



ASSOCIATION OF PENSION LAWYERS

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Corporate Governance and Stewardship
Financial Reporting Council
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BY EMAIL: stewardshipcode@frc.org.uk

Dear Sirs

FRC consultation on proposed revision to the UK Stewardship Code (the Consultation)

I am writing on behalf of the Investment Sub-Committee of the Association of Pension Lawyers of the United Kingdom ("APL"). The APL is a not-for-profit organisation whose members comprise over 1,100 UK lawyers, including most of the leading practitioners in the field, who specialise in providing legal advice on pensions to sponsors and trustees of pension funds and others, including the largest pension funds in the UK. Its purposes include promoting awareness of the role of law in the provision of pensions and to make representations to other organisations and governments on matters of interest to APL members.

We write in connection with the Consultation. The APL's response to the questions set out in Consultation are 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 consider that the proposed Sections cover the core areas of stewardship responsibility and there are no stewardship responsibilities that in our view should be added or strengthened in the proposed Principles and Provisions. As a general comment, however, there are a number of Provisions which are unlikely to be well aligned with trustees of occupational pension schemes (e.g. the Provision that signatories should explain how they ensure the organisation (ie the pension trustee board) has appropriate incentives in place for the delivery of the investment strategy and stewardship objectives is unlikely to be appropriate to a board of trustees that are not remunerated for their role (or are remunerated on a fixed fee or time cost basis). To a large extent, we suspect it is inevitable that not all Provisions will apply to all

types of asset owners. However, where there is a desire to encourage pension fund trustees as asset owners to become signatories, it may be helpful to note in the guidance those Provisions which may be unlikely to apply and for which pension trustees might be expected to disclose against.

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

We believe that the Principles set sufficiently high expectations of effective stewardship for all signatories to the Code. However, we retain a general concern that pension trustees seeking to integrate stewardship with their investment approach may continue to struggle in practice to do this as long as their appointed asset managers are required only to demonstrate how their “organisation” (ie the wider group to which the asset manager belongs) takes ESG issues into account rather than in relation to the specific assets managed under the manager’s appointed mandate with the trustees. Many of our pension trustee clients tell us that this makes it hard for them in practice to demonstrate how they are taking account of material ESG factors (including climate change), when this information is not provided from their appointed asset managers. The FRC may wish to consider whether Provision 21 or related guidance could be enhanced to make clear that signatory asset managers would be expected to engage with their asset owner clients at mandate-level, rather than broader manager-level and noting the comments in paragraph 81 of consultation document.

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

We support this approach. As noted in our response to Q1, there are a number of Provisions which are unlikely to be well aligned with trustees of occupational pension schemes and which we would anticipate that most trustees would disclose against.

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

In order to encourage pension trustees to become asset owner signatories it may be helpful to signpost in the guidance those Provisions which may be unlikely to apply to pension trustees. We would be happy to provide further input on this if helpful to the FRC’s consultation.

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. Furthermore, in relation to pension scheme trustees, as asset owners, we agree that it is sensible to allow them to cross refer to other documents (for example, the Statement of Investment Principles, which may contain the Trustee's policy on exercising rights and engagement activities).

However, it is important to recognise that trustees will want to have as much control over the style and format of any communications or documents that may be seen by the lay members (beneficiaries) of the pension scheme. As such, for asset owners, we would suggest that more flexibility is allowed on the content and format of the Activities and Outcomes Report than, say, an asset manager.

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.

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 believe that the Code addresses the Kingman recommendations.

There is one point worth noting, in relation to pension scheme trustees, that comes from the general discussion surrounding this question. Many large pension schemes have established their own in-house fund manager (often authorised by the FCA as an "OPS Firm"). Here the only client of the in-house fund manager will be the trustee of the pension scheme that has established it. As a result, we wonder whether it is worth highlighting whether this would be caught by the asset owner regime, or the asset manager regime. To our mind, there is an argument that the in-house manager is just seen as an extension of the trustee (as it carries out its objectives) and is therefore subject to the same regime as the asset owner, its trustee client. As a result, only the trustee client would sign up to the Code.

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

In principle, yes. However, we believe that for pension scheme trustees, this provision will need further guidance to be of value. For example, to the extent that it is the organisational purpose that helps inform trustees' stewardship objectives and governance, there is a risk that most trustees will look at their purpose as simply being to act in the best financial interest of the scheme beneficiaries. This would devalue what seems to be a key initial part of this process.

Furthermore, the values and strategy of a pension scheme trustee will be disclosed, to some extent, in other pension scheme documents (such as the Statement of Investment Principles).

