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

28 March 2019

By email: stewardshipcode@frc.org.uk

Dear Sir/Madam

Proposed revision to the UK Stewardship Code

PricewaterhouseCoopers LLP welcomes the opportunity to respond to the consultation on proposed revisions to the UK Stewardship Code ("the Code"). We support many of the proposals, which we believe set a framework for supporting a significant upgrading of stewardship activity, but we consider that there remain some areas where more could be done to improve the draft Code. We summarise below the areas in which we broadly agree and our thoughts on potential for improvements. A number of other observations are listed under "Other points and suggestions". We have addressed the specific consultation questions in the Appendix to this letter.

Areas we support in the draft revised Code

The proposed revised Code is a significant step in the right direction in a number of ways compared with the 2012 version. In particular we support:

- **The definition of stewardship** that has been adopted. Although it is somewhat broad, especially given the clear fiduciary responsibilities that are already established in the FCA's regulations, the focus on sustainable value is helpful. However, it would be useful to be clearer that 'sustainable' in this context relates to the long-term performance of companies for the benefit of savers and society to avoid confusion with the environmental sense of the term.

- **The extension of stewardship to asset classes beyond equities.** Being a responsible and engaged investor does not depend on asset class, although asset class may determine the issues that are important to you, those about which you will engage or monitor investments, and the mechanisms available. It should also be noted that holders of debt and equity may at times have conflicting stewardship objectives and so it may not always be possible for an asset manager to have a unified approach to a particular issue across all securities held in the company, as each fund will have fiduciary obligations to its holders. An integrated approach across asset classes may be more possible for an asset owner holding securities directly rather than via funds.

- **Recognition of the need for some fund-level reporting.** Different funds may have different stewardship approaches or areas of focus. It is therefore appropriate to require disclosure where a fund deviates from the firm level approach.

- **The mirroring of the UK Corporate Governance Code format** with the addition of Provisions so that it is clearer to which elements the comply-or-explain reporting mechanism should be applied. The breadth of Principles introduced will certainly create change in requiring more people of greater seniority within investment houses to be closely engaged with the development of policy in line with the Code's recommendations and its reporting requirements.

- **The combination of an 'apply and explain' framework for Principles and 'comply or explain' for Provisions** should help to move the emphasis from reporting to practice, and enables the setting of a high stewardship ambition, but with flexible implementation depending upon the role of a signatory.

- **The two-part reporting framework** (i.e. the initial Policy and Practice Statement and the subsequent Annual Activities and Outcomes Report) will help make the stewardship intentions clearer as well as show how those intentions are being implemented over time. We hope this will help to move ongoing reporting beyond boilerplate.

- **The FRC's plans for more scrutiny of signatories**, before they are 'admitted' and on an ongoing basis. We believe that the FRC should apply rigorous admission criteria and disclose on what basis the tiering decisions are made (e.g. reporting quality). This will, of course, involve the FRC putting in place the necessary resources.

Areas in which we think improvements could be made

In our view, the existing version of the Stewardship Code could have resulted in better outcomes if it had triggered a greater focus on stewardship activity and outcomes in the investment industry, rather than merely reporting. Although it did not expressly prevent signatories from reporting on activities and outcomes, the fact that this form of reporting wasn't required meant that in many cases it wasn't done. The challenge for the new Code (especially in the light of Recommendation 42[1] in the Kingman review) is to achieve a shift in emphasis towards stewardship activity, so that the Code provides a level of confidence for external parties about the quality of stewardship that is being exercised by signatories. If it is to do so, the following will be important:

[1] Recommendation 42 of Kingman Report: "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.

- **Aligning the Code to the realities of the structure of the industry**: It is important to the Code's future credibility to recognise that not all market participants will necessarily choose to be signatories. Some potential signatories will not see stewardship as a priority; there needs to be a demonstrable benefit to adopting the Code, so that it acts as a 'kitemark' for a particular type of engaged ownership, informing choice for clients and beneficiaries.

  The introduction to the Code should therefore address how organisations that are committed to 'stewardship' fit within the investment industry as a whole. This would have the benefit of a) making it clear to market participants that the FRC understands the industry, and that stewardship (of the kind being advocated) is a choice that not every market participant will opt to make in full; and b) allowing beneficiaries and others to understand the nature of the commitment that signatories have made, thus meeting the FRC's aim of, in effect, creating a market for stewardship commitment.

  There is a distinct cultural expectation in the framework being proposed, particularly in the Provision 2 concept of signatories being 'stewards of the market'; neither the market nor the FRC would wish to see those whose business models lack any focus on measures of stewardship attempting to sign up to the Code.

