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This article first appeared in a slightly different form in *Accountancy Age*, 22 July 2010

THE UK STEWARDSHIP CODE: THE END OF ABSENTEE LANDLORDS?

By Rani Mina and James Trentham

The Stewardship Code, whilst not expanding significantly on the existing Institutional Shareholders Committee guidelines, is heralded as being a real step towards promoting active engagement between institutional investors and the companies in which they invest and so improving corporate governance.

There is a strong expectation that institutional investors will voluntarily comply with the Code. It will acquire more teeth if authorised asset mangers are required to report on compliance (or explain why not) which is a move that seems likely to happen, regardless of the Government's plans to reorganise the FSA.

If institutional investors choose to comply, they will need to disclose how they will discharge their stewardship responsibilities. But is it always appropriate for investors to tackle under performance in a company? Some investors may only buy a stock to re-balance their portfolio. What about tracker funds who are required to hold stock in whatever index they are tracking? In theory, they should have more incentive to take an active stance because they must hold the stock, but this may not fit with their business model, which is often built around a low cost tracker service, not a higher cost interventionist strategy.

In practice, this will depend largely on what investors are seeking to achieve. Ultimately, all institutional investors seek to ensure an attractive return to their clients, who may be better served by selling an underperforming stock and moving on, rather than tying up time and resource by engaging closely with a Board on the future direction of a company. Those investors who do choose to comply will still need to monitor the costs of doing so to ensure that increased activism does in fact pay.

They will also need to assess, before taking action, whether they are prepared to become insiders and potentially lose the ability to trade out of a stock for a period of time. This risk arises in any discussions with a Board about a company's strategy and is one that the Code recognises, but offers little guidance on how to manage. Questions remain about whether investors will cross the line to become insiders in the name of responsible stewardship.

Even compulsory reporting will not necessarily provide the level of engagement the Code seeks to encourage. It is the openness and liquidity of the UK's capital market which makes it increasingly attractive to foreign investors, who may not be within the UK regulator's remit. There is nevertheless an expectation that, in the post-Walker world, companies will have increasing numbers of investors with more transparent stewardship policies. The best encouragement for other investors to apply the Code's principles is if this does indeed influence a company's share price over time and improve long-term

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returns to investors. If so, the problems identified are likely to be overcome, with the Code developing into a significant piece of the UK regulatory regime, in much the same way as the original Combined Code has developed over nearly 20 years into the Corporate Governance Code of today.

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August 2010