

Response

## LAPFF Response to FRC

### Consulting on a Revised UK Corporate Governance Code

**The Local Authority Pension Fund Forum** was set up in 1991 and is a voluntary association of 72 local authority pension funds based in the UK with combined assets of approximately £200 billion. It exists to promote the investment interests of the funds, and to maximise their influence as shareholders to promote high standards of corporate governance and corporate responsibility amongst the companies in which they invest. The Forum has taken the opportunity below to provide our view on those issues which we consider relevant to our activities.

#### Summary – the FRC’s own governance problems

The Financial Reporting Council (FRC) has requested comments regarding its consultation on a Revised Corporate Governance Code issued in November 2017.

It’s not appropriate to respond to the consultation without referring to the FRC’s own governance problems, not least in view of the emphasis being placed on culture and diversity by the FRC. LAPFF is on public record in response to the consultation from the Department of Business in 2016 (Green Paper for Corporate Governance Reform) that the FRC needs to be disbanded – and a replacement body reconstituted under primary legislation.

However, that was before the recent discovery through answers to Parliamentary questions that the FRC has been designated a public body since 2004<sup>1</sup> but has avoided the obligations that stem from that status<sup>2</sup>. More detailed information released by the Office of National Statistics (ONS) has revealed the FRC stating itself to be a collaboration between the Confederation of British Industry (CBI) and the CCAB (the Accounting Institutes’ umbrella body) with seats on the FRC board to those parties as the result for funding it. LAPFF cannot think of clearer evidence of regulatory capture.

LAPFF considers that the positions of the FRC Chair and the Chief Executive are untenable and considers that the FRC should be put into special measures, to be run by commissioners until a new body is set up under primary legislation.

It has been noticeable for several years that the more positive leadership on problems with director pay and conduct has been coming from other market bodies, such as the Institute of Directors, not the CBI. The impact of the problems with the FRC is particularly relevant to executive pay, where the FRC has been noticeably reticent in any criticism of LTIPs. It is also of concern that egregious pay schemes are advised by Big 4 firms acting as remuneration consultants. Also of note is that the

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<sup>1</sup> PQ HL5057

<sup>2</sup> PQ HL4991

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recent CBI response to the BEIS Select Committee in 2016 cited the PwC and KPMG view on remuneration<sup>3</sup>.

The Cadbury Code was predicated on accounts being the foundation for proper corporate governance. But accounting practice has clearly taken the wrong direction, under the auspices of the FRC, and has come adrift from Company law. The International Accounting Standards model was actively pursued by the Big 4 accounting firms, without doubt as it suits their global interest and it is disappointing to note that this Code consultation is almost entirely divorced from any reference to accounting matters, including in the context of pay.

LAPFF is encouraged that a statement by the FRC after the collapse Carillion, now sets out both s172 (Director duties) and s393 (True and Fair view) properly. However, this correct citation supports rather than diminishes the case of disbanding the FRC, as it should not have taken the occasion of a high profile collapse for the FRC to get the law right.

LAPFF therefore raises the incongruity of the FRC campaigning on the importance of 'culture', given its own deep seated problems. Recognising the proper form of the law the FRC has been too late in the cases of Carillion, and BHS. It was in 2016 that LAPFF wrote to FTSE 350 companies stating how and why the FRC position should be disregarded, and LAPFF remains firmly behind its decision to have done so.

## Summary – the Code revisions

The importance of exercising pooled fund voting rights by asset owners has been constantly deferred by the FR in the interests of asset management.

In respect of stakeholder engagement, LAPFF would like to see more legal requirements to ensure that stakeholder voices of all types are taken into consideration and in particular those of employees and consumers. Further guidance could be helpful to elucidate legal requirements in this area.

With a disappointing lack of action on executive pay, the proposed Code changes do appear to be a minimal response to the recent White Paper and Green Paper in order to give the impression of the FRC taking action.

