Consultation on a revised UK Corporate Governance Code: Response from City of London Green Finance Initiative

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1 Introduction

In December 2017, the Financial Reporting Council (**FRC**) published a consultation paper (the **Consultation**) in relation to proposed revisions to the UK Corporate Governance Code (the **Code**). The Consultation is accompanied by a draft revised Code reflecting the proposed revisions (the **Revised Code**). The Consultation also seeks views about the future direction of the UK Stewardship Code.

The City of London Corporation has taken a leading role in the growing global green finance market. The private sector is already playing a significant role in financing the low-carbon energy transition. The City of London has established the Green Finance Initiative (**GFI**), to leverage the experience and expertise of the City of London to deliver listed and unlisted investment in UK and global green infrastructure, ranging from the successful work in growing the Green Bond market to over $100 billion of annual issuance, to pioneering direct renewable infrastructure investments by UK pension funds.

This document provides the GFI's general comments in relation to the Consultation and the Revised Code, together with specific responses to the questions.

Please note that the following areas are outside of our field of expertise and therefore we have not provided a response to:

- Questions 7 and 8 relating to independence and tenure of directors; and
- Questions 9-11 which relate to diversity in the boardroom (although we are supportive of implementing measures to increase diversity in the boardroom).

Please do not hesitate to contact Ben Caldecott for further information on anything contained in this response.

2 General comments

The introduction of a comprehensive and world-leading UK climate-related and sustainability related financial disclosure framework is a key priority for the GFI.

The GFI has each established a Working Group to formulate detailed recommendations on the successful implementation of such a disclosure framework. A significant part of the work undertaken by these committees has focused on how to implement the Task Force on Climate-related Financial Disclosures (**TCFD**) recommendations in the UK.

Following the publication of the TCFD recommendations on 29th June 2017, there has been increasing calls for the TCFD recommendations to be incorporated into national corporate governance and reporting frameworks. Most recently, the final report of the High Level Expert Group on Sustainable Finance (published on 31 January 2018) recommended that the EU endorse the TCFD recommendations and implement them at the EU level (and recognises the 2018 review of the Non-Financial Reporting Directive is a unique opportunity to do this).[1] In the UK, our Government has endorsed the TCFD recommendations and encouraged all listed companies to implement them.[2]

The GFI believes that, with the requisite support from financial regulators, the TCFD recommendations can be integrated in the UK corporate governance and reporting framework without additional legislation.

2.1 Incorporating the TCFD recommendations in the Revised Code

Incorporating the TCFD recommendations in the Revised Code is a key means by which the TCFD recommendations can be implemented within the FRC's sphere of responsibility, and would achieve a much needed systemic change in reporting practice in relation to climate-related financial risk by listed companies.

As set out in the Listing Rules, the Revised Code would apply to all companies with a premium listing of equity shares, whether they are incorporated in the UK or elsewhere, but in addition other listed and unlisted companies may adopt the Revised Code in whole or in part.

We believe that it is not a great leap for the TCFD recommendations to be incorporated in the Revised Code. As the FRC already recognises '[t]he four overarching recommendations of the TCFD relating to governance, strategy, risk management, and metrics and targets, are similar in nature to the requirements of the strategic report.'[3] Furthermore, for each of the five sections of the Revised Code, the TCFD recommendations set out industry best practice in relation to how the Principles and Provisions should apply to governance practice in the context of a changing climate and the low carbon transition.

There is a precedent for the FRC establishing a new reporting requirement as evidenced by the introduction of the long term viability statement in the 2014 version of the Code.

1 EU High-Level Expert Group on Sustainable Finance, 2018. Financing a Sustainable European Economy [Online] Available at: https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report_en.pdf
2 https://www.gov.uk/guidance/green-finance#green-finance-taskforce
3 FRC, 2018. Letter to BEIS in response to consultation on streamlined energy and carbon reporting. [Online] Available at: https://www.frc.org.uk/getattachment/f827020b-4b8c-445b-9e16-7a03ab901c31/FRC-response-to-DBEIS-Carbon-reporting-consultation-4-Jan-2018.pdf

Therefore we believe that it would not be a great leap for the Revised Code to include a provision in relation to disclosure in line with the TCFD recommendations.

