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By email: stewardshipcode@frc.org.uk

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Dear Sir / Madam

Stewardship Code Consultation

The Chartered Governance Institute is the professional body for governance and the qualifying and membership body for governance professionals across all sectors. Its purpose under Royal Charter is to lead effective governance and efficient administration of commerce, industry, and public affairs working with regulators and policymakers to champion high standards of governance and providing qualifications, training, and guidance. As a lifelong learning partner, the Institute helps governance professionals achieve their professional goals, providing recognition, community, and the voice of its membership.

One of nine divisions of the global Chartered Governance Institute, which was established 130 years ago, the Chartered Governance Institute UK & Ireland represents members working and studying in the UK and Ireland and many other countries and regions including the Caribbean, parts of Africa and the Middle East.

As the professional body that qualifies Chartered Secretaries and Chartered Governance Professionals, our members have a uniquely privileged role in companies' governance arrangements. They are therefore well placed to understand the issues raised by this consultation document. In preparing our response we have consulted, amongst others, with our members. However, the views expressed in this response are not necessarily those of any individual members, nor of the companies they represent.

Our views on the questions asked in your consultation paper are set out below.

General comments

Overall, we agree with a lot of the proposed changes to the Stewardship Code. These have clearly been the outcome of a lot of thought and, as the consultation paper makes clear, feedback from many stakeholders.

However, we do have two central problems with the proposed new Code; one specific, the other perhaps more existential.

The first of these is a specific concern about the proposed new definition of stewardship. We have dealt with this in more detail in our response to your question 1 below. Suffice it to say here that we are concerned by the approach being taken.

In our response dated 29 March 2019 to the last consultation on Proposed Revisions to the UK Stewardship Code, we commented on the then proposed definition: 'The original Code led to significant improvements in voting by institutional investors, leading to a clearly differentiated approach and increased engagement. The new definition of Stewardship is extremely broad and appears to be seeking to capture all types of investment, potentially leading to very long reports which include a lot of detail, much of which will add little value. It does not seem to be focused on a clearly stated problem that the proposed changes are seeking to solve. It is therefore not clear what would be successful outcomes or how they might be measured.' It seems to us that these concerns have been borne out by the feedback you have received and that the new definition is an attempt to reduce the amount of detail required in reporting by signatories.

We believe that you have gone too far. The proposed definition is a very good definition of one element of stewardship, but its focus on the fiduciary stewardship of client monies disregards the other element – the stewardship responsibilities to wider society as owner of a company. It is this element of the definition of stewardship on which much UK corporate law is based, particularly the concept that owners have a responsibility to step in where their agents, the directors, are mismanaging the company. There are some really strong sections in the proposed Code dealing with engagement and the reporting of engagement but, under the proposed definition, disinvestment rather than engagement may be the appropriate step. This undermines one core purpose of effective stewardship and risks diluting its important role in our economy and society.

Under the Companies Act, the directors of a UK company are required to act 'in the way [they consider], in good faith, would be most likely to promote the success of the company for the benefit of its members

as a whole', having regard to the interests of various stakeholders and 'the need to act fairly as between members of the company.' The proposed definition of stewardship, limits it to 'the responsible allocation, management and oversight of capital to create long-term sustainable value for clients and beneficiaries'. Of course, this may all be the same thing, but it isn't always and creates a risk that directors and investors may be pulling in different directions.

We urge the FRC to reconsider the proposed changes and ensure that the definition of stewardship properly reflects its importance for society, the economy, and the environment.

As to our second, more overarching concern, one of the criticisms of the original Stewardship Code was that it lacked 'teeth'; that there was little disadvantage to those investors who chose not to become signatories, or even to those who did become signatories but did not pay more than lip service to the requirements of the Code.

The feedback that we got from members was that the Stewardship Code helped good stewards to be even better, but did little to raise the standards of those who were poor stewards, as they could largely, or entirely, ignore it without penalty. Feedback from members is that this has changed little – good stewards are still good stewards; poor stewards are still poor stewards. This is very different from the position of listed companies reporting against the UK Corporate Governance Code. It is probably beyond your remit but, in the same way that the FCA mandates that listed companies comply or explain against the UK Corporate Governance Code, we believe that it should mandate that regulated investors comply or explain against the UK Stewardship Code. We regularly hear of investors who decline to engage with companies on a raft of issues and, in our view, there should be a mechanism for companies to refer such investors for regulatory sanction where appropriate.

