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CONSULTATION ON PROPOSED REVISION TO THE UK STEWARDSHIP CODE

Response by Allianz Global Investors

Allianz Global Investors (AllianzGI) welcomes the opportunity to respond to the public consultation on Proposed Revision to the UK Stewardship Code. The views expressed in this document represent AllianzGI's position as an investment manager and do not reflect the formal position of Allianz SE as a listed issuer or views of other entities within Allianz Group.

AllianzGI is a diversified active investment manager, managing EUR 535 billion[1] in assets for individuals, families and institutions around the world. We invest for the long term across a range of different investment strategies, and pay close attention to growth prospects, return on capital, good governance, market positioning and quality of franchises of companies we invest in. Furthermore, we believe that material environmental and social considerations are critical to the success of a company looking for long-term outperformance. Consistent with our investment philosophy, we routinely engage in dialogue with investee companies. Our investment views are influenced by the outcomes of these engagements and are linked organically to the proxy voting process, forming a consistent stewardship approach.

General comments

AllianzGI welcomes the efforts by the FRC and the FCA to set new and substantially higher expectations for stewardship. We found the FCA/FRC joint discussion paper "Building a regulatory framework for effective stewardship" (DP 19/1) particularly useful as it clearly outlines the role of stewardship in delivering sustainable value to end beneficiaries, enhancing the integrity of the UK financial markets, and leading to long-term benefits to the economy and society. We also agree with the key challenges to effective stewardship by investment firms set out in the paper, and see these as the key areas that should be targeted by the revised Stewardship Code.

[1] As at 30 September 2018.

In our view, the main obstacle to an effective market for stewardship in the UK is insufficient understanding among many members of the institutional investment community of the importance of stewardship, how to implement it effectively, and how it can benefit them, their clients and beneficiaries.

With SRD II requirements being implemented in the UK, a minimum standard for stewardship, including policies and disclosures, will be set in regulation. We, therefore, believe that the role of the Code should be to set best practice standards over and above these minimum requirements, and to provide guidance to the investment industry as to why stewardship is important for all participants in the investment chain, and, crucially, how it can be encouraged and implemented effectively across the institutional investment community. Ultimately, the success of the Code should be measured by increase in the quality of the stewardship activities coming from a growing number of participants, rather than solely by enhanced reporting by a small number of market players who are already fulfilling their stewardship responsibilities reasonably well.

The Stewardship Code can help create an effective market for stewardship if it includes:
- High-level principles that encapsulate desired outcomes;
- Provisions that explain and clarify the principles and how their application can benefit institutional investors, their clients and beneficiaries; and
- Non-prescriptive guidance that offer practical suggestions on how the principles can be achieved and provisions implemented, while allowing flexibility for different business models and investment approaches.

While we agree that reporting of activities and outcomes is a critical component of demonstrating excellence in stewardship, we would argue that it is the quality and positive impact of stewardship activities that the Code should be aiming for. **As it stands, we do not believe that the proposed revisions to the Stewardship Code will help achieve this objective.** On the contrary, we are concerned that excessive focus on the policies and processes, prescriptive approach to implementation, and very granular reporting requirements will drive compliance-led behaviours resulting in high-volume low-quality engagements that would undermine the very purpose of stewardship and its investment benefits.

Detailed comments on certain aspects of the proposals

We do not believe that the proposed Code adequately reflects the purpose of stewardship and core areas of stewardship responsibilities. In particular, we believe that the following changes need to be made:

- **Definition:** The proposed definition of stewardship is problematic insofar as it is at odds with the asset managers' primary duty to clients and beneficiaries. It also neglects the importance of "oversight of assets" entrusted into asset managers' care, which has been and should continue to be the key aspect of stewardship.

  We find the core areas of stewardship responsibilities to be more adequately reflected in the DP 19/1 para 1.9. We suggest that the Code build on this definition and propose a new definition to read as follows: "*Stewardship involves the responsible allocation and active oversight of assets by asset owners and asset managers to generate sustainable, long-term value creation for beneficiaries. This helps enhance the quality and integrity of financial markets and leads to long-term benefits for society and the economy*".

- **Principles**: We agree with the expectations implied in the Principles, but believe the wording should be modified to focus on expected outcomes instead of prescriptive actions and disclosures currently proposed under many principles. This approach would allow different participants in the investment industry to apply the Principles in the way that makes sense for their business model and investment approach.

  For example, we propose Principle A should read *"Organisational purpose, strategy, values and culture of a signatory organisation should support and enable achieving their stewardship objectives"* instead of current *"Signatories must develop their organizational purpose and disclose how their purpose, strategy, values and culture enable them to fulfil stewardship responsibilities".*

  Similarly, Principle B should read *"Signatories should demonstrate how their stewardship approach and objectives serve the interests of clients and beneficiaries"*. This shifts the emphasis from development of policies and disclosures for compliance reasons to more thoughtful consideration of the benefits of effective stewardship and how these are best implemented within each signatory organisation.

We recommend that all the Principles should be reviewed through this lens and wording adapted accordingly.

- **Provisions**: We see two main issues with the Provisions in the revised Code:
  1. Many provisions conflate the roles and responsibilities of asset managers and asset owners. There has to be clarity as regards expectations from: i) asset owners and their advisers (e.g. investment consultants), such as greater focus on capital allocation, as well as selection and monitoring of managers; and ii) asset managers, such as, for example, greater focus on selection and oversight of assets, direct fulfilment of stewardship responsibilities for those assets (i.e. proxy voting and engagement), and monitoring of service providers used in the stewardship process (e.g. proxy advisers or engagement service providers).
  2. Provisions should focus on actions and outcomes that would help signatories to apply the Principles in an effective and productive way. We are concerned that many of the revised Code provisions amount to little more than prescriptive reporting guidance. Any reporting guidance should be separated into an appendix that would be useful when providing public and client disclosures, but should not be subject to “comply or explain” principle to avoid a shallow box-ticking numbers-driven engagement approach.

- **Guidance:** As highlighted above, there needs to be a fundamental review of the Provisions and Guidance. Guidance should be split into implementation guidance and reporting guidance. Neither of these should be mandatory, but should serve as helpful suggestions of best practice approach.

  Furthermore, in putting forward implementation guidance, the FRC needs to take into account the interaction between investment and engagement processes at different organisations. There are considerable differences among asset managers in this respect, which largely depend on their business models and investment approaches. We are concerned that the current guidance risks further separating engagement activities from the investment process and decision-making, which would be counterproductive and undermine the very effectiveness of stewardship by institutional investors.

  In developing reporting guidance, the FRC needs to provide clarity as to whether specific disclosures are expected at a firm level or a strategy/fund level. In large investment organisations, strategy/fund level disclosures will be both onerous and voluminous for public disclosure purposes, while entirely appropriate for client/fund reports. The FRC should also consider how global asset managers can implement public reporting guidance while remaining compliant with rules and requirements in other markets.

Conclusion

In conclusion, we would recommend that the FRC consider re-drafting the Code using the joint FCA/FRC discussion paper (DP 19/1) rather than the proposed revisions as the basis. DP 19/1 already contains all the building blocks for a new Code that would help financial market participants to improve the quality of their stewardship activities and outcomes for clients and beneficiaries, while increasing participation levels and enhancing reporting to clients as well as public disclosures.

We hope our comments are helpful. Should you have any questions or need further information, please do not hesitate to contact us.

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