INSTITUTIONAL SHAREHOLDERS' COMMITTEE

CODE ON THE RESPONSIBILITIES OF INSTITUTIONAL INVESTORS

Introduction & Scope

This Code has been drawn up by the Institutional Shareholders' Committee[1] and covers the activities of both institutional shareholders and those that invest as agents, including reporting by the latter to their clients.

The Code aims to enhance the quality of the dialogue of institutional investors with companies to help improve long-term returns to shareholders, reduce the risk of catastrophic outcomes due to bad strategic decisions, and help with the efficient exercise of governance responsibilities.

The Code sets out best practice for institutional investors that choose to engage with the companies in which they invest. The Code does not constitute an obligation to micro-manage the affairs of investee companies or preclude a decision to sell a holding, where this is considered the most effective response to concerns.

In the Code the term "institutional investor" includes institutional shareholders such as pension funds, insurance companies, and investment trusts and other collective investment vehicles and any agents appointed to act on their behalf.

Institutional shareholders' mandates given to fund managers or agents should specify the policy on stewardship, if any, that is to be followed.

Institutional shareholders are free to choose whether or not to engage but their choice should be a considered one, based on their investment objectives. Their managers or agents are then responsible for ensuring that they comply with the terms of the mandate as agreed[2].

The Code applies to institutional investors on a comply-or-explain basis. Institutional investors that do not wish to engage should state publicly that the Code is not relevant to them and explain why.

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[1] ISC members are: the Association of British Insurers; the Association of Investment Trust Companies; the National Association of Pension Funds; and the Investment Management Association.

[2] In the case of pension funds best practice is set out in the 2008 Myners' Principles under Principle 5*.

- * Trustees should adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents.
- A statement of the scheme's policy on responsible ownership should be included in the Statement of Investment Principles.
- Trustees should report periodically to members on the discharge of such responsibilities.

Institutional investors that elect to engage should provide a statement on how they implement the Principles in practice. Institutional investors that apply the Code will be listed on the ISC's website (www.institutionalshareholderscommittee.org.uk). This statement should contain information on what steps have been or will be taken in respect of verification.

Fulfilling fiduciary obligations to end-beneficiaries in accordance with the spirit of the Code may have implications for institutional investors' resources. These should be sufficient to allow them to fulfill their responsibilities effectively, commensurate with the benefits derived. The duty of institutional investors is to their end-beneficiaries and/or clients and not to the wider public.

The Code may also be applied by overseas investors, including Sovereign Wealth Funds. The ISC would welcome their commitment to the Code and may also list those that choose to sign up on the ISC's website. The Code will be reviewed biennially by the ISC in line with the FRC's review process for the Combined Code.

Principle 1: Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities

<u>Guidance</u>

The policy should include:

- How investee companies will be monitored. In order for monitoring to be effective, where necessary, an active dialogue may need to be entered into with the investee company's board.

- The strategy on intervention.

- Internal arrangements, including how stewardship is integrated with the wider investment process.

- The policy on voting and the use made of, if any, proxy voting or other voting advisory service, including information on how they are used (see Principle 6).

- The policy on considering explanations made in relation to the Combined Code.

Principle 2: Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.

Guidance

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

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

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

Principle 3: Institutional investors should monitor their investee companies

Guidance

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

As part of this monitoring, institutional investors should:

- seek to satisfy themselves, to the extent possible, that the investee company's board and sub-committee structures are effective, and that independent directors provide adequate oversight; and

- maintain a clear audit trail, for example, records of private meetings held with companies, of votes cast, and of reasons for voting against the investee company's management, for abstaining, or for voting with management in a contentious situation.

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

Institutional investors may not wish to be made insiders. They will expect investee companies and their advisers to ensure that information that could affect their ability to deal in the shares of the company concerned is not conveyed to them without their agreement.

Principle 4: Institutional investors should establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value

Guidance

Institutional investors should set out the circumstances when they will actively intervene and regularly assess the outcomes of doing so. Intervention should be considered regardless of whether an active or passive investment policy is followed. In addition, being underweight is not, of itself, a reason for not intervening. Instances when institutional investors may want to intervene include when they have concerns about the company's strategy and performance, its governance or its approach to the risks arising from social and environmental matters.

Initial discussions should take place on a confidential basis. However, if boards do not respond constructively when institutional investors intervene, then institutional investors will consider whether to escalate their action, for example, by:

- holding additional meetings with management specifically to discuss concerns;
- expressing concerns through the company's advisers;
- meeting with the Chairman, senior independent director, or with all independent directors;
- intervening jointly with other institutions on particular issues;
- making a public statement in advance of the AGM or an EGM;
- submitting resolutions at shareholders' meetings; and
- requisitioning an EGM, possibly to change the board.

Principle 5: Institutional investors should be willing to act collectively with other investors where appropriate

Guidance

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

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

Institutional investors should disclose their policy on collective engagement.

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

Principle 6: Institutional investors should have a clear policy on voting and disclosure of voting activity

Guidance

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

If they have been unable to reach a satisfactory outcome through active dialogue then they should register an abstention or vote against the resolution. In both instances, it is good practice to inform the company in advance of their intention and the reasons why.

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

Principle 7: Institutional investors should report periodically on their stewardship and voting activities

Guidance

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

Transparency is an important feature of effective stewardship. Institutional investors should not, however, be expected to make disclosures that might be counterproductive. Confidentiality in specific situations may well be crucial to achieving a positive outcome.

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

Those that sign up to this Code should consider obtaining an independent audit opinion on their engagement and voting processes having regard to the standards in AAF 01/06[3] and SAS 70.[4] The existence of such assurance certification should be publicly disclosed.

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

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