- **Categorisation of signatories**: The Code rightly and necessarily focuses primarily on asset owners and asset managers. However, these are broad categories and the FRC should consider how it might best encourage development of best practice stewardship approaches that are relevant for different types of entity. We are struck by the different approaches taken by the investment trust sector, for example, indicating uncertainty as to the relevance of the Code to those organisations (which constitute a significant part of the FTSE 350).

  The section on service providers, in particular, needs to allow for a more detailed analysis of the various participants in the market that it is intended to cover, based on the specific ways in which each might be expected to apply stewardship of the kind being advocated, e.g. how stewardship objectives are taken into account when consultants advise their clients. Broader requirements on conflicts of interest, service standards, resourcing, and professional standards could be cross-referred to industry voluntary codes (such as the Best Practice Principles). It would be helpful for Provision 6 to outline what areas should be covered by such a Code. Rather than change the Code Provisions significantly at this stage we believe that more detailed analysis around its application is best provided in the Guidance.

- **Actions and outcomes focus**: The Code should focus signatories on actions and outcomes, as opposed to process and reporting. This would mean amending some of the Provisions to avoid the risk that signatories' response is simply to confirm that there is a process of the sort envisaged in the Code. Examples of this include Provisions 9 and 13 for asset owners and managers and Provision 4 for service providers. It also needs to be recognised that, in some cases, evidence of outcomes may not be seen for a number of years, and therefore good stewardship reporting will need to address this.

- **Stewardship vs engagement:** The draft revised Code currently implies that it is essential to engage in order to exercise good stewardship. In our view, stewardship and engagement are not synonymous terms, so engagement should be only one factor and not necessarily drive either becoming a signatory or decisions by the FRC on tiering.

- **Priorities for positive engagement, where appropriate:** We believe there are three principal characteristics of positive engagement and that the revised Code should emphasise these as part of building its credibility. First, a focus on matters that are strategically important to the business; second, adequate resourcing and expertise on the part of those doing the engaging; and last, confidence that, even if engagement is carried out by the governance team (and not directly by the fund manager) of an investment firm, this will still have an influence on the organisation's investment decisions.

- **Good practice**: Sufficient clarity should be provided on what good practice is, in both activities and actions *and* reporting. Potentially, this could mean moving some of the Guidance into the Code itself (and building on it, for instance by recognising that many organisations are committed to frameworks such as the PRI). Examples include the Guidance on Provisions 9 and 14 (we believe the latter is particularly important and could be expanded). Ideally, the Code Principles and Provisions would be largely self-explanatory and the Guidance could then focus on case studies and examples of good practice, rather than further elaboration on each Provision.

  It would also be helpful for the FRC to maintain a repository of examples from individual organisations' published reports – the Financial Reporting Lab could help to develop this. The reports of the Investor Forum (which tend to be particularly outcomes-focussed because of the nature of the cases that they deal with) may be a good starting point.

  Where case studies and examples are used by signatories they need to be part of an overall disclosure which shows that stewardship has been applied consistently throughout the period.

- **Environmental, Social and Governance (ESG) matters**: We agree with the sentiment behind the requirement to include ESG matters in the Code. However, we believe that ESG has become a widely misunderstood term. It would be better to refer to material information (financial and operational) reported outside the statutory financial statements that can affect the company's business model and note that these include, but are not limited to, environmental and social matters. This would also have the beneficial effect of avoiding the Code becoming outdated as ESG becomes more naturally integrated into investment analysis.

Other comments and suggestions

- We agree with the recommendation in Provision 8 around seeking assurance, and suggest that clear guidance for the scope and approach of an external review is provided to replace the current guidance included in the supplement to the ICAEW AAF 01/06 standard. We are happy to work with either the FRC, or the ICAEW if appropriate, in exploring options for the form of that assurance, and recommend that a working group be established to develop this, as we expect that there will be signatories amongst the Tier 1 category who will seek out independent assurance as a marker of their commitment to the Code, and with the expectation that it may provide a degree of competitive advantage.

- We are not convinced of the need to move to the proposed new term "collaborative" engagement (in Provision 20), and prefer to retain "collective" engagement. This is a concept that the industry already understands. Investors carrying out stewardship activities may sometimes have a common goal for a number of their activities, but won't always have a common goal in all their activities, so "collective" appears to work better in these circumstances.

If you have any questions regarding the views in this letter, please do contact me. We would be happy to discuss any of the issues raised and provide detailed drafting suggestions if this would be helpful.

