



Jen Sisson

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Dear Ms Sisson,

UK Stewardship Code Consultation 2019

Invesco welcomes the opportunity to provide its feedback on the consultation by the Financial Reporting Council on the UK Stewardship Code. Invesco is an independent investment management firm dedicated to delivering an investment experience that helps people get more out of life. We are privileged to manage more than \$930 billion in assets on behalf of clients worldwide (as of January 31, 2019). We have specialized investment teams managing investments across a comprehensive range of asset classes, investment styles and geographies and employ over 7,000 employees focused on client needs across the globe, with an on-the-ground presence in 25 countries.

In the UK our main operations are under Invesco Asset Management Limited (IAML). For the avoidance of doubt, the comments and views in this consultation are from IAML in relation to the assets managed under this entity in the UK. These asset classes include actively managed UK equities, EU equities, US equities, Asian, Japanese and emerging market equities, global equities, corporate and sovereign fixed income, bank loans and multi-asset strategies.

Invesco is committed to adopting and implementing responsible investment principles in a manner that is consistent with our fiduciary responsibilities to our clients. As fiduciaries, our priority is to protect our clients' interests, while seeking to deliver strong, long-term investment performance. Invesco is a signatory to the UN Principles of Responsible Investment ("UN PRI") and recognizes the importance of ESG issues as part of a robust investment process. Invesco was awarded an A+ rating in 2017 and 2018 for Strategy and Governance by the UN sponsored PRI. Invesco are current signatories to the UK Stewardship Code and are proud to have received a Tier 1 rating in the last assessment.

Invesco welcomes the review of the UK Stewardship Code and are broadly supportive of the proposed changes. In considering the questions raised in this consultation, we wish to emphasise the following points:

1. How investors consider ESG materiality.

Materiality is one of the three pillars that underpins our ESG philosophy. It refers to the consideration of ESG issues on a risk-adjusted basis and in an economic context. We

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believe it is important that as active investors we can take a view on the definition of materiality.

As high conviction investors, we look at each sector and company individually; and we consider the materiality of ESG issues at a fundamental level. While there may be nuances within sectors and companies, climate-related risks – such as carbon emissions, water intensity, waste generation and biodiversity impact – will almost always form part of our analysis. Where we consider that an issue can be material, we pay particular attention to trends in performance over time, quantifiable metrics and transparency of approach. These issues form the basis for further analysis and engagement activities.

2. Definition of stewardship.

The changes in the definition of stewardship are positive in our view to reflect greater focus on the inclusion of stewardship in the active investment decision of asset managers. In the context of materiality however, we see the core focus as creating sustainable value for beneficiaries. As such we have suggested an amendment to the definition to this effect.

3. Extension of stewardship beyond UK equities.

In principle we are supportive of these changes and it is aligned with our approach to integrate ESG issues as part of our investment process. We have outlined in our comments and answers below where we see the need for greater guidance on expectations for those asset classes where traditional mechanisms of stewardship are not available.

4. Requirement for annual reporting.

The requirement for annual reporting is not surprising. We would encourage as much overlap as possible with existing reporting requirements in for example the UN sponsored PRI.

Consultation questions

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 Principles and Provisions are comprehensive and cover the core areas of stewardship. The changes are comprehensive, and we do not see need for further principles or provisions.

We would encourage the Code however to recognise and put the Code in the context of corporate behaviour aligned to the UK Corporate Governance Code and equivalent global standards. Stewardship is not only the responsibility of shareholders, but also relies on strong corporate governance and culture. While the changes to the Code go beyond UK companies, the principles of good governance are global in nature. This approach aligns to the approach taken in the UK Corporate Governance Code where it specifically refers to investors and the UK Stewardship Code.

We welcome the inclusion of allocation of capital in the new definition of stewardship. This goes hand-in-hand with our view of active investment strategies being particularly well aligned with stewardship. However, we also believe that the FRC should recognise that there are several levels of stewardship and there may not be a specific outcome to certain aspects of stewardship. For example, the vast majority of corporate dialogue is information-gathering engagement to support a better informed investment decision. While this may not have a specific outcome, this most certainly is a form of stewardship as companies react to the questions and areas of interest of investors. Equally, where stewardship takes the form of very targeted objectives, some outcomes may take a number of years to materialise as a result of sustained engagement and stewardship. In the vast majority of cases, it may be difficult to identify a clear cut investment outcome as a result of stewardship because investment decisions are inevitably the result of a multitude of factors.

