Consultation

Financial Reporting Council

January 2019

Proposed Revision to the UK Stewardship Code

The FRC's mission is to promote transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

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INTRODUCTION

The UK Stewardship Code (the Code) was first published in 2010 to improve long-term returns to beneficiaries by enhancing the quantity and quality of engagement between investors and companies. It was introduced as a result of Sir David Walker's *Review of corporate governance in UK banks and other financial industry entities*. The Review recommended that the Financial Reporting Council's (FRC) remit be extended to develop and encourage best practice stewardship of UK-listed companies by institutional investors.

Evidence from surveys, our discussions with market participants and our assessment of signatory statements show there has been an improvement in stewardship since the Code's introduction.1 There have also been significant changes in expectations of stewardship and the landscape of institutional investment in this time. The Code now requires significant revision to ensure its effectiveness and differentiate excellence in stewardship.

Since 2012, when the Code was last revised, the UK's overall high standards of corporate governance have continued to attract investment. However, there have been examples of poor governance practice, poor decision-making and underperformance that have contributed to corporate failure. Effective stewardship has an essential role to play across a variety of investment approaches and asset classes. By challenging on material issues, institutional investors can influence decision-making to improve the effectiveness of capital allocation in the economy. This will benefit investors and society, and support sustainable economic growth.

Effective stewardship is an important part of institutional investors' responsibilities to their clients and the draft 2019 Code is an integral part of the UK's overall corporate governance framework. It significantly raises the standard expected from institutional investors and aims to create a market for stewardship driven by a demand from asset owners and beneficiaries for better quality information about how asset managers and service providers fulfil their responsibilities. Those who become signatories will be making a serious commitment to maintaining and improving the quality and integrity of UK financial markets. The FRC will be devoting more resource to evaluating the quality of disclosure of both policies and activities.

In preparing the draft 2019 Code and this consultation we have undertaken extensive outreach and sought feedback from 170 members of the investment community, company organisations and representative bodies. This has included the largest UK asset managers, pension funds, key international investors, representatives of the local government pension pools, service providers, UK listed companies, the Investment Association, the Pensions and Lifetime Savings Association, the UN-supported Principles for Responsible Investment, ShareAction, UK Sustainable Investment and Finance Association, ICSA: The Governance Institute, the 100Group, the Investor Relations Society and the Purposeful Company Task Force. We have also held outreach events with investors based in the USA and Canada, and engaged with investors in Europe and Asia.

[1] Between 2010-18 the Investment Association (IA) conducted a series of surveys on the stewardship activities of IA members. The FRC undertook an extensive assessment of all signatory statements in 2016.

SUMMARY OF KEY CHANGES TO THE CODE

1. Stewardship is the responsible allocation and management of capital across the institutional investment community to create sustainable value for beneficiaries, 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.

2. This new definition identifies the primary purpose of stewardship as looking after the assets of beneficiaries that have been entrusted to the care of others. At the same time, it broadens the scope of the Code to include investment decision-making and investment in assets other than listed equity.

Purpose, values and culture

3. Signatories will be asked to establish an organisational purpose, strategy, values and culture that enable them to fulfil their stewardship objectives. Their stewardship objectives must enable them to fulfil their obligations to their clients or beneficiaries. This focus on purpose aligns the draft 2019 Code with the UK Corporate Governance Code and ensures that effective stewardship behaviours are embedded across the signatories' business.

Integration of stewardship and investment approach

4. The draft 2019 Code sets higher standards for asset owners and asset managers regarding how they integrate their stewardship responsibilities into their investment processes, including investment decision-making, mandate design and other activities.

Stewardship beyond listed equity

5. The Code has its origins in seeking to make the UK listed equities market more effective for shareholders. Yet capital is invested in a range of asset classes over which investors have different terms and investment periods, rights and levels of influence. There has been significant growth in investment in assets other than listed equity, such as fixed-income bonds and infrastructure equity. Signatories should use the resources, rights and influence available to them to exercise stewardship, no matter how capital is invested.

Recognising the importance of environmental, social and governance (ESG) issues

6. The draft 2019 Code reflects the significant developments that have taken place in sustainable finance, responsible investment and stewardship since 2012. The Code now makes explicit reference to ESG factors. Signatories are expected to take into account material ESG factors, including climate change, when fulfilling their stewardship responsibilities.

7. The Code aims to encourage greater demand for an engaged approach to stewardship and investment decision-making which is aligned to the investment time horizons of beneficiaries.

Clear expectations of different entities in the investment chain

8. Most respondents to the FRC's consultation on the future direction of the Code (part of the consultation on the UK Corporate Governance Code) said that it should be more clearly tailored to the role of different entities in the investment community. The draft 2019 Code addresses this through more detailed Provisions and Guidance. It is written for asset owners, asset managers and entities providing services to the institutional investment community, including: investment consultants, proxy advisers and other

service providers that want to demonstrate their commitment to effective stewardship. The Code does not prescribe a single approach, but allows signatories to demonstrate stewardship that is aligned with each signatory's business model, objectives and activities to fulfil obligations to beneficiaries and clients.

Restructuring to align with the UK Corporate Governance Code

9. The structure of the draft 2019 Code mirrors the UK Corporate Governance Code, with numbered Sections, Principles and Provisions accompanied by supporting Guidance. With this alignment the 2019 Code aims to improve trust in business through encouraging the investment community to play its part in developing successful companies.

More rigorous reporting requirements

10. All signatories will be required to make public disclosures about their stewardship activities and their assessment of how effectively they have achieved their stated objectives. Reporting will now be in two parts: a Policy and Practice Statement upon signing the Code and an annual Activities and Outcomes Report.

HISTORY OF THE CODE

11. The Code was first published by the FRC in 2010. It followed the 2009 Walker Review on the governance of banks and other financial institutions, which was prompted by failings in the banking system during the financial crisis.[2]

12. The Walker Review recommended that the FRC's remit be extended to cover the development and adherence by institutional investors to best practice stewardship of UK listed companies. The Government asked the FRC to take responsibility for the Code on the Responsibilities of Institutional Investors issued by the Institutional Shareholders' Committee (ISC), and following consultation this became the UK Stewardship Code.[3]

13. In December 2010, the Financial Conduct Authority (FCA) introduced a rule in its Conduct of Business Sourcebook, which required certain financial services firms to disclose the nature of their commitment to the Code or otherwise explain its alternative investment strategy.[4]

14. The *Kay Review* of 2012 concluded that the purpose of equity markets, to enhance the performance of UK companies and enable savers to benefit, was hampered by short-termism, caused by a decline in trust and misalignment of incentives through the equity investment chain.[5] The *Kay Review* made 17 recommendations, including changes to the Code to expand the role of stewardship and require investors to engage with companies on strategy as well as corporate governance. Following the *Kay Review*, the FRC consulted on revisions and an updated Code was issued in 2012.[6]

15. By June 2016 there were 305 signatories to the Code, of which 215 were asset managers, 75 asset owners (pension funds, endowment funds and charities) and 15 service providers (investment consultants, proxy advisers and research providers).