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<sup>3</sup> Written evidence from the Confederation of British Industry (CGV0069) BEIS Select Committee 2016

## Detailed response

### Culture and the FRC's own compliance problems

Given that the consultation refers a lot to culture, it's not possible to escape the fact that the FRC has inherent internal 'cultural problems' a culture problem itself. In the response to the BEIS Green Paper on Corporate Governance in 2016, LAPFF said:-

*“The Treasury Select Committee described the position of the FRC as “inexplicable as it is unacceptable”. We agree and believe that Downing Street needs to take an active interest in the position of the FRC; it falls so far short of the standards expected in public life, it warrants intensive investigation. LAPFF believes serious consideration should be given to disbanding it, and recommends that an independent Companies Commission be set up.”*

In addition to the series of serious problems already identified by LAPFF, has been the recent discovery that the FRC has been designated a public body since 2004.

This lack of transparency and obfuscation cannot be explained to elected members, officers and pensioners without raising questions of direct criticism of the FRC. It's immediately apparent, given how public sector recruitment operates, that there will be a layer of staff at the FRC who will not have been recruited according to appropriate public sector norms, and this includes members of the board itself.

LAPFF is also surprised - given that the FRC had attempted reclassification since December 2004 - that the FRC did not once mention this, not only in various meetings with LAPFF, but to Parliament itself in various appearances before committees. All of this appears even more incongruous given that the FRC was appearing before Parliament asking for more powers<sup>4</sup>, whilst at the same time in private it was seeking to avoid being a public body<sup>5</sup>.

As previously highlighted, a Freedom of Information Act request (FOI) showed that the position put by the FRC Chief Executive to the House of Lords – on the issue of the Bompas opinion - was stating the position of the government incorrectly. The FOI showed the Department of Business official having to correct the FRC three times to prevent misstatement on the same issues to the press; but even then the Times had already been given a line that cited the government position without the government having cleared it. The same position was the case for Parliament.

In the light of this, LAPFF wrote to the six largest accounting firms in April 2016, setting out FRC inconsistencies and errors and was disappointed to discover that the FRC convened a meeting, for which no public minutes exist, to agree a position, that most of the accounting firms adopted in response to the LAPFF line. That process cannot be regarded as acceptable for a public body.

### Accounts, distributions, net assets and going concern

The following statement in the subsequent letter from LAPFF to one of the Big 4 accounting firms from July 2017 is particularly relevant in the case of what appears to have occurred at Carillion. It is quite clear, as pointed out at the time of the Sharman Review of 2012, that the FRC position on IFRS as a suitable basis to determine going concern was defective, for the simple reason that IFRS is not prudent.

<sup>4</sup> e.g. evidence to the BEIS Select Committee in November 2016.

<sup>5</sup> Source, Freedom of Information request on the Office of National Statistics

The LAPFF letter stated.

*“The fact that your letter states that the FRC held a meeting further to our letter – particularly in the absence of public minutes from that meeting – merely creates more questions for us about the conduct of the FRC. In our experience the FRC will go to great lengths to state it is correct, on grounds which do not then hold water. However, the fact that some FRC guidance is correct (it is consistent with Mr Bompas), merely identifies that other FRC guidance is then wrong”*

*I think that we can agree that the FRC has a position on s830 and annual accounts based on a position from Martin Moore QC. However, Mr Moore was not asked about annual accounts and s831 (the net assets test), nor s837, nor s92. Were he to be asked, we are sure that the problems we have identified would have been apparent to him, and the FRC.*

*“As you will already be aware, the FRC has a different position on the standard of annual accounts required for the net assets test (as set out in FRC Guidance on s92 and s831 CA 2006) compared to its position on the standard of annual accounts required for s830 (the profits test).*

*“You may also be aware that in its guidance on s837 (the standard of accounts where the auditor has qualified his opinion) the FRC has correctly cited the profits test (s830) in a way which sets a standard for annual accounts which is consistent with Mr Bompas, and thus contrary to Mr Moore.”*

*“We are sure that you will also appreciate that there are other implications from, the various errors and limitations of scope. The fact that FRC Guidance on ‘Going Concern’ regards going concern as an emphasis of matter issue, and not a qualification is also a problem. Because doubt about going concern is an issue relevant to the numbers stated in the accounts for net assets and distribution capacity, then auditor doubts about going concern should be triggering qualified audit reports and hence s837 statements by your firm.”*

