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Dear Ms Horton

**Proposed revisions to the UK Corporate Governance Code and Guidance on board effectiveness – Initial consultation on the future direction of the UK Stewardship Code**

PricewaterhouseCoopers LLP welcomes the opportunity to respond to the consultation on proposed revisions to the UK Corporate Governance Code ('the Code') and Guidance on board effectiveness ('the Guidance'), as well as the initial consultation on the future direction of the UK Stewardship Code ('the Stewardship Code'). We broadly support the proposals and agree with much, but not all, of the detail of what is being proposed. We summarise below the main areas where we broadly agree or disagree, along with our initial views on the Stewardship Code. A number of other observations not covered by the consultation questions are in Appendix 1 to this letter and our responses to the specific consultation questions are in Appendix 2.

**Areas we broadly support in the proposals for the Code**

*Overall shape of the Code*

We like the cleaner form of the Code, with the removal of supporting principles and the increased emphasis on the role of the new principles. We also like that the number of provisions has also been reduced, again reflecting the focus on principles. It is, however, important for companies not to interpret the reduced length and emphasis on the principles as meaning that the proposed Code and Guidance are less demanding. The analysis that we have carried out to break down the proposals into their constituent parts shows that there are now over 10% more 'elements' to be considered, including those that have been transferred to the Guidance. This is not surprising, given that the new Code deals in more detail with areas such as shareholder and other stakeholder engagement and that much of what has been taken out of the Code has been moved to the Guidance rather than being deleted entirely. We would be happy to share our analysis with the FRC if this would be helpful.

*Long-term sustainable success and the emphasis on stakeholders*

Two clear priorities have driven the policy-making agenda around governance reform: the need to encourage business to take a long-term view of value creation and the need for companies and boards to help rebuild trust by doing more to demonstrate that the interests of stakeholders – particularly employees – are being considered.

Therefore we support the proposed introduction of principles and provisions into the Code to address these issues, a number of which also reflect the outcome of the Government's 2016 Green Paper on governance reform. In particular we welcome the following:

- The emphasis on long-term sustainable success in Principle A and on the sustainability of the business model in Provision 1. The latter has the potential to refocus companies and boards on

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- rigorously assessing the prospects of businesses in a way that goes beyond the extended going concern statement format that most viability statements have assumed to date.
- The flexibility in Principle C and Provision 3, supported in the Guidance, for how boards are expected to gather the views of the workforce. Inevitably, there will be challenges for the boards of multinational businesses in achieving equally effective engagement across the organisation, but we believe that it is important for engagement to go beyond the UK workforce in such cases. For this to happen, the Code and Guidance must, as in the current draft, remain sufficiently flexible to enable multinationals to combine approaches across their workforce. Regulations and norms governing engagement, as well as the principal areas of employee concerns, will vary across geographies and businesses.

We also support the emphasis in Section 3 of the Code on the importance of diversity at board and senior management levels for business success.

#### *Removing the relaxations for smaller listed companies*

We agree with the application in full of all the provisions of the Code to premium listed companies outside the FTSE 350 index, including the provisions on board and committee composition, annual re-election of directors and externally-facilitated board evaluations. While some smaller listed companies may find it challenging to identify and recruit more independent non-executives, our view is that listed companies regardless of market capitalisation have a significant impact on a range of stakeholders and, if private and AIM registered companies are to be subject to higher standards of governance in future, there should be a still higher standard for premium listed companies. The comply-or-explain mechanism also remains open to smaller listed companies in relation to these and all other provisions of the Code.

#### *Section 172 and the Code*

The duties of the directors of UK incorporated companies, including Section 172 of the Companies Act 2006, are referred to at the start of the existing Code in Principle A.1 but the focus is on the primary duty to promote the long-term success of the company, rather than the matters that directors must also 'have regard to' under Section 172. The proposed revisions to the Code go well beyond this with the new emphasis on stakeholders and, by appearing to put contributing to wider society at the same level as promoting long-term sustainable success and generating value for shareholders, the new Code arguably also goes beyond the 'enhanced shareholder value' model that is reflected in Section 172.

We believe it is reasonable for the Code to go beyond the strict legal requirements for directors – indeed many see this as one of the functions of a governance framework based on principles and good practice. However, we suggest that the FRC (perhaps in the Introduction to the Code) should make it clear that the intention is not to override the legal primacy of shareholders nor to extend the legal form of Section 172; the encouragement to increase the focus on the social contribution and impact of companies is ultimately because this is important to their long-term sustainable success.

#### *Governance and controlling shareholders*

Concern about governance in a small number of companies with controlling shareholders was one of the catalysts of the wider reform debate, and therefore we welcome the introduction into the Code of Provision 7, which would clearly apply to such situations. However it is not sufficiently clear at what other situations this Provision is aimed; the reference to '*ensur[ing] that the influence of third parties does not compromise or override independent judgement*' is quite broad and the expected actions are



not clear. In our opinion the Guidance could be used to indicate more clearly the scope and significance of this Provision.

We also note that conflicts of interest need to be ‘managed’ under the Companies Act 2006 rather than ‘eliminated’ as the Provision suggests.

### *Reporting*

Another of the FRC’s priorities in this review of the Code was to refocus users on the principles as a means of moving away from a box-ticking, provisions-led approach to both governance processes and reporting. We hope that the comments on reporting in the Introduction to the Code encourage more companies to report on how the governance processes and procedures have been applied to the key issues for, or developments in, the business, so that governance reporting centres more on actions and outcomes rather than descriptions of roles and responsibilities. This is something that we have advocated for several years through our Building Public Trust Award<sup>1</sup> for corporate governance reporting.

However we are concerned that companies may not make this shift in areas where the Code has not changed significantly. We encourage the FRC to make it clear that reporting can be improved even when the underlying processes and procedures remain the same. Options for improving all aspects of governance reporting include the use of case studies, discussion by the chair in the introduction to the governance report, and the use of the board evaluation disclosure to provide evidence and insight into important aspects of the underlying governance procedures.

### **Areas in which we disagree with the proposals for the Code**

Although we support much of what the FRC has proposed, there are some areas that we believe should be reconsidered.

#### *Director and chair independence*

We have particular concerns about the proposed changes in Provision 15 of the Code on the independence of directors. In our view:

- The proposed removal of the element of judgement around independence runs counter to the emphasis on principles in the rest of the Code and, in our opinion, ‘independence’ should not simply be defined or determined by passing a number of specific ‘tests’. The introductory paragraph to the existing Code provision (B.1.1) recognises this, by requiring boards to determine ‘*whether there are circumstances which are likely to affect, or could appear to affect, the director’s judgement*’. The seven ‘tests’ that have been carried across into the proposed revised Code are then given as examples of such circumstances, but not the only ones that need to be considered. We therefore disagree with the proposed change in approach because it appears to weaken the Code in relation to the independence of non-executive directors.
- The proposal to apply the independence tests to the chair as well as the other non-executive directors only makes sense in the context of the more limited understanding of independence described above. To carry out the role effectively, a chair will be involved with the business to an extent that means they cannot be independent in the same way as other non-executives: we have

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<sup>1</sup> <https://www.pwc.co.uk/build-public-trust/the-building-public-trust-in-corporate-reporting-awards.html>



already had a number of chairs asking whether they would need to reduce their involvement in the business in future, in order to be compliant with the Code provision. We therefore disagree with this change and question whether this was the FRC's intention.

