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A Legal Update from Dechert's Corporate and Securities Group

## Improving Engagement Between Companies and Institutional Investors in the UK - ICSA Consultation

The Institute of Chartered Secretaries and Administrators ('ICSA') in the UK, in conjunction with the Investor Stewardship Working Party, has launched a consultation paper on stewardship entitled 'Improving Engagement Practices by Companies and Institutional Investors'.

The paper, issued on 12 October 2012, results from ICSA's review of the current state of investor stewardship in the context of:

- a report of the Investor Stewardship Working Party (a group of six institutional investors, supported by Tomorrow's Company (a London-based think tank which researches issues regarding business-society relations), which came together to consider what was meant by better 'investor stewardship'), entitled '2020 Stewardship – Improving the quality of investor stewardship' and published in March 2012<sup>1</sup>;
- the final report of the review undertaken by John Kay on behalf the Secretary of State for Business, Innovation and Skills of activity in UK equity markets and its impact on the long-term performance and governance of UK quoted companies, entitled 'the Kay Review of UK equity markets and long-term decision making', published in July 2012<sup>2</sup>; and
- the revised UK Stewardship Code, published by the Financial Reporting Council in September 2012<sup>3</sup>.

The Investor Stewardship Working Party asked ICSA to establish a steering group to develop and progress two recommendations of the Working Party's report:

1. the development by companies and their institutional investors of a guide to good engagement practice, with the aim of encouraging more productive meetings between them; and
2. helping companies and institutional investors find more ways to seek feedback on the quality of meetings and, over time, utilise this feedback to identify and improve good stewardship.

Consequently, ICSA established a steering group for this purpose, consisting of 15 members from companies, investors and other key stakeholders.

The consultation paper notes the following four challenges regarding the quality and quantity of stewardship identified in the Working Party's report which must be overcome in order to establish good stewardship engagement:

1. **quality of meetings:** companies want meetings and engagement that are more purposeful and effective, but become frustrated when investors present divergent opinions on company performance and governance issues;
2. **quality of information:** there is a lack of information about different stewardship approaches;
3. **resource limitations:** the resources for stewardship are limited, and the best use is not always made of those resources which are available; and
4. **critical mass:** a critical mass of stewardship investors – funds capable of engaging companies in

constructive dialogue and holding their boards accountable to shareowners.

The steering group requests views on the following key issues in the consultation paper:

## A 'new conversation' to improve the quality of the engagement process

The consultation paper notes that the engagement process between companies and their institutional investors must be improved, and should also be accompanied by a 'new conversation' between them. In order to encourage companies to create long-term value for their investors, the steering group recognises that meetings between a company and its investors should focus on aspects which go towards developing long-term value.

The steering group notes that companies should engage investors on potentially controversial AGM issues well before the proxy materials are published; both companies and investors could make greater effort to improve the quality of the engagement process; regular engagement would increase mutual trust, so that bad news could be better understood when put into context; and the engagement should allow companies to promote their business model and explain their strategy to investors. The consultation paper states that the views of institutional investors could add value to companies through challenge, and investors could articulate the behaviours and performance they require from a company in order for them to remain as long-term investors.

The consultation paper asks for views on whether stewardship guidance would help strengthen engagement practices and, if not, what could be introduced to achieve this.

## Improvements to the process of holding engagement meetings

The steering group identifies a number of practical measures in the consultation paper which could be implemented by both companies and investors which could improve the quality of engagement meetings to make them more productive for all parties. In essence, the steering group believes that, in its preparation for engagement meetings, the company should have a clear strategy for the engagement, covering:

- the purpose of the meetings;
- with whom the communication is to take place;
- what is on the agenda;
- what preparation is needed; and
- how long and how frequent the meetings should be.

Views are requested on whether the measures outlined would improve the quality of engagement meetings.

## Provision of feedback

The steering group notes that brokers or other advisers routinely report back to a company's executive team following investor presentations. The consultation seeks views as to whether direct feedback from investors to the company would lead to more effective engagement. The consultation paper also outlines a questionnaire format which a company could use to obtain feedback on investor meetings, and the consultation paper asks for views on this proposed format.

## Additional considerations

The steering group suggests in the consultation paper that greater deliberation of stewardship engagement generally would be beneficial, including consideration of the following matters:

- whether, as recommended by the Kay Review<sup>4</sup>, it would be beneficial to establish an investors' forum to allow institutional investors the collective opportunity to engage more effectively with companies;
- whether companies should make presentations on a topic or a range of topics to a group of investors, and whether this could be more effectively facilitated by a shareholder advisory body;
- how the chairman can best ensure that all directors are made aware of the company's major investors' issues and concerns; and

- what strategies a company and its investors should adopt to ensure there is continuing dialogue between them.

The consultation paper requests views on what other mechanisms could be used to encourage good practice engagement.

Details of the consultation can be accessed from ICSA's website (see <http://www.icsaglobal.com/about-icsa/latest-from-icsa/article/stewardship-consultation-launched>).

## A timely opportunity?

Companies and investors may view this consultation as an opportunity to declare their views on stewardship engagement at a time when this matter is a current hot topic of discussion. There is, currently, no single prevailing view regarding what constitutes the best approach for stewardship engagement. The steering group therefore believes that it would be valuable if companies and investors shared their experiences of approaches which have resulted in successful engagements, as well as their views of what approaches they think would result or not result in successful engagements.

## Next steps

Responses to the consultation are due by 30 November 2012, and may be submitted at meetings organised by ICSA to gather feedback, or through written submissions. The ICSA steering group responsible for this consultation intends to issue guidance in March 2013.

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### Footnotes

1 Available here: <http://tomorrowcompany.com/2020-stewardship-improving-the-quality-of-investor-stewardship-the-report-3>

2 Available here: <http://www.bis.gov.uk/assets/biscore/business-law/docs/k/12-917-kay-review-of-equity-markets-final-report.pdf>

3 Available here: <http://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship-Code.aspx>

4 Recommendation 3: an investors' forum should be established to facilitate collective engagement by investors in UK companies, at page 51 of the final report of the Kay Review.

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