The problems that the FRC have go right to the top of the organisation and accountability must reside with the Chief Executive. LAPFF has identified instances where an FOI on the Government has revealed that the FRC had made incorrect statements. However, we have a clear example of the FRC Chief Executive, Stephen Haddrill, taking an incorrect position even where the FRC is correct. In presenting to the BEIS/DWP Joint Select Committee, on being asked about ‘going concern’ by Antoinette Sandbach MP, Mr Haddrill stated:-

*“I think where the problem lies is that a ‘going concern’ judgement is seen by the public and many investors to be a judgement over the next year.”*

However, the FRC’s Sharman Review into going concern correctly states the position which is at least one year forward view, as indicated by the following:

*‘106. One difference is that the minimum period referred to varies (twelve months from date of approval of the financial statements is referred to in FRS 18 and the UK auditing standards; twelve months from the end of the reporting period is referred to in the international accounting and auditing standards). The Panel believes that a period of twelve months from the date of approval is more appropriate, as it reflects the period to the end of the next cycle for annual reporting, and that international harmonisation on this approach should be encouraged.’*

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## Executive Remuneration

Given that this consultation is the FRC's response to the Government White Paper, the following is part of LAPFF's response to that consultation:-

*“LAPFF believes that this consultation avoids the opportunity to redefine the debate on executive remuneration. The Forum is concerned that the current remuneration system is broken.*

*There are two principal reasons, the first is the long-standing concern about ‘rewards for failure’, where executives are highly rewarded despite subsequent failures in continuing company performance. The second reason is the growing belief by many stakeholders that executive pay at UK companies might be too high in general.*

*A more fundamental question is whether performance-related pay – a significant proportion of total pay - is really effective in motivating directors in the first place, or aligning their interests with those of shareowners.*

*The Forum is of the view that simply ‘tinkering at the edges’ of pay will not achieve the fundamental change that is required. Adjusting performance periods, setting acceptable minimum and maximum thresholds, or requiring more and more disclosure, will not lead to a dramatic reduction in pay. Nor will it necessarily result in an appropriate realignment with financial performance and shareowner interests.”*

Against this, the proposed revisions to the Code appear to be minor cosmetic changes, largely around process. There is no analysis of pay outcomes in the document and Provision 37 – the ability of boards to override inappropriate outcomes – is articulating a) something that ought to be in pay scheme in any case as a basic fiduciary duty and b) that there is an inherent problem with schemes that can produce such outcomes.

## The FRC's own board – the ONS classification matter

Given the problems with the FRC's own governance, LAPFF did a review of the independence of the FRC board as at April 2017 and reached the conclusion that only three members could be classed as independent (i.e. not executives, prior employees or operating board members), namely Keith Skeoch, Mark Zincola and Sir Brian Bender.

However, given that Sir Brian Bender was Permanent Secretary at the DTI (and the successor department) at the time that the dispute with the ONS was in its early phase<sup>6</sup> we can no longer regard him as independent.

The FOI on the ONS also highlights discrepancies with the FRC's own public board minutes. Even were the ONS only to have made a decision in 2014 that the FRC was a newly created public body (and we know that the decision was 2004), it is difficult to understand why the FRC board is only first told of a classification problem in December 2016 (in outline) and not in any detail until May 2017.

*“Ms McArthur reported that following Board consideration at its February meeting and further discussions with BEIS a draft report confirming the BEIS view, agreed with HMT, had been issued. The view confirmed that the FRC could not be classified as a Public Non-Financial Corporation.*

*The Board noted that, having sought input from external solicitors, there is no scope to challenge the current classification or to seek reclassification and consequently considered accepting the 2014 decision. 5.4 The*

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<sup>6</sup> PQ HL5468

*Board noted that accepting the 2014 decision would provide clarity and enable the executive to focus on securing the best position possible in terms of our operational independence and discussed the implications of the classification on the retention of fines, operations, staff and the role of the Board. 5.5 The Board agreed that the FRC should accept the HMT classification decision and work with BEIS to clarify what changes arise from the classification and with HMT to take forward discussions on the retention of fines.”*

Unless all the board were told which the board minutes don't show, we can only conclude that there may have been a 'board within a board', with executives and some non-executives knowing more than others. That clearly would be at odds with the principle that a board of a public body employs the executives, rather than what appears to be the case here where the executives appear to run the board.

