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Tuesday 30 April 2019

To whom it may concern,

Building a Regulatory Framework for Effective Stewardship

We welcome the opportunity to respond to the Financial Conduct Authority and the Financial Reporting Council's joint consultation on Building a Regulatory Framework for Effective Stewardship.

The Quoted Companies Alliance *Corporate Governance Expert Group* has examined the proposals and advised on this response from the viewpoint of small and mid-size quoted companies. A list of Expert Group members can be found in Appendix A.

Overall, we welcome your work to promote and raise the standards of stewardship to build a regulatory framework for it and ensure its effectiveness. We believe that effective stewardship is essential for companies in the delivery of their services to their shareholders and beneficiaries, as well as the functioning of the UK's financial markets as a whole in contributing to long-term, sustainable value creation for their shareholders and giving rise to wider economic and societal benefits.

Small and mid-sized quoted companies are keen to receive constructive feedback from their shareholders on matters of concern they may have, and thus, any measure to improve the effectiveness of this dialogue between companies and their shareholders is welcomed. In order to enhance the quality of the markets, it is important to ensure that a company's engagement with stewardship is not only appropriate for its shareholders, but also that it is contributing to the fulfilment of its business strategy or purpose, as doing so will improve the UK's corporate governance landscape as a whole.

Stewardship is at its most effective when asset managers and owners, as well as other institutional investors, work collaboratively to promote value creation, avoid short-termism and meet their financial interests. This is a requisite for effective stewardship; however, issuers, including small and mid-sized quoted companies, will have a sizeable role to play in facilitating interaction and engagement to ensure the optimal effectiveness of stewardship and deliver growth to the economy.

If you would like to discuss our response in more detail, we would be happy to attend a meeting.

Yours sincerely,

Tim Ward
Chief Executive

General comments

The absence of continuous engagement between companies and their investors, as well as poor corporate governance practices, are often adjudged to be the components engendering corporate failure. To correct such wrongdoings, we support the idea of building a regulatory framework for effective stewardship that will overcome these issues.

Small and mid-sized quoted companies welcome opportunities to enhance stewardship to promote an environment whereby all stakeholders, including companies and both the retail and institutional investment communities, have a clear understanding of a beneficiaries financial interests. Developments to improve the effectiveness of stewardship must run in accordance with developments in corporate governance. Just as companies should be challenged on their management and strategies, investors should be challenged on their priorities and engagement approach.

That said, any proposals made within this consultation aimed at improving the effectiveness of stewardship that could result in increased work for issuers must be proportionate and balanced. Typically, smaller companies, and, in particular, those on the AIM market, have more limited resources than their larger counterparts residing on the Main Market. While such companies will commonly have a more concentrated share register than larger companies and feature a lower proportion of distant passive investors, they equally have very limited internal resource dedicated towards investor relations and thus may not necessarily be able to cope with the additional costs or administrative burdens that may arise if changes are made.

From the perspective of small and mid-sized quoted companies, we welcome suggestions to extend the remit of stewardship to include both fixed income and private equity. When recognising investment assets, it is important to consider these too, as they have historically played a rather dormant role in stewardship. If stewardship is to become more effective it would benefit from both fixed income and private equity playing a more proactive role, especially in light of increasing engagement to protect and enhance value.

It is important to emphasise that small and mid-sized quoted companies occupy the AIM market as it is intended for companies seeking to grow. The companies who reside on this market are the ones who want to attract long-term oriented asset managers that will offer continued support and remain with them throughout their growth journey. Contrastingly, for larger companies, stewardship is often characterised as being more akin to policing and accountability, as well as monitoring corporate capital allocation decisions. Whereas for smaller companies, stewardship is more akin to partnership, genuine stewardship of investor capital and guidance.

Q1 Do you agree with the definition of stewardship set out here? If not, what alternative definition would you suggest?

Yes, we support the revised definition of stewardship as set out in the paper. In particular, we welcome how the discussion paper explores how consideration needs to be given to extend the scope of stewardship to include assets beyond UK listed equity assets, including UK investors internationally and international investors in the UK.

