Proposed revision of Stewardship Code

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UK Stewardship Code Consultation

Introduction

This document sets out Aon's response to the Financial Reporting Council’s consultation on proposed revision to the UK Stewardship Code.

Aon is a leading global professional services firm providing a broad range of risk, retirement and health solutions, with more than 50,000 colleagues in 120 countries. We work with the trustees and sponsors of around 1,000 UK pension schemes. Globally, we work with more than 2,300 clients with assets totalling $3.8 trillion.

Summary

Aon’s main investment business is on the advisory side to pension funds and their trustees in addition to having a strong fiduciary management business. As such, we play a key role within the investment community and undertake our own stewardship duties carefully. By helping our clients to understand manager exposures more holistically, with respect to longer term investment horizons and sustainable capital allocations, we help to raise levels of Stewardship. Given our position in the industry, we bridge all the proposed stewardship themes and are well positioned to respond to the FRC’s consultation. Given the need for signatories to serve the quickly evolving and regulated landscape that is Responsible Investment, we welcome the new structure of the code and we fully support the revised recommendations.

Question 1

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

The core areas of responsibility have been covered. Where we would prefer to see particular areas emphasised, we have highlighted these in our answers below, namely guidance around aligning to longer term investment horizons, requiring a process for Engagement priorities, more evidence-based reporting and directed accountability for Stewardship within an organisation.

We appreciate the delineation of signatory type and the call for more granularity of reporting and disclosure items. To date, we find a range of behaviours in this regard and a code identifying areas for focus specific to signatory type, will encourage those managers who to date have been failing in this regard.

While Provision 12 calls for the disclosure of investment beliefs and Provision 17 calls for an engagement policy, there is no call for a

Responsible Investment policy. A Responsible Investment policy would better articulate the sustainable imperatives of an asset owners or manager and we find more constructive engagement around sustainability results where there is greater clarity around these beliefs and values.

Question 2

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

In our view, higher expectations need to be set with respect to Engagement reporting.

More emphasis is needed for a manager's Engagement policy to be aligned to its agreed engagement priorities and how the manager has settled on these priorities for the year of reporting. These priorities should naturally align to a manager's Responsible Investment policy. Too often we see only random case studies of engagement. For engagement to be effective, it needs to be understood in the context of what a signatory is trying to achieve and why.

Not only should a manager be required to communicate on the engagement policy, process and methods (Provisions 17 – 19) but the reporting of actual engagement activities undertaken over the reporting year, would be an informative addition to Engagement reporting. This would enable the asset owner to assess whether the nature of those engagements is aligned with their own policies as well as an asset manager's engagement priorities. This reporting may be limited due to the potential sensitivity of information, nevertheless, some qualitative substance should be given. In the case of information sensitivity, case studies can be referenced at a later, more suitable time.

Question 3

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

Yes. It is important to offer the flexibility around explanations in order to capture the essence of a signatory's intention. With respect to accountability, we may add that requiring a signatory to identify the office/team/title/department, responsible for ensuring the application of the Principles, would result in better definition and accountability.

Question 4

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

While the code requires explanation around how a conflicts of interest policy has been applied, further clarity around when escalation procedures should be put in place would be informative and enhance accountability.

Question 5

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?

We support this more active approach, it enables better scrutiny of signatories by the public review of annual responses. A template for the provision of basic information would be preferable to referencing other sources. A prescribed template would minimise the risk of patchy information or defective links/locations to essential policy documents.

Annual reporting keeps a signatory alive to the actions it is undertaking in the name of Stewardship and avoids the inertia to which the 2012 code was subject. It could be expected that smaller businesses may struggle to provide the necessary resource.

Question 6

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?

The benefits of a signatory being included in the first list of signatories has not been made clear.

Given many signatories have already considered many angles of their stewardship, the deadline of December 2019 for the first list should not be overly burdensome.