It is also very odd for the employees of a public body, (which the large number of executives on the FRC board are), being delegated the function of determining the role of the board of a public body, especially one that hasn't been conducting itself as one<sup>7</sup>.

Further, the statement that three external solicitors were involved is difficult to reconcile with the answer to the following Parliamentary Question as to the cost of legal advice sought on the classification.

#### **Lords HL5058**

Asked by: Baroness Bowles on: 24 January 2018.

*"To ask Her Majesty's Government what was the total cost of external legal advice sought by the Financial Reporting Council regarding the classification decision of the National Accounts Classification Committee, including any attempts at reclassification."*

Answered by: Lord Henley Answered on: 01 February 2018

*We are informed by the Financial Reporting Council (FRC) that their total spend on external legal advice on all issues arising out the FRC's classification as a public body is £6,482.70 inclusive of VAT. This is a cumulative figure covering the period from 2004 through to 2017.*

Finally, we find it difficult to reconcile the statement "*The Board agreed that the FRC should accept the HMT classification decision*" (being May 2017) when a legal agreement signed by the Chief Executive of the FRC with the Chief Executive of the Institute of Chartered Accountants in England and Wales dated September 2016, had already stated that the FRC is a public body<sup>8</sup>. It is also demonstrably inaccurate as the National Accounts Classification Committee of the ONS not HMT decides classification status.

#### **The FRC board – other issues**

We note that the chair of the FRC's remuneration committee was the chair of the remuneration committee at Pearson.

Pearson received a 68% opposition vote from shareholders to pay (the remuneration report) at the 2017 AGM, the highest in FTSE 350. This level of opposition was not only the highest, it was well ahead of the next highest, WPP, with 21%. In addition, this was at the same time Pearson was paying £224,000 to its remuneration consultant, the eighth highest payment in the FTSE-All Share.

<sup>7</sup> PQ HL4991 "Up to that point the FRC determined its own policies on these matters. This is with the exception of the appointment of its Chair and Deputy Chair by the Secretary of State, which followed best practice for ministerial appointments.

<sup>8</sup> Delegation agreement between the FRC and the ICAEW 28 September 2016.

By raising the issue of culture and diversity, the FRC is highlighting that the FRC's own Board composition does very badly in these respects. However, it is what might be expected given the 'collaboration model' that the correspondence from both the FRC and the DTI reveals very clearly was the model for board selection. It more resembles a club.

*"it may appear that the Secretary of State has wide discretion over who she appoints. However, this is not the reality of the situation. In practice, the Secretary of State simply rubber stamps the appointment of two of the five directors. The heads of the CCAB [the Accounting Institutes] and CBI are always appointed to two of the posts. The terms of these appointments would be concurrent with their terms of appointment as heads of the CCAB and CBI. We are not aware of any instance when the Secretary of State has appointed anyone other than the current heads of the CCAB and CBI<sup>9</sup>."*

## THE CONSULTATION

Despite the foregoing, LAPFF wishes to comment on the consultation on its own merits, with reference to the foregoing where appropriate.

LAPFF supports more emphasis on implementing the Code rather than taking a 'comply or explain' approach. In any case, over the years, there has been an increased involvement of the law in many of the areas under discussion. On directors pay, there is now a legally binding policy vote and statutorily required disclosure. On audit, there are now legislative limits on auditors' tenure, the exclusion of certain non-audit services, as well as limits on those services that are permitted.

The stronger emphasis on independence of non-executive directors is viewed as a positive change.