16. In 2016 the FRC reviewed and evaluated all signatories' statements against the Code and found that the quality of statements varied significantly. An initial assessment placed 40 signatories in Tier 1 – 'providing a good quality and transparent description of their approach to stewardship and explanations of an alternative approach where necessary'.

17. The FRC wrote to all signatories and asked them to report more clearly on their stewardship policies and practices. Signatories were given an opportunity to revise their Statements before being reassessed and tiered according to the quality of their Statements. This aimed to distinguish between signatories that reported well and demonstrated a commitment to stewardship, and those where improvements were necessary. At the end of the exercise, 120 signatories had met the reporting expectations for Tier 1.[7]

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[2] *A review of corporate governance in UK banks and other financial industry entities*, November 2009.
[3] ISC members were the Association of British Insurers, the Association of Investment Trust Companies, the National Association of Pension Funds (now PLSA), and the Investment Management Association.
[4] FCA Conduct of Business Sourcebook, 2.2.3R.
[5] *The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report*, 2012
[6] FRC Consultation on the UK Stewardship Code, 2012.
[7] This represented 90 per cent of assets under management of members of the Investment Association.

18. Following a period of six months, signatories that did not meet at least Tier 2 reporting expectations were removed from the list of signatories. This was the FRC's first step in setting higher expectations of stewardship practice and reporting. There are now 280 asset owners, asset managers and service providers who are signatories to the Code.

19. There has been criticism that the number of signatories in the Tier 1 category (the highest level) does not accurately reflect those that are committed to stewardship excellence. The FRC recognises this limitation and is now seeking to raise the level of expectation of practice and reporting through revising the Code.

20. In 2017, the FRC consulted on a revised UK Corporate Governance Code. As part of this consultation, the FRC asked some initial questions about revising the Code. The responses to these questions were summarised in the overall consultation Feedback Statement published in July 2018 – an extract of the UK Stewardship Code section is contained in Appendix A to this paper.[8] The main points have been incorporated or considered in the draft 2019 Code.

21. Since the introduction of the Code in 2010 there have been improvements in the quantity and quality of stewardship. This has been indicated by surveys, the FRC's assessment of signatory statements to the Code and discussions with market participants.[9] There have also been many regulatory and policy developments in the UK and internationally, as well as a significant shift in the landscape of institutional investment and of stewardship. These developments provide the context for the proposed revisions to the Code in this consultation.

[8] FRC, *Consulting on a revised UK Corporate Governance Code*, December 2017, Initial consultation – this refers to questions about the UK Stewardship Code as part of the consultation on the UK Corporate Governance Code. A summary of responses can be found in Appendix A.

[9] See footnote 1.

CONTEXT FOR REVISING THE CODE

UK

22. In July 2012, as well as changes to the Code, the *Kay Review* recommended that an investors' forum be established to facilitate collective engagement by investors. This was set up in 2014.[10] Many of the issues the Review identified continue to exist – for example, short-termism in equity markets, the misalignment of incentives and issues of trust arising from intermediation. The draft 2019 Code seeks to continue to address these issues.

23. In October 2012, legislation began requiring workplaces with more than 250 employees to automatically enrol them into a workplace pension. In 2015 the government announced it would work with the Local Government Pension Scheme (LGPS) funds to create pension fund pools. There were previously 90 pension funds and there are now eight pools running nearly all LGPS assets. The value of the assets under management (AUM) means that in exercising stewardship these pools have considerable influence over the assets for which they are responsible and the agents that manage them on their behalf. Two of these pools are signatories to the 2012 Code.

24. In 2014, the Law Commission reviewed the legal concept of fiduciary duty with regards to investment. It stated that 'there is no impediment to trustees taking account of environmental, social or governance (ESG) factors where they are, or may be, financially material' and recommended that the government should clarify that it is part of trustees' duties to consider long-term systemic risks such as climate change.[11] Building on this, the Law Commission issued a report in 2017 called *Pension Funds and Social Investment*, which identified a critical distinction between ESG and ethical factors, and began to explore options for regulatory reform.[12]

25. Following this, the Government established an independent advisory group in 2017 that published a report into social impact investing in the UK, making recommendations to help investors enable savers to support the things they care about through their savings and investment choices.[13]

26. In 2016 and 2017, The Pensions Regulator (TPR) updated its guidance for defined contribution and defined benefit schemes, advising that trustees need to take all factors that are financially material to investment performance into account, including ESG factors.

27. In 2018, the Department for Work and Pensions (DWP) issued amendments to the Occupational Pension Schemes Regulations.[14] The investment regulations require funds to take ESG factors into account in their Statement of Investment Principles and disclose a stewardship policy. The governance regulations require TPR to update its code of practices to cover how the trustees' system of governance considers ESG factors in investment decisions, and an assessment of new or emerging risks, including climate change.

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10 Investor Forum website: www.investorforum.org.uk/about/history/
11 The Law Commission, *Fiduciary Duties of Investment Intermediaries*, 2014.
12 The Law Commission, *Pension funds and social investment*, June 2017.
13 *Growing a culture of social impact investing in the UK*, November 2017.
14 DWP, *Clarifying and strengthening trustees' investment duties*, June 2018.

28. In 2017, the House of Commons' Business, Energy and Industrial Strategy Committee reported on its corporate governance inquiry after the Committee identified a series of corporate governance failings.[15] There were several suggestions made to the FRC about the UK Corporate Governance and the UK Stewardship Codes. It was recommended that the UK Stewardship Code be reviewed to provide 'more explicit guidelines on what high-quality engagement would entail, a greater level of detail in terms of requirements, and an undertaking to call out poor performance on an annual basis'. The draft 2019 Code will implement these recommendations.

29. In 2018, the Department for Business Energy and Industrial Strategy (BEIS) consulted on *Insolvency and Corporate Governance*.[16] On stewardship, the Government response committed to promoting the inclusion of outcomes-focused stewardship in the investment mandates given to asset managers by asset owners. The draft 2019 Code supports this aim.