Linked to that is our concern about the revised Code lowering the reporting requirements for signatories. We can entirely understand and accept that, if investment clients do not use some elements of stewardship reporting, it is reasonable to reduce these requirements. However, there are significant elements of reporting to comply with company law and, dare we suggest it, the UK Corporate Governance Code about which the same might be said. We are concerned that perhaps a little too much weight has been given to representations from investors that reporting is onerous, and not enough to the good that is served by the discipline of that reporting.

Specific questions asked in the consultation form

1. Do you support the revised definition of stewardship?

We strongly oppose the revised definition of stewardship, which we believe reduces stewardship to little more than a fiduciary duty, which is the bare minimum legally required. It suggests that firms only need to consider their 'clients and beneficiaries'.

As explained above, we see this as a very good definition of one element of stewardship, but this focus on the fiduciary stewardship of client monies disregards the other element – the stewardship responsibilities to wider society as owner of a company. Much UK corporate law is based on the principle that investors will act responsibly and step in when management are mismanaging a company. There are some really strong sections in the proposed Code dealing with engagement and the reporting of engagement but, under the proposed definition, disinvestment rather than engagement may be the appropriate step. This undermines one core purpose of effective stewardship and risks diluting its important role in our economy and society.

Under the Companies Act, the directors of a UK company are required to act 'in the way [they consider], in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole', having regard to the interests of various stakeholders and 'the need to act fairly as between members of the company.' The proposed definition of stewardship, limiting it to 'the responsible allocation, management and oversight of capital to create long-term sustainable value for clients and beneficiaries'. Of course, this may all be the same thing, but it isn't always and creates a risk that directors and investors may be pulling in different directions.

Good stewardship is good not only for investors but also for companies and for the broader environmental, social, and economic context, including its role in driving economic growth. The explanatory paragraph under the definition mentions that stewardship 'supporting sustainable, long-term returns may lead to wider benefits for the economy, environment, and society'. This is inadequate. These elements should be directly included in the definition itself.

We understand that the FRC aims to 'appropriately reflect developing stewardship practice', covering a range of market participants and investment philosophies. Reducing stewardship to just fiduciary duty does not achieve this goal. Good stewardship should be seen as a competitive differentiator, setting those who commit to it and deliver on that commitment apart from those who do not. The FRC has stated that it aims to 'maintain the Code's global standing'. However, the proposed definition undermines

this objective. By reducing stewardship to fiduciary duty, the definition loses the ambition that is key to the Code's respected global position.

Finally, the justification for the proposed changes, which claims that 'some stakeholders' have interpreted the previous 2020 definition as positioning ESG as the primary objective of stewardship, is not sufficient. The views and agendas of these stakeholders do not justify significantly watering down the concept of stewardship. What is needed is broader education on the purpose and value of stewardship. We urge the FRC to reconsider the proposed changes and ensure that the definition of stewardship properly reflects its importance for society, the economy, and the environment.

Our suggested definition is: 'Stewardship is the responsible allocation, management and oversight of capital to create long-term sustainable value for clients and beneficiaries, recognising their responsibilities as owners to ensure that their investee companies activities benefit society at large through collaborative, two-way engagement on company-specific topics with appropriate escalation.'

2. **Do you support the proposed approach to have disclosures related to policies and contextual information reported less frequently than annually? If yes, do you support the approach set out above?**

We support this approach. It aligns with the FRC's aim of avoiding the imposition of 'onerous reporting burdens' on signatories (p. 4, para 8 of the consultation document).

Regarding the submission of the Policy and Context Disclosure, the suggestion that this will be reviewed by the FRC every three years, with updates by the signatory 'only as necessary', makes sense. The proposal states that 'it will be for signatories to determine minor amendments and those that are more significant' (p. 7, para 29). However, we recommend that the FRC provides further guidance and examples on what it considers to be significant amendments. This would help signatories make more informed decisions about when updates are necessary and ensure consistency in reporting.

Additionally, we believe there should be greater transparency regarding how the FRC will assess and referee signatories' disclosures under the proposed reporting system. Clearer information on this process would promote confidence and accountability among signatories.