On the subject of the removal of exemptions for companies not in the FTSE350, we raise some concern about board reviews, given that there is a direct cost of conducting these. On the basis that we are not aware of any board publishing the outcome of a review that was negative, or that resulted in direct disclosed changes to boards, we would be concerned at loading additional costs onto smaller capitalisation companies with no effect. LAPFF has a specific policy on board reviews which is attached as an appendix.

On the subject of employee involvement we merely note that the discussion papers include the three options from the (Government Green and White Papers), with no direct question on applicability:-

- Director from the workforce
- Formal work force advisory council
- Designated liaison NED.

There is some reference to whether investors should be applying NGO standards and if so, which. It is a fair question but it would seem fraught with difficulty for the FRC to be sanctioning one NGO (or certain of its standards) compared to another, not least given that we now know that the FRC is a governmental body itself. This is partly a result of the incongruity of the FRC (which is not an investor led organisation, and has no asset owner, or NGO representation at all) being involved in the Stewardship Code itself. There is no statutory basis for the FRC to be doing this, and as seems likely, the FRC's successor body will need a statutory basis. Stewardship is about protecting rights

<sup>9</sup> ONS FOI/2017/3410

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and there may need to be intervention when needed to remove directors (who may be prominent CBI members).

It is clear that a CBI influenced FRC board is not necessarily going to have the same view of stewardship as the CBI. LAPFF for example had strong objections to the role of Sir John Sunderland on the Board of Barclays (and CBI appointee on the FRC), having been chairman of the Remuneration Committee which determined the remuneration of Bob Diamond.

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## UK Corporate Governance Code and Guidance on Board Effectiveness

### Q1. Do you have any concerns in relation to the proposed Code application date?

LAPFF has no problems with the date.

### Q2. Do you have any comments on the revised Guidance?

LAPFF's concerns would be what is not in it as well as what is. The focus on 'Culture' is not only superficial but has the effect of excluding what appeared to be the objectives of the government in the Green and then White Papers.

There is a remarkable lack of substantive action on pay. There is no analysis and no mention of Long Term Incentive Plans (LTIPs). The inclusion of a Code provision to allow for override of pay outcomes is positive in itself, but is an indictment of schemes that can result in such outcomes.

There is no substantive material on financial reporting and audit which is relevant given the clear and abject failures in this area. LAPFF notes that the original Cadbury Review placed financial reporting and audit at the heart of the Code.

### Q3. Do you agree that the proposed methods in Provision 3 are sufficient to achieve meaningful engagement?

The term 'meaningful engagement' is rather loaded. It merely begs the question of 'meaningful for whom?' The fact that the FRC has been a collaborative effort between the CBI and the accounting profession would explain a form of "meaningfulness" that deals with things from that perspective. For example, we have little evidence to show that the CBI regards effective engagement and corporate governance as a response to the problem of principal-agent.

LAPFF is surprised that employee representation on the board is being seen as a 'meaningful engagement' issue. LAPFF considers that the intention of the Prime Minister's statements have been for large public interest companies to be run better and to deal with perceived excesses and bad outcomes. In our view, this is not 'meaningful engagement' but meaningful participation.

### Q4. Do you consider that we should include more specific reference to the UN SDGs or other NGO principles, either in the Code or in the Guidance?

There are particular problems with a regulatory body preferring one NGO over another. This is a particular problem given, as we now know, that the FRC is a public body. The FRC in its current form is wholly unsuited to make any decision on these matters, not least given that the FRC to a great extent, been run as a collaboration between the accounting firms and the CBI.

### Q5. Do you agree that 20 per cent is 'significant' and that an update should be published no later than six months after the vote?

LAPFF considers anything greater than 10% as significant and that 10% better aligns to the general principle that certain minority protections are offered at a 10% threshold. Six months is considered to be too long. Given that AGMs tend to be three to four months after the year end, adding six months to that takes the time closer to the next year end date. Three months should be perfectly adequate time for action. LAPFF also takes the view that such an update needs to have conditions attached: a formal document reporting on what specific shareholder engagement on the issues of concern raised by the oppose vote has been taken and the proposed outcomes by the company and how these are to resolve shareholders concerns] is necessary.

