

A group of people are silhouetted against a bright, warm light source, likely a window, in a modern office setting. They are seated around a table, engaged in a discussion. The light creates a strong glow and long shadows, emphasizing the collaborative atmosphere.

Q&A on stewardship codes

August 2017

Corporate governance expectations for all market participants have changed since the 2008 financial crisis, including increasing demands as well as a growing sense that governance should serve a broader stakeholder community. For investors, these changes are partly reflected by the growing number of stewardship codes, principles and guidelines (collectively, “codes”) adopted around the world. These codes typically offer guidance to investors on how they should exercise their ownership and governance responsibilities, and how they should interact with the companies in which they invest.¹

Given their potential implications for investor engagement and the wider environment for audit, stewardship codes are an important trend for both corporate boards and investors. The following Q&A provides additional information on stewardship codes and provides EY’s perspective.

¹ The proliferation of stewardship codes is also mentioned in the [Organization for Economic Co-operation and Development’s Principles of Corporate Governance](#) (updated 2015).

1. What are stewardship codes?

Stewardship codes are a tool for enhancing investor engagement and transparency about how investors define and discharge their ownership and governance responsibilities. These codes, which have been developed by regulators or investors, aim to clarify basic governance expectations and responsibilities in ways that enhance the quality of investor-company dialogue and contribute to the long-term success of companies. They also provide a mechanism for investors to communicate their priorities more broadly.

Stewardship codes typically apply to institutional investors (i.e., asset owners and asset managers of equity holdings in listed companies). Institutional investors can include banks, insurance companies, mutual funds and pension funds. In addition, some codes generally apply to service providers (e.g., proxy advisors).

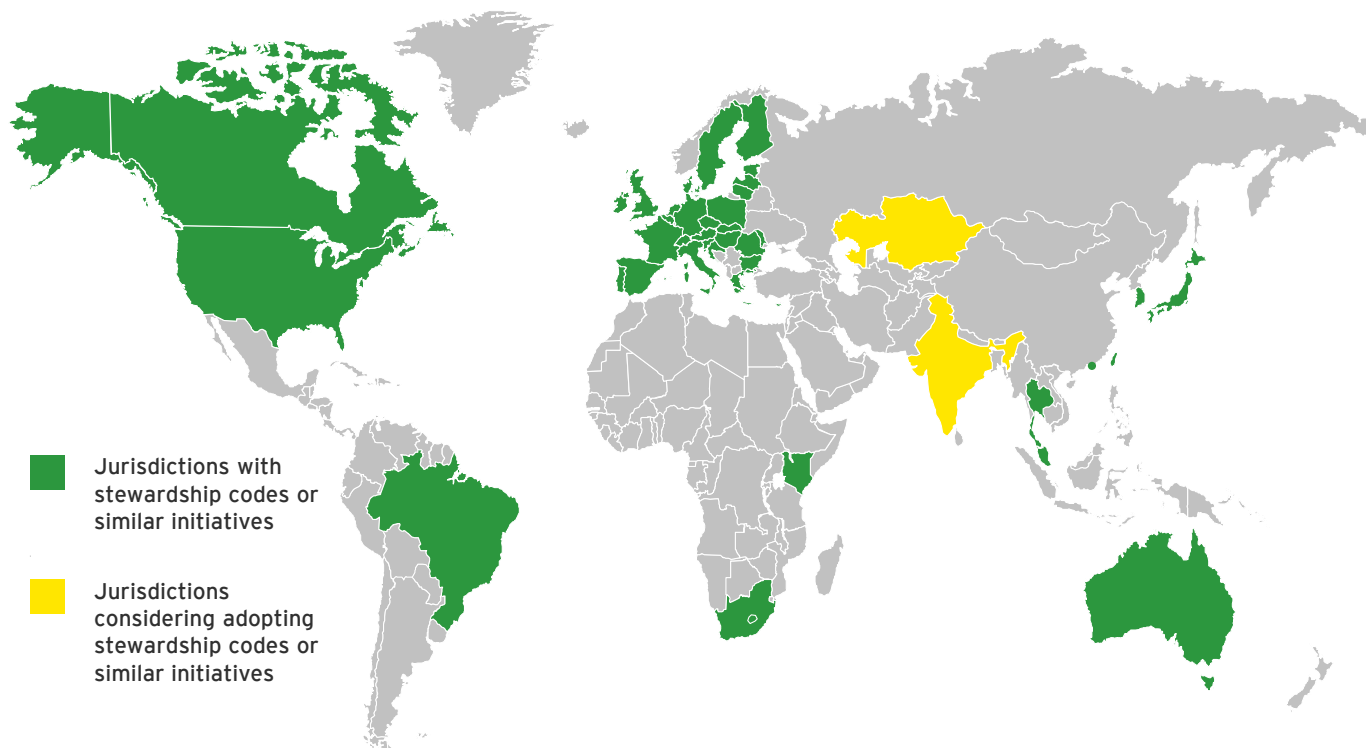
2. How are stewardship codes applied?

