Aviva Investors response to FRC's consultation on revisions to the Stewardship Code

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Aviva Investors is the global asset management business of Aviva Plc. The business delivers investment management solutions, services and client-driven performance to clients worldwide. Aviva Investors operates in 14 countries in Asia Pacific, Europe, North America and the United Kingdom with assets under management of £263bn as at the end of 2011.

Introduction:

The Stewardship Code was an important and necessary development in ensuring that the UK's comply or explain regime works effectively. We believe that in its first two years, the Code has contributed significantly to the robustness of the system as can be seen by further improvement in voting out-turns, more considered voting that has led to more engagement, negative voting outcomes for companies and resulted in a number of executives resigning.

We hope that this level of activity that holds boards to account continues. We have concerns that shareholders will start to get complacent post the "shareholder spring" and feel they have done enough. Certainly we think this is a danger when the economy improves. It may be that over time, the Stewardship Code will need to be given more "teeth" to ensure that shareholders continue to be vigilant and active.

Areas that need strengthening:

While we believe that the Stewardship Code has had a good start, and we are supportive of most of the revisions proposed, there are some areas that we believe need strengthening. These are as follows:

- **Culture and ethical behaviour.**

  There needs to be more emphasis on the need for an appropriate culture at companies and the need for ethical behaviour. The issues around Barclays (LIBOR) and GSK (misselling) and other high profile cases here and around the world should provide sufficient justification for the need for focus in these areas.

  For this reason we believe that paragraph 4 on page one should be amended as follows:

  "4. For investors, stewardship activities include monitoring and engaging with companies on matters such as strategy, performance, risk, remuneration, culture, corporate responsibility and corporate governance, as well as voting. Engagement is purposeful dialogue with companies on those matters as well as on issues that are the immediate subject of votes at general meetings."

- **Responsibility of shareholders.**

  Although it is implicit within the Code, and acknowledging that not all investors need to engage and vote, we believe there would be some benefit if the Stewardship Code more clearly articulates the responsibilities (rather than the activities expected) of shareholders for proper stewardship of their investments on behalf of clients. Therefore, we believe paragraph 2 on page 1 could be strengthened by inserting an additional words so paragraph 2 reads "In publicly listed companies responsibility for stewardship is shared. The primary responsibility rests with the board of the company. Investors also have a responsibility to ensure, where stewardship is relevant to the fund, that there is proper

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stewardship at the companies in which they are invested if they are to fulful their duties to their clients". This reflects the role of shareholders as stated in the UK Corporate Governance Code.

We also believe that all investors should be required to disclose whether or not they apply the Stewardship Code to their funds, and if not, why not. This would cover asset owners that have not yet signed up to the code as well as asset managers. This is not to say they have to sign up, but they should make a declaration as to why they have not signed up. These statements should also be on the FRC website so it is easier to track the activities of all institutional investors.

- **The reach of the Code:**

  Paragraph 2, page 3 : We feel that the code should also apply, by extension, to more than just proxy advisors and investment consultants. There are other players in the market that can help shareholders hold management to account. This would be a good opportunity to extend the expectation to consider stewardship to other advisors such as sell side analysts who very rarely comment on stewardship matters or investment banks who give advice on strategy and corporate structures.

  Paragraph 4, page 3: With the growth of DC pension schemes and retail funds, (where the responsibility of making the investment choice sits with the individual and good stewardship is arguably more important as returns are not as secure as say, DB pension schemes), the Code should more explicitly encourage asset managers and the trustees of these funds to communicate their role as good stewards to their clients. We should mention boards and trustees of DC schemes, UCITs and OIECs and other retail funds as also having the same responsibility as those running large segregated accounts. When reference is made to the Stewardship Code, it is often in the context of asset owners and asset managers of the big pension funds and large life company funds. More emphasis on retail accounts would make it clear that it may be just as important for smaller retail funds.

  Paragraph 10, page 4. There has been some discussion about whether the FRC's remit extends to asking UK shareholders to disclose how they apply the Code to overseas equity holdings. We are in the camp of supporting such a disclosure. As we believe that good stewardship of our companies can add value to our portfolios to our clients' returns, then it makes sense that we should try to apply it to all our portfolios, whenever possible, whether UK ones or further. After all it is only a disclosure requirement. If adherence to the Stewardship Code is meant to be a competitive differentiator, it should be as complete as possible. For example, potential clients may be interested in overseas portfolios and would want to know which fund managers apply stewardship beyond the UK.