**Q6. Do you agree with the removal of the exemption for companies below the FTSE 350 to have an independent board evaluation every three years? If not, please provide information relating to the potential costs and other burdens involved.**

The cost issue could be a problem. Recently corporate failures and problems (e.g. the banks, Carillion, Tesco, Rolls Royce) would indicate that it is the larger companies that have the more ineffective boards. It is a matter for further analysis as to whether there is a correlation with director remuneration or there is a causative link.

Given that post banking-crisis reforms have assumed a causative relationship between executive pay and corporate risk, it may be the case that applying the same measures required of FTSE 100 companies onto FTSE 250 and smaller companies should be independently reviewed prior to extending the measures. Again, the fact that the company representation on the FRC board has been drawn from the higher echelons of the CBI is part of the problem. There is a noticeable difference in long-term performance between the FTSE 100 and the FTSE 250 for example, with the latter having superior long-term returns.

**Q7. Do you agree that nine years, as applied to non-executive directors and chairs, is an appropriate time period to be considered independent?**

LAPFF continues to support the original 'Higgs' rationale for nine years.

**Q8. Do you agree that it is not necessary to provide for a maximum period of tenure?**

This is difficult to answer given that it has been expressed as a negative, and is presumptive, and with no balanced discussion of the perceived merits or otherwise. A stronger evidence base for change is required.

**Q9. Do you agree that the overall changes proposed in Section 3 of the revised Code will lead to more action to build diversity in the boardroom, in the executive pipeline and in the company as a whole?**

LAPFF believes for the reasons stated, that the problem to be addressed is those boards that are very obviously not diverse, rather than getting into precise profiling of those boards that are.

**Q10. Do you agree with extending the Hampton-Alexander recommendation beyond the FTSE 350? If not, please provide information relating to the potential costs and other burdens involved.**

Yes.

**Q11. What are your views on encouraging companies to report on levels of ethnicity in executive pipelines? Please provide information relating to the practical implications, potential costs and other burdens involved, and to which companies it should apply.**

In general terms it would appear that concerns about a lack of appropriate ethnic diversity should start with identifying how far the company business model would benefit from such encouragement, and on that basis build up strategies to break down any perceived limitation on diverse board candidates.

The subject can come up against the difficult issue of racial profiling, which would be more of a problem for those boards that do have diversity, in having to create labels for the diversity that they already have. The concept of ‘*a level of ethnic diversity in executive pipelines*’ is equally tricky, as well as sounding like jargon. It’s far easier for boards that aren’t diverse to be described as such in plain terms. Any proposed measures should be about placing the burden on the problems not the successes. Incidentally, we note that the FRC itself is noticeably less diverse than even the FTSE 100.

**Q12. Do you agree with retaining the requirements included in the current Code, even though there is some duplication with the Listing Rules, the Disclosure and Transparency Rules or Companies Act?**

LAPFF considers that the current position on ‘Internal Control’ is confused and has not been properly reassessed since the banking crisis. This is a manifestation of the FRC seeking to champion its past and present outputs rather than properly reassess them. It is clear that, in some cases, the statements of ‘group wide internal control’ do not accord with directors duties’ and may owe more to defensive interests of the accounting firms. On that basis this area needs to be completely reassessed with proper independent legal advice.

**Q13. Do you support the removal to the Guidance of the requirement currently retained in C.3.3 of the current Code? If not, please give reasons.**

We do not support the removal of anything relating to transparency from the Code itself.

**Q14. Do you agree with the wider remit for the remuneration committee and what are your views on the most effective way to discharge this new responsibility, and how might this operate in practice?**

This is a subject worthy of further and fuller consultation. Given the clear failure of some remuneration committees in setting board level pay, and their clear dependence on remuneration consultants there could well be perverse outcomes in extending the committee’s remit. LAPFF also believes that the failure of PLC boards to adhere to public sector equal opportunities recruitment practices and structures, such as ‘open advertising,’ job descriptions and person specifications for board positions, needs to be addressed by all remuneration committees.