We note also an inconsistency in that Provision 24 of the Code would still prevent the chair being on the audit committee: would this be necessary if the chair were now regarded as independent in accordance with the proposed wording of Provision 15?

The expected benefits of these changes around independence are not made clear in the consultation. We accept that it is important for boards to be refreshed in order to bring new ideas and avoid group-think, and indicators around non-executive director tenure are already in place in the existing Code (such as provision B.2.3). If the FRC's intention is to strengthen the expectations regarding tenure, or if there is a particular concern about the tenure of chairs, this can be achieved by focusing specifically on these matters, without changing the subjective nature of judgements around independence. We do not believe that there should be mandatory limits to tenure, however, as this would be contrary to the principles-based nature of the rest of the Code.

The following suggestions would address the issues raised above while still strengthening the Code in relation to tenure, particularly the tenure of the chair:

- Include at the start of Provision 15 the second and third sentences of the first paragraph of Provision B.1.1 of the existing Code;
- Delete the reference to the chair in the first line of Provision 15; and
- Add the following at the end of Provision 15: *'In normal circumstances no non-executive director, including the chair, should serve on the board for more than nine years from the date of their first election'*. If a company chooses to depart from this, it should explain the nature of the circumstances. The Guidance could make it clear that long periods of tenure with the same executive team is particularly discouraged (this being the major concern in this area for a number of shareholder groups).

Principle E states that 'the chair should demonstrate independent and objective judgement'; we would delete the word 'independent' here but believe that 'objective' could be retained as a non-defined term, and something which should reasonably be expected of a chair.

#### *Dealing with significant dissent*

Although we would prefer companies and their shareholders to have a dialogue *before* significant dissent against a general meeting resolution arises, we agree that the Code should set out how companies are expected to respond in such cases. However, we do not consider that interim six-month reporting should be recommended unless there is an important message to communicate. Clear reporting in the AGM statement and subsequent annual report may often be sufficient.

Moreover, we would not set a specific threshold for 'significance' of dissent in the Code. We believe the Code should be applied on the basis of directors' judgement and we would expect boards often to decide that they should engage with shareholders before dissent levels reach the proposed 20% threshold: if one or two major (e.g. top 5) shareholders vote against a resolution, 10% dissent (or even less) could well be seen as 'significant' and the Code should not be seen to discourage engagement in such cases. Conversely, a vote against of 20% driven by a negative proxy agency voting



recommendation may not be deemed significant if, say, the top ten shareholders are all supportive. A hard threshold may give proxy advisers undue influence.

We are not convinced that the '20% in year one' threshold that is in place for the Investment Association Public Register is the right level, and would support a change to allow companies the chance to respond to dissent in year one without it appearing on the register. But if the dissent recurs in year two it needs to appear on the register. Clearly, however, the operation of the register is outside the scope of the FRC's consultation.

We recommend the inclusion of a footnote to the Code noting that the Investment Association register is available for companies' reporting, and would specify in that footnote (rather than in Provision 6 itself) that the register applies to dissent of 20% or more. This would keep the Code and the register appropriately separate.

#### *Extension of the role of the remuneration committee*

Principle O sets out the board's responsibility with regard to company remuneration and workforce policies and practices. Although we agree with the concept, we have two main concerns with this principle:

- First, in our opinion, the use of the phrase 'policies and practices' suggests too operational a focus and creates the risk of board over-reach into executive management responsibilities. We suggest that better wording for this principle would be: *'The board should satisfy itself that the company's people strategy for the workforce, including remuneration, promotes its long-term success, is aligned with its strategy and values, and is subject to appropriate governance so that it is applied throughout the company and supports the desired culture'*. It may be that this Principle would be more appropriate as an addition to section 1 of the Code, given that its focus is the board's promotion of long-term success, strategy and values.
- Second, paragraph 104 of the Guidance provides that the oversight role can be delegated to the remuneration committee or an alternative committee. This appears to be in conflict with Provision 33, which states that the remuneration committee should have delegated responsibility for overseeing 'remuneration and workforce policies and practices, taking these into account when setting the policy for director remuneration'. We agree that the remuneration committee should be required to take into account workforce remuneration policies and practices when setting executive remuneration, but we do not consider that there should be a requirement for the remuneration committee to perform the oversight role. Some boards may wish to reserve this directly to themselves or to delegate it to another committee such as the sustainability committee. Companies should not be put in a position of non-compliance with the Code if they choose to do this.



Associated with this, Provision 41, and particularly the penultimate bullet, conflates the role of the remuneration committee in setting executive pay with the oversight role required under Principle O. There should instead be a separate reporting provision relating to Principle O such as: *‘The annual report, either in the strategic report or a report of an appropriate committee, should contain an explanation of the principles of the company’s approach to investing in, developing, and rewarding the workforce; how that approach supports the company’s strategy and values; and an explanation of the governance that ensures these principles are reflected in policies and practices throughout the company’.*

### **Observations on the initial Stewardship Code consultation**

#### *Increasing the influence of the Stewardship Code*

The Stewardship Code is a much less well-established component of the UK governance system than the Code and it will no doubt continue to develop over time. However, in our view, it will only achieve its intended purpose to promote dialogue and understanding between companies and their shareholders if it is made more rigorous and clearly describes the benefits of stewardship to both parties. This will enhance its credibility so that it can be used more systematically (and publicised more widely) as a yardstick that clients and beneficiaries (including retail shareholders and pension fund beneficiaries) can use to judge the stewardship activities and outcomes of asset owners, asset managers and other service providers. Greater rigour in the Stewardship Code would also make it more assurable, again enhancing its credibility and usefulness.

#### *Relevance to different parts of the investment chain*

The current Stewardship Code is not sufficiently clear about how it should be applied by some in the investment chain, particularly asset owners and service providers, including investment consultants and proxy advisers. In our view it should be a priority for the next Stewardship Code to create clear, tailored expectations for these different groups, focusing on how each of them could answer the question of how their actions have promoted the long-term success of the company involved. Providing clarity about the role of asset owners is particularly important because they have the ability to promote the stewardship activities of asset managers and service providers. Service providers may need their own annex in addition to the generally applicable aspects of the Stewardship Code as their activities are very different from the other parts of the investment chain. This should reflect the fact that most of the main shareholder advisory firms operate under the Best Practice Principles for Shareholder Voting Research of the BPP Group, and in future will need a code that is sufficiently targeted to meet the requirements of the Shareholder Rights Directive (subject to knowing more about how this will be implemented). Ideally the Stewardship Code would be fit for purpose under the Directive.

We think it is important to retain a unified ‘core’ Stewardship Code that explains how it pertains to the various players and shows the link between them through the investment chain. A single Stewardship Code will:

- Allow some signatories, such as insurance companies and pension funds that are asset managers as well as asset owners, to use a single set of requirements rather than comply with multiple – but similar – stewardship codes, which could be confusing and onerous;
- Help each player along the investment chain hold to account the others up and down the chain because they will all know what is expected of them, and how their activities relate to and affect the others;



- Promote continuous improvement in stewardship across the investment chain because there will be visibility of good practice; and
- Create the opportunity for a coherent implementation of the Shareholder Rights Directive.

#### *A focus on stewardship activity*

A weakness of the current Stewardship Code is its focus on reporting as opposed to activity. The revised Stewardship Code should emphasise and explain how signatory firms should set up their organisation, resourcing, processes, and approach in a way that aligns with their approach to stewardship, and *then* explain how this has been done.

