FRC Consultation on Proposed Revision to the UK Stewardship Code

Background information

The Church Commissioners for England and the Church of England Pensions Board are charitable statutory corporations.

The Church Commissioners manage an £8.3 billion investment fund and exist to support the work and mission of the Church of England. Their investments contribute towards the cost of mission projects, dioceses in low-income areas, bishops, cathedrals, and pensions for clergy accrued in respect of service up to the end of 1997.

The Church of England Pensions Board manages funds in excess of £2.3 billion and provides retirement housing and pensions, set by the Church of England, for those who have served or worked for the Church.

The Commissioners and Pensions Board are strong proponents of investor stewardship and receive advice on ethical investment policy from the Ethical Investment Advisory Group of the Church of England ('EIAG'). The EIAG frames its advice to be consistent with the Commissioners' and Pensions Board's fiduciary duties. Both bodies are also committed signatories of the UN-backed Principles for Responsible Investment (PRI).

In addition, the Commissioners, Pensions Board and CBF Church of England Funds (known collectively as the Church of England's National Investing Bodies or "NIBs") work collaboratively with other Christian groups through the Church Investors Group, a coalition of church organisations with combined investment assets of approximately £21 billion, including through a common proxy voting template.

In January 2017 the NIBs and the Environment Agency Pension Fund launched the Transition Pathway Initiative (TPI). This global initiative, led by asset owners and supported by asset managers, assesses companies' preparedness for the transition to a low-carbon economy, supporting evidence-based engagement on climate change, including by participants in Climate Action 100+, for which TPI is a company benchmarking tool.

Church House, Great Smith Street, London SW1P 3AZ
Website: www.churchofengland.org

Response on behalf of the Church Commissioners for England and the Church of England Pensions Board

Q.1 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 revised Code defines the core areas of stewardship responsibility comprehensively and is now more fully reflective of the remit of investor stewardship. It distinguishes appropriately between the stewardship roles of different industry actors and shows alignment with the existing provisions of the Law Commission, the Pensions Regulator, and international best practices, especially in relation to ethical or environmental, social and governance (ESG) issues material to investors, and to disclosure of investment beliefs[1]. We are pleased to see the stronger emphasis on engagement on environmental and social issues, corporate ethics and reputational issues, specific reference to climate change, the requirement for signatories to disclose their purpose, objectives, and governance, the emphasis on reporting, and broadening adoption beyond listed equities investment.

Q.2 Do the Principles set sufficiently high expectations of effective stewardship for all signatories to the Code?

We believe the proposed expectations of effective stewardship are set sufficiently high, but we maintain that signatories should treat the Principles as prompts rather than compliance hurdles. Together with the FRC, UK investors should foster a regime in which stewardship and its reporting are driven by ownership, excellence and innovation, and not mere compliance.

1 Law Commission (2014) Pension trustees' duties when setting an investment strategy: Guidance from the Law Commission; Pensions Regulator (2018) Investment guidance: for defined benefit pension schemes; ICGN (2016) Global Stewardship Principles.

Q.3 Do you support 'apply and explain' for the Principles and 'comply or explain' for the Provisions?

Yes, we broadly support "apply and explain" for the Principles and "comply or explain" for the Provisions. A degree of flexibility is afforded by 'comply or explain' that is appropriate for the Provisions. One size does not always fit all. Above all, investor reporting ought to reflect on the positive impact/benefit that stewardship delivers to the ultimate beneficiaries and investors.

On specifics, our preference is that collaborative engagement should not get "demoted" to a Provision but should remain a core Principle of the Code.

Q.4 How could the Guidance best support the Principles and Provisions? What else should be included?

We would welcome analysis comparing PRI reporting and FRC Stewardship reporting, and facilitating joined-up reporting. We would also suggest that the Guidance document is updated regularly so it can reflect the fast pace of change and development of stewardship practices.

Q.5 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?

Yes, we support the introduction of a reporting requirement, but we note that there are significant challenges associated with measuring outcomes or stewardship effectiveness. When we seek to exert influence as asset owners, we aim to do so as effectively as possible given a number of constraints (e.g. time, resource, priorities). Furthermore, decision makers (such as CEOs and Chairs of investee companies), face many competing influences, and an individual investor is one voice among many. Ultimately, the trustees of our institutions are responsible for assessing our stewardship effectiveness, and they receive regular reporting from our stewardship teams.

We welcome the simple structure for reporting in an annual activities and outcomes report. We are hopeful that stewardship reporting will also remain flexible and open to new entrants and ideas.