We believe that an easy way of incorporating the TCFD recommendations in the Revised Code would be to have an additional provision at the end of *Section 4 (Audit, Risk and Internal Control)*. This additional provision should state:

"The recommendations from the Task Force on Climate-related Financial Disclosures set out industry best practice to in relation to how these Principles and Provisions should apply to governance practice in the context of a changing climate and the low carbon transition. The board should include in the annual report each of the Recommended Disclosures in Figure 4 of the recommendations from the Task Force on Climate-related Financial Disclosures."

We believe that there should be accompanying explanation in the *Guidance on Board Effectiveness* to include:

- climate change poses serious risks to the global economy and will have an impact across many sectors;
- the large-scale and long-term nature of the problem makes it uniquely challenging in the context of business decision-making;
- the TCFD recommendations provide a best practice framework for complying with the disclosure requirements of the strategic report for UK incorporated companies (or the management report or other narrative reports for companies incorporated elsewhere); and
- the TCFD recommendations provide a best practice framework for identifying climate related risks and factoring these into board decision-making for compliance with directors' duty to promote the success of the company (as set out in S172 Companies Act 2006 for UK incorporated companies).

2.2 Incorporating the TCFD recommendations in the Stewardship Code

Incorporating the TCFD recommendations in the Stewardship Code is a further means by which the TCFD recommendations can be implemented within the FRC's sphere of responsibility. The TCFD believes that asset managers and asset owners, including public- and private-sector pension plans, endowments, and foundations, should implement the TCFD recommendations. Incorporating the TCFD recommendations in the Stewardship Code could achieve a dual purpose.

First, it could introduce a requirement to report in line with the TCFD recommendations for asset managers, asset owners and others who are acting in compliance with the Stewardship Code. We believe that the extent of reporting under the Stewardship Code is insufficient at the moment (and in addition, some principles can be complied with without much substantive effort). However the Consultation indicates that the FRC is considering significant enhancements to the Stewardship Code. We believe that one such enhancement could include a mechanism or framework for reporting meaningfully on compliance with the Stewardship Code (which includes reporting in line with the TCFD recommendations).

Second, it could enhance any requirement in the Revised Code for companies' reporting in line with the TCFD recommendations by making explicit reference to investors' oversight of climate risk information provided by investee companies and the fact that this information should be reported in line with the TCFD recommendations.

Given the Consultation is an initial high-level consultation on the future direction of the Stewardship Code, it is not possible to state the best way/location of incorporating the TCFD recommendations at this stage.

2.3 FRC approach and GFI recommendation

The FRC has up to this point been reluctant to support TCFD implementation by citing that the level of detail set out in the TCFD recommendations will distort reporting and result in disclosure which is not clear and concise. At the same time, the FRC recognises that investors' interest in environmental matters has grown significantly and therefore the scope of information required by the existing legislative framework has broadened. We believe that the FRC needs to heed these calls and further its mission to promote transparency and integrity in business through working towards TCFD implementation within its sphere of responsibility - both in the Revised Code and the Stewardship Code.

3 Responses to questions

Q1. Do you have any concerns in relation to the proposed Code application date?

The GFI will publish in Spring 2018 its recommendation on *Establishing the World's Best Framework for Climate-related and Sustainability-related Financial Disclosures* which sets out a process by which this may be achieved.

We suggest a two-step process where the Government and regulators: (1) create and publish guidelines which cover the TCFD recommendations and voluntary Sustainability-related Financial Disclosure recommendations; and (2) appropriately reference these guidelines in the corpus of relevant UK rules and codes.

The guidelines should be prepared and published in 2018/19. The GFI, together with relevant regulators and Government departments, can begin an inclusive process involving key private sector stakeholders, to generate the guidelines. This could significantly reduce the burden on financial regulators and the UK Government associated with preparing new guidance in a short period of time.

We see the Revised Code as a key part of the corporate governance and reporting framework which could reference these guidelines. However we recognise that the guidelines are unlikely to be developed in a relevant timeframe for the Consultation (given that the closing date for the Consultation is 28 February 2018 and the aim is to publish the Revised Code by early summer 2018).