We do see a need to amend the definition of stewardship slightly. Stewardship and ESG research are part of our investment processes for our funds that have financial objectives at their core. This means that stewardship and ESG activities are carried out in the interest of beneficiaries and the code should reinforce the primacy of our fiduciary duties. This may or may not have a benefit to society and the economy. As such we would suggest amending the definition to:

Stewardship is the responsible allocation and management of capital across the institutional investment community to create sustainable value for beneficiaries which may also benefit the economy and society. Stewardship activities include monitoring assets and service providers, engaging issuers and holding them to account on material issues, and publicly reporting on the outcomes of these activities.

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

The Principles are sufficiently high level that they can be applied in a variety of ways which is necessary given the diversity of approaches applied in terms of responsible investment.

The expectations and associated actions taken with the Code are comprehensive and sufficiently stretching.

We believe Principle F. should be reworded to make clear that it is disclosure of the policy towards prospective and current investments that is required, rather than a very granular disclosure of how every single prospective and historic investment decision is aligned with their stewardship approach. We would propose:

“Signatories must actively demonstrate their approach to ensure that stewardship applies to both prospective and current investments.”

In the associated Provision 9 we would suggest that the statement highlights that stewardship activities should be factored into investment decision making in **a proportionate manner, aligned with materiality.**

It could usefully be clarified that “prospective investments” refers to investments which are undergoing detailed analysis as candidates for inclusion in a portfolio, rather than the entire permissible investment universe for a given fund/mandate, as the latter approach would not be feasible.

We also see a need to recognise that “demonstrate” (in Principles E and F) can and should be broadly interpreted. For example, it might be appropriate to so demonstrate by way of ESG policies and procedures, as opposed to publicly disclosing internal modelling or rating methodology, which can be commercially sensitive.

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

We do not see a problem with this approach.

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

Given the Code has been updated to include wider asset classes we would suggest that the guidance under section 1: Purpose, objectives and governance, is amended to be clearer on the scope of the Code and application of stewardship and associated reporting.

This is particularly relevant for asset classes where the traditional mechanisms of stewardship (eg voting) are not an option. For example, the proposed extension of the UK Stewardship Code to Fixed Income investments should be considered in light of the potential lack of corollary disclosure obligations on issuers. A lack of transparency at the issuer level could inhibit how effectively UK asset managers can comply with their stewardship obligations.

This needs to be analysed from both an instrument and an issuer perspective. For example, listed bonds issued by an entity outside the UK’s governance regime will carry a certain level of transparency as required by law (although query to what extent this will extend to e.g. ESG topics). However, non-listed debt instruments (for example, bank loans) issued by an entity outside the governance regime will only be subject to contractual transparency obligations; such obligations are typically limited to financial information. The issuers of non-listed debt instruments can often be private entities (both at an issuer and sponsor level). As such, not only are they often outside the scope of transparency and disclosure laws, but they can be resistant to providing such information given the lack of any legal obligation to do so.

Certain teams at Invesco which often invest in non-listed debt have encountered a range of responses from such “private” issuers, when making enquiries relevant to, for example, ESG matters. Some issuers and sponsors are extremely cooperative; others are unwilling to provide anything beyond what is required either by law (often very little) or pursuant to contractual provisions. If the market as a whole begins to move and there is sufficient consensus to demand enhanced lender contractual rights, this could be one solution. However, there is no guarantee either that this will occur, or that it will occur in a sufficiently timely manner to complement asset managers’ stewardship obligations in the interim

In particular on 4.19, the Guidance should be clear as to whether the corollary Provision also covers bank loans. Additionally, the Guidance should recognise that covenant design (whether in respect of bonds or bank loans) is primarily market led. We (along with many of

our peers) will attempt to negotiate documentation prior to issuance, but the extent to which we are successful will usually depend on factors outside of our control. Finally, the Guidance should be clearer as to what it means by “work with equity holders”. Our fixed income teams seek a collaborative approach with issuers and sponsors/equity holders – but ultimately the two asset classes do not always have aligned interests (this also relates to the documentation point above, where (often private) sponsors will seek maximum flexibility, where fixed income investors would prefer tighter documentary provisions).

Furthermore in 2.10 we suggest deleting “in most cases, a long-term perspective is required”. We understand the reasoning behind this wording, but given the extension of the Code to all asset classes, this does not feel appropriate. In particular, fixed income instruments are properly used for short, medium and long term investments – the investment theses behind fixed income instruments (and the levers available to fixed income investors) are often quite different to those in the context of listed equity investments.

In particular on 5.23, the Guidance should acknowledge that “ownership” of a fixed income instrument is exercised in a very different way (and on a much less frequent and much more ad hoc basis) than in relation to equity ownership. Similarly, in relation to 5.26, this Guidance should be more tailored toward fixed income assets where appropriate; for example, votes may not be capable of being made public (where the instrument is e.g. a bank loan) and query whether disclosure serves any meaningful purposes, given the ad hoc nature of corporate actions re. fixed income instruments. The corresponding Provision (5:26) might also need to be amended in this regard.

