

3529105 **Corporate Governance and Stewardship  
Financial Reporting Council**

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29 March 2019

**Dear Sir or Madam**

## The UK Stewardship Code consultation

**I am writing on behalf of Lane Clark & Peacock LLP in response to the consultation on the proposed revision to the UK Stewardship Code (the “Code”), issued in January 2019.**

Lane Clark & Peacock LLP (“LCP”) is a specialist consulting firm with around 700 personnel in the UK and Europe, including 116 partners. We have offices in London, Winchester and Ireland.

The provision of actuarial, investment and pensions administration advice, benefits, and directly related services, is our core business. About 95% of our work is advising trustees and employers on all aspects of their pension arrangements, including investment strategy. The remaining 5% relates to insurance consulting and business analytics. We provide investment advice to pension schemes with assets under management totalling around £136bn.

We are supportive of the Financial Reporting Council's work to promote the long-term success of companies, thereby benefiting companies, investors and the economy as a whole. We welcome the chance to comment on the proposed revision to the Code. Please note that references to the FRC in our response should be interpreted to include any successor bodies where appropriate.

**3529105** Our high-level comments are as follows:

- Page 2 of 13
- § Overall, we support the proposed strengthening of the UK stewardship regime, with its shift in focus from policy statements to activities and outcomes and its extension beyond UK listed equity.
  - § Whilst we generally consider the strengthened expectations to have been set at an appropriate level for asset managers, we believe that the proposed Code is likely to be too onerous for most pension schemes. It may only be the very largest pension schemes that have the resources to allow them to report to the standards required under the proposals and hence the number of asset owner signatories may fall significantly. It may therefore be more effective to set lower expectations for asset owners initially, with greater emphasis on monitoring the stewardship practices of their asset managers.
  - § We are also concerned that smaller asset managers may find the reporting requirements onerous. Some may cease to be signatories or be penalised by the tiering process if they opt to provide less detailed disclosures, despite fulfilling their stewardship responsibilities well. This could potentially have unintended consequences such as further accelerating consolidation of asset managers or acting as a barrier for new asset managers to enter the UK market.
  - § We welcome the annual Activities and Outcomes Report, which we consider to be one of the most important changes to the Code. We would prioritise better reporting over more detailed or demanding Principles and Provisions.
  - § We do not find the proposed split of material between Principles, Provisions and Guidance to be particularly clear. In some cases, there is significant overlap between Principles and Provisions, whereas in other instances Principles are not covered by Provisions at all. We suggest that Guidance is provided for Principles as well as Provisions and that it follows immediately after the corresponding Principle/Provision rather than in a separate section of the Code.

Our responses to the consultation questions are attached as Appendix 1, with detailed drafting comments on the proposed Code in Appendix 2.

We are happy for our comments, which represent the collective view of a number of people within LCP, to be attributed to LCP. We hope that our response is helpful and if

**3529105** you have any questions, or would like to discuss anything further, then please contact me.

Page 3 of 13

Yours faithfully

+ Prepared as an attachment to an email  
at 17:49 on 29 March 2019

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**This Appendix sets out our responses to the 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.**

Yes, the core areas are covered.

We suggest the emphasis is strengthened for senior responsibility and oversight. There is currently little reference to such oversight in the Principles and Provisions. We would expect senior management accountability to feature more prominently, if standards are to be improved.

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

Yes, the proposed Principles represent a significant strengthening of stewardship expectations and we do not think they should be set any higher at this stage. In fact, we are concerned that they may be set too high for signatories with fewer resources.

We believe the expectations for asset owners are much higher than current practice for almost all pension schemes, and this is likely to deter all but the largest and most committed schemes from signing up. It may therefore be more effective to set less detailed expectations for asset owners (at least initially), with greater emphasis on monitoring the stewardship practices of their asset managers. Alternatively, if the Code is primarily intended for large asset owners, there could be a role for guidance from The Pensions Regulator that clarifies stewardship expectations for trust-based pension schemes of all sizes.

