ALDERSGATE GROUP
LEADERS FOR A SUSTAINABLE ECONOMY

Consultation on a revised UK Stewardship Code

Aldersgate Group submission, March 2019

BACKGROUND

1. The Aldersgate Group is an alliance of major businesses, academic institutions, civil society organisations and cross-party politicians which drives action for a sustainable and competitive economy. Our corporate members, who come from across the economy and have a collective global turnover of nearly £600bn, believe ambitious and stable environmental policies make clear economic sense for the UK.

2. In March 2018, the Aldersgate Group published a major report, *Towards the new normal: increasing investment in the UK's green infrastructure*, which set out key recommendations for government, business and investors to facilitate greater investment flows into critical green infrastructure needed to meet the UK's policy goals and reduce risk in the financial system.[1] The report, which was based on extensive interviews with business and finance sector leaders, argued institutional investors should take longer-term risks into account in their investment strategies. Taking such an approach can result in better investments more suited to the investment horizons of their beneficiaries, such as investment in infrastructure that is resilient to extreme weather events and assets that are less at risk from future policy changes.

3. The Aldersgate Group was a member of the Green Finance Taskforce (GFT) and endorses its recommendations. We strongly agree that taking proper account of the financial risks and opportunities that Environmental, Social and Governance (ESG) considerations pose is essential to enable the UK financial system to respond in a timely way to climate risk and clean growth opportunities.

INTRODUCTION

4. The Aldersgate Group welcomes the draft Code's new definition of stewardship responsibilities. It supports that the Code now makes explicit reference to ESG factors, and in particular the focus on responsible allocation and management to create sustainable value.

5. The Aldersgate Group is pleased to see that the FRC will be devoting more resource to evaluating the quality of disclosure of both policies and activities. Monitoring and enforcement of the Code will be key to its proper function.

6. We support the statement that there should be a commitment across signatory organisations to achieve stewardship objectives, and that individuals responsible should have an appropriate level of skills and experience, alongside accountability and influence internally and externally. We particularly support that signatories are asked to ensure how incentives align with investment strategy and stewardship objectives.

[1] Aldersgate Group (March 2018) *Towards the new normal: increasing investment in the UK's green infrastructure*

7. To effectively discharge Stewardship duties with reference to climate change factors, signatories must adequately identify and understand the associated risks within the longer-term investment horizons of beneficiaries. We therefore believe the Code should strongly encourage signatories to engage with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFDs) and particularly with the use of scenario analysis to identify longer term risks. Implementation of the TCFDs is nascent and that there will be a process of trial and error to identify how best to implement the recommendations and develop associated scenarios. The best way to build this knowledge base is by encouraging voluntary compliance.

8. There is considerable momentum for TCFD implementation. **The Green Finance Taskforce recommended that TCFDs should ultimately be incorporated in UK legislation**, including recommending a government review of disclosure in 2020 to monitor and encourage market adoption amongst both issuers and users and for TCFDs to be implemented in the corporate governance and reporting framework.[2] Similar movements are happening globally including in the European Union through the Commission's Sustainable Finance Action Plan, which proposes to revise guidelines on non-financial reporting to further align them with the TCFDs.[3] The Code can therefore help investors prepare for future regulatory change by strongly encouraging gradual compliance with TCFDs.

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.

9. We welcome that the new definition identifies the primary purpose of stewardship as looking after the assets of beneficiaries that have been entrusted to the care of others and focuses on sustainable value. We further agree that signatories to the Code should use the resources, rights and influence available to them to exercise stewardship however capital is invested, beyond just investments in listed equities.

10. We welcome the explicit expectation for signatories to take into account material ESG factors, including climate change, when fulfilling their stewardship responsibilities. However, we recommend that the language of 'encouraging decision-making aligned to investment time horizons of beneficiaries' could be strengthened to 'requiring', as 'creating sustainable value for beneficiaries, the economy and society' is predicated on aligning decisions with those investment time horizons.

11. We support the proposal to explicitly include climate change in the wording, as it poses the clearest systemic risk for the financial system[4] and is therefore vital to good stewardship of beneficiary assets. We recommend that the Code could include a more specific reference to using TCFD-aligned reporting to identify and plan for material climate change factors. The definition could also include greater acknowledgement that other environmental and social risks and opportunities may also be material to investment strategy.

[2] Green Finance Taskforce (March 2018) *Accelerating Green Finance*
[3] European Commission (March 2018) *Sustainable Finance Action Plan*
[4] As set out by Mark Carney in his Tragedy of the Horizon speech at Lloyds, September 2015

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

12. Yes. A 'comply or explain' approach is suitable. This is already a well-recognised approach across existing voluntary and mandatory financial reporting requirements and has been effective, for example in the Mandatory Carbon Reporting requirements for large listed companies under the Companies Act 2013. It is important that this is well enforced to ensure to ensure a level playing field between signatories.

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

13. Signatories should be required to disclose their approach to stewardship and how their strategy on how both financial and non-financial (ESG) factors are taken into account in developing investment policies meets the definition of stewardship as set out by the Code.

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?

14. We agree that asset managers should disclose funds that deviate from the organisational stewardship policy or approach to avoid administrative burden while retaining transparency. A threshold of funds deviating from that policy could be established, which once breached should trigger a review of the policy and require development and disclosure of a new stewardship approach, to retain the integrity of disclosures under the Code.

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

15. We agree that institutional investors remain responsible for ensuring outsourced activities are carried out in a manner consistent with their own approach to stewardship, and are therefore responsible for monitoring third parties. Consultants still see ESG services as niche and only provide this at an extra cost, rather than engaging with long-term ESG issues systematically.[5] This expectation on signatories may therefore help to create a stronger market driver for service providers to take a more responsible approach where incentives currently lacking.

[5] UN PRI (2017) *Investment consultant services review*