers based on their ability to integrate ESG issues in the investment process or where stewardship teams work with portfolio managers when material issues arise.

In addition to the above, respondents were asked to clarify how stewardship is integrated into the investment process in terms of portfolio managers/analysts' involvement in voting decisions and meetings with dedicated specialists. For about two thirds of respondents portfolio managers/analysts are involved in either all voting decisions or when there is a controversial issue or a vote against (Table 15). Moreover, only for 13 per cent of respondents, specialists and portfolio managers/analysts do not attend together meetings with the investee companies.

Table 15: Integration into the investment process

	Per cent of respondents 2013
Portfolio managers/analysts in voting decision	
All voting decisions	27
Controversial voting decisions and/or against	40
None of the voting decisions	4
Other	29
Specialists attend investee company meetings with portfolio managers/analysts	
Always	3
Often	33
Sometimes	51
Never	13
Sample size	**55**[20]

Experience

The FRC's 2013 Report on Developments in Corporate Governance noted: *"another potential barrier to effective engagement is a perceived lack of appropriate skills and experience within investment management firms, particularly where greater responsibilities are being placed on analysts rather than corporate governance specialists*[21]*".*

Forty-six respondents with specialists provided details on the experience of these teams. On average these teams have been in place for twelve years. However, there are wide variations – for example, four respondents have had a specialist team for only two years whereas six have had a team for more than 20 years. The most senior member of the team had on average seventeen years experience – ranging from two to forty-one years – compared to an average of almost ten years experience for other team members[22].

A number of respondents provided details of the training given to these specialists. Most commonly, this is in-house training, internal and external seminars, workshops and conferences, as well as official qualifications from the CFA Institute, e.g. the Investment Management Certificate or the Chartered Financial Analyst Program. Other examples were:

- *"3 members are recent alumni of the ICGN ESG training programme."*
- *"All of the members of the team possess a university Bachelor's degree, two [have] Masters degrees and one is a qualified lawyer."*
- *"One dedicated specialist is a Fellow Chartered Accountant with extensive industry experience and CPD obligations. The other dedicated specialists and others have extensive industry experience and keep up to date through appropriate development programmes."*
- *"Responsible Investment Course offered by the Responsible Investment Association Australasia."*
- *"The range of backgrounds within the team includes fund management, sell-side research, quantitative analysis, legal and experience of responsible investment issues."*
- *"The team has built up on the job experience over many years, and undertaken ad hoc training, e.g. negotiation skills. The team works closely with the in-house analysis and portfolio managers to set out specific governance or other concerns and to ensure a shared perspective, objective and tactics in any engagement undertaken."*

[20] Includes two respondents that did not answer and their responses are taken from the corresponding question in 2012.

[21] Page 23.

[22] Forty-nine and forty-four respondents provided details on the years of experience of the most senior and other members of the specialist team, respectively.

Service providers

Resources are often supplemented by service providers that process voting instructions and provide research, recommendations and other customised services. The Guidance to **Principle 6** states that the stewardship policy should disclose: *"the use made of, if any, proxy voting or other voting advisory service".* New text was added in 2012 that *"they should describe the scope of such services, identify the providers and disclose the extent to which they follow, rely upon or use recommendations made by such services".*

In this context, 78 per cent of respondents disclose the use of proxy voting or other voting advisory services in their Code statement. Where there is no such disclosure, certain respondents clarified, for example, that they:

- do not use such services so this does not apply to them (seven respondents).
- do not identify Service Providers by name or the scope of services provided (two respondents).

Processing voting instructions can be resource intensive and 83 per cent of respondents use at least one Service Provider for this purpose, consistent with the previous year (Table 16). There is, however, a higher proportion of respondents that do not use this service – 17 per cent compared to 13 per cent in 2012[23].

Table 16: Service providers that process voting instructions

	Per cent of respondents			
No. of providers	**2013**	**2012**	**2011**	**2010**
Three +	–	2	–	4
Two	14	10	13	10
One	69	74	64	67
None	17	13	17	15
No response	–	1	6	4
Sample size	**85**	**80**	**64**	**48**

Similar to 2012, 78 per cent of respondents receive research from service providers with more than half of these using only one provider (see Table 17).

Table 17: Service providers that provide research

	Per cent of respondents	
No. of providers	**2013**	**2012**
Three +	9	12
Two	25	26
One	44	40
None/No	22	21
No response	–	1
Sample size	**85**	**80**

For the 59 respondents that receive research, service providers also issue voting recommendations. Whilst 95 per cent do not necessarily or only sometimes follow the provider's recommendation, five per cent always follow them (see Table 18).

Table 18: Recommendations followed

	Per cent of respondents			
No. of providers	**2013**	**2012**	**2011**	**2010**
Not necessarily				
>Four	–	–	–	8
Four	2	7	7	–
Three	3	3	6	8
Two	19	15	11	13
One	15	21	16	18
	39	46	40	47
Sometimes				
>Four	–	2	9	-
Four	2	–	7	3
Three	–	–	–	–
Two	3	-	24	16
One	51	50	16	31
Not given	–	2	–	–
	56	54	56	50
Always				
One	5	–	4	3
Sample size	**59**	**58**	**55**	**38**

[23] Respondents that do not use service providers to process voting instructions have been approached individually and it was established that they vote through a custodian (either in-house or external) or directly via voting platforms. Only one respondent stated that it tends not to vote its holdings whereas another has a policy to attend and vote at company AGMs in person.

There are several reasons why respondents do not follow providers' recommendations. The most prominent among these are when the recommendation deviates from the respondent's voting policy, and when respondents do not consider it to be in the best interests of their clients. Several respondents decide this on a case-by-case basis and three stated that portfolio managers and analysts ultimately review all voting decisions that are controversial or against company management. Two respondents clarified:

- *"recommendations are followed when the size of our holding is below a defined threshold".*
- *"for companies held in index strategies or in the unmanaged portion of private client accounts, where a proposal is not covered by our policies, we will consider the views of our third party research services provider".*

For 20 (or 56 per cent) out of the 36 respondents that sometimes or always follow recommendations, these are based on a policy specifically tailored to respondents' institutions or clients. As such, only 16 respondents follow recommendations based on service providers' standard policies.

5. Monitoring and engagement, together with practical examples

Principle 3 states that: *"institutional investors should monitor investee companies"* and its guidance adds 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 states 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".*

Monitoring

Although the Code expects institutional investors to monitor investee companies, it does not prescribe how monitoring should be undertaken. Previous reports have shown that the majority of respondents monitor all investee companies as part of their investment process[24]. For 2013, respondents that carry out all or part of their engagement in-house were invited to describe their framework for monitoring UK investee companies.

Out of 85 respondents 76 explained how they monitor companies. Broadly, they use one or a combination of the following:

- regular contacts and/or meetings with companies.
- contacts with other investors or general stakeholders of the investee companies.
- in-house research team.
- analysis of company news and reports.
- third party research services and use of external media.
- a particular person or function is assigned to each company.