We believe the expectations for asset managers are more realistic. Nonetheless, they may have the unintended consequence of penalising smaller asset managers with limited resources for public reporting, even though they may have good stewardship practices. They might decide not to become a signatory or to sign up but opt not to comply with some provisions on cost grounds. Either way, they may wrongly be perceived as weak at stewardship which would be counterproductive if it harms their client acquisition and retention. This might in turn encourage asset manager consolidation or present a barrier to entry for new managers, both of which we would consider undesirable if driven by this factor. We encourage the FRC to consider how the tiering process could guard against these unintended consequences.

3529105

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

**Appendix 1 (cont)**

Page 5 of 13

Yes, we support this approach in principle. Naturally, the use of “apply and explain” would make it imperative that the Principles are suitable for all intended signatories. As noted in response to Q2, the nature of the draft Principles could deter smaller potential signatories, particularly if they were compulsory. We comment on some specific Principles in Appendix 2, including Principle F which could be made more relevant for index-tracking managers and asset owners.

We note that some Provisions seem to require an explanation in order to comply, not just in the case of non-compliance. It would be helpful if the Provisions made it clear when further explanation is required when complying with them. For example, Provisions 14 and 15 do not indicate that any explanation is required and yet the related Guidance states “should explain...”.

We note that there is significant overlap between some Principles and Provisions (for example conflicts of interest in Principle D and Provision 7) whereas some Principles (for example Principle A) are not covered by Provisions at all. It would be helpful if there was clearer alignment and less overlap between the Principles and Provisions.

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

We have a few suggestions:

- § It might be useful to have guidance for Principles as well as Provisions. It would also be easier to review the Guidance if it directly followed each Provision.
- § More guidance is needed on proportionate approaches for asset owners who do not manage assets themselves.
- § More guidance on asset classes other than listed equity would be useful.
- § Guidance for service providers is quite limited, particularly for providers other than proxy advisers, for example investment consultants like ourselves. More detailed guidance may be difficult given the diversity of service providers, but it would be useful at least to have some clarification of expectations where stewardship is only relevant to a subset of the services offered.
- § We note paragraph 62 of the consultation suggests that investment consultants that provide fiduciary management services would need to respond to both the asset owner and service provider Principles and Provisions. We think that the difference in requirements for advisory-only investment consultants against those investment consultants that also offer fiduciary management services should be made clear in the Guidance.

3529105

We provide more specific comments on the draft Guidance in Appendix 2.

Appendix 1 (cont)

Page 6 of 13

**Q5. Do you support the proposed approach to introduce an annual Activities and Outcomes Report? If so, what should signatories be expected to include in the report to enable the FRC to identify stewardship effectiveness?**

Yes, we support an annual Activities and Outcomes Report. It would be helpful if the FRC could outline the content expected for different categories of signatory, perhaps in the form of a template report (or template reports).

We also note that the consultation document states that "Signatories are required to review and confirm or update their [Policy and Practice] Statement each year", but this isn't clear from the draft Code.

We have the following suggestions for inclusion in the Report:

- § Confirmation that the Statement has been reviewed and an outline of any changes made to the Statement and underlying policies since the previous Report.
- § Summary information about activities and outcomes for the year, ideally with some standardisation across signatories. Standardisation would be easiest for voting, for example number of votes for / against / withheld / not exercised, perhaps split between regions, and stating the extent to which voting is delegated to proxy advisers or own judgement applied. The information could also include the number of engagements with companies, ideally indicating the topics, depth and outcomes and the proportion of investee companies with which engagement has taken place (by number and/or assets under management).
- § Forward-looking information about future stewardship activities, for example engagement priorities for the forthcoming year (the guidance under Provision 20 mentions collaborative engagement priorities and we think this should be extended to non-collaborative engagement).

It may be helpful for reports to describe activities and outcomes separately for the major asset classes (eg equity, credit and other) since the stewardship approaches may be quite different.