**Q15. Can you suggest other ways in which the Code could support executive remuneration that drives long-term sustainable performance?**

For a difficult subject, the simplest answer is to do more to discourage LTIPs

**Q16. Do you think the changes proposed will give meaningful impetus to boards in exercising discretion?**

No. It could and should be made much clearer to boards that paying senior executives where they are not merited is a basic breach of fiduciary duty.

## UK Stewardship Code Questions

**Q17. Should the Stewardship Code be more explicit about the expectations of those investing directly or indirectly and those advising them? Would separate codes or**

### **enhanced separate guidance for different categories of the investment chain help drive best practice?**

LAPFF has long held that the position of asset owners is different to that of asset managers. The issues revolve around conflicts of interest, including fund management fees. This is commonly known as an 'agency problem'. As currently structured, with its current problems, the FRC is not the right party to be issuing new guidance. LAPFF has long noted that asset owners are not represented on the FRC Board, and that the asset managers that are represented are FTSE 100 listed companies themselves. Just another aspect of the FRC resembling a club.

### **Q18. Should the Stewardship Code focus on best practice expectations using a more traditional 'comply or explain' format? If so, are there any areas in which this would not be appropriate? How might we go about determining what best practice is?**

Given that the issue of stewardship flows from fiduciary duties, the constructs of 'comply or explain' and 'best practice' don't necessarily accord with that approach. LAPFF members are well acquainted with third party asset managers who don't necessarily 'walk the walk?' and will be adept at using complexity and abstractions to obscure that.

The FRC has signally failed to require systematise asset manager voting records. Many asset managers do not report on a comparative basis, quarter by quarter, or store in perpetuity voting outcome data on their public websites, where they report at all. Currently (February 2018) State Street makes no voting disclosures for 2017.

### **Q19. Are there alternative ways in which the FRC could highlight best practice reporting other than the tiering exercise as it was undertaken in 2016?**

LAPFF believes that a key test of proper stewardship is voting against relevant resolutions where appropriate and attending difficult AGMs, such as Sports Direct. LAPFF therefore questions whether the Tiering exercise took account of that. LAPFF also believes that making engagement positions public, including speaking with the press is beneficial as well as transparent and helps positions – because they are public – be more robust.

In addition it is now time for the Stewardship Code to be taken out of the FRC's responsibilities and for an independent body to be established accountable to Parliament for managing the Stewardship Code.

### **Q20. Are there elements of the revised UK Corporate Governance Code that we should mirror in the Stewardship Code?**

As set out in the response to Q17, LAPFF believes that this is not the right time for the FRC to be taking on this responsibility.

### **Q21. How could an investor's role in building a company's long-term success be further encouraged through the Stewardship Code?**

LAPFF questions whether it can through the existing FRC framework. The defects in accounting and auditing have been causes of significant loss. The banks, Tesco, and now Carillion are examples of that. LAPFF is has been clear that the FRC should be replaced with

an independent Companies Commission. Such a body should not be overseeing investment activities.

**Q22. Would it be appropriate to incorporate ‘wider stakeholders’ into the areas of suggested focus for monitoring and engagement by investors? Should the Stewardship Code more explicitly refer to ESG factors and broader social impact? If so, how should these be integrated and are there any specific areas of focus that should be addressed?**

As previously stated, LAPFF considers that there are significant problems with the FRC operating in this area. Specific examples have arisen in connection with climate change reporting, with some FRC views according more with the consumers of capital (the management of extractive industries) rather than the providers of capital.

**Q23. How can the Stewardship Code encourage reporting on the way in which stewardship activities have been carried out? Are there ways in which the FRC or others could encourage this reporting, even if the encouragement falls outside of the Stewardship Code?**

LAPFF is clear that regulated fund managers should disclose voting outcomes for votes that are exercised at their discretion.

**Q24. How could the Stewardship Code take account of some investors’ wider view of responsible investment?**

LAPFF questions whether the Code is the right place to lead or accommodate the diversity of views in this area.