For example, respondents stated:

- *"… Investee companies are monitored through regular review of company statements, results, reports and, more importantly, actions. In many cases we are in direct contact with company representatives and have the ability to express views or concerns through this ongoing dialogue. In addition, we use a governance expert, [Company] to provide analysis of governance issue[s] to assist with proxy voting. …"*
- *"… Research activities include analysing public disclosures, interviewing company management, speaking with company competitors, making on-site visits to company facilities, attending industry conferences and trade shows, and reviewing specialized industry journals. … Analysts continuously monitor their companies under coverage by staying abreast of company news, participating in quarterly company conference calls, and communicating with company management or investor relations. …"*
- *"As part of our investment research process we meet with and interview the management of investee companies where possible. We continue to meet with the companies after the initial decision to invest, as well as continuing to monitor the fundaments based on publicly available information, company reports, external analysis research, and news flows etc."*
- *"As part of their daily routine, [Manager]'s fund managers monitor company announcements, selected stockbroker research and press commentary on all of the companies in which they invest in order to ensure that the investment thesis that justified the original investment remains intact. This will include reviewing the report and accounts for each of the companies, any trading statements or other reporting produced. …"*
- *"… We seek to develop both a long term relationship and an understanding of mutual objectives and concerns with the companies in which we invest on behalf of our clients. We do this through regular meetings. These meetings are held between our*

[24] IMA, Adherence to the FRC's Stewardship Code 2012, page 23.

investment team of analysts and portfolio managers and, typically, the company's chief executive and finance director. In any given year we would normally expect to have around 7,000 such meetings globally. In addition we also meet with chairmen and other board members. …"

- *"… [Monitoring] is primarily the responsibility of our research analysts. These experienced professionals conduct the initial research that leads to an investment in a company or issuer, typically including meetings with management, and often with suppliers and customers. Once we have an investment, analysts continue to monitor each company/issuer we own to understand developments likely to affect the value of our clients' holdings. …"*
- *"Monitoring will include reviewing all statutory company announcements, reports and other shareholder circulars, as well as research published about the company by sell side analysts. Fund managers spend a great deal of their time meeting company management teams as part of their appraisal of a company's prospects, business quality, and value. …"*
- *"Our in-house team of analysts monitor "their" companies on an on-going basis. This is their job, alongside research new investment opportunities. Our UK team, like our other global analysts / portfolio managers, meet management, research analysts and independent experts on a regular basis to keep up to date on developments at investee companies. We also seek to keep abreast of other institutional investor concerns with particular companies."*

Of the Service Providers[25], one monitors *"the FTSE All Share, some ineligibles and the AIM 100"* and researches and analyses all companies to the same standard. Another has a *"policy specific to determining recommendations for the meetings of UK companies"* and a team carries out the research and prepares the recommendations for these meetings. One Service Provider assesses the investment managers' monitoring frameworks as part of its manager research and monitoring process.

Prioritisation

In 2010,[26] respondents indicated that lack of resources was the most significant barrier to stewardship. In its report on developments in Corporate Governance 2013 the FRC stated that: *"Where investors hold shares in a large number of companies and/or allocate a relatively small proportion of their overall investments to UK equities, their stewardship resources are stretched thinly and the pressure on those resources is as significant a constraint for them as it is for companies. In practice this means investors are able to engage only with those companies in which they have large holdings or about which they have concerns."*

"While recognising that there are capacity constraints, the FRC believes that investors cannot use capacity constraints as an excuse not to exercise stewardship responsibilities. Rather investors need to consider how they can best exercise those responsibilities with the resources they have available[27]".

Thus, due to necessity, respondents prioritise engagement in two ways: first, the particular holdings and secondly, the particular issues that are important for example, strategy, board structure, remuneration etc.

Table 19 shows the criteria respondents use when deciding which holdings they will engage with. About one third engage with all of their holdings, just over one quarter when there are significant issues, eight per cent with actively managed holdings, and five per cent with large holdings. Only two respondents delegate this to an external party.

Respondents that selected "other" use a range of criteria, including whether the holding is sufficiently material so that they can influence a company, how approachable a company was in a previous engagement, or whether their portfolio managers included the company on a 'watch list'. Other comments included:

- an Asset Owner that delegates engagement with passive holdings to an external asset manager and engages with active holdings either through a pension fund forum or directly when it decides to vote against a resolution.

[25] One did not consider this applicable as it does not directly hold UK equities.
[26] IMA, Adherence to the FRC's Stewardship Code 2010, page 18.
[27] Page 22.

- one Asset Manager that has *"regular dialogue with companies [where] we have active positions".*
- a further two respondents that do not engage with UK equity holdings because either they are not part of their portfolio or their policy is to engage with companies in their (non-UK) domestic market.
- one respondent that engages with *"all directly held holdings".*
- one respondent that engages with *"companies across all equity investment strategies with the exception of our quantitative driven investment process".*
- one specified: *"we will vote where we have researched issues and arrived at an informed opinion that we believe is important to shareholder value".*

Table 19: Prioritisation of engagement

	Per cent of respondents
	2013
All holdings	34
Actively managed holdings only	8
Largest holdings	5
When there are significant issues	26
Other	25
No response	2
Sample size	**85**

Regarding Service Providers, for two, engagement is delegated to a manager or an overlay service and for one this is not relevant as it does not engage on behalf of its clients.

The issues respondents prioritised are set out in Table 20 according to the frequency of engagement. As per the prior years, board remuneration is the most frequently addressed issue followed by strategy and objectives. In this context, remuneration is subject to an annual vote and it may be that companies initiate the engagement as opposed to the respondents, in the interests of ensuring that the board remuneration report is approved. Board leadership and composition also rank highly whereas issues such as pre-emption rights, audit and audit tendering are the least frequently addressed issues. The fact that pre-emption rights do not rank highly reflects the fact that there were few rights issues in 2013.

Table 20: Most frequently addressed issues[28]

		Ranking	
	2013	**2012**	**2011**
Board remuneration	1	1	1
Strategy and objectives	2	2	2
Board leadership – Chairman/CEO	3	3	8
Board and committee composition/succession	4	n/a	n/a
Board diversity & committee membership	n/a	4	3
Board succession planning	n/a	8	9
Corporate actions and restructuring	5	5	10
Mergers and acquisitions	6	7	6
Environmental/social issues	7	6	4
Risk appetite	8	9	5
Audit and audit tendering	9	n/a	n/a
Pre-emption rights	10	10	7
Sample size	**68[29]**	**80**	**64**

One Service Provider indicated that the three topics it most commonly engages with are remuneration, board leadership and environmental and social issues.

The above should be compared to the issues that respondents consider to be the most important as set out in Table 21. This shows that strategy and objectives, followed by board leadership and board and committee composition/succession are considered the most important. Remuneration is ranked in fourth place.

[28] The two issues of "Board diversity & committee membership" and "Board succession planning" were merged into the broader issue of "Board and committee composition/succession" in 2013. Moreover, the issue of "Audit and audit tendering" was an option for the first time in 2013.

[29] Seventeen respondents did not provide any information regarding the most frequently addressed issues.

Overall, board issues, strategy and remuneration are the matters respondents both consider to be most important and most frequently engage on. Notably, audit and audit tendering are second from last and last in these two Tables. However, the Competition Commission published late last year a series of measures with the aim of increasing competition within the audit market and ensuring that audits better serve the needs of shareholders in the future. This included a proposal for all FTSE 350 companies to put their audit to tender every ten years[30]. As a result, it is possible that audit and audit tendering may rank higher in future surveys.

Table 21: Most important issues

	Ranking 2013
Strategy and objectives	1
Board leadership – Chairman/CEO	2
Board and committee composition/succession	3
Board remuneration	4
Mergers and acquisitions	5
Corporate actions and restructuring	6
Risk appetite	7
Environmental/social issues	8
Pre-emption rights	9
Audit and audit tendering	10
Sample size	**72[31]**

Two Service Providers ranked the issues that are most important for them with remuneration being first for the one and strategy for the other. Board leadership was in second place for both.

Annual General Meetings

In 2013 almost one third of respondents attended Annual General Meetings (AGMs) "whenever possible" or "where they have a major holding and/or where appropriate" (see Table 22). This is a slight increase compared to 28 per cent in 2012 and 30 per cent in 2011. However, as many as 37 per cent of respondents still do not attend any AGMs.