Q2 Are there any particular areas which you consider that investors' effective stewardship should focus on to help improve outcomes for the benefit of beneficiaries, the economy and society (e.g. ESG outcomes, innovative R&D, sustainability in operations, executive pay)?

As a result of an increasing interest in how companies and investment firms manage their organisations environmental, social and governance (ESG) risks, we believe that this is one particular area in which investors' effective stewardship should focus on. Due to the newfound interest in the likes of sustainable investment, climate change and green finance, shareholders are progressively demanding information on ESG issues to be disclosed in order for them to then provide a challenge if they do not deem the ESG outcomes to be of an acceptable nature. Therefore, developments in investment stewardship on ESG outcomes will make stewardship as a whole more effective, and the benefits to shareholders and wider society would be significant.

Q3 To what extent do the proposed key attributes capture what constitutes effective stewardship? Which attributes do you consider to be most important? Are there other attributes that we should consider? If so, please describe.

We believe that the proposed key attributes capture what should constitute effective stewardship well.

However, with regards to 'a clear purpose', the provisions associated with service providers would benefit from being better explained as they are currently quite unclear.

Q4 What do you think is the appropriate institutional, geographical and asset class scope of stewardship? How can challenges associated with issues such as the coordination of stewardship activities across asset classes, or the exercise of effective stewardship across borders, be overcome?

We believe that in order for stewardship to be wholly effective it has to be integrated comprehensively, thus meaning that stewardship should be conducted for all asset classes, including both public and private. This is particularly important in order to support smaller companies transitioning from private to public ownership with the myriad of, often, competing interests at play around these events (e.g. PE exiting, intermediaries advising, investors investing in the IPO etc.). Larger companies, who have the resources to manage, should be required to engage in stewardship across all asset classes, whereas smaller companies should only be encouraged to do so if they have the capacity.

The challenges associated with the coordination of stewardship activities across asset classes can be overcome with the publication of guidance. The guidance should focus on how performing stewardship should be adapted and conducted for different asset classes.

Q5 We welcome examples of how firms with different objectives and investment strategies approach stewardship. In particular, we welcome input on how stewardship practices differ across active and index-tracker funds, in the following areas:

- **i. How firms prioritise and conduct stewardship engagements**
- **ii. What investments firms have made in stewardship resources**
- **iii. How stewardship activity is integrated with investment decisions.**

For smaller companies, passive investment, and indeed overseas investment, is a far smaller proportion of their register. Inversely, retail ownership is more common and this is a constituency of investor that is often forgotten about with regards to stewardship.

The FCA needs to give consideration to enfranchising mechanisms for the retail investor whom wishes to exercise their vote without excessive cost burdens. Additionally, care should be taken to ensure that fair disclosure rules are adhered to. For example, while shareholder engagement is not around market-sensitive information, it is nonetheless in essence privileged access to management and board members for professional investors, which the retail investor does not have. For this reason, consideration should also be given to the retail investor to enable them similar opportunities.

Q6 To what extent do you agree with the key barriers to achieving effective stewardship identified in this DP? What do you believe are the most significant challenges in achieving effective stewardship? We would particularly welcome views on the investment required to embed effective stewardship in investment decision-making.

We agree with the barriers to achieving effective stewardship as identified in this discussion paper.

The path to achieving effective stewardship will encounter many difficulties and barriers that need to be overcome. For instance, there is an issue with free-riding. Investors actively engaging with issuers takes a considerable time and requires significant resources, and, as a result of this, there is the risk that some will free-ride on the stewardship activities of others.

As well as this, the markets are increasingly complex and made of many components. This presents another significant challenge as there are now multiple interested parties in the chain of intermediaries, as the likes of proxy advisers and investment consultants are becoming more and more involved. Furthermore, there is also greater geographical dispersion of an investors asset holdings that adds another layer of complexity and a further barrier to achieving effective stewardship.

