Business, Energy and Industrial Strategy Committee

House of Commons, London SW1A 0AA

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Dear Stephen,

I am writing on behalf of the Committee to contribute to your current review of the Stewardship Code. These views are drawn from our work in examining a range of corporate governance issues and major company collapses, such as Carillion.

Our overall conclusion is that the Stewardship Code has not been effective in encouraging responsible long-term investment, nor consistently high standards of effective engagement between investors and company boards. Whilst ultimate responsibility for decisions rest with the board, the constant stream of reports of apparently unjustifiable decisions on executive pay, poor business practices and unfair employment policies raise serious questions about the value and quality and of stewardship.

The proposed new draft does represent an improvement, notably in setting out more clearly the expectations for both asset owners and asset managers and in giving more prominence to environmental, social and governance (ESG) issues. The sharper focus for signatories on establishing organisational purpose and culture is sensible. We also welcome the attempt to align the Code with the updated Corporate Governance Code.

However, re-arranging the wording of a non-mandatory Code does not, in our view, go far enough. Nor will it provide a strong platform on which the new regulator can build a strong reputation for proactively driving up standards of stewardship.

The wording in many places is far too weak to be effective. For example, signatories are required to "take into account" ESG issues, including climate change. If the UK is to meet its climate change targets, investors will have an important role in driving company behaviour. There is no attempt in the Code to actively promote environmentally-friendly investment. Similarly, the well-documented incentives in the investment chain driving short-term decision-making are not countered effectively by the Code.

Whilst we welcome the shaper focus on transparency in the revised Code, we do not believe that the wording around disclosure will be effective in providing the public, whose money is being invested on their behalf, with clarity on investment decisions and the principles underlying them. We believe that there should be full disclosure, readily accessible, of a wide range of investment decisions, including those relating to ESG matters, executive pay, board diversity and workforce issues. Clear and comprehensive disclosure will promote board accountability and encourage better performance by company executives. It should also help foster a market in good stewardship which can help investors become drivers of responsible corporate performance.

To achieve a functional market in stewardship the Code should place a greater responsibility on asset owners to drive more responsible behaviour by those investing their funds. Greater clarity and prominence of investment mandates, including guidance on ESG matters, should be at the heart of measures that enable investors to make informed decisions about where to invest their savings and pensions.

The evidence we have seen indicates that engagement between investors and boards is frequently inadequate and incapable of preventing boardroom decisions which undermine the company but also the reputation of British business as a whole. The incentives to "encourage" better engagement and stewardship, whether by passive or active investors, are insufficiently strong when placed in the context of resource requirements around engagement and the existing constraints around collective action.

We have proposed measures to improve the engagement of investors on audit matters and recommended the broadening of the concept of audit to include non-financial indicators of responsible governance. A more convincing regime of external assurance is required to improve trust. The revised Code should be capable of taking into account the conclusions on these matters of the current Brydon Review on the scope and effectiveness of audit.

We note that the Kingman Review expressed doubts about the quality of engagement between the FRC and senior investors and share its concern that the Code is better at encouraging worthy but formulaic policy statements than ensuring meaningful action. The absence of meaningful enforcement mechanisms and the ineffectiveness of the tiering system in incentivising better performance severely undermine the credibility of the Code. We agree with Sir John Kingman that unless significant improvements can be made a new approach should be considered.

I hope these observations are helpful and we look forward to seeing the outcome of your current review.

with my best wishes

[redacted]

Rachel Reeves MP
Chair of the Business, Energy and Industrial Strategy Committee