



IMPLEMENTATION TASKFORCE RESPONSE TO THE FRC'S CONSULTATION ON PROPOSED REVISIONS TO THE UK STEWARDSHIP CODE

We are writing in our capacity as an Implementation Taskforce on Growing a Culture of Social Impact Investing in the UK. The Implementation Taskforce was formed in January 2018 and is an independent Taskforce whose focus is to ensure that as many recommendations of the Advisory Group come to fruition as possible and that sustained industry engagement continues at a sufficient pace. The Implementation Taskforce is based in the UK, but is drawn from international as well as domestic firms, with over 80 firms and industry associations, across a number of different sectors now directly involved in the work groups focusing on taking the recommendations forward.

In December 2016, the UK government set up an independent Advisory Group chaired by Elizabeth Corley (Former CEO of Allianz Global Investors) to answer an important question: How can the providers of savings, pensions and investments engage with individuals to enable them to support more easily the things they care about through their savings and investment choices?

The Advisory Group published their report [‘Growing a Culture of Social Impact Investing in the UK’](#) in November 2017 making recommendations in five key areas and the Taskforce is now moving to implement them.

- Improve deal flow and the ability to invest at scale.
- Strengthen competence and confidence within the financial services industry.
- Develop better reporting of non-financial outcomes.
- Make it easier for people to invest.
- Maintain momentum and build cohesion across initiatives

The Taskforce welcomes the FRC's proposed revisions to the UK Stewardship Code

The FRC proposes to define stewardship as ‘the responsible allocation and management of capital for the purpose of creating sustainable value for beneficiaries, the economy and society’. While we are sympathetic to the intent of the FRC's definition, we consider that it is open to misinterpretation and does not sufficiently reflect asset owners and asset managers primary responsibilities as fiduciaries to promote the financial interests of their beneficiaries and clients.

The current proposed definition might be read as suggesting that additional activities in relation to evidencing ‘value to society’ are required to achieve best practice stewardship. We suggest that the FRC make more clear that stewards must fully embrace the notion that consideration of societal¹ impact (value) is an essential and integral part of stewardship in the financial interests of their clients and beneficiaries. Such a case is well made in recent academic research on the lower cost of capital achieved by companies who manage their environmental and social impacts well²³ and also by the obvious risks to shareholder value arising from damage to corporate reputation when it is perceived that a company is not acting in the interests of wider society.

We see that the definition proposed for use in the Stewardship Code consultation is aligned with the FRC's and FCA's definition of stewardship included in their discussion paper on ‘building a regulatory framework for effective stewardship’. However, we note that in 2.7 of the FCA's ‘consultation on

¹ Given the Taskforce's remit, we typically refer to ‘society’ or ‘societal’ in our response. This is not to ignore or exclude broader sustainability factors, notably the environment.

² *ESG and financial performance: aggregated evidence from more than 2000 empirical studies*; by Friede, Busch & Busson (Dec 2015; <https://www.tandfonline.com/doi/abs/10.1080/20430795.2015.1118917>)

³ *The link between ESG, alpha and the cost of capital: Implications for investors & CFOs*; by Kolbel & Busch (March 2017; https://www.researchgate.net/publication/315815434_The_link_between_ESG_alpha_and_the_cost_of_capital_Implications_for_investors_and_CFOs)



proposals to improve shareholder engagement' there seems to be a suggestion that the FCA is using a different and narrower construct. We strongly recommend that the FCA and FRC adopt a single definition of stewardship. However we recognise that for the purposes of implementing the baseline Shareholder Rights Directive it may be appropriate for the application of the single definition to be more focussed.

We recommend that the FRC consider amending its definition to: 'stewardship is the responsible allocation and management of capital, for the purpose of creating sustainable value for beneficiaries, including policies and activities which positively impact wider society'. Such a definition would be directly aligned with (1) the Stewardship Code's requirement to report on both policies and activities and (2) the Corporate Governance Code which requires the Board of a company to 'generate value for shareholders and contribute to wider society'. It would also be more consistent with the FCA's narrower application and would implicitly support the continued growth in the market for impact investments.

We consider that such a definition would better recognise the primary responsibilities of asset owners and asset managers while allowing for approaches which range from, a narrow minimalist review of ESG factors material to financial performance, to a broad, holistic approach reflecting an investment belief that what is good for society will ultimately be good for value generation for beneficiaries. Our view is that a definition which is holistic, far reaching and future-proofed approach is appropriate for the purposes of the Stewardship Code which is intended to set a best practice, world leading standard for stewardship.

