

Financial Reporting Council
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EC2Y 5AS

Via email: stewardshipcode@frc.org.uk

5 April 2019

Dear Sir/Madam,

BMO Global Asset Management's Response to Proposed Revision to the UK Stewardship Code

I am writing to you on behalf of BMO Global Asset Management (BMO GAM). BMO GAM is an investment management firm whose institutional and retail clients collectively represent over £198 billion of assets. In addition, BMO GAM has been mandated to vote and/or engage in dialogue on behalf of a further 36 investment institutions with assets totalling nearly £123 billion (as at 30 September 2018).

We are committed to good stewardship of our portfolio companies which is integrated into our investment approach. BMO Global Asset Management has long been an active voice in support of robust corporate governance standards and environmental, social and business ethics practices for companies in all jurisdictions where we invest. We have been engaging with our investee companies on corporate governance and broader ESG matters for many years and we integrate ESG factors in investment processes; we also make our views known through our votes at shareholder meetings, which we disclose publicly and also proactively share with companies to encourage further dialogue. Our culture and institutional structures support effective stewardship.

We therefore welcome the overarching objectives of the proposed Stewardship Code (the 'Code') and thank you for the opportunity to comment. Our response focusses on the key areas where we believe changes to the proposed approach are needed.

We believe that the Code has been an important driver of good standards for stewardship in the UK. The implementation of the Shareholder Rights Directive will set minimum standards for stewardship for market participants. In this context, we believe that the role of the current UK Stewardship Code could be further improved to ensure that it keeps up with evolving standards of best practice for all market participants. The Code could support effective stewardship by clearly setting out the differing roles and responsibilities of asset owners and asset managers (and other market participants) and promoting transparent reporting that enables

signatories to demonstrate the outcomes of their stewardship activities to clients and beneficiaries. The Code also has a role to promote effective stewardship beyond equity markets and cover assets held by UK investors internationally.

We particularly welcome the intention to:

- Develop signatories' disclosures on their approach to stewardship across all asset classes. Stewardship can facilitate sustainable value creation across all asset classes.
- Focus on reporting on activities and outcomes. We believe that, done effectively, this can shift the focus away from policies and processes and towards the outcomes of stewardship and will be an important accountability mechanism for asset owners.
- In particular set more demanding expectations of asset owners. This is essential to creating demand for stewardship.
- Explicitly reference Environmental, Social and Governance (ESG) factors – this is an important development that reflects market best practice.
- Require signatories to coordinate their approach to stewardship with their firms' overarching objectives and governance and integrate stewardship into the investment process.

We have concerns that some of the draft language of the Code may hinder the important developments described above and to the detriment of an effective market for stewardship:

The Definition of Stewardship used by the proposed Code conflicts with asset managers and asset owners' fiduciary duty to clients and beneficiaries.

Definition in the new Code: "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".

For us, the central purpose of stewardship to support sustainable value for the beneficiaries of the investment process, the end owners of capital. Sustainable value may be achieved over the relevant time horizons for beneficiaries – both short- and long-term. The definition also needs to allow for different approaches to stewardship across different business models, asset classes and across the investment chain. We also feel it is important that the definition allows the public to understand what stewardship actually entails.

The proposed definition of stewardship may also conflict with asset managers and asset owners' fiduciary duty to clients and beneficiaries by putting the benefit of society and the economy on an equal footing with the benefit of beneficiaries. We, therefore, propose amending the definition to align more closely with that contained in the FCA/FRC Discussion Paper on building an effective regulatory framework, as follows:

"Stewardship involves the responsible allocation of capital and active oversight of investments by asset owners and asset managers to support sustainable value for beneficiaries. Effective stewardship leads to long-term benefits for society and the economy."

Purpose, Governance and Objectives: We have some concerns with how Principle A in particular will be implemented in practice. While this presents a helpful opportunity for asset managers and owners to set out how their approach to stewardship ties in with their overall organisational approach, the Code should focus on how an organisation's purpose, strategy and values relate to stewardship, for example:

- Principle A therefore should read: "Signatories should *disclose* how their organisational purpose, strategy, values and culture, enable them to fulfil their stewardship objectives"
- Principle B: "Signatories should disclose their stewardship approach and objective and how these reflect the relevant time horizon of clients and beneficiaries"

Report on Activities and Outcomes: The implementation of SRD II will necessarily result in asset owners having more consistent information and being able to better differentiate asset managers by excellence in stewardship. This should already improve the market for stewardship. The existence of a market itself implies that some participants outperform others. We would therefore strongly caution against the Code becoming too prescriptive about the manner in which outcomes are achieved; this could result in the Code being treated as compliance exercise.

