THE PURPOSEFUL COMPANY

March 2019

The Purposeful Company Response to FRC consultation on Proposed Revision to the UK Stewardship Code

The Purposeful Company Steering Group

Response to Stewardship Code Consultation

1. Introduction

The Purposeful Company was established by the Big Innovation Centre in 2015, with the support of the Bank of England, to transform British business with purposeful companies committed to creating long-term value through serving the needs of society. We are a consortium of leading companies, investment houses, business schools and business consultancy firms. We have been examining how the governance and capital markets environment in the UK could be enhanced to support the development of value generating companies, acting with purpose to the long-term benefit of all stakeholders.

In February 2018 we produced two papers on stewardship that set out our views on:

- The need for an integrated approach to regulation of stewardship; and
- Suggestions for how the Stewardship Code could be developed to improve stewardship practice.

In these documents we set out the evidence as it relates to stewardship. This shows how there is not a single right approach to stewardship, and indeed certain forms of ownership and stewardship activity can be complementary within the system as a whole. It is therefore important to look at stewardship on a systems basis, and avoid promulgation of a one-size-fits all model. In particular it is important to recognise that the evidence suggests that decisions about buying, holding, and selling securities, and activism, are at least as important in the stewardship ecosystem as visible activities such as voting and ongoing engagement. We do not revisit the evidence here but instead focus on implications (see Alex Edmans' individual submissions to the FRC consultation and to the FRC/FCA joint consultation for further discussion of relevant evidence).

Although there is not a one-size-fits all approach to stewardship, we do believe that it is appropriate for the Stewardship Code to set a standard of engaged ownership that may not be fulfilled by all market participants. For example, quantitative trading strategies may play an important part in ensuring liquidity, market efficiency, and price discovery. However, they may not constitute stewardship in the sense of the word implied by the Code. Similarly, an ultra low-cost index investment offering with no governance function may meet a market demand for cheap access to market returns, but again may not constitute stewardship. This is not to invalidate these market offerings. But being a signatory to the Stewardship Code should demand an approach and set of behaviours that represents a type of engaged ownership that of itself can contribute to improved company performance and long-term value for beneficiaries. This should then help competition by building market confidence in the 'kite mark' that is provided by being a Stewardship Code signatory.

2. General Comments

In this submission we respond specifically to the FRC's consultation questions. We applaud the FRC's efforts to raise the bar on the quality of stewardship. There is much to be welcomed in the new Code:

- The structure of the Code, aligned to the approach taken in the UK Corporate Governance Code, including the combination of Apply and Explain Principles and Comply or Explain Provisions;
- The adoption of Signatory and Annual Activity Statements;
- Expectations of a higher standard of stewardship activity and outcomes as opposed to just reporting;
- Differentiation between roles, and in particular a specific Code for service providers.

However, we do believe that significant developments are required in order to meet the ambition of the Code as something that will genuinely raise stewardship quality. In order of importance, the issues that need to be addressed are as follows:

- The Provisions as drafted need strengthing. Too often they simply reiterate the principles or refer to reporting obligations. Instead, as with the UK Corporate Governance Code, they should refer to the activities that signatories need to undertake (or explain why not) to demonstrate application of the Principles. Having specific required activities on a comply or explain basis, rather than just reporting, will provide a valuable tool for those asset owners (or beneficiaries) that want to hold their asset managers (or asset owners) to account. We do not believe that enhanced reporting is sufficient to develop a market for stewardship – there should be a reasonable expectation on behalf of asset owners of the quality of underlying stewardship activity, analogous to the UK Corporate Governance Code, which gives comfort to investors about good practices that listed companies will adopt.
- Given that all signatories are expected to apply the Principles, these must be sufficiently flexible to be applicable to both asset owners and asset managers, and to different styles of investment management (e.g. active and index). In some cases an active style is assumed. With Provisions, we believe it is legitimate for some issues to be included, for example in relation to decision-making in relation to investment, even if these do not apply to all styles of asset management (e.g. index funds) as in this case non-compliance with the Provision can readily be explained.
- We felt that the separation between asset managers and asset owners within the Provisions did not work effectively. Having explored different approaches (including greater separation of Codes for asset managers and asset owners) we concluded that a single Code applying to both would be most effective, as this sets out the overall objective for stewardship across the chain. Depending on the nature and role of the participant, the Provisions can then be interpreted intelligently to that role. In particular, asset owners may delegate certain of their stewardship responsibilities to an asset manager, and so would not have directly to meet all the Provisions themselves. That is perfectly satisfactory and the preamble to the Code should make that clear. However, that should not absolve them from the responsibility of overseeing the asset manager to fulfil those responsibilities.
- The grouping of the Principles is not always logical and as such they do not yet create a simple picture of the essence of stewardship. Some Principles artificially point in two directions (for example Principal G refers to monitoring of assets and monitoring of service providers, which are completely different dimensions of stewardship).
- The approach to disclosure is not robust enough. Given that no set of disclosure requirements can fully cover what all aspects of stewardship mean for all types of investor, there should be an apply or explain Principle relating to provision of transparent disclosure that enables clients to assess the stewardship approach undertaken.
- We believe that if the Provisions are strengthened as we suggest, and an approach of 'sensible interpretation' to the role of the signatory is adopted, then it should be possible for the Code to be free-standing without lengthy additional interpretive Guidance. Instead, the Guidance could focus on matters such as case studies for different types of stewardship and reporting examples and templates to aid compliance.