The annual reporting of activities will serve to raise awareness of ESG standards and be an active yardstick through which these standards can be monitored and improved. Public scrutiny and review of annual reporting further serves to mitigate the pitfalls inherent to self-reporting and lack of auditing.

Question 7

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?

Ascribing a team within an organisation, tasked with responsibility of overseeing the application of the code, would increase accountability for the application of the code.

Delisting terms could be articulated to avoid the loose implementation of the Principles.

While a lesser priority, showcasing leading behaviours could provide inspiration towards higher standards of stewardship.

Question 8

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

Yes. We consider it key to understanding the nature of a signatory. A statement of purpose and the process of articulation is central to the culture of a signatory. It further acts as a point of firm reference which a stakeholder/partner can use to form fair expectations of the signatory in whatever capacity under review. From a declared stance around purpose, fall other policies, all of which can be used to hold the signatory to account in the wider sense and as appropriate.

Question 9

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?

The new code makes it clear that the stewardship of assets applies to all assets, regardless of how a company raises capital. We agree, but while the FRC guidance requires a manager to describe how they apply stewardship across the different asset classes, it could expand expectations here. Applying the stewardship principles is easier the more direct the link to the underlying entity – e.g. as for Equity holdings and voting rights. The more remote an asset allocation is from an underlying entity (e.g. Hedge funds, Diversified Growth Funds), the less transparency there is around appropriate stewardship duties. Rather than lose the focus of stewardship at this level, more direction could be provided around expectations of best practice.

Question 10

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?

Best practice in terms of integrating ESG risk factors across asset classes other than Equities, Bonds and Real Estate is still developing. It would therefore be premature to require specifics but a description of the spirit behind what asset classes seek to capture in terms of stewardship, would help form expectations and understanding. Disclosure for Equities and Fixed Income should be specific.

Where investments have longer term investment horizons, further guidance reporting around how investment processes have been aligned to the longer term, could be given.

Question 11

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?

It is essential for asset owner to disclose their investment beliefs. It is here that asset owners can develop their asset allocation strategy and define the longer-term purpose of capital allocation. An asset owner’s belief will enable them to determine what a more successful and sustainable partnership with an asset manager may look like. During the process of defining beliefs, an asset owner will come to understand which aspects of sustainability are important to them, how to invest for them and to what extent they believe the market reflects key risks for them. This can more effectively drive stewardship and provide guidance for asset managers.

Question 12

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

Yes, only through actively monitoring can a signatory enable themselves, or their assets, to be held to account with regard to stewardship. Engagement, as a stewardship behaviour, is key and active monitoring contributes well to Engagement. With respect to Responsible Investment and climate risk in particular (Principle E), more emphasis could be placed on the recommendations of the Task Force on Climate Related Financial Disclosures (TCFD) where more definition of approach is provided towards the overall management of climate risk factors.

The monitoring of service providers or third-party agents is generally overlooked.

Question 13

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

Yes, given the need for common understanding and language, the word 'collaborative' has more relevant connotations than the word 'collective'. It is also the term used by the UN Principles for Responsible Investment (PRI) Reporting framework and to differ would serve to confuse and lose resonance.

Question 14

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

We would support such a mechanism. This would serve to alert a company, without the threat of public censure, of a potential damaging issue. This may result in the earlier mitigation of risk and a higher chance of avoiding a negative result, undesirable to both parties. The mechanism would benefit from confidentiality. However, the circumstances around which escalation and the potential future disclosure of information, would need to be thought through.

Question 15

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

See Q9 above. Demonstrating effective stewardship in listed Equity and Fixed Income can be evidenced through case studies, in addition to general reporting and disclosure. This would equally apply to other asset classes to the extent specific stewardship there can be defined.

In Section 5, we particularly welcome Provision 26. To date the disclosure of voting rationales has generally been poor, yet key to constructive engagement.

Question 16

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?

See Q2 above. A template of prescribed information would be preferable to the reliance on a signatory to self-report. Consistent templated information would aid comparison across signatories, providing an overall context for understanding.