As set out in other responses, we believe that the TCFD recommendations can be incorporated in the Revised Code anticipated by the Consultation. However we would like to see a commitment from the FRC to hold a consultation in relation to incorporating the guidelines in the Revised Code, once these guidelines have been developed.

Q2. Do you have any comments on the revised Guidance?

S172 duty

Paragraph 10 sets out the duty in Section 172 Companies Act 2006 for directors to promote the success of the company for the benefit of its members as a whole, and in doing so have regard to various matters set out in that section.

The GFI believes there is widespread lack of awareness of both the existence of the S172 duty and what compliance with the S172 duty actually entails.

The GFI supports the reference to the S172 duty here, as this will enhance the link between compliance with the S172 duty and effective corporate governance. But in light of the above mentioned lack of awareness, we query whether the revised Guidance is sufficiently informative on this issue. In particular, we believe that:

- the references to the S172 duty are not reflected as a pervasive theme running through the revised Guidance;
- the only place where the S172 duty is set out in full is in paragraph 10 of the revised Guidance – this replicates the text in Companies Act 2006 with no accompanying

commentary to provide explanation or clarification. This means that it is easy for a reader to miss that compliance with the S172 duty requires having regard to the matters set out in paragraphs (a) to (f); and

- it would be useful to reiterate that the S172 duty is a legal obligation and that directors may be liable where they breach that duty. It would also be useful to provide further guidance on the fact that compliance with the S172 duty requires directors to have regard to the matters set out in paragraphs (a) to (f).

In addition, the reference to the S172 duty will need to be contextualised to reflect the fact that the Revised Code would apply to all companies with a premium listing of equity shares, whether they are incorporated in the UK (in which case the S172 duty applies) or elsewhere (in which case the S172 duty does not apply).

Decision making

Paragraph 15 sets out various factors which boards should be aware can limit effective decision making. The GFI believes that this paragraph could be significantly improved by explicit reference to environmental, social and governance matters.

We suggest that the final bullet point of this paragraph should be amended to read as follows:

‘inadequate information or analysis, including failure to gather information on long-term financial risks and opportunities associated with environmental, social and governance issues;’

We also suggest that an additional bullet point could be added to this paragraph

‘undue focus on short-term time horizons.’

Culture

Paragraph 37 states that the board has a responsibility for the health of the company and needs to take a longer-term view. The GFI believes that this paragraph could also be improved by explicit reference to environmental, social and governance matters and should read as follows:

‘Boards have a responsibility for the health of the company and need to take a longer-term view and environmental, social and governance issues into account. This can be in contrast with some investors or potential investors who may focus on short-term returns.’

Viability statement

Paragraphs 98-101 of the revised Guidance deals with what is termed therein the *viability statement*.

It is perhaps pertinent that what is termed the *viability statement* in the revised Guidance was previously termed the *longer term viability statement* in the *Guidance on Risk Management, Internal Control and Related Financial and Business Reporting*. In addition the revised Guidance states '[t]he period selected for the viability statement often appears to be based on the company's medium-term business plan.'[4] Together these appear to be an undesirable watering down of the original ambition in relation to what these statements were designed to achieve.

However, as the revised Guidance points out, the *Guidance on Risk Management, Internal Control and Related Financial and Business Reporting* states that other factors should be taken into account including investment and planning periods and the board's stewardship responsibilities.

Investors have previously voiced disappointment that companies involved in fossil fuel extraction in particular are not giving an adequate weighting to their investment and planning periods when determining the length of their viability statements.[5]

We therefore support the explicit recognition in the revised Guidance that '[i]ndustries such as mining and property investment companies typically have longer term investment strategies and funding arrangements'[6] but query whether this goes far enough.

We would suggest that Paragraphs 98-101 of the revised Guidance should be amended in two ways: (1) to give greater prominence to the other factors which should be taken into account when determining the duration of the viability statement; and (2) to ensure that when providing these viability statements, companies provide more detail on how they have determined the duration of the viability statement.

Q3. Do you agree that the proposed methods in Provision 3 are sufficient to achieve meaningful engagement?

The Consultation states '[t]he Government requested that the FRC consult on a specific Code Principle relating to companies taking into account wider stakeholder views and a Code Provision requiring the adoption, on a 'comply or explain' basis, of one of three employee engagement mechanisms.'[7] This reflects Action 7 from *The Government response to the green paper consultation*.

