

**Proposed Revision  
to the UK  
Stewardship Code  
– TUC response**

**March 2019**

## Executive summary

- The TUC strongly supports the FRC's aims of setting higher substantially higher expectations of stewardship and having a greater focus on stewardship outcomes. However, we fear that the revisions to the Stewardship Code do not support this sufficiently.
- The main problem is a lack of focus on the real world impacts of investments and assets within the Code. These impacts - workforce practices, climate change, community impacts and so on – are barely mentioned in the Code. The focus on more rigorous stewardship processes and reporting, while welcome, is not a substitute for this and risks signatories focussing on stewardship processes over stewardship outcomes. To address this, the consideration of the real world impacts of investments should be incorporated throughout the Code, and especially in section 3.
- At times the differentiation between the principles, provisions and guidance does not work. In particular, some of the provisions are too vague and some of the guidance should be incorporated into the provisions.
- The structure or design of some investment products can make it difficult for investors to have an impact on decisions that affect the real life impacts of their investments. This affects all asset classes to some extent but is a particular problem in certain asset classes. The revised Code should encourage asset managers and those offering investment products to design them in ways that enable other actors in the investment chain to apply effective stewardship policies to all investment products and across all asset classes.
- Asset managers failing to allow clients investing in pooled funds to direct their voting undermines the stated aims of the Code. Asking for disclosure on this point is too weak and the Code should make it clear that asset manager signatories should allow clients investing in pooled funds to direct their voting if they wish to do so.
- The expected standard of voting disclosure for asset manager signatories should be higher. The Code should make it clear that asset managers are expected to disclose all votes publicly in a timely manner and to leave voting information in the public domain indefinitely.

## Introduction

The Trades Union Congress (TUC) exists to make the working world a better place for everyone. We bring together more than 5.6 million working people who make up our 50 member unions. We support unions to grow and thrive, and we stand up for everyone who works for a living.

We welcome this opportunity to respond to the FRC's consultation on the proposed revision to the UK Stewardship Code (henceforth consultation or Code as appropriate). Working people are often at the sharp end of corporate decision-making shaped by the UK's framework of corporate governance and investment stewardship. In addition, the retirement and other savings of working people make up a substantial proportion of the funds invested by shareholders on others' behalf. And there is a broader public interest in

the impact of investment priorities and practices that affects working people along with the rest of civil society. We therefore bring an important and unique perspective to discussion of the stewardship role of investors.

The TUC supports the FRC's stated aim "to set new and substantially higher expectations for stewardship". To this end, it is very welcome that signatories will be required to produce an annual activities and outcomes report and we strongly support this requirement. But the thrust of the revised Code itself is still very focussed on processes, with little mention of the real world impacts of investments. This risks allowing signatories to produce reports that will note the things they are doing while having little impact on the workforce practices of investee companies and doing little to tackle urgent global challenges like climate change. It is the real world impacts of investments – ie, the impact on workforce practices, climate change, community impacts and so on - that will denote whether the revised Stewardship Code has been successful, not the length or even the quality of the reports that stem from it.

It is the TUC's assessment that on average the quality of employment in the UK is now worse than it was a decade ago. Average real wages are still lower than they were before the financial crash<sup>1</sup> – and workers have experienced the longest period of wage stagnation since the Napoleonic era – in other words, for 200 years.

At the same time there has been a sharp rise in insecure employment. The TUC estimates that there are 3.7 million people in insecure work<sup>2</sup>. This includes people on zero hours or short hours contracts, low-paid self-employment (including some bogus self-employment) and people being employed through agencies or other intermediaries. And piece work has made an unwelcome return to the UK's labour market.

Official figures suggest that people working for less than the national minimum wage – not the living wage but the legal minimum – is at the highest level since the year 2000 (which was just two years after its introduction) and is now around 1.6% of employees<sup>3</sup>.

While these figures do not differentiate between the public and private sectors, these trends are largely a direct result of the employment practises of corporations. If the revised Stewardship Code is to have an impact on the employment practices of investee companies, we would expect over time to see improvements on the trends outlined above.