**Q25. Are there elements of international stewardship codes that should be included in the Stewardship Code?**

See the response to Q24 above.

**Q26. What role should independent assurance play in revisions to the Stewardship Code? Are there ways in which independent assurance could be made more useful and effective?**

We refer to the point made in response to Q 19 above.

In addition we are totally wary of this, if this in any way carry the risk of introducing the Big 4 accounting firms into this area, it should be avoided at all costs. The financial crisis and recent developments have demonstrated a clear departure from properly representing the public interest. This point is not made lightly, but flows in the wake of; the arrests of KPMG partners in Ireland, the arrest of the senior partner in a California office of KPMG for providing inside information, and the arrests in New York in connection with former KPMG partners at the Public Company Accounting Oversight Board (PCAOB) passing on information as to which KPMG audits would be inspected. There is also the case of PwC and the Lux-leaks whistleblower.

**Q27: Would it be appropriate for the Stewardship Code to support disclosure of the approach to directed voting in pooled funds?**

LAPFF supports the directing of votes in pooled funds, i.e. split voting. This issue represents the clearest breach by the asset management industry of facilitating the fiduciary rights of asset owners. It remains a scandal, particularly in the light of asset pooling measures affecting pension funds in the LGPS.

**Q28: Should board and executive pipeline diversity be included as an explicit expectation of investor engagement?**

LAPFF already engages on this subject. As explained above, the focus needs to be with engaging with those boards that are demonstrably not diverse.

**Q29: Should the Stewardship Code explicitly request that investors give consideration to company performance and reporting on adapting to climate change?**

Yes. LAPFF considers that climate-related risks and opportunities will be financially material to the performance of investment portfolios and the Stewardship Code is an appropriate vehicle to direct investors towards influencing the corporate response to climate change. Reference could be made to the Financial Stability Board Task-Force on Climate-Related Financial Disclosure (TCFD) guidance recommendations which are also applicable to investors. More detail on how such 'consideration' would work in practice is provided in the the Climate Change Investment Policy Framework (page 6, 'Company Engagement')<sup>10</sup>.

**Q30: Should signatories to the Stewardship Code define the purpose of stewardship with respect to the role of their organisation and specific investment or other activities?**

Yes.

**Q31: Should the Stewardship Code require asset managers to disclose a fund's purpose and its specific approach to stewardship, and report against these approaches at a fund level? How might this best be achieved?**

Yes.

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<sup>10</sup> [http://www.lapfforum.org/wp-content/uploads/2017/11/Climate\\_Change\\_Investment\\_Policy\\_Framework.pdf](http://www.lapfforum.org/wp-content/uploads/2017/11/Climate_Change_Investment_Policy_Framework.pdf)

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## APPENDIX

### Board Evaluation

*“The board should undertake a formal and rigorous evaluation of its performance with external facilitation of the process at least every three years, and should include a statement on this evaluation in the corporate governance section of the annual report. “*

The Forum considers that this reporting should include meaningful, high-level information to assist shareholders’ understanding of the main features of the evaluation process. Relevant disclosure in this regard is likely to be found in:

- i. The behaviours that the board evaluation is designed to measure and encourage.
- ii. The board’s learning from the evaluation.
- iii. The action points arising from the evaluation process.
- iv. Performance against prior action points.
- v. Evidence that the outcome of board evaluations has been fed back into board planning more broadly.
- vi. The extent to which the board has established “the tone for risk management and internal control and put in place appropriate systems to enable it to meet its responsibilities effectively.”

Outside agencies can appraise the board’s composition, including its mix of skills and experience. The Forum concurs with Walkers’ observation that board composition is a poor predictor of board performance. Our view is that only when shareholders get better disclosure on past board performance will they be in a position to predict future board performance.

Progress on reporting the critical dynamics created by a board’s composition and the nature of the board’s functioning as a high performance team has been slow. We believe this puts a greater onus on boards to evidence how they function as a team, particularly in regard to the quality of any challenge process to decisions on major risk and strategic issues. The most likely place for such disclosure is in the board’s annual evaluation statement.

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