Yours faithfully

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Appendix to PwC response on FRC Proposed Revision to Stewardship Code

Questions	Answers
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.	As set out in our covering letter, we support: **The definition of stewardship that has been adopted:** Although it is somewhat broad, especially given the clear fiduciary responsibilities that are already established in the FCA's regulations, the focus on sustainable value is helpful. However, it would be useful to be clearer that 'sustainable' in this context relates to the long-term performance of companies for the benefit of savers and society to avoid confusion with the environmental sense of the term. As we also explain in our covering letter, however, we think that the overarching challenge for the Code is to achieve a shift in emphasis towards stewardship *activity*, so that adopting it provides a level of confidence for external parties about the quality of stewardship that is being exercised by signatories. If it is to do so, the following will be important: **Aligning the Code to the realities of the structure of the industry:** It is important to the Code's future credibility to recognise that not all market participants will necessarily choose to be signatories. Some potential signatories will not see stewardship as a priority; there needs to be a demonstrable benefit to adopting the Code, so that it acts as a 'kitemark' for a particular type of engaged ownership, informing choice for clients and beneficiaries. The introduction to the Code should therefore address how organisations that are committed to 'stewardship' fit within the investment industry as a whole. This would have the benefit of a) making it clear to market participants that the FRC understands the industry, and that stewardship (of the kind being advocated) is a choice that not every market participant will opt to make in full; and b) allowing beneficiaries and others to understand the nature of the commitment that signatories have made, thus meeting the FRC's aim of, in effect, creating a market for stewardship commitment. There is a distinct cultural expectation in the framework being proposed, particularly in the Provision 2 concept of signatories being 'stewards of the market'; neither the market nor the FRC would wish to see those whose

	business models lack any focus on measures of stewardship attempting to sign up to the Code. **Actions and outcomes focus:** The Code should focus signatories on actions and outcomes, as opposed to process and reporting. This would mean amending some of the Provisions to avoid the risk that signatories' response is simply to confirm that there is a process of the sort envisaged in the Code. Examples of this include Provisions 9 and 13 for asset owners and managers and Provision 4 for service providers. It also needs to be recognised that, in some cases, evidence of outcomes may not be seen for a number of years, and therefore good stewardship reporting will need to address this. **Stewardship vs engagement:** The draft revised Code currently implies that it is essential to engage in order to exercise good stewardship. In our view, stewardship and engagement are not synonymous terms, so engagement should be only one factor and not necessarily drive either becoming a signatory or decisions by the FRC on tiering. **Priorities for positive engagement, where appropriate:** We believe there are three principal characteristics of positive engagement and that the revised Code should emphasise these as part of building its credibility. First, a focus on matters that are strategically important to the business; second, adequate resourcing and expertise on the part of those doing the engaging; and last, confidence that, even if engagement is carried out by the governance team (and not directly by the fund manager) of an investment firm, this will still have an influence on the organisation's investment decisions. **Environmental, Social and Governance (ESG) matters:** We agree with the sentiment behind the requirement to include ESG matters in the Code. However, we believe that ESG has become a widely misunderstood term. It would be better to refer to material information (financial and operational) reported outside the statutory financial statements that can affect the company's business model and note that these include, but are not limited to, environmental and social matters. This would also have the beneficial effect of avoiding the Code becoming outdated as ESG becomes more naturally integrated into investment analysis.
Q2. Do the Principles set sufficiently high expectations of effective stewardship for all signatories to the Code?	Our covering letter contains the following comments on this area: **Categorisation of signatories:** The Code rightly and necessarily focuses primarily on asset owners and asset managers. However, these are broad categories and the FRC should consider how it might best encourage development of best practice stewardship approaches that are relevant for different types of entity. We are struck by the different approaches taken by the investment trust sector, for example, indicating uncertainty as

	to the relevance of the Code to those organisations (which constitute a significant part of the FTSE 350). The section on service providers, in particular, needs to allow for a more detailed analysis of the various participants in the market that it is intended to cover, based on the specific ways in which each might be expected to apply stewardship of the kind being advocated, e.g. how stewardship objectives are taken into account when consultants advise their clients. Broader requirements on conflicts of interest, service standards, resourcing, and professional standards could be cross-referred to industry voluntary codes (such as the Best Practice Principles). It would be helpful for Provision 6 to outline what areas should be covered by such a Code. Rather than change the Code Provisions significantly at this stage we believe that more detailed analysis around its application is best provided in the Guidance. <u>Other comments</u>: We would also note that, in establishing a more demanding standard for stewardship, the Code may impose a resource requirement that is difficult for smaller funds or asset owners to meet, even if they are keen to be good stewards. It would be unfortunate if the requirements of the Code discouraged its adoption by, for example, smaller pension funds. Therefore, in the 'entry requirements' for signatories, the FRC could consider some element of proportionality either in the Code requirements themselves or how compliance is assessed. This might involve the FRC taking into account the size and significance of the entity when looking at issues such as: detail or frequency of reporting (including for example AGM voting records as well as policy and activity reporting); expectations of collective engagement; client and beneficiary engagement; and acting as stewards of the market.
Q3. Do you support 'apply and explain' for the Principles and 'comply or explain' for the Provisions?	As set out in our covering letter, we support: **The mirroring of the UK Corporate Governance Code format** with the addition of Provisions so that it is clearer to which elements the comply-or-explain reporting mechanism should be applied. The breadth of Principles introduced will certainly create change in requiring more people of greater seniority within investment houses to be closely engaged with the development of policy in line with the Code's recommendations and its reporting requirements. **The combination of an 'apply and explain' framework for Principles and 'comply or explain' for Provisions** This should help to move the emphasis from reporting to practice, and enables the setting of a high stewardship ambition, but with flexible implementation depending upon the role of a signatory.

