STATE STREET GLOBAL ADVISORS

29 March 2019

State Street Global Advisors
20 Churchill Place
Canary Wharf, London E14 5HJ

T +44 20 3395 6000

ssga.com

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

Via email submission: stewardshipcode@frc.org.uk

State Street Global Advisors' response to the Financial Reporting Council's (FRC's) consultation on the 'Proposed Revision to the UK Stewardship Code'

Dear Sir/Madam,

State Street Global Advisors welcomes the opportunity to comment on the FRC's consultation on the proposed revisions to the UK Stewardship Code (the Code). State Street Global Advisors is the asset management arm of State Street Corporation. With over $2.51 trillion[1] of assets under management (AUM) across a range of asset classes and investment styles, for which $93 billion[2] of AUM is invested in UK listed companies.

As near-permanent capital investors in the world's largest companies, we hold at the centre of our stewardship framework the belief that companies that adopt robust and progressive governance and sustainability practices should be better positioned to generate long-term value and manage associated risks. As a Tier 1 signatory, we firmly support the stewardship principles embodied in the Code and the ongoing efforts of the FRC to identify best practice in this area.

With this in mind, we welcome the FRC's continued commitment to a principles-based approach to stewardship, whilst setting out additional provisions and guidance to raise the bar. While the FRC raises several important issues, this submission addresses select questions where we believe our feedback would be most meaningful given our experience as one of the world's largest index managers that engages with a large number of companies globally.

Harmonisation among Stewardship Codes and International Standards

Excellence in stewardship is an international pursuit for most asset managers and asset owners. As a global investor and signatory to various codes and principles, we encourage greater harmonisation among stewardship codes and standards. Therefore, we are supportive that the FRC has considered various global initiatives to inform the proposed

[1] AUM figure listed is as of 31/12/2018. AUM reflects approx. $32.45 billion (as of 31/12/2018) with respect to which State Street Global Advisors Funds Distributors, LLC serves as marketing agent; SSGA FD, LLC and State Street global Advisors are affiliated.
[2] As of 31/12/2018.

amendments to the Code. It is imperative that the UK Stewardship Code remains consistent with other Codes – whether they are governed by competent authorities or established by industry – and wider regulatory frameworks. To deliver the right outcomes globally, the development of a consistent global framework that can apply across jurisdictions is crucial. Clarity and harmonisation is essential for global asset managers and their multinational clients alike and so compliance with the revised Code should not hamper nor detract from existing disclosure made under other globally-accepted standards such as the United Nations-supported Principles for Responsible Investment (UN PRI). Moreover, although the consultation paper makes explicit reference to incoming reporting requirements under the revised EU Shareholder Rights Directive, we would welcome additional clarity as to how UK authorities intend for investors to satisfy similar requirements introduced in the draft Code. It would be prudent to ensure unnecessary duplicative reporting requirements are avoided and excessive costs kept to a minimum.

Definition of "Stewardship"

The revised definition of stewardship seeks to better reflect its multi-faceted nature, and allow signatories to define the issues they consider material to the long-term success of their investments. This is an approach that we thoroughly endorse.

However, we are concerned that the revised definition includes reference to "the responsible allocation and management of capital across the institutional investment community to create sustainable value for beneficiaries, the economy and society". Such a definition is likely to distort today's well-established understanding of stewardship practices insofar as this appears to go beyond governing the interaction between investors and investee companies. The particular reference to "responsible allocation of capital" does not sufficiently take into account the investment style and objectives of index managers, in our view. Unlike our active investment strategies where we are able to sell a company's stock when a disagreement arises with management, our index-based funds do not possess the ability to choose the shares in which they invest and thus are obliged to own a company's stock for as long as it is included in the index.

Consequently, we would recommend that the FRC retains the central focus and purpose of stewardship, which is to maximise the probability of sustainable long-term returns on behalf of asset owners. Should the reference to "capital allocation" be included, we highly recommend that the FRC clearly distinguishes between the role of an asset owner and manager in the context of that definition. Alternatively, the associated regulatory provisions and supporting guidelines could be amended in a way that clarifies that the direction of capital allocation only applies where appropriate or relevant to the investment mandate.

Stewardship Beyond Listed Equity

Equity investors, as owners of companies, have historically taken the lead on stewardship. This is because they would be directly impacted by any failures in relation to corporate governance, including poor management or mitigation of sustainability-related risks inherent to any business. In addition, proxy voting at shareholder meetings provides equity owners the leverage needed to engage with companies on a host of matters ranging from long-term strategy to environmental management practices. Nevertheless, material sustainability risks can also bear an impact on the financial returns of fixed-income assets. Such risks therefore need to be considered by asset managers, which we think should be done as part of dedicated fixed-income stewardship programs. This is something that has been integrated into our fixed-income investment process since 2015.

