

Allianz Global Investors GmbH, UK Branch

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Proposed Revisions to the UK Corporate Governance Code

Response by Allianz Global Investors

Allianz Global Investors (AllianzGI) welcomes the opportunity to respond to the public consultation on the Proposed Revisions to the UK Corporate Governance Code (CG Code). The views expressed in this document represent our position as an investment manager and an investor in UK's listed companies.

Allianz Global Investors is a diversified active investment manager, managing EUR 498 billion¹ in assets for individuals, families and institutions around the world. We invest for the long term across a range of different investment strategies, and pay close attention to growth prospects, return on capital, good governance, market positioning and quality of franchises of companies we invest in. Furthermore, we believe that material environmental and social considerations are crucial to the success of a company looking for long-term outperformance. Consistent with our investment philosophy, we routinely engage in dialogue with investee companies. Our investment views are influenced by the outcomes of these engagements and are linked organically to the proxy voting process, forming a consistent stewardship approach.

General comments

AllianzGI welcomes the comprehensive review of the CG Code, which should ensure the Code continues to serve as a powerful tool for improving the quality of governance of the UK publicly listed companies. We also welcome the format of the new Code and agree that the emphasis should be on the application of the Principles, rather than box-ticking compliance with the Provisions and Guidance. We would like to see all companies carefully consider how Principles can be best applied to benefit the business and report in a manner that investors can understand and use in their analyses.

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Before commenting on the Code, we believe it is critical to underscore that Annual Report and Accounts should first and foremost address the needs of investors and should not be designed as a primary tool of communication with a broader range of stakeholders. We are very concerned that annual reports have been growing in length and have been used to accommodate disclosures requested (or mandated) by a range of stakeholders irrespective of their materiality for the business. This trend has diluted the value of annual reports for investors and made it difficult for companies to communicate material issues in a clear, fair and understandable way. We strongly encourage the FRC to reverse this trend by making “materiality for the business” a guiding criterion for the information to be included in the annual report. Information that is important for other stakeholders can be provided in other regular or ad-hoc disclosures (including Sustainability or CSR reports). This would help investors to have more productive conversations with boards and management of investee companies if there is a divergence of views on what is material and why. Given the ever rising reporting requirements it may also be a good suggestion for Boards to consider having a Disclosure Committee, as already done by some UK companies.

Principle A: We believe that the FRC needs to provide more guidance on what “contribution to wider society” and “company’s purpose” means to ensure these are not confused with a “social purpose” of an enterprise. “Contribution to wider society” can be defined in economic, social and environmental terms. “Company’s purpose” can be limited to delivering financial returns on investment. Not every business models lends itself to having a credible “social purpose”. It is important that businesses do not feel compelled to define a “social purpose” if such is not firmly embedded in the business model or practices of a company. It is equally important that businesses with a strong “social purpose” be able to articulate it.

Provision 3: We agree that the board should establish a method for gathering the views of the workforce. However, we do not support the inclusion of the three specific methods in the Code. The Guidance on Board Effectiveness provides a list of possible methods that companies can chose from (para 35). The three methods mentioned in the Code - a director appointed from the workforce, a formal workforce advisory panel and a designated non-executive director - should be removed from the Code and added to the Guidance alongside other suggestions.

We would encourage the use of employee engagement surveys, not only to ensure the employee voice is heard in the boardroom, but also to give investors an insight into the views of the workforce. Investors would benefit from companies disclosing the main survey results (e.g. full disclosure on the corporate website with a reference in the annual report and accounts) to add to the views expressed by directors and management.

Provision 14: We believe that the recommendation that “full-time executive directors should not take on more than one non-executive directorship” should apply to any publicly listed companies, not just FTSE 100 equivalent. In our view, a company’s size is not a good proxy for time commitment, as smaller companies often need more time, specialist advice and guidance from their non-executives than well-run large-caps; the same would apply to PE or VC roles. As an example, if an executive director sits on the

board of more than one company, AllianzGI requires a very strong justification including how the board makes sure that external commitments do not affect the full-time role; we often vote against non-executive appointments in such circumstances. (Note: It may be appropriate for an executive director to take on additional non-executive appointments once they have announced they will be stepping down from the Board at the next AGM; such situations need to be clearly explained under the “comply or explain” approach).

Provision 16: The company secretary should have a reporting line to the Board only. This is a very important role that should not be combined with responsibilities that require a reporting line into executive functions.

Principle J: We agree with the principle as a whole; however, we would prefer to see specific diversity characteristics (i.e. gender, social and ethnic background, cognitive and personal strengths) included in the Guidance on Board Effectiveness (para 13 and 82) rather than the Code. The Code needs to empower the Boards to decide which diversity characteristics are important for the business and can help enhance board effectiveness. The directors and the Chairman should be able to explain to investors their views and choices. We believe this would be more effective in achieving greater diversity and would help investor engagement, rather than encourage boards to tick respective diversity boxes for compliance reasons.