We believe the changes required to the draft Code, in order to fulfil the objectives set out in the Kingman review, are more than cosmetic. We have therefore appended to this submission in Appendix 1 a proposed redraft of the Code that addresses the concerns raised above and the feedback given in our response.

3. Responses to specific 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.

The comments in this response are limited to the main Code for investors. We comment separately under Q. 16 on the Code for service providers.

Overall, the Principles cover broadly the right ares. However, we do not believe that they are grouped into the right Sections. Section 3 conflates monitoring of investments with monitoring of service providers. Instead, Sections 2 and 3 should be combined and put into a single Section called 'The Investment Process' which covers the investment approach and approach to monitoring investments. Section 4 then conflates engagement with companies with engagement with other stakeholders. Voting is a separate section, yet voting is part of engagement with companies. Instead, engagement with companies and voting should be combined into a section called 'Engagement and Voting' which in essence combines your Principles H and J. There should then be a Section called 'Stakeholder Engagement'. This then simplifies the Code for investors into four Sections covering:

1. Purpose, Objectives and Governance, which covers how firms need to organise and govern themselves, and how their approach to stewardship supports their purpose.
2. The Investment Process, which covers all aspects of how stewardship is built into the overall approach to investment, but also the practice, including monitoring of companies.
3. Engagement and Voting, which covers how firms interact with investee companies.
4. Stakeholder Engagement, which covers engagement with clients and beneficiaries and participation in the wider market for stewardship.

Commenting now more specifically on each of the current draft code sections.

Section 1: Purpose, objectives and governance

Principle A suggests that purpose, strategy, and culture enable stewardship. Instead, the logical order should start with purpose and strategy, then how the stewardship approach supports that, before moving onto alignment of the organisation behind that, including culture. At the moment the drafting suggests that the purpose and strategy are defined to support the stewardship approach, but it must be the other way around.

The problem with the Provisions in this section is that they in many respects just repeat the Principles or in effect say that firms should provide supporting disclosures. Alternative Provisions that provide more 'bite' and are more additive, describing the underlying activity, have been provided in our revised version of the draft Code in Appendix 1 of this submission.

Sections 2 and 3: Investment decision making and Active Monitoring

As discussed above, Sections 2 and 3 should be combined into a single section covering The Investment Process. We believe that ESG considerations should appear as a Provision not a Principle, as it is possible to conceive of investors that are good stewards but fulfil their fiduciary duty through prioritising dimensions other than ESG, such as innovation, long-term investment, and capital allocation. Moreover, ESG considerations may not always be material to the value of an asset, and therefore an asset owner or manager fulfilling their fiduciary responsibility may not prioritise ESG. This should therefore be comply or explain. Under the current section 3 we felt it was confusing to conflate monitoring of providers with monitoring of assets as they are quite different. Monitoring of assets is the key stewardship obligation that should apply as a Principle. Monitoring of providers, to the extent they are used to help fulfil stewardship obligations, can therefore appear as a Provision (13 in our draft).

Once stewardship is integrated into the investment approach, which by definition includes the screening of prospective investments, we do not see the added value in principle F, which talks about considering whether prospective investments are aligned with their stewardship approach. So although this is a very important activity, we see it as a Provision – i.e. an activity that supports the Principle. Moreover,index funds have no ability to screen assets for stewardship considerations prior to acquisition, and they are not able to sell voluntarily, so it is not clear how they would apply this Principle. Princples should be capable of being complied with by asset manager following either active or index strategies. However, an index fund could legitimately explain that they do not comply with the sale or purchase part of our Provision 10.

In terms of Provisions in these Sections, again we would suggest removing Provisions that simply restate the Principles, and Provisions that are disclosure requirements that could be dealt with through guidance or an overall disclosure Principle. The Provisions needed to say more about interaction between risk takers and governance departments, co-ordination across asset classes etc, as well as about how in practice the approach to monitoring and stewardship are integrated with buy / hold / sell decisions. In our strengthened provisions set out in Appendix 1, we have emphasised the importance of good stewards understanding purpose and strategy so they can either challenge or support it. We have incorporated a provision about use of suppliers.

We have put in as a Provision the requirement to monitor compliance with the UK Corporate Governance Code – particularly important given the new Code. Having this as a Provision still allows the possibility that a very specialist investor, but still a good steward, may not view this as a priority and hence explain.

Sections 4 and 5: Constructive engagement and clear communication and Exercise rights and responsibilities

These two sections should be reorganised. Engagement with companies has been mixed up with engagement with other stakeholders. Yet while the first is core to the implementation of stewardship the second is more relevant to defining the implementation approach and reporting back. We felt that engagement sat more naturally with voting (which is really what the exercising rights section is about). Therefore, we have recommended splitting the sections into a Section 3 on Engagement and Voting (combined with your current Section 4) and a Section 4 on Stakeholder Communication. We have also set out some example Provisions that could be used, building on the style and comments in relation to earlier sets of Provisions. We have included references to escalation and collective engagement as these are important aspects of stewardship.