For 25 respondents attendance at AGMs varies. Six attend AGMs when engagement on specific issues has not been effective and they wish to escalate matters and another two when there is a controversial issue. Five respondents rarely attend and one stated that this is because *"company management normally holds more informative and interactive analyst meetings".* Other respondents described that they attend:

- *"1-5 AGMs per year maximum".*
- *"as requested by clients".*
- *"occasionally to enable voting at the last moment".*
- *"occasionally where we feel action might be required, but very infrequently".*

Table 22: Attendance at Annual General Meetings

	Per cent of respondents			
	2013	**2012**	**2011**	**2010**
Whenever possible	2	8	2	-
Where have a major holding, and/or where appropriate and practicable[32]	29	20	28	38
Other	31	31	36	35
Never	37	37	33	25
No response	1	4	1	2
Sample size	**85**	**80**	**64**	**48**

[30] More details can be found here.

[31] Thirteen respondents did not provide any information regarding the issues they consider to be most important.

[32] Includes five respondents that selected "Other" but described that they attend AGM's when appropriate and practical. One also described that it *"tends to cover off issues with companies prior to the AGM or through private external meetings with either the non-executive directors or the management team itself".*

The 54 respondents that attend AGMs were asked for the first time to confirm the number of meetings they attended in the year to 30 September 2013 (see Table 23). Nearly half attended at least one AGM with 7 per cent attending more than ten. Thirty-eight per cent did not attend any AGM but this could be due to various factors such as appropriateness, practicability, effectiveness of prior engagement etc. It should be noted that these respondents that did not attend any AGM are different from the 37 per cent of respondents that have a policy never to attend AGMs as reported in Table 22.

Table 23: Number of AGMs attended

	Per cent of respondents 2013
Ten +	7
Five-Ten	15
Four	-
Three	7
Two	13
One	7
None	38
No response	13
Sample size	**54**

Two Service Providers gave details of attendance at AGMs. One never attends whereas the other does so as requested by clients and attended just fewer than ten in the year to the 30 September 2013.

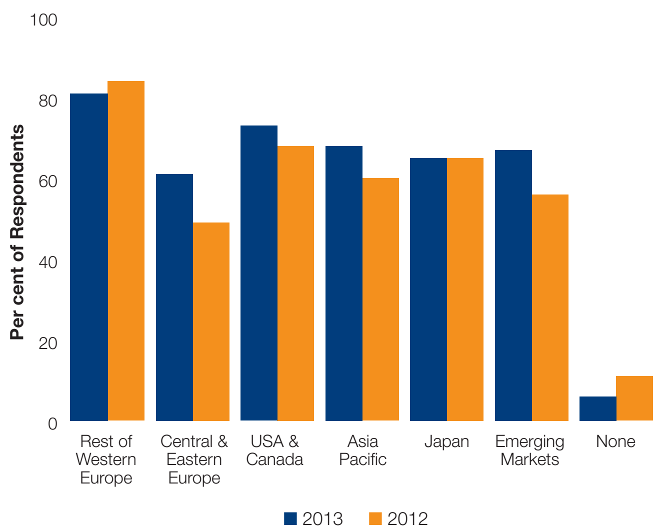
Engagement with other assets

Although the Code applies to institutional investors with equity holdings in UK listed companies in the section on the Code's application the FRC states: *"where institutions apply a stewardship approach to other asset classes, they are encouraged to disclose this".*

Charts 1 and 2 show respondents' engagement with equities listed in countries other than the UK and with asset classes other than equities, respectively.

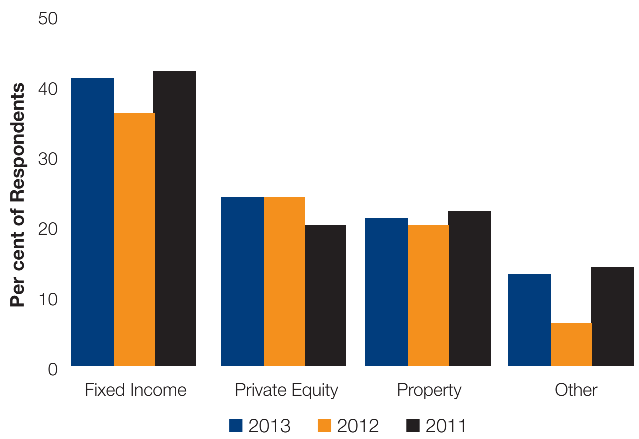
In 2013 a smaller proportion of respondents did not engage with any companies where their equity holdings are listed outside the UK – 6 per cent relative to 11 per cent in 2012. At the same time, there was an increase in those that engaged in particular markets, such as Central and Eastern Europe (61 per cent in 2013 compared to 49 per cent in 2012) and Emerging Markets (67 per cent in 2013 relative to 56 per cent in 2012). The proportion that engaged with equity in the rest of Western Europe and Japan remained relatively stable at 81 and 65 per cent in 2013, respectively, compared to 84 and 65 per cent in 2012.

Chart 1: Engagement with companies listed outside the UK



As regards other asset classes, the most notable change is the increase in the proportion of respondents that engage with fixed income investments at 41 per cent from 36 per cent in 2012. There has also been an increase in the proportion of respondents that engaged with "other" asset classes, such as hedge funds, infrastructure, commodities, and deposit funds, from 6 per cent in 2012 to 13 per cent in 2013.

Chart 2: Engagement with asset classes other than equity



Practical Examples

To assess what actually happens in practice, respondents were asked how they escalated matters and engaged on certain issues with particular companies. In more detail, respondents were invited to answer:

- whether they had a holding in the company concerned, if there were any conflicts of interest, whether they engaged and if so, whether the engagement was successful and if their interest in the company changed.
- what their engagement involved, who the engagement was between (whether it was the portfolio manager, the dedicated stewardship specialist or a mixture of the two) and how many times and who they engaged with at the company.
- whether they engaged in collaboration with other investors, and if so, who instigated the collaboration and whether it was effective.
- whether they attended the Annual General Meeting and how they voted on specific resolutions and why.

For the first time this year, respondents were asked to select a number of companies from the following and provide details of their engagement[33]:

- Afren plc
- AngloAmerican plc
- Barclays plc
- Bumi plc
- Carnival plc
- First Group plc
- Glencore Xstrata plc
- Lonmin plc
- Redrow plc
- RSA Insurance Group plc

[33] All references to the number of respondents with a holding in and that engaged with each company relate to the subsample that selected the company concerned.

The in depth analysis is set out here and the examples are summarised below in descending order in terms of the number of respondents that engaged with each. Respondents were also invited to give an example of their engagement with any other company that they wished to highlight – these are set out at the end of this Section.

Generally, engagement with companies is not within the remit of the Service Providers, but where they did provide details, they are referred to separately in the in depth analysis here.

Barclays plc

A number of significant changes took place in the board composition of Barclays in the aftermath of the London Interbank Offered Rate (LIBOR) manipulation case for which Barclays received a £290million fine by British and US regulators[34]. The CEO, Bob Diamond, and the Chairman, Marcus Agius, resigned in 2012.

Forty respondents had a holding in Barclays and 31 engaged – more than any of the other examples. As for 2012, respondents' principal aim was to bring about changes in remuneration although this year improving the overall culture was also considered important. For example, one respondent stated that there was *"continuing progress in changing the bank's culture, rebuilding trust and reputation, and remuneration practices more aligned with shareholders' interests to enable a more appropriate distribution between shareholders and staff".*

Respondents had extensive communication with Barclays, having an average of nearly seven contacts each. The majority communicated with Investor Relations and the Executive Directors but there was also much engagement with the Company Secretary, the Chairman and the Remuneration Committee Chair. Most contact was by the portfolio managers/analysts.

Almost 60 per cent of the 31 respondents collaborated with other investors, mainly by attending joint meetings with Barclays. The majority of collaborations were instigated by an established investor group and all of them were considered effective.