30. In December 2018, the Competition and Markets Authority (CMA) concluded its investigation into competition in the investment consultancy and fiduciary management sector. Proposed changes to tackle competition problems in the market include requiring firms to provide clear information on fees and performance to potential clients, and the Government extending regulation to capture all the activities of investment consultants.[17]

31. The FCA and the FRC have jointly issued a wider discussion paper on *Building a regulatory framework for effective stewardship.*[18] The paper sets out the relationship between the Code and regulation in raising the standard of stewardship in the UK. It calls for input on how best to encourage the institutional investment community to engage more actively in stewardship.

32. The FCA is also consulting on proposed new rules to implement sections of SRD II that are relevant to regulated asset managers and life insurers in the UK.

33. The EU Shareholder Rights Directive II (SRD II) seeks to further encourage long-term shareholder engagement by promoting increased transparency and engagement between asset owners and asset managers.[19] Among its provisions, SRD II introduces minimum reporting requirements for all asset owners and asset managers to report on their engagement policy and investment strategy. The Directive also introduces new transparency measures for proxy advisers, including the requirement for member states to ensure that proxy advisers publicly disclose reference to a code of conduct.[20]

34. The new reporting requirements under the draft 2019 Code are more demanding than those of SRD II and it is the intention of the FRC that in reporting against the 2019 Code, signatories to the Code will have regard to any relevant reporting requirements of the laws, rules, regulations and administrative provisions that transpose SRD II. The FRC will amend references to the SRD II to the relevant UK rules and regulations. Signatories should have regard to these when reporting against the Code.

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[15] BEIS Select Committee, *Report on Corporate Governance*, March 2017

[16] BEIS, *Insolvency and corporate governance: Government response*, August 2018.

[17] CMA, *Investment consultants market investigation – final report*, December 2018.

[18] FCA, FRC, *Building a regulatory framework for effective stewardship – discussion paper*, January 2019.

[19] Directive 2017/828 of the European Parliament and of the Council of 17 May 2017, amending Directive 2007/36/EC. Laws, regulations and administrative provisions to implement the EU Shareholder Rights' Directive II (SRD II) must be put in place by member states by 10 June 2019.

[20] SRD II, Chapter 1b Articles 3 (g)(h)(i)(j).

35. In March 2018, the UK Government and the European Commission agreed the terms of an implementation period, which was included in the draft Withdrawal Agreement. In implementing relevant provisions of SRD II for FCA-regulated asset managers and life insurers, the FCA is catering for the scenario where an implementation period is in place after the UK's departure. Under this transition period arrangement, the UK will remain subject to EU rule-making. During this period, set to start on 29 March 2019 and lasting until 31 December 2020, EU law will continue to apply in the UK. This would require the UK to implement SRD II by 10 June 2019.

International

36. When the Code was published in 2010, it was the first and only Stewardship Code. There are now more than 20 stewardship codes globally. Although international stewardship codes have been largely based on the original UK Code, some have introduced new requirements, including commitments to adequate resourcing for stewardship and expectations to consider ESG issues.[21] The International Corporate Governance Network (ICGN) also updated its stewardship principles and guidance for investors in 2016.

37. In 2015 countries around the world adopted 17 UN Sustainable Development Goals (SDGs) and in 2016 the Paris Agreement on climate change took effect to try and tackle the world's most urgent problems. Investors are recognising the need to align their investment strategies to their goals and many are going further by seeking investments that contribute in a meaningful and measurable way to meeting these targets.

38. The Task Force for Climate-related Financial Disclosures published its final report in 2017 with recommendations to help companies disclose climate-related financial information that is clear, comparable and consistent. The framework will help investors understand how organisations assess climate-related risks and opportunities.[22]

39. The UN-supported Principles for Responsible Investment (PRI) is now a major force in the global investment community. In 2018, the PRI had more than 2,300 signatories with a combined AUM of over $100 trillion. This global commitment to responsible investment is reflective of an overall trend of responsible investment, stewardship and ESG incorporation becoming mainstream.

40. A variety of influential initiatives, including the UK Green Finance Taskforce, the Social Impact Investing Taskforce, the Sustainable Stock Exchanges Initiative, the EU High Level Expert Group on Sustainable Finance, and the EU Action Plan on Sustainable Finance, continue to contribute to a significant shift in governmental and public expectations of the role of the institutional investment community in capital markets and wider society.

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[21] These include Australia, Brazil, Japan, the Netherlands and South Africa.
[22] FSB and TCFD, *Recommendations of the Task Force on Climate-related Financial Disclosures*, June 2017.

THE CONSULTATION AND HOW TO RESPOND

The FRC is consulting on a revised Code to encourage effective stewardship that operates in the interest of savers, companies, the economy, environment and society, reflects growing trends in investment, and complements recent and imminent regulatory changes.

The FRC asked a series of questions on the Code as part of the consultation on the revised UK Corporate Governance Code in December 2017. There were 109 responses to these questions and the feedback is summarised in Appendix A of this paper. This feedback has been considered in developing the draft 2019 Code.

The FRC welcomes comments on the proposed revisions to the Code and a full list of consultation questions can be found at the end of this paper.

Comments on the questions set out in this consultation document are requested by **29 March 2019**. Responses should be sent by email to stewardshipcode@frc.org.uk

or in writing to:

Corporate Governance and Stewardship
Financial Reporting Council
8th Floor
125 London Wall
London
EC2Y 5AS

Responses by email are preferred. All responses will be acknowledged.

It is the FRC's policy to publish on its website all responses to formal consultations unless the respondent explicitly requests otherwise. A standard confidentiality statement in an email message will not be regarded as a request for non-disclosure. The FRC does not edit personal information (such as telephone numbers or email addresses) from submissions; therefore, only information that you wish to be published should be submitted.

PROPOSED REVISIONS TO THE CODE – GENERAL

Definition

41. The 2012 Code states the aim of stewardship is to 'promote the long-term success of companies in such a way that the ultimate providers of capital also prosper. Effective stewardship benefits companies, investors and the economy as a whole.'[23]

42. The draft 2019 Code defines stewardship as 'the responsible allocation and management of capital across the institutional investment community, to create sustainable value for beneficiaries, 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.

43. This new definition identifies the primary purpose of stewardship as looking after the assets of beneficiaries that have been entrusted to the care of others. At the same time, it broadens the scope of the Code to include investment decision-making and investment in assets other than listed equity.[24]

Structure

44. In the initial consultation, many respondents agreed that it would be helpful for the Code to follow a similar format and structure to the UK Corporate Governance Code of Sections, Principles and Provisions, accompanied by supporting Guidance.[25]

45. Most respondents thought clearer expectations of the stewardship responsibilities of those with different roles in the investment chain would be helpful. However, there was very little support for introducing separate codes for asset owners, asset managers, proxy advisers and investment consultants. A clear majority favoured a single code with supporting Guidance for signatories according to their role in the investment community. Many respondents called for specific attention to be paid to the role of proxy advisers.