Paragraph 2.42 of *The Government response to the green paper consultation* states '[t]he Government expects guidance to be prepared by the FRC in collaboration with business on the best practice mechanisms that company boards could adopt to comply with the new principle.' While paragraph 26-36 of the revised Guidance (referred to in our response to Question 2 above) do cover relations with the workforce and wider stakeholders, it is unclear whether these are intended to satisfy the Government expectation referred to above.

In any case we believe that paragraphs 26-30 do not provide adequate guidance in relation to identifying relevant stakeholders. Paragraph 27 states: 'Boards should start by identifying their different sets of stakeholders. This will include the workforce, customers, suppliers, which could be particular to the sector or location. Boards should seek input from these stakeholders to ensure they have a rounded view of how the company does business and the impact of its activities.' We would suggest that the wording 'this will include the workforce, customers, suppliers …' implies a narrow view of relevant stakeholders - whereas in reality a wider view may be more appropriate. We note that 'contacts with interest groups

4 Revised Guidance, Paragraph 98.
5 https://www.documents.clientearth.org/wp-content/uploads/library/2016-03-02-letter-to-frc-on-viability-statements-coll-en.pdf
6 Revised Guidance, Paragraph 99.
7 Consultation, Paragraph 26.

and the local community' is listed as a possible source of information - whereas these constituencies could be given greater prominence as a relevant stakeholder.

In addition Provision 3 does not give any guidance to boards on their engagement with stakeholders (this provision relates solely to the workforce). We believe that companies should be encouraged to have a forum for participation by stakeholders who have been impacted by a company's operations. This information needs to be assimilated in board decision making in order to comply with the S172 duty.

As a result, we believe that while Principle C and Provision 3 comply with the letter of Action 7 from *The Government response to the green paper consultation*, more could be done to comply with the intent of the Government as a whole in relation to stakeholder views. At the moment, these Principles, Provisions and guidance have a focus on the workforce to the detriment of other stakeholders.

Q.4 Do you consider that we should include more specific reference to the UN SDGs or other NGO principles, either in the Code or in the Guidance?

The UN SDGs and other NGO principles can provide a useful framework for considering how the long-term sustainable success of a company intersects with environmental, social and governance (**ESG**) concerns. These considerations need to be assimilated in director decision making in order to comply with the S172 duty.

However, each framework on its own may not lead to consideration of all relevant issues required for compliance with the S172 duty. Therefore we re-iterate our points made in other responses that the Revised Code and revised Guidance are not sufficiently informative on what is required for compliance with the S172 duty.

In addition, the FRC flags Principles A and C as ways of reflecting the SDGs. We believe that the SDGs have a broader focus than is currently reflected in these Principles. Furthermore it is disappointing to see no explicit mention of the environment in these Principles - or anywhere else in the Revised Code for that matter.

As set out in our response to Question 1, the GFI will publish in Spring 2018 its recommendation on *Establishing the World's Best Framework for Climate-related and Sustainability-related Financial Disclosures*. We suggest a two-step process where the Government and regulators: (1) create and publish guidelines during 2018/19 which cover the TCFD recommendations and voluntary Sustainability-related Financial Disclosure recommendations; and (2) appropriately reference these guidelines in the corpus of relevant UK rules and codes.

The guidelines which will be developed will include (in the Sustainability-related Financial Disclosure recommendations) reference to various frameworks (including the SDGs). Although we recognise that the guidelines are unlikely to be developed in a relevant timeframe for the Consultation (given that the closing date for the Consultation is 28 February 2018 and the aim is to publish the Revised Code by early summer 2018).

Q5. Do you agree that 20 per cent is 'significant' and that an update should be published no later than six months after the vote?

We suggest that further research is required in relation to the appropriate threshold for shareholder opposition to be deemed significant. We note that *The Government response to the green paper consultation* articulated 20% as significant principally in relation to votes against the directors' remuneration report. Therefore we query whether a different percentage would be deemed significant in relation to votes on other issues.

We also note that Provision 6 is in relation to votes *against* a resolution. In the context of an increasing number of shareholder resolutions filed with companies in furtherance of investor stewardship activities (for example, the recent spate of shareholder resolutions filed in the UK and across the globe calling for great disclosure on climate related risk), we believe that similar obligations should exist where there has been support for a resolution (whether that be 20% or otherwise) but which is nevertheless insufficient for the resolution to be passed.