**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?**

The schedule looks broadly reasonable, although we think more time should be allowed for some stages.

3529105

Page 7 of 13

We suspect it will take more than one quarter for the FRC to review all Statements submitted and engage with prospective signatories. When the FRC introduced tiering, we found the engagement process to be valuable. We encourage the FRC to adopt a similar process this time, whereby prospective signatories are given time to improve their Statements before the list of 2019 Code signatories is first published. If this is done, we think it unlikely that the list would be ready for publication before Q2 2020.

**Appendix 1 (cont)**

Similarly, we encourage the FRC to engage with signatories and allow them to improve their annual Reports before the tiered list of signatories is first published, allowing at least two quarters for this process. This is particularly important given the significance attached to tiering and the current uncertainty surrounding the FRC's reporting expectations. Hence the first tiered list of 2019 Code signatories may not be available until Q3 2021.

Based on the proposed schedule, it seems likely that many prospective signatories will submit their Statements in late 2019 and hence will be due to provide their first Report by late 2020. To spread workloads for the FRC and enable signatories to align their Reports with other reporting periods, we suggest encouraging them to submit their first Reports throughout 2020, rather than giving the impression that they are expected at the end of 2020.

**Q7. Do the proposed revisions to the Code and reporting requirements address the Kingman Review recommendations? Does the FRC require further powers to make the Code effective and, if so, what should those be?**

The proposed revisions achieve a shift in focus from policy statements to outcomes and effectiveness, as recommended by the Kingman Review. Use of quantitative metrics in reporting (as we have suggested in our answer to Q5) would make it harder for signatories to give a misleadingly positive impression of their stewardship activities.

We don't think more powers are needed at this stage to assess and promote compliance with the Code. However, we consider it likely that the FRC or its successor will need more resource to review and score signatories' submissions, and engage with signatories, if this is to be done effectively.

We note that Recommendation 43 needs to be addressed separately as the Stewardship Code is unlikely to facilitate sufficiently broad and senior dialogue with investors.

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

Principle A requires signatories to "disclose how their purpose, strategy, values and culture enable them to fulfil their stewardship objectives". We support this Principle to some extent, but not a broader requirement to disclose organisational purpose, values,

3529105

strategy and culture. We have reservations as to whether Principle A will result in useful disclosures. We suggest that guidance is provided that encourages signatories to provide concise disclosures, perhaps with a wordcount limit, that focus on specifics.

Appendix 1 (cont)

Page 8 of 13

**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?**

We do not think extra Provisions are needed and instead favour expanding the Guidance to existing Provisions to make them more relevant to other asset classes. (Indeed, we suggest that Provision 27 is not needed – see Appendix 2).

Further guidance could include the nature of ownership rights and responsibilities and expectations for engagement in respect of:

- § ownership of (equity in) investments that are not companies in the usual sense of the phrase “listed equity” (eg property); and
- § investments in debt instruments, not limited to corporate bonds but more widely such as loans (traded and private), sovereign debt, debt-based derivatives such as swaps, and securitised assets such as asset-backed securities.

In the first case, for example, it could refer to engagement with other parties in the investment chain (eg tenants and managing agents for property). In the second case the absence of voting rights should be recognised, and the weaker position that this usually entails. However, it should explain that engagement is still possible (for example, in the common situation where debt instruments are not particularly long-term in nature and so require refinancing regularly). We suggest the FRC seeks input from investment managers in the broad debt management area.

In addition, the guidance could cover engagement with relevant regulators and policymakers on systemic issues, which may be the primary route for influence where ownership rights are limited.

We note that conflicts of interest may arise within asset managers in undertaking stewardship activities when they own different parts of the same company’s capital structure. For example, if they own both debt and equity in a company, their interests may cease to be aligned if the company gets into financial difficulty. The Guidance could usefully address this situation.