46. The draft 2019 Code includes Principles and Provisions for asset managers and asset owners and Principles and Provisions for service providers, with Guidance to support the whole Code.

47. The Code recognises the important and influential role that service providers such as investment consultants and proxy advisers have, and their role in supporting an effective investment market. However, many of the Principles and Provisions that apply to asset owners and asset managers – who have fiduciary responsibilities – are not appropriate or relevant for service providers. We have therefore included separate Principles and Provisions for service providers that better reflect their role and responsibilities in the institutional investment community.

48. The Principles are actions and behaviours that all signatories are expected to demonstrate. The Provisions are more specific policies, processes and activities that most signatories will be expected to follow in order to fulfil their stewardship responsibilities and meet the Principles.

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[23] FRC, The UK Stewardship Code, 2012.

[24] FCA and FRC discussion paper, *Building a regulatory framework for effective stewardship*, January 2019, includes a question on the definition of stewardship.

[25] See footnote 7.

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.

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

49. The Principles are to be followed on an 'apply and explain' basis. This means that all signatories to the Code should apply the Principles and explain clearly how they have done so, in a manner that enables their beneficiaries and/or clients to evaluate their Statements.

50. The Provisions are to be followed on a 'comply or explain' basis. It is expected that most signatories will be able to comply with most Provisions and meaningfully describe how they have done so. The Code, however, is not a rigid set of rules and provides the opportunity to explain an alternative approach.

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

Guidance

51. The Guidance is not mandatory. It contains suggestions of good practice and ways in which the Code can be followed, how signatories can report against it and includes links to the relevant requirements of the SRD II, should signatories wish to fulfil their reporting requirements for the SRD II at the same time as reporting against the Code.

52. Unlike the UK Corporate Governance Code, which is supported by a separate document, the *Guidance on Board Effectiveness*, the draft 2019 Code is presented at the end of the Principles and Provisions. To reflect changes in practice and better support signatories in following the Code, the FRC may update the Guidance more frequently than the Code and may do so without public consultation.

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

Application

53. While many of the Principles, Provisions and Guidance are applicable across different entities in the investment community, they have been tailored to three broad categories of Code signatories.

    - **Asset owners**: institutions responsible for investing capital on behalf of beneficiaries. Examples of activities asset owners undertake related to their stewardship responsibilities include: setting investment beliefs, asset allocation, awarding investment mandates, designing investment strategies, and monitoring the performance and behaviours of service providers who act on their behalf.
    - **Asset managers**: individuals or institutions that are responsible for the day-to-day management of assets. Examples of activities asset managers undertake related to their stewardship responsibilities include: investment processes, monitoring and engaging with companies, voting, as well as monitoring the performance and behaviours of service providers who act on their behalf, and reporting on how they have fulfilled their stewardship responsibilities.

- **Service providers**: individuals or organisations that do not manage investments directly or do not have fiduciary responsibility, but play a key role in the investment community, and as such must provide services that allow clients to deliver quality stewardship. Service provider activity that is considered to fall within this scope includes, but is not limited to: engagement, voting recommendations and execution, research and data provision, advice, and provision of reporting frameworks and standards.

Reporting

54. The draft 2019 Code does not include separate Principles or Provisions on disclosure and reporting. Instead it is a requirement of being a signatory to the Code to publicly report against all the relevant Principles and Provisions, with reference to the signatory's particular circumstances, and in a manner that enables the reader to understand and evaluate their approach.

55. The purpose of reporting is to:

    - increase the transparency of stewardship policies, practices, activities and outcomes so that beneficiaries and clients may hold signatories to account;
    - create a market for effective stewardship by highlighting different approaches and standards of stewardship;
    - increase the effectiveness of the Code and thereby raise stewardship standards and their effectiveness;
    - provide an evidence base to regulators and government on what stewardship activities are taking place in the UK, their effectiveness and how practice is evolving to inform future policy developments and other action.

Becoming a signatory to the Code

56. The FRC will require a named contact for stewardship – both for the regulator and for wider stakeholders. For Code reporting, this is to be subject to the approval of the signatories' board.

57. **Policy and Practice Statement** (the Statement): to be a signatory to the Code, entities will be required to submit to the FRC a Statement which confirms the primary category of Principles and Provisions that best describes the signatory (asset manager, asset owner or service provider), identifies any other Principles or Provisions that are relevant to them, and explains how their stewardship policies and practices enable them to apply all the Principles and comply with the Provisions that are relevant to them.

58. **Annual Activities and Outcomes Report** (the Report): after one year of being a signatory to the Code, and every 12 months thereafter, signatories should submit a Report that details: compliance with their Statement, any departures, activities they have undertaken to implement Provisions in the preceding 12 months, and an evaluation of how well stewardship objectives have been met, and/or have enabled clients to meet theirs, and the outcomes achieved. Annual activity will be made publicly available.

59. Names of signatories to the Code will be published on the FRC website, with links to the Statement and Report on the signatory's website. The FRC recognises that some signatories may follow other reporting frameworks or requirements that meet the reporting expectations of the Code. To avoid duplication and unnecessary burden, signatories may signpost to these reports to fulfil, in part, the reporting requirements of the Code.

Assessment

60. For the 2019 Code to be effective in increasing transparency, encouraging more effective stewardship practice and creating a market for stewardship, the FRC will provide more detailed analysis on the implementation of the Code by:

- more clearly differentiating signatories based on the quality of reporting on their stewardship policies, objectives, activities and outcomes;
- evaluating asset owners' reported oversight of their investment managers' implementation of their stewardship;
- evaluating asset managers' reported stewardship of the assets they manage;
- evaluating asset managers' monitoring of the service providers they engage.

Policy and Practice Statement

61. The Statement must confirm which primary category of signatory an entity is applying for, for example, asset owner, asset manager or service provider. Some signatories may have responsibilities and roles that require them to follow Principles and Provisions in more than one category.

62. For example, pension funds that have internally managed assets would respond to both the asset manager and asset owner Principles and Provisions. Investment consultants providing fiduciary management services using delegated asset managers to run portfolios would respond to both the asset owner and service provider Principles and Provisions.

63. Signatories should apply and explain all the Principles and comply or explain with all the Provisions that are appropriate to them. Where they do not comply, a meaningful explanation of an alternative approach must be provided. Signatories should explain why they are reporting against more than one category.