Q6. Do you agree with the removal of the exemption for companies below the FTSE 350 to have an independent board evaluation every three years? If not, please provide information relating to the potential costs and other burdens involved.

In principle we agree with the removal of this exemption. As the Consultation points out: '[a]lthough a company might be outside the FTSE 350 it may be of similar size and structure. Equally, these companies may also have significant impacts on their workforce and wider stakeholders and as such they should be subject to the same levels of corporate governance.'[8]

Q7. Do you agree that nine years, as applied to non-executive directors and chairs, is an appropriate time period to be considered independent?

No response.

Q8. Do you agree that it is not necessary to provide for a maximum period of tenure?

No response.

Q9. Do you agree that the overall changes proposed in Section 3 of the revised Code will lead to more action to build diversity in the boardroom, in the executive pipeline and in the company as a whole?

No response.

Q10. Do you agree with extending the Hampton-Alexander recommendation beyond the FTSE 350? If not, please provide information relating to the potential costs and other burdens involved.

No response.

Q11. What are your views on encouraging companies to report on levels of ethnicity in executive pipelines? Please provide information relating to the practical implications, potential costs and other burdens involved, and to which companies it should apply.

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8 Consultation, Paragraph 49.

No response.

Q12. Do you agree with retaining the requirements included in the current Code, even though there is some duplication with the Listing Rules, the Disclosure and Transparency Rules or Companies Act?

Yes. Despite the fact that there is some duplication with the Listing Rules and the Disclosure and Transparency Rules in this section, we believe there is merit in retaining the completeness of the document for the benefit of other listed or unlisted companies who have chosen to adopt the Revised Code (despite having no formal requirement to do so).

Q13. Do you support the removal to the Guidance of the requirement currently retained in C.3.3 of the current Code? If not, please give reasons.

We do not support any revisions which reduce investors' access to information about the companies they are invested in. Therefore we question the rationale for the removal to the Guidance of the requirement currently retained in C.3.3 of the current Code.

Q14. Do you agree with the wider remit for the remuneration committee and what are your views on the most effective way to discharge this new responsibility, and how might this operate in practice?

We support the wider remit of the remuneration committee which 'should oversee remuneration and workforce policies and practices, taking these into account when setting the policy for director remuneration.'[9] We do not agree that the remuneration committee should be able to delegate oversight of workforce policies to other committees.

We do not have any concrete suggestions for the most effective way to discharge this new responsibility. However we note that *The Government response to the green paper consultation* cited various benefits to linking the role of the remuneration committee to wider workforce pay. These include increased staff motivation, perceptions of fairness and a better sense of collective company purpose. In addition many investor respondents suggested that it is in a company's long-term interests that executive remuneration is demonstrably aligned with workforce pay and incentives.[10] In light of these issues we believe that the remuneration committee should report on their activities to relevant stakeholders and provide a justification for decisions they have reached.

Q15. Can you suggest other ways in which the Code could support executive remuneration that drives long-term sustainable performance?

As *The Government response to the green paper consultation* notes, there is increasing recognition of the misalignment to LTIPs with the long term sustainability of the company. However the Government response also notes that concerns had been expressed that shareholders and advisors would not support an approach to executive remuneration that differed significantly from market practice.

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9 Revised Code, Provision 33.
10 BEIS, 2017. The Government response to the green paper consultation [Online] Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/640631/corporate-governance-reform-government-response.pdf Paragraph 1.22 (Paraphrased).

As the role of the Revised Code is to improve market practice, on the issue of supporting executive remuneration that drives long-term sustainable performance, the Revised Code should encourage companies to adopt a broader range of performance metrics.

For companies in certain sectors, various climate related metrics could be used to ensure companies align with the economic transition associated with the Paris Agreement. But metrics based on other ESG or stakeholder factors, can also be relevant in other economic sectors. Metrics could be designed to cover economic, environmental and social capitals (therefore incorporating both direct and indirect financial aspects).

Q16. Do you think the changes proposed will give meaningful impetus to boards in exercising discretion?