We suggest the FRC seeks input from organisations such as the PRI (Principles for Responsible Investment) and investors who specialise in asset classes other than listed equity to ensure the guidance is suitable for all major asset classes.

3529105

Page 9 of 13

**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?**

Appendix 1 (cont)

Provision 1 seems to be sufficient for pooled funds, but it may be worth reviewing its appropriateness once the Statements show how managers implement it in practice. Given the large number of funds offered by some managers, there is a risk they may make broad brush statements which are not sufficiently informative.

This Provision does not explicitly cover the approach for other asset manager mandates (eg segregated rather than pooled fund arrangements). For these, we suggest that managers disclose their default stewardship approach and comment on the extent to which actual practices may vary depending on the specific requirements of the mandate.

**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?**

We consider it good practice for asset owners to disclose their investment beliefs, but we do not consider Stewardship Statements to be an appropriate place for such disclosures. In practice, for pension schemes, we would expect this information to be included in the Statement of Investment Principles and, in some cases, as part of a standalone document.

We do not think it appropriate to require asset managers to disclose their investment beliefs, as their role is to provide products that meet their clients' differing needs. Moreover, they may not have consistent beliefs across different strategies.

If Provision 12 is retained, we suggest it is restricted to asset owners and the fit between their beliefs and their stewardship activities.

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

Yes, clarification that signatories should monitor their agents is welcome and the draft Code sets sufficiently high expectations given the current state of stewardship practices. It would be helpful to clarify the possible agents that might be covered under Section 3, including the use of external asset managers by asset managers.

We think there should also be an expectation of action if the monitoring identifies shortcomings. Currently, there is a brief reference in Guidance 16, which could be expanded. We believe that, as a first step, signatories should provide feedback to agents and request improvements from them where necessary.

3529105

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

**Appendix 1 (cont)**

Page 10 of 13

Yes.

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

We are not well placed to comment on this.

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

Please see our answer to Q9.

**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?**

The draft service provider Principles and Provisions are a significant improvement on the current Code, which doesn't properly cater for service providers (although we note in our answer to Q4 that the draft guidance seems to be limited for service providers and, in particular, service providers that are not proxy advisers). We believe they set sufficiently high expectations given the current state of stewardship practices.

Please see Appendix 2 for our detailed comments on the service provider sections of the draft Code.

**This Appendix sets out our detailed drafting comments on the proposed 2019 UK Stewardship Code, other than those covered by our responses to the specific consultation questions.**

**Section 1 – Purpose, objectives and governance**

- § Provision 4 – The term “workforce” is not well-suited to trust-based pension schemes. We would expect this provision to apply to trustees and in-house staff, and so suggest “directors and staff” as a compromise that is suitable for a wide range of signatories. We note that introducing a reference to directors would increase the emphasis on senior involvement with the Code (see our response to Q1).
- § Provision 7 – As drafted, this provision covers all conflicts of interest, unlike the 2012 UK Stewardship Code principle which refers to “conflicts of interest in relation to stewardship”. A general policy on conflicts of interest may cover little or nothing of relevance of stewardship. We suggest that the provision is restricted to stewardship or the corresponding guidance clarifies that specific references to stewardship-related conflicts are expected.
- § Guidance 8 – In our experience, it is very rare for pension schemes to obtain third party or internal “assurance” of the implementation of their stewardship processes and the reported outcomes. Instead, we would expect the trustees to exercise oversight of the work done on their behalf by asset managers, in-house staff and advisers – for example seeking copies of their asset managers’ assurance reports. We suggest the guidance is expanded to refer to such oversight and/or split between asset owners and asset managers.