Note that including engagement as an apply and explain Principle excludes the possibility having a signatory who invests purely on long-term factors and uses monitoring and exit as the stewardship approach, but does not engage. As outlined in our Thoughts for Change document, monitoring and exit, and the consequent price signals sent, is one of the most powerful mechanisms for bringing about change and therefore exercising stewardship. For example, a diligent monitor might hold onto a company despite low short-term earnings, or exit a company despite high short-term earnings if they have been achieved through investment cuts – thus deterring such cuts in the first place. We therefore think it is regrettable that a company that did not engage, but adopted long-term principles on monitoring and exit, might not be able to be a Code signatory. We have therefore reframed this principle to require a policy on engagement consistent with the approach to stewardship. Given the importance of monitoring as a stewardship activity, we have suggested some strengthening of the relevant Principles and Provisions in this Section.

We have also included a Provision about signatories not having a default of following proxy adviser recommendations. Good stewardship will typically not be consistent with this, although there is the opportunity to explain if there is a good reason (for example, if the approach to stewardship prioritises mechanisms other than informed voting).

In our new 'Section 4: Stakeholder engagement' we are recommending focussing this on engagement with stakeholders other than investee companies, as engagement with the latter has been put into our new Section 3. We have introduced here a Principle on reporting and disclosure, which we believe means that we can dispense with a number of the disclosure-related Provisions. Principles and Provisions relating to broader engagement in the market on stewardship have been included here, which were in an earlier section in your version. We believe it is particularly important to impose a general obligation, via a Principle, for signatories to provide the communication necessary for stakeholders to assess their stewardship approach.

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

On the whole we believe the Principles do set high standards, but see our response to Q1 regarding reorganising the principles. Also see our comment on adding a reporting Principle – it is very important in our view that clear communication is viewed as an obligation on an apply and explain basis rather than being governed purely by guidance and Provisions.

The draft Code raises the bar for stewardship, and with our proposed revised Provisions would do so to an even greater degree. It is worth acknowledging that this may increase the burden on small asset owners or asset managers and make them less willing to be signatories to the Code. It may also create an unwelcome burden on, for example, small Local Authority Pension Funds that are expected under regulatory guidance to be signatories. We think it would be unfortunate if smaller players were thereby discouraged from becoming signatories and starting on the path towards stronger stewardship. We therefore think that it would be worthwhile the FRC considering how a proportionality regime could be developed. This could either operate informally, in terms of the expectations set by the FRC for smaller signatories, or more explicitly through a 'Small Investors' exemption for asset owners and managers below a certain size. This could create explicit exemption from some of the requirements. Consultation with the industry would be required to identify those that are most burdensome, but these might include some of the requirements on: voting, stakeholder engagement, being stewards of the market, and reporting. As one example, signatories in the Small Investors section could be permitted simply to lodge a Signatory Statement and be exempted from the annual Acitivities and Outcomes Report, similar to the current regime.

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

Yes. We believe this is the right way to encourage behaviour change rather than a 'tick-box' mindset. We would say, however, that this approach means it is particularly important that the Principles do not contain requirements that would exclude good stewards, and so enforce a narrow one-size-fits-all view of stewardship. In our discussion of the principles in response to Q1 we have highlighted some such examples in the current draft and have suggested amendments accordingly, for example relating to active and index management.

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

We are sceptical of the value of lengthy additional guidance. We believe that if the provisions are strengthened as we have suggested then the Code could be free-standing, and we believe this should be an ambition of the FRC. However, we do think that it could be benefitical for the FRC to work with the industry to develop case studies for what good stewardship looks like depending on the investment style. For example:

	Index Fund	**Active Fund**	**Activist Fund**
Portfolio size	Large	Medium	Small
Active share	Zero	Medium	High
Holding duration	Long	Depending on company's pursuit of long-term value	Medium
Stake-size	Medium	Varied	High
Areas of focus	Generalised ESG focus	Wide range of areas spanning ESG and strategy	Specialised focus on strategy, portfolio, leadership
Mechanisms	Engagement Voting	Engagement Voting Exit	Proxy fights Board appointments Collective action
Collective engagement	Lends support	Leads or lends support	Leads
Key stewardship requirements	Sufficient resource to understand strategic context; willingness to engage collectively	Emphasis on monitoring long-term performance factors; sufficient portfolio focus; clear and strong connections between governance function and portfolio managers	In depth strategic specialism; ability to lead collective action; long-term value perspective

Different investors add value to stewardship in different ways:

- Index investors through their wide holdings across companies help drive up standardised measures of ESG quality, including issues such as board independence, across the market. They can also partner with activist investors in engagements on specialist, tailored issues by lending their votes.

- Active managers engage on issues of purpose and strategy, and through monitoring long-term performance factors and consequent buy/hold/sell decisions can incentivise long-term value creation through price signals.

- Activist investors are experts in strategy and bring about specific performance enhancements through strategy, portfolio, or leadership changes, taking a leadership role in a collective engagement effort.

Examples of each type of investor who are poor stewards are likely to be so for quite different reasons. A non-stewarding index investor, who may be a top 10 investor in almost every company, may not deploy sufficient resource to fulfil the stewardship responsibilities that this position in the market engenders. A non-stewarding active manager may be spread too thin and undertake superficial engagement and monitoring, in effect being a closet tracker. A non-stewarding activist investor may attack companies opportunistically and on a short-termist basis rather than in a way that supports increased long-term value.

Accordingly, the approach to stewardship needs to be described and evaluated in a way that reflects the role of the investor in the market for stewardship, rather than according to a one-size-fits all view. It is for this reason that development of case studies of key investment styles and how they can be effective could be a very helpful resource to support the Stewardship Code.

