Corporate Governance and Stewardship
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By email to stewardshipcode@frc.co.uk

March 2019

Dear Sir or Madam,

The Green Finance Initiative (GFI) welcomes the opportunity to respond to the Financial Reporting Council's (FRC) consultation on proposed revisions the UK Stewardship Code (the Code).

The City of London Corporation – the body responsible for running London's Square Mile – regards green finance as prudent, profitable and one of the best tools available in the race to cut carbon. That's why, in January 2016, we launched our Green Finance Initiative in partnership with government. The initiative brings together international expertise from across the financial and professional services sector. It aims to: provide public and market leadership on green finance; advocate for specific regulatory and policy proposals that might enhance the green finance sector worldwide; and promote London and the UK as a leading global centre for the provision of green financial and professional services.

We are therefore delighted to have the opportunity to respond positively to what we feel is a welcome improvement to the Code. In our consultation response, we wish to emphasise the following points:

1. ***Definition of stewardship***
   We wholeheartedly welcome the proposed definition of stewardship employed in the draft revised Code. The strengths of the definition are that it:
   a. Applies to asset classes beyond listed equities. Were it to fail to do so, a significant portion of an institutional investor's portfolio will be unaffected by improvements in stewardship.
   b. Refers to capital allocation decisions, not just "what happens afterwards".
   c. Recognises of the ultimate stakeholders in investment decision-making, i.e. beneficiaries, the economy, and society.

2. ***Material ESG factors including climate change***
   We welcome the explicit and specific reference to "material ESG factors, including climate change". This has many benefits to long-term investors (and beneficiaries, the economy and society). The new language is clear, and it aligns with the DWP's recent government response on *Clarifying and Strengthening Trustees' Investment*

Duties[1]. It would be unwelcome to have contradictory regulatory language. We also refer to a recent report, issued by the GFI's Working Group on Data, Disclosure and Risk[2]. We think there are strong reasons why 'climate change' should be mentioned specifically (beyond other ESG risks), including its magnitude and universality (i.e. as a long-term risk factor), and also owing to the fact that if it were not mentioned, this might send the wrong signal to Code signatories. As a recognised leader for global investment stewardship, were the UK Code to take this opportunity to refer specifically to climate change, this might embolden the arbiters of other stewardship codes to follow suit.

3. ***Inclusion of more guidance, including TCFD***
   We believe the guidance could be improved by suggesting reference materials to signatories, particularly asset classes and issues newly covered by the Code. In particular we recommend that the guidance refers to the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD) as (currently) the best-practice framework for disclosing on climate change issues. This is consistent with arguments the GFI has advanced in its recent report on climate-related disclosure[3].

We applaud the consultation work undertaken by the FRC and we are looking forward to the publication of the consultation responses of other members of the investment industry. Were the FRC to receive responses that seek to dilute the definition of stewardship, or to downplay the relevance of ESG factors and climate change, we would urge the FRC to consider whose interests are being served by such views: it is unlikely to be beneficiaries, the economy, or society.

Our additional comments are provided with respect to the consultation questions below.

Should you wish to contact the GFI about this consultation response, please do not hesitate to get in touch.

Yours sincerely,

Dr Ben Caldecott
Chair, Data, Risk and Disclosure Working Group
UK Green Finance Initiative

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1 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/739331/response-clarifying-and-strengthening-trustees-investment-duties.pdf

2 http://greenfinanceinitiative.org/wp-content/uploads/2018/04/Data-Risk-and-Disclosure-Paper.pdf

3 Ibid.

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.

A1. Yes, with the caveats offered below.

The draft is well constructed and has incorporated several progressive features including:

- Expanding the scope beyond listed equities
- Mirroring the corporate governance code
- Including reference to investment decisions, not just post-investment activities
- Activities and outcomes focus
- Focus on purpose, culture and values

We endorse the reference to "ESG factors including climate change" under Principle E. For consistency we think all references to ESG in the document should be accompanied by "including climate change", for example in Provision 11. The new language is clear, and it aligns with the DWP's recent government response on *Clarifying and Strengthening Trustees' Investment Duties*[4]. It would be unwelcome to have contradictory regulatory language. We also refer to a recent report, issued by the GFI's Working Group on Data, Disclosure and Risk[5]. We think there are strong reasons why 'climate change' should be mentioned specifically (beyond other ESG risks), including its magnitude and universality (i.e. as a long-term risk factor), and also owing to the fact that if it were not mentioned, this might send the wrong signal to Code signatories. As a recognised leader for global investment stewardship, were the UK Code to take this opportunity to refer specifically to climate change, this might embolden the arbiters of other stewardship codes to follow suit.

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5 http://greenfinanceinitiative.org/wp-content/uploads/2018/04/Data-Risk-and-Disclosure-Paper.pdf

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We think that the *Service Providers Stewardship Code* needs more work, particularly in the guidance so that the expectations of different providers can be fleshed out. For example, consultants supporting manager selection and manager monitoring. We expand on this in A16 below.

Finally, assessment and enforcement are described in the consultation questions but not in the Code document. We think it would be useful to include some details of assessment and enforcement on pages 4-5 of the Code.

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

A2. Yes, subject to our comments below.

