

## FRC CONSULTATION ON THE UK STEWARDSHIP CODE

Mercer is a signatory to the UK Stewardship Code as both a service provider ([Mercer Limited](#)) and as a fiduciary manager ([Mercer Delegated Solutions](#)).

### Question

*Questions 1 – 16 relate to the Corporate Governance Code questions. Mercer has responded to these questions under separate cover.*

### UK Stewardship Code Questions

17. 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?

**Context:** Some signatories of the Stewardship Code feel it is not explicit enough about application of the Code to different parts of the investment chain. Separate codes would differentiate between the signatory categories (asset managers, asset owners and service providers) as opposed to an overarching code for all categories.

- In our view, it would be helpful for the Stewardship Code to set out more clearly its expectations at all stages in the investment chain, including asset owners, investment managers and service providers. In addition, the FRC should distinguish between different types of service provider. We do not believe that separate codes are necessary and we do not believe this would be a helpful change given the same principles of stewardship apply broadly across the investment chain. However, separate and more detailed guidance clarifying the different expectations across the investment chain would be very helpful given the different roles played.
- Currently we do not feel the guidance for asset owners or service providers is sufficiently clear, with the majority of guidance being styled towards the role of investment managers. In our view this has impacted the number of asset owner signatories to the Stewardship Code as well as the quality of disclosure from non-investment manager signatories. It is important that demand from both asset owners as well as service providers is better represented in terms of signatories.

18. 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?

**Context:** The Stewardship Code focuses on disclosure and transparency.

- We support the current comply or explain approach and it would be helpful for the Stewardship Code to set out best practice guidance in order to provide clearer aspiration/ direction of travel for signatories. For example, at present, it is not fully clear what constitutes a Tier 1 signatory and how Tier 1 signatories may be distinguished from each other. Mercer has developed its own assessment tool to assess UK Stewardship Code compliance. Details of this assessment methodology have been provided to the FRC separately as part of the tiering exercise.
- Best practice expectations would also help provide clarity on areas where there is currently very broad scope for compliance. For example, Principle 5 in particular is easy to comply with based on a stated 'willingness to engage collectively'. However, in practice we see a wide variation in collective engagement activity undertaken across the industry. It would be helpful to tighten the existing guidance in areas which are currently too broad in scope.
- In determining best practice, the FRC could further consult with industry participants, for example through workshops etc. In our view, best practice guidance should be set out by category of investor as per Q17.
- Clarity on best practice reporting (under Principle 7) would also be helpful. We provide additional comment on this in our response to Q23.

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

**Context:** The FRC conducted a tiering exercise to differentiate between quality of disclosures of signatories by examining their statements. The Shareholder Rights Directive, as it is transcribed into UK law, could lead to a greater number of asset managers and other institutional investors being required to report on stewardship activities. The FRC believes this could hinder its own ability to review and tier, given a greatly increased number of statements and is interested in alternative approaches.

- We would support the continuation of the tiering approach given this exercise was deemed to be valuable and improved levels of disclosure.

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

- In general, the UK Stewardship Code and Corporate Governance Code should be aligned. We support the inclusion of reference to long-term success, Environmental, Social and Corporate Governance (ESG) issues and the UN Sustainable Development Goals (SDGs) as investors are increasingly referring to the SDGs as a framework to measure and monitor the impact of their investment activities. We would encourage the FRC to avoid referring to ESG issues as non-financial issues given the evidence that ESG issues can be financially material.

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

**Context:** A suggestion from the consultation takes reference from section 172 of the Companies Act 2006 whereby directors must act in a manner most likely to promote long term company success. It is argued that investors could be required to act in a section 172-like manner which could be incorporated into the Stewardship code.

- Other than as noted in Q20, Mercer has no specific comments on this question.

22. 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 broad social impact? If so, how should these be integrated and are there any specific areas of focus that should be addressed?

**Context:** Suggested focus in on the long-term factors of success, productivity and sustainability related to investment. The FRC believes that the Stewardship Code should be relevant for ESG decision-making.

