Corporate Governance and Stewardship
Financial Reporting Council
8th Floor
125 London Wall
London EC2Y 5AS

By email: stewardshipcode@frc.org.uk

29 March 2019

ICGN Response to the Proposed Revision of the UK Stewardship Code

The International Corporate Governance Network (ICGN) is pleased to respond to the UK Financial Reporting Council (FRC) consultation on its Proposed Revision of the UK Stewardship Code.

Led by investors responsible for assets under management in excess of US$34 trillion, ICGN is a leading authority on global standards of corporate governance and investor stewardship. Our membership is based in more than 45 countries and includes companies, advisors and other stakeholders. ICGN's mission is to promote high standards of professionalism in governance for investors and companies alike in their mutual pursuit of long-term value creation contributing to sustainable economies world-wide. Our policy positions are guided by the ICGN Global Governance Principles[1] and the ICGN Global Stewardship Principles (GSP)[2], both of which have been developed in consultation with ICGN Members and as part of a wider peer review. For more information on ICGN please see: www.icgn.org.

One of ICGN's core policy priorities is to make successful stewardship a reality.[3] ICGN's GSP date back to 2003 and provide an international framework for investors to implement their fiduciary obligations on behalf of clients and beneficiaries. The GSP are currently endorsed by a wide range of influential institutional investors globally.[4] The GSP, along with ICGN's Model

[1] See: ICGN Global Governance Principles: http://icgn.flpbks.com/icgn_global_governance_principles_jpn/
[2] See: ICGN Global Stewardship Principles: https://www.icgn.org/sites/default/files/ICGN_Global_Stewardship_Principles_JPN_1.pdf
[3] See ICGN Policy Priorities: https://www.icgn.org/sites/default/files/ICGN%20Policy%20Priorities%202018-9.pdf

[4] See list of investor endorsers of ICGN's Global Stewardship Principles: https://www.icgn.org/policy/icgn-global-stewardship-principles-endorsers

Saffron House 6-10 - Kirby Street - London - EC1N 8TS - UK
VAT No. 927 1665 09 | Registered in England No 6467372
t: +44 (0)207 612 7011
f: +44 (0)207 612 7085
e: secretariat@icgn.org
w: www.icgn.org
@ICGNCorpGov
ICGN

Mandate[5], published in 2012, have been emulated in markets around the world, most notably in Asia and Europe.

A more recent addition to ICGN's policy output on stewardship was the publication of a member-approved Guidance on investor fiduciary duty in 2018.[6] In late 2018 ICGN also launched its Global Stewardship Awards and published a series of model stewardship disclosure guidance documents relating to conflicts of interest, monitoring, engaging and voting.[7] Most recently, ICGN released in February 2019 its first annual Investor Stewardship Survey, which was completed by over 40% of ICGN's investor members, representing assets under management in excess of £10 trillion.

With regard to the UK and its Stewardship Code, ICGN has long engaged with the FRC about both corporate governance and stewardship. In our early 2018 response to the FRC regarding the UK Corporate Governance Code, we addressed a range of preliminary questions about the then-planned review of the UK Stewardship Code.[8]

In this context we are pleased to continue this dialogue with the FRC, and in doing so we recognise the leadership that the UK has shown in helping to define and shape the practice of stewardship in markets globally. Our approach to this consultation is not to address each of the 16 individual questions. Rather, we will provide some overarching views and stress a few key points to consider as you finalise the Code.

As a starting point, there are important elements to the draft Code that ICGN supports. These include:

- The emphasis on improving stewardship in practice, focusing both on stewardship activities and outcomes. We believe that ICGN's disclosure templates provide useful real examples of best practice in this context.

- The importance of purpose, values and culture of institutional investors acting as stewards. ICGN's Stewardship Principle 1 stresses the "internal governance" of investment firms as the foundation of effective stewardship. Related to this we support the request to signatories to articulate their organizational purpose, strategy and values

[5] See ICGN Model Mandate: https://d3n8a8pro7vhmx.cloudfront.net/intentionalendowments/pages/27/attachments/original/1420777456/ICGN_Model_Mandate_Initiative.pdf?1420777456

[6] See ICGN Guidance on Investor Fiduciary Duties (2018): http://icgn.flpbks.com/icgn-fiduciary_duties/

[7] See Stewardship page on ICGN website: https://www.icgn.org/stewardship-0

[8] See ICGN 2018 submission to the FRC's consultation on the UK Corporate Governance Code: https://www.icgn.org/sites/default/files/4.%20ICGN%20Comment%20FRC%20UK%20Corporate%20Governance%20Code%20Consultation%20Feb%202018_0.pdf

Saffron House 6-10 - Kirby Street - London - EC1N 8TS - UK
VAT No. 927 1665 09 | Registered in England No 6467372
t: +44 (0)207 612 7011
f: +44 (0)207 612 7085
e: secretariat@icgn.org
w: www.icgn.org
@ICGNCorpGov
ICGN

to enable them to fulfil stewardship objectives. ICGN supports the emphasis on rigorous reporting requirements, as we are of the opinion that disclosure generally drives improved performance.