Resolution 2, to approve the Remuneration Report received just under 95 per cent of votes in support at the 2013 AGM. However, only two thirds of respondents voted in support on the basis there were encouraging signs of changes in Barclays' remuneration culture. Those that voted against considered remuneration was still misaligned with shareholder returns.

Resolution 18, to authorise the Directors to allot securities received 92 per cent of votes in support at the AGM but almost all respondents voted in support as they felt that the proposed amount and duration were within acceptable limits.

Almost 90 per cent of the respondents that engaged found their engagement to be partly or completely successful considering the new CEO and Chairman appointments and the steps taken to change culture. Nevertheless, for many, engagement is on-going as cultural change is a long-term issue and further reforms, particularly in remuneration, are needed.

Glencore Xstrata plc

The contested merger between Glencore and Xstrata was completed in April 2013. Shareholders particularly opposed remuneration arrangements that involved high retention awards and proposals for Xstrata directors to join the board of the merged company.

Thirty-six respondents had a holding of which 27 engaged, the highest number after Barclays. As expected, the main concerns were in relation to the merger, the composition of the board and the strategy of the new company. Some also raised ESG issues. To quote: *"Initially, we engaged with the Company to get a better idea of the Merger terms and benefits and to ask the Company to withdraw the inappropriate retention awards …. Then, we engaged to make the Company aware of our vote decisions for the 2013 AGM (including opposing the pay report and withholding support on all of the Remuneration committee members of the former Xstrata board) and to make the company aware of our preference for a new chairman and some board refreshment in general. We also advised the company of our concerns that the combined company is not appropriately managing the company's considerable environmental and social impacts. There are numerous*

[34] BBC.co.uk 17 February 2014

outstanding allegations of environmental pollution and labour issues associated with Glencore operations, in particularly in the DRC. We have also previously raised concerns regarding the high number of fatalities and the absence of comprehensive GHG emissions in Glencore's 2011 report…"

Most engagement was with the Executive Directors and many also contacted Investor Relations and the Chairman. Respondents had on average 4.2 contacts each. Most contacts were undertaken by respondents' dedicated specialists and portfolio managers/analysts separately.

Forty-four per cent of the 27 respondents collaborated with other investors, mainly by attending joint meetings with the company. Only one respondent did not consider this collaboration effective.

At the first AGM of the merged company in May 2013, the re-election of four directors, all of whom were previously with Xstrata, was not supported.

Just fewer than 70 per cent of the 27 respondents voted against or abstained on Resolution 7, to re-elect the Chairman, Sir John Bond, which received 81 per cent of votes against at the AGM. Many cited their disappointment with his oversight of the merger and the proposed retention payments.

The re-election of Ian Strachan was supported by 65 per cent of the respondents mainly due to his relative independence and lack of succession planning but received 64 per cent of votes against at the AGM. Similarly, most respondents supported the re-election of Peter Hooley who was not involved in the Xstrata Remuneration Committee and was deemed sufficiently independent. The resolution for his re-election received 57 per cent of votes against at the AGM. The re-election of Con Fauconnier, on the other hand, was not supported by almost half of respondents due to his membership of the Xstrata remuneration committee. He received 75 per cent of votes against at the AGM.

Generally, respondents were discontent with the way the merger had been arranged and the lack of representation of minority shareholders. This was reflected in their engagement as well as their voting decisions.

In most cases, respondents considered they only partly achieved their objectives. The merger was finalised on better terms for Xstrata, the Chairman was not re-elected, and there were some improvements in the remuneration structure. However, no permanent Chairman was appointed and engagement is on-going.

AngloAmerican plc

AngloAmerican faced protests by its shareholders over the negative environmental and social impact of its operations in Colombia and South Africa.

Twenty-three respondents had a holding of which 13 engaged. The main concern related to the company's leadership and in particular, the appointment of a new Chief Executive Officer. Moreover, some respondents engaged to raise questions over health and safety and environmental and social issues. To quote: *"We sought to understand the new management's approach to ESG issues, specifically in light of the labour unrest in South Africa and delays to projects in South America".*

Respondents had on average just over three contacts each. The majority communicated with the Chairman and Executive Director. Most contact was by the portfolio managers/analysts.

Almost a quarter of the 13 respondents collaborated with other investors by attending joint meetings with the company, agreeing to vote in the same way and sending joint letters. In all cases, the collaboration was considered effective.

All 13 respondents voted in support of Resolution 17, to give the directors authority to allot shares, as they considered the proposed amount and duration to be acceptable, whereas this received 30 per cent of votes against at the AGM. They also all voted in favour of Resolution 18, to disapply pre-emption rights, particularly after the company issued a statement assuring shareholders that less than 7.5 per cent of the issued capital would be allotted on a non-pre-emptive basis. This did not receive the necessary 75 per cent of votes in support at the AGM.

Most respondents achieved their objectives at least partly given that a new Chief Executive Officer was appointed, however, some stressed that improvements in operational performance remain to be seen.

Carnival plc

As a result of a number of incidents on its ships, including the Costa Concordia, Carnival was subject to much criticism from media and regulators, and its share price dropped significantly. Moreover, Micky Arison had held the combined roles of Chairman and Chief Executive Officer since 2003. He stepped down from the latter in July 2013 and was replaced by Arnold Donald, who had been director since 2001.

Twenty-two respondents had a holding in Carnival and of these, 12 engaged with main objective being the resolution of health and safety and strategic issues. To quote: *"…we raised a number of governance and Health & Safety issues, which highlighted systemic issues in terms of how the firm has managed its operational risks. We asked the company how it is addressing these issues and what steps the firm has taken to manage/limit the negative media coverage, and the potential financial impact of litigation and customer refunds, not least the outstanding litigation from Costa Concordia sinking…".*

Respondents had on average three contacts each. Most of the contact was between portfolio managers/analysts and the company's Investor Relations and Executive Directors.

Few of the 12 respondents (25 per cent) collaborated with others by attending joint meetings with the company or sending a joint letter. The collaboration was considered effective in all cases.

All resolutions at the AGM in April 2013 received a high percentage of votes in support. However, about half of the 13 respondents voted against Resolutions 1, to re-elect the Chief Executive Micky Arison, and 3, to re-elect the Executive Director Arnold Donald. The reason for the former was concern over Micky Arison's combined role as Chief Executive and Chairman. Respondents voted against the re-election of Arnold Donald as they considered he lacked independence.

The majority of respondents achieved their objectives fully or partly largely due to the split of the combined Chief Executive/Chairman roles. However, two respondents considered their engagement unsuccessful with one stating that access to independent directors was limited.

RSA Insurance Group plc

RSA reported £479 million profit before tax in 2012, a 20 per cent drop from 2011 that was attributed to the aftermath of the Italian earthquakes, extreme wet weather in the UK and falling bond yields. The 2012 dividend was cut as a result.

Moreover, there were concerns regarding the independence of the auditors, Deloitte, given the level of fees for non-audit services. RSA announced it would change its auditor to KPMG which also raised questions as the Chair of the Audit Committee had been a long-serving partner at KPMG.

Twenty-one respondents had a holding of which 11 engaged on strategic issues as well as over concerns regarding the dividend cut and the change of auditor. To quote: *"We had a number of concerns that were raised with the Chairman including the change to the dividend policy which we believed was unnecessary and badly communicated, concerns about the company's strategy to make selected acquisitions in emerging markets and various issues about the change to the company's auditor."*

Respondents had an average of just over four contacts each. This was mainly with the Executive Directors and the Chairman but several respondents also contacted the Audit Committee Chair. The majority of contacts was by dedicated specialists and portfolio managers/analysts separately.

Seven of the 11 respondents, i.e. a higher proportion than in any of the other examples, collaborated with other investors mainly by attending joint meetings with the company. All considered their collaboration was effective.