3. **Do you agree that the Code should offer 'how to report' prompts, supported by further guidance?**

We agree that the proposed changes make the Code more streamlined. However, not all the 'how to report' prompts in the draft are clear and unambiguous. These should be tested with stakeholders to ensure they are fully understood and actionable.

There are specific examples where clarity is needed, as detailed below. The page numbers refer to 'Appendix B: Proposed Updated UK Stewardship Code':

- **Page 17, Policy and Context Disclosure, Point a):** The prompt 'how the above information influences your approach to stewardship' is important and should be highlighted in bold to ensure its importance is clear.
- **Page 18, Policy and Context Disclosure, Point b):** The prompt 'your approach to diversity and inclusion within your organisation' is very broad and its direct relevance to stewardship is unclear. There is significant variation in the level of diversity, equity, and inclusion (DEI) activity and policies across organisations, and it is not clear how much detail should be included here.
- **Page 19, Policy and Context Disclosure, Point d):** The current prompts do not sufficiently address conflicts of interest. While having a conflicts of interest policy is important, it is not enough. Asking signatories to report on hypothetical examples of conflicts and how they would manage them is unrealistic and unhelpful, as signatories could easily create fictitious examples and responses.
- **Page 20, Activities and Outcomes Report, Introductory Statement:** This section feels like a repetition of the Policy and Context Disclosure and could be more concise to avoid redundancy.
- **Page 20, Activities and Outcomes Report, Principle 1:** More guidance is needed here to clarify what types of examples are required and how many examples are necessary to 'show how you have integrated stewardship activities and investment processes.'
- **Page 27, Activities and Outcomes Report for Service Providers, Principle 2:** The prompt 'Explain how you have ensured the quality and accuracy of research or recommendations and responded where stakeholders have requested to engage' is likely to lead to vague disclosures. More importantly, it places the onus for engagement on other stakeholders, rather than on the service provider. It should be made more explicit or accompanied by more detailed guidance to support clearer reporting. It should also require proxy advisers to report on how they have engaged with issuers to ensure that their research and voting recommendations are as accurate as possible, how they have taken issuer explanations for deviation from the UK Corporate Governance Code into account, and state how they deal with inaccuracies reported to them.

The guidance will be very important and, as such, it may be helpful to have a formal consultation on the initial guidance, although we accept that, in the interests of ease of update, it may not be appropriate to make every subsequent change subject to consultation. That said, it must be remembered that there are conflicting views about many of these issues. At a minimum, we suggest that the guidance be developed with input from a broad range of stakeholders through informal engagement opportunities, such as roundtables or feedback on draft versions. The Institute would be happy to support this process and provide our comments.

Finally, we thought the structure of the specimen guidance in appendix D, with its 'questions to consider' box, very helpful. It provides a useful framework for addressing the key areas of stewardship.

4. **Do you agree that the updated Code for Asset Owners and Asset Managers should have some Principles that are applied only by those who manage assets directly, and some that are only applied by those who invest through external managers?**

Yes.

5. **Do the Principles of the updated Code better reflect the different ways that stewardship is exercised between those who invest directly, and those who invest through third parties?**

Yes, the updated Principles of the Code better reflect the different ways stewardship is exercised between those who invest directly and those who invest through third parties. By recognising these distinctions, the Code acknowledges that the responsibilities and approaches to stewardship may vary depending on the type of investment strategy employed. For direct investors, there is a greater emphasis on direct engagement and oversight of investee companies, while for those who invest through third parties, the focus is more on ensuring that third-party managers and service providers align with the signatory's stewardship principles. This tailored approach ensures that both groups are held to the same high standards of stewardship, while also taking into account the practical realities of their respective investment models. The revised Code also provides flexibility for signatories to adapt their stewardship practices to their specific investment approach, which should improve the overall relevance and applicability of the Code for a diverse range of market participants.

6. **Do you agree that the updated Service Providers' Code should have some Principles that are applied only by proxy advisors, and some that are only applied by investment consultants?**

Yes, this approach makes the principles of the Code more specific and directly applicable. Since these two groups have different functions in the market, it is logical to tailor the Code to suit their distinct roles.