In particular on 5.27, the Guidance should make clear that (i) this is only required to the extent possible (often investors are given very little time to engage with issuers pre-issuance – this is not within investors’ control), (ii) this does (or does not) also extend to bank loans (there are similar timing issues as with bonds). More generally, some fixed income asset classes are better suited than others to meaningful pre-issuance engagement, e.g. green bonds or loans, where the issuer is fully aligned with investors re. what it should disclose. The corresponding Provision (5:27) might also need to be amended in this regard.

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?

Yes we understand the need for reporting on the application of the Code. We would expect to report on stewardship activities relating to the assets that we have deemed to be in scope. We would not expect to report on assets that are out of scope. We would expect this reporting to be ring-fenced to the activities that are relevant to certain asset classes.

We would suggest greater guidance is provided on this particular point in future either directly by the FRC or in collaboration with other parties, such as the Investment Association.

In regard to tiering, we would appreciate greater guidance on the weighting between the policy and the activities and outcomes report.

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?

We tend to agree with the proposed schedule. Consideration could be given to privately tiering in the first year rather than immediately publicly tiering firms. In this way signatories have a year to work on any gaps identified.

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 proposed revisions fully address the challenges posed by the Kingman Review. No further powers are required.

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

We support the idea that stewardship is not carried out in a void and that the investment manager or asset owner itself has responsibilities.

On the specific item of linking stewardship to remuneration we would encourage greater guidance. There currently is limited guidance on what this can entail. Stewardship can be both directly and indirectly linked to the incentives of employees and greater guidance on what is expected in terms of disclosures linked to remuneration would be helpful.

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 extension to other asset classes beyond listed equity is relevant as we are undertaking stewardship activities in asset classes beyond listed equity. However, the question and last principle in relation to exercising rights, remains most relevant for equities. As per our earlier comment, we expect to set out the meaning of stewardship for each asset class.

The provision (27) under exercising rights and responsibilities could be clarified in relation to fixed income in particular. The extent and nature of engagement will vary with the type of issuer (eg corporate versus sovereign) and instruments (bonds versus loans) and it would be good to reflect that in this statement.

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?

This Provision is sufficient but as noted in Q4, the Guidance can be improved in this respect. Signatories should not be expected to list differences between funds, but rather be free to group funds and assets as is most appropriate according to the stewardship activity and internal organisation.

Specifically, we suggest that Provision is amended to eg. “Signatories should clearly disclose their stewardship policies and practices regarding specific funds or asset classes”.

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?

As long term, valuation led, active investors, our investment process is aligned with ESG integration and active ownership. Providing information to beneficiaries on the alignment between investment beliefs and stewardship should be helpful to beneficiaries, clients and prospective clients. Simply stating investment beliefs in isolation is not helpful. As such, amending Provision 12 to: Signatories should disclose the alignment between investment beliefs and stewardship, would be more meaningful.

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

Section 3 is adequate in its expectation of monitoring. Provision 15 however suggests that for asset managers, all investors have a set of written investment and stewardship policies. This is not always the case. Amending Provision 15 to include “where relevant” may be appropriate to reflect the holistic nature of most asset managers investor base.

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

Yes we support the use of collaborative engagement which is consistent with our terminology.

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

Existing mechanisms such as the UK Investor Forum is a useful mechanism to assist investors to raise issues and gather critical mass for engagement. Other similar regional and local organisations exist, and the PRI is a useful resource particularly for thematic or large scale concerns.

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

Yes, as highlighted in question 9 we believe Provision 27 could be amended.

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 commend the Code for specifically including service providers. Under the Principle “B” it would be prudent to include the relationship between service providers and companies. As such adding the “corporate community” would be helpful, ie: “*Signatories must ensure they execute their role in the investment **and corporate** community in a manner that promotes and enables effective stewardship.*”

We would suggest that the lack of coverage by service providers in under researched asset classes such as high yield, bank loans and smaller companies is a significant impediment to stewardship activities currently. As such Provision 1 could possibly be amended along the

lines of: *“Signatories must indicate the range of services they offer and the objectives they have to close gaps to enable effective stewardship across asset classes and regions.”*
Under Provision 2 we would suggest consideration of timeliness of data is also included.
Perhaps a suggestion could be: **“Signatories must disclose the accuracy and timeliness of their service...”** More timely data would do a lot for more pointed and directed stewardship activities.

We appreciate the opportunity to respond to this consultation and look forward to continuing our dialogue with the FRC on these issues. Should you have any queries or points for clarification, please do not hesitate to contact me.

Yours sincerely,

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