Many of the largest listed companies employ a significant proportion of their workforce outside the UK. Globally, vulnerable employment is on the rise, with the significant progress achieved in the past having stalled since 2012. According to the ILO, there were almost 1.4 billion workers estimated to be in vulnerable employment in 2017, with an additional 35m

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<sup>1</sup> According to the [latest ONS figures](#), real average weekly earnings are £466. This is still £7 lower than their pre-crisis peak. The ONS uses CPIH inflation and 2015 prices for its real wage figure. Using the Annual Survey of Household Earnings (ASHE), real median weekly pay was still £20.33 lower in 2018 than in 2008 (using CPI, and 2018 prices) (Source: ASHE 2018, TUC analysis)

<sup>2</sup> For TUC analysis of the figures and data sources see <https://www.tuc.org.uk/news/two-million-self-employed-adults-earn-less-minimum-wage>

<sup>3</sup> <https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/jobspaidbelowminimumwagebycategory>

expected to join them by 2019. Vulnerable employment affects three out of four workers in developing countries and around 42 per cent of workers worldwide<sup>4</sup>.

While the TUC represents and focusses on the interests of working people, we fully recognise the importance of the other real world impacts of the activities from which investors benefit, including impacts on other stakeholder groups and on climate change. The urgency of tackling climate change and meeting our commitments under the Paris Agreement, including a just transition for workers, cannot be overstated, and achieving this requires significant action from corporations.

It is in this challenging context that the revised Stewardship Code will operate. It is by its impact on the employment and other ESG impacts of investee companies and activities that its success will be judged.

## Consultation questions

***Q1. 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.***

***Q2. Do the Principles set sufficiently high expectations of effective stewardship for all signatories to the Code?***

The TUC supports the revised Code's definition of stewardship as "the responsible allocation and management of capital across the institutional investment community to create sustainable value for beneficiaries, the economy and society". We also support the differentiation within the Code for different types of signatory and the extension of the Code to asset classes other than equities.

However, as set out in the introduction, we are concerned that the Code itself has an insufficient focus on the concrete real world impacts of investments and urge that this is rectified in the final version. Signatories must be encouraged throughout the Code to focus their attention and engagement on the what is happening to workers, communities, suppliers and the environment as a result of the entities or activities in which they invest. This relatively brief point is the most significant of our comments on the revised Code.

***Q3. Do you support 'apply and explain' for the Principles and 'comply or explain' for the Provisions?***

We do support the distinction between high-level principles that should be applied and more detailed provisions which should be complied with unless an explanation for why this is not the case is given. However, we believe that in some instances the provisions are themselves too high-level and should be more detailed. In some cases, it would make sense to simply incorporate some or all of the guidance within the provisions. Given that signatories are entitled to adopt a different approach to that set out in the provisions so

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<sup>4</sup> [ILO World Employment and Social Outlook - Trends 2018](#)

long as they explain this, we believe that strengthening the provisions would act to raise stewardship standards without reducing justifiable flexibility for signatories.

***Q4. How could the Guidance best support the Principles and Provisions? What else should be included?***

As set out above, the TUC is concerned that the current split between the provisions and guidance does not work in all cases. We are not convinced that having three layers (principles, provisions and guidance) within the Code is beneficial and would suggest that consideration be given to simplifying the current structure by incorporating key points from the guidance into the provisions throughout the Code.

If the current structure is retained, we would still urge that in some places points from the guidance are moved into the provisions. In particular, we believe that the provision on voting disclosure is too vague. This is not a new issue within the Stewardship Code and organisations like the TUC and ShareAction have repeatedly raised concerns about the variable standard of voting disclosure among asset managers. We would suggest that provision 26 should be amended along the following lines:

‘Signatories should publicly disclose their voting records, disclosing all voting information in a timely manner. Past voting information should be left in the public domain to enable comparisons over time to be made.’ If guidance is retained, this could include a template for voting disclosure, drawing on the excellent practice that has developed among some asset managers in this area.

***Q5. 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?***

The TUC strongly supports the introduction of an annual Activities and Outcomes Report. In our view this is one of the most important revisions made in the new Code and perhaps the most likely to drive potential improvements in stewardship practice.

It is essential that those undertaking stewardship understand that the aim is to drive improvements in the real world impacts of their investments. A large number of engagement calls, letters and so on is of little worth if nothing has changed as a result and no improvement made in the practice of the investee entity or activity.