Q5. Do you support the proposed approach to introduce an annual Activites and Outcomes Report? If so, what should signatories be expected to include in the report to enable the FRC to identify stewardship effectiveness?

We support this approach and believe that it will help users of the report understand in practice how stewardship is carried out and the impact that it has.

The danger of imposing any specific disclosure requirements is that they may create a tick-box mentality based on superficial but visible activity, or inadvertently favour one form of stewardship over another. Some of the most impactful stewardship, in terms of influence, takes place via decisions to buy, hold, or sell shares based on monitoring of long-term factors. The price signal exerts discipline on companies. Yet this is much harder to demonstrate than, for example, engagement meetings or voting.

Signatories could be asked to develop their own criteria and metrics for measuring stewardship quality, set out in their Signatory Statement, against which they report on a consistent basis in their annual Activity and Outcomes Report. We set out below some examples of what such metrics could be.

Notwithstanding the need to recognise the diverse contributions that different styles of investor may make to stewardship, and the consequent focus on tailored disclosures, it is still likely that some standardised disclosures could be helpful. The Investment Association's Framework for Stewardship Reporting sets out some examples. A body equivalent to the FRC's Reporting Lab could develop further frameworks. These would be tailored to the activities of the investor, however, some general disclosure expectations could be set under the following headings, for example:

Category	Example disclosures

Policies and process	• Drawn from a systematic review of the Principles and Provisions of the new Code
	• Will cover items such as:
	  ○ Signatory purpose and approach to stewardship
	  ○ Priority issues, stewardship mechanisms, and consequences
	  ○ Interaction between stewardship function and portfolio management (if separate)
	  ○ Approach to incentives: mandates, contracts, fees, and remuneration
	  ○ Use of service providers
	  ○ Voting, escalation, and collective engagement
	  ○ Stock-lending and recall for voting policy
	  ○ Conflicts of interest

Input activities	• Organisation, quantity, and seniority of stewardship resource
	• Narrative description of stewardship focus for the year (issues addressed, extent to which generalised – e.g. carbon disclosure – or specialised – e.g. capital allocation etc)
	• Portfolio description in terms of number and size of holdings, active share
	• Analysis of engagement split by nature, intensity, and topic as below (an analogous set of disclosures could be developed for stewardship via monitoring and investment or exit rather than engagement); proportions shown by number of companies in portfolio and by value of holdings in portfolio
	• Proportion of investee companies engaged with by nature of engagement (set in context of portfolio characteristics and size):
	  ○ General ongoing engagement
	  ○ Engagement on a specific issue initiated by investee company
	  ○ Engagement on a specific issue initiated by signatory

<table>
<tr><th>Category</th><th>Example disclosures</th></tr>
<tr><td></td><td>Split by intensity of engagement:
Low: uncontentious one or two round exchange
Medium: repeated exchange expressing difference of opinion over several rounds of exchange, with potential to lead to a stewardship consequence
High: intense and repeated engagement on a specific issue, possibly following signatory's escalation mechanism or collective engagement, with the potential to lead to a stewardship consequence
Also split by issue of engagement (strategy, operations, financial performance, capital allocation, leadership, remuneration, board composition and diversity, culture, environment, audit and reporting, competition, human capital, social)
Voting record and statistics, including frequency of deviation from house policy (if applicable)
Proxy advisers used and extent of alignment with / deviation from their recommendations (if applicable)
Participation in collective engagements and industry-wide initiatives</td></tr>
<tr><td>Outcomes</td><td>Proportion of engagement by nature, intensity, and topic leading to no, some, or significant company change, leading to a voting sanction, escalation, or to a decision to sell, hold or buy.
Case study description of key engagements</td></tr>
</table>

A further idea would be to develop a common language framework to harmonise stewardship reporting, in a manner analogous to the Sustainable Development Goals. For example, stewardship reporting by investors could be enhanced if the devised a set of unified stewardship themes, such as executive pay, capital allocation, and climate change. Then, an investor could highlight which themes it prioritises and explain its unique approach to each. It might use say-on-pay-votes to improve executive pay, engage with companies on capital allocation, and divest from firms that don't take action on climate change.

For example, drawing on the the engagement themes in the Investment Association's Stewardship Reporting Framework and their 2018 Stewardship in Practice survey, signatories could report against a common framework as follows, which aligned these themes to the key stewardship channels:

Theme	Priority level	Market, sector, or firm specific	Key stewardship priorities	Stewardship channel employed			
				Voting	Shareholder proposals	Engagement	Monitoring / trading
Strategy							
Operations							
Financial performance							
Capital allocation							
M&A and structuring							
Leadership							
Remuneration							
Board composition							
Culture							
Environment							
Audit and reporting							
Competition							
Human capital							
Social and stakeholder							

Development of this framework would require further collaborative engagement with the industry.

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 Outomes Report?

The current review has represented the opportunity to undertake a root and branch review of the Stewardship Code. However, given the earlier work of the FRC through 2017 and 2018 on the UK Corporate Governance Code, we are not convinced that there has been sufficient time for iteration and reflection on the new Code. As highlighted in the Kingman Review, the revised Code must be a genuine catalyst for improved stewardship activity and outcomes rather than just reporting. In order to ensure that this objective is achieved, we believe that it is important to allow sufficient time for reflection. Moreover, increased interest by the FCA and DWP in stewardship matters, coupled with the recommendation for replacement of the FRC by an Audit Reporting and Governance Authority (ARGA), we believe it would be sensible to delay implementation of the new Code.

