UKSIF
UK Sustainable Investment and Finance Association

29th March 2019

Response to FRC Consultation on the revised Stewardship Code

The UK Sustainable Investment and Finance Association (UKSIF) is the membership organisation for those in the finance industry committed to growing sustainable and responsible finance in the UK. Our vision is a fair, inclusive and sustainable financial system that works for the benefit of society and the environment. UKSIF was created in 1991 and has over 240 members and affiliates including financial advisers, institutional and retail fund managers, pension funds, banks, research providers, consultants and NGOs.

We strongly support the policy intent of the FRC's proposed stewardship code. We believe that good stewardship improves market function, encourages more efficient capital allocation, and can drive innovation and help hold investee companies to account. As the membership organisation for those in the financial sector who believe in a financial system that serves people and planet, we welcome the proposed revised code. Our response is based on consultation with members the majority of whom will be applying the new code as signatories. While members are supportive, one common item of feedback was that the FRC should seek to minimise the reporting burden, and that where existing reporting initiatives existed, the FRC should seek to align those with the requirements in the new Code.

Detailed comments and feedback 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.

Yes, we believe the proposed sections cover the core areas of stewardship responsibility. We support the intent behind the revised definition of stewardship, although we would prefer it to include references to 'resilient' value, rather than sustainable value. This would help avoid confusion. It would also sit more comfortably with the way in which environmental, social and governance factors are incorporated into section 2, 'Investment Approach', which references 'material ESG factors'.

Some members feel that the elements "economy and society" in the opening paragraph of "defining stewardship" place an unrealistically large burden on particular links in the stewardship chain whose remit is better captured by the more narrow definition in the second paragraph. Whilst UKSIF is a broad-based organisation and welcomes the reference to "economy and society", not all of our members can be reasonably expected to prioritise those areas; some should legitimately focus on the narrower definition in the second paragraph.

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

Yes.

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

Yes, we believe this strikes the right balance of a broad, principles-based approach. We support the inclusion of Provisions, which adds helpful context and information to those applying the code, and we believe it would be appropriate for the Provisions to remain on a comply or explain basis.

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

We believe the Guidance could be made more useful if it contained more detail, and was expanded to cover each of the five principles. The Guidance for 'Investment Approach' could be helpfully expanded to contain some more information about how ESG factors could be taken into account, including examples of best practice.

As the consultation document notes, the FRC expects signatories to the revised Code to exercise stewardship across a range of assets, not just listed equity. This innovation may require some explanation to signatories, which should be included in the Guidance.

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 broadly support the proposed Activities and Outcomes Report, although we believe it would be helpful if the FRC could clarify that reporting against the Code could be integrated into firms' existing reporting practices. This would help keep the cost and administrative burdens low for signatories.

While we welcome the new focus on outcomes, we would like to stress that these can be hard to measure and attribute to particular activities. Where it is difficult for signatories to measure and attribute outcomes, the FRC should clarify that signatories should report their activities alongside how these activities fit in with the intended outcome of the engagement.

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, we believe schedule sets out a clear and reasonable timescale for signatories to comply with the new code.

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?

The Kingman review found that the Stewardship Code is "not effective in practice", and recommended that "a fundamental shift in approach is needed to ensure that the revised Stewardship Code more clearly differentiates excellence in stewardship". The Kingman review called for the code to be focused on "outcomes and effectiveness, not on policy statements", and for the Government to consider "whether any further powers are needed to assess and promote compliance with the Code." Lastly, the Kingman review recommended that if the revised Code is not shown to be effective, the FRC should consider abolishing it.

We believe the revised code does represent a shift in focus away from process and toward outcomes, which does address the main thrust of the Kingman review's recommendations. However, neither the consultation document nor the proposed implementation schedule mentions a timeline for the Code's overall effectiveness to be reviewed, in line with Sir John Kingman's recommendation that the Code be abolished if it is not shown to be effective. We believe the FRC should commit to conduct a further review of the Code in the coming years to fulfil this recommendation.

We believe the powers the FRC currently has are sufficient.

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

Yes.

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?

Owners of financial assets other than equities have traditionally been less active in stewardship, and the revised Code's extension beyond liquid equity will represent a change for some signatories. We support a revised approach removing an arbitrary focus on listed equity. For instance, activities of large private companies can have just as great or even a greater impact on society as listed companies, and the high value of institutional holdings in alternative and private equity means that stewardship of such investments is arguably just as important. Therefore, it would be appropriate for the guidance to set out examples of how signatories can undertake stewardship activities.

For example, investors in bonds have an interest in overseeing the actions of Boards and a management to assess a company's capacity to service debt. Active engagement can help to help reveal risks or vulnerabilities in corporate strategy or operations that could significantly affect the issuer's creditworthiness. Bondholders can also influence an issuer's disclosures. One example is to encourage more comprehensive, credit-relevant and forward-looking ESG-related disclosures. The Guidance could make clear that almost all a bondholder's engagement will take place before issuance and in advance of periodic re-financings, since bondholders do not have voting rights. The Guidance could also set out the kinds of non-voting engagement with management and Boards that might take place after issuance.

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?

We support the suggestion that asset managers disclose how far stewardship practice differs across their funds.

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?

Yes, we support the suggestion that signatories disclose their investment beliefs. This is an important element of integrating ESG considerations in an investment approach.

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

Yes.

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

We do not have a strong preference, though in our experience we believe 'collaborative engagement' is a more widely-used term.

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

Investors are currently able to raise concerns with investee companies in private by seeking meetings or writing to them, using their soft power as funders. We do not believe there is any need for an additional mechanism at this time.

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

Please refer to our answer to question 9.

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?

We believe that it would be helpful to add guidance in the section covering service providers. From 1st October 2019, pension scheme trustees will be required to consider ESG factors as they draw up their statement of investment principles. The role of advisers will be key to pension schemes meeting their new statutory duties. This section of the Code could helpfully be updated with guidance setting out the kinds of things which service providers should be doing to help pension schemes meet their statutory duties. For more information about what these activities might include, please see UKSIF's recent report, prepared with the AMNT, on the role of advisers in helping schemes meet their new statutory responsibilities.[1]

We think translating the thrust of the UKSIF/AMNT report into a code of conduct for this key section of the investment industry would be desirable and we would be happy to engage with you further on this.

[1] http://uksif.org/wp-content/uploads/2018/12/FINAL-investment-consultant-December-2018-report.pdf