Most respondents voted in support of Resolution 9, to re-elect the Audit Committee Chair, Alastair Bardour, having been given an explanation on his independence. Also following constructive discussions with RSA, all respondents voted in support of Resolution 14, to appoint KPMG as auditor, and all but one supported Resolution 15 to authorise the directors to determine the auditor's remuneration. This broadly followed the AGM result.

Given the dialogue respondents had with RSA, most respondents considered their engagement partly or fully successful. Only two respondents were not as satisfied due to the dividend cut and engagement is on-going.

First Group plc

In late 2012, First Group lost the bid for the West Coast Main Line rail franchise which the Department for Transport awarded to Virgin Rail. Moreover, in May 2013 First Group announced plans to raise £616million via a rights issue and the Chairman of 27 years announced his intention to resign once a successor was appointed.

Twenty respondents had a holding, of which 11 engaged mainly on the fees incurred on the rights issue and the Chairman's succession.

Respondents had on average just over three contacts each mostly with the Executive Directors and Chairman.

At the AGM in July 2013, a little under a quarter of votes were against the re-election of the Chairman but most respondents supported the resolution on the basis that it had already been announced that he would be standing down. Resolution 17, to authorise the company to make political donations received almost 12 per cent of votes against at the AGM but was supported by all 10 of the 11 respondents that voted.

Broadly, respondents considered engagement partly successful given the change of Chairman but intent to continue to monitor First Group's strategy, performance and remuneration.

Lonmin plc

During 2012 Lonmin faced labour unrest and violent strikes at the Marikana mine in South Africa. In November of the same year, it announced a rights issue to raise about USD777 million.

Thirteen respondents had a holding of which eight engaged mainly on the situation at the Marikana mines as well as remuneration.

Respondents had an average of three contacts each. This was mainly between the dedicated specialists and the Company Secretary, Chairman and Management.

At the AGM in January 2013, Resolution 5, to re-elect the Chairman, Roger Phillimore, received a quarter of the votes against. However, all eight respondents voted in support as the investigations into the Marikana incident were still in progress. Moreover, although Resolution 15 to authorise directors to allot shares received only 62 per cent of votes in support at the AGM, all eight respondents voted in favour as they considered the proposal to be within acceptable limits.

Respondents were broadly satisfied with the outcome of their engagement citing Lonmin's increased responsiveness to their concerns and improved transparency.

Bumi plc

Trading in Bumi shares was suspended for three months in 2013 and the reporting of its financial results delayed due to accounting irregularities at its subsidiary Berau Coal. At the same time, a public battle for control ensued between co-founders Nat Rothschild and the Bakrie family.

Ten respondents had a holding of which six engaged mostly on issues around the Rothschild-Bakrie battle for control. Respondents had on average just over four contacts each principally between the Senior Independent Director and Executive Directors and the dedicated specialists.

At the AGM in June 2013, Resolution 1 to adopt the company accounts received only 65 per cent of votes in support but none of the six respondents supported the resolution given concerns about the accounting. On the other hand, four of the six respondents voted in support of Resolutions 13 and 16 to give authority to allot shares and disapply pre-emption rights in that the proposals were in accordance with best practice – both resolutions received only 24 per cent of votes in support at the AGM.

Respondents considered their engagement was partly successful but three considered there were still issues to be resolved such as payments to former director, Rosan Roeslani.

Afren plc

At Afren's 2013 Annual General Meeting, almost 80 per cent of shareholders voted against the Remuneration Report and six of the directors, including the Chairman, received more than 25 per cent of votes against their re-election.

Fourteen respondents had a holding of which six engaged, mostly on remuneration.

Respondents had on average two contacts each, mainly between the respondents' dedicated specialists and the Remuneration Committee Chair and Management.

At the AGM in June 2013, four of the six respondents voted in support of the re-election of the Chairman, Egbert Imomoh, on the basis he was working towards improvements in the company – he received 30 per cent of votes against at the AGM. Four voted against the re-election of the Non-Executive Director, Peter Bingham, as they considered that his membership could affect the impartiality and effectiveness of the audit and remuneration committees. He received 44 per cent of the votes against at the AGM.

The majority considered their engagement partly successful as they saw positive changes, particularly around remuneration, but concerns over the lack of consultation remained.

Redrow plc

In 2012, Redrow's Executive Chairman, Steve Morgan, disclosed plans to take over the company as part of a consortium with two other shareholders. There were complaints that the bid was unfair to minority shareholders and that the price was too low. No agreement could be reached and the consortium eventually terminated discussions.

Nine respondents had a holding in Redrow of which five engaged, primarily in relation to the proposed takeover.

Respondents had on average over six contacts – only Barclays had more contacts on average. Most of the engagement was between dedicated specialists and non-executive directors.

At the AGM in November 2012, nearly a quarter of votes were against Resolution 5, to re-appoint the non-executive Deputy Chairman, Alan Jackson. None of the five respondents voted in support citing their dissatisfaction with the degree of representation of minority shareholders' interests during the takeover discussions. On the other hand, Resolution 6, to re-appoint the Non-Executive Director, Debbie Hewitt, which received almost 9 per cent of votes against at the AGM, was supported by all respondents as they found discussions with her constructive and wished to retain her as a Non-Executive Director.

Respondents achieved their objectives since the proposed takeover was not completed but engagement is on-going in order to appoint more independent non-executive directors.

Other examples

Forty respondents provided examples of their engagement with other companies. As reflected in Table 20, the most common themes were executive remuneration, board leadership and board structure. Respondents engaged with a wide range of companies such as Cairn Energy, WPP, GlaxoSmithKline, Asian Citrus Holdings, Latchways, SAB Miller and Synthomer.

There were also other issues that respondents sought to address in their engagement such as human trafficking, climate change and cultural change in the banking sector. To quote:

- *"[We engaged] with [Company] on trafficking in the hospitality sector. Objective was to make company aware of the risk and initiate discussion around adopting policy and processes to enable staff training around trafficking. Company has progressed, signed a trafficking protocol, and we continue to press for enhanced disclosure."*

- *"During the year … [a] coalition was established to support investee companies in the low-carbon transition. The engagement asked ten major UK listed utilities and extractives companies to aim for continuous inclusion in CDP's Climate Performance Leadership Index (CPLI) by achieving and retaining an "A" Performance Band. The program is ongoing, however following the first year one of the companies* *has already met the grade required. More importantly, all those contacted entered into constructive engagement with the coalition. …"*

- *"[We] assessed risk from [Company] entering Burma; as part of review process on attitudes towards investing in Burma, [we] met the company in Oslo and discussed policies and risk management approach to human rights reputational risk. [The] outcome [was] positive. [The] objective [was to] assess competency to manage in country risk."*

- *"We engaged with [Company] by letter over redundancy compensation for workers of one of their suppliers who absconded. Other stakeholders also engaged. In the end the company agreed to meet its obligations to the workers."*

- *"The sustainable and responsible investment team engaged with a London listed pharmaceutical company about allegations of bribery and corruption made by the Chinese authorities against the company. The objective of the engagement was to encourage the company to position its behaviour to ensure that it maintains a licence to operate as well as a reputation for conducting fair business with good patient outcomes. Following the engagement, the SRI team reviewed its sustainability matrix rating for the company. The rating determines the company's eligibility for inclusion in the team's funds."*

- *"As in the case of Barclays we reached out to all the major UK banks on the themes of conduct, risk management and remuneration - encouraging that these issues are joined up and that the board has clear oversight on this. We have encouraged business ethics to play a larger role for banks to help "futureproof" them against further scandals. While this remains work in process we do believe that UK banks are heading in this direction. The new code of conduct at RBS and the formation of an Integrity Committee at Barclays are two positive examples. We are generally seeing a recognition across the board at the major banks that conduct and values issues can have clear commercial consequences for banks and that these issues require more robust governance."*

6. Voting

Principle 6 states that *"institutional investors should have a clear policy on voting and disclosure of voting activity".*

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".*

This section only addresses those 83 respondents that conduct all or some of their voting in-house. Although Service Providers often execute institutional investors' voting instructions, they do not hold equity for investment purposes and so this section is not relevant to them.