Action 1 of *The Government response to the green paper consultation* states that the Government will '[i]nvite the FRC to revise its UK Corporate Governance Code to set out the steps that companies should take when they encounter significant shareholder opposition to executive pay.'

Although we note the general provision in relation to shareholder dissent of 20% or more - see our response to Question 5 - neither Principles O-Q nor Provisions 32-41 of the Revised Code set out further steps in relation to dissent on directors' remuneration. Consequently, while the Revised Code does take steps in the right direction, we have concerns that it does not go far enough.

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?

We believe that the Stewardship Code would benefit from further detail about the expectations of those investing directly or indirectly and those advising them. For example:

- in relation to asset owners, we believe the Stewardship Code should set out further detail on the mandates given to asset managers including (as the Consultation refers to itself) the requirement on asset owners to provide direction on ESG factors (including climate-related risk) and consider preferred voting criteria; and
- in relation to asset managers, we believe the Stewardship Code should set out further detail on how asset management activities should reflect the requirements of asset owners and end beneficiaries (including ESG factors) and detail where the asset owners preferences have not been followed. In this regard, we also note the final report of the High Level Expert Group on Sustainable Finance, which recommended that investors should explicitly incorporate the sustainability preferences of the ultimate beneficiaries in their investment decisions.

Having said this, we do not believe that separate codes are necessary for different actors in the investment chain. Similar stewardship principles apply to all constituencies in the investment chain. We think that the most advantageous structure is for: (1) general guidance aimed at all investors; and (2) specific guidance which recognises the differentiation between different categories of investor.

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?

We believe that the Stewardship Code suffers from a lack of oversight which diminishes its practical impact. In particular, regulatory oversight is poor (and consists principally of the tiering exercise referred to in Question 19) and there is currently no oversight by other constituencies (in an equivalent way to investors' oversight of a company's compliance with the Code).

We do not believe that the extent of reporting under the Stewardship Code is sufficient at the moment: some principles can be complied with without much substantive effort and the reporting is not always informative.

It is not clear to us what is meant by a 'more traditional "comply or explain" format' but we would be generally supportive of the Stewardship Code mirroring the structure of the Code (i.e. setting out detailed Principles and Provisions and having accompanying guidance) provided this was accompanied by a mechanism or framework for reporting meaningfully on compliance with the Stewardship Code.

We do not believe there are any areas where it would be inappropriate to have this comply or explain approach.

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

As set out in our response to Question 18, we believe there is lack of oversight in relation to the Stewardship Code. In our view this oversight gap is then increased by the FRC's emphasis on highlighting best practice (as referred to in this Question and elsewhere in the Consultation) with what is already expressed to be a best practice set of principles (rather than attention being given to ensuring compliance with the Stewardship Code). Regulatory oversight to date has consisted principally of the tiering exercise performed by the FRC in 2016 and there is no oversight by other constituencies (in an equivalent way to investors' oversight of a company's compliance with the Code). In our view the tiering exercise is not sufficiently driving best practice and further oversight of meaningful compliance (not just claims of compliance which are not backed up by behaviour) is needed.

We note that the tiering exercise did not consider those investment managers who chose to explain rather than comply with the Stewardship Code, making it difficult to conduct a comprehensive assessment of market practice.

In addition, the FRC states that '[a] requirement for a larger group of asset managers and other institutional investors to report on their stewardship activities is likely to affect the FRC's ability to assess statements in order to tier them.'[11] We are concerned that this indicates an unwillingness by the FRC to devote the necessary resources and capacity to assess the increased number of stewardship statements anticipated to flow from any change to the Stewardship Code - we would urge the FRC to devote resources and capacity to

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11 Consultation, Paragraph 13.

ensuring that increased stewardship reporting can be appropriately monitored and reported on.,

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

Clearly the Corporate Governance Code and the Stewardship Code must be complementary – high standards of governance and management of companies for long term success is not possible if the stewardship activities of investors operate to contradict this objective.

In particular we believe the Stewardship Code should mirror the Revised Code in the following areas:

- the Stewardship Code should make explicit reference to investors' oversight of climate risk information provided by investee companies and the fact that this information should be reported in line with the TCFD recommendations;
- the Stewardship Code should make explicit reference to investors' oversight of other ESG information provided by investee companies and the fact that this information should be reported in line with recognised frameworks such as the UN SDGs or other NGO principles (please see our response to Question 4); and
- the Stewardship Code should make explicit reference to investors' oversight of compliance by directors of investee companies with the S172 duty.

