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Policy and Planning Officer
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By email to: plan@frc.org.uk

12th February 2016

Dear Sirs,

Draft Plan & Budget and Levy Proposals 2016/17

We would like to respond to the above consultation paper relating to the FRC's Draft Plan & Budget and Levy Proposals 2016/17. ShareAction is a registered charity established to promote transparency and Responsible Investment ("RI") practices by pension funds and other institutional investors. We are a member organisation and count amongst our members well-known NGOs and charitable foundations, as well as over 35,000 individual supporters.

Since our inception 10 years ago, ShareAction has undertaken surveys and studies of the investment sector. This includes, since its introduction in 2010, looking at how the Stewardship Code (the Code) is being applied in practice by asset managers and owners.

1. Do you have any comments on the regulatory approach we are proposing for our new three year strategy?

We believe that the Code has an important role to play in increasing transparency, which is imperative for demonstrating and building accountability within the investment system. Applied well, it can engender good practice within asset managers and owners. It is important to the beneficiaries, the ultimate providers of capital, and it has a wider public interest, given the impact that large corporations have on society and the economy. We believe it is also important to the asset managers who take stewardship, engagement and governance seriously.

When it was introduced, the Code's objectives included increasing the quality and quantity of engagement, as well as accountability down the investment chain to clients and beneficiaries. The FRC said that it would regularly review the Code for "content and impact".[1] However, although the Code has only been revised once since its introduction in 2010, we understand from this consultation that the FRC is not intending to change any of the codes and standards for which it is responsible for at least the remainder of the 2016/19 strategy period (and longer if possible). It is focusing instead on monitoring the uptake and application of the Code. By contrast, the Corporate Governance Code has been revised regularly since its inception, including twice since 2010.

We welcome the FRC's proposal to scrutinise adherence to the Code. As the Code passes its five year anniversary, we think that there is an argument for looking at how it has been implemented in practice and considering its strengths and weaknesses. This is particularly important in light of legislation being discussed in Europe to introduce a similar style code across member states. We believe that by making considered minor amendments to the Code, the FRC could have a significant impact on the way in which investors engage with the stewardship process.

Environmental, social and governance (ESG) factors

One key issue with the Code in its current form is that there is a prevailing idea that stewardship relates principally to governance, with social and environmental risks being seen as of lesser concern (and mentioned only in Principle 4). ShareAction found in its 2015 survey of the 33 largest asset managers[2] that although stewardship relates to all ESG issues, in practice asset managers focused on governance factors. Only 42% of the asset managers we surveyed publicly disclose policies on how they incorporate environmental and social considerations into the investment process. A qualitative analysis of the survey responses, including the examples of engagements that respondents cited, confirms this trend. Only 17% of survey respondents said they would be willing to attend a company AGM to engage on an environmental issue, 29% for workforce issues such as pay, safety or labour relations and 13% for wider social issues.[3]

A further indication that environmental risks are not receiving proper attention is that only 13% of survey respondents were able to disclose a clear strategy for managing the risks associated with stranded carbon assets. The theory of stranded carbon assets is gaining mainstream acceptance; the Bank of England announced an inquiry into the topic in late 2014[4].

We would recommend that the Code is amended to give greater emphasis to the management of environmental and social issues by investors. The Code should also specifically require disclosure on how ESG considerations are integrated into processes for monitoring and engaging with companies.

The importance of environmental considerations for institutional investors was recently highlighted by the 2015 diesel emissions scandal, which resulted in a coalition of 19 investors with over £625 billion in assets under management writing to 11 major automobile companies to call for improved reporting of their public policy interventions on emissions standards.[5] Saker Nusseibeh, chief executive of Hermes Investment

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1 Financial Reporting Council (2010). *Implementation of the UK Stewardship Code*, London, p3. Available from: https://www.frc.org.uk/FRC-Documents/FRC/Implementation-of-the-UK-Stewardship-Code.pdf [accessed: 12 February 2016].

2 Galdiolo, S. and de Ste Croix, C. (2015). *Responsible Investment Performance of UK Asset Managers: The 2015 ShareAction Survey,* London: Fairshare Educational Foundation (ShareAction): Available from: http://action.shareaction.org/page/-/Survey%20Report-2015.pdf [accessed: 12 February 2016].

3 *Ibid*, p13.

4 Bank of England (2016). *Supervisory activities - Climate Change Adaptation Reporting*. Available from: http://www.bankofengland.co.uk/pra/Pages/supervision/activities/climatechange.aspx [accessed: 12 February 2016].

5 Phillips, J. (2015). *Concerned investors with over £625 billion under management call for greater clarity on emissions lobbying by*

Management, commented in response to the scandal, "For those who think the objective of the market is simply to make as much money as possible, our answer is, you cannot possibly do that without taking environmental issues into effect"[6].