It is important that signatories adopt a transparent approach for the selection of information for their reports. A full range of real world ESG impacts should be included. Signatories may want to focus in particular on investments where they have a significant stake; investments that raise particularly serious issues; engagements that have been successful; engagements that have been unsuccessful; engagements that have taken up the most time over a particular period; and so on. Whatever selection criteria are used should be disclosed. Over time, it is possible that a consensus may develop about what is considered best practice in terms of selection criteria.

While for the first year or two it may be beneficial to allow innovation in the development of Activities and Outcome Reports, this should be kept under review and consideration given to publishing a template to help signatories organise their Reports in the future.

An issue that has hampered disclosure of engagement outcomes in the past is that of confidentiality. It may be useful for the FRC or another regulator to issue guidance that counteracts the idea that engagement with specific entities should remain confidential. Otherwise it may be difficult for readers to judge the veracity of stewardship reports.

***Q6. Do you agree with the proposed schedule for implementation of the 2019 Code and requirements to provide a Policy and Practice Statement, and an annual Activities and Outcomes Report?***

The proposed schedule is very flexible as signatories can join at any time. For those who wish to be in the first wave of signatories, they have until the end of 2019 to produce a Policy and Practice Statement and until the end of 2020 to produce their first Activities and Outcomes Report. This seems a reasonable and achievable timetable, especially for those that already have reasonably good stewardship processes and practices in place. If it does prove challenging, organisations can simply delay joining until they are ready.

***Q7. 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?***

The essence of Kingman's critique of the Stewardship Code was that it led to reports that were overly focussed on processes and policy statements rather than the effectiveness of stewardship and stewardship outcomes.

We recognise that revisions have been made to the Code that aim to address these concerns and as stated in response to Q5 we strongly support the introduction of an annual Activities and Outcomes Report. However, as also already stated, we do remain concerned that much of the Code itself – ie the principles, provisions and guidance, as opposed to the introductory sections – is still very focussed on stewardship processes. Given it is the principles, provisions and guidance that signatories are likely to spend most time focussing on, we believe there is a danger that stewardship continues to be overly focussed on processes rather than outcomes and that the quality of stewardship is judged by the number and range of engagements, the sophistication of processes and the length of reports, rather than by the real world impact of investee companies and activities. It is by the latter that signatories should ultimately be judged.

We would suggest that within the introductory sections there is a full discussion of the range of real world impacts of investee entities and activities that signatories should consider when designing their stewardship activities and assessing their impact.

In addition, throughout the Code itself, within the principles, provisions and guidance, the theme of real world impacts should be firmly inserted so that signatories are not in danger of regarding stewardship as a set of activities rather than a standard relating to real world impacts. This is especially important in Section 3.

We believe that the FRC should act decisively if signatories are found to be below the standard that would reasonably be expected from signatories of the Code. This standard must be focussed on stewardship outcomes and the real world impacts of investee entities and activities, rather than on the extent of stewardship processes.

***Q8. Do you agree that signatories should be required to disclose their organisational purpose, values, strategy and culture?***

We agree with the aim of this requirement, but believe that the current formulation within the revised Code could be confusing. Some of this may be drafting but some may be conceptual.

We are concerned that a requirement for signatories to 'develop their organisational purpose' year after year does not really make sense. Asset owners such as pension funds have a very simple overall purpose – basically to safeguard and deliver pension rights/benefits to their members (depending on the type of scheme). It is not really clear how they should develop this on an ongoing basis. In addition, for pension funds in particular, we are not convinced it makes sense for them to disclose how their purpose enables them to fulfil their stewardship activities; it would seem to make more sense the other way round.

We believe that Principle A needs some additional thought to ensure that it makes sense for all types of signatories and on an ongoing basis. The provisions and guidance do not seem to support the idea that purpose should support stewardship rather than the other way round, so it may be that this is a drafting issue.

It may be more effective to ask signatories to start by stating their organisational purpose (rather than developing it) and asking them to state their stewardship objectives. Additional questions could probe how these serve beneficiaries' interests, how their strategy supports these aims and so on.

We have some additional textual comments on section 1, which are included under 'additional comments'.

