

Response to FRC Consultation on a revised UK Stewardship Code

Local Pensions Partnership (LPP) welcomes the opportunity to share further insights with the Financial Reporting Council (FRC) as part of its consultation on a revised UK Stewardship Code.

Formed in 2016 as a collaboration between founding shareholders Lancashire County Council and the London Pensions Fund Authority (LPFA), LPP currently manages £17bn of pension assets and provides pensions administration services to more than 580,000 members across Local Government, Police and Firefighters pension schemes.

LPP's investment management and advisory services are provided by LPP Investments Ltd (LPPI) which is a company authorised and regulated by the Financial Conduct Authority. Reflecting the practicalities of the delegation under which LPPI represents, performs stewardship functions and undertakes ownership responsibilities on behalf of pension funds as investment clients, LPP is an Asset Owner signatory to the Principles of Responsible Investment (PRI).

LPP has been in dialogue with the FRC as part of pre-consultation outreach on the revised code during which we emphasised the importance of flexibility and practicality within an approach aimed at simultaneously ensuring strong foundations, encouraging greater transparency and enabling the differentiation of stewardship excellence.

Within earlier feedback we communicated our recognition that at the core of effective stewardship are the relationships, responsibilities and delegations which formalise the management of assets by one party on behalf of another. These exist and are contractualised at different points in the investment chain and arise from and recognise local contexts.

The expansion of the UK Stewardship Code to encompass a broader scope, encourage improved stewardship across multiple dimensions and promote more effective stewardship disclosure is necessary but is inevitably challenging. Our largely positive responses (below) to the specific questions posed by the FRC reflect that a workable future framework has been proposed but, within this, we reflect that further refinements and additional detail are needed, particularly around implementation and regulation.

We remain supportive of the further development of the UK Stewardship Code to achieve the objectives outlined. Our contact for continuing a collaborative dialogue is Frances Deakin, Head of Responsible Investment, LPPI.

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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.

Yes. Collectively, the proposed sections cover the core areas of stewardship responsibility.

However, the FRC's introductory definition of stewardship indicates boundaries for asset owner and asset manager responsibilities which extend considerably beyond the duty to act in the best interests of beneficiaries. As drafted, the definition implies a wider responsibility for both the market and its impact on economy and society.

In practice, asset owners and managers are participants in an investment chain whose actions (undertaken in protection of beneficiary interests) can also and additionally have a positive impact on the market and a wider social benefit, though this is not their primary objective. This is a fundamental point relating to remit and responsibility which the FRC's definition should seek to convey more precisely.

The FRC identifies "a significant shift in governmental and public expectations of the role of the investment community in capital markets and wider society (Proposed Revision to the UK Stewardship Code point 40, p8) but also identifies the primary purpose of stewardship is "looking after the assets of beneficiaries that have been entrusted to the care of others". The focus of the term stewardship is the role and actions of a steward who represents and acts on behalf of another party. Acting in fulfilment of a fiduciary relationship, the primary focus in executing stewardship responsibilities is the promotion and protection of the financial interests of the client.

Asset managers focus on helping clients to achieve their investment objectives on behalf of beneficiaries. These objectives may or may not include wider outcomes than sustainable investment growth.

Encouraging signatories to explain how their beliefs, approach and practices shape their stewardship approach and objectives and how they also contribute to broader socially beneficial outcomes will help to identify evolved stewardship practices as a differentiating factor. However, the FRC's core definition of stewardship should not convey that such additional considerations are a universal fiduciary duty, though they are clearly both important and desirable outcomes.

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

Yes. The principles set sufficiently high expectations in identifying that signatories should publicly disclose the details required to understand and evaluate the quality and sufficiency of their stewardship activity, specifically by:

- articulating the foundations of their stewardship arrangements within their purpose, culture, and operational context;

- indicating how these foundations translate into governance and resourcing arrangements and flow through into policies, procedures, and practices;
- confirming minimum standards in relation to the consideration of ESG factors, active oversight and ownership, constructive engagement, and clear communication;
- reporting on actual activities and outcomes annually (providing examples).