- We believe it would be valuable to incorporate 'wider stakeholders' into the areas of suggested focus given the increasing consideration of environmental and social issues across the industry. At present there is limited reference to environmental and social issues within the Stewardship Code.
- We would support the Stewardship Code referring more explicitly to ESG issues, social impact and the SDGs. Such reference, in the context of 'comply or explain', would enable investors to better articulate how their active ownership activities impact on society more broadly.

23. 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?

**Context:** The FRC notes that the provisions mandating stewardship activities are only monitored by the FRC through the stewardship statements, which it accepts may not give a true reflection of complication with the Stewardship Code. One suggestion in the consultation refers to refocusing the expectations in reporting towards engagement, not just voting. Similarly, it has also been suggested that the code could highlight best practice, alongside the principles.

- As noted in q18, the FRC could provide best practice guidance with respect to reporting, providing additional detail of its expectations of reporting across the investment chain.
- In our experience, reporting across the signatory base is inconsistent at present and additional guidance here would be helpful. In our view, the provision of additional guidance by the FRC would likely encourage increased asset owner demand in terms of expectations for reporting by service providers and investment managers, further improving standards across the industry.
- The FRC could consider setting out example template reporting based on feedback from its signatories.
- The FRC could review reporting as part of future iterations of the tiering exercise to ensure that reporting developments continue to be captured.

<p>24. How could the Stewardship Code take account of some investors' wider view of responsible investment?</p> <p><b>Context:</b> The FRC wants to make sure the Stewardship Code addresses that fact that investors review their responsibilities in different ways. The Stewardship Code is focussed on shareholder in publicly listed companies, who take a different outlook to those who consider themselves responsible investor, as opposed to responsible shareholders, for example.</p> <ul style="list-style-type: none"><li>· The FRC could do this by encouraging signatories to disclose how their stewardship activities relate to their broader RI activities.</li></ul>
<p>25. Are there elements of international stewardship codes that should be included in the Stewardship Code?</p> <ul style="list-style-type: none"><li>· The Stewardship Code should make explicit reference to ESG, such as the codes of Australia and the Netherlands.</li></ul>
<p>26. What roles should independent assurance play in revisions to the Stewardship Code? Are there ways in which independent assurance could be made more useful and effective?</p> <p><b>Context:</b> Principle 7 of the “comply or explain” section of the Stewardship Code looks at the right to challenge stewardship explanations when dissatisfactory, but points out that deviation from the code does not necessarily mean a breach unless the “explain” part is insufficient. It has been suggested that the use and frequency of independent assurance could be better stated.</p> <ul style="list-style-type: none"><li>· Mercer has no specific comments on this question.</li></ul>
<p>27. Would it be appropriate for the Stewardship Code to support disclosure of the approach to directed voting in pooled funds?</p> <ul style="list-style-type: none"><li>· It would be appropriate for the Stewardship Code to support disclosure of the approach to directed voting in pooled funds given the ‘comply or explain’ basis in which the Stewardship Code operates.</li></ul>
<p>28. Should board and executive pipeline diversity be included as an explicit expectation of investor engagement?</p> <p><b>Context:</b> The Hampton-Alexander review suggested that gender balance in senior management should be assessed by investors. An amendment to the Stewardship Code in this respect would align with the proposed change to gender pay reporting in the Corporate Governance Code.</p> <ul style="list-style-type: none"><li>· The UK Stewardship Code and Corporate Governance Code should be aligned with respect to board and executive pipeline diversity.</li></ul>

<p>29. Should the Stewardship Code explicitly request that investors are given consideration to company performance and reporting on adapting to climate change?</p> <ul style="list-style-type: none"><li>• We support reference to climate change related disclosure within the Stewardship Code. We would encourage this to be framed in the context of broader environmental and social issues to enable flexibility.</li><li>• In our view the Stewardship Code should align with other industry initiatives to support consistency of reporting and disclosure, in particular the recommendations of the Taskforce on Climate-related Financial Disclosure (TCFD).</li></ul>
<p>30. 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?</p> <ul style="list-style-type: none"><li>• Yes, this would provide useful context to an organisation's statement of commitment.</li></ul>
<p>31. 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?</p> <ul style="list-style-type: none"><li>• At present, stewardship activities are reported at a firm-level so this would be a significant change. It would enable investors to better define the approach for each underlying investment strategy but could be resource intensive, both for the industry and the FRC.</li></ul>

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