***Q9. The draft 2019 Code incorporates stewardship beyond listed equity. Should the Provisions and Guidance be further expanded to better reflect other asset classes? If so, please indicate how?***

The TUC supports the extension of the Code to cover asset classes beyond listed equity. Equity is just one of a range of asset classes that most asset owners and managers hold and it is important that stewardship should be applied across the whole range of investment activities rather than selectively. For example, infrastructure is an increasingly popular asset class and also one which can carry significant ESG risks. And there have been significant concerns expressed about the impact of commodity speculation on price volatility and the livelihoods of commodity producers. All asset classes carry ESG risk of different kinds and it does not make sense to limit stewardship to a selective range of asset classes.

However, stewardship tools and processes are not equally developed across different asset classes. In addition, the structure or design of some investment products can make it difficult for asset owners or managers to have an impact on decisions that affect the real life impacts of the investments. This affects all asset classes to some extent but is a particular problem in certain asset classes.

We believe that the structure of investment products in some asset classes will need to change in order to allow stewardship along the investment chain to be truly effective. Some

thought should be given to this in the revised Code and those offering investment products should be encouraged to design them in ways that enable other actors in the investment chain, and crucially asset owners, to apply effective stewardship policies towards all asset classes and all investment products. The differential approach developed in the Code for different categories of signatories would allow for this and enable the Code to encourage asset managers to incorporate the role of stewardship into product and investment design.

More generally, it may be useful for guidance to be developed in relation to stewardship in particular asset classes (eg, infrastructure, bonds, commodities etc) as there is arguably less stewardship practice and experience to date in relation to these.

***Q10. Does the proposed Provision 1 provide sufficient transparency to clients and beneficiaries as to how stewardship practices may differ across funds? Should signatories be expected to list the extent to which the stewardship approach applies against all funds?***

We would support signatories being required to list the extent to which their stewardship approach differs across all of their asset classes and funds. Where there is a differential approach across different asset classes an explanation should be given. In addition, while there may be a case for some flexibility over timing, it should not be permissible for signatories to apply stewardship selectively on an ongoing basis.

A differential approach across asset classes may in some instances reflect the point made above that the design of some investment products, especially in certain asset classes, is not conducive to a stewardship approach. The revised Code should aim to act as a driver for change in this regard. If signatories are required to work towards raising standards of stewardship across all asset classes, and are not permitted to apply stewardship selectively on an ongoing basis, the Code is more likely to act as a driver to improve the design of investment products to improve their facilitation of stewardship.

***Q11. Is it appropriate to ask asset owners and asset managers to disclose their investment beliefs? Will this provide meaningful insight to beneficiaries, clients or prospective clients?***

We believe that it will be useful for signatories to set out the wider framework of investment decision-making in which stewardship considerations play their part. However, the provision, as worded, is too vague, and without looking at the guidance it is not clear what this provision is asking for. We would suggest that the aim of this provision should be to invite disclosure of investment factors other than stewardship which guide investment decision making and that additional text is included to clarify this.

***Q12. Does Section 3 set a sufficiently high expectation on signatories to monitor the agents that operate on their behalf?***

We believe that the need to assess the real life impacts of investments should be set out within this section. It should be clear that what should be monitored are the actual impacts of investee entities and activities on stakeholders, the environment and so on, rather than stewardship processes.

As set out above, this is our most important comment in relation to the draft Code, and these issues are particularly relevant to section 3.

***Q13. Do you support the Code's use of 'collaborative engagement' rather than the term 'collective engagement'? If not, please explain your reasons.***

We believe the term 'collaborative engagement' will probably be better understood than 'collective engagement' and therefore support its use.

***Q14. Should there be a mechanism for investors to escalate concerns about an investee company in confidence? What might the benefits be?***

Developing a mechanism for stakeholders to raise concerns about company practice with the regulator would be beneficial. However, access to this should not be restricted to investors but should also be open to other company stakeholders. A credible referral system and a framework for dealing with such concerns would need to be developed.

***Q15. Should Section 5 be more specific about how signatories may demonstrate effective stewardship in asset classes other than listed equity?***

Yes – please see our response to question 9.

## **Additional comments**

### ***Voting in pooled funds***

The approach taken to voting in pooled funds in the draft Code is too weak and is not consistent with promoting higher standards of stewardship among asset managers and asset owners. If asset owners cannot direct their own voting, this deprives them of an important stewardship tool.