**Section 2 – Investment approach**

- § Principle E – As currently drafted, it appears that signatories must demonstrate all ways in which they take account of material ESG issues, not just the ways relating to stewardship. We would remove “material” before “ESG factors”.
- § Principle F – It is not clear how this would be implemented, particularly for index-tracking managers (who have no scope to align their investments) and asset owners (who delegate day-to-day investment decisions to others). If this is to be an “apply and explain” principle, it must be appropriate for all asset owners and managers. It would help to have guidance on what is meant by “actively demonstrate”, but the structure of the draft Code does not permit guidance on principles.
- § Provisions 11 and 13 for asset owners – These seem appropriate for segregated mandates, but not investments in pooled funds. We would expect investors in pooled funds to explain rather than comply unless the drafting is amended.

3529105

Page 12 of 13

§ Guidance 9 – The text seems applicable to asset managers primarily (including in-house management by asset owners). If asset owners carry out stewardship directly, they might establish mechanisms to communicate the resulting insights to their asset managers. Otherwise, we would only expect asset owners to gather information through oversight of managers' stewardship activities. They should factor this information into manager selection and monitoring, but this is arguably covered by other provisions.

**Appendix 2 (cont)**

### Section 3 – Active monitoring

- § Provision 14 – The reference to time horizons may be problematic when investors have different investment time horizons, particularly in pooled funds but also across a manager's different strategies if stewardship is conducted centrally.
- § Guidance 14 – We suggest the wording is amended to make it more applicable to asset owners, who may tend to conduct thematic engagement rather than consider issues affecting individual assets.

### Section 4 – Constructive engagement and clear communication

- § Provision 18 – We suggest that "strategy" is replaced by "processes" or "decisions".
- § Guidance 20 – The third, fifth and sixth bullet points could usefully be disclosed for non-collaborative engagements too (under the relevant provisions).

### Section 5 – Exercise rights and responsibilities

- § Principle J – We would insert "ownership" before "rights" so the principle is not unintentionally broad.
- § Provision 26 – Asset owners often delegate the exercise of their voting rights to others, in which case it may be difficult for them to comply with this provision. Information provided to them by their asset managers is typically aggregated across all strategies, so includes voting rights attaching to stocks that are not owned by the asset owner.
- § Provision 27 – It is not clear to us why bonds have been singled out here. The provision is covered by Principles 1 and 17, except the reference to pre- and post-issuance engagement which could perhaps be incorporated into guidance. If the principle is retained, it would fit better in Section 4.
- § Guidance 23 – This largely repeats Provision 23. It could usefully comment on typical ownership rights for asset classes other than listed equity.
- § Guidance 25 – This seems more appropriate for asset managers than asset owners. The latter may not have detailed information about their stock holdings, particularly for investments in pooled funds. It may be more appropriate for asset owners to understand and oversee the processes and policies being followed by asset managers on their behalf.

3529105

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Guidance 27 – This could be improved by providing examples of best practice and making it clearer that engaging with bond issuers should be regarded as standard practice (it currently reads as though it expects that many signatories will not seek to engage).

**Appendix 2 (cont)**

Page 13 of 13

### Service providers

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Preamble – The reference to “advice” could usefully be expanded to clarify which aspects of consultants’ work it envisages are covered. We consider stewardship to be most relevant for our asset manager research, advice on manager selection and monitoring, and advice on setting investment policies. It is also relevant when providing trustee training and news updates. It would also be helpful to clarify what’s expected where only some of the providers’ services are relevant to stewardship.

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Provision 2 – We would amend this as follows:

*“Signatories must inform clients about the quality (and where appropriate accuracy) of their services and demonstrate this service quality by providing information about how products and services are prepared to best support clients’ stewardship.”*

In our view this would be more applicable across the range of services that might be provided, particularly within investment consultancy where judgement is an important element of the service. (We can see that “accuracy” would be relevant for proxy advisers to ensure votes are exercised in the way that their clients specified but this seems inappropriate for many of the other service providers.)

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Guidance 1 – This recognises that “some service providers are part of larger organisations” but doesn’t say what is expected in these cases.

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Guidance 2, 5 and 6 – The SRD II references only apply to proxy advisers. Guidance for other service providers, particularly investment consultants, would be useful.