We do not believe it is absolutely necessary to have the new Code in place in time for implementation of the Shareholder Rights Directive in July 2019. Although, of course, synchronising these initiatives would have been ideal, in practice the Directive will need to be implemented directly in UK law as appropriate, and not via the Stewardship Code. We would therefore recommend, unusually, an extended period of industry outreach and reflection, including scope for iteration, before the Code is finalised. This might even include a second consultation run by a newly formed ARGA, and would provide time for the powers and responsibilities of ARGA in relation to the Code to be fully developed.

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?

In this submission we have expressed our view that, as drafted, the Code does not go far enough to act as a real catalyst to improve the quality of practiced stewardship, which is what the Kingman Review demanded. We have outlined the changes to the Code that we consider necessary to achieve this, in particular a significant strengthening of the Provisions.

The FRC[1] could continue with the Tiering approach based on reporting in order to encourage clear articulation, although consideration should be given to raising the bar so that Tier 1 is reserved for reports deemed to be in the top quartile of reporting quality, thereby creating an incentive for continuous improvement.

Given the likely increased emphasis in the new Code on stewardship activity, rather than on policies and reporting, a more challenging review process could be considered. It will not be reasonable to review the stewardship activities of all signatories every year. However, a number of approaches could be undertaken:

- Signatories could be require to self-review the effectiveness of implementation of their stewardship approach at least every three years.

- The results of these self-reviews could be available to the FRC on request.

- The FRC could randomly review a set of the self-reviews each year, supplemented by their own analysis, or could adopt a risk-based approach to review based on factors such as reporting quality, market share, market feedback.

- Those wishing to be assigned to the highest category of signatory could be required to have the triennial review undertaken by an independent external party with the key findings published, and the full report made available to the FRC.

These approaches are similar to how financial regulators have approached areas of regulation of the financial services sector. For example, all financial services firms subject to CRD4 have to produce a Remuneration Policy Statement, signed off by the firm's governing body, which explains how their remuneration practices align with the remuneration regulations. Although, other than for the largest firms, this is not required to be submitted to the regulator as a matter of course, it must be available for the regulator to review. Not only does this create an emphasis within boards on ensuring compliance with the regulatory requirements, it also provides a tool, if required, for the regulator to undertake monitoring and enforcement. Moreover, we have suggested in our Provision 5 (see Appendix 1) that where weaknesses in implementation of the stewardship approach are identified by the governing body of the firm, they should be addressed. Again, an area a regulator could review would be the effectiveness of remediation.

The FRC could also undertake a periodic review of stewardship effectiveness in the market. This would be undertaken on a questionnaire basis issued to Asset Owners, Asset Managers, and Companies, which would

[1] We recognise that for different investment chain entities, and post implementation of the SRD, there may be different regulatory authorities overseeing different aspects of stewardship or different segments of the market. Oversight could be provided by the FCA, DWP, or a new Audit, Reporting and Governance Authority. In this section, use of 'FRC' should be read as encompassing the FRC or other relevant authority.

gain feedback in a systematic way on the quality of stewardship exhibited by named parties in the investment chain across key dimensions. Signatories would receive their own data against an anonymised peer benchmark. As confidence in the study grew, consideration could be given to publishing the findings to help drive up standards and inform choices in development of a market for stewardship.

Stewardship is undertaken in diverse ways by different asset managers. This diversity reflects the managers' particular skills, reach, and investment styles. There is not a one-size-fits-all approach to stewardship and so not a one-size-fits-all approach to stewardship reporting. However, efforts must be made to adapt reporting and review to get more to the essence of stewardship practice as opposed simply to quality of reporting, which should be just one of the dimensions considered. A combination of case studies to provide guidance, self-directed reporting, standardised reporting, self-review requirements, external regulator review processes, and market-wide stewardship studies could create effective mechanisms to support sharing of best practice and creation of accountability for following through on stewardship commitments.

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

We believe that this is useful, although the objective of requiring this as part of the Stewardship Code (as opposed to, for example, the UK Corporate Governance Code or Wates Principles) needs to be thought through. As we have outlined in our revised Principles A and B, we believe it is important that signatories establish their purpose and strategy, and define the role stewardship plays in fulfilling these. They then need to develop an approach to stewardship that does indeed support the purpose, and to ensure that their values and culture support that approach to stewardship. Therefore, disclosures about purpose, strategy, and values should be in the context of the approach to stewardship, rather than attempting to be all-encompassing.

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?

We support the introduction of other investment classes – particularly debt –within the remit of the Stewardship Code. However, this issue needs to be treated with caution, and not over-emphasised. Debtholders only perform a subset of the activities an equity investor may undertake. Typically, the main stewardship decisions will be whether to invest in a company's debt in the first place and whether to hold or exit at points in the future.

Moreover, beneficiaries of debt and equity instruments can at times have divergent interests and, therefore, asset managers may have difficulty in reconciling conflicting objectives under a combined stewardship policy. It would seem to us to be difficult for a debt fund to act in a way that prejudiced its beneficiaries in order to benefit the equity holders via another fund within the business. Debt holders have rights that are quite different from equity holders, and arguably therefore also have different responsibilities. We think it is legitimate to ask signatories to consider how they operate stewardship across asset classes other than equity, and how, on occasion, a combined approach in the interests of all beneficiaries may be taken, and what processes they have for assessing this. However, given the issues outlined above it is difficult to be prescriptive, and a holistic stewardship approach across all asset classes may in some cases be impossible. Therefore, the Code should pose the question rather than setting specific requirements. Our Provision 7 addresses this issue as part of the Provision on conflicts of interest. We do not believe that there should be extensive additional Provisions extending to other asset classes.

