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Dear Sirs,

Response to the FRC's consultation on the revised Stewardship Code

As the primacy of shareholders is enshrined in company law, the *quid pro quo* is shareholders holding investee companies to account, thereby supporting the aim of rebuilding trust in business. An effective Stewardship Code will help drive this mission. In response to your request for comments on the proposed draft principles, provisions and guidance for the Stewardship Code, we set out below our observations in respect of questions raised.

General Observation

The Stewardship Code was introduced to improve long-term returns to beneficiaries by enhancing the quantity and quality of engagement between investors and companies.

The research undertaken in the Grant Thornton Corporate Governance Review has shown a continuing decline in the quality of shareholder engagement over the past four years, as evidenced by the increasingly limited disclosure. Our most recent review shows 31% of companies provided good or detailed disclosures of their engagement, compared to 55% in 2015. We have however found that while the quality of reporting of engagement has declined, more companies report on meetings with investors. This is more common in the FTSE 100, with more mention of face-to-face meetings with Board members other than Executives. Where such meetings occur, the Chair is generally the main point of contact for investors with 50% of the FTSE 350 stating that their chair met with shareholders in direct meetings. Yet significant numbers either do not state explicitly that their Chair meets with shareholders or disclose that the Chair is available for meetings but did not attend any. We have also found that the level of engagement between non-executive directors and shareholders is very limited. Although 46% of the FTSE 350 state that their NEDs are available to meet with shareholders only 22% report any such engagement with the most common (13%) involving the Remuneration Committee chair. This raises concerns.

From the investor perspective, anecdotal evidence suggests that investors believe that the level of activity has increased with more meetings and governance events than ever before. And yet pressures on ESG team budgets mean additional resources are hard to come by. As a consequence, there is an acknowledgement that it is the smaller and mid-sized companies who are the losers as they struggle to get airtime.

What do we conclude from the above?

Firstly, not only does there need to be greater and wider engagement between boards and investors, the quality of those engagements has also to improve if the Stewardship Code is to achieve its objective. However, aspiring to achieve more with the same resources will have its limitations and will come at a cost.

Secondly, greater transparency about the nature and frequency of engagement from both investors and the investee companies will facilitate a better appreciation of the influence and accountability that investors wield. However, simply providing more disclosure without a change in the underlying practices of investors will change little.

Thirdly, achieving lasting change among all signatories will require greater policing. The introduction of three levels of tiering had an initial impact suggesting that such public accountability can influence change. But clear and continued differentiation is essential to maintain the pressure for change.

Specific Responses

With specific reference to the questions raised, our responses are as follows.

1) 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

We believe that core areas of stewardship, are covered, with similarity seen in Stewardship Codes available internationally. We also agree that service providers should be covered by the Code.

Responsibilities that could be strengthened include:

Section 3: Active Monitoring

Beyond monitoring of performance, this might also include the monitoring of the accuracy, quality and completeness of company reporting in the front end of the accounts. For example, if a company's reporting on the frequency and nature of engagement with the signatory does not align with the signatory's experience, this should be challenged. The monitoring of reporting is given as an example of monitoring activities in the guidance however by including this in the main body of the Code it would be given more prominence.

Section 4: Constructive engagement and clear communication

There must be a real drive on quality of engagement as opposed to quantity. In order to drive the quality of engagement, the Code would benefit from definitions being provided for the terms constructive or collaborative engagement.

In addition, reporting on engagement would be enhanced by disclosure of relevant KPIs to inform clients, ultimate beneficiaries and wider stakeholders as to their levels of engagement in the period. This disclosure should also detail their engagement over non-UK based asset classes.

We note that this section is silent on shareholder activism, which is important given the increasing frequency of these activities.

Section 5: Signatories must actively exercise their rights and responsibilities

This can be strengthened by emphasising voting as an ownership right and responsibility. The requirement to disclose voting records should be on an apply or explain basis as opposed to comply or explain. Such disclosure of voting records would enable relevant signatories to be held to account.

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

We believe the principles have increased significantly the expectations of effective stewardship for all signatories to the Code. However, it is important that the enhanced reporting requirement for all signatories provides insightful information against which their exercise of stewardship responsibilities can be judged. This requires more disclosure of the `how' as opposed to the `what'. For example, the guidance to support provision 5 currently requires signatories merely to confirm that they are incentivised to align their investment strategy with the profile and duration of the assets they own. Whereas for this disclosure to be effective it needs to disclose how they are incentivised. Care should to be taken to avoid the provision of bland statements which provide no real insight.

3) Do you support 'apply and explain' for the Principles and 'comply or explain' for the Provisions?

We believe that the proposed approach is sensible, however the common factor and key focus of how signatories respond to both the principles and the provisions should be the quality of their explanations. This aligns with the emphasis of the new Corporate Governance Code for higher quality explanation and is reflected in the recommendations of the Kingman review - which recognises the need to drive excellence in stewardship practices rather than focusing on compliance.

