GAZETTE NOTICE NO………

THE CAPITAL MARKETS ACT
(Cap 485A)

DRAFT STEWARDSHIP CODE FOR INSTITUTIONAL INVESTORS, 2015

IN EXERCISE of the powers conferred by sections 11(3) (d) and 12A of the Capital Markets Act, the Capital Markets Authority issues the Stewardship Code for Institutional Investors, 2015 set out in the Schedule hereto, for application by institutional investors investing in the capital markets.

SCHEDULE

DRAFT STEWARDSHIP CODE FOR INSTITUTIONAL INVESTORS

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I. DEFINITIONS

- **Institutional investors** are Asset Owners and Asset Managers with equity holdings in public listed companies.

- **Stewardship** means the responsible management and oversight of assets for the benefit of the institutional investors' ultimate beneficiaries or clients.

- **Code** means the Stewardship Code for Institutional Investors, 2015.

- **Asset Owners** are the collective investment vehicles which collect funds on behalf of their beneficiaries or clients and manage them internally or externally and include pension funds, private pension scheme providers, insurance companies, takaful operators and investment trusts.

- **Asset Managers** are the agents of asset owners who provide fund management and other investment services on a commercial basis to asset owners pursuant to an investment management agreement or the governing documents of individual investment funds and often act as stewards and nominees of asset owners.

- **Service providers** include-
  - custodians as agents responsible for maintenance and safekeeping of records of the asset owners and asset manager's assets, including sub-custodians
  - proxy advisors, investment consultants and trustees as agents who undertake functions mandated by asset owners and asset managers to support their activities.

- **Apply or Explain** means that the principles and best practices in the Code should be applied by institutional investors and an explanation must be given for any departure or non-adherence.

II. INTRODUCTION TO THE CODE

In October 2012, the Capital Markets Authority (CMA) commenced the process towards the reform of corporate governance legal and regulatory framework for public listed companies. The reforms sought to update corporate governance requirements, align standards to global best practice and establish institutional strengthening for listed companies, market intermediaries and the investors.

In 2014, the Code of Corporate Governance for Issuers of Securities to the Public was finalized. One of the principles set out by the Corporate Governance Code is the need for institutional investors to have transparent, honest and fair practices in their dealings with the companies in which they invest so as to promote sustainable shareholder value and long term success of such companies. In view of the recommendations under the Corporate Governance Code, CMA together with institutional investors, government bodies and other stakeholders developed the Stewardship Code for Institutional Investors. The development of the Code was coordinated by the Capital Markets Stewardship Code Committee composed of representatives from government, institutional investors and capital market players[1].

Stewardship can be defined broadly as the responsible management of something entrusted to one's care. This suggests a duty of care on the part of those agents entrusted with management responsibility to act on behalf of the end beneficiary.

The purpose of the Stewardship Code (the Code) is to encourage the institutional investment community to take action to serve as responsible stewards for their beneficiaries and to help to promote good corporate governance and the sustainable success of listed companies (issuers) in the capital markets. The Code seeks to enhance the market's further growth and development.

The Code reflects the commitment of CMA and institutional investors to establish effective institutional investor stewardship practices in the capital market. The Code sets out seven stewardship principles and guidance on their application. It also highlights the roles of all the parties involved in the implementation and monitoring of the Code including asset owners, asset managers, listed companies and CMA.

[1] The following institutions were represented in the Committee: National Treasury, Insurance Regulatory Authority, National Social Security Fund, The Actuarial Society of Kenya, Association of Retirement Benefits Schemes, Fund Managers Association, Listed companies and the Association of Kenya Insurers

III. APPLICATION OF THE CODE

1. The Code applies to asset owners and asset managers domiciled in Kenya with regard to their investments in companies whose equity is listed on the Nairobi Securities Exchange (NSE). Overseas institutional investors in Kenyan equities are encouraged to become signatories to the Code. The Code seeks to reinforce the implementation of the Corporate Governance Code to ensure that listed companies adhere to the corporate governance requirements. This will be achieved through engagements between institutional investors and listed companies to improve the long term return to shareholders and the efficient exercise of governance responsibilities

2. In cases of controlling foreign ownership by multinationals, the controlling owner may also be an important party to stewardship discussions, balancing the interests of the global multinational with the interests of minority shareholders in the NSE, and thereby providing a potentially robust engagement theme.