64. Signatories are required to review and confirm or update their Statement each year.

Annual Activities and Outcomes Report

65. Signatories should submit to the FRC and publish a Report that details the activities they have undertaken to follow the Code within 12 months of becoming a signatory. This should include an evaluation of how well they have met the stewardship objectives set out in their Statement, and/or how they have enabled clients to meet their objectives, and the outcomes achieved. Reports must be submitted and published annually.

66. It is expected that signatories will demonstrate the activities they undertake and the effectiveness of their stewardship using both quantitative and qualitative information, for example, case studies of engagement on particular issues, description of monitoring activities, or voting records including explanations for voting decisions. The Report should clearly link stewardship activities to objectives set in the Statement, and demonstrate how those activities have been effective in leading to stewardship outcomes.

67. Responses to the initial consultation showed strong support for the tiering process, with most respondents noting that they would like to see this continue. Many respondents noted that they had found the process useful, either internally in further embedding good stewardship, or as a tool for asset owners to review asset managers. However, there were concerns that the tiering process had been devalued by having too many signatories in Tier 1.

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?

68. The FRC recognises that some signatories may follow other reporting frameworks or requirements that meet the reporting expectations of the Code. To avoid duplication and unnecessary burden, signatories may signpost to these reports to fulfil, in part, the reporting requirements for the Code.

Transition timings

69. Applications to become a signatory to the 2012 Code will cease on publication of the 2019 Code. Thereafter, any entity wishing to become a signatory will need to apply to the 2019 Code. The list of signatories to the 2012 Code will be archived in Q1 2020. Details of the proposed schedule for implementation of the 2019 Code can be found in Appendix B.

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?

Oversight of reporting

70. A number of suggestions were made about the ways the FRC could highlight best practice. Many felt that the Code would benefit from further oversight, via an annual monitoring survey, a review of signatories through annual stewardship reports, or through a mechanism akin to the FRC Financial Reporting Lab.

71. Oversight will be an ongoing process, which includes the review of signatories' disclosures to ensure that signatories to the Code are providing required disclosures within appropriate timelines and to the required standard. This may include compliance with the reporting requirements of the SRD II.

72. The FRC may also consider highlighting those signatories that it considers report to a high standard, and those whose implementation and reporting are lagging.

73. The FRC may also publish thematic reviews that focus on the quality of reporting against particular Principles, Provisions, or based on signatory category.

Links to regulations

74. The FCA's Conduct of Business Sourcebook (COBS) currently requires 'any firm authorised to manage funds, which is not a venture capital firm and which manages investments for professional clients that are not natural persons, to disclose clearly on its website the nature of its commitment to the FRC's UK Stewardship Code, or where it does not commit to the Code, its alternative investment strategy'.[26] Pending feedback on both this consultation and on the FCA's proposed new rules to implement SRD II, the FCA does not propose to change the rule that references the Code at this time.

Kingman Review recommendations

75. In reviewing the FRC and the Code, Sir John Kingman agreed with the FRC's proposals for a comprehensive review of the Code, higher expectations for stewardship practice and the introduction of more rigorous public reporting expectations that focus on outcomes.

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26 FCA COBS 2.2.3.

76. He states: ‘The Review recommends that a fundamental shift in approach is needed to ensure that the revised Stewardship Code more clearly differentiates excellence in stewardship. It should focus on outcomes and effectiveness, not on policy statements. The Government should also consider whether any further powers are needed to assess and promote compliance with the Code. If the Code remains simply a driver of boilerplate reporting, serious consideration should be given to its abolition.’

77. The FRC understands that Sir John’s main objective is to distinguish clearly between those who execute stewardship well, and those who need to improve, and we believe that the new code, along with an enhanced monitoring regime will achieve this. The draft 2019 Code sets a higher bar for effective stewardship and requires enhanced reporting of activities as well as policies.

Q7. Do to 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?

PROPOSED REVISIONS TO THE CODE – PRINCIPLES AND PROVISIONS

1 PURPOSE, OBJECTIVES AND GOVERNANCE

Purpose and objectives

78. In July 2016, the FRC published *Corporate culture and the role of boards*, which explored the responsibility of a company's board to connect purpose to strategy and culture, align values and incentives, and assess and measure culture continually.[27] The report focused mainly on the culture of companies and their boards, but it also observed that investors need to reflect on their own culture, and challenge themselves on the behaviours they encourage in companies when engaging with them.

79. The 2018 UK Corporate Governance Code includes Principles and Provisions on company purpose and culture. We have aligned the draft 2019 Code with this and will require signatories to disclose their organisational purpose as well as their stewardship objectives. An organisation's purpose is the reason it exists, and a well-defined purpose will enable signatories to articulate their role in the institutional investment community, and demonstrate how the alignment of purpose, values, strategy and culture enables them to fulfil their stewardship objectives.

80. We asked if signatories should also define the purpose of their stewardship activity. There was clear support for this from nearly all respondents.[28]

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

Fund level and asset class disclosure

81. Currently, signatories to the 2012 Code disclose a commitment to stewardship at an organisational level. Through our questioning of signatories when reviewing their Statements, it is apparent that in many cases the stewardship policy as set out in the Statement against the Code is not always applied to all funds. By making broad commitments, asset managers do not provide sufficient disclosures to asset owners at a fund or asset class level to enable them to determine the extent to which, or if, stewardship policies are being applied.

82. We asked how disclosure at fund level might best be achieved. Requiring individual funds to become signatories to the Code could result in both significant administrative burdens for asset managers and owners. There was support for asset managers disclosing funds that deviate from the organisational stewardship policy or approach. This approach would ensure that asset managers remain signatories to the Code, while requiring them to define a fund's purpose and its specific approach to stewardship, and how this contributes to the asset manager's overall approach to stewardship.

Stewards of the market

83. Signatories should explain what activities they undertake to support effective stewardship and positive outcomes that contribute to building a sustainable financial system, which both manages systemic risks and drives capital towards more sustainable investments. Activities may include but are not limited to engagement with other participants in the financial ecosystem, policymakers, regulators and other

[27] FRC, *Corporate culture and the role of boards – report of observations*, 2016.
[28] See footnote 7.

relevant industry initiatives. The effective implementation of stewardship requires constructive coordination of many market participants working towards positive outcomes for stewardship and sustainable financial markets.

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?

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?

Governance and resourcing stewardship

84. A criticism of the effectiveness of stewardship activity is that in many cases the governance, organisation structures and reporting lines that exist are not suitable, and the resources insufficient for signatories to appropriately fulfil their stewardship responsibilities. This is explored in more detail in the FCA and FRC's joint discussion paper.