Pension funds, especially smaller ones, are increasingly choosing to invest in pooled funds because of their lower costs. This should not mean, however, that they are forced to give up their voting rights to the underlying assets that they own.

Asset managers often raise administrative concerns about the voting execution required to allow clients to ensure their own views are properly represented. While some simply refuse to allow investors in their pooled funds to direct their voting, in other cases they may make an additional charge. The effect of this is the capture of pension scheme beneficiary property rights, which should be used for the beneficiaries' sole interest and not those of asset managers.

Many beneficiaries, including pension funds, will often take a more critical stance on issues such as executive pay than is the case with the majority of fund managers. Ensuring that clients in pooled funds are able to direct their own voting, should they wish to do so, could have an important impact on shareholder votes on executive pay and other issues.

The Stewardship Code should encourage all asset manager signatories to allow clients investing in pooled funds to direct their own voting policy.

## Provision 2

The use of the word 'stakeholder' is confusing. It appears (judging from the guidance) to refer to other market participants, rather than company stakeholders or stakeholders affected by the real world impacts of the investment. Given the FRC's stated aim of aligning the Stewardship Code more closely with the revised Corporate Governance Code, using words differently across the two codes should be avoided. Within the Corporate Governance Code, 'stakeholder' refers consistently to company stakeholders. Assuming that this is not what is meant in provision 2, a different word should be used. This is especially important given the point made above that there is insufficient emphasis on the real world impacts of investments throughout the draft revised Stewardship Code and the need for this to be addressed.

## Provision 5

The reference to 'appropriate incentives' implies that remuneration should be structured using incentive pay aligned to the investment strategy. There is considerable evidence that incentive pay is not effective in managing behaviour, reflected for example in the recommendation of the BEIS Parliamentary Committee that companies should move away from its use and instead use fixed pay combined with an allocation of shares<sup>5</sup>. The text in provision 5 should be revised so it does not encourage the use of incentive pay.

## Provision 14

The introduction talks about creating 'sustainable value for beneficiaries, the economy and society'. However, provision 14 uses the word 'value' without clarifying this wider meaning. There is a strong danger that it will be read as meaning economic value only and this should be rectified.

## Provision 21 for asset managers

This implies that what should be discussed is how the choice of assets align with stewardship. It should be revised to clarify that how the assets are managed is also relevant.

## Provision 22 for asset owners

This should be revised to clarify that the word 'needs' is wider than economic or financial needs.

## Service providers section – provision 3

As with provision 2 above, the use of the word 'stakeholder' here is confusing.

## Service providers section – provision 6

This should clarify what the code of conduct is expected to cover.

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<sup>5</sup> <https://publications.parliament.uk/pa/cm201719/cmselect/cmbeis/2018/201802.htm>

### Guidance paragraph 2

This should explicitly encourage signatories to encourage policy developments that will promote higher standards of business conduct, or to remain neutral in relation to them. It should not be acceptable for signatories of the Code to lobby government against policy developments that will raise standards in relation to workforce practices, climate change and other real world impacts of investments.

### Guidance paragraph 7

We believe that differentiation between asset managers and asset owners would be appropriate in this paragraph as they are likely to face differential challenges in this area. Generally, conflicts of interests are more likely to be a significant issue for asset managers and those such as fiduciary managers than for asset owners.

### Guidance paragraph 8

There is a lack of available skills to ensure that assurance of stewardship outcomes (as opposed to processes) is carried out accurately, certainly in relation to workforce issues. There is a danger that poor quality audits put a glossy spin on inadequate practice and we would not support making assurance of stewardship outcomes a requirement without the provision of much more detailed guidance about how this could be carried out accurately.

### Guidance paragraph 11

This should be included in the provisions rather than the guidance.

### Guidance paragraph 13

Shares with dual class voting rights can be used to encourage long-term shareholding and as such are fully compatible with the aims of stewardship. The reference to dual class voting rights, with the implication that they may not be suitable for signatories to hold, should be cut.

### Guidance paragraph 14

It is essential that this includes reference to workforce practices.

### Guidance paragraph 18

The meaning of the word 'value' in this context should be explained.

In addition, it is essential that this includes reference to workforce practices.

### Guidance paragraph 26

As argued above, this should be included in the provisions.