3. In the investment context, stewardship calls for diligence on the part of institutional investors, both asset owners and asset managers, to exercise ownership rights actively and responsibly as part of their fiduciary responsibility to their clients. The role of a stewardship code is to codify the key institutional investor responsibilities that come with ownership rights and to provide guidance on how institutional investors should act as responsible stewards in their oversight of issuers. A stewardship code also articulates the commitment that institutional investors make to their clients to address these responsibilities.

4. While listed companies as issuers are not themselves signatories to the Code, they also have a role to play to make the Code effective, through cooperating in good faith with institutional investors, particularly in the engagement process, and more generally in respecting shareholder rights.

5. For an "apply or explain" system to be effective, an issuer's explanation of non-application with the Corporate Governance Code needs to be monitored to ensure its explanations are well-reasoned, convincing and provide for acceptable governance arrangements in the event of non-application. This is where institutional investors have a role to play.

6. In the event that an issuer's explanations are inadequate, it is the role of institutional investors to monitor issuer non-application and to use ownership rights to challenge issuers when necessary. Without the active monitoring of explanations by institutional investors, an "apply or explain" system would lack an ultimate means of enforcement or influence. The Code therefore plays a critical role in providing a market-based system for institutional investors to hold issuers to account for their corporate governance practices. The application of the Code requires willingness and good faith on the part of institutional investors.

7. The signatories to the Code agree to either apply the Principles of the Stewardship Code in their investment practices or explain why specific aspects of the provisions may not have been adhered to. This statement is to be displayed publicly on the institutional investor's own website and on CMA's website.

IV. CORE PRINCIPLES OF THE CODE

The Stewardship Code is based on seven core Principles:

Principle 1: **Stewardship/Responsible Investment Policies**

Institutional investors should develop a policy on how the institutional investor approaches stewardship and responsible investment.

Principle 2: **Monitoring Companies Held in Investment Portfolios**

Institutional investors should actively monitor issuers in terms of strategy, risk, performance, governance and other factors that influence sustainable long-term success.

Principle 3: Active and Informed Voting Practices

Institutional investors should ensure that their equity positions are voted diligently at shareholder meetings and in a way that supports good corporate governance practices.

Principle 4: Engagement, Escalation and Collaboration with Other Institutional investors

Institutional investors should engage with issuers to build dialogue and understanding, and to express concerns or exert influence in areas that give rise to concern; this can include collaboration with other institutional investors, as well as escalation of engagement if concerns regarding an issuer persist.

Principle 5: Conflicts of Interest

Institutional investors should have an effective process in place for identifying and managing conflicts of interest that might interfere with their obligations to act in the interests of clients or beneficiaries.

Principle 6: Focus on Sustainability Issues, Including Environmental, Social and Ethical Factors

Institutional investors should act responsibly in promoting sustainable markets and societies, and should factor environmental, social, and ethical issues into their investment process.

Principle 7: **Public Disclosures and Client Reporting**

Institutional investors should publicly disclose their stewardship policies and activities relating to stewardship.

V. GUIDANCE ON THE APPLICATION OF THE CODE

Principle 1: Stewardship/Responsible Investment Policies

Institutional investors should develop and disclose publicly a policy on how they approach stewardship and responsible investment.

Guidance:

- **1.1** Policies on stewardship are a critical foundation to the development and execution of stewardship practices. Such policies should address the seven Principles of the Stewardship Code.
- **1.2** Stewardship policies should include supporting explanations of how these policies are applied in the investment process. This should include the approach to stewardship in the following areas:
    - Investment analysis--including the integration of environmental, social and governance (ESG) factors
    - Voting at shareholder meetings
    - Engagement with issuers
    - Managing conflicts of interest
    - Client/beneficiary reporting
- **1.3** Stewardship policies need not be lengthy documents, but should be clear and specific with regard to scope, and should carry the explicit endorsement of the institutional investor and executive management.
- **1.4** Institutional investors may choose to establish one overarching policy document that takes into consideration the individual Principles of the Code
- **1.5** Not all individual components of a stewardship policy need be in the public domain. For example, an institutional investor may wish to develop its own proprietary approach to voting guidelines, or conflict of interest protocols may exist in other internal compliance documents. In such cases the institutional investor should confirm that such protocols exist even if not all the details or underlying documents are in the public domain

Principle 2: Monitoring Companies Held in Investment Portfolios

Institutional investors should actively monitor issuers in terms of strategy, risk, performance, governance and other factors that influence sustainable long-term success.

