Dear Sir/Madam

Proposed Revisions to the UK Stewardship Code

Legal & General Investment Management (LGIM) is one of the largest international investors globally with over £1 trillion of assets under management (as at 31 December 2018). We manage assets for a wide range of global clients, including pension schemes, sovereign wealth funds, fund distributors and retail investors.

LGIM has built a business through understanding what matters most to clients (both institutional and retail) and transforming this insight into valuable, accessible investment products and solutions. This enables pension funds to help meet their key long-term financial objective of ensuring fund assets match future financial liabilities and pay pensions.

Since the inception of the Stewardship Code in 2010, LGIM has been an active supporter and signatory of the Code. We believe that the Code plays an important part in underpinning and promoting good stewardship behaviour in the UK. Furthermore, we welcome the FRC in reviewing the Code given the evolving nature of stewardship and changing practices of market participants.

With regards to the new Stewardship Code, LGIM is broadly supportive of its approach. We welcome the wider focus of stewardship beyond UK equites to different asset classes and the connection between wealth creation in companies with value for beneficiaries. Furthermore, the apply and explain approach to the Principles strengthens its application by signatories.

In Appendix A, we have outlined our response to specific questions in the consultation. However, below we have outlined three areas which we believe are important and should be considered further by the FRC:

1. **Outcomes and Activities Report**

   The Outcome and Activities Report is essential to ensure that excellence in stewardship is demonstrated by signatories across the investment chain. The FRC should ensure that reporting under the Outcome and Activities Report is sufficiently robust and signatories understand that this report will be used as a key tool to assess a firm’s stewardship capabilities by stakeholders. It needs to be clear and outlining best practice examples of behaviour.

   In addition, within an asset management firm, the Outcome and Activities Report should be signed-off by the independent non-executive director who can attest to its statements. The non-
executive director is then held accountable for the application of the stewardship policies within
the firm to ensure that high level monitoring of stewardship is undertaken, and enough resources
are allocated to fulfil these objectives.
(For more perspectives on the Outcome and Activities Report, see our answer to question 5).

2. Definitions

We support the FRC’s definition of stewardship which encourages positive outcome for
beneficiaries, the economy and society. However, this wording could slightly be amended to
clarify how stewardship impacts wider stakeholders. Therefore, our preference of the definition
would be “The responsible allocation and management of capital across the institutional
investment community, to create sustainable value for beneficiaries, which leads to wider
economic and societal benefits.”

Secondly, whilst we understand that some market participants prefer to highlight in the definition
that ‘active oversight’ of assets is needed to demonstrate stewardship, we do not believe this is
appropriate as it does not reflect the wide range of stakeholders and investment approaches in
the market. For example, ‘active oversight’ may be interpreted by some as only referring to active
fund managers. This disregards index investors and the role they play in creating wealth in
companies and the market.

Lastly, we understand that some market participants prefer to exclude specific reference to
‘climate change’ when setting out their approach to ESG considerations because it focuses only
on one aspect of ESG. LGIM disagrees with this argument and supports the FRC in explicitly
referring to ‘climate change’ because this is already widely understood and utilised by market
participants. Furthermore, given the collective action by the Bank of England and regulators (e.g.
FCA, PRA, DWP) on climate change, this specific reference would be aligned with their efforts in
tackling this issue.
(For more perspectives on other definitions, please see our answer to question 13).

3. Separate guidance on reporting

Some areas of the Shareholder Rights Directive II (SRD II) overlap and are duplicated in the
Stewardship Code. This adds confusion of where the minimum legal standards are set compared
to the higher best practice disclosure requirements of the Code.

Therefore, our preference would be for the guidance to be separated out of the Stewardship
Code, so that it focuses primarily on the Principles and Provisions. Furthermore, a Stewardship
Reporting Lab should be formed to get relevant parties together and discuss best practice
reporting.

We hope that you find our comments constructive and would welcome a meeting to discuss any
further questions you may have on our response.

Yours sincerely,

Sacha Sadan
Director of Corporate Governance
LGIM
Appendix 1 – Response to questions

1. 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.

2. Do the Principles set sufficiently high expectations of effective stewardship for all signatories to the Code?
   
   2.1. LGIM supports the Principles and Provisions in the new Stewardship Code.
   
   2.2. However, in Provision 20, we would prefer to use the word “collective” engagement to highlight the significance of aggregate action to influence companies rather than just investors discussing issues/themes with each other (see answer to question 13 for more details). In addition, given the importance of collective engagement, we would like to see this being escalated as one of the main principles that underpins good stewardship behaviour.
   