#### *Specific engagement topics in the Stewardship Code*

We believe that the specific topics for engagement discussed in the initial consultation (such as diversity, culture, climate change and other environmental, social and governance ('ESG') matters) are often important factors in making investment decisions, in which case they should be the subject of engagement with boards and management. However, specifying which topics should be the subject of engagement is likely to result in box-ticking and no real change. The revised Stewardship Code needs to be sufficiently principle-based and 'future proofed' to avoid requiring, or giving the impression of requiring, signatories to engage on specific topics that may differ in importance (or relevance) by company and change over time. In our view, stewardship reporting, like reporting under the Code, should be focused on activities and outcomes and demonstrate how engagement with companies is applied to the key issues for the investee businesses, in the context of the firm's stated approach to stewardship. We also think the Stewardship Code should not use 'engagement' and 'stewardship' synonymously because being a good steward is not only about engaging with the company.

If you have any questions regarding the views in this letter, please contact Tom Gosling on 020 7212 3973. We would be happy to discuss any of the issues raised and make further drafting suggestions if this would be helpful.

Yours sincerely,

A handwritten signature in black ink that reads "Tom Gosling". The signature is written in a cursive, flowing style.

PricewaterhouseCoopers LLP



## **Appendix 1 – Other observations on points not covered by the consultation questions**

### *Engagement between committee chairs and shareholders*

We support the recommendation in Provision 5 of the proposed Code that committee chairs should ‘engage with shareholders on significant matters related to their areas of responsibility’. In practice this change is probably most likely to affect audit and nomination committee chairs (as remuneration committee chairs are already more regularly involved with shareholders). We think that it would help for the Guidance to emphasise that this Provision relates to situations where there are ‘significant matters’ to discuss – it is not intended to make engagement with audit and nomination committee chairs an automatic or mandatory part of investor meetings.

### *Reporting on engagement – With relevant stakeholders*

Although Provision 3 on the expected mechanisms for engagement relates only to the workforce, Provision 4 of the proposed new Code introduces a requirement to report on engagement with other stakeholders too. Boards should be reminded (probably in the Guidance) that appropriate mechanisms will need to be in place for them as a basis for this reporting. It should also be made clearer that the focus of this reporting relates to stakeholders material to the long-term success of the company, not every potential stakeholder.

### *Remuneration committee and setting non-executive pay*

Provision 33 suggests that the non-executive directors on the remuneration committee should set their own pay. Clearly this is in conflict with the last sentence of Principle Q: ‘No director shall be involved in determining his or her remuneration outcome’. This is a shift away from the current practice of the executive directors (and possibly the chair) determining the fees of non-executive directors. We don’t anticipate that this was intended and suggest that Provisions 33 and 34 be amended as follows:

33. *The remuneration committee should have delegated responsibility for determining the remuneration policy and setting remuneration for the chair, executive directors and senior management, taking into account workforce pay policies and practices.*
34. *The Board, or a committee drawn from the chair, executive directors [and senior management] should determine the remuneration of the non-executive directors, within the limits set by the Articles of Association. Levels of remuneration for the chair and other non-executive directors should reflect the time commitment and responsibilities of the role. Non-executive directors should not be eligible to receive share options or other performance-related remuneration.*

### *Updating Listing Rules, Disclosure Guidance and Transparency Rules and auditor responsibilities*

The FRC will need to ensure that the FCA updates the Listing Rules (LR 9.8.6) and Disclosure Guidance and Transparency Rules (‘DTR’) (including DTR 7.2.8) on a timely basis to reflect the structure and numbering of the new Code. With the extent of change in this version of the Code it is important that there is no delay.

The guidance for auditors on the ‘review’ of 13 provisions of the Code required under the Listing Rules is also significantly overdue for revision. It comes largely from 2006 (APB Bulletin 2006/5) and does not reflect amendments to the Code since that time including fair, balanced and understandable confirmations and the viability statement.



## **Appendix 2 – Responses to consultation questions**

### ***Question 1 – Do you have any concerns in relation to the proposed Code application date?***

We expect that the proposed changes to the Code will increase the number of departures from the provisions of the Code, particularly in the early years after they become effective and among smaller companies. We do not, however, advocate a longer delay in application than is currently proposed – as long as all market participants, and in particular proxy advisers, are willing to accept appropriate use of the comply-or-explain reporting mechanism and engage positively with companies in areas of concern.

We think the following changes are particularly likely to lead to a higher rate of explanations:

- **Appointment of new independent directors and chairs** To find, go through the recruitment process and appoint new people will take time, including the need for more companies to find external candidates for the role of chair.
- **Compliance with the stakeholder engagement requirements** Putting in place, or revising, arrangements for stakeholder engagement (remembering that this applies to all key stakeholders, not only the workforce) could take considerable time if it is done thoroughly as boards must (1) identify key stakeholders, (2) decide what methodology to adopt in terms of engagement, (3) carry out the engagement and then (4) report on it. For employees they must decide whether to follow one of the specific recommendations set out in the Code or an alternative that is more appropriate to their circumstances.
- **Externally-facilitated board evaluations for smaller companies** One of the concerns when this provision was introduced into the Code for FTSE 350 companies in 2010 was the small number of appropriate providers. We are not convinced that this situation has changed much since then, so there could be problems with finding facilitators with whom boards can work.

### ***Question 2 – Do you have any comments on the revised Guidance?***

We appreciate the questions for boards and others that are included in the proposed new Guidance and its focus on culture, diversity, succession planning, remuneration and nomination committee work, but we have concerns about the clarity of its status.

There is always a risk that FRC Guidance relating to the Code won't be read, as in our experience companies often focus almost exclusively on the Code alone. This risk increases over time and could mean that matters that are currently automatically included in governance reports are gradually omitted (especially, perhaps, if they are seen as 'boilerplate' or procedural). To address this the FRC should emphasise the importance of considering the Guidance alongside the Code on an ongoing basis.

The fact that the Guidance is structured under the same section headings as the Code is a step in the right direction, but it would also be helpful to take an approach similar to that adopted in International Standards on Auditing and in International Financial Reporting Standards, where the 'application material' is cross-referenced to the related 'requirement'. This would increase the chance of the Guidance being used without altering its status.



As noted above, the Guidance now includes questions for boards to ask both themselves and management, which may be helpful for companies in deciding how to assess their effectiveness in particular areas. When using these questions, boards will need to strike the right balance (applying their judgement as to relevance and other matters that might need to be addressed) to avoid a tick-box approach.

It might be helpful to split the questions up, and place them in proximity to where the underlying issues are discussed in the Guidance. In our opinion this would make their relevance clearer and also reduce the risk that they are interpreted as additional recommendations in effect.

We recognise that the Guidance builds on and incorporates the existing 2011 Guidance on Board Effectiveness but, as this version goes well beyond the topics addressed in the original version, we suggest renaming it in order to clarify its scope.

We note that the Guidance is silent on the proposed change in the Code for the chair to remain independent post appointment (which, as stated in our covering letter, we disagree with in principle). We also note that the description of the chair's role is considerably shorter than in the 2011 version of the Guidance. Assuming that the proposed Provision 15 is incorporated into the Code as currently drafted (which we disagree with) it would be helpful for the FRC to include an explanation in the Guidance as to why independence is recommended for the chair and clarify what changes to the role this may infer.

