



Association
of International
Certified Professional
Accountants®

Association of International Certified Professional Accountants Response to The Financial Reporting Council's Proposed Revision to the UK Stewardship Code

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BACKGROUND

The Association¹ welcomes the opportunity to comment on the Financial Reporting Council's (FRC) proposed revision. The Association submitted a response to the review of the 2019 Corporate Governance Code and believes that the stewardship code which was originally drafted in 2010 will benefit from a commensurate review.

We recognise the Stewardship Code revision as an important part of the UK Government's corporate governance agenda which aims to restore public trust in business and strengthen accountability. It is critical at this time that the UK fosters the right balance between this accountability and the need to foster business investment so that we remain globally competitive. This response is given in the sole context of the UK market and, as such, does not relate to any other jurisdiction.

As stated in the proposed revision's consultation document we acknowledge that the purpose of the stewardship code is as a mechanism to enhance engagement between stakeholders and ensure that long term value is secured. The Code was developed very much in response to the issues highlighted through the financial crisis of 2008-09 and we believe that those issues are still highly pertinent today. The stewardship code was at the time, the first of its kind in the world and we believe that it has led to some improved engagement from the investment community. The voluntary nature of the code has allowed investors to engage with the code as

¹ The Association of International Certified Professional Accountants (the Association) is the largest professional accounting body in the world, combining the strengths of the American Institute of CPAs ([AICPA](#)) and the Chartered Institute of Management Accountants ([CIMA](#)) to power opportunity, trust and prosperity for people, businesses and economies worldwide. It represents 650,000 members and students in public and management accounting and advocates for the public interest and business sustainability on current and emerging issues. With broad reach, rigor and resources, the Association advances the reputation, employability and quality of CPAs, CGMA designation holders and accounting and finance professionals globally.

appropriate and the code has acted as a springboard for greater discussions on how investors might contribute to the greater public good. However, we believe that the current code is only a starting point. As part of the CIMA academic research programme, we have sponsored a project led by Dr Julia Mundy of the University of Greenwich, *Is the Stewardship Code fit for purpose? A field study of engagement by asset management firms*². This provides rigorous research into the application of the code and its impact on the market place. What this evidence shows is that while the code fosters discussions and good intentions its impact on action is more limited.

While there is strong evidence that investor pressure can shape corporate strategy and fine tune how company's make investment decisions³ there is a far less clear link between this pressure and the stewardship code. Given the recent update of the UK Corporate Governance code it is an opportune moment to revise the stewardship Code so that this link is made explicit. Our recommendations therefore aim to build on the code's profile as a set of principles by making it more relevant in terms of actions.

CONTEXT

At the current time, public trust in business continues to remain low⁴ and the polarization of society both politically and economically has become more entrenched. There is a view that major businesses need to prioritize building integrity and trustworthiness by delivering what is right rather than expedient. At the same time increasing expectations that business should deliver wider benefits to society have led to ever more calls for Government intervention to address these concerns. Notably there have been calls for tighter corporate governance, increased reporting requirements and a need to include worker representation on boards. As external investment is a key component of the capital markets system it is important that the public at large see the benefit from stewardship that investors in large organisations can provide. As shareholders influence companies primarily through their decision to buy or sell there is traditionally a low incentive for asset managers to engage and support companies achieve long-term success. The asset management industry predominantly focuses on delivering outperformance versus a benchmark through trading shares. This is in contrast to delivering value by supporting the companies they own to achieve long-term success for all stakeholders. It is therefore important that the stewardship code seeks to redress this balance.

OUR VIEW

In terms of **remit** we support the revised definition of investment as this should mean that the code has a **wider impact on the investment community**. In view of the challenges above we are pleased that the new code promotes outcomes and activity above policy statements. The Code signatories should be encouraged to report against their stated purpose on the basis of *Apply and Explain*, rather than *Comply or Explain*. This focus is appropriate as the emphasis is on actively affecting decisions. At the same time, the burden of reporting on major corporates is

² <https://www.cimaglobal.com/Research--Insight/Research-Funding/academic-research-reports/>

³ https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1316408##

⁴ https://www.edelman.com/sites/g/files/aatuss191/files/2019-02/2019_Edelman_Trust_Barometer_Global_Report_2.pdf?utm_source=website&utm_medium=global_report&utm_campaign=downloads

already considerable and we welcome the flexibility within the code around how disclosures can occur. It is also important that the code does not simply lead to a greater volume of disclosures but rather leads to improved efficiency through better investment decisions being made as a result of its existence. Ultimately it would be useful for **signatories to highlight how the code has influenced investment decisions** in the direction of long term value through their own reporting mechanisms.