Our experience in reviewing changes in front end reporting in the annual accounts of the FTSE 350 shows that while those companies that claim compliance with the Code has been steadily growing (now 72%), only 27% discuss the application of the principles in a meaningful way- for example explaining how they have been applied or specifying actions and outcomes.

In examining the Stewardship Code, we note that signatories are required to establish a conflicts of interest policy on an apply and explain basis however they are then required to disclose how that policy works on a comply or explain basis? In such a case without a clear explanation of how it is implemented, the statement merely confirms the existence but gives no real insight. It is also not clear why the provision requiring signatories to have appropriate governance policies and/or structures to enable the delivery of stewardship obligations is on a comply or explain basis given the importance of setting the tone from the top,

Regarding the Policy and Practice statement, requiring a meaningful alternative approach to be provided for provisions which they do not comply with, while robust, appears to be apply and explain by other means. Where signatories do not comply, they should provide explanations for non-compliance which may include the use of alternative approaches. We agree that requiring a signatory to state if, and when, the signatory expects to comply in the future is a sound approach.

Overall, we believe focusing on `comply' or `apply' will have limited impact unless quality explanations are provided in support. We therefore feel that greater emphasis should be placed on the need for and resultant provision of quality explanations.

4) 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 agree this is a sensible approach.

The Annual Activities and Outcomes report should provide or address the following:

- Useful statistics/KPIs on stewardship activities separated by each asset class, aligned to investment time horizons. For example – roles of those engaged with, number of meetings, topics, desired outcome, final outcome and case studies
- Where an issue has received more than 20% of votes against it, there should be an explanation of the signatory's approach/engagement on this issue in a separate section of the report
- A balance needs be struck between disclosing too much and providing insufficient information to enable an understanding of the matter. Situations requiring confidentiality should be explained
- The impact of engagement outcomes for clients and beneficiaries should be provided; consideration should be given to the impact of significant outcomes on wider stakeholders
- Should contain voting records and regarding proxy advisors – statistics on to what extent they have followed or deviated from the recommendations of proxy advisors
- Should contain useful information/statistics on signatory's stock lending

It should be made clear that all desired outcomes will not always be achieved however a high percentage of outcomes not being achieved should require a re-assessment of engagement methods.

5) 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? Are further powers needed to assess and promote compliance with Code?

The Kingman Review requires the Stewardship Code to drive excellence in the exercise of stewardship. We would agree that effective stewardship is as much if not more about the quality of engagement between signatories and investee companies as it is about the application and compliance of the code's principles and provisions.

To the extent that the reporting process can provide transparency and through this an insight into a signatory's exercise of its stewardship responsibilities, it is the quality of the explanations that will provide that insight. The difficulty is that judging the quality of explanations is a subjective exercise, the assessment of which benefits from experience gained over the passage of time. This observation is based on our experience of monitoring the application of the UK Corporate Governance Code across all FTSE 350 companies for the last 17 years. Our research suggests that when new guidance, which requires a response which is not binary (yes or no), is issued, it can take up to 5 years for all those companies who wish to embrace it to do so.

Further our research suggests that where the FRC seeks to encourage debate on areas that warrant greater attention, this heightens awareness and stimulates changes in practice. However, this alone as a means of bringing about change is not enough as the example of the FRC's promotion of culture following its 2016 detailed consultation shows. Here adoption rose to 39% from 20% in the year following the consultation but then waned quickly to 33% last year when the FRC's attention switched to the development of the new Code. We believe that keeping the pressure on signatories thereafter is key to effecting lasting change.

It is not for us to comment on the practicalities of the proposed timeline for implementation and reporting. We would, however, recommend that in order to bring about lasting change, following the first year of annual reporting, the FRC, rather than adopting, formally, the tiering process, considers providing supportive feedback privately and publishes a general report identifying areas they consider to be good practice and those which would benefit from further attention. We note that the use of examples as might be provided by the Reporting Lab can be helpful, but it must be recognised that this can lead to slavish adoption by those who would rather follow practice than lead it. It is only in subsequent years once the FRC has had the opportunity to moderate and share its assessment process that tiering should be formalized and published. It is only at this point that consideration should be given as to whether further powers are needed to assess and promote the application of the Code.

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

We believe that the ability of an organization to clearly articulate and demonstrate their purpose, values, strategy and culture is the foundation stone of good governance and this is further evidenced by the fact that all recent governance codes issued in 2018 refer to these key elements.

That this is not yet common practice among public companies is apparent from the results of the 2018 Grant Thornton Corporate Governance Review which shows that - 60% of the FTSE 350 companies do not state their purpose, 33% do not articulate their values, and only 33% provide good or detailed accounts of their culture.

It is self-evident that signatories seeking to hold others to account must themselves aspire to and evidence best practice in the field of governance. Providing these disclosures is a key step in the exercise of good governance.

Yours faithfully,

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