We therefore support the expansion of the Code beyond listed equities, not least because it would recognise the fact that asset managers and asset owners are increasingly using their positions in other instruments to engage with investee companies. However, it is essential that the FRC avoids establishing prescriptive provisions in relation to stewardship for alternative asset classes given stewardship practices in relation to non-equity issuers are less mature. To enable continued innovation in this area, it is imperative that the FRC permits a degree of proportionality and flexibility in adherence to the Code when stewards are dealing with non-equity issuers.

Enhanced Reporting and 'Tiering'

We welcome the FRC's intention to evaluate the quality of signatories' reporting on compliance with the Code via the establishment of an additional 'tiering' process. However, an opaque evaluation process and publication of an arbitrary tier / score would not be an effective tool. We would therefore suggest that the FRC seeks to ensure that the criteria by which it will perform such an evaluation are developed in collaboration with industry stakeholders, with the resulting criteria made available to signatories and investors so as to not deter sustainable investments. It would be helpful to subject this specific aspect of the FRC's proposals to further public consultation in order to garner input from signatories which can support the FRC in driving the right outcomes.

Furthermore, some signatories already produce extensive disclosures on their stewardship activities, which align or overlap with the proposed requirements of the Code. It would therefore be prudent to allow those signatories to signpost existing disclosure as a means to satisfy the enhanced reporting requirements.

Organisational Purpose, Objectives and Governance of Signatories

We welcome the proposal to require signatories to develop their organisational purpose and state how their purpose, strategy, values and culture enable them to promote effective stewardship. It is our firm belief that corporate values and culture are becoming increasingly recognised as key intangible value drivers that affect a company's ability to achieve its strategic objectives and differentiate themselves from competitors.

In acknowledgment of this, we included the broad topic of culture as an area of stewardship priority for our 2019 activities. As such, a letter[3] was distributed earlier this year to the boards of our portfolio companies in which we articulated the importance of corporate culture to the successful execution of long-term strategy, and provided a guideline framework to help senior management navigate the complex process of assessing and monitoring corporate culture.

[3] SSGA letter to Boards, 'Aligning Corporate Culture with Long-Term Strategy', https://www.ssga.com/investment-topics/environmental-social-governance/2019/01/2019%20Proxy%20Letter-Aligning%20Corporate%20Culture%20with%20Long-Term%20Strategy.pdf, January 2019.

Furthermore, from our experience in engaging with investee companies, we have observed that there is a great deal of confusion among companies in terms of their interpretation of terminology such as ‘organisational purpose’, ‘values’ and ‘culture’. This, in turn, has meant that companies do not always demonstrate a clear understanding of how each of these can have a disparate impact on a company’s goals, strategy and objectives. Whilst we support the introduction of these requirements for signatories, we think it would be helpful for the FRC to further clarify its specific expectations to ensure that any additional disclosure is meaningful, as opposed to standardised across industry.

Recognising the Importance of material ESG Issues

We support the FRC’s suggestion to include a requirement that signatories take into account material Environmental, Social, Governance (ESG) factors, including climate change, when fulfilling their stewardship responsibilities.

As part of our stewardship program, we consider material ESG matters while evaluating and engaging with investee companies given it is widely-accepted that material ESG factors not only bear an impact on the reputation of companies, but can also present significant operational risks and costs to businesses. ESG issues must therefore be incorporated into board leadership and oversight of a company’s long-term strategy.

Consequently, we issued a guidance[4] in 2017 to the boards of our investee companies, calling upon them to incorporate sustainability into their long-term business strategies as well as asking them to outline their approaches to assessing and, if necessary, mitigating climate change-related risks. The Board of our wider Corporation had already included the monitoring of ESG risks within its board charter. This has resulted in the establishment of a committee that is responsible for performing a materiality assessment of such risks on an annual basis, which then informs the firm’s response to them.

Should you wish to discuss this submission further, please do not hesitate to contact Robert Walker, Head of Asset Stewardship EMEA (Robert_Walker@ssga.com) or Philip Vernardis, Vice President - Asset Stewardship (Philip_Vernardis@ssga.com).

Yours sincerely,

Bill Street
Senior Managing Director
Head of Investment, EMEA

Robert Walker
Managing Director
Head of Asset Stewardship, EMEA

[4] SSGA guidance, ‘Incorporating Sustainability into Long-Term Strategy’, https://www.ssga.com/mea/ae/consultant/en/our-insights/viewpoints/incorporating-sustainability-into-long-term-strategy.html, January 2017.