- **Disclosure**.

  Currently there is no consistency in the way asset owners or asset managers make their stewardship disclosures. The statements run from as short as one page to over twenty pages. The content of the statements also vary widely. We agree with the revisions already being proposed in this review for improving disclosures but we also believe that there should be more consistency in the way the information is disseminated. This would make it easier to compare the practices of each owner and manager and will facilitate creating a market for stewardship. Therefore, we support initiatives such as the recommendation made by the Investor Stewardship Working Party in their paper 2020 Stewardship: Improving the quality of investor stewardship (of which we are a member) to disclose activities through a Stewardship Framework/matrix whereby all asset managers (and owners where they manage their own investments) should disclose their activities in a consistent framework.

Other comments:

The principles of the Code (page 8):

The sixth bullet point should refer to engagement as well as voting, so institutional investors should "have a clear policy on engagement and voting and disclose engagement and voting activity"

Principle 1 (page 9):

Again we would reiterate that in the first paragraph under Guidance should include culture and corporate responsibility to reflect our view on paragraph 4 on page 1.

The second paragraph under Guidance should mention the fiduciary responsibilities of institutional investors so we would recommend that this paragraph should read "Institutional investors' policy on stewardship should disclose how the institutional investor meets its fiduciary responsibilities by applying stewardship with the aim of enhancing and protecting the value for the ultimate beneficiary or client."

The fourth paragraph under Guidance says that "The statement should reflect the institutional investor's activities within the investment chain as well as the responsibilities that arise from those activities….". Aviva Investors feel that there is also room to reflect the beliefs and reasons why those activities take place. For example, why are they signing up to the Stewardship Code? What issues do investors think are important to their portfolios etc. The reason why we feel this is appropriate is because it makes it easier for clients to understand the motivations of the institutional investor and this will make it harder for signatories to sign up in a box ticking way if they are not expected to explain why they are carrying out these activities in the first place. We suspect there are asset managers who will outsource much of their stewardship in order to be able to tick the box on activities.

Principle 2 (page 10):

We obviously believe in effective policies and activities, in this case around conflicts of interests. However, we were wondering how an "effective" policy might be measured, in particular, with respect to AAF 01/06 standards. We would need to know the standard of proof required from us to meet the standard. Some guidance here would be helpful.

Principle 3 (page 10):

We approve of the escalation of the importance of leadership in the guidance to monitoring investee companies. Ultimately this is the most important aspect of governance and investors should ensure, as far as possible, that the board and senior management have all the right skills and attributes to secure the company's longer term prosperity.

(page 11). We believe that second paragraph under the bullet points is written too negatively. Institutional investors should endeavour to identify opportunities as well as problems. A more balanced approach would reflect the value of working with shareholders to enhance the performance of companies as well as for shareholders to alert boards to potential issues.

Principle 4 (page 12)

We believe an additional bullet point should be inserted which says "withholding support or voting against resolutions and/or re-election of the board". This chimes with Principle 6.

Principle 6 (page 13):

As already mentioned, we believe Principle 6 should also include a clear policy on engagement and that disclosures should include engagement.

We agree it is essential for investors to explain their use of proxy voting services especially in view of the perception that the services are becoming overly influential. We are increasingly being asked by companies about how we use the agencies. This information will help companies understand how their investors approach voting.

Principle 7 (page 14):

We note that the paragraph regarding audit trails under principle 3 has been deleted and instead, there is a new sentence under Principle 7 Guidance that says that institutional investors should have processes to maintain a clear record of their stewardship activities. We feel the additional information provided in the old Principle 3 was helpful in identifying what clear records mean in guiding institutional investors. This would provide practical guidance to what is meant by “clear record”

This aligns with the ABI view that they would like the FRC to provide further guidance on the types of ways asset owners’ should feasibly apply the code principles. In this regard, we would point to a document written by Aviva Investors with the NAPF in 2011 entitled “Stewardship made Simple”.

Conclusion:

We are generally supportive of the revisions proposed. We have highlighted areas where, in our view, the Stewardship Code can be improved and we hope you will be able to take these into account.

Yours sincerely

Steve Waygood
Chief Responsible Investment Officer