85. Effective stewardship requires an investment in a workforce with the appropriate level of skills, experience and influence to monitor and engage effectively, whether these resources are in-house, provided by a third party or a combination of the two. There should be a commitment across the organisation to achieving stewardship objectives, and those individuals responsible should have appropriate accountability and influence internally and externally.

Assurance

86. Many respondents to our initial consultation did not find the Guidance recommendation for external assurance in the 2012 Code helpful, noting it had added little value to their processes or their clients. In the draft 2019 Code we have included a Provision requiring signatories to disclose how they review and assure stewardship.

87. Signatories should obtain assurance of their stewardship processes and reported outcomes. Assurance may be undertaken by an external party, or as part of the signatories' internal audit processes, based upon relevant international standards. Signatories should make a statement that assurance has been undertaken and, if not an explanation as to why. If requested, clients should be provided access to assurance reports on the signatories' stewardship activities and reported outcomes.

Appropriate incentives

88. The *Kay Review* in 2012 identified misaligned incentives of entities in the institutional investment community as a barrier to delivering long-term returns to savers.[29] The joint discussion paper explores this issue in more detail. Signatories are asked to ensure how incentives align with investment strategy and stewardship objectives.

[29] See footnote 4.

2 INVESTMENT DECISION-MAKING

89. The preamble to the 2012 Code references the role of institutional investors in allocating assets, awarding investment mandates and designing investment strategies. However, the Principles and Guidance themselves do not build on this responsibility.

90. This is because historically the Code and the activities of stewardship have focused on how asset managers monitor and engage with companies to improve corporate performance, and how they exercise their rights as shareholders.

91. If the purpose of stewardship is understood to focus more holistically on protecting and creating value for beneficiaries via their assets, then stewardship responsibilities cannot only be regarded as the careful management of assets to improve long-term company performance. Asset owners have a central role to play in promoting effective stewardship practice, and in the selection, monitoring and evaluation of the performance of asset managers who act on their behalf.

92. The draft 2019 Code aligns to the recent changes to pension regulations put forward by the DWP consultation response in *Clarifying and strengthening trustees' investment duties*.[30] The regulations require trustees to set out in their Statement of Investment Principles how they take account of financially material considerations, including (but not limited to) those arising from ESG considerations, including climate change. The Code mirrors the language from the regulations, which was extensively consulted on.

93. The Code also aligns with the SRD II which will require asset owners to disclose:

    - how their equity investment strategy is consistent with the profile and duration of their liabilities;
    - how they incentivise asset managers to align with their investment strategies, the profile and duration of their liabilities; and
    - how they make investment decisions based on financial and non-financial performance.[31]

    Similarly, it will require asset managers to report to their clients on how they have fulfilled these requirements.

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?

3 ACTIVE MONITORING

94. The monitoring by asset managers of investee companies is a well-established stewardship activity and forms Principle 3 of the 2012 Code. This continues to be a central activity of stewardship and enables signatories to fulfil some of their stewardship responsibilities.

95. Institutional investors may choose to outsource to external service providers some of the activities associated with stewardship. However, institutional investors cannot delegate their responsibility for stewardship. They remain responsible for ensuring those activities are carried out in a manner consistent with their own approach to stewardship. Accordingly, the Code requires signatories to explain how they have ensured service providers have supported their stewardship objectives.

[30] DWP, *Clarifying and strengthening trustees' investment duties*, September 2018.
[31] EU Shareholder Rights Directive II – Chapter 1b, Article 3h, 1, 2 (a) and (b), May 2017.

96. The draft 2019 Code puts a greater and more explicit requirement on signatories to monitor the third parties they employ to enable them to discharge their stewardship responsibilities. Asset owners should closely monitor the performance of asset managers, investment consultants and others that advise or act on their behalf. Asset managers must monitor the third-party service providers they employ in addition to assets and the companies in which those assets are invested.

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

4 CONSTRUCTIVE ENGAGEMENT AND CLEAR COMMUNICATION

97. The 2012 Code says 'engagement is purposeful dialogue with companies on matters such as strategy, performance, risk, capital structure and corporate governance, including culture and remuneration', but there is no specific Principle on engagement.

98. Engagement which is constructive, and where there is a clear intention or objective, is one of the most effective ways that investors fulfil their stewardship responsibilities. However, there is frequent criticism from companies that investors often engage with them on a limited range of issues, only when they have concerns, or not at all. The draft 2019 Code includes a Principle on constructive engagement and a Provision on collaborative engagement. The Principles in this section also require signatories to establish an engagement policy and how they integrate this into their investment strategy and set out methods of engagement and escalation.

99. The 2012 Code included a Principle on acting collectively with other investors where appropriate. Provision 20 of the draft 2019 Code requires signatories to 'state the extent to which they participate in collaborative engagement'. The term 'collaborative engagement' has been chosen as it is more widely used internationally than 'collective engagement'.[32] It can also be interpreted in a broader sense than just investors with listed equity holdings seeking to collectively influence the companies in which they are invested. For example, bond holders and shareholders working together, and investors working with other stakeholders to engage on an issue.

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

100. The DWP consultation introduced a requirement in the Occupational Pension Scheme Regulations that will take effect on 1 October 2020, whereby trustees must set out how they would take account of the views that, in their opinion, members hold. Provision 20 (asset owner) seeks to complement this.

101. In its response to the consultation *Insolvency and Corporate Governance*, the Government committed 'to see whether and how a new mechanism can be established through which institutional investors can escalate their concerns about a company or its directors. The FRC agreed with the BEIS to seek views on what the benefits might be of establishing a mechanism for investors to escalate concerns about an investee company in confidence.[33]

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

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32 The PRI, the ICGN, the Australian Asset Owners Code, Canadian Coalition for Good Governance and the South African Code for Responsible Investment use 'collaborative engagement'.

33 BEIS, *Insolvency and corporate governance – government response*, August 2018.

5 EXERCISE RIGHTS AND RESPONSIBILITIES

102. If the purpose of stewardship is to create sustainable value for investors in the first instance, through the responsible allocation and management of capital across the institutional investment community, then it is appropriate that stewardship objectives, activities and outcomes apply not just to listed equity, but to other asset classes where investors are able to exert influence and exercise any rights they hold.

103. The initial consultation feedback supported extending the Code to apply to other asset classes, and through our outreach and engagement we have identified investors that are applying their stewardship approach across asset classes.