Most stewardship codes are voluntary. This means institutional investors are encouraged to become code signatories and to disclose their commitment to the code's principles, where relevant. In the United Kingdom (UK), however, all UK-authorized asset managers (a sub-set of institutional investors) are required to produce a "comply or explain" statement of commitment to the UK Stewardship Code under the UK Financial Conduct Authority's (FCA) Conduct of Business Rules.

3. Where do stewardship codes exist?

In 2010, the UK became the first jurisdiction to adopt a stewardship code, following Sir David Walker's 2009 post-crisis review of corporate governance in UK banks and other financial institutions. A number of other jurisdictions have followed, including Denmark, Hong Kong, Japan, Kenya, Malaysia, South Africa, Taiwan and Thailand. More recently, the European Union (EU) adopted a Shareholders Rights Directive that includes elements found in existing stewardship codes, and India and Kazakhstan are actively considering the adoption of stewardship codes or similar initiatives.²

Investor-led best practice guidance currently exists in Australia, Brazil, Canada, Italy, the Netherlands, Singapore, South Korea, Switzerland and the United States (US).³ In addition, the International Corporate Governance Network (ICGN), whose members represent governance professionals from over 47 countries, adopted Global Stewardship Principles in 2016.



² In April 2017, the European Council adopted a revised Shareholders Rights Directive. New measures include a requirement for institutional investors to publicly disclose their policy for how they integrate shareholder engagement in their investment strategies or explain why they have chosen not to do so.

³ Members of certain membership bodies or associations may also need to adhere to stewardship standards. In Australia, compliance with the Financial Services Council's (FSC) Standards is compulsory for all full FSC members and the FSC has recently developed a new standard focused on internal governance and asset stewardship.

4. How do stewardship codes change corporate governance expectations for investors?

Typically, stewardship codes seek to promote higher levels of investor engagement by encouraging the development and public disclosure of policies on how investor stewardship responsibilities are discharged. These include investor obligations in a number of key governance areas, most commonly: conflicts of interest, voting, monitoring and engaging with the investee company, and the consideration of environment, social and governance (ESG) factors. In addition, stewardship codes often encourage investors to disclose their policies prominently, typically on the investor's web site and/or within an annual report, and to provide annual updates.

Stewardship codes often focus on the following types of investor policies:

1	Identifying and managing conflicts of interest	Investors are encouraged to develop and disclose policies on managing conflicts of interest (i.e., when interests of investors, clients and beneficiaries diverge).
2	Voting	Investors are encouraged to have and to disclose a voting policy, which may include a requirement to vote all shares held. Most codes also encourage the disclosure of voting activities, including the use of proxy voting or other advisory services. Some codes discourage investors from reflexively supporting the board.
3	Monitoring and engaging with the investee company	Investors are encouraged to monitor and engage with investee companies on strategy, performance, risk management, corporate governance arrangements and emerging trends that may have implications for the business. This is intended to deepen investor knowledge and to support the effective management of investee companies. Some codes note that investor engagement with investee companies should not violate applicable insider trading laws and regulations.
4	Consideration of environmental, social and governance (ESG) factors	Investors are generally encouraged to factor ESG considerations into their stewardship activities. The South African code goes further and observes that institutional investors have a responsibility to invest in a way that promotes long-term sustainability.
5	Collective action	Some codes encourage investors to act or engage collectively in certain circumstances, such as during periods of corporate or economic stress or when risks threaten the investee company.