We believe that the above areas in particular need to be at the forefront of investors' minds when going about their stewardship activities. However, to the extent that the Revised Code reflects concerns identified in *The Government response to the green paper consultation*, these should also be reflected in the Stewardship Code (although accompanying guidance to the Stewardship Code may be the most appropriate way to do this).

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

As set out in our response to Question 20, we believe the Stewardship Code should make explicit reference to investors' oversight of: climate risk information provided by investee companies (and the fact that this information should be reported in line with the TCFD recommendations); and other ESG information provided by investee companies (and the fact that this information should be reported in line with recognised frameworks).

We believe that a company's proper management of climate risk and other ESG issues is critical to the long term success of that company. Therefore the key means by which investors can play a role in building a company's long-term success is through proper oversight of these issues and exercising of rights attached to their investment. This emphasis needs to be made clearer in the Stewardship Code. At present, ESG matters are only referenced in the guidance to Principle 4 as an area where investors may want to escalate their stewardship activities.

Our response to Question 20 also set out our belief that the Stewardship Code should make explicit reference to investors' oversight of compliance by directors of investee companies with the S172 duty. This recognises that proper management of other (non-environmental) factors is also critical to the long term success of that company. Therefore a further means by which investors can play a role in building a company's long-term success is through proper oversight of these issues. This emphasis needs to be made clearer in the Stewardship Code. At present, we believe that there is too little scrutiny of corporate reports for compliance with the overarching duty to inform shareholders how directors have performed their duty under S172.

It is unclear to us what is meant by the possible "use of a 'section 172' for asset managers". However, the role of asset owners (such as pension fund trustees) in mandating asset managers and then holding them to account on stewardship activities should not be forgotten. We would encourage consideration to be given to how the Stewardship Code could incorporate best practice reporting requirements of asset managers to asset owners.

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?

Yes, the Stewardship Code should more explicitly refer to ESG factors and broader social impact. As set out in our responses to Questions 20 and 21, we believe the Stewardship Code should make explicit reference to investors' oversight of: climate risk information provided by investee companies; ESG information provided by investee companies; and directors' of investee companies' compliance with the S172 Duty.

In relation to incorporating wider stakeholders into the areas of suggested focus, we believe that investors' proper oversight of the compliance by directors of investee companies with the S172 duty will necessarily incorporate wider stakeholders into the areas of focus for monitoring and engagement by investors.

We are supportive of explicit reference to ESG factors and broader social impact in order to provide guidance on how investors can comply with the various duties they are subject to. It is increasingly important that asset owners (such as pension fund trustees) understand how the companies in which they are invested (directly or indirectly) are managing ESG and social impact issues. Legally, pension fund trustees are required to act in the best financial interests of their members and when investing pension fund assets, trustees need to take into account any factor which is financially material, including factors historically considered as ESG factors but which are now recognised to be financial factors, such as climate risk.

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?

Currently, the Stewardship Code states that 'the FRC expects signatories of the Code to publish on their website, or if they do not have a website in another accessible form, a statement that: describes how the signatory has applied each of the seven principles of the Code and discloses the specific information requested in the guidance to the principles; or if one or more of the principles have not been applied or the specific information requested in the guidance has not been disclosed, explains why the signatory has not complied with those elements of the Code.'[12] Further, 'signatories are encouraged to review their policy statements annually, and update them where necessary to reflect changes in actual practice.'[13]

We believe that the information currently disclosed under the Stewardship Code (whether this be by virtue of the policy statement or otherwise) is not sufficient to provide a meaningful picture of precisely what stewardship activities and decisions have occurred during a year.

However, there is no reason in principle why the Stewardship Code could not include a much more comprehensive reporting obligation (and, as alluded to in other questions in the Consultation, the FRC is considering moving in this direction). We would generally be supportive of the Stewardship Code requiring an annual report of stewardship activities and decisions occurring during the year and setting out detailed guidance on what should be reported.

