

## LAPFF FRC Stewardship Code Consultation Response 2019

### Summary

- LAPFF welcomes the opportunity to respond to the 2019 Stewardship Code Consultation. The Forum also welcomes the aim of proposed Code to increase transparency and accountability for stewardship throughout the investment chain, including in relation to environmental, social and governance (ESG) issues.
- There are a few areas in which LAPFF considers the proposed Code could be further clarified or strengthened. For example, ESG considerations could be more explicitly acknowledged as potentially material financial considerations and included in the Principles elements of the Code. To this end, LAPFF recommends more direct links to legal standards on ESG, such as the Companies Act, Shareholder Rights Directive, and the Modern Slavery Act and environmental law, to name a few, be made. Any references to legal standards underpinning the Code should also be made in the Principles sections of the Code as ‘must haves’, rather than in the Provisions sections or the Guidance, which are, respectively, ‘should haves’ and ‘could haves’.
- Certain fundamental principles, such as conflicts of interest, should also be brought to the fore. Conflicts of interest should be dealt with in a comprehensive manner at the Principles level. Accountability is another principle that should be emphasised more substantially. For example, the Forum would prefer not to see the 2012 Code voting chain provisions deleted from the 2019 Code. To the contrary, voting chain disclosure and accountability should be a core point of emphasis in the new Code.
- The introduction to the proposed Code could benefit from an explanation of how it is envisioned that the Corporate Governance Code and the Stewardship Code will work together. Clarification of alignment between responsibilities of asset owners, asset managers and service providers would also be welcome. Notwithstanding the concerns about different roles and responsibilities of service providers and a prior attempt to bring them within the main body of the Code, it would be good to include all three categories side by side in the Provisions tables to reinforce the need for the entire investment chain to work together on stewardship.

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## LIST OF CONSULTATION QUESTIONS

Q1. Do the proposed Sections cover the core areas of stewardship responsibility? Please indicate what, if any, core stewardship responsibilities should be added or strengthened in the proposed Principles and Provisions.

**It is worrying that the requirement for institutional investors to vote all shares held has been removed from the proposed Code. This requirement seems a fundamental responsibility of all institutional investors, including for their ability to exercise their ESG duties and responsibilities.**

**Additionally, there are areas that could be strengthened. For example, elements addressing conflicts of interest should be elevated to the level of 'Principles' rather than left in 'Guidance'. There is also a section on effective monitoring that has been moved to Guidance but that appears to be part of investors' fiduciary duty; this should also be included at the 'Principles' level. To this end, it should be clear in the translation of the 2012 Code Principle 4 Guidance that ESG factors can be financially material, in which case institutional investors might be obligated to intervene or act as part of their fiduciary duty.**

Q2. Do the Principles set sufficiently high expectations of effective stewardship for all signatories to the Code?

**The new Code should require greater transparency of the investment chain. Therefore, a disclosure of how institutional investors engage and use asset managers and investment advisors is critical and should be elevated to the level of 'Principle' in the new Code. Additionally, taking into account the challenges cited with adding Service Providers alongside Asset Owners and Asset Managers in the tables, it would be helpful to set out the service provider provisions alongside those of asset owners and asset managers so that this chain, and decision-making within it, is clear to the investment community, including beneficiaries.**

Q3. Do you support 'apply and explain' for the Principles and 'comply or explain' for the Provisions?

**The difference is not explained sufficiently – there would need to be greater clarity to make an assessment. However, in any case, creating divergent standards in a single tool could be conceptually and practically problematic.**

Q4. How could the Guidance best support the Principles and Provisions? What else should be included?

**The Principles appear to be 'must haves', the provisions 'should haves', and the guidance 'could haves'. This construction is fine. It must just be clear that any reference to legal standards must be in the Principles – not the Guidance - as they are obligations, not discretionary.**

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Q5. Do you support the proposed approach to introduce an annual Activities and Outcomes Report? If so, what should signatories be expected to include in the report to enable the FRC to identify stewardship effectiveness?

**In principle, LAPFF supports the annual activities and outcomes report. However, in practice, it must be aligned with, or better yet use, other reporting tools such as the PRI reporting framework where possible so as not to place an undue administrative burden on reporting entities. Signposting to these reports is helpful, but any extent to which they can be integrated into the FRC framework would be best.**

Q6. Do you agree with the proposed schedule for implementation of the 2019 Code and requirements to provide a Policy and Practice Statement, and an annual Activities and Outcomes Report?