5. Have stewardship codes improved corporate governance?

The existence and adoption of stewardship codes varies widely by country. More time is needed to gauge whether these codes have an impact on improving corporate governance. In Japan, for example, although over 200 institutional investors have signed up to the local code, there has been a noticeable absence of signatories from leading non-financial corporate pension funds.⁴ This has been compounded by concerns about the “mechanical” application of corporate governance reforms as compliance obligations, rather than embracing the measures as good governance.⁵ The Japan Financial Services Agency (JFSA) has since responded by issuing a revised stewardship code with strengthened provisions in a number of areas.⁶

Policy makers in some jurisdictions are also turning their focus to the quality of signatories' disclosures. For example, the UK Financial Reporting Council (FRC) has expressed interest in determining whether signing up to the UK code is a “true marker of commitment”. Last year, the FRC reviewed signatory statements and introduced a public tiering system for UK code signatories in order to improve their reporting.⁷ The FRC recently reported on the impact of the tiering system, and intends to consult on specific changes to the UK Stewardship Code in 2018.⁸

⁴ Financial Times, [Companies fail to buy into Japan's stewardship code](#) (October 2016).

⁵ JFSA, [Principles for Responsible Institutional Investors](#) (Updated May 2017).

⁶ In March 2017, the JFSA consulted on proposed revisions to the local stewardship code for institutional investors. An updated code was issued in May 2017 and changes include strengthened provisions related to managing conflicts of interest, voting and encouraging “collective engagement.”

⁷ The UK FRC has categorized signatories to the UK Stewardship Code into three tiers based on the quality of their statements. Tier 1 (reporting of good quality), Tier 2 (many reporting expectations met) and Tier 3 (significant reporting improvements needed). [Tiering of signatories to the Stewardship Code](#) (November 2016).

⁸ UK FRC, [FRC removes Tier 3 categorization for Stewardship Code signatories](#) (August 2017).

EY believes effective investor engagement strengthens corporate governance and improves the wider environment for financial statement audit. By increasing awareness of investor expectations and responsibilities, stewardship codes may help to drive better engagement between investors and companies and increase a company's emphasis on long-term results. However, the extent of investor engagement is often shaped by the local corporate governance culture and requires adequate resources from investors and investee companies alike. In addition, stewardship codes represent just one tool for investor engagement. Investors can and do engage well with companies in markets where these codes do not exist.

Stewardship codes or similar initiatives

Australia  The Financial Services Council (FSC) Standard 23: Principles of Internal Governance and Asset Stewardship July 2017	Brazil  The Association of Capital Markets Investors (AMEC) Stewardship Code October 2016	Canada  Principles for Governance Monitoring, Voting and Shareholder Engagement, Canadian Coalition for Good Governance December 2010
Denmark  Stewardship Code November 2016	European Union  Revised Shareholders Rights Directive April 2017	Hong Kong  Principles of Responsible Ownership March 2016
International Corporate Governance Network  ICGN Global Stewardship Principles September 2016	India  The Insurance Regulatory and Development Authority of India (IRDAI) decision to implement a stewardship code for insurers March 2017	Italy  Stewardship Principles for the Exercise of Administrative and Voting Rights in Listed Companies Updated September 2016
Japan  Principles for Responsible Institutional Investors Updated May 2017	Kazakhstan  TheCityUK and the Astana International Financial Center Responsible Shareholder Engagement – A Kazakh Stewardship Code March 2017	Kenya  Stewardship Code for Institutional Investors Gazetted June 2017
Malaysia  Malaysian Code for Institutional Investors June 2014	Netherlands  Best Practices for Engaged Share-Ownership, EUMEDION Corporate Governance Forum June 2011	Singapore  Stewardship Principles for Responsible Investors, Stewardship Asia Centre November 2016
South Africa  Code for Responsible Investing in South Africa July 2011	South Korea  Korean Corporate Governance Service (KCGS) Stewardship Code March 2017	Switzerland  Guidelines for institutional investors governing the exercising of participation rights in public limited companies January 2013
Taiwan  Stewardship Principles for Institutional Investors June 2016	Thailand  Thai Securities and Exchange Commission (SEC) Investment Governance Code February 2017	United Kingdom  The UK Stewardship Code Updated September 2012
United States  Investor Stewardship Group (ISG) Stewardship Framework for Institutional Investors January 2017		

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EYG no. 04714-173Gbl

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GA 1005571

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