The focus on locating the foundations of stewardship practice within organisational purpose and objectives is an important route for encouraging disclosure which explains the signatory's investment context and how their investment objectives have shaped implementation arrangements.

We particularly welcome the specific reference made to ESG and climate change within the revised code which recognises the evolution of fiduciary duty and the breadth of material risks relevant within the long-term investment horizon of institutional pension funds.

It is a general observation that the draft code as presented is a significant distillation of the detailed consultation literature which comprises a main document and two Annexes. Annex A – Revised UK Stewardship Code - highlights only key points from amongst more extensive considerations given detailed explanation within in the main document. Within the distillation process, the Code loses elements of colour, flavour and intent to achieve brevity. As a standalone document it does not currently contain adequate detail in some areas and would benefit from expansion.

There are gaps and omissions within introductory sections 1-7 of the proposed code which should be addressed to improve understanding and outcomes. Specifically, section 6 on "Becoming a signatory to the Code" is light on guidance around the Policy & Practice Statement which will be a standing record of the signatory's approach, and the measure against which the annual Activities and Outcomes report will be evaluated.

Details on how the FRC (or ARGAs as successor) will evaluate and interact with signatories are also scant, as is the intended basis for assessing the relative quality of stewardship disclosure and the consequences of poor performance.

We suggest that the detailed main consultation document could be usefully repurposed as a companion document to the final code (once agreed) and be a valuable source of detailed insights which facilitate a thorough understanding of the quality of stewardship practice and disclosure required and aid their fulfilment in practice.

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

Yes. This is an appropriate approach which allows necessary flexibility and accepts that different approaches and arrangements will be appropriate dependent on circumstances.

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

Our response to question 2 highlights that detailed discourse laid out in the main consultation document (particularly pages 10 to 20) is very helpful context for achieving an understanding of the reasoning and justification for the individual principles, provisions and what they intend to achieve. Transposing this detail into the guidance or providing it within a companion document would be a worthwhile supplement to the current guidance.

Attention to a clearer differentiation between the roles and responsibilities of asset owners and asset managers would be appropriate under some of the provisions where they are currently being conflated. In particular, acknowledgement that the resourcing available for stewardship will differ significantly between asset owners and asset managers (as a reflection of their different roles and delegations in place) should be reflected within the expectations placed on them.

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

Yes. The aim of the revised code is to better enable stakeholders to evaluate the stewardship practices of different actors in the investment chain and to stimulate a market for evolved stewardship.

An Activities and Outcomes report which supplements the Policy & Practices Statement and includes recent examples of activity is an important means of increasing disclosure, moving the focus away from policy and stimulating regular consideration (by both asset owners and asset managers) of the sufficiency of their approach and the quality of their public reporting on this.

We welcome the recognition that signatories are likely to be disclosing information on their stewardship and responsible investment elsewhere and that it is acceptable to signpost to this content as a part of the fulfilment of the annual duty to disclose against the revised code.

The role of the FRC (ARGA as successor body) should be to encourage disclosure rather than to precisely mandate its form and content beyond requiring that compliance with the principles and provisions is adequately demonstrated.

Following the adoption of a revised code, examples of good practice by individual signatories could be showcased as an indication of the quality being achieved by the most progressive practitioners and as a measure for relative self-assessment.

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

Yes, but we recommend an ongoing review process post the publication of the final code to ensure feedback from signatories around issues arising from

practical implementation is being captured in a responsive way and informing evolving dialogue and guidance.

Q7. Do the proposed revisions to the Code and reporting requirements address the Kingman Review recommendations? Does the FRC require further powers to make the Code effective and, if so, what should those be?