Provision 21: It would be helpful for investors to understand how an external board evaluation added value, if at all.

Provisions 25 and 26: We believe that a reference to the quality of audit - alongside independence, objectivity and effectiveness - would be helpful.

Provision 31: There needs to be a better guidance to companies and investors on what viability statements should contain; the basis of their preparation and, consequently, how much reliance can be placed on them. On one hand, we understand from companies that many found preparing viability statements a worthwhile exercise that helped to review and strengthen internal systems and controls. On the other hand, there have been a number of instances since the statements were introduced, whereby companies' circumstances and actions contradicted the board's statement within weeks or months of its publication; in some cases the issues were long-standing and should have been known to the board at the time of publication. As a result, the integrity of the viability statements is being questioned. The FRC should address this issue.

Provision 34: We agree that remuneration for non-executive directors should not include share options or performance-related elements.

Provision 35: We believe that the Code should explicitly prohibit the use of remuneration consultants that have other connections with the company or individual directors. Any conflicts of interests by remuneration consultants should be avoided as investors usually pay a heavy price for these.

Consultation questions

Proposed Revisions to the UK Corporate Governance Code

Q1. Do you have any concerns in relation to the proposed Code application date?

No.

Q2. Do you have any comments on the revised Guidance?

AllianzGI comments on the Revised Guidance on Board Effectiveness:

Para 13: See our comment on Principle J in relation to board diversity.

Para 24: Please see above our general comment on the purpose and use of the annual report and accounts.

Para 26: It must be acknowledged that board decisions can have a positive impact on some stakeholders and a negative impact on other. The board, therefore, must be able to take difficult decisions that the directors believe are in the best long-term interests of the company, even if it means a short-term negative impact on some stakeholders (e.g. employees). We suggest that the Guidance explicitly refer to this point.

Para 33: The Guidance should recommend that whistleblowing facilities should be extended to customers and suppliers.

Para 35: See our comment on Provision 3 in relation to the suggested methods of gathering the views of the workforce. It is important to encourage the use of employee engagement surveys, not only to ensure the employee voice is heard in the boardroom, but also to give investors an insight into the views of the workforce. Investors would benefit from companies disclosing the main survey results (e.g. full disclosure on a corporate website with a reference in the annual report and accounts) to add to the views expressed by directors and management.

Para 37: We suggest this paragraph is considered for inclusion in the Code.

Para 66 and 78: It would be helpful to have more guidance on what minimum time commitment expectations should be for a non-executive director, a board committee chair, a Senior Independent Director and a Chairman.

Para 72: See our comment on Provision 16 above.

Para 80: This paragraph should be moved to the Code as a provision supporting Principle J. Please also see our comment on Principle J.

Para 100: See our comment on Provision 31.

Q3. Do you agree that the proposed methods in Provision 3 are sufficient to achieve meaningful engagement?

Please see our comments on Provision 3 of the Code and Para 35 of the Guidance on Board Effectiveness.

AllianzGI agrees that boards need to understand and consider the views and interests of employees, customers, suppliers and other major stakeholders as appropriate. However, we believe that companies should have flexibility to: decide who their key stakeholders are; examine any negative impacts on key stakeholders arising from business activities or decisions; and select the most appropriate mechanisms for stakeholder engagement. The Guidance offers a number of suggestions for companies to consider, and the three options mentioned in Provision 3 should be included in the Guidance.

Q4. Do you consider that we should include more specific reference to the UN SDGs or other NGO principles, either in the Code or in the Guidance?

Reference to the UN Sustainable Development Goals (SDGs) in the Guidance would be helpful. SDGs has become a widely recognised international framework that can help companies think about their contribution to the wider society, assess positive and negative externalities of their business activities, and explain these to investors and other stakeholders. Adoption of SDG framework by companies and investors should help develop a “common language” to define and assess social impacts of businesses.

At the same time “contribution to wider society” should not be confused with “social purpose”, and companies should not be forced to develop the latter where it is not inherent to the purpose of the company, its business model and/or culture. Please see our comments on Principle A of the Code.

Q5. Do you agree that 20 per cent is ‘significant’ and that an update should be published no later than six months after the vote?

We agree.

Q6. Do you agree with the removal of the exemption for companies below the FTSE 350 to have an independent board evaluation every three years? If not, please provide information relating to the potential costs and other burdens involved.

We agree with the removal of the exemption for companies below FTSE 350 to have an independent board evaluation every three years. However, we recognise that there is a wide range of companies in

FTSE Small Cap, and while some would undoubtedly find it useful, it may be too onerous and less necessary for others. Given the “comply or explain” approach, the removal of the exemption should not create unnecessary burden for smaller companies. We suggest this proposal is reviewed again after companies have had an opportunity to share their experience, including on burdens and costs.