Voting and engagement activities

ShareAction's 2015 survey of asset managers[7] found that the quality of reporting on voting and engagement activities has improved amongst the asset managers who do report, but the proportion of firms failing to report has not improved since 2010. 91% of asset managers disclose their policy on voting shares and 64% disclose engagement and voting reports containing both qualitative and quantitative information.[8]

This represents a meaningful improvement compared with 2010, when only 24% of asset managers surveyed by ShareAction had disclosed detailed voting reports. However, 18% of the 33 asset managers still do not disclose any voting records at all, compared with 17% of the 29 asset managers surveyed in 2010. The quality of engagement and voting disclosure also varies greatly between asset managers, ranging from summary data of limited informative value to resolution-by-resolution voting records with their supporting rationale. Although the Code has resulted in more transparency and large quantities of voting information entering the public domain, it is now clear that this information is of limited value without context and explanation. We would recommend that the FRC updates the Code to specify that voting disclosures include qualitative information to contextualise statistics.[9]

3. Do you have any comments on the FRC's proposed projects and activities in 2016/17?

As previously commented, we are very pleased that the FRC is intending to scrutinise adherence to the Code and we are keen to work with the FRC on this proposal. We agree that it is essential to encourage asset managers and owners to provide better accounts of their stewardship policies and practices by strictly monitoring compliance. We understand that, having given signatories time to consider and take action where necessary, the FRC will issue a public statement on those who have met Code requirements and those who have not. We would recommend that serious cases of non-compliance should also be referred to the Financial Conduct Authority and firms should be prevented from saying that they are signatories until they have made the necessary changes.

To demonstrate the importance of ensuring compliance, we refer, by way of example, to a finding from our 2015 survey of asset managers. One key principle of the Code is that institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship, and this should be publicly disclosed. ShareAction found in this survey that 36% of asset managers still do not publicly disclose their conflicts of interest policy. Although some of these firms say they disclose a policy to their clients, this is less than satisfactory given that the Code clearly states institutional investors should have, and publicly disclose, a robust conflicts of interest policy. Five firms neither disclose publicly

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automobile companies. Available from: http://shareaction.org/concerned-investors-over-%C2%A3625-billion-under-management-call-greater-clarity-emissions-lobbying-autom

6 Wallace, T. (2015). *VW scandal could herald revolution in investment industry, says Hermes*. Available from: http://www.telegraph.co.uk/finance/newsbysector/industry/11912736/VW-scandal-could-herald-revolution-in-investment-industry-says-Hermes.html [accessed: 12 February 2016].

7 Galdiolo, S. and de Ste Croix, C. (2015). *Responsible Investment Performance of UK Asset Managers: The 2015 ShareAction Survey,* London: Fairshare Educational Foundation (ShareAction): Available from: http://action.shareaction.org/page/-/Survey%20Report-2015.pdf [accessed: 12 February 2016].

8 *Ibid*, p10.

9 *Ibid*, p10.

nor state that they disclose to their clients and fail to provide an explanation for this. Furthermore, many of these policies cannot be considered 'robust' as only 21% of the asset managers disclose actual procedures on how they manage conflicts of interests in relation to stewardship. ShareAction has long identified conflicts of interest in and around the investment chain as an obstacle to meeting the best interests of clients and end beneficiaries of the asset management industry. It is disappointing that disclosure in this area is still lacking.[10]

Based on our analysis of the best policies, a comprehensive conflicts of interest policy should:

- Specify ways in which a conflict may arise in the particular organisation.

- Specify the procedures in place for managing such conflicts, including:
    - rules on gifts and entertainment;
    - internal staff training on conflicts of interest;
    - maintenance of conflicts register;
    - procedure for the voting of shares held in the manager's parent company;
    - rules on personal account dealing by staff;
    - disclosure to clients of conflicts of interest that cannot be managed;
    - instructions for an independent third-party to make a voting decision when the conflict cannot be managed; and
    - information barriers and other procedures to control the exchange of information.[11]

I suggested at the FRC's Priorities 2016/17 Open Meeting that one means of remedying this problem may be for the FRC to publish further guidance on what a robust policy should include, and offer model policies and templates for reporting. I understand from a helpful conversation with Melanie McLaren following the Open Meeting that the FRC feels that publishing model policies and templates would tend to lead to an increase in boilerplate statements in policies and reports. I understand that the FRC's proposed response is instead to facilitate more discussions between asset owners and asset managers, to clarify the type and format of information which would be of most use. We would be delighted to be invited to a discussion on this topic. We feel that we could offer valuable insights from the perspective of the individual savers whose money underpins the investment system, many of whom bear the risk of investments.

We understand from the FRC's Priorities 2016/17 Open Meeting that the FRC will be engaging with stakeholders in finalising its plan and budget by April 2016. We also understand from this consultation paper that the FRC is particularly concerned to ensure that the perspective of long-term investors is reflected in its work. We would be keen to attend a meeting with the FRC to discuss our recommendations in more detail.

[10] *Ibid*, pp8-9.
[11] *Ibid*, p9.

Yours sincerely,

R Haworth

Rachel Haworth, Policy Officer