While the FRC has explained that some procedural aspects of governance that had previously been covered by the Code have been moved to the Guidance, we believe that some of the principles and provisions that have been moved are more than merely procedural. There is a risk that because these items have gone from being mandatory or 'comply-or-explain' to the Guidance, they will be seen as merely optional. If the basis for moving some of these items from the Code to the Guidance is due to the historically high levels of compliance, consideration should be given as to how compliance will be monitored in future. If monitoring reveals evidence of this falling away, we believe that the relevant points might need to be reinstated in the Code in due course.

Particularly pertinent examples of this include:

- **Provision A.1.1** *'The board should meet sufficiently regularly to discharge its duties effectively. There should be a formal schedule of matters specifically reserved for its decision.'* We think the 'Matters Reserved for the Board' documents are extremely important as they define those matters that may only be approved by the board and not by management; therefore it is critical that this schedule of matters continues to be a key document for good governance by boards.
- **Supporting Principle B.1** *'No one other than the committee chairman and members is entitled to be present at a meeting of the nomination, audit or remuneration committee, but others may attend at the invitation of the committee.'* This supporting principle has in the past been helpful to companies. If it is moved to the Guidance, we would recommend that the Guidance also states that the underlying principle should be reported on when disclosing director attendance at committee meetings and included in committee terms of reference.

- **Provision B.3.2** *‘The terms and conditions of appointment of non-executive directors should be made available for inspection. The letter of appointment should set out the expected time commitment. Non-executive directors should undertake that they will have sufficient time to meet what is expected of them. Their other significant commitments should be disclosed to the board before appointment, with a broad indication of the time involved and the board should be informed of subsequent changes.’* Making the letters of appointment for non-executive directors available for inspection offers an important level of transparency to all stakeholders. When deciding whether to appoint a prospective director, it is vitally important that the board have information about whether a non-executive director will have sufficient time to perform the role that is expected of him or her, supported by a disclosure to the board of their other significant commitments (and associated time commitments). While we note the requirement in Provision 14 of the Code for all directors to *‘ensure they have sufficient time to meet their board responsibilities’*, in our opinion this falls some way short of the safeguards regarding time commitment set out in Provision B.3.2.
- **Main Principle B.4** *‘All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.’* For directors to meet their statutory duties effectively, we believe it is vitally important for them to receive an induction on joining a board, along with regular updates to their skills and knowledge. The broader wording of Principle H of the proposed new Code is not as specific on the subject of induction.
- **Provision B.5.1** *‘The board should ensure that directors, especially non-executive directors, have access to independent professional advice at the company’s expense where they judge it necessary to discharge their responsibilities as directors.’* We believe there are numerous potential circumstances where non-executive directors in particular may seek to rely on this Code provision, with companies being compelled to explain themselves in the event that any such advice is not provided. One such scenario could be a takeover offer for a listed company, from a substantial shareholder with board representation. In such circumstances, the independent non-executive directors may need to seek independent professional advice before deciding how best to proceed and meet their statutory duties.

The FRC could explore the use of online reporting in relation to matters of this kind, which are often ‘standing data’. This would address the risk of them disappearing entirely as time goes on.

**Question 3 – Do you agree that the proposed methods in Provision 3 are sufficient to achieve meaningful engagement?**

We welcome the flexibility for companies to choose the method of engagement that best suits their circumstances in the proposed Code Provision 3. In our experience many directors agree with this and see it as particularly important to consider the views of employees. The current wording in the Code and Guidance creates the right balance between setting a clear expectation relating to the quality and rigour of engagement and providing flexibility on the mechanism. This flexibility will be particularly important for multi-business and multinational companies. Legal requirements and cultural norms about engagement vary enormously by geography, as do employee concerns. It is therefore essential that employee engagement can take place locally where it is relevant. Over-centralisation of the approach to listening to the employee voice could be counterproductive, while recognising that reporting the findings to the board should be integrated and insightful.

The term ‘workforce’ appears in Principle D and Provision 3 of the Code and in paragraph 31 of the Guidance. Given the novelty of the term, we think it would be particularly helpful to include a footnote



cross referencing from the Code to paragraph 31 of the Guidance, so as to provide clarity on its intended meaning.

Notwithstanding this suggestion, we have the following specific concerns around the use of the term:

*Inclusion of 'remote workers, agency workers and contractors'* – Although we can see the benefit of including these types of workers, we expect including them in engagement will be a logistical challenge for many companies, with the following issues arising:

- Defining exactly who qualifies as a contractor/agency worker for this purpose. The definition should exclude anyone who may provide services to the company where the company is effectively just a client of the person's business. The definition of 'worker' as contained for example in section 54 of the National Minimum Wage Act 1998 may be appropriate here. If not, a plumber coming for one job could be included in this.
- Given the transitory nature of contractor supply in many cases, we believe there is an argument for a minimum engagement period to trigger the application of the engagement mechanism. Six months may be appropriate, although the Agency Worker Regulations give agency workers a right of comparability with the hirer's own employees in the case of assignment of 12 weeks or more, so this could be a starting point.
- Many organisations will simply not have the necessary information about contractors to apply an engagement mechanism where these workers are provided by agencies. There may need to be a corresponding duty on agencies to provide companies with information to enable them to comply.
- Such parties are typically more difficult for the board to oversee and are often a smaller population (compared to employees) which makes it harder to protect anonymity when collating and reporting on data.

In our experience, for many companies, interpreting 'workforce' as 'employees' will result in little loss of value in relation to the intent of the Code and should be permissible where appropriate.

We also note the wording in Provision 3 regarding companies providing a means for the workforce to raise concerns in confidence and (if they wish) anonymously, similar to that in provision C.3.5 in the 2016 Code, but with oversight now coming from the board as opposed to the audit committee. This could appear to result in a conflict with industry-specific regulation such as that set out in the Financial Conduct Authority's (FCA) Senior Manager Arrangements, Systems and Control (SYSC) sourcebook. SYSC 18.4 requires UK relevant authorised persons to allocate the prescribed senior management responsibility for acting as the firm's whistle-blower champion to a non-executive director (where applicable), typically the chair or the chair of the audit committee. The Guidance could make it clear that the board is still able to delegate this duty.

Paragraph 30 of the Guidance is broadly drafted and does not appear to allow for the range of specific factors that directors must take into account in some circumstances. For example, a board may be involved in a series of transactions that in isolation appear not to be in the interests of the company or particular stakeholders but, due to commercial sensitivity the full strategic or long-term picture cannot be given at the particular point in time. The Prospectus Rules already cover information to be provided in relation to significant transactions for companies, but the Guidance as proposed does not differentiate between significant decisions and routine decisions taken by the board.



Overall, in this area of the Code and Guidance, maximum flexibility should be retained, while maintaining the context of the broader expectation that engagement should be meaningful and intentional.

***Question 4 – 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 many NGOs working on how to manage and disclose information about environmental and social matters and, in our opinion, the Code and Guidance should not promote some at the exclusion of others.

In general, it is important that anything that is referred to in either the Code or Guidance is directly related to companies' governance arrangements and in our view this does not apply to the UN SDGs. Having said that, business should do its part and should consider both how it will contribute to doing so and communicate its efforts.

***Question 5 – Do you agree that 20 per cent is 'significant' and that an update should be published no later than six months after the vote?***

As per our covering letter:

Although we would prefer companies and their shareholders to have a dialogue before significant dissent against a general meeting resolution arises, we agree that the Code should set out how companies are expected to respond in such cases. However, we do not consider that interim six-month reporting should be recommended unless there is an important message to communicate. Clear reporting in the AGM statement and subsequent annual report may often be sufficient.