Guidance:

- **2.1** Monitoring involves keeping track of issuer performance, including internal and external developments.
- **2.2** Institutional investors should hold regular meetings with issuer management and directors to discuss financial, strategic and governance matters; this can also be linked to engagement activity.
- **2.3** Institutional investors should seek to develop an understanding of executive management leadership and the quality of board oversight.
- **2.4** In addition to traditional forms of financial monitoring, a key dimension of monitoring issuers under the Stewardship Code is to develop an understanding of an issuer's governance practices and the extent to which they support minority investor interests.

In particular this calls for institutional investors to monitor issuer non-compliance with governance codes and to assess the quality of explanations of non-compliance. Monitoring of this nature is essential if the “apply or explain” Code of Corporate Governance is to have impact.

2.5 Institutional investors should seek to develop analytical tools to assess financial and operational risks, including environmental, social and governance risks, and to integrate these factors within traditional investment research and analysis.

Principle 3: Active and Informed Voting Guidelines and Practices

Institutional investors should develop responsible voting guidelines to allow them to vote their equity positions diligently and in a way that supports good corporate governance practices.

Guidance:
Voting should cover all shares held, and this should be reflected in the overarching stewardship policy.

3.1 Institutional investors should develop guidelines on voting in conjunction with the broader policy on stewardship. Such guidelines would reflect broad principles of corporate governance as presented in the Corporate Governance Code and have relevance for the nature of the specific resolutions presented for voting at shareholder meetings.

3.2 Voting guidelines should provide guidance to institutional investors in identifying the types of governance practices that might justify voting for or against a management resolution. Specific guidelines might reflect how negative voting activity could be triggered in shareholder meeting resolutions relating to director elections, approval of financial statements, appointing the auditor, approval of director remuneration, issuance of capital or other corporate actions.

3.3 Voting guidelines may exist separately from the broader stewardship policy. Such voting guidelines can be more granular and proprietary to the individual institutional investor.

3.4 Institutional investors should be prepared to vote against (or abstain on) management resolutions when these conflict with their voting guidelines or good corporate governance practices.

3.5 Institutional investors should endeavour to communicate with the issuer the reasoning behind any resolutions that they did not support. Ideally this communication would take place before the shareholder meeting, but if that is not possible this could take place following the shareholder meeting.

3.6 Disclosure of the institutional investor’s voting record should be a standard feature of reporting to clients. Public disclosure of voting outcomes by institutional investors is encouraged.

Principle 4: Engagement, Escalation and Collaboration with Other Institutional Investors

Institutional investors should engage with issuers to build dialogue and understanding, and to express concerns or exert influence in areas that give rise to concern; this can include collaboration with other institutional investors, as well as escalation of engagement if concerns regarding an issuer persist.

Guidance:

4.1 Engagement should be viewed as a constructive dialogue between institutional investors and issuers. In the context of the Stewardship Code, the purpose of engagement is to promote sustainable company success over the long term.

4.2 Engagement can take many forms, including face to face meetings, letters, emails, telephone conversations, and to various levels of the issuer, including both its executive management and the board.

4.3 The scope of engagement dialogue is broad, and can extend to any area which has relevance for the issuer's ability to provide sustainable long-term returns to institutional investors. This can include topics such as strategy, risk, shareholders rights, board effectiveness, remuneration, ethics, and corporate responsibility.

4.4 A key area of engagement should relate to corporate governance, particularly in cases of non-compliance with the corporate governance code.

4.5 Institutional investors should address how issuers are prioritised for engagement in terms of risk, holding size or other factors.

4.6 A clear approach to escalation should exist to provide guidance on how an institutional investor should handle difficult situations that require resolution. This can include meeting with board members, making public statements, filing resolutions, requisitioning for general meetings where necessary or making portfolio decisions about individual holdings.