Q7. Do you agree that nine years, as applied to non-executive directors and chairs, is an appropriate time period to be considered independent?

We agree with the proposed strengthening of the provisions on director independence in the Code. However, we disagree with the expectation expressed in the consultation paper that all directors should, under normal circumstances, step down from the board after becoming non-independent due to tenure. We believe in the importance of having a balanced board. We also believe that having continuity, institutional memory and deep knowledge of the business can be an asset for the board. Therefore, provided the board is majority independent and board committees’ independence is in line with the Code recommendations, we would have no objection for a valued long-tenured director to remain on the board. It is not in the interest of shareholders if good directors are forced off the board.

We would also suggest that nine years may be too short a period, and a 12-year period could be considered in line with best practice recommendations in many other markets.

Q8. Do you agree that it is not necessary to provide for a maximum period of tenure?

We agree.

Q9. Do you agree that the overall changes proposed in Section 3 of the revised Code will lead to more action to build diversity in the boardroom, in the executive pipeline and in the company as a whole?

Please see our comments on Principle J of the Code and para 13, 24 and 80 of the Guidance.

Q10. Do you agree with extending the Hampton-Alexander recommendation beyond the FTSE 350? If not, please provide information relating to the potential costs and other burdens involved.

We agree that diversity of the executive pipeline at UK companies is an important issue, but would advocate better reporting on the composition and diversity of all workforce, not just two levels below the board.

Q11. What are your views on encouraging companies to report on levels of ethnicity in executive pipelines? Please provide information relating to the practical implications, potential costs and other burdens involved, and to which companies it should apply.

We do not believe that such granular reporting issues should be addressed through the Code.

Q12. Do you agree with retaining the requirements included in the current Code, even though there is some duplication with the Listing Rules, the Disclosure and Transparency Rules or Companies Act?

We cannot respond without assessing this area on a case-by-case basis.

Q13. Do you support the removal to the Guidance of the requirement currently retained in C.3.3 of the current Code? If not, please give reasons.

We support.

Q14. Do you agree with the wider remit for the remuneration committee and what are your views on the most effective way to discharge this new responsibility, and how might this operate in practice?

We support a wider remit for the remuneration committee and understand that many companies already have this in place. It is important, however, that the remit is limited to overseeing company remuneration and wider workforce policies, while leaving individual compensation decisions to the management as appropriate.

Q15. Can you suggest other ways in which the Code could support executive remuneration that drives long-term sustainable performance?

The Code should be less prescriptive on remuneration practices and allow companies to decide what works best for them and make a strong case to their shareholders.

Initial Consultation on Future Direction of the UK Stewardship Code

Q17. Should the Stewardship Code be more explicit about the expectations of those investing directly or indirectly and those advising them? Would separate codes or enhanced separate guidance for different categories of the investment chain help drive best practice?

We agree that the Stewardship Code should be more explicit about the expectations of those investing directly and indirectly, and those advising them. It is particularly important that the Code should address the implications of separating investment and stewardship, e.g. situations where investment and voting decisions are taken by different entities.

Q18. Should the Stewardship Code focus on best practice expectations using a more traditional 'comply or explain' format? If so, are there any areas in which this would not be appropriate? How might we go about determining what best practice is?

We agree that best practice expectations should be set, and signatories should provide explanations as regards their stewardship activities by reference to best practices. We do not see any areas where best practices cannot be developed.

It is important that the definition of stewardship as set out in the current Code be reinforced. We are concerned that stewardship is often seen as applicable in the ESG engagement context only, which undervalues investor efforts to raise issues around the strategy, capital management, performance and other issues material to companies and investors alike. We also believe that investors should be able to provide an explanation where stewardship does not suit certain investment styles and strategies they employ.

Q19. Are there alternative ways in which the FRC could highlight best practice reporting other than the tiering exercise as it was undertaken in 2016?

The main objective of the Code should be to improve stewardship practices; it should be in the self-interest of the signatories to improve their reporting. Tiering of signatories in 2016 was a useful exercise that helped improve stewardship disclosures. In future, differentiation between signatories should be based on explanations of how stewardship is implemented. Establishing best practices against which implementation can be explained should make monitoring easier, and will help asset owners, consultants and other stakeholders to undertake own assessments of investment institutions' stewardship practices.

Q21. How could an investor's role in building a company's long-term success be further encouraged through the Stewardship Code?

An investor's role in building a company's long-term success can be further encouraged through the Stewardship Code in the following ways:

- Definition of stewardship should be strengthened to emphasise all matters that are material to the long-term success of the business. Materiality is critical in defining the focus of engagement, as businesses face different challenges and certain issues may be more material to some than others. There should be no restrictions and no prioritisation of one matter over another.
- Promotion of long-term success of businesses is important for those who invest for the longer-term. The Code should set out best practices for asset owners and advisors that would encourage longer-term approach to monitoring investment performance.