In addition, we would like to emphasise the point made in our *General comments* that the Stewardship Code is a key means by which asset managers and asset owners could be incentivised to report in line with the TCFD recommendations. We urge the FRC to ensure that reporting under the Stewardship Code includes this requirement.

In relation to the second part of this question (how can this reporting be encouraged) we suggest that the FRC should collaborate with other financial regulators to identify which areas of the existing corporate governance and reporting framework can be amended to ensure that relevant investors are subject to a requirement to provide this annual report of stewardship activities (regardless of the constitutional status of the investor). In relation to pension fund investors we would encourage the FRC to collaborate with the Pensions Regulator on how to encourage further direct and indirect stewardship activities and to ensure that relevant guidance is complementary and not contradictory. We note that the FRC does not have a Memorandum of Understanding in place with the Pensions Regulator as it does with other key financial regulators and would suggest that further collaboration between the two bodies would be helpful in ensuring sufficient oversight.

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

As set out in other responses, the Stewardship Code needs to be clearer on how stewardship activities relate to investors' legal duties in relation to managing risks. We believe that much of what is currently regarded as 'responsible investment' (particularly in the areas of climate change and ESG risks) is merely compliance with the legal duties of investors. We believe that the Stewardship Code should articulate this dynamic more clearly.

But in relation to different investment philosophies - provided that the minimum standard in relation to stewardship activities and legal duties in relation to managing risks is met - then the Stewardship Code could take account of these different philosophies by setting out how the points of differentiation should be disclosed.

The logical home for disclosures of this type would be in relation to the policy statement - but we believe that further guidance could be provided on how investors can substantiate their

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12 Stewardship Code, p.2.
13 Stewardship Code, p.3.

points of differentiation (e.g. definition of responsible investment, how an investment is deemed responsible or otherwise, when an investment must be exited if no longer deemed responsible, internal governance and decision making, screening criteria etc.)

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

The *Australian Financial Services Council's Principles of Internal Governance and Asset Stewardship* (July 2017) includes a requirement to disclose information on the following stewardship activities and the governance and oversight associated with each one:

"1. monitoring of company performance on financial and non-financial matters;
2. engagement with company management and the board (as appropriate) and escalation of issues in instances where initial engagements have not been adequately responded to;
3. approach to considering Environmental, Social and Governance factors (risks and opportunities) and whether these considerations influence investment decision-making and company engagement;
4. proxy voting (see FSC Standard 13);
5. collaborative engagement with other investors including involvement with industry groups and associations;
6. principles used for policy advocacy including participation with industry groups and associations; and
7. the approach to client engagement, education and communication regarding asset stewardship."

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?

Other than general statements about the benefits of providing assurance that the systems and process outlined in the statement are being adhered to, there is too little information in the Consultation to say anything on the role assurance currently plays in relation to the Stewardship Code. For example, there is no information on the extent to which assurance is currently provided.

In any case, if - as we have suggested in other responses - the Stewardship Code is amended to include a more comprehensive reporting obligation we suggest that the question of what role assurance could play should be revisited in light of the proposed new framework.

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

No response.

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

No response.

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

Yes, we believe that the Stewardship Code should make explicit reference to investors' oversight of climate risk information provided by investee companies and the fact that this information should be reported in line with the TCFD recommendations. We believe that the company's management of climate risk needs to be at the forefront of investors' minds when going about their stewardship activities.

However - as set out in other responses - climate change is one of many ESG and broader social impact issues which investors should have oversight of in order to properly carry out their stewardship activities.

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?

As set out in other responses, the Stewardship Code needs to be clearer on how stewardship activities relate to investors' legal duties in relation to managing risks.

In addition, it seems clear to us that where the organisation has specific points which differentiate it from other similar organisations then - provided that the minimum standard in relation to stewardship activities and legal duties in relation to managing risks is met - this information should also be disclosed (please see our response to Question 24).

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?

In general we are supportive of further transparency and granularity in relation to information reported under the Stewardship Code, but it is not clear to us that this necessitates reporting at a fund level. Rather, we think that provided there is a sufficiently comprehensive reporting requirement in relation to the Stewardship Code generally, then the issue of reporting at fund level (when is it appropriate, what should be reported etc.) could be dealt with in accompanying guidance.

27 February 2018