We are broadly supportive of the way in which the new Stewardship Code has raised the bar on consideration of societal impact but consider that further strengthening in relation to consideration of social and environmental matters would be in the public interest. Specifically we recommend that:

- engagement strategies are required to state the signatory's policy on engaging with companies on ESG risks and opportunities, and those companies' impact on or contribution to the SDGs
- stewardship and investment policy should be required to make clear whether investment beliefs on approaches to ESG issues rest on a broad or narrow interpretation of the link between societal impact and beneficiaries' interests
- the Activities and Outcome Report should include a report on how signatories have engaged with beneficiaries and clients on their views in relation to environmental and social issues
- in the event that an asset owner or investment firm adopts a variety of investment approaches across portfolios/funds, they should reflect transparently in their reporting the extent to which they are using broad and narrow methods, and avoid reporting only on the broadest unless this represents a significant majority of their assets (under management) See Q 10.
- further thought should be given as to how the Activities and Outcomes Report might be emphasised as the more important of the two reports, perhaps by reference to drivers of tiering of signatories
- the Service Providers Principles and Provisions mirror the asset owner / manager in requiring evidence of how they take into account material ESG issues including climate change

We believe that putting consideration of environmental and social matters at the heart of stewardship will support the creation of a more resilient world and thus provide the context for the sustainable value creation which will further the interests of beneficiaries over the long term.



Our detailed response to your questions is provided below.

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.

We support the proposed core areas of stewardship responsibility. In particular, we support:

- the introduction of a Section on Purpose, Objectives and Governance, and the principle in that Section which requires signatories to 'develop and disclose their stewardship approach and objectives, and how they serve the interests of clients and beneficiaries'
- the principle in the Section on Investment Approach which requires that material ESG factors be taken into account
- the principle and provision in the Section on Constructive Engagement and Clear Communications which requires asset owners to (1) communicate clearly with beneficiaries on how they have fulfilled their stewardship responsibilities and (2) describe how they take account of beneficiaries needs and the extent to which they seek to engage with beneficiaries to understand their views.

We consider that these sections should be strengthened in the following respects:

- At 422, we suggest that interests replaces 'needs'
- At 4, given the importance of ESG issues to long term beneficiaries and clients, and the varied approaches taken to integrating ESG issues into investment and stewardship approaches, we suggest that there should be a provision requiring the engagement strategy to state the signatories approach to engaging with companies on ESG risks and opportunities and those companies' impact on or contribution to the SDGs.

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

Stewardship and Investment Policy should be required to state explicitly whether approaches to social and environmental factors rest on a broad or narrow interpretation of beneficiary interests.

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

Yes

It is important for signatories to apply all of the Principles, as all of the Principles are important for effective stewardship and applicable to all signatories.

It seems appropriate for the Provisions to be applicable on a 'comply or explain' basis, as not every Provision will be relevant to every signatory.

This approach will require asset owners and asset managers to think through the Principles and Provisions carefully and justify any non-application or non-compliance.

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

We consider that these sections should be strengthened in the following respects:



(1B) Provide guidance which indicates that in establishing organisational purpose, consideration should be given to how societal impact is linked to the interests of clients and beneficiaries

(2E) It is not clear from the guidance how 'material ESG factors' are to be determined. This begs the question of material to whom and to what. Again we recommend that asset owners and asset managers investment beliefs specifically address the link between consideration of societal impact and beneficiaries' interests.

(422) We suggest that interests replaces 'needs' and that guidance is given on the need to clarify whether a narrow or broad interpretation of the link between societal impact and beneficiaries interests has been adopted

(422) We suggest that guidance indicates that best practice engagement with benefactors and clients will include seeking views on whether or not, and if so how, broad environmental and social impact concerns, should be factored into the asset owners and asset managers approach to stewardship and investment.

In general, further guidance is needed to ensure that the Principles are interpreted in a way which allows best practice approaches to stewardship and investment to take full account of the broad interests of beneficiaries and clients while ensuring that primary fiduciary responsibilities are always honoured in accordance with the Law Commission's findings.

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?

Yes, because:

- An Activities and Outcomes Report should help minimise the risk of the Policy and Practice statement being a box-ticking, compliance exercise that does not reflect organisational practices.
- The proposed Report should also help ensure that even those schemes producing good Stewardship Code statements reflect on how those statements are influencing their actual decision-making.
- Publicising the Activities and Outcomes Report will enable better transparency about how well signatories are living up to their stewardship policies.