For example, to support sustainable value for beneficiaries, stewardship involves oversight and engagement on the material issues that will impact on sustainable value of the asset. This may include a variety of issues selected on the basis of their relevance and materiality for the asset under consideration at that time. Different investors may take a different view on what are the material issues.

Asset managers will also decide which particular stewardship activities will be most effective for the asset under consideration and at which time. These activities may include monitoring, engagement, escalation of engagement, exercising voting rights and responsibilities, and how these can impact making buy or sell decisions (for active managers).

It is somewhat unclear whether the FRC envisages that all signatories need to meet all of the elements of stewardship captured by the definition. The Code should recognise that different signatories have different responsibilities in stewardship, for example, asset owners should not necessarily be expected to provide active oversight of individual companies as that role is typically delegated to their asset manager.

Differentiation of the roles and responsibilities of asset owners and asset manager: The Code conflates the roles and responsibilities of asset managers and asset owners; this may disincentivise asset owners from becoming signatories.

For example, there needs to be clear demand from asset owners for asset managers to dedicate sufficient resource towards stewardship activities and this will drive up standards across the industry as clients differentiate excellence between providers. Asset owners can help generate this demand by making stewardship an explicit part of their expectations of asset managers in their selection process and contractual arrangements.

Responses to consultation questions

Q1: Do the proposed sections cover the core areas of stewardship responsibility? Please indicate what, if any, core stewardship responsibilities should be added or strengthened in the proposed principles and provisions.

The sections of the Code reflect essential aspects of stewardship. However, would urge the FRC to revise its proposed definition of stewardship that these principles are built upon as described above.

Q2: do the principles set sufficiently high expectations of stewardship for all signatories to the code?

Overall, the Provisions aimed at asset owners should encourage a better demand for stewardship activities, better performance assessment of managers and a quality approach to manager selection.

For asset managers, overly prescriptive and not sufficiently flexible provisions should be avoided so that signatories are able to articulate different approaches to stewardship in line with their particular business model and strategic objectives. If these issues remain unaddressed, the Code will not be able to meet its aspiration to place focus on outcomes instead of policies and processes. Conversely, it could become an instrument for driving counterproductive, compliance-led behaviour?

We also remain slightly unclear how the “must” recommendations of the Principles would apply in practice. Would they allow for sufficient differentiation between signatories? Also, is it the case that only those organisations that are capable of applying all Principles to a good standard may remain signatories to the Code? We would urge against the loss of the aspirational aspect to of the Code and encourage the FRC to articulate more clearly its thinking in this area.

Q3: do you support ‘apply and explain’ for the principles and ‘comply or explain’ for the provisions?

Good stewardship relies on investors choosing the right approach and material issues to engage on depending on the specific circumstances of their investments and their investment approach. Therefore, the high-level principles should not prescribe specific activities or topics that investors must comply with, which is the case, for example with Principle E.

We would therefore not support the ‘apply and explain’ approach for the Principles, unless these concerns, as well as those highlighted in the response to question 2 are addressed. ‘Comply or explain’ is appropriate for the provisions to provide flexibility for asset managers to explain what may or may not be appropriate in their circumstances.

Q4: how could the guidance best support the principles and provisions? What else should be included?

We recommend that the guidance clarifies which of the principles and the provisions are specifically designed to satisfy the minimum requirements expected under SRD II, as currently it is not always clear which aspects of the guidance are particular to SRD II and which are particular to the Code.

Q5: do you support the proposed approach to introduce an annual activities and outcomes report? If so, what should signatories be expected to include in the report to enable the FRC to identify stewardship effectiveness?

We welcome the addition of an annual activities and outcomes report which would allow signatories to clearly articulate how they have helped to create sustainable value for beneficiaries. This is a key aspect of the new Code which will shift the emphasis on the Code away from policies and practices and towards outcomes. Clients can use these reports to identify the different approaches of asset managers and assess their stewardship capabilities by considering the outcomes achieved. We are therefore supportive of this new recommendation as it will help improve transparency and accountability.

We caution against creating additional reporting burden for those who already report on their activities to clients, as the content of these publications is driven by client demand. The FRC should also not encourage duplication of existing public reporting where this is substantially aligned with the annual Activities and Outcomes report envisaged by the Code. We have previously advocated for and are supportive of the FRC referring to market-led guidance, for example by the Investment Association’s Stewardship Reporting Framework, on how asset managers can report on their stewardship activities.

We encourage the FRC to use the first full year of the Code’s application (2020) to monitor developing best practice before conducting an assessment/tiering exercise of signatories. This will allow time for a proportionate approaches to develop regarding reporting on outcomes.