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 do not think it is necessary to do so. The wording in the Code is clear enough to require stewardship beyond equity, but flexible enough to allow signatories to form a common sense view of how those ownership rights might reasonably be exercised. It may be that if there is too much divergence in how this provision is interpreted and operated, that further guidance is required in the future. However, in the short term we believe that your current approach is sensible.

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?

From an asset manager perspective, we believe that it is right that the manager should be required to provide details of stewardship at a fund level (or to the extent that a particular fund differs from the organisational approach). This is because an asset owner, such as a pension scheme trustee, will invest at a fund level and, accordingly, will require information at that level. Please see also our answer to question 2 above.

A pension scheme trustee, as asset manager, should be encouraged to provide details of how policies differ only at an asset class level – as set out in Provision 1.

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?

The investment beliefs of asset owners (including pension scheme trustees) and asset managers are integral to the design and approach of their investment objectives and policies. Therefore, disclosure of investment beliefs are likely to be valuable in giving an asset manager insight into and an understanding of the rationale behind the asset owner's investment policy and objectives (and vice versa). In turn this increases the likelihood of alignment between the asset manager's approach and the asset owner's investment and stewardship policies which should facilitate more effective stewardship.

The disclosure of asset owners' investment beliefs should also help asset managers to comply with the proposed new rules currently being consulted on under FCP CP 19/7 on the implementation of the Shareholders Rights Directive (SRD II) – specifically the requirement for asset managers to make disclosures relating to their arrangements with asset owners and how their investment strategies are consistent with the medium and long-term performance of their assets.

For these reasons, we support this change to the Code. However, we are aware that most trustees of pension schemes do not have a set of investment beliefs in place and therefore for whom this requirement will add to the challenge of complying with the Code and therefore may reduce the number of signatories. In other words, the requirement could contribute

towards potential signatories, including pension scheme trustees, who do not already have developed investment beliefs, taking the view that complying with the Code is too difficult / onerous.

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

In our view, Section 3 makes it clear that signatories must monitor third party service providers that it appoints to assist with its stewardship duties. However, it could be further clarified by adding that the obligation under Provision 16 to ensure the services enable effective stewardship means stewardship that is aligned with their or their clients' (as applicable) investment and stewardship policies. This would also bring the obligation under Provision 16 into line with Provision 15 which deals with the monitoring of asset managers and by asset managers.

Separately, we note in the guidance for Section 3 that signatories are expected to explain the "tools or processes they use to monitor issues that may impact asset value". Our view is that potential signatories may be unclear as to what type of tools or processes could be used. It may therefore be helpful to soften this requirement or, alternatively, for the Code to provide some examples on what those tools or processes may include. Without practical guidance, our view is that many pension scheme trustees will take the view that the requirement is unclear and use it as another reason why complying with the Code is too difficult.

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

Yes, we are supportive of the terms "collaborative engagement" and agree that it encompasses a wider concept than collective engagement as it suggests that signatories must work and communicate with other stakeholders in a meaningful way to facilitate their stewardship policies and objectives.

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

Such a mechanism could potentially be of benefit as another way of holding an investee company to account but this would depend on the design of the mechanism and the potential consequences upon a concern being escalated. Our view is that the ability to raise a concern confidentially is likely to be more appropriate and beneficial for persons other than investors. Also, a key concept behind effective stewardship by investors is transparency and openness which is less likely to be aligned with a mechanism that allows concerns to be raised

confidentially. Therefore, overall, we are not clear that such a mechanism would be of material benefit, or be utilised in practice, by investors.

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

Whilst many signatories to the Code are likely to be familiar with what effective stewardship of investments in listed equity involves, the concept of effective stewardship in other asset classes (particularly illiquid assets such as long term infrastructure projects) may not be familiar. However, in line with our comments on Question 9 above, we support a flexible approach which allow signatories to form a common sense view of how those ownership rights might reasonably be exercised. As such, we do not think Section 5 should be more specific. It may be that if there is too much divergence in how this provision is interpreted and operated, that further guidance is required in the future.

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?

Our view is that the Service Provider Principles and Provisions generally do set sufficiently high expectations of practice and reporting.

One additional Provision that we consider would be helpful to include is an explicit obligation on the Service Provider to be familiar with and take into account the client's stewardship objectives and policies when providing their service. Currently, the obligation under Provision 2 of the Service Providers section of the Code states that Service Providers should provide "information about how products and services are prepared to best support clients' stewardship". This appears to be limited to what services are available rather than placing an obligation on the service provider regarding the way in which they carry out their services once appointed by the asset owner /manager.

Please direct any reply to the APL in this matter to Rebecca McKay at rmckay@towers.com or at the address set out above.

Yours faithfully



Rebecca McKay

For and on behalf of the Association of Pension Lawyers