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

SERVICE PROVIDERS PRINCIPLES AND PROVISIONS

104. As a result of feedback to the initial consultation questions, calling for a single Code for all signatory types, the earliest drafts of the revised Code included columns for investment consultants and proxy advisers. Through early testing with stakeholders, we determined this approach not to work. This is because many of the responsibilities that asset owners and asset managers – with fiduciary duties – have are not appropriate for service providers. Although service providers, including proxy advisers and investment consultants, hold significant influence and have a role to play in supporting the effective functioning of the marketplace, it is ultimately the role of asset owners and asset managers to ensure they discharge their stewardship responsibilities, and, in doing so, hold to account those whose services they employ to advise or act on their behalf.

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?

LIST OF 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.

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

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

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

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?

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?

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?

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

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?

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?

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?

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

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

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

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

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?

APPENDIX A – SUMMARY OF INITIAL CONSULTATION OF UK STEWARDSHIP CODE

First published in Feedback Statement to UK Corporate Governance Code consultation, published in July 2018.

1.1 As part of its consultation on the UK Corporate Governance Code, the FRC also included some initial questions on the future of the UK Stewardship Code (the Stewardship Code).

1.2 The Stewardship Code seeks to secure long-term value by enhancing the quality of engagement between investors and companies to improve long-term risk-adjusted returns to shareholders.

1.3 Evidence from surveys, discussion with market participants, and assessment of statements from signatories to the Stewardship Code show there has been an improvement in the quantity and quality of engagement with companies since it was introduced. However, the Stewardship Code was last reviewed in 2012 and we wish to consider the role it could play in driving improved outcomes in stewardship practice.

1.4 There were 109 responses to the consultation questions on the Stewardship Code. Overall, respondents to the consultation recognised the role the UK played in influencing stewardship practice and were positive about the prospect of a strengthened Stewardship Code as an opportunity to lead international good practice. A summary of responses to the consultation questions can be found below.

1.5 The feedback to these initial questions on the Stewardship Code will inform the development of a revised Stewardship Code for public consultation later this year.

Q17: 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?

1.6 While some respondents felt that the current Stewardship Code is working well and saw no need for significant changes, the majority agreed that it would be helpful to have clearer expectations of the stewardship roles and responsibilities of those at different points in the investment chain. However, there was very little support for introducing separate codes for asset owners, asset managers, proxy advisers and investment consultants. A clear majority of responses favoured the FRC maintaining a single Stewardship Code with supporting guidance for the different stakeholders. Many respondents called for specific attention to be payed to the role of proxy advisers.

Q18: 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?

1.7 Many respondents agreed that it would be helpful to reformat the Stewardship Code so it was similar to the UK Corporate Governance Code – with principles, provisions and supporting guidance. Some respondents acknowledged that establishing a principles and provisions structure would help asset owners in establishing benchmarks when evaluating fund manager performance as part of their due diligence and monitoring process.

1.8 While many agreed that a 'comply or explain' structure is a good approach, other respondents noted best practice stewardship is constantly evolving, and raised concerns using supporting guidance to highlight examples of a range of good practice, rather than a single best practice.

1.9 For some topics it was generally considered easier to define good practice, for example stock lending and the use of external advisers. Other areas clearly present more challenges, particularly in accommodating the wide variety of investment approaches, styles and goals across the market. Where respondents were in favour of defining good practice, they suggested using the knowledge gleaned from the FRC's tiering process and leveraging the work done by other bodies such as the UN PRI and academic research, alongside a broad consultation with all parts of the investment chain to build consensus on what those practices might be. A few respondents were strongly against the idea of defining best practice, stating if role expectations were more clearly defined (as per Q17) they would prefer to maintain the flexibility of the current Code, which they feel allows signatories to explain their approach.

Q19: Are there alternative ways in which the FRC could highlight best practice in reporting other than the tiering exercise as it was undertaken in 2016?

1.10 Responses to the initial consultation showed strong support for the tiering process, with most respondents noting that they would like to see this continue. Many respondents noted that they had found the process useful, either internally in further embedding good stewardship, or as a tool for assessing asset managers. However, there are concerns that the tiering process had been devalued by having too many signatories in the top tier.

1.11 A number of suggestions were made of ways the FRC could highlight best practice. Many felt that the Stewardship Code would benefit from further oversight, via an annual monitoring survey, a review of signatories through annual stewardship reports, or through a mechanism akin to the FRC Financial Reporting Lab.

1.12 There was a broad consensus that focusing on the quality of stewardship activities and outcomes would be more useful that commenting on the quality of description of policy. Those who had been supportive of moving to a best practice format, felt that highlighting best practice in reporting would make oversight and monitoring easier and more effective.

Q20: Are there elements of the revised UK Corporate Governance Code that we should mirror in the Stewardship Code?

1.13 Some respondents felt strongly that it was not appropriate to mirror the UK Corporate Governance Code, again noting that this risks a box ticking, compliance approach and that maintaining flexibility is critical. However, the majority of respondents favoured introducing at least some mirrored elements. There was support for strengthening the definition of the purpose of stewardship and for the inclusion of issues such as culture and diversity, workforce matters and other elements of environmental, social and governance (ESG) matters within the Stewardship Code. Many respondents were also in favour of including a similar duty for investors as exists under section 172 of the Companies Act for directors. There was support for signatories to report on how they had considered a wide range of stakeholders in their own organisations, their investment process and the companies in which they invest.

Q21: How could an investor's role in building a company's long-term success be further encouraged through the Stewardship Code?

1.14 There were mixed views on how the Stewardship Code could better encourage investors to support the long-term success of investee companies. Some felt that the Stewardship Code was not an appropriate mechanism to determine the role investors can play in supporting long-term business success. There was also support for embedding long-termism throughout the whole stewardship code, with some respondents believing that signatories should demonstrate how their approach to stewardship improves sustainable company performance.

1.15 A variety of specific ideas to build a company's long-term success were put forward by respondents. These included explicitly referencing bond holders to encourage a wider group of investors to engage in stewardship, reporting on timescales of investments (including a principle dedicated to responsible investment), requiring more reporting on ESG integration and how managers are monitoring and engaging with investee companies.

Q22: 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?

1.16 The majority of respondents agreed that the effective consideration of long-term issues, including ESG matters, and assessment of a company's impact on its wider stakeholders, is a critical part of good stewardship. Views were mixed on how best to integrate these ideas more explicitly in the Code, particularly if they comprise a core part of the overall investment process.

1.17 While many respondents were supportive of specific references to ESG and the need to be more explicit about the need for investors to hold company directors to account for their duties, many also felt that a prescribed list of ESG issues would be unhelpful, preferring to encourage engagement on the issues which the investor considers material. There was a broad preference for the Stewardship Code to encourage a focus on material long-term issues, or to require a description of how investments and stewardship approaches align with clients' long-term best interests, as a useful way of encouraging signatories to consider ESG issues, without being too prescriptive.