Moreover, we would not set a specific threshold for 'significance' of dissent in the Code. We believe the Code should be applied on the basis of directors' judgement and we would expect boards often to decide that they should engage with shareholders before dissent levels reach the proposed 20% threshold: if one or two major (e.g. top 5) shareholders vote against a resolution, 10% dissent (or even less) could well be seen as 'significant' and the Code should not be seen to discourage engagement in such cases. Conversely, a vote against of 20% driven by a negative proxy agency voting recommendation may not be deemed significant if, say, the top ten shareholders are all supportive. A hard threshold may give proxy advisers undue influence.

We are not convinced that the '20% in year one' threshold that is in place for the Investment Association register is the right level, and would support a change to allow companies the chance to respond to dissent in year one without it appearing on the register. But if the dissent recurs in year two it needs to appear on the register. Clearly, however, the operation of the register is outside the scope of the FRC's consultation.

We recommend the inclusion of a footnote to the Code noting that the Investment Association register is available for companies' reporting, and would specify in that footnote (rather than in Provision 6 itself) that the register applies to dissent of 20% or more. This would keep the Code and the register appropriately separate.



Additional comment:

Provision 6 of the proposed Code refers to action being needed if *'more than 20% of votes have been cast against a resolution'* but the Investment Association register refers to dissent of *'20% or more'*. If the proposed reference to a threshold is retained in the Code (which we do not support) the threshold used should be consistent and the Investment Association's version is likely to be what was intended by the FRC in any case.

***Question 6 – 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.***

See our comment about the shortage of high-quality providers of independent board evaluations in response to Q1 above.

As per our covering letter:

We agree with the application in full of all the provisions of the Code to premium listed companies outside the FTSE 350 index, including the provisions on board and committee composition, annual re-election of directors and externally-facilitated board evaluations. While some smaller listed companies may find it challenging to identify and recruit more independent non-executives, our view is that listed companies regardless of market capitalisation have a significant impact on a range of stakeholders and, if private and AIM registered companies are to be subject to higher standards of governance in future, there should be a still higher standard for premium listed companies. The comply-or-explain mechanism also remains open to smaller listed companies in relation to these and all other provisions of the Code.

***Question 7 – Do you agree that nine years, as applied to non-executive directors and chairs, is an appropriate time period to be considered independent?***

As per our covering letter:

We have particular concerns about the proposed changes in Provision 15 of the Code on the independence of directors. In our view:

- The proposed removal of the element of judgement around independence runs counter to the emphasis on principles in the rest of the Code and, in our opinion, 'independence' should not simply be defined or determined by passing a number of specific 'tests'. The introductory paragraph to the existing Code provision (B.1.1) recognises this, by requiring boards to determine *'whether there are circumstances which are likely to affect, or could appear to affect, the director's judgement'*. The seven 'tests' that have been carried across into the proposed revised Code are then given as examples of such circumstances, but not the only ones that need to be considered. We therefore disagree with the proposed change in approach because it appears to weaken the Code in relation to the independence of non-executive directors.
- The proposal to apply the independence tests to the chair as well as the other non-executive directors only makes sense in the context of the more limited understanding of independence described above. To carry out the role effectively, a chair will be involved with the business to an extent that means they cannot be independent in the same way as other non-executives: we have already had a number of chairs asking whether they would need to reduce their involvement in



the business in future, in order to be compliant with the Code provision. We therefore disagree with this change and question whether this was the FRC's intention.

We note also an inconsistency in that Provision 24 of the Code would still prevent the chair being on the audit committee: would this be necessary if the chair were now regarded as independent in accordance with the proposed wording of Provision 15?

The expected benefits of these changes around independence are not made clear in the consultation. We accept that it is important for boards to be refreshed in order to bring new ideas and avoid group-think, and indicators around non-executive director tenure are already in place in the existing Code (such as provision B.2.3). If the FRC's intention is to strengthen the expectations regarding tenure or if there is a particular concern about the tenure of chairs, this can be achieved by focusing specifically on these matters, without changing the subjective nature of judgements around independence. We do not believe that there should be mandatory limits to tenure, however, as this would be contrary to the principles-based nature of the rest of the Code.

The following suggestions would address the issues raised above while still strengthening the Code in relation to tenure, particularly the tenure of the chair:

- Include at the start of Provision 15 the second and third sentences of the first paragraph of Provision B.1.1 of the existing Code;
- Delete the reference to the chair in the first line of Provision 15; and
- Add the following at the end of Provision 15: *'In normal circumstances no non-executive director, including the chair, should serve on the board for more than nine years from the date of their first election'*. If a company chooses to depart from this, it should explain the nature of the circumstances. The Guidance could make it clear that long periods of tenure with the same executive team is particularly discouraged (this being the major concern in this area for a number of shareholder groups).

Principle E states that 'the chair should demonstrate independent and objective judgement'; we would delete the word 'independent' here but believe that 'objective' could be retained as a non-defined term, and something which should reasonably be expected of a chair.

**Question 8 – Do you agree that it is not necessary to provide for a maximum period of tenure?**

See our comments in relation to Q7 above.

**Question 9 – 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?**

We welcome the proposed changes to section 3 of the Code as a step in the right direction which will encourage greater transparency on the positive actions that companies are taking to improve their diversity (this being an important contribution to the overall direction of change across society), as well as broadening the definitions of diversity. Ultimately, greater transparency, as proposed in Provision 23, increases the ability for investors and customers to hold companies to account and should be welcomed.



Change still needs to be better embedded in the system, as the Code acknowledges, through a focus on the pipeline of senior leaders and, ultimately, the culture of organisations. To achieve this requires genuine buy-in and accountability from the executive leadership, supported by a robust action plan and a careful consideration of the bias that may exist within existing HR policies and processes. Some of this is inevitably beyond the detailed oversight of the board. However, increasing disclosure in this area, as well as enhancing the role of the nomination committee, are positive steps to encourage these actions.

Broadening the focus of the Code to include social and ethnic diversity and covering the 'workforce' is consistent with the opportunities to increase diversity over time which have been identified since 2011 when Lord Davies first published his report 'Women on Boards'. The proposed changes will strengthen the diversity in the pipeline to executive committee level ('Exco') and to 'Exco minus 1'. This in turn fuels the pipeline for both executive director and non-executive director appointments and it is these leadership roles that can have a direct impact on company culture and provide the real opportunity to make major changes in diversity levels.

Transparency of actions taken and the related metrics (as per Hampton-Alexander on the gender balance of the executive management team and their direct reports) have, in our experience, created a stronger sense of accountability which is essential to progress. The Code remains perhaps the most persuasive and influential source of governance recommendations, so the proposed changes should usefully reinforce this direction of travel.

Two points of detail in this area are as follows:

- Those companies that are subject to the Disclosure Guidance and Transparency Rules DTR 7.2.8A will need to address the Code alongside those specific new reporting requirements and it would be useful for the FRC (working with the FCA) to provide guidance on how the two can best be integrated, while complying with both frameworks.
- We wonder whether the reference in Principle J to diversity of 'cognitive strengths' could be better worded. We suggest amending the end of the Principle to 'and promote diversity of gender, social and ethnic backgrounds, and a range of different cognitive and personal strengths'.