   2.3. Whilst the Principles covers the core behaviours of signatories to exercise good stewardship, it will be important that the policy statements in the provisions and support the main principles are properly demonstrated in the Outcomes and Activities Report (see answer to question 5 for more details).

3. Do you support ‘apply and explain’ for the Principles and ‘comply or explain’ for the Provisions?
   
   3.1. Yes, however it is important that the explanations provided by signatories are meaningful. These should be regularly assessed by the regulator.
   
   3.2. The Outcome and Activities Report will also be important in assessing whether the activities of the signatory represent good stewardship by applying their policies.

4. How could the Guidance best support the Principles and Provisions? What else should be included?
   
   4.1. Our understanding is that the Stewardship Code sets the high bar for stewardship behaviour in the UK whilst the Shareholder Rights Directive II (SRD II) is the absolute minimum required in law. The current framework consists of Sections, Principles, Provisions and Guidance all within one document.
   
   4.2. We believe that there could be a risk of the Stewardship Code being a tick-box exercise and causing confusion in its messaging on the Principles and Provisions if the Guidance is fitted within the structure. Furthermore, the disclosure could risk becoming boilerplate given the level of detailed required and link with SRD II.
   
   4.3. Therefore, given that the Guidance is not mandatory we would rather have this in a separate document. A Stewardship Reporting Lab should be formed to get relevant parties together and discuss best practice reporting. The FRC can regularly update the Guidance document and provide recent examples of stewardship excellence as disclosure and transparency evolves. Furthermore, as there are different actors in the investment chain, separate guidance can be produced to better connect the signatory to
how they should report. This will provide more clarity on how they should disclose against the Principles and Provisions.

5. 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?

5.1. The Outcome and Activities Report is essential to ensure that excellence in stewardship is demonstrated by signatories across the investment chain. As highlighted by Sir John Kingman, this requires a “fundamental shift in approach” which is currently set by the FRC. In the absence of an informative Outcome and Activities Report, the Stewardship Code risks being a large collection of policy statements rather than explaining what is being done or what stewardship has achieved.

5.2. Therefore, without setting a prescriptive template, the FRC should ensure that reporting under the Outcome and Activities Report is sufficiently robust. Signatories should understand that this report will be used as a key tool to assess a firm’s stewardship capabilities by stakeholders. LGIM supports an evidence-based approach which focuses on the action/outcomes of the work being carried out. This transparency also enables all participants in the investment chain to see the multiple different activities that underpins good stewardship.

5.3. This report should provide full disclosure of evidence of how stewardship is conducted and is consistently applied across a firm. LGIM expects, at a minimum, the following actions and outcomes to be demonstrated clearly:

- 5.3.1. the exercise of voting rights, engagement with impact;
- 5.3.2. conflict of interest in practice;
- 5.3.3. use of collective engagement to influence company behaviour;
- 5.3.4. public policy/regulatory activities which seek to improve market standards and the regulatory framework as a whole; and
- 5.3.5. evidence of interaction/engagement up and down the investment chain (e.g. for LGIM it would be with asset owners and trustees).

5.4. In addition, within an asset management firm, the Outcome and Activities Report should be signed-off by the independent non-executive director who can attest to its statements. The non-executive director is also held accountable for the application of the stewardship policies within the firm to ensure that high level monitoring of stewardship is undertaken, and enough resources are allocated to fulfil its objectives.

6. 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?

6.1. Yes, we agree with the proposed schedule.

7. 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?

7.1. Please see answer to question 5.
8. **Do you agree that signatories should be required to disclose their organisational purpose, values, strategy and culture?**

8.1. Yes. LGIM believes that good stewardship connects all parties along the investment chain from the savers and citizens who provide capital for investment, to companies whose function in the economy is to create wealth and distribute this back to its citizens.

8.2. By being transparent on an organisation's purpose, values, strategy and culture, it provides a stronger link in the investment chain and promotes a better understanding of each firm's place in the system. This is essential to promote a stewardship culture within the UK.

9. **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?**

9.1. We agree that good stewardship is determined at the core of the way an asset manager operates, not at the asset level. Therefore, there should be no restriction on the investments used to carry out stewardship responsibilities.