Q23: 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?

1.18 While some respondents were concerned that reporting on engagement activities and outcomes presents a significant challenge, mainly due to the need for context, the time engagements can take, the variety of investment approaches and a lack of clear measures, the majority were in favour of enhanced reporting. Many asset owner respondents noted that the current reporting on policies is not as helpful to them in their selection and monitoring over asset managers as more fulsome reporting focusing on activities and outcomes would be. Respondents were broadly supportive of some kind of periodic reporting, and many noted existing frameworks that they feel work well, including the UN PRI, the Investment Association Stewardship Reporting Framework and guidance issued by the National Association of Pension Funds (now the Pensions and Lifetime Savings Association).

Q24: How could the Stewardship Code take account of some investors' wider views of responsible investment?

1.19 Views were mixed regarding how the Stewardship Code might reflect some investors' views of responsible investment. Many respondents were concerned that by prescribing responsible investment, the Stewardship Code would become too prescriptive and fail to recognise the variety of investment approaches across the market. They felt it was more appropriate to ensure that the Stewardship Code is based on high level principles that allow the flexibility for signatories to report their own approaches. Others felt that it would be useful for signatories to discuss the nature of their responsible investment approach if they have one.

1.20 There was broad agreement that including an increased range of asset classes in the Stewardship Code would be helpful, with fixed income assets being the most frequently cited as appropriate for inclusion. Many respondents encouraged any revisions to the code to be cognisant of other global developments, including the outputs of the EU High Level Expert Group on Sustainable Finance.

Q25: Are there elements of international stewardship codes that should be included in the Stewardship Code?

1.21 Respondents generally acknowledged the Stewardship Code's leading position internationally. While they noted that many international codes use the UK Code as a starting point, there were some specific items that were cited as potentially useful to include in a revised UK code. Highlighted items included ESG requirements in Japan, Australia and elsewhere, criteria on stock lending in the Dutch code and the Japanese code requirement to ensure investors are using resources of the right calibre for their engagement. Many respondents also acknowledged the ICGN's Global Stewardship Principles as a useful guide.

Q26: 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?

1.22 Many respondents do not believe that the current external assurance process is helpful, noting it had added little value to their processes or their clients. Many also noted that their stewardship activities are already subject to internal audit which has a broader scope than the current focus of external code assurance. Other respondents commented that the provision of non-audit assurance has evolved significantly since the last version of the Code and that it could be possible to develop external assurance that is more useful. While some respondents are in favour of assurance to validate the assertions made by signatories on a periodic basis rather than annually, there was broad consensus that it is not helpful to mandate external assurance.

Q27: Would it be appropriate for the Stewardship Code to support disclosure of the approach to directed voting in pooled funds?

1.23 While many asset owners strongly support the code asking asset managers to disclose their approach to voting in pooled funds, the majority of asset managers were not supportive of making this a requirement of the Code. Many concerns about the practicality of offering split voting were raised, as well as the benefits of pooled investments in terms of lowering costs. However, it was also acknowledged that this is a market issue, that needs to be resolved on a competitive basis between various asset managers and with their clients.

Q28: Should board and executive pipeline diversity be included as an explicit expectation of investor engagement?

1.24 There was broad agreement that board and pipeline diversity is an important part of investor engagement, and that mirroring the requirements of the UK Corporate Governance Code would be helpful. However, many respondents raised significant concerns about being overly prescriptive and creating box ticking behaviour. Some respondents were very clear that it would be unhelpful to focus on particular parts of the UK Corporate Governance Code and would prefer an approach that encourages investors to consider all aspects of the corporate governance code and material issues related to the companies they are investing in.

Q29: Should the Stewardship Code explicitly request that investors give consideration to company performance and reporting?

1.25 The majority of respondents favour a materiality-based approach rather than a checklist of specific issues, in this case, climate change. It is notable that there was significant support for investors to pay much more attention to environmental issues, and for the reporting requirements as set out by the Taskforce for Climate-Related Financial Disclosures. Respondents who were against mandating a climate change consideration were generally accepting that it may occur as a material issue on which they engage with investee companies.

Q30: 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?

1.26 There was clear support from an overwhelming majority of respondents for signatories giving a definition of the purpose of stewardship with respect to the role of their organisation. There were very few concerns raised with this suggestion, however those that were raised mainly focused on the risk of these statements adding little value or becoming boiler-plate.

Q31: 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?

1.27 While respondents saw no need to replicate the entire stewardship statement at the fund level, they were broadly supportive of setting out fund specific approaches on a voluntary basis or through fund level regulations rather than the Stewardship Code. Many respondents feel that this would add transparency and be useful to asset owners in understanding the different purposes and approaches of various funds. However, others raised concerns that this would lead to excessive and costly reporting burdens on asset managers and would lead to boiler-plate disclosure.

APPENDIX B – PROPOSED IMPLEMENTATION SCHEDULE FOR 2019 CODE

Date	Activity
16 July 2019 **2019 Code published**	2019 Code is published and comes into effect. FRC begins accepting applications. New applications to the 2012 Code cease.
From July 2019 **Outreach** **Signatory deadline to submit first Policy and Practice Statement**	FRC outreach on the 2019 Code. To be included in the first list of signatories to the 2019 Code, entities must submit a Policy and Practice Statement (the Statement) by 31 December 2019.
Q1 2020 **Signatory names and Statements to be published**	The FRC will undertake a preliminary evaluation of the quality of the Statement and engage with prospective signatories to communicate whether they have been accepted as a signatory. The FRC publishes a list of 2019 Code signatories to each category on the FRC website, along with links to their Statements. The 2012 Code signatory list will be archived. Only signatories to the 2019 Code will be considered 'signatories to the UK Stewardship Code'.
Q2 2020 onwards **Signatory names and Statements published throughout 2020**	Applications will continue to be accepted after the 31 December 2019 and these Statements will be added to the list of 2019 Code signatories on an ongoing basis.
By 31 December 2020 **Signatories submit first annual Activities and Outcomes Report**	Signatories must submit an annual Activities and Outcomes Report (the Report) within 12 months of submitting their Statement. Signatories are also required to update, or confirm, their Statement remains the same.
Q1 2021 **Signatory Statements and Reports are evaluated**	FRC evaluates signatories' Reports alongside their previously submitted Statements then communicates a combined 'score' and how these have been assessed.
Q2 2021 **Signatory assessments published**	FRC publishes on the website a 'tiered' list of 2019 Code signatories under each category.

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