- The extension of stewardship to a broader range of asset classes than equities, with a particular emphasis on the role of the creditor and fixed income assets in stewardship. This is consistent ICGN Stewardship Principle 4.1.

- The recognition of the importance of environmental, social and governance (ESG) factors in company monitoring, voting, engaging and investment decision making. This is consistent with ICGN Stewardship Principle 6: promoting long-term value creation and integration of ESG factors.

- Recognition of the complexity of the investment chain. This is what ICGN calls the "ecosystem" of stewardship, and we think it is appropriate for the UK Stewardship Code to address how stewardship matters may differ between asset owners, asset managers and service providers, while keeping these distinct principles under one common Code.

- Alignment with key elements of the UK Corporate Governance Code, particularly with regard to how the interests of investors link to a company's stakeholder relations.

- It is sensible to align the Code with the European Union's revised Shareholder Rights Directive on disclosure items relating to investment strategy, asset manager incentivisation and investment decision-making.

Against this background we would also like to highlight potential areas for further consideration:

- **Defining stewardship**. We note that the new definition of stewardship in the draft Code articulates a broad remit not only to consider investment beneficiaries but also to consider wider impacts on "the economy and society." We recognise that the broader social purpose that is articulated is paralleled in the revised UK Corporate Governance Code, with its emphasis on social benefits and the importance of stakeholders. While we agree that aligning the two UK Codes in this way is sensible, we are aware of some interpretations that this broader articulation of stewardship effectively downgrades the standing of investors vis-à-vis stakeholders. It is not our interpretation that the revised Stewardship Code is suggesting such a paradigm shift. Having said that we think there may be scope in the final version of the Code for a clearer articulation of the intent behind this new definition and how this might affect the standing of investors. The FRC may also wish to add systemic risk to this discussion on stewardship, which we elaborate upon below.

- **Time horizon.** ICGN supports the Code's intent to promote long-term thinking, particularly noting that a substantial proportion of ICGN member assets is linked to support pension funds and other long-term savers. Not all investor strategies are long-

Saffron House 6-10 - Kirby Street - London - EC1N 8TS - UK
VAT No. 927 1665 09 | Registered in England No 6467372
t: +44 (0)207 612 7011
f: +44 (0)207 612 7085
e: secretariat@icgn.org
w: www.icgn.org
@ICGNCorpGov
ICGN

term in nature, and this is reflected in Provision 2.10 calling for a statement of time horizon. And in the related Guidance section the Code rightly states that "in most cases a long-term perspective is required". But we think that the Code could be a bit more forceful in its emphasis on long-term horizons, and that on the whole a default position for investor stewardship should be guided by a long-term perspective. A possible additional dimension to add emphasis to this might be to ask investors to describe how they define their own time horizons in their varying investment strategies.

- **Resourcing**. The Code's section on Investment Approach addresses issues that touch on how stewardship is resourced. But resourcing itself could be more clearly addressed in the Code. Particularly for large institutional investors whose portfolio holdings encompass thousands of companies globally, it is not feasible to apply the Code equally to all holdings—no matter how committed the investor might be to good stewardship. In this context the Code may wish to seek greater clarity from investors with regard to how they prioritise their investment portfolio in terms of investment attention and the extent to which this process of "triage" affects stewardship on individual investment holdings.

- **Wider range of asset classes**. ICGN supports the call to investors to use their rights and influence to exercise stewardship no matter how capital is invested. However, the disclosure regime for certain types of assets, such non-publicly traded assets, may be problematic in terms of generating like for like, relevant data for investors, and may require a staged approach with guidance on suitable metrics and processes.

- **Fixed Income.** In many cases we believe that fixed income will be the most obvious starting point for considering wider asset classes in stewardship. This is an important asset class, reflecting both the size of the global fixed income market and the role that creditors play in providing risk capital to companies and governments. Sustainable companies should seek to maintain a positive and balanced relationship with both shareholders and creditors. Debt is a form of long-term capital for companies, and even though individual issues of debt are (usually) repaid and often rolled over it is important for companies to have ready access to cost effective debt capital. It is also worth noting that for companies that are not in the mode of issuing new equity capital, debt can be the main source of new corporate funding and plays a strategic role in this context. Moreover, the preferences of creditors to limit risk and provide a healthy counterpoint to shareholder preferences for companies to take on risk in a way that might help to enhance long-term thinking sustainable value creation. In particular, the FRC may wish to develop guidance on engagement in the fixed income sector.