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?

Different types of fund may have different stewardship approaches by their very nature, at least in certain aspects of their activity. At the same time, a particular firm is likely to have areas of consistency across all funds. What is important for transparency is that beneficiaries / asset owners are able to see where the standard policies are not being applied. We believe that Provision 1 broadly ensures this, although we have reframed it as our Provision 3, in a manner that applies commonly to asset owners and asset managers.

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?

In order to market their services to clients and explain them to beneficiaries, asset managers and owners should be able to articulate their investment beliefs. Any meaningful disclosure of stewardship approach should outline how it fits into the firm's particular investment philosophy and beliefs. It is then important is that firms think through and enact how this is implemented in practice through tangible policies and processes. The provision as framed is likely to lead to rather high level disclosures of questionable meaning, and we would rather it were grounded in in these practical realities, as outlined in our Provision 2.

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

We believe this could be strengthened further. We have identified two separate areas where agents need to be monitored. One is in areas relating to the investment process and one in relation to engagement and voting. Our Provisions 13 and 20 address this, and make the further point that advisory services should not be used to out-source judgement and that firms should not have an automatic or default position of following an adviser recommendation. We have also suggested that where stewardship obligations are delegated they should be clearly set out in the mandate or tender, and taken into account in how the relationship is managed.

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 this is a potentially unhelpful change. The concept of collective engagement is well understood in the UK market. The term collaborative engagement could be misinterpreted as meaning that engagement should always be undertaken with companies in a consensual manner. In his separate submission, Alex Edmans highlights the fact that to be effective from a stewardship perspective, shareholder engagement often has to overcome significant company opposition.

If this terminology is adopted, it is very important that it be emphasised that this is not endorsing a 'softer' approach to engagement.

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

The Government's Response to the Insolvency and Corporate Governance Green Paper and the Kingman Reiew both refer to an ability / obligation for certain market participants to alert regulators when they have concerns about the viability of a company. We do support this suggestion and have built it into our suggested

Provision 21, as we think it is reasonable that signatories be expected to use this safe channel reporting mechanism. The benefits are potentially twofold. One is that such reporting makes the insight from investors available to regulators, and may act as a trigger for regulatory intervention, in case imperilled viability is associated with, and potentially given heightened risk through, regulatory non-compliance or weakness. The other benefit is that such information could, after the event, prove useful in establishing evidence for early warning systems that are effective in identifying potential corporate failures.

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

Please see our response to Question 9. We believe this is an area that should be approached with caution and do not see the need for further provisions in this area in Section 5.

Q16. Do the Service Provider Principles and Provisions set sufficiently high expectations of practice and reporting? How else could the Code encourage accurate and high-quality service provision where issues currently exist?

We believe that the two key issues in relation to service providers and stewardship are:

- Investment advisers not doing enough to emphasise the importance of stewardship to their asset owner clients, or to help them to develop, implement, and monitor a stewardship approach; and
- Proxy advisers inadvertently contributing to a system where stewardship judgements are outsourced.

These system weaknesses are ultimately the responsibility of the asset owners and asset managers commissioning the advice. However, we do believe that advisers who are Code signatories could do more themselves to lessen these risks. Therefore, we belive that the Principles and Provisions in the Stewardship Code section should focus on these issues. For this reason, rather than suggesting broad-based disclosure of purpose, strategy, values, and culture, we have suggested two key principles (A and B in our suggested code):

- Signatories must define the role that they play in helping clients fulfil their stewardship responsibilities.
- Signatories must provide services in a way that promotes the role of stewardship to clients and makes it clear that both the approach to stewardship and final decision making are properly matters for the client and not the service provider.

Our Provisions 1 and 2 in the service provider Code then address head-on the two risks outlined above.

We also think it is worthwhile including key professional and good standards practice in the service provider's Code, but with a read across to the Best Practice Principles for Providers of Shareholder Research & Analysis (BPPs), once amended. The BPPs cover the basics of professional standards in the industry, but do not address the key stewardship risks outlined above.

In due course consideration could be given to how other service providers affect the stewardship chain, including for example equity analysts and brokers. However, we believe it is appropriate to focus initially on investment consultants and proxy advisers.

The Task Force and Steering Group

This Task Force is co-chaired by Will Hutton and Clare Chapman and is led by a Steering Group and supported by a wide group of Contributors with research resources from the Bank of England. Other Steering Group members are:

- Alex Edmans, Professor of Finance at London Business School
- Tom Gosling, Partner at PwC and Executive Fellow at London Business School
- Colin Mayer, Professor of Management Studies at Saïd Business School

The Steering Committee would also like to express its thanks to Professor Julian Franks from London Business School for his contribution to our thinking on stewardship reporting and monitoring set out in our responses to Questions 4, 5, and 7.

March 2019

The Code

1 Purpose, objectives and governance

A. Signatories must establish their organisational purpose and define the role stewardship plays in fulfilling that purpose and in supporting the signatory's strategy.

B. Signatories must establish their approach to stewardship in support of their purpose, how they serve the interests of clients and beneficiaries, and how this creates sustainable value for investors, the economy, and society.