***Question 10 – 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.***

We agree with this proposal. The focus of the Hampton-Alexander review on executive pipeline is critical to improving the diversity of leadership and, within this, transparency on the diversity of senior teams is an important tool. As such, any provision that encourages this transparency in more organisations should be seen as a positive step, and we do not envisage any specific issues for other companies in reporting on the gender balance of their executive team.

On the basis that organisations with over 250 employees are now required to calculate and publish their Gender Pay Gap, and many have also chosen to publish an explanatory narrative, the almost inevitable consequence is to publish demographic information, especially the gender diversity of the executive pipeline.



Irrespective of whether an organisation has an HR system/function, all organisations have payroll systems that include NI information (NI being a gender identifier) and so the required analysis is feasible.

***Question 11 – 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.***

The principles and provisions in the Code which reference diversity should promote a consistency of approach for gender, ethnic and social background and thus support the recommendations of the Parker report.

However, in practice we are aware this is a significant challenge as FTSE 100 companies have been working to gather baseline data since the publication of the Parker report and, potentially, this will be an even greater challenge for FTSE 250 companies and beyond (unlike gender, there is no obvious formal identifier of ethnicity). Under UK law, companies cannot compel their employees to disclose their ethnic background; such information is provided by the employee on a voluntary basis. As such, companies could report on this area only if they have received the data voluntarily from individuals. Furthermore, ethnicity is harder to discern than gender and to be useful would need to be considered along with race (for example, a person from South Africa may or may not be black and the debate would need to be had about whether it is most important to disclose that x% are black versus x% are from South Africa). Therefore, although disclosures on the actions that are taken to improve the ethnic mix of executive pipelines may be appropriate, disclosing the numerical mix may not be practical at this time.

The Code rightly acknowledges that it is important that diversity is considered in all its dimensions when developing policies and action plans in this area. We also know from reviews such as Parker that there remain considerable challenges to achieving ethnic diversity in senior leadership. We think that including encouragement to deal with such issues in the Code, including reporting elements in Provision 23, will help to accelerate change and strengthen diversity over time.

***Question 12 – 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?***

Yes, we agree, principally because the Code is applied by companies to which the Listing Rules, Disclosure Guidance and Transparency Rules and the Companies Act 2006 may not apply. DTR 7.1, for example, does not apply to non-UK companies.

***Question 13 – 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.***

It is hard to see that this small change about the need to make the audit committee terms of reference available is worth making, but it appears to us unlikely to change matters in practice as it will still be in the Guidance (subject to our comments about the persuasiveness of that Guidance). See our comments about the need to monitor the ongoing impact of moving elements of the Code to Guidance in our response to Q2 above.



**Question 14 – 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?**

As per our covering letter:

Principle O sets out the board’s responsibility with regard to company remuneration and workforce policies and practices. Although we agree with the concept, we have two main concerns with this principle:

- First, in our opinion, the use of the phrase ‘policies and practices’ suggests too operational a focus and creates the risk of board over-reach into executive management responsibilities. We suggest that better wording for this principle would be: *‘The board should satisfy itself that the company’s people strategy for the workforce, including remuneration, promotes its long-term success, is aligned with its strategy and values, and is subject to appropriate governance so that it is applied throughout the company and supports the desired culture’*. It may be that this Principle would be more appropriate as an addition to section 1 of the Code, given that its focus is the board’s promotion of long-term success, strategy and values.
- Second, paragraph 104 of the Guidance provides that the oversight role can be delegated to the remuneration committee or an alternative committee. This appears to be in conflict with Provision 33 that states that the remuneration committee should have delegated responsibility for overseeing *‘remuneration and workforce policies and practices, taking these into account when setting the policy for director remuneration’*. We agree that the remuneration committee should be required to take into account workforce remuneration policies and practices when setting executive remuneration, but we do not consider that there should be a requirement for the remuneration committee to perform the oversight role. Some boards may wish to reserve this directly to themselves or to delegate it to another committee such as the sustainability committee. Companies should not be put in a position of non-compliance with the Code if they choose to do this.

Associated with this, Provision 41, and particularly the penultimate bullet, conflates the role of the remuneration committee in setting executive pay with the oversight role required under Principle O. There should instead be a separate reporting provision relating to Principle O such as: *‘The annual report, either in the strategic report or a report of an appropriate committee, should contain an explanation of the principles of the company’s approach to investing in, developing, and rewarding the workforce; how that approach supports the company’s strategy and values; and an explanation of the governance that ensures these principles are reflected in policies and practices throughout the company’*.

Additional comment:

The extension of the remuneration committee’s remit to include senior management will not, in our experience, expand its workload significantly as many remuneration committees already have responsibility for determining the remuneration of members of the executive committee (which is typically the next tier of management below the board).



**Question 15 – Can you suggest other ways in which the Code could support executive remuneration that drives long-term sustainable performance?**

*Encouragement of more innovative incentive schemes*

We do not object to the changes made around incorporating the design of remuneration arrangements into the Code, but we would have liked to see more encouragement of innovation – at least in the Guidance or the feedback statement that will presumably accompany the final version of the Code. This could include more explicit endorsement of the final report of the Investment Association’s Executive Remuneration Working Group. Explicit recognition that traditional long-term incentive plans may not be appropriate for all companies would also be helpful, for example in Provision 40.

Although there is reference in Principle O and Provision 40 to the alignment of remuneration with culture and strategy, and Provision 41 requires there to be an explanation in the annual report of the strategic rationale for executive directors’ remuneration policies, structures and performance metrics, we think it would help to have a more explicit requirement for performance conditions for executive directors’ incentive arrangements to be consistent with the company’s strategic priorities. It would be helpful in this context for the Code to explain that traditional long-term incentive plans are not always the best approach, and that other options as set out in the final report of the Investment Association Executive Remuneration Working Group may also be appropriate, including, for example, restricted stock and performance-on grant schemes, which promote long shareholding through simple structures. We think it is important to emphasise that any innovative incentive structures do need to be simple and easy to understand.

*Holding periods*

In our view, executive remuneration is most likely to drive long-term sustainable performance if it involves the executive holding significant value in shares over the medium to long-term. The Code provision requiring a five year period between award and realisation (and longer periods where appropriate) will cause companies to introduce holding periods or longer vesting periods or explain why these are not appropriate in their circumstances. However, Provision 36 does not distinguish between deferred bonuses and long-term incentive plans, and the former would not typically be expected to be subject to such long deferral.

Provision 36 should also anticipate the possibility of phased rather than cliff deferral schedules by making the requirement an average requirement. Post-employment periods should also be considered separately from longer vesting or holding periods. We suggest that the second and third sentences could therefore be amended to: *‘In normal circumstances, long-term incentive awards, or share awards granted in lieu of long-term incentives, should be subject to a combined average vesting and holding period of at least five years, and longer periods may be appropriate. Remuneration committees should consider a formal policy for post-employment shareholding requirements encompassing both unvested and vested shares’.*



***Question 16 – Do you think the changes proposed will give meaningful impetus to boards in exercising discretion?***

Although many companies have already provided for the remuneration committee to have discretion to adjust outcomes, having an explicit Code provision that boards must have the ability to override formulaic outcomes will empower the remuneration committee to make adjustments that may be unfavourable to executives. In particular, the provision will encourage remuneration committees to check that award documentation, particularly of long-term incentives, provides them with sufficient powers to override formulaic outcomes where appropriate.