Voting policy and processes

During 2013, 69 per cent of respondents did not change their voting policy or processes. One respondent clarified that its voting policy is to be updated in the first quarter of 2014 following a major organisational change in 2013 and another two that their voting policy and processes are regularly reviewed but no changes were made.

Thus 31 per cent of respondents changed their voting policy or processes (40 per cent in 2012). For five the changes were minor although one added *"major enhancements were made to the transparency of our policies by breaking out regionally based guidelines to give greater clarity into how we approach voting in specific markets".* Four respondents updated their voting policies to take a stronger stance against companies with limited gender diversity and four to integrate ESG considerations and climate change. Examples of other changes included:

- *"A number of amendments … proposed to reflect the knowledge and experience gained from the most recent voting season … also proposed to take account of changes to the UK Corporate Governance Code and changes in UK and global best practice."*
- *"Improved documentation of reasoning and outcome of shareholder proposals, contentious proposals or where voted against management as a tool for further engagement."*
- *"To clarify issues around board composition, remuneration, alignment of management to shareholders' long term interests and value creation, share issuances, protection of shareholder rights and the appointment of auditors."*
- *"Updates to our stock lending procedures and policy guidelines."*
- *"[We] expanded our voting perimeter to ensure that we vote globally in line with our clients' investment footprints."*
- *"[We] introduced a tailored voting policy, as well as further incorporated environmental and social analysis into our voting decisions through coding of companies into our voting system and has begun publically disclosing our voting decisions online."*

Voting in particular markets

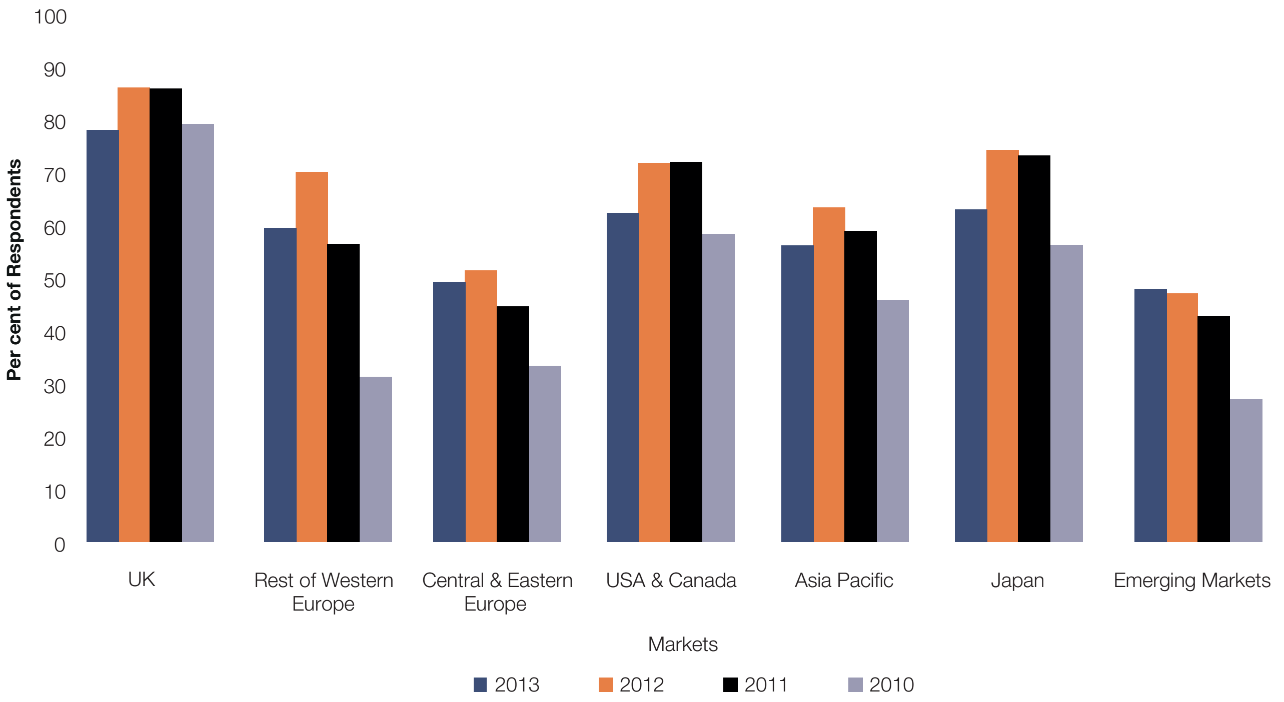
The FRC 2013 report of developments in Corporate Governance noted that *"The annual survey of voting results in Europe carried out by ISS found that voter turnout at UK general meetings rose slightly from 73.1 per cent in 2012 to 73.5 per cent in 2013. Turnout in the UK is higher than in any of the other markets analysed by ISS, and compares favourably with the European-wide average of 65.5 per cent for 2013[35]".*

Whilst respondents' voting levels remain high in all markets, they have declined from 2012 and 2011 levels – see Chart 3 which shows the proportion of respondents that vote all shares in individual equity markets and Appendix 3 which sets out a more detailed analysis of the percentage of holdings voted.

Seventy-eight per cent of respondents vote all shares held in UK equities, a decrease from 86 per cent in 2012. The largest decrease was for Japanese equities to 63 per cent in 2013 from 74 per cent in 2012 and for the rest of Western Europe equities to 59 from 70 per cent in 2012. There was also a decrease to 62 from 72 per cent and to 56 from 63 cent for equities in USA and Canada and Asia Pacific, respectively. Voting in respect of equities in Central and Eastern Europe only decreased to 49 from 51 per cent whereas for Emerging Markets there was an increase to 48 from 47 per cent.

The table in Appendix 3 shows that the number of respondents that vote "most" or the "majority" of their holdings remained at a similar level to that of 2012 for all markets. However, relative to previous years, more respondents voted a "few" (a quarter or less) of their holdings.

Chart 3: Markets where all shares voted



[35] Page 24.

Advising management

When the outcome of engagement is not satisfactory, the Guidance to **Principle 6** states that institutional investors *"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".*

The FRC 2013 report of developments in Corporate Governance stated that *"if signatories do not follow this practice, it would expect this to be made clear in the statement on how the Code has been applied[36]".*

An increasing proportion of respondents – 47 per cent compared to 35 per cent in 2012 – "always" or in the "majority of instances" give advance notice of their intention to abstain or vote against management resolutions (see Table 24). Nevertheless, a quarter of respondents do not provide advance notice or do so very rarely. Thirteen per cent of respondents that do not always give advance notice, notify management in arrears in the majority of instances.

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".*

Similar to 2012, 66 per cent of respondents disclose their voting records. Of the 27 per cent of respondents that do not, nearly 60 per cent disclose the reason why this is the case, as compared to only half in 2012 (Table 25). Of the others, seven provided an explanation why they do not make any disclosure:

- three respondents make this information available only to clients.
- one respondent does not disclose publicly following instructions from its sole client.
- two respondents plan to disclose their voting records in the future, one via their website in January 2014 and the other for the period 1 July 2013 to 30 June 2014 in August 2014.
- one respondent explained that *"most clients have a fund of funds portfolio so [we] rarely vote on specific company issues".*

Table 24: Advising management

	Per cent of respondents						
	Voting against or abstaining on management resolution						
	2013		2012		2011		2010
	Notify in advance	**Notify in arrears**	**Notify in advance**	**Notify in arrears**	**Notify in advance**	**Notify in arrears**	**Notify**
Always	19	–	20	3	16	2	17
Majority of instances	28	13	15	9	23	9	29
Occasionally	19	36	29	19	30	20	17
Very rarely	12	23	14	15	16	14	10
Never	13	13	18	13	12	13	2
When not in advance	–	–	–	11	–	20	–
N/A as in advance	–	–	–	24	–	19	–
Other	–	–	–	–	–	–	19
No response	9	15	4	6	3	3	6
Sample size	**83**	**67[37]**	**80**	**80**	**64**	**64**	**48**

[36] Page 25.