C. Signatories' values and culture must enable them to fulfil their stewardship objectives, supported by appropriate governance, processes, resources, and remuneration.

D. Signatories must identify and establish policies to manage conflicts of interest which put the interests of beneficiaries and / or clients first.

Provisions

1. The purpose of the organisation and the role stewardship plays in fulfilling that purpose should be approved by the board or other governing body of the signatory.

2. The approach to stewardship should be specifically defined in terms of key dimensions including: the issues and long-term factors the signatory focusses on as a matter of priority; the methods used for exerting influence; and consequence actions (escalation, sale etc) in case of unsuccessful stewardship activity. This approach should be linked to the signatory's investment beliefs to set out how the stewardship activity creates sustainable value for clients and beneficiaires, and thereby the economy and society in support of the signatory's purpose.

3. Where a signatory adopts different approaches to stewardship for certain funds or asset classes then this should be clearly set out either in the signatory's stewardship statement or in fund documentation.

4. Signatories should ensure that stewardship objectives are considered and appropriately incorporated when inviting tenders, selecting service providers, and designing mandates, as well as being reflected in the overall management of the relationship. Where an asset owner delegates asset management, then they shoud be clear about the aspects of the stewardship approach under Provision 3 that they expect to be adopted by the asset manager as opposed to being left to the discretion of the manager.

5. The signatory should periodically review the implementation of the stewardship approach, and how this is supported by the signatory's culture, values, processes and incentives. If there is reason to believe that any of these aspects is undermining the signatory's ability to apply its stated approach to stewardship then corrective action should be taken. Signatories should ensure that adequate resource, in terms of quantity and capability, is available to deliver on its stewardship approach.

6. Incentives can play a particularly significant role in supporting or undermining stewardship and signatories should satisfy themselves that mandates, contracts, and remuneration are structured in a way that supports the signatory's stewardship approach. This should take into account both the performance metrics used and the time horizon over which they are measured, reflecting that of clients or beneficiaries, and having particular regard to how quality of stewardship may be measured.

7. The policy for managing conflicts should address how matters are handled when the interests of clients or beneficiaries diverge from each other. Signatories should have a policy and process for whether and how they co-ordinate their stewardship approach when they hold investments in a company across different funds or asset classes, and for managing any conflicts that may arise when the stewardship objectives of different funds or asset classes differ.

2 The investment process

E. Signatories must integrate their approach to stewardship into their investment approach.

F. Signatories must actively monitor the performance of assets for which they are responsible, or where asset management has been delegated must actively oversee the performance of the asset manager.

Provisions

8. Signatories should ensure that they devote sufficient resource to understanding the purpose and strategy of investee companies and key market and industry trends, to ensure they can exercise informed stewardship and challenge or support that purpose and strategy as appropriate.

9. Signatories should actively monitor the performance of companies on dimensions relevant to the stewardship approach, including financial, non-financial, and ESG factors that are material to the company's long-term success and key to the investor's strategy. These factors should be considered over the time horizon of beneficiaries and / or clients. There should be a clear connection between the monitoring activities and the investment strategy and stewardship approach.

10. Signatories should have an approach for how stewardship considerations and monitoring are taken into account in decisions to buy, hold, or sell securities, and in voting and engagement activity, and should ensure this approach is implemented in practice.

11. Signatories should have a clear process for delivering their approach to stewardship, including the responsibilities and ultimate authorities of different parties, for example portfolio managers and the central governance or stewardship function (if any), and how they should interact in relation to stewardship matters. This should include liaison on stewardship engagements with companies, on decisions to buy, hold, and sell securities (if relevant), and voting decisions.

12. Investors are responsible for monitoring implementation of the UK Corporate Governance Code. Given the importance of the Code in ensuring a high standing for business in society as a whole, signatories should consider Code compliance as part of their monitoring process. Where companies have given a reasoned explanation for non-compliance, investors should give this due regard, and should engage with companies to clarify any areas of concern.

13. Where signatories use service providers either for delegated services to meet these provisions (for example an asset owner delegating management of assets) then they should effectively oversee the performance of the service provider in fulfilling the stewardship obligations, which should be clearly set out in the mandate or tender, as well as reflected in the overall management of the relationship. They should be diligent in monitoring performance of service providers in how they support the signatory's stewardship objectives.

3 Engagement and Voting

G. Signatories must have a policy on engagement that supports their approach to stewardship and so protect and enhance the value of assets.

H. Signatories must exercise their rights and fulfil their responsibilities in a considered manner, consistent with their approach to stewardship.

Provisions

14. Signatories should establish an engagement policy, including the issues they will engage on and the circumstances under which, and methods by which, they will engage with a company. The engagement policy should include clear guidelines on when and how the signatory will escalate their engagement activities, whether through voting or other mechanisms. Signatories should be willing to act collectively with other investors where appropriate and should establish an approach for how and under what circumstances they would do this.

15. Signatories should have a policy for voting shares for listed assets setting out the key criteria that will guide their decision on different categories of resolution, or, if voting is delegated, setting out how it is delegated and how the signatory ensures that voting will be in line with their stewardship approach.

16. Signatories should set out their approach to execution of votes in pooled funds, how they ensure and monitor that actual votes cast are executed reliably in line with their voting intention.

17. Signatories should explain their stock lending policy, including whether they recall lent stock for voting, and why it is consistent with their approach to stewardship.