9.2. To assist the market in its transparency obligations, we believe that a separate Guidance document (*as highlighted in our answer to question 4*) should set out examples of how the Provisions will be applied to different investment instruments as well.

10. **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?**

10.1. As outlined in question 9, stewardship is determined at the core of the way an asset manager operates. We do not believe that stewardship policies at fund level is appropriate because it will lead to an excessive reporting obligation for the signatory. There are limited benefits reporting at fund level and for LGIM which manages approximately over 6000 different funds, this would be onerous and demanding.

10.2. However, we also understand that there may be variation between different approaches across funds and asset classes and it is important that group level disclosure doesn’t result in misleading statements about the extent to which different stewardship approaches are applied by the asset manager.

10.3. Whilst we understand the objective of Provision 1, it will be helpful if the FRC provided more Guidance and examples of the appropriate disclosure it expects to ensure that it is proportionate. A Stewardship Reporting Lab should be formed to get relevant parties together and discuss best practice reporting.

10.4. Furthermore, to strengthen the links within the investment chain (beneficiaries, asset owners and asset managers), we believe that the FRC could provide better guidance of how signatories can engage at different levels along the investment chain. This supports and gives greater primacy to a two-way communication between signatories and their clients.
10.5. For example, every year when reviewing policies, LGIM holds an external stakeholder roundtable event where we interact with clients and thought leaders to discuss our approach to stewardship. This manages expectations of how stewardship is applied and can be improved by LGIM.

11. 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?

11.1. Yes.

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

12.1. Yes, however we believe there needs to be better oversight on the impact the Stewardship Code is having and how it is being applied by signatories.

12.2. LGIM views good stewardship as more than just about disclosure, voting and engagement. Ultimately, better stewardship entails the right connected behaviours and accountabilities by participants in the investment chain (e.g. asset owners, asset managers and companies) to create generate wealth and value. For this to be carried out and optimised, a strong supervision framework needs to be in place to facilitate and define the correct actions.

12.3. Given that the FRC utilises rankings as a way of judging the stewardship capabilities of firms, we recommend a higher bar is set in the assessment based on the Outcomes and Activities Report. Furthermore, the use of sanctions/suspensions may also be needed (as a tool of enforcement) to penalise those who don’t meet the FRC’s stewardship expectations.

12.4. An example of a criteria that could be used by the FRC to better assess the disclosure on climate change activities could be the extent that they report under the Taskforce Climate Financial Disclosures (TCFD) framework. This sets a high bar on reporting on climate change and the information they produce for stakeholders.

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

13.1. We understand that ‘collaborative’ engagement is a term used more widely internationally and that it involves different parties working towards an agreed goal.

13.2. However, when groups of investors are engaging on a particularly issue, we believe that the term ‘collective’ engagement better reflects the intent of investors coming together and acting as one group to achieve an outcome. This is because collective engagement involves an aggregation of investor’s individual efforts to make an impact. This goes beyond investors just discussing a broader issue/topic.

13.3. We also note that the term ‘co-operative’ is used in the SRD II. This could be used to describe the broader work investors are doing with each other.
13.4. Given the importance of this activity for stewardship, we believe this should be elevated to a main Principle rather than keep it as a Provision in the Code.

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

14.1. LGIM would support a mechanism in which investors are able to escalate concerns about a company. Currently it is unclear how issues reported to the FRC are handled and leads to meaningful consequences for companies who do not act in accordance with market expectations.

14.2. In addition to adding transparency, a formal mechanism will enable the FRC to hear from market participants directly on issues and act more urgently if there are numerous complaints on a specific company. This could prevent the situation worsening and impacting the wider market.

14.3. We would expect the mechanism to also include in its processes the issuance of notices, regular market updates of investigations and seeing the judicial procedure on cases if action was taken by the regulator.

14.4. To conclude, we believe a mechanism for formal complaints will strengthen market integrity and deal with matters quickly and fairly through the legal process.

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

15.1. We do not believe that the FRC should be overly prescriptive but would welcome additional information in the Guidance of how signatories can demonstrate effective stewardship. This includes setting out practical examples and be able to appeal to a wide range of asset classes and different stewardship practices. A Stewardship Reporting Lab should be formed to get relevant parties together and discuss best practice reporting.

16. **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?**

16.1. No comments.