[37] Excludes the 16 respondents that 'always' notify management in advance.

Table 25: Disclosure of voting records

	Per cent of respondents			
	2013	**2012**	**2011**	**2010**
Disclose voting information	66	65	73	65
Do not disclose				
Reason disclosed	16	15	14	–
Reason not disclosed	10	15	11	–
Commit to publish	–	3	2	–
	27[38]	33	27	33
No response	7	2	-	2
Sample size	**83**	**80**	**64**	**48**

Of the 55 respondents that publicly disclose voting records, only 5 per cent include the rationale for all votes. Seventeen per cent provide the rationale for exceptional votes, or votes abstained or against whereas 40 per cent do not give any rationale. The proportion of respondents that disclose a summary report increased from 32 per cent in 2012 to 38 per cent in 2013 (see Table 26).

Table 26: All votes publicly disclosed

	Per cent of respondents			
	2013	**2012**	**2011**	**2010**
All votes[39]				
Rationale for all	5	6	9	–
Rationale for against or abstained, and exceptional	6	10	6	–
Rationale for against or abstained	11	8	4	–
No rationale	40	44	49	–
	62	68	68	68
Summary report	38[40]	32	30	32
No response	–	–	2	–
Sample size	**55**	**52**	**7**	**31**

As shown in Table 27, when respondents disclose voting records the majority – 65 per cent up from 60 per cent in 2012 and 57 per cent in 2011 – do so quarterly in arrears. 11 per cent publish voting information six months in arrears and 20 per cent annually – down from 25 per cent in 2012 and 28 per cent in 2011. Only 4 per cent do so for a period longer than one year but this is still an increase compared to the 2 per cent in 2012.

Table 27: Disclosure of voting information in arrears

	Per cent of respondents		
	2013	**2012**	**2011**
Quarterly or less	65	60	57
Six months	11	13	13
One year	20	25	28
More than one year	4	2	2
Sample size	**55**	**52**	**47**

[38] Includes one respondent that stated it did not disclose voting information but did not give further information as to the reason why not.

[39] The options whether all votes were publicly disclosed with or without rationale were not available in 2010.

[40] One respondent commented that in the future it plans to disclose all global votes, without rationale, on a quarterly basis.

7. Reporting

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

The Guidance to **Principle 7** states that Asset Managers are required to *"regularly account to their clients or beneficiaries as to how they have discharged their responsibilities. Such reports will be likely to comprise qualitative as well as quantitative information".* Similarly, Asset Owners *"should report at least annually to those to whom they are accountable on their stewardship policy and its execution"*. The respondents' approach to these requirements is reflected in Tables 28 and 29.

This section addresses the 85 Asset Managers and Asset Owners that conduct all or part of their engagement in-house. As shown in Table 28 nearly all (94 per cent) report to their clients and beneficiaries. Over one half report quarterly (2012: 50 per cent; 2011: 61 per cent; and 2010: 54 per cent) and the frequency of reporting varies according to client for 27 per cent of respondents.

Table 28: Frequency of reports to clients/beneficiaries

	Per cent of respondents			
	2013	**2012**	**2011**	**2010**
Monthly or more frequently	2	3	5	2
Varies according to client	27	23	20	31
Quarterly	53	50	61	54
Annually	12	20	11	11
Do not report	1	2	3	–
No response	5	2	–	2
Sample size	**85**	**80**	**64**	**48**

Forty-eight per cent of respondents report on both voting and engagement (2012: 56 per cent; 2011: 53 per cent; and 2010: 69 per cent), 21 per cent report only on voting (2012: 21 per cent; 2011: 23 per cent; and 2010: 17 per cent) and 8 per cent only on engagement (2012, 2011 and 2011: 2 per cent) – see Table 29. Examples of "other" included:

- report on both voting and engagement but also include other details such as ESG assessments and quality reviews, public policy engagement, details of thematic research, and policy updates.
- issue voting and engagement reports separately at a different frequency.
- provide details as requested by clients.
- restrict the content to specific issues, e.g. one respondent informs clients on public policy work, one that they have signed up to the Code, and one on issues that have arisen and their objective in voting on them.
- one Asset Manager that clarified that when voting for clients it will *"provide reports on all voting activity undertaken on their behalf on a monthly, quarterly, semi-annual or annual basis as directed by the client, inclusive of our vote rationale for voting the specific agenda queried. Periodically, we also take examples of [Manager]'s engagement on ESG issues with companies to produce Case Studies, which illustrate engagement activities undertaken with a goal to enhance shareholder value".*

Table 29: Content of reports

	Per cent of respondents			
	2013	**2012**	**2011**	**2010**
Both voting and engagement	48	56	53	69
Engagement only	8	2	2	2
Voting only	21	21	23	17
Other	16	15	19	10
No response / do not report	7	6	3	2
Sample size	**85**	**80**	**64**	**48**

For the first time in 2013, signatories were asked whether the reports on stewardship are part of their performance reports. 52 per cent of respondents include stewardship in their performance reports and 40 per cent do not[41].

[41] There was no response from 8 per cent of respondents.

Independent opinion

Following the 2012 revisions, the Code is now more explicit on the matter of signatories having their voting and engagement processes subject to an independent review. In particular, the wording in the Guidance to **Principle 7** changed from *"should consider obtaining an independent audit opinion"* to *"should obtain an independent opinion".*

Additionally, the FRC 2013 report of developments in Corporate Governance noted that obtaining an independent opinion on engagement and voting processes is *"another means by which owners can distinguish between managers*[42]".

As shown in Table 30, exactly half of respondents obtained an independent opinion or plan to do so within the next year. For 22 per cent of respondents the opinions were only on voting and for 16 per cent on both voting and stewardship. Just 2 per cent of respondents covered only stewardship. In the majority of cases – for 38 per cent of respondents – the independent opinion was obtained within the last 12 months.

The main reasons why respondents did not obtain an independent opinion and do not plan to do so are that it is not considered cost effective or that clients have not requested it. Moreover, some respondents rely on their own internal arrangements to review stewardship and voting processes.

Table 30: Independent opinion on processes[43]

	Per cent of respondents			
	2013	**2012**	**2011**	**2010**
Both voting and stewardship				
Over 12 months	–	–	–	–
Within last 12 months	17	14	10	6
Ad hoc	–	–	–	2
Stewardship only				
Over 12 months	–	n/a	n/a	n/a
Within last 12 months	1			
Ad hoc	1			
Voting only				
Over 12 months	1	–	–	2
Within last 12 months	21	20	20	36
Ad hoc	–	–	–	2
Intend to within the next year[44]	9	11	17	10
No, and no plans to do so	45	51	48	29
No response	5	4	5	13
Sample size	**85**	**80**	**64**	**48**

The Guidance to **Principle 7** also requires from signatories to disclose publicly whether they have obtained an assurance report according to standards such as AAF 01/06.