Q22. Would it be appropriate to incorporate 'wider stakeholders' into the areas of suggested focus for monitoring and engagement by investors? Should the Stewardship Code more explicitly refer to ESG factors and broader social impact? If so, how should these be integrated and are there any specific areas of focus that should be addressed?

We do not believe there is a need to specifically incorporate "wider stakeholders" or refer to ESG factors and broader social impacts in the Code. ESG integration is accelerating precisely because ESG factors

and social impacts are becoming more material for the long-term success of businesses. By focusing on material issues with an explicit reference to long-term performance, the Code would encourage monitoring of and engagement on these factors. The effectiveness of stewardship depends on the degree of its integration into the investment process, which can be best achieved by focusing on materiality and not pre-determined specific areas of focus.

Q23. How can the Stewardship Code encourage reporting on the way in which stewardship activities have been carried out? Are there ways in which the FRC or others could encourage this reporting, even if the encouragement falls outside of the Stewardship Code?

Public reporting on engagements and particularly engagement outcomes is difficult as there can be a prolonged period of time between the initial engagement and the desired outcome; it also requires an explanation of the context of and reasons for engagement. Furthermore, success of engagements is based on trust between companies and investors - any requirement to put detailed information on individual engagements in public domain would undermine this trust.

From an asset manager perspective, we believe that all engagement activities should be reported to clients in the context of a specific investment approach. Similarly, outcomes of engagements must be discussed in the context of investment performance, and not as a separate matter. While we do not object to a recommendation that an overview of engagement activities be published, the format and content should be left to the discretion of individual investment institutions.

Q24. How could the Stewardship Code take account of some investors' wider view of responsible investment?

The concept of stewardship is relevant for all investors who are interested in the long-term success of investee companies. We believe that bond-holder engagement should be encouraged alongside shareholder engagement, and would welcome corresponding recommendations in the Stewardship Code.

Q25. Are there elements of international stewardship codes that should be included in the Stewardship Code?

AllianzGI is a signatory to national Stewardship Codes in a number of markets. Our Stewardship Statement already addresses the requirements of all these codes, but it would indeed be helpful if the UK Stewardship Codes were more explicit about the ability for signatories to make statements applicable to a range of codes.

We suggest that the FRC looks at the differences with other national and international codes and include the analysis in the forthcoming consultation for respondents to comment on.

Q26. What role should independent assurance play in revisions to the Stewardship Code? Are there ways in which independent assurance could be made more useful and effective?

Our experience to date points to little added value provided by independent assurance of stewardship statements. We suggest this provision be removed from the Code for now and reviewed again when best practice has emerged, assurance providers have developed a good understanding of how processes and systems should work, and can advise clients accordingly, instead of going through a box-ticking exercise. When it comes to stewardship, systems and processes are secondary to quality and impact, and therefore assurance of the former does not guarantee the latter.

Q27: Would it be appropriate for the Stewardship Code to support disclosure of the approach to directed voting in pooled funds?

Please see our response to Q17. We would support a guidance in the Code as regards the link between voting, engagement and investment decisions. This should be done in the context of setting out respective roles and responsibilities of signatories, who invest directly and, therefore, are responsible for investment decisions, and those who invest via intermediaries.

Separately from the Code, a clarification from a competent regulatory body as regards the entitlement of investors in pooled funds to voting rights in respect of fund holdings proportionate to their share of the fund units, as well as market disclosure and other legal/compliance responsibilities of parties seeking directed voting in pooled funds would be very helpful.

Q28: Should board and executive pipeline diversity be included as an explicit expectation of investor engagement?

No. Please see our response to Q21. Board composition and diversity, including gender balance of boards, is already a key corporate governance issue that is being actively addressed by investors.

Q29: Should the Stewardship Code explicitly request that investors give consideration to company performance and reporting on adapting to climate change?

No. Please see our response to Q21 and Q22.

Q30: Should signatories to the Stewardship Code define the purpose of stewardship with respect to the role of their organisation and specific investment or other activities?

Q31: Should the Stewardship Code require asset managers to disclose a fund's purpose and its specific approach to stewardship, and report against these approaches at a fund level? How might this best be achieved?

We agree that different stakeholders along the investment chain should define the purpose of stewardship as it relates to their specific activities. We do not see a conflict between public firm-level

stewardship statements outlining the asset manager's commitment to stewardship (including approaches to proxy voting and engagement, management of conflicts of interests, escalation processes, etc. applied throughout the firm) and providing fund-level disclosures to asset owners. To be clear, there is no need to replicate the entire stewardship statement at the fund level, but there should be no significant barriers to setting out a fund's approach to stewardship and providing evidence of stewardship activities, if any, by individual funds.

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

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