Finally, there is an overarching issue associated with the culture of investment decisions and issuers' strategies. This being, the culture of short-termism. In order for this to be overcome, there needs to be structural changes to ensure that everyone operating on the markets prioritises longer-term goals.

Q7 To what extent do you consider that the proposed balance between regulatory rules and the Stewardship Code will raise stewardship standards and encourage a market for effective stewardship?

We agree that in order to ensure effective stewardship practices, there needs to be a balance between regulatory rules and the revised Stewardship Code.

That said, any regulatory rules that are introduced to run in conjunction with the Stewardship Code must be proportionate and balanced. This will help create the conditions needed for the markets to engage in effective stewardship, whilst not impeding the growth of smaller companies.

Q8 To what extent are there issues with proxy advisers that are not adequately addressed by SRD II and proposed revisions to the Stewardship Code?

With regards to director overboarding and proxy advisers making their own, more specific guidelines, which cover both executive and non-executive directors, we believe that the limits placed within these guidelines and the challenges they have been making are unduly. Certain proxy advisers go as far to set out specific guidance in their voting policies, something of which we believe is unnecessary and exceeds the limits of what is reasonable.

Q9 We welcome feedback on other specific aspects of the regulatory framework described above. In particular, we are interested in views on:

- **i. Whether and to what extent the FCA's proposed rules for asset owners should be extended to SIPP operators?**
- **ii. The case for regulatory rules to expand the reach of stewardship beyond listed equity**
- **iii. Whether there is a role for UK regulators in encouraging overseas investors to engage in stewardship for their asset holdings in the UK**
- **iv. The extent to which additional rules might be necessary either to improve stewardship quality or prevent behaviours that might not be conducive to effective stewardship**
- **v. For differences between active and index-tracker strategies in the practice of stewardship, whether there are particular regulatory actions we should consider to address any perceived harms.**
- **vi. Whether the FCA's proposed rules to implement certain provisions of SRD II should apply on a mandatory, rather than 'comply or explain', basis.**

We have no comment to make on this question.

Q10 We welcome feedback on whether, to support effective stewardship, we should consider amendments to other aspects of the regulatory framework that affect how investors and issuers interact (such as the LRs, PRs and DTRs)?

We have no comment to make on this question.

Appendix A

The Quoted Companies Alliance *Corporate Governance Expert Group*

Will Pomroy (Chair)	Hermes Investment Management Limited
Tracy Gordon (Deputy Chair)	Deloitte LLP
Edward Beale	Western Selection PLC
Nigel Brown	Gateley
Amanda Cantwell Julie Stanbrook	Practical Law Company Limited
Jo Chattle	Norton Rose Fullbright LLP
Richie Clark	Fox Williams LLP
Jonathan Compton	BDO LLP
Louis Cooper	C/o Non-Executive Directors Association (NEDA)
Edward Craft	Wedlake Bell LLP
Tamsin Dow	Hogan Lovells International LLP
Peter Fitzwilliam	Mission Marketing Group PLC
David Fuller	CLS Holdings PLC
Nick Gibbon	DAC Beachcroft LLP
Nick Graves	Burges Salmon
Ian Greenwood	Korn Ferry
David Hicks	Charles Russell Speechlys LLP
Alexandra Hockenhull	Hockenhull Investor Relations
David Isherwood	BDO LLP
Daniel Jarman Kalina Lazarova	BMO Global Asset Management
Colin Jones	Candid Compass
Damien Knight	MM & K Limited
Peter Kohl	Kerman & Co LLP
James Lynch	Downing LLP
Marc Marrero	Stifel
Efe Odeka	UHY Hacker Young
Darshan Patel	Hybridan LLP
Sahul Patel	FIT Remuneration Consultants
Phillip Patterson	PricewaterhouseCoopers LLP
Jack Shepherd	CMS
Carmen Stevens	Jordans Limited
Peter Swabey	C/o ICSA
Melanie Wandsworth	Faegre Baker Daniels LLP
Kerin Williams	Prism Cosec