4.7 Institutional investors should be prepared to collaborate when an engagement message is most effectively or efficiently achieved in the context of a larger group of institutional investors.

4.8 Institutional investors may wish to develop or make use of institutional investor associations to facilitate collective engagement. Institutional investor associations can be formal or informal arrangements for institutional investors to come together to cooperate collectively on promoting good corporate governance in issuers and responsible investment practices by institutional investors.

Principle 5: Conflicts of Interest

Institutional investors should have a robust process to identify and manage conflicts of interest that might interfere with obligations to act in the interests of clients or beneficiaries. This approach to conflicts of interest should be addressed in the institutional investor's stewardship policy.

Guidance:

5.1 A defined approach to addressing conflicts of interest should reflect explicit recognition of the need for institutional investors to act in the interests of clients (including asset owners) and end beneficiaries (including pensioners, holders of insurance products and individual savers). This can be included within the broader stewardship policy, or could also exist as a standalone document.

5.2 Real or potential conflicts of interest should be managed, using tactics including firewalls and segregation of duties.

5.3 The approach for managing conflicts of interest should be publicly disclosed.

5.4 Particular care should be taken in voting and engagement activity when the institutional investor is an interested party. Examples include investment holdings in related companies held in client portfolios (such as corporate pension fund clients).

5.5 Institutional investors are encouraged to disclose how conflicts of interest are identified and overseen. In the event that a formal policy is not disclosed they should be prepared to discuss with clients and regulators how conflicts are identified and mitigated.

Principle 6: Focus on Sustainability Issues, Including Environmental, Social and Ethical Factors

Institutional investors should act responsibly in promoting sustainable markets and societies, and should factor environmental, social, and ethical issues into their investment process.

Guidance:

6.1 The Corporate Governance Code has a standalone section on Ethics and Social Responsibility, which relates to the role of listed companies in contributing to responsible social outcomes as a dimension of good corporate governance. Accordingly, the Stewardship Code reflects the importance of institutional investors focusing on these sustainability factors as part of their monitoring of issuer compliance to the Corporate Governance Code.

6.2 Both institutional investors and issuers need to build awareness and sensitivity with regard to the impact of companies on key long-term stakeholders and society at large. Institutional investors should call for ethical and responsible conduct by listed issuers as a component of their engagement activity.

6.3 In the investment context, the main focus of institutional investors is on those aspects of social, environmental and ethical practice by issuers that may pose a material commercial risk or opportunity. Attention to these sustainability issues in the investment process should be regarded as part of an institutional investor's fiduciary responsibility to the ultimate beneficiaries.

6.4 Institutional investors are called upon to act responsibly, both as a matter of ethics and as a way to promote greater systemic health and stability.

6.5 As a matter of responsible investment practice and for full consideration of "non-financial" risks facing issuers, institutional investors should factor an issuer's social, environmental and ethical performance into monitoring, voting and engagement activities. Relevance of an ESG factor may depend on each investor's investment policy and may differ according to specific investee companies.

6.6 Integrated reporting should allow for material environmental, social and ethical factors to be linked to an issuer's performance drivers. Institutional investors may wish to advocate issuer adoption of integrated reporting as a dimension of their engagement outreach.

6.7 To the extent that issuer disclosures on its sustainability performance are limited, or do not allow for a full understanding of related risks and opportunities, institutional investor engagement should include calls for more robust issuer disclosure of material social, environmental and ethical factors. This will include how the companies address risks arising from social and environments matters.

Principle 7: Public Disclosures and Client Reporting

Institutional investors should publicly disclose their policies and activities relating to stewardship.

Guidance:

7.1 Institutional investors should confirm annually their compliance to each of the seven Principles of the Code to CMA. This statement of compliance should be a matter of public record on both the institutional investor's website and CMA website.

7.2 Institutional investors should systematically record their engagement with issuers, investment analysis and voting activity.