For example, a proportion of stewardship activity may not lead to a demonstrable outcomes that can be captured in a report for a number of years while nevertheless being in the interests of the ultimate beneficiary. Equally, a significant part of active ownership activities, including, for example, letter writing outreach by asset managers, may result in preventing potentially negative developments within companies or markets that cannot be easily quantified.

Finally, we would like to caution against potential unintended consequences of reporting of outcomes for the sake of reporting. The FRC should be cautious that a system is not created which would drive spurious activity (for example, engagement by asset managers with issuers) for the sake of recording certain outcomes on topics where outcomes may be quick to see but which do not deliver value to clients.

We believe that the FRC should focus on assessing how consistently signatories are reporting their outcomes in line with their policies and processes. We strongly urge the FRC to refrain from assessing the quality of the outcomes achieved when they conduct their tiering exercise. This assessment should be left to asset owners in their scrutiny of prospective managers and beneficiaries in their scrutiny of asset owners.

Any assessment/tiering exercise based on reporting against the proposed Code will be more challenging than the current assessment undertaken by the FRC given the additional detail and complexity of the intended disclosure. The body that replaces the FRC would need to have sufficient expertise and resource to do this well. Given the significant changes in reporting required it would be helpful for the FRC to give private feedback on the quality of reporting in the first instance, and allow time for improvement before making their tiering assessments public.

Q6: do you agree with the proposed schedule for implementation of the 2019 code and requirements to provide a policy and practice statement and an annual activities and outcomes report?

We believe that we are already making stewardship disclosures above the level set out by the 2012 Stewardship Code and are well placed to make disclosures in line with the new Code, including our approach to ESG integration, considering stewardship across multiple asset classes, etc. However, many may be just embarking on this process for whom the proposed timeframe could be a challenge as it may entail significant changes to processes and staffing levels.

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 those should be?

The proposed Code is a step in the right direction towards the outcomes-based approach recommended by Kingman. However, the Code is too focused on prescriptive guidance on policies and processes. The quality of the activities and outcomes statements will be critical in allowing asset owners to differentiate asset managers based on their approach and their outcomes.

At this point in time, it would not be appropriate for the FRC to be granted additional powers, until we can see how these reforms, including the implementation of the SRD II work in practice.

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

We are supportive of the expectation that institutional investors describe their approach to stewardship as well as their firms' overarching objectives and governance.

Q9: the draft 2019 code incorporate stewardship beyond listed equity. Should the provisions and guidance be further expanded to better reflect other asset classes? Is so, please indicate how?

We agree that stewardship should not be limited to listed equities as stewardship can help to play an important role in helping to create sustainable value across all asset classes.

The Code should ask signatories to explain the approach they take to stewardship in different asset classes, rather than being prescriptive about what form these activities should take. It is also important that this reflects on the particular agreement between asset owners and asset managers regarding the asset owners'

expectations. This flexible approach that gives room for signatories to describe if the approach they take and how it is applied.

Q10: does 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 across all funds?

We agree with the approach taken in the proposed Code which encourages asset managers to disclose either their institutional approach or fund level approach and then to highlight where this might deviate by exception.

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?

It is not clear to us how this is expected to relate to Principle A and B on signatories' disclosures about their organisational purpose, strategy values, stewardship approach and objectives.

Q13: do you support the code's use of 'collaborative engagement' rather than the term 'collective engagement'. If not, please explain your reasons.

We value both collective engagement, through representative bodies such as the IA or the Investor Forum, and collaborative engagement efforts where we meet with issuers alongside other investors or stakeholders. Both approaches are important components of our stewardship activities, for example as part of escalation strategies for engagement.

We believe there are differences in the way market participant, particularly outside the UK, understand terms like "collaborative" and "collective" engagement and encourage the Code to provide a brief definition, for example, stating that the term chosen encompasses all the approaches described above and extends to asset classes beyond equities.

Q14: should there be a mechanism for investors to escalate concerns about investee companies in confidence? What might the benefits be?

Investors would need to have confidence that, if they were to channel concerns to the new body, they would be dealt with the expertise and sensitivity demanded. It would be important for this to be provided as a option for rather than a duty on investors.

Q15: should section 5 be more specific about how signatories may demonstrate effective stewardship in asset classes other than listed equity?

Please see response to question 9.

Q16: do the service provide principles and provisions set sufficiently high expectations of practice and reporting? How else could the code encourage accurate and high-quality service provisions where issues currently exist?

The service provider principles and provisions set sufficiently high expectations of practice and reporting.

Yours sincerely,

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