Indeed, we wonder whether there should be different categories or levels of asset owner signatories to the Code, so that more asset owners feel encouraged to support it, including in their relations with their asset managers, without being put off by overly burdensome reporting requirements that they are not resourced to meet.

Q.6 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?

Yes, we support the proposed schedule, although, as noted above, the FRC should take into account the burden on smaller institutions, particularly asset owners, especially if they are already reporting through voluntary mechanisms, e.g. PRI. We strongly support the FRC and PRI pursuing alignment of stewardship reporting requirements.

Q.7 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?

We believe the Code addresses the key concerns addressed by the Kingman review:

> *"The Review recommends that a fundamental shift in approach is needed to ensure that the revised Stewardship Code more clearly differentiates excellence in stewardship. It should focus on outcomes and effectiveness, not on policy statements. The Government should also consider whether any further powers are needed to assess and promote compliance with the Code. If the Code remains simply a driver of boilerplate reporting, serious consideration should be given to its abolition. The FRC needs to engage at more senior level in a much wider and deeper dialogue with UK investors, including both fund managers and representatives of end-investors."*

Whilst we recognise that the FRC may be perceived as "not tough enough" by some stakeholders, we maintain that investors should interpret "effectiveness" in their own terms, which will be linked to their fiduciary duty to clients/beneficiaries.

Last but not least, we support investors' board approval of the Code statement as it sets the right tone about accountability.

Q.8 Do you agree that signatories should be required to disclose their organisational purpose, values, strategy and culture?

Organisations should at least be required to disclose their purpose and strategy. The FRC should be alive to the risk that a requirement for values and culture disclosure could turn out to be a recipe for "boilerplate" or aspirational language that would tell us little of value. Defining, assessing and measuring the values and culture of an organisation are difficult.

With regards to Section 1[2]: Provision 4 on signatories' workforce, we hope that responsible investment remains an inclusive industry and signatories should own their own definition of "appropriate experience" for employees in their context.

Q.9 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 are supportive of the Code incorporating stewardship beyond listed equity and this should be backed up with proportionate Provisions and Guidance. The FRC could draw on the experience of the PRI in asset classes beyond listed equity.

Q.10 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?

Without requirements becoming overly prescriptive, signatories should report the extent to which their stewardship approach applies across all funds and disclose why certain funds may be excluded.

Q.11 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?

Yes, investment beliefs should be transparent to clients and beneficiaries.

---

2 We are referring to Section 1 "Purpose, Objectives, and Governance".

Q.12 Does Section 3 set a sufficiently high expectation on signatories to monitor the agents that operate on their behalf?

We believe Section 3 sets sufficiently high expectations on signatories to monitor the agents that operate on their behalf.

Q.13 Do you support the Code's use of 'collaborative engagement' rather than the term 'collective engagement'? If not, please explain your reasons.

We support the use of the term "collaborative engagement" as this is how the industry refers to these activities. Above all we support the practice of collaborative engagement because "investors are now so varied and fragmented that they find it difficult to influence corporate decisions, even when it is in their collective interests to do so"[3]. Collaborative engagement provides an opportunity to act in our collective interests and augment individual shareholders' voices.

Q.14 Should there be a mechanism for investors to escalate concerns about an investee company in confidence? What might the benefits be?

As first step, we propose that the FRC publishes more details about its work relating to Corporate Reporting Review. Investors may benefit from knowing which companies are targeted by the FRC and the issues raised. We would welcome further details on the suggested mechanism for investors to escalate concerns with the FRC in confidence, particularly on how all investors would benefit from the confidential mechanism.

Q.15 Should Section 5 be more specific about how signatories may demonstrate effective stewardship in asset classes other than listed equity?

We broadly support the Principle and Provisions of Section 5. However, we believe that Provision 26 goes beyond the SRD II requirements. The SRD II states that "investors should set their own criteria regarding which votes are insignificant on the basis of the subject matter of the vote or the size of the holding in the company and apply them consistently". We would like to see the UK Stewardship Code integrating this caveat. This only seems to be flagged in Guidance Item 15.

3 Law Commission. 2014. Fiduciary Duties of Investment Intermediaries. [Online]. [25 March 2019]. Available from: http://www.lawcom.gov.uk/app/uploads/2015/03/lc350_fiduciary_duties.pdf

Q.16 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?

Yes. We also believe that the Best Practice Principles for Shareholder Voting Research already set high expectations of practices and reporting.