- **Government bonds.** It is important to note that much of the fixed income market is comprised of government or government related debt. We suspect the FRC is primarily focusing on stewardship with regard to corporate debt, but it would be good to clarify the scope of issuers that are mainly envisioned. In particular, we suggest that the Code also provides guidance on the extent to which engagement on government debt is anticipated.

Saffron House 6-10 - Kirby Street - London - EC1N 8TS - UK
VAT No. 927 1665 09 | Registered in England No 6467372
t: +44 (0)207 612 7011
f: +44 (0)207 612 7085
e: secretariat@icgn.org
w: www.icgn.org
@ICGNCorpGov
ICGN

- **Capital Allocation.** The focus on fixed income in stewardship is linked to capital allocation in investee companies more broadly. We believe that capital allocation is where corporate finance meets corporate governance; yet the emphasis in many codes of governance – and, in turn, mirrored in stewardship practices- is often more on board effectiveness, shareholder rights, remuneration, and, more recently, ESG issues. While the new Code does appropriately begin its definition of stewardship as “the responsible allocation and management of capital” we believe the Code could be more explicit about capital allocation as a dimension of stewardship.
  In this context, we suggest that the Code may place greater emphasis on how investor stewardship can help to support a fair and sustainable equilibrium in a company’s capital structure and allocation to achieve long-term corporate success, while meeting the needs of shareholders and creditors for risk adjusted returns on capital. We also believe that where investment institutions have both stewardship specialists and portfolio managers, a greater focus on capital allocation and stewardship would likely draw more portfolio managers into the stewardship process – which we would see as positive.

- **“Constructive Engagement”.** ICGN views engagement with investee companies as a fundamental shareholder right as well as a responsibility. By engaging or exercising ‘voice over exit’ institutional investors can encourage firms to adopt measures which improve their quality of corporate governance, which in turn can inspire investor confidence and correlate to better risk adjusted returns. Collaborative and multi-year engagements tend to be especially successful. Section 4 of the draft Code, which is headed 'Constructive Engagement' does not actually say anything about what constructive engagement might look like, and neither does the draft guidance on that section (and the same applies to Section 5 when discussing voting). We suggest you flesh this out a bit or at least provide a clearer definition for “constructive engagement”.

- **ESG, Systemic Risk and Sustainable Development Goals.** As noted above, we support the inclusion of the reference as to the inclusion of ESG factors as a dimension of stewardship, and we believe this supports long-term thinking and sustainable value creation. As an ESG consideration, ICGN is increasingly focusing on systemic risks, as they may relate to financial system stability, climate change, income inequality and similar factors, and note that these systemic risks of this nature have the potential to severely impact the long-term health of economies and markets.

  Investors with long-term horizons are directly affected by systemic risks and we believe that relevant systemic risks, where relevant and material, should therefore feature in their engagement outreach. The 17 United Nations’ Sustainable Development Goals (SDG) presents a broad landscape of social goals, whose flipside is systemic risk. While many of these goals are primarily under the purview of governmental oversight and initiative, we also believe it is important that investors build understanding of SDGs and how they materially related to investee companies. Accordingly, the FRC might consider

Saffron House 6-10 - Kirby Street - London - EC1N 8TS - UK
VAT No. 927 1665 09 | Registered in England No 6467372
t: +44 (0)207 612 7011
f: +44 (0)207 612 7085
e: secretariat@icgn.org
w: www.icgn.org
@ICGNCorpGov
ICGN

making mention of SDGs in its Guidance section as one dimension of considering ESG factors.

- **Reporting Outcomes**. We have heard some concerns expressed in investor circles that the new reporting requirements under the Code are straying away from a principles-based approach towards a more prescriptive and process-based approach to stewardship. That is not our interpretation of the new Code's intent, but there may be scope for greater clarification on this point. We are supportive of the Code's greater focus on reporting outcomes, because this is what stewardship should ultimately seek to deliver. We also believe that it is important for the evidence base regarding the impact of stewardship to become clearer, and that a greater focus on reporting outcomes may usefully contribute to this evidence base.

We hope these comments are useful in your deliberations. If you would like to follow up with us with questions or comments, please contact our Policy Director, George Dallas: george.dallas@icgn.org .

Yours sincerely,

Kerrie Waring
Chief Executive Officer, ICGN

Copy:
Niels Lemmers, Co-Chair, ICGN Shareholder Responsibilities Committee: nlemmers@veb.net

Alison Schneider, Co-Chair, ICGN Shareholder Responsibilities Committee: Alison.Schneider@aimco.alberta.ca

Saffron House 6-10 - Kirby Street - London - EC1N 8TS - UK
VAT No. 927 1665 09 | Registered in England No 6467372
t: +44 (0)207 612 7011
f: +44 (0)207 612 7085
e: secretariat@icgn.org
w: www.icgn.org
@ICGNCorpGov
ICGN