The proposed revised code is a significant step forward from the current code and incorporates some important extensions to scope and expectations, namely that stewardship exists beyond listed equities and is not focussed only on assets in ownership but in the evaluation of opportunities and risks as part of investment selection. The code also embodies a shift in focus away from reporting only on policy to disclosing on practice and outcomes annually in order to support evaluation and the differentiation of stewardship best practice.

The consultation process on the Stewardship Code has been overtaken by events with the announcement that the FRC will be replaced by a successor organisation with a different structure and powers. Regarding the powers needed to make the code effective; the outcome of the initial consultation on the recommendations of the Independent Review of the FRC (which closes in June) will help to inform decision-making on the final powers required by ARGA in this regard.

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

Yes, on the basis that these form the foundations of the approach to stewardship and should be reflected in relationships, responsibilities and objectives which are the context for stewardship arrangements and activity in practice.

However, it should be recognised that the role and responsibilities of asset owners differ from those of asset managers and that the new requirements the code places on owners to articulate and demonstrate will be felt as a significant resourcing burden which will need to be accommodated and addressed over a period of time.

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

The expectation that stewardship (and therefore disclosure) captures dimensions of asset ownership beyond listed equities is clearly made. To the extent further provisions and guidance are warranted to encourage disclosures specific to other asset classes these should reflect and draw upon continuing work by other organisations including UNPRI and BVCA which can contribute informed insights around their work and guidance on current practices.

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?

Yes, the code promotes sufficient transparency and yes, to the extent that they differ materially, signatories should be expected to explain any significant differences in approach between funds and asset classes as part of assisting stakeholders to understand their stewardship arrangements and the contributing influences.

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?

Yes, it is appropriate to ask them to do so, but important that flexibility is allowed for in the manner of explaining these beliefs and interpreting how they feed into stewardship arrangements if the objective of encouraging real insights is to be achieved.

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

Yes, the specification is detailed and extensive.

Provision 14 is an example of conflation between asset owner and asset manager responsibilities referred to in our response to question 4. As drafted it implies an expectation that asset owners will be immersed in the detail of monitoring individual companies which is likely to be logistically impossible but also misses the delegation in place to investment managers who have the resources and appropriate expertise to undertake the monitoring role.

The more appropriate focus for asset owners (provision 16) is on understanding and evaluating the effectiveness of their managers' approach to active monitoring and in establishing their reporting needs in relation to being informed about material issues.

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

Yes. Collaborative engagement is more appropriate terminology as it better expresses the intent to achieve a joint purpose through shared activity.

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

Whilst this is something which merits further investigation it is not without challenges and dependent on multiple factors, some not currently at a stage which support informed consideration. For example, the role and duties of ARGAs and the relationship the new body forms with the investment community will be a critical component of any proposal to be brought forward.

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

Further guidance and examples could be provided as an assistance to encouraging more developed thinking, but the expectation is clear that signatories are required to report on their stewardship in both private and public markets and to explain how oversight operates. This said, the focus of the narrative within the code retains an orientation towards public markets with listed equities and bonds being specifically referenced.

The routes for having influence within private markets are affected by both the investment vehicle (whether the relationship is direct with a company or with/through an investment intermediary) and the scale of the investment and whether this affords representation through a board seat or alternative forum.

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?

The service provider expectations (principles, provisions and guidance) are noticeably less well developed and expressed than the rest of the proposed code. Further work is required here to define with greater clarity what is required as a minimum standard by service providers in the main sectors anticipated to become signatories.

The lack of a direct fiduciary responsibility does not preclude service providers from supporting and directly delivering the stewardship requirements falling on asset owners and asset managers. In practice external providers are the alternative to resourcing delivery internally and should be held accountable to the same standards of stewardship.

Asset owners and managers must explain how they ensure the fulfilment of stewardship responsibilities of an appropriate quality when using external providers. The counter balance to this is to require service providers to explain how they respond to and meet the requirements asset owners and managers have of them and how their services differentiate them as appropriate stewards on behalf of investment clients with a fiduciary duty to protect the financial interests of beneficiaries.

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