### Initial consultation on the Stewardship Code

***Question 17 – 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?***

As per our covering letter:

The current Stewardship Code is not sufficiently clear about how it should be applied by some in the investment chain, particularly asset owners and service providers, including investment consultants and proxy advisers. In our view it should be a priority for the next Stewardship Code to create clear, tailored expectations for these different groups, focusing on how each of them could answer the question of how their actions have promoted the long-term success of the company involved. Providing clarity about the role of asset owners is particularly important because they have the ability to promote the stewardship activities of asset managers and service providers. Service providers may need their own annex in addition to the generally applicable aspects of the Stewardship Code as their activities are very different from the other parts of the investment chain. This should reflect the fact that most of the main shareholder advisory firms operate under the Best Practice Principles for Shareholder Voting Research of the BPP Group, and in future will need a code that is sufficiently targeted to meet the requirements of the Shareholder Rights Directive (subject to knowing more about how this will be implemented). Ideally the Stewardship Code would be fit for purpose under the Directive.

We think it is important to retain a unified ‘core’ Stewardship Code that explains how it pertains to the various players and shows the link between them through the investment chain. A single Stewardship Code will:

- allow some signatories, such as insurance companies and pension funds that are asset managers as well as asset owners, to use a single set of requirements rather than comply with multiple – but similar – stewardship codes, which could be confusing and onerous;
- help each player along the investment chain hold to account the others up and down the chain because they will all know what is expected of them and how their activities relate to and affect the others;
- promote continuous improvement in stewardship across the investment chain because there will be visibility of good practice; and
- create the opportunity for a coherent implementation of the Shareholder Rights Directive.

Additional comments:

We think the revised Stewardship Code should contain specific guidance on stewardship relating to proxy advisers, both in terms of how asset owners and asset managers use proxy advisers, and the role proxy advisers play in stewardship as service providers. As noted in our covering letter, we think it would be useful if the Stewardship Code focused on how proxy advisers, like other parties, would answer the question of how their actions have contributed to clients’ fulfilling their stewardship responsibilities. They also need to recognise how their recommendations are used and their causal impact on voting outcomes. They have a responsibility to introduce safeguards to ensure that stewardship works across the investment chain as a whole, and that there is not inadvertent outsourcing of judgements that should be made by investors. Having said that, the Stewardship Code



should be clear that the ultimate responsibility for stewardship judgement should lie with shareholders.

We also think that asset managers and asset owners should not follow proxy advisers' recommendations without question and that they need to engage with the companies concerned. They should not be able to assert compliance with the Stewardship Code if they simply outsource their stewardship activities to a proxy adviser.

We suggest that the FRC consider the Stewardship Code's application to fixed income investors, rather than just focusing on those investing in listed equities. See our response to Q24.

***Question 18 – 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?***

We agree that the Stewardship Code should move towards a more traditional 'comply or explain' approach. As it stands, the Stewardship Code consists of principles and guidance but no provisions, and it is the provisions that are subject to comply or explain in the UK Corporate Governance Code. Therefore, we think the Stewardship Code should include more specific procedural recommendations in a style similar to the provisions of the Code. In some areas the current Stewardship Code contains guidance that could be relatively easily converted into provisions (or equivalent). These include the guidance in Principle 3 on monitoring and Principle 4 on escalation. The same approach could be extended to Principle 1.

In all cases the detailed 'provisions' would need to be flexed to the particular circumstances of the different components of the investment chain, and care would need to be taken that such provisions did not reinforce a one-size-fits all interpretation of what constitutes good stewardship or become a box-ticking compliance exercise. This additional specificity and rigour would also allow the implementation of the Stewardship Code to be more effectively assured, adding to its credibility.

We think the FRC should conduct a review of existing stewardship statements in Tier 1 to identify which signatories' stewardship activities represent best practice against each principle, and distil that best practice into the revised Stewardship Code (perhaps supplemented by case study examples). We suggest that the FRC then conducts interviews or surveys of asset owners and beneficiaries, and possibly corporates, to understand whether they think their interests are met and to see if they agree with the FRC's assessment of best practice. It is important that any approach to best practice recognises the very different, and equally valid, approaches to stewardship that different signatories may adopt.

***Question 19 – Are there alternative ways in which the FRC could highlight best practice reporting other than the tiering exercise as it was undertaken in 2016?***

Although a tiering system may provide some motivation for signatories to aim for the highest tier and the related standard of practice, it is not necessary for the FRC to continue with that system in order for it to highlight good practice in stewardship processes and reporting; a review of a sample of reports and appropriate consultation with market participants could also serve as the basis for this.

Whatever approach the FRC takes, it is important to be clear on the criteria that it uses, and why it regards particular aspects of reporting as best practice.



**Question 20 – Are there elements of the revised UK Corporate Governance Code that we should mirror in the Stewardship Code?**

The Guidance to Principle 1 of the existing Stewardship Code states that “[s]tewardship activities include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration”. We think a revised version does not need to go much further than this in terms of specific elements of the UK Corporate Governance Code, and we think it is important that the areas listed remain as illustrative suggestions rather than a checklist. We suggest also including stakeholder engagement as we think shareholders should understand how their own needs align or conflict with the needs of other stakeholders in promoting the long-term success of a company. See also our response to Q22 below.

Some signatories to the Stewardship Code are also themselves subject to the UK Corporate Governance Code, or are part of a group which is subject to that Code. These companies in particular should be expected to take their procedural and reporting responsibilities under the UK Corporate Governance Code seriously. They should also discuss their stewardship activities in the annual report, not just in their statement on stewardship, and consider whether their own internal practices (e.g. on remuneration and diversity) reflect what they expect from investee companies.

Even signatories who are not subject to the UK Corporate Governance Code need to consider whether they themselves exercise good governance. As good stewards, their engagement and voting policies and behaviour should reflect their own internal practices.

**Question 21 – How could an investor’s role in building a company’s long-term success be further encouraged through the Stewardship Code?**

We agree that the Stewardship Code should address more explicitly how investors can and should play a role in building a company’s long-term success, for example through engagement on matters that affect the business in the long term. We also think the Stewardship Code should require all signatories to consider how their actions help promote the long-term success of the company involved. But although we think they *play a role* in the company’s long-term success, we don’t think they have a responsibility to make it so. Although a director’s responsibility is to promote the success of the business for its members (shareholders), that is not reciprocal; asset owners and asset managers have a fiduciary duty to their clients and beneficiaries, not a responsibility for making the company a success and the Stewardship Code needs to recognise that.

There is increasing recognition that the long-term success of a business is closely related to ESG factors and that considering such factors is ultimately in the best interests of shareholders as well as other stakeholders. This goes beyond the remit of a responsible investment mandate since ESG factors can affect the financial results and therefore, the value of a company. Investors can continue pushing for positive change in their investee companies through their engagement and voting policies in action. We suggest that they also continue the push for elements of the Investment Association’s *Long-term reporting guidance*<sup>2</sup> to be reported by their investee companies.

The Stewardship Code is currently relatively silent on the question of incentives (both remuneration and charging structures), yet these are key drivers of behaviour. Therefore, we think the FRC should address them more fully than is currently the case as part of the expectation that firms will align incentives with their approach to stewardship. This could be true for all investment chain participants, not just asset managers.

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<sup>2</sup> <https://www.ivis.co.uk/media/12519/Long-Term-Reporting-Guidance.pdf>



***Question 22 – 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?***

Consistent with our responses to Q20 and Q21 above, stakeholders, beyond shareholders, should be included in the list of suggested areas of stewardship focus to the extent they would impact the long-term success of the company. Such stakeholders include employees, customers and suppliers. The same applies to ESG matters.