7. **Do the streamlined Principles capture relevant activities for effective stewardship for all signatories to the Code?**

No, we believe the proposed changes have significantly weakened the Code. To some extent, this is because the rest of the Code builds on the definition of stewardship outlined at the start, and the diluted definition has had a major impact on the principles that follow. These principles no longer capture the full scope of activities necessary for effective stewardship.

In particular, Principle 2, which addresses market-wide and systemic risks, is potentially less stringent. The definition of market-wide and systemic risks in the current Principle 4 explicitly covers some very important issues and, if not included in the Code should at the very least be included in the guidance to require reporting of what signatories are doing to protect their clients against changes in interest rates; geopolitical issues; currency rate fluctuation; climate change; and the failure of a business or group of businesses etc. Market-wide and systemic risks cannot be tackled by individual market participants alone, which is where collaborative engagement plays a crucial role (as discussed in the next point).

Principle 3, which focuses on engagement, has also been significantly diluted. The revised version limits engagement to the goal of 'maintaining and enhancing asset value'. However, engagement often aims to achieve other objectives, such as improving governance. While we do not oppose the idea of combining the previously separate principles on engagement, collaborative engagement and escalation, this should only be done if the core content of each principle is preserved. Again, this is a product of the flawed definition of stewardship and the concatenation of these principles risks creating the impression that engagement is not a fundamental element of good stewardship. It is, for example, possible that, for some signatories, disinvestment will be preferable to engagement as a better use of client funds.

We would also have liked to see clear requirements as to how signatories report on engagement. Our members regard engagement between investors and investee companies as a key element of the effective functioning of the stewardship role. To be clear, there are many investors who are good stewards and whose engagement with their investee companies is greatly valued. But codes and regulation are not designed to apply standards to those who already do a good job, but to create a

minimum performance standard for those who don't. Consequently, we believe that the watering down of the principles relating to engagement is a missed opportunity to help those who currently do not engage well to understand what responsible ownership looks like. While we recognise that there is a range of approaches amongst investors and that there will be no one size fits all, clear reporting on engagement would enable issuers, asset owners and others to hold signatories to account and to test whether engagement has been timely, consistent and effective.

All that said, we support some aspects of the streamlining process. For example, combining the principles on the 'selection and oversight of external managers' with those on 'monitoring service providers' seems to be a positive development.

Finally, this seems an appropriate place to mention the role of proxy advisers. We still get feedback from members that their experience of proxy advisers is that they do not all fully embrace the comply or explain ethos of the UK Corporate Governance Code.

In our response to question 3 above, commenting on the helpful 'how to report' prompts included in the Code, which we understand will be supported by further guidance, we suggested additions to the prompt 'Explain how you have ensured the quality and accuracy of research or recommendations and responded where stakeholders have requested to engage' on Page 27 of the consultation document, Activities and Outcomes Report for Service Providers, Principle 2. We believe that this section should also require proxy advisers to report on how they have engaged with issuers to ensure that their research and voting recommendations are as accurate as possible, how they have taken issuer explanations for deviation from the UK Corporate Governance Code into account, and state how they deal with inaccuracies reported to them. As drafted, this prompt also places the onus for engagement on 'other stakeholders' rather than on the service provider.

8. **Should signatories be able to reference publicly available external information as part of their Stewardship Code reporting, recognising this means Stewardship Code reports will no longer operate as a standalone source of information?**

Yes, signatories should be allowed to reference publicly available external information as part of their Stewardship Code reporting. This approach would enable signatories to build upon a wider body of evidence and insights, thus enhancing the transparency and comprehensiveness of their stewardship activities. However, this shift should be handled carefully to ensure that the Stewardship Code reports do not lose their effectiveness as a standalone document. To address this, the FRC could provide clear guidance on how signatories should balance the use of external sources with their own disclosures,

ensuring that the reports remain clear, focused, and directly relevant to the principles of the Code. Importantly, referencing external sources should not diminish the accountability and specificity expected from signatories within their Stewardship Code reports.

9. Do you agree with the proposed schedule for implementation of the updated Code?

Yes.

If you would like to discuss any of the above comments in further detail, please do feel free to contact me.

Yours faithfully,

Peter Swabey
Policy and Research Director
The Chartered Governance Institute UK & Ireland