7.3 Institutional investors should disclose key aspects of this stewardship activity in regular client reporting.

7.4 Key features of engagement activity and performance should be disclosed publicly, at least on an annual basis.

7.5 Public disclosure on voting is regarded as best practice.

5.6 External assurance of stewardship activities by an independent auditor is encouraged as best practice.

V. IMPLEMENTATION AND MONITORING OF THE CODE

CMA will monitor Stewardship Code take-up by the institutional investment community, and will develop views on the quality of Code's implementation and effectiveness. However it is also critical that the monitoring of an individual asset manager's compliance to the Code should be undertaken by its asset owner to ensure that the asset manager's activities support the Code in a manner consistent with the asset owner's expectations.

Monitoring of the asset owner's Code compliance should be undertaken by the asset owner's trustees to ensure that the asset owner is taking the necessary steps to conform to the Stewardship Code on behalf of the asset owner's end beneficiaries.

1. What do Asset Owners need to do?

Asset owners should-

- champion the Code.
- together with their representative bodies, publicly support the Code by becoming signatories.
- develop policies on stewardship outlined in the Code including:
    - overarching responsible ownership policy
    - voting
    - conflicts of interest
- establish compliance with the Code as a component of asset management mandates, and call on asset managers to become signatories to the Code.
- call for asset managers to consider sustainability/ environmental, social and ethical issues, both as an aspect of risk assessment and responsible investment.
- show diligence in overseeing that asset managers take on these tasks, and should call for disclosures and reporting from asset managers along stewardship performance, not just financial performance reports.
- encourage and facilitate training in stewardship and fiduciary duties.

2. What do Asset Managers need to do?

Asset managers should-

- be willing to become Code signatories and take on these responsibilities in support of the Code's seven Principles.
- post their statement of Code compliance on their own websites, in addition to sending these on to CMA.
- meet with issuers and provide constructive engagement in support of the Code and to promote long-term company success.
- be open to forming institutional investor associations or use existing associations to promote collective engagement.
- develop and implement policies on stewardship outlined in the Code including:
    - overarching responsible ownership policy
    - voting guidelines
    - conflicts of interest
- vote actively on behalf of the asset owner, based on governance policies and without relying solely on custodians.
- be willing to oppose management resolutions where necessary.

3. What do Listed Companies (Issuers) need to do?

Listed companies should-

- engage with institutional investors, including in collective meetings with a number of institutional investors
- provide the opportunity for institutional investors to engage with both company executive management and with board members when relevant to governance concerns
- establish an investor relations function. If a formal investor relations function does not exist, issuers should identify a point of contact to support institutional investors in terms of providing access to management and a source for information requests
- engage with institutional investors that might oppose or challenge company actions or resolutions at shareholder meetings, and should not withhold access to institutional investors acting in good faith to uphold their responsibilities under the Code
- provide sufficient disclosure about governance and sustainability performance to provide "hooks" for institutional investor dialogue
- introduce voting by poll, rather than show of hands, during shareholder meetings to ensure that all investor votes are taken into consideration and to better understand areas where institutional investors may have concerns
- encourage corporate pension funds to consider stewardship responsibilities as asset owners
- identify potential training needs and facilitate relevant training for management and board members relating to engagement and institutional investor stewardship initiatives

4. What does CMA need to do?

CMA should-

- serve as champion and promoter of the Code in the capital markets;
- encourage institutional investors to become Stewardship Code signatories, and also encourage issuers listed on the Nairobi Securities Exchange or any other exchange to engage with institutional investors as part of the stewardship process;
- seek to build support for the Stewardship Code among relevant institutional investor representative bodies, market participants and public sector bodies;
- establish a section on its website where it hosts the statements of Stewardship Code application by institutional investors for public display;
- monitor the adoption of the Stewardship Code by institutional investors who are signatories. CMA can choose as to whether it prefers to use its own resources or engage third-party assistance to monitor the Code's take-up and effectiveness. As part of this process CMA may undertake or commission an annual survey of market participants including asset owners, asset managers and issuers to gauge the effectiveness of the Code;
- report on its monitoring of the Stewardship Code and its assessment of the Code's effectiveness, as well as the effectiveness of the "apply or explain" framework;
- periodically review the language of the Stewardship Code, particularly as the Corporate Governance Code undergoes changes, to ensure the Code remains relevant and up-to-date;
- periodically convene meetings and workshops involving Stewardship Code signatories to discuss the Code's effectiveness and best practices in implementing the Principles of the Code.