18. Signatories should disclose how they have voted on resolutions at UK company meetings within a reasonable time period of the meeting being held.

19. Where a signatory is a major investor in a company, it should, if asked and if not inconsistent with the interests of beneficiaries, respond to reasonable requests to disclose to the company their voting intention on contentious resolutions ahead of casting their vote, in order to enable the company to judge the likely level of support. If the signatory plans to vote against management then it should give a reasonable opportunity for dialogue to attempt to resolve any differences. If the signatory plans to vote with management but has concerns, it should voice these concerns despite the positive vote.

20. Advisory services should be used to inform the judgement of the principal, not used as a mechanism for outsourcing judgement. Asset managers and owners should enable clients and beneficiaries to understand the key advisory relationships used (for both investment consultants and shareholder advisory services) and how they are used. Where signatories use shareholder advisory services to advise on voting then they should not have an automatic or default position of following the adviser's recommendation but should consider each case on its merits, taking the adviser's recommendation into account as just one input. Similarly, where signatories have a 'house' voting policy, it should ensure that it is used in a considered manner. The 'house' policy should be clear about the circumstances under which the policy may not apply.

21. Exit from a shareholding can be an important part of an investor fulfilling their stewardship obligations to clients and beneficiaries. However, where a signatory has sold a company's shares as a result of serious concerns about governance, leadership, strategy, or financial performance that could call into question the company's viability then they should make use of available safe channels[2] to report their concerns to regulators.

[2] The Government's Response to the Insolvency and Corporate Governance Green Paper and the Kingman Review both refer to an ability / obligation for certain market participants to alert regulators when they have concerns about the viability of a company. This provision will be aligned with the development of such 'safe channel' reporting mechanisms.

4 Stakeholder engagement

I. Signatories must produce a Signatory Statement on adopting the Code and at least annually thereafter produce an annual Activities and Outcomes Report. Signatories must report on their stewardship activities in an open and transparent manner that enables current and potential clients or beneficiaries to understand how they have applied the Code's principles and complied with its provisions.

J. Signatories must engage with clients or beneficiaries so their views inform development of their stewardship policy.

K. Signatories must engage appropriately and proportionately with industry-wide efforts to enhance the quality of stewardship across the market.

Provisions

22. The Signatory Statement and Activities and Outcomes Report should be prepared taking into account relevant guidance and should enable third parties to understand how the signatory has applied the Code's Principles and complied with its Provisions

23. Signatories should use the Activities and Outcomes Report to demonstrate how stewardship has been undertaken and its impact, making use where possible of objective quantitative metrics and qualitative case studies.

24. As well as complying with relevant legislation on engagement of beneficiaries, signatories should make authentic efforts to understand the stance of clients and beneficiaries on key stewardship matters and have regard to this insight when developing their stewardship approach.

25. Signatories should be prepared to work with other stakeholders to promote stewardship, enhance stewardship practices, develop understanding of effective stewardship approaches and exercise a role as 'stewards of the marketplace'. Signatories will normally be members of the Investor Forum and may contribute to academic research or public inquiries on stewardship.

Service providers stewardship code

Principles

A. Signatories must define the role that they play in helping clients fulfil their stewardship responsibilities.

B. Signatories must provide services in a way that promotes the role of stewardship to clients and makes it clear that both the approach to stewardship and final decision making are properly matters for the client and not the service provider.

C. Signatories must provide services that are delivered in accordance with agreed client specifications, and reflecting recognised professional standards of competence, transparency, integrity, objectivity, due care, and confidentiality.

D. Signatories must have a publicly disclosed policy that details their procedures for addressing potential or actual conflicts of interest that may arise in connection with the provision of services.

E. Signatories must produce a Signatory Statement on adopting the Code and at least annually thereafter produce an annual Activities and Outcomes Report. Signatories must report on their stewardship activities in an open and transparent manner that enables current and potential clients or beneficiaries to understand how they have applied the Code's principles and complied with its provisions.

Provisions

1. Investment consultants should encourage asset owners to develop a stewardship approach and to consider stewardship as part of asset manager selection and mandate design, deploying appropriate research and methodologies to facilitate this. Evaluations of manager performance should also include evaluation of stewardship approach.

2. Decision making on strategic stewardship matters should never be outsourced. Shareholder voting advisory services that provide voting recommendations should recognise the risk of de facto outsourcing of decision making that arises from voting recommendation services. Voting recommendations that involve on complex judgements across many factors, including strategic factors specific to the company, and where compliance with the adviser's voting policy is a matter of judgement, should be additionally marked as 'FOR STRATEGIC JUDGEMENT'. This does not preclude the offering of a recommendation to vote FOR, AGAINST, or ABSTAIN. The additional labelling will help clients fulfil their responsibilities under provision 20 of the investor section of the Stewardship Code.

3. Where a shareholder voting adviser gives voting recommendations and uses a formulaic approach to governance scoring or pay-for-performance analytics that has a material impact on those recommendations, then the adviser should disclose what independent expert review of the methodology has been undertaken and the principal findings of that review.

4. In fulfilling principles C to E, shareholder advisers should have regard to the Best Practice Principles for Providers of Shareholder Research & Analysis.

5. The Signatory Statement and Activities and Outcomes Report should be prepared taking into account relevant guidance and should enable third parties to understand how the signatory has applied the Code's principles and complied with its provisions.

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