Q4. How could the Guidance best support the Principles and Provisions? What else should be included?	Our covering letter includes the following on the proposed Guidance: **Good practice:** Sufficient clarity should be provided on what good practice is, in both activities and actions and reporting. Potentially, this could mean moving some of the Guidance into the Code itself (and building on it, for instance by recognising that many organisations are committed to frameworks such as the PRI). Examples include the Guidance on Provisions 9 and 14 (we believe the latter is particularly important and could be expanded). Ideally, the Code Principles and Provisions would be largely self-explanatory and the Guidance could then focus on case studies and examples of good practice, rather than further elaboration on each Provision. It would also be helpful for the FRC to maintain a repository of examples from individual organisations' published reports – the Financial Reporting Lab could help to develop this. The reports of the Investor Forum (which tend to be particularly outcomes-focussed because of the nature of the cases that they deal with) may be a good starting point. Where case studies and examples are used by signatories they need to be part of an overall disclosure which shows that stewardship has been applied consistently throughout the period.
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?	As explained in our covering letter, we support the two-part reporting framework (i.e. the initial Policy and Practice Statement and the subsequent Annual Activities and Outcomes Report). This will help make the stewardship intentions clearer as well as show how those intentions are being implemented over time. We hope this will help to move ongoing reporting beyond boilerplate.
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	In our view, especially at this time of transition for the regulator and acknowledging the multiple reviews that are currently in play, it is important for the FRC to take the necessary time to get the revision right, as it may be some time before another review is possible. We encourage the FRC to continue to work with the FCA and others to come to an agreed long-term solution to the issue of improving the effectiveness of stewardship in the investment market on an ongoing basis.

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?	See our comments on Q1 and Q2 above in relation to the general effectiveness of the proposed revisions to the Code. As we explain in our covering letter, we support the FRC's plans for more scrutiny of signatories, before they are 'admitted' and on an ongoing basis. We believe that the FRC should apply rigorous admission criteria and disclose on what basis the tiering decisions are made (e.g. reporting quality). This will, of course, involve the FRC putting in place the necessary resources. We also support the recommendation in Provision 8 around seeking assurance, and suggest that clear guidance for the scope and approach of an external review is provided to replace the current guidance included in the supplement to the ICAEW AAF 01/06 standard. We are happy to work with either the FRC, or the ICAEW if appropriate, in exploring options for the form of that assurance, and recommend that a working group be established to develop this, as we expect that there will be signatories amongst the Tier 1 category who will seek out independent assurance as a marker of their commitment to the Code, and with the expectation that it may provide a degree of competitive advantage.
Q8. Do you agree that signatories should be required to disclose their organisational purpose, values, strategy and culture?	Nothing to add to our other responses.
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?	As explained in our covering letter, being a responsible and engaged investor does not depend on asset class, although asset class may determine the issues that are important to you, those about which you will engage or monitor investments, and the mechanisms available. The Code should reflect that holders of debt and equity may at times have conflicting stewardship objectives and so it may not always be possible for an asset manager to have a unified approach to a particular issue across all securities held in the company, as each fund will have fiduciary obligations to its holders. An integrated approach across asset classes may be more possible for an asset owner holding securities directly rather than via funds.

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?	As we note in our covering letter, different funds may have different stewardship approaches or areas of focus. It is therefore appropriate to require disclosure where a fund deviates from the firm level approach.
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?	Nothing to add to our other responses.
Q12. Does Section 3 set a sufficiently high expectation on signatories to monitor the agents that operate on their behalf?	Nothing to add to our other responses.
Q13. Do you support the Code's use of 'collaborative engagement' rather than the term 'collective engagement'? If not, please explain your reasons.	As explained in our covering letter, we are not convinced of the need to move to the proposed new term "collaborative" engagement (in Provision 20), and prefer to retain "collective" engagement. This is a concept that the industry already understands. Investors carrying out stewardship activities may sometimes have a common goal for a number of their activities, but won't always have a common goal in all their activities, so "collective" appears to work better in these circumstances.

Q14. Should there be a mechanism for investors to escalate concerns about an investee company in confidence? What might the benefits be?	Nothing to add to our other responses.
Q15. Should Section 5 be more specific about how signatories may demonstrate effective stewardship in asset classes other than listed equity?	See our response 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?	See our responses to Q1 and Q2 in particular.