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The UK Stewardship Code

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BACKGROUND

Following the Financial Reporting Council's ("FRC") consultation on the content, application and monitoring of a stewardship code during the first quarter of 2010, the FRC has concluded that the Institutional Shareholders' Committee's Code on the Responsibilities of Institutional Investors (the "ISC Code") provides an appropriate basis for the stewardship code. The FRC published the first UK Stewardship Code for institutional shareholders (the "Stewardship Code") on 2 July 2010.

The purpose of the Stewardship Code is to promote better dialogue and engagement between institutional shareholders and company boards, and to provide more transparency about the way in which investors oversee the companies that they own, so as to deliver better long-term returns to shareholders.

APPLICATION OF THE STEWARDSHIP CODE

The Stewardship Code applies primarily to firms that manage assets on behalf of institutional shareholders such as pension funds, insurance companies and investment trusts, and the FRC expects such firms to disclose how they have applied the Stewardship Code. The FRC also strongly encourages all owner institutional shareholders and other service providers, such as proxy voting services, to comply with the Stewardship Code and to report on their websites how they have complied with the code.

"COMPLY OR EXPLAIN"

Institutional shareholders are free to choose whether to apply the Stewardship Code or not; those institutional shareholders that choose to engage with the Stewardship Code should do so on a "comply or explain" basis.

The institutional shareholder's website should describe how the principles of the Stewardship Code have been applied and disclose the information listed under principles 1 and 5 to 7 inclusive (see "The main principles of the Stewardship Code" below) or explain why these elements of the Stewardship Code have not been complied with. The statement should also name an individual who can be contacted for further information and by those interested in collective engagement.

The FRC encourages institutional shareholders to publish the statement explaining the extent to which they have complied with the Stewardship Code on their website by the end of September 2010. As from October 2010, the FRC will retain on its website a list of investors that have published such a statement.

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THE MAIN PRINCIPLES OF THE STEWARDSHIP CODE

The Stewardship Code comprises seven principles which, as noted above, are based on the ISC Code with some minor amendments. Institutional shareholders should:

- Publicly disclose their policy on how they will discharge their stewardship responsibilities (Principle 1);
- Have a robust policy on managing conflicts of interest in relation to stewardship and publicly disclose this policy (Principle 2);
- Monitor their investee companies (Principle 3);
- Establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value (Principle 4);
- Be willing to act collectively with other investors where appropriate (Principle 5);
- Have a clear policy on voting and disclosure of voting activity (Principle 6); and
- Report periodically on their stewardship and voting activities (Principle 7).

KEY CHANGES FROM THE ISC CODE

The key differences between the original ISC Code and the Stewardship Code are contained in the guidance to Principle 3 which has been amended to:

- encourage investors to meet the chairman of the company in which they invest and, where appropriate, other board members;
- to attend general meetings of companies in which they have a major shareholding; and
- to carefully consider companies' explanations for not following the UK Corporate Governance Code.

MONITORING AND FUTURE DEVELOPMENTS

The FRC will begin annual monitoring of the take-up and application of the Stewardship Code in the second half of 2011. It also intends to discuss how to promote and develop the Stewardship Code with the Institutional Investor Council being established by the Institutional Shareholders' Committee.

The FRC also intends to review the content and impact of the Stewardship Code regularly to reflect developments in good engagement practice, market structure and the broader regulatory framework. The FRC also intends to review some of the issues raised in response to the 2010 consultation, including whether institutional investors should disclose their policies on stock lending and the nature of information to be disclosed on voting records. A decision on the timing of the first review will be made in the second half of 2011.

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