We very much welcome the revised code's emphasis on **organisational purpose and objectives**. In our view a board that has a clear purpose and an understanding of the company culture helps build long term sustainable business success. In relation to the investment sector it is also important that purpose should be about long term desirable outcomes for society rather than simply a desire to beat a benchmark holding. Our research shows that where organisations clearly articulate and understand their purpose; this produces better long term and sustainable outcomes. In particular, the Corporate Culture and Role of Boards report⁵ that we contributed to in 2016 demonstrates the importance in fostering the right culture and that this very often starts with a well understood purpose. This principle also now aligns well with the redrafted corporate governance code.

We very much welcome the new **focus of the code on material Environmental, Social, Governance (ESG)** requirements as these are fundamental to the long term sustainability of major corporates. The evidence base strongly suggests that these factors have a material impact on profitability and it is critical that investors also consider these in their investment decisions. As highlighted in the recent Alliance for Corporate Transparency Report⁶ there is a considerable lack of homogeneity to ESG disclosures at the current time and it is therefore important that the revised code seeks to foster development of comparable ESG measures as a basis for sound investment. The Code should also dovetail with the International Integrated Reporting Council's IR Framework⁷ which seeks to emphasise the importance of capital beyond financial capital.

We welcome the code's initiative in **splitting out responsibilities** for asset owners and asset managers in the investment chain. Until now it has been unclear exactly who should apply the code provisions and we feel that this development is a useful addition.

However, we feel that the Code should cover not only stewardship policies but the **actual delivery of stewardship**. Signatories should commit to explain the buying or selling of stock on the grounds of long term stewardship objectives and encourage investors to use the threat of sale to engender change. Where a company fails to cut greenhouse gas emissions or tackle human rights abuses for example, the threat or actual sale of stock on these grounds could be reported against the code. The publication in itself would give both reassurance to the public and information to the market. This would be using

⁵ <https://www.frc.org.uk/getattachment/3851b9c5-92d3-4695-aeb2-87c9052dc8c1/Corporate-Culture-and-the-Role-of-Boards-Report-of-Observations.pdf>

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http://www.allianceforcorporatetransparency.org/assets/2018_Research_Report_Alliance_Corporate_Transparency-66d0af6a05f153119e7cffe6df2f11b094affe9aaf4b13ae14db04e395c54a84.pdf

⁷ <http://integratedreporting.org/wp-content/uploads/2015/03/13-12-08-THE-INTERNATIONAL-IR-FRAMEWORK-2-1.pdf>

a market mechanism to achieve a clear public policy goal. This is necessary because there are widespread concerns that the Code's tiering is based on the quality of the signatory's Code statements, rather than specific activity related to stewardship. Ideally the business model of investors should also be linked to code objectives and the code should explicitly encourage such a link so that the code is not seen as an additional governance requirement.

We feel that the code could also have gone further in **promoting designated investments that relate to the stewardship principles**. This would again help to integrate the codes objectives into the business models of corporate investors so that a clear link between the code and investment decisions is visible. It would be useful in our view, if the code were to better encourage delegation of responsibilities further so that fund managers could apply the provisions more actively. We would also highlight *recommendation 42* recently made in the Kingman Review⁸ regarding a need to shift the focus of the code towards outcomes and effectiveness. **The Code should reinforce the criticality of an integrated approach to stewardship** throughout the investment chain. The importance of developing reporting away from boiler plate disclosures is also critical to its success.

Finally, it is vital to the future of the code that an **evidence base** is developed that can be used to highlight the benefits of stewardship action to investors going forward. A greater evidence base would improve further iterations of the code and address concerns over its effectiveness going forward. We would also emphasize the importance of the integrated reporting framework in providing an overall picture of company activities. The code should ideally refer to this framework as a mechanism for making investment decisions and encouraging a longer term perspective in business.

CONCLUSION

In summary, we believe that the revised code takes a step forward in providing accountability and transparency to the capital markets system. The new code emphasizes critical new developments in ESG reporting and investing and seeks to embed the core values of purpose and long termism into the market place. The 'comply or explain' principle is extended and the link to the different parts of the investment chain is made more explicit. However, we feel that the code could go further still in integrating the principles with investment decisions and their consequent outcomes.

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⁸ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/767387/frc-independent-review-final-report.pdf