Response to the Consultation on the Wates' Principles of Corporate Governance: Stewardship Alliance

This response has been authored by Tomorrow's Company on behalf of the Stewardship Alliance, comprising colleagues from Aviva, Blackrock, Legal & General Investment Management, RPMI Railpen, USS and HSBC Global Asset Management. The aim of this group has been to improve the stewardship of listed assets by the UK investment chain. The group has been working together with Tomorrow's Company since 2012 when it produced 2020 Stewardship: improving the quality of investor stewardship, which helped lay the foundations for the adoption by the pensions industry of a Stewardship Framework and a new guide for investor engagement published by the ICSA. This in turn followed work by Tomorrow's Company in 2008, called Tomorrow's Owners: stewardship of tomorrow's company, which helped lay the ground for the Stewardship Code.

In responding to the consultation, we draw on our collective experience as representatives of major institutional investors, as well as the work we have produced through consultations with groups and individuals across the investment chain. These can be accessed at - Better Stewardship, Stewardship 2020.

This response was collated and penned by Tomorrow's Company but remains distinct from their response.

Our Response

We support the overall intention of the Principles in their encouraging better disclosure of the governance arrangements of private companies. As outlined in our Better Stewardship report we believe wholeheartedly in the importance of a good quality engagement between investor and company, and that this should be underpinned by appropriate disclosure and accountability. We also recognise the need for the principles of corporate governance to be applied in a proportionate way to unlisted companies.

However, we feel the approach in the current text is potentially too high-level. One alternative approach to addressing this issue could have been to take the UK Corporate Governance Code and remove elements which were excessively prescriptive for Private Companies. This would have ensured greater alignment of messaging to companies, aiding high-growth potential private companies who may wish to go public at some point. In drafting the final Principles, we would recommend the committee review any areas where they could be made better aligned to the UK Corporate Governance Code, particularly around remuneration (as mentioned below).

We would also flag that we as investors have a common set of governance priorities for listed and unlisted companies i.e. we will discuss board diversity, independence etc with both groups, even if we may be more flexible on interpretation of those priorities for smaller private companies. We feel it is important that the Principles map on to widely regarded understanding of what constitutes good governance, so as to be meaningful for those companies and investors that already look at measures of corporate governance.

Finally, we would also emphasise the value of encouraging companies to disclose information about their environmental and social issues, and recommend the Principles and/or guidance explicitly mention ESG reporting.

Consultation questions

Consultation: Wates Corporate Governance Principles for Large Private Companies (June 2018)

1. Do the Principles address the key issues of the corporate governance of large private companies? If not, what is missing?

We would emphasise explicitly the value of encouraging companies to report on ESG, and that the guidance should therefore include environmental and social issues (as well as their governance). This is largely missing from the Principles as they stand, and could be included in the guidance on Responsibilities.

Connection with stewardship code. It may be beneficial to include in the guidance explicit mention of the Stewardship Code, and their mutual interest in encouraging better corporate governance through better engagement between companies and their investors/shareholders/bondholders. We would highlight the importance of considering how the current stewardship principles (and the reviewed principles when they are published) apply to the relationship between companies and bond holders, and how this can be used and adopted with the Principles.

2. Are there any areas in which the Principles need to be more specific?

Purpose: In relation to "Key shareholders, the board and management must own and maintain a commitment to embedding the company's desired culture throughout the organisation."- we would be concerned that it is not feasible to expect shareholders to own and embed the company's desired culture. This should be the responsibility of management, while the board should reflect and embody the culture to set 'tone from the top', and the shareholders to engage with the board on the issue of culture.

Responsibilities: 'clear corporate governance practices' and 'company leadership working together to deliver long-term value' are aspects of good stewardship (rather than concepts that 'give insight to' stewardship). We agree with the importance placed on engaging with the entire investor chain, including companies, to promote better stewardship. We recommend that the wording states that these 'promote' stewardship (rather than 'giving insight' to, which is more aligned with reporting).

Stakeholders: While we appreciate that the wording around Stakeholders is primarily drawn from the Section 172 requirements for directors to account for the views of wider stakeholders (i.e. 'non-shareholders') we feel this Principle and the guidance should still include explicit mention of shareholders/investors/bondholders as one of the major stakeholders that directors and boards need to account for. It is not clear for instance why the Principle explicitly states 'including the workforce' over any other stakeholder, and it may be more appropriate to simply state material stakeholders and then use the guidance to expand on what good engagement with all stakeholders could look like: we note that the guidance also includes explicit outline of workforce engagement but does not mention other specific stakeholder engagement.

3. Do the Principles and guidance take sufficient account of the various ownership structures of private companies, and the role of the board, shareholders and senior management in these structures? If not, how would you revise them?

No response or comment.

4. Do the Principles give key shareholders sufficient visibility of remuneration structures in order to assess how workforce pay and conditions have been taken account in setting directors' remuneration?

We agree that the board should establish a clear policy on the transparency of remuneration structures that enable effective accountability to key shareholders. As outlined in our opening statement we feel that there is an opportunity to draw on the UK Corporate Governance Code, take the current Corporate Governance Code and then removing elements which are excessively prescriptive, as it encourages companies to provide visibility of remuneration structures. This will ensure greater alignment of messaging to companies and provide greater insight to shareholders.

5. Should the draft Principles be more explicit in asking companies to detail how their stakeholder engagement has influenced decision-making at board level?

At a recent series of consultation events held by Tomorrow's Company and the Stewardship Alliance four roundtables were conducted with 75 participants including asset managers, asset owners, investment consultants, pension funds, investment institutions, businesses and advisory and representative groups. The aim of the discussion was to bring together representatives of the whole stewardship chain to discuss improvements and recommendations to better stewardship. it was pointed out that the voice of the 'stakeholder' is broad, and that any one individual is at once a representative of many different stakeholder groups (being, for instance, an employee of a company, a shareholder of another through pensions investment, part of a supply chain of another, a customer, *etcetera*). We feel this could be acknowledged in the guidance, and companies encouraged to think creatively about how they are engaging, how they report on this engagement and how the engagement has influenced decision making at board level. Given that private companies are likely to have a broad range of differing ownership and shareholding models we also think this is an opportunity to mention these different kinds of ownership, to acknowledge that these differing owners and investors are stakeholders themselves.

6. Do the Principles enable sufficient visibility of a board's approach to stakeholder engagement?

See comments above.

7. Do you agree with an 'apply and explain' approach to reporting against the Principles? If not, what is a more suitable method of reporting?

Overall, we are in favour of any measure that encourages good quality disclosure and accountability, and welcome the flexibility of the approach that will encourage companies away from boiler-plating. Our only concern is that the high-level nature of the Principles will make reporting against these Principles more difficult, and not lead to greater disclosure or detail for stakeholders and shareholders.

8. The Principles and the guidance are designed to improve corporate governance practice in large private companies. What approach to the monitoring of the application of the Principles and guidance would encourage good practice?

As above, we feel that this will be driven by good quality disclosure and accountability. While we want to see improvement in corporate governance, we also want to encourage companies to improve their disclosure, which will enable better investment decisions and more sustainable companies.

9. Do you think that the correct balance has been struck by the Principles between reporting on corporate governance arrangements for unlisted versus publicly listed companies?

No response.