We refer back to our support in A1 for the proposed definition of stewardship, and our strong endorsement of the specific reference to “material ESG factors including climate change”. With regards to the latter, it is important that it is included as a principle, rather than a provision, in order to guarantee its status as “apply and explain” rather than “comply or explain”.

We note two points of consistency:

Code (Annex A), p7: Provision 11 should say “ESG factors including climate change” for consistency with Principle E.

Code (Annex A), p1: reference to ESG factors should say “including climate change”.

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

A3. Yes. We support greater structural consistency between the Code and the UK Corporate Governance Code.

We reiterate our remark in A2 that it is important that reference to “material ESG factors including climate change” is included as a principle, rather than a provision, in order to guarantee its status as “apply and explain” rather than “comply or explain”.

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

A4: The Guidance needs more work to provide more support on the ‘how to’. We also support more guidance on other asset classes such as fixed interest and private markets. We would encourage references to best practice guidance produced by, among others, UN PRI (most major asset classes), BVCA (private equity), and GRESB (infrastructure and real estate). We are happy to share work we are developing in this area over time and hope other signatories can do likewise to facilitate sharing of best practice.

In some cases, the guidance offers little more to the reader than is already in the provision text. e.g. Provision 5, Provision 8, Provision 10, Provision 11, etc. More signposts to existing initiatives that drive best practice stewardship disclosure would be beneficial.

Notably absent is a reference to the TCFD recommendations in the guidance itself. For code signatories looking to disclose against Provision 3 (governance) or Provision 11 (ESG integration), a link to the TCFD recommendations in the guidance would be beneficial. While the TCFD recommendations might be replaced or developed in time, the Code's guidance is flexible and can be updated by the FRC without consultation. We note that the UK Government has endorsed the TCFD recommendations and encouraged all listed companies to implement them[6].

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?

A5. We are supportive of the proposal to an annual Activities and Outcomes Report.
We believe the overriding principal that guides the content of the report should be that it is useful and engaging and meets the needs of its stakeholders.

When it comes to disclosures relating to climate change, we think that guidance relating to the Activities and Outcomes report should refer to the recommendations of the TCFD. Beneficiaries, regulators, clients, and other stakeholders, would benefit from the adoption of a consistent, accepted, and robust framework for climate-related disclosures.

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?

A6. Yes.

We think it would be useful to include on pp4-5 of the draft Code some details explaining that the FRC will check your Policy and Practices Statement and of the assessment of the Outcomes Reports.

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?

[6] https://www.gov.uk/guidance/green-finance#green-finance-taskforce

A7. We believe enforcement of the new version of the Code needs to improve considerably compared with enforcement against the current version. This will necessitate the FRC recruiting more stewardship professionals. We do not have a comprehensive set of recommendations for enforcement, but suggest that the threat of de-listing signatories could be an option. We believe it would be worthwhile engaging the FCA to discuss appropriate enforcement actions.

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

A8. Yes. Signatories should make clear their role in the investment chain, and explain why they have resolved to design and resource their approach to stewardship in the way they have.

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?

A9. Yes.

One of the core strengths of the new code is the expansion beyond listed equities.

We believe the guidance could be improved by suggesting reference materials to signatories, particularly asset classes and issues newly covered by the Code. In particular we recommend that the guidance refers to the recommendations of the TCFD as (currently) the best-practice framework for disclosing on climate change issues. In addition, guidance for newly covered asset classes could signpost to the good work done by the UN PRI (most major asset classes), BVCA (private equity), and GRESB (infrastructure and real estate), among others.

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?

A10. Yes, subject to the comment below.

Investors need to know about the approach to stewardship undertaken on the strategy in which they are invested. If this differs from the approach articulated in the firm's stewardship disclosures, then the investor ought to be made aware of this. The argument is particularly poignant when considering stewardship – including allocation of capital, and engaging and voting – of climate change. An investor should be made aware if his or her capital is not, from a climate risk perspective, subject to the same quality of stewardship as in other investment products covered by the firm's stewardship disclosures.

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?

A11. Yes. Investment beliefs should be the foundation upon which one's stewardship approach is built. This guarantees an intentional rationale for the stewardship approach. We have noted an increase in institutional investors disclosing a specific investment belief with regards to climate change, and we would encourage increased adoption of this practice.

We believe that the guidance under Provision 12 for asset owners could link to the tPR (the Pensions Regulator) guidance, which includes guidance on investment beliefs and example beliefs relating specifically to climate change.

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

A12. No comment.

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

A13. Yes.

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

A14. No comment.

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

A15. No comment.

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?

A16. No.

Service providers including investment consultants play a pivotal role in the extent to which ESG, RI, climate change, and stewardship are considered and acted upon by investors. Unfortunately we do not believe – with some notable exceptions – that the risks associated with climate change are given due consideration by service providers. We think that the Service Providers Stewardship Code should include, in line with the Code for asset owners and asset managers, specific reference to "material ESG factors including climate change".

We also recommend the work of the AMNT https://amnt.org/wp-content/uploads/2018/12/FINAL-investment-consultant-December-2018-report.pdf and imminent work by the PRI to assist in the development of the minimum stewardship requirements for investment consultants.