We agree that it is appropriate for signatories to include case studies of engagement on particular issues, description of monitoring activities and voting records including explanations for voting decisions. Signatories should also report on:

- how they have engaged with beneficiaries and clients on their views in relation to social and environmental matters and integrated these into their approaches to stewardship and investment
- the process by which asset owners/ managers are engaging with companies in which they invest on material ESG risks and opportunities; and, contributions to, or negative impacts on, achievement of the SDGs.
- the outcomes of engagement activities; and
- how asset owners/ managers plan to improve their stewardship in the future in order to ensure continued improvements and adaptation of their investment approach to changing circumstances – particularly with regard to social and environmental risks.



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?

Yes, because:

- The proposed schedule is reasonable and should allow signatories sufficient time to produce both their first Policy and Practice Statement (by 31 December 2019, for those who want to be included in the first list of signatories) and Activities and Outcomes Report (12 months later).
- Since applications will continue to be accepted on an ongoing basis from 31 December 2019, we cannot see how any respondents could object to this time frame.

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?

We are pleased to see proposals for the new Code to require board approval of the Code statement. This should send the right messages to signatories about importance and accountability.

The Kingman Review was concerned that the Stewardship Code may drive boilerplate reporting with its focus on policy statements, rather than outcomes and effectiveness. The introduction of an Outcomes and Activities Report goes some way to addressing this concern. However, we suggest that further thought be given to how the Activities and Outcomes Report might be emphasised as the more important of the two reports. Perhaps the Code might make clear that it is the content of the Activities and Outcomes report which will be the primary driver of any published tiering of signatories.

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

Yes, because requiring signatories to disclose organisational purpose, values, strategy and culture will provide useful context which may prompt the signatories to take a broader, more purposeful, view of how they might discharge their responsibilities leading them to engage with beneficiaries and clients on social and environmental issues.

As stated in the consultation document, introducing this requirement aligns the Stewardship Code with the FRC's previous work on company culture and the revised Corporate Governance Code.

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?

We support the Code's increased scope to asset classes beyond equities and the inclusion of guidance for bondholders on engaging and escalating engagement. Share Action's recent report, *"Sleeping Giants: Are Bond Investors Ready to Act on Climate Change?"* found that bond investors' engagement practice still falls short of what is required for climate change mitigation.

We would recommend including infrastructure in the Provisions and Guidance, given the Government's interest in encouraging pension funds to invest more extensively in infrastructure (for example, the Government's recent consultation on investment innovation).



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?

We support the requirement for asset managers to disclose how far stewardship practice differ across funds (or portfolios). However, the provision should also require signatories to explain how far the stewardship approach described applies to each and all of the assets they own or manage. Some funds may focus on particular SDGs or address specific ESG risks and opportunities and it is important to overall improvements to stewardship that best practice is known and shared.

We understand that there are numerous instances of asset owners and managers referring to their responsible investment and/or stewardship approach and linking to a website page that outlines their work as a corporate group. Whilst this may help to establish a general understanding of the owner/manager approach, it can often give clients and beneficiaries little insight into how their specific assets are being stewarded and in particular the extent to which consideration of ESG factors is embedded into the management of all funds.

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, given concerns about long term non-financial risks, it is particularly appropriate to expect asset owners and asset managers to disclose their investment beliefs with respect to climate change and other sustainable development or ESG risks and opportunities. Beneficiaries and clients with access to this information can then assess whether their own beliefs and interests are aligned.

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

Yes, although the Principle should state more explicitly that asset owners retain responsibility for stewardship even if some activities are delegated.

Whilst the Code focuses primarily on the owners and managers of assets and their stewardship duties, there are other agents in the value chain that play an influential role, notably investment consultants and advisors, and increasingly rating agencies and index providers. We would recommend that the FRC considers what elements of the Code might be appropriate to extend more explicitly to these agents and consult accordingly.

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

Yes.

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

No view.

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

See Q9.



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?

Yes, but we would strongly encourage the FRC to state explicitly that service providers must “demonstrate how they take into account material ESG issues, including climate change” in the Service Provider Principles and Provisions. This is because: The PRI’s recent Investment Consultant Services Review found that most investment consultants and their asset owner clients are still failing to consider ESG issues in investment practice.

Surveys indicate that many pension trustees rely heavily on consultants’ advice in their decision-making. 2015 landscape research from the Pensions Regulator said “it was rare that the trustee board disagreed with its external advisors. Across all of the advisor types, the majority of schemes indicated that they rarely (58%) or never (24%) disagreed with this advisor