**Again, yes in principle, but it must be concise, relevant, and should not place an undue administrative burden on reporting entities.**

Q7. Do the proposed revisions to the Code and reporting requirements address the Kingman Review recommendations? Does the FRC require further powers to make the Code effective and, if so, what should those be?

**At this point, the second question is no longer relevant. We will have to wait for details about the new regulator to assess this further, but the new regulator will need improved enforcement powers to ensure that the Code is effective. This will make clear whether the outcomes and effectiveness aspect of the new Code called for by the Kingman assessment is sufficient or needs further strengthening.**

Q8. Do you agree that signatories should be required to disclose their organisational purpose, values, strategy and culture?

**Yes, this disclosure should be required and compared with signatory stewardship practice to ensure there is consistency in policy and practice.**

Q9. The draft 2019 Code incorporates stewardship beyond listed equity. Should the Provisions and Guidance be further expanded to better reflect other asset classes? If so, please indicate how?

**In principle, the entire Code should be further expanded to better reflect other asset classes. A good starting point would be to have asset managers disclose stewardship in relation to fund-level marketing prospectuses as these prospectuses should reflect good stewardship policies and practices as a differentiating factor for investors. Where they do not, investors and beneficiaries need to know.**

Q10. Does the proposed Provision 1 provide sufficient transparency to clients and beneficiaries as to how stewardship practices may differ across funds? Should signatories be expected to list the extent to which the stewardship approach applies against all funds?

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As in Q9.

Q11. Is it appropriate to ask asset owners and asset managers to disclose their investment beliefs? Will this provide meaningful insight to beneficiaries, clients or prospective clients?

**Yes, this is an appropriate request. It is equivalent to asking companies to disclose their policies on a range of issues. Not only will these beliefs flag different investment approaches, but they will serve as a check against what asset owners and asset managers are doing in practice. If there is a discrepancy, this should be noted and addressed.**

Q12. Does Section 3 set a sufficiently high expectation on signatories to monitor the agents that operate on their behalf?

**ESG factors should be explicitly included in the expectations of what signatories need to monitor at agents operating on their behalf. As mentioned above, it would also be helpful to include service provider expectations alongside the expectations for asset owners and asset managers so that the Code provides a clear visual and conceptual link through the investment chain.**

Q13. Do you support the Code's use of 'collaborative engagement' rather than the term 'collective engagement'? If not, please explain your reasons.

**It is important to be careful using the term 'constructive engagement'. This was a Reagan-era term used to describe US engagement with apartheid South Africa, effectively justifying US links to an unjustifiable regime. Especially in the stewardship and ESG context, the historical use of this term is problematic. Therefore, either 'collaborative engagement' or 'collective engagement' are preferable terms. The justification provided for the former term is adequate.**

**Furthermore, it would be helpful to know if 'collective engagement' gives rise to concert party concerns, especially in markets where collaborative engagement is less well known (but obviously not the UK). LAPFF engages in collaborative engagement which still allows for individual engagement with the companies concerned.**

Q14. Should there be a mechanism for investors to escalate concerns about an investee company in confidence? What might the benefits be?

**LAPFF cannot currently comment on this point as it remains to be seen whether the structure and capacity of the FRC's successor can accommodate this type of mechanism.**

Q15. Should Section 5 be more specific about how signatories may demonstrate effective stewardship in asset classes other than listed equity?

**The guidance to Section 5 should clarify effective stewardship expectations for asset classes other than listed equity, especially as ESG-related stewardship expectations for**

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these other asset classes are newer and less developed than they are for listed equities. Therefore, to the extent guidance can clarify expectations for these other asset classes, signatories and their beneficiaries will begin to get a feel for where these stewardship expectations overlap with those of listed equities and where and how they diverge. Investors can then begin to target their stewardship activities by asset class.

Q16. Do the Service Provider Principles and Provisions set sufficiently high expectations of practice and reporting? How else could the Code encourage accurate and high-quality service provision where issues currently exist?

**The point about differing responsibilities and roles in the investment chain for service providers is taken. However, one important opportunity for the Stewardship Code is to make clear how the investment chain operates as a whole and who to hold accountable for stewardship. Therefore, it seems feasible to incorporate the Service Provider columns next to the Asset Owners and Asset Managers columns and provide stewardship roles and expectations that stem from the duties and responsibilities of asset owners and managers.**