Of the 35 respondents that have an independent report on their processes, 60 per cent disclose it publicly but 40 per cent – well over one third – do not. Where the assurance report is not public, the majority of respondents keep it internally and make it available to clients on request. Other explanations included:

- four respondents that plan to make their assurance report public in the future (one specified that this would be in the first quarter of 2014).
- one respondent that is currently reviewing the disclosure policy.
- one respondent that *"did not deem [it] important".*

[42] Page 24.
[43] The option "Stewardship only" was available for the first time in 2013.
[44] This replaced "Intend to in respect of 2012" as appeared in Table 25, Adherence to the FRC's Stewardship Code 2012, page 37.

The forty-six respondents that had not obtained an independent report were asked whether their internal audit conducted a review of their stewardship and/or voting processes. For more than half – 59 per cent – an internal audit on processes either had already been carried out or would be done in the next 12 months (Table 31).

The internal audit review was in almost all cases either on only voting or on both voting and stewardship. One respondent only covered stewardship. For almost two thirds of respondents the internal review was conducted within the last 12 months.

Table 31: Processes reviewed by internal audit

	No. of respondents 2013	Per cent of respondents 2013
Yes		
Both voting and stewardship	7	15
Stewardship only	1	2
Voting only	11	24
Over 12 months	6	13
Within last 12 months	12	26
Not known	1	2
	19	41
No, but will do in the next 12 months	8	18
No, and no plans to do so	18	39
No response	1	2
Sample size	**46**	**100**

In most cases, the lack of an internal audit function is why an internal audit review was not carried out (seven). Others provided various explanations:

- three respondents are considering this and may have an internal audit review in the future; one specified that this would be done by their internal risk function.
- one plans to obtain an external opinion in the future.
- one explained that *"the prioritisation for planning of internal audit resource is on a risk based approach. Stewardship and Proxy Voting form part of their process but there is currently no plan to carry out an audit of these processes".*
- one does not deem it necessary.
- one clarified *"we are a small team and all investment and senior managers are involved in management engagement and so aware on a day to day basis of these issues".*
- one does not consider it worthwhile *"due to the nature and size of the business".*

Appendix 1
Steering Group members

Stephen Haddrill (Chair)	Financial Reporting Council
Hannah Armitage	Financial Reporting Council
Frank Curtiss	RPMI Railpen Investments
Richard Davies	Investor Relations Society
David Jackson	BP plc
Huw Jones	M&G Investment Management
Liz Murrall	IMA
Anastasia Petraki	IMA
Andreas Stepnitzka	EFAMA
Jarkko Syyrila	EFAMA

Appendix 2
Respondents to the questionnaire

Asset Managers

- 7IM
- Aberdeen Asset Management
- Adelphi Capital
- Advance Emerging Capital
- Aerion Fund Management
- Alliance Bernstein
- Amati Global Investors
- Arcus Infrastructure Partners
- Artemis Investment Management
- Aviva Investors Global Services
- AXA Investment Managers
- BAE Systems Pension Funds Investment Management
- Baillie Gifford & Co
- Baring Asset Management
- Beagle Partners
- BlackRock Asset Management
- BP Investment Management
- Capital International
- Cavendish Asset Management
- Cazenove Capital Management
- CCLA Investment Management
- Ecclesiastical Investment Management
- Ethos Foundation Switzerland
- F&C Management
- Fidelity Worldwide Investment
- Generation Investment Management
- Goldman Sachs Asset Management
- Governance for Owners
- Harding Loevner
- Henderson Global Investors
- HSBC Global Asset Management
- Ignis Asset Management
- Impax Asset Management
- Invesco Perpetual
- Investec Asset Management
- J O Hambro Capital Management
- J O Hambro Investment Management
- JPMorgan Asset Management
- Jupiter Asset Management
- Kames Capital
- Kempen Capital Management
- Lazard Asset Management
- Legal & General Investment Management
- Liontrust
- Longview Partners
- Loomis Sayles Investments
- M&G Investment Management
- Martin Currie Investment Management
- MFS Investment Management
- Misland Capital
- Morgan Stanley Investment Management
- Newton Investment Management
- Oldfield Partners
- Origin Asset Management
- PD Capital Management
- Pictet Asset Management
- Progressive Asset Management
- Rathbone Unit Trust Management
- Royal London Asset Management
- Royal London Asset Management (CIS)
- Russell Investments
- Sarasin & Partners
- Schroder Investment Management
- Scottish Widows Investment Partnership
- Slater Investments
- Standard Life Investments
- State Street Global Advisors
- SVG Investment Managers
- SVM Asset Management
- Taube Hodson Stonex Partners
- The Central Finance Board of the Methodist Church
- Thomas Miller Investment
- Threadneedle Investments
- TOBAM
- TT International
- Turcan Connell Asset Management
- UBS Global Asset Management
- UK Financial Investments
- USSIM
- Vanguard Asset Management
- Wellington Management Company
- WHEB Asset Management

Asset Owners
Alliance Trust
BBC Pension Trust
Bedfordshire Pension Fund
British Airways Pensions
British Coal Staff Superannuation Scheme
DHL Group Retirement Plan
Environment Agency
Greater Manchester Pension Fund
Harmsworth Pension Scheme
Hermes Equity Ownership Services
Lancashire County Pension Fund
Merchant Navy Officers Pension Fund
Merchant Navy Ratings Pension Fund
National Employment Savings Trust
NI Local Government Officers' Superannuation Committee
North East Scotland Pension Fund
Royal Mail Pensions Trustees
RPMI Railpen
Siemens Benefits Scheme
Strathclyde Pension Fund
The Co-operative Pension Scheme (PACE)
The Joseph Rowntree Charitable Trust
The Marks and Spencer Pension Scheme
The Royal Bank of Scotland Group Pension Fund
The Wellcome Trust
Trustees of the Mineworkers' Pension Scheme
West Midlands Pension Fund

Service Providers
EIRIS
Glass Lewis
Manifest
Mercer
Towers Watson

Appendix 3
Markets and proportion of shares voted

	UK				Rest of Western Europe				Central & Eastern Europe			
	2013	**2012**	**2011**	**2010**	**2013**	**2012**	**2011**	**2010**	**2013**	**2012**	**2011**	**2010**
All	64	68	55	38	47	54	35	15	34	36	25	16
Most (>75%)	7	5	6	6	14	13	18	18	12	13	13	12
Majority (51-75%)	2	–	1	1	1	–	1	6	4	3	1	3
Some (25-50%)	1	2	–	–	–	1	2	2	–	3	3	1
Few (<25%)	3	2	1	1	8	4	3	2	7	5	3	5
None	1	–	1	–	2	3	2	2	3	4	5	6
No equities held	1	1	–	–	4	3	2	–	14	10	8	–
No response	4	2	–	2	7	2	1	3	9	6	6	5
Total	**83**	**80**	**64**	**48**	**83**	**80**	**64**	**48**	**83**	**80**	**64**	**48**

No. of respondents															
USA & Canada				Asia Pacific				Japan				Rest of the World			
2013	**2012**	**2011**	**2010**	**2013**	**2012**	**2011**	**2010**	**2013**	**2012**	**2011**	**2010**	**2013**	**2012**	**2011**	**2010**
48	51	41	28	41	45	33	22	46	52	41	27	35	33	24	13
9	7	5	8	13	12	10	10	8	5	5	7	13	12	10	13
1	2	2	–	1	1	4	1	1	–	–	1	7	7	5	4
1	1	1	2	–	2	1	2	–	1	–	1	1	4	3	2
5	3	2	2	4	3	2	4	3	4	5	3	4	3	5	4
3	2	3	4	5	3	2	4	5	2	2	4	5	4	4	6
6	9	7	–	10	9	8	–	10	10	8	–	10	10	8	–
10	5	3	4	9	5	4	5	10	6	3	5	8	7	5	6
83	**80**	**64**	**48**	**83**	**80**	**64**	**48**	**83**	**80**	**64**	**48**	**83**	**80**	**64**	**48**