We have noted that most discussions on Section 172 of the Companies Act focus on the stakeholders mentioned in sub-paragraphs 1 (b) to (d), without due consideration for sub-paragraphs (a) and (e): a company’s consideration of its stakeholders and the environment has to be seen in the context of the consequences of any decision in the long term and maintaining a reputation for high standards of business conduct. This should be reflected in the Stewardship Code.

***Question 23 – 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?***

For the Stewardship Code to be successful, there needs to be a market for stewardship. Only if it can be made more rigorous and credible – showing the benefits of being a good steward – will there be an incentive for asset owners, asset managers and service providers to sign up to it, to use it to ensure they are applying its principles (and, ideally, future provisions) and to report against it well. It is also worth noting that ‘stewardship’ and ‘engagement’ are not synonymous.

The FRC should also consider educating the investment community to raise the profile of the Stewardship Code, particularly with asset owners and their clients and beneficiaries. Making advice on best practice reporting on voting practices and stewardship activities available is likely to be helpful to raise standards on the quality of disclosure, as well as the activities themselves, as explained in our responses to Q18 and Q19.

***Question 24 – How could the Stewardship Code take account of some investors’ wider view of responsible investment?***

The term ‘responsible investment’ could be regarded as an unfortunate one as it implies that those not following that approach are not being responsible. ‘Responsible investment’ is a term usually used in the context of a particular approach applied across a portfolio of investments (e.g. on the basis of environmental or social matters). We think the principles in the Stewardship Code should apply equally across different types of investment approach.

If the question is not about ‘responsible investment’ in that context, but rather in the context of being a responsible, engaged investor versus shareholder, we think that the Stewardship Code should not be limited to shareholders (we don’t think stewardship activities differ between ‘responsible shareholders’ and other ‘responsible investors’). We think the FRC should also acknowledge the responsibilities of fixed income investors, given the influence they have over companies’ financing and the size of the debt market, which is significantly larger than the equity market.



Although the relationship a bondholder has with a company is contractual, bondholders will monitor their investments to assess ongoing credit risk. To the extent that they see the company engaging in activities that may increase the risk that the bondholder may not be repaid (e.g. increasing pension deficits or dividend payments to shareholders), bondholders should have a responsibility to engage with the company. There may be other investment types that should be included in the revised Stewardship Code, such as infrastructure, real estate and private equity.

***Question 25 – Are there elements of international stewardship codes that should be included in the Stewardship Code?***

We are in favour of the principles-based nature of the UK Stewardship Code and think that should be maintained. Because the investment community is global, it is helpful for practices on stewardship activities to be aligned and, therefore, we think it would be useful for the FRC to review other codes and stewardship practices around the world, being mindful that some stewardship codes tend to focus on the legal regime and cultural norms of the country in which they are applied. The FRC should also keep in mind the changes that will come from the implementation of the Shareholder Rights Directive, and ensure that the revised code covers all requirements arising from that for all entities across the investment chain.

As noted in our response to Q20, we think that investors should exercise and demonstrate good governance themselves. With this in mind, we think the FRC should consider the International Corporate Governance Network's (ICGN) principle on internal governance, particularly the guidance on appropriate remuneration and fee structures which are aligned with the interests of beneficiaries. See also our response to Q21.

***Question 26 – 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?***

As noted in our covering letter, we think the Stewardship Code would have more influence if it were more rigorous and credible and that this would allow it to be more assurable. Currently there is some uncertainty as to what the FRC regards as good practice and this needs to be resolved in order to have a solid framework upon which to provide assurance.

In our experience, those signatories that obtain assurance tend to have their statement assured every two or three years, rather than on an annual basis. This is usually intended to align with when there are material updates being made to the statement. It may be that if stewardship reporting is changed to reflect a more rigorous overall framework with more regular, bespoke stewardship activities the frequency of assurance should also increase.

Our clients that obtain independent assurance have told us that it is a useful process to go through as it provides comfort to the signatory's management that their reported statements are an accurate representation of their processes, and they appreciate the benchmarking and highlighting of good practice that is provided as part of the engagement. Obtaining assurance is also a useful way for signatories to demonstrate that they take stewardship activities seriously.

We note that the inclusion of the Stewardship Supplement in the Technical Release AAF 01/06 in relation to "Assurance Reports on Internal Controls of Service Organisations made available to Third Parties" has resulted in some confusion over the nature and extent of the different assurance



engagements, and the way in which the Stewardship Code assurance opinion can be used and made available to end users. Separating the Stewardship Supplement from the AAF 01/06 Technical Release and clarifying the fact that the assurance opinion may be made publicly available may help to increase the perceived benefits of obtaining assurance over the Stewardship Code, which in turn may promote better quality reporting and stewardship activities.

***Question 27 – Would it be appropriate for the Stewardship Code to support disclosure of the approach to directed voting in pooled funds?***

Disclosure should be encouraged to enhance transparency for the different investors in pooled funds and to show alignment with investment mandates as applicable. Asset owners, asset managers and service providers should disclose their respective approach to directed voting and whether they are applying initiatives such as the Association of Member Nominated Trustees' (AMNT) Red Line Voting. However, the Stewardship Code should only specify the principle and not any particular directed voting approaches.

***Question 28 – Should board and executive pipeline diversity be included as an explicit expectation of investor engagement?***

Consistent with earlier responses about the need not to be overly prescriptive, we think that the Stewardship Code should suggest that investors give consideration to board and executive pipeline diversity as a matter for engagement when this is appropriate. Investors should have the discretion to engage with a company on diversity depending on whether it is a relevant issue for that company or that investor's particular stewardship focus, e.g. when the investee company is not considered to be doing well or enough on the matter. If diversity becomes an explicit topic required for every engagement, there is the risk this could become a box-ticking exercise. The Stewardship Code should also note that diversity goes beyond gender, and includes social and ethnic diversity, although signatories will need to accept the caveats we note in our responses to Q10 and Q11.

***Question 29 – Should the Stewardship Code explicitly request that investors give consideration to company performance and reporting on adapting to climate change?***

See our comments in the responses to Q21 and Q22 on ESG matters. Investors should certainly engage on climate change where it is appropriate and relevant to the particular business.

***Question 30 – 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?***

As noted in our covering letter, the revised Stewardship Code needs to be clear about the role of stewardship for different parties in the investment chain, and signatories should specify how stewardship is relevant to their respective activities.

***Question 31 – 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?***

We agree that different funds can have different purposes so a one-size-fits-all approach will not always be appropriate across an asset management firm (or in an asset owner that also manages



assets, whether their own or for clients and beneficiaries). This would allow for the fact that funds can have different purposes (e.g. a specific investment strategy that lends itself to a particular level of or approach to engagement), and recognise the need to know the fund's purpose before being able to define its approach to stewardship.

However, some firms have a consistent approach to stewardship across all their funds. We think that in principle reporting against the Stewardship Code should be done at the firm level with fund documentation summarising how the firm's stewardship approach is applied in the context of that fund's purpose. If a firm has a common stewardship approach that applies across all of their holdings in different funds, then this common approach could be referred to in fund documentation. Thereby, fund-specific disclosures would only highlight those areas of stewardship approach that were specific to the fund and not captured in the firm-wide approach.