INVESTMENT ASSOCIATION RESPONSE

FRC CONSULTATION ON A REVISED UK STEWARDSHIP CODE

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The Investment Association is a company limited by guarantee registered in England and Wales. Registered number 04343737. Registered office as above.

ABOUT THE INVESTMENT ASSOCIATION

The Investment Association is the trade body that represents UK investment managers, whose 250 members collectively manage over £7.7 trillion on behalf of clients.

Our purpose is to ensure investment managers are in the best possible position to:

- Build people's resilience to financial adversity
- Help people achieve their financial aspirations
- Enable people to maintain a decent standard of living as they grow older
- Contribute to economic growth through the efficient allocation of capital

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks & shares ISAs.

The UK is the second largest investment management centre in the world and manages 37% of European assets.

Investment Association (IA) members hold in aggregate, one third of the value of UK publicly listed companies. We use this collective voice to influence company behaviour and hold businesses to account. More information can be viewed on our website.

1. EXECUTIVE SUMMARY

The Stewardship Code (the 'Code') is an important tool for setting best practice standards for stewardship in the UK. Since its inception it has played an important role in setting expectations and driving up standards.

The FRC should have clear objectives for what an effective market for stewardship looks like and how the revised Code will contribute to its development - the FCA/FRC joint discussion paper "Building a regulatory framework for effective stewardship" provides a compelling framework for a good market for stewardship.

A revised Code should contribute to a good market for stewardship by setting clear best practice standards for all market participants to aspire to, being clear on the differing roles and responsibilities of asset owners and asset managers (and other market participants) and promoting transparent reporting that enables signatories to demonstrate the outcomes of their stewardship activities and clients and beneficiaries to hold them to account.

The proposed Code makes some progress towards developing an effective market for stewardship. We strongly welcome the direction of travel and the broad changes to the Code that have been proposed. We particularly welcome the intention to:

- Develop signatories' disclosures on their approach to stewardship across all asset classes. Stewardship can facilitate sustainable value creation across all asset classes.
- Introduce a new 'Activities and Outcomes' report. Done effectively, this will start to shift the focus away from policies and processes and towards the outcomes of stewardship, and will be an important accountability mechanism for asset owners.
- Adapt the Code to set explicit standards for stewardship at different junctures in the investment chain, in particular by setting more demanding expectations of asset owners. This is essential to creating demand for stewardship.
- Explicitly reference Environmental, Social and Governance (ESG) factors – this is an important development that reflects market best practice.
- Require signatories to coordinate their approach to stewardship with their firms' overarching objectives and governance, and integrate stewardship into the investment process.

However, we have a number of concerns with how these important developments have been drafted. If not addressed, these will result in a Code that hinders the development of an effective market for stewardship. In particular:

1. **Definition of Stewardship:** The new proposed definition of stewardship conflicts with asset managers' and asset owners' fiduciary duty to clients and beneficiaries.
2. **Activities and Outcomes**: The Code is too prescriptive about certain policies and processes, and doesn't have sufficient emphasis on improving outcomes for clients and beneficiaries.
3. **Stewardship for active and index strategies:** The Code doesn't have sufficient flexibility to be adopted across different investment strategies. It assumes that good stewardship can only be achieved by active management, when in fact stewardship forms an essential component of both index and active management strategies.
4. **Differentiation of the roles and responsibilities of asset owners and asset managers:** The Code conflates the roles and responsibilities of asset managers and asset owners; this may dis-incentivise asset owners from becoming signatories.

Alongside new, relevant content that drives best practice, the Code needs to be complemented by an appropriate role for 'ARGA', the regulatory body that will replace the FRC, in terms of monitoring and assessing the quality of signatories' reporting. This will be essential to promoting the integrity of the UK stewardship market. Investors need to have

confidence that the new regulatory body has the expertise, resources and effectiveness to drive best practice.

The revision of the UK Stewardship Code is a crucial step in helping to create a more effective market for stewardship. The proposed Code is being developed amidst a number of significant reforms in the stewardship market, including the implementation of the Revised Shareholder Rights Directive (SRD II), which will help set minimum standards for all market participants; the reform of the FRC itself, and a number of questions pertaining to the appropriate regulatory approach to stewardship. The FRC needs to take stock of these developments before publishing the new Code to ensure that it provides a holistic and coherent approach to stewardship.

Our concerns are summarised below and set out in more detail in our responses to the particular questions in this consultation. With careful redrafting, we believe that this Code can deliver on expectations and make a significant contribution to a better market for stewardship.

1. **Definition of Stewardship**

The Stewardship Code needs to be built around a definition of stewardship that captures the *central purpose* of stewardship, which our members believe is to generate sustainable value for the beneficiaries of the investment process, the end owners of capital. By *sustainable value*, we mean sustainable over the relevant time horizons for beneficiaries – both short and long term. This definition also needs to provide a framework where different approaches to stewardship across different investment strategies, asset classes and across the investment chain are legitimised – it needs to work for asset owners, both index and active strategies, as well as asset managers acting on behalf of both institutional and retail clients. Getting this definition right will help savers and the public to understand what stewardship is and the important role it plays in creating sustainable value for beneficiaries; this will in turn help to facilitate greater demand for it.

The new definition of stewardship proposed in this consultation conflicts with asset managers' and asset owners' fiduciary duty to clients and beneficiaries; this will ultimately hinder rather than promote the development of an effective market for stewardship. We propose amending the definition to read as follows:

"Stewardship involves the responsible allocation and active oversight of assets by different actors across the investment chain to generate sustainable value for beneficiaries. Effective stewardship should lead to long-term benefits for society and the economy."

The FRC needs to make a clear statement accompanying the definition that different actors in the investment chain have differing roles and responsibilities when it comes to stewardship – they are not all expected to play a role in both oversight and allocation. For example, asset owners should not necessarily be expected to provide active oversight of individual companies, as that role is typically delegated to their asset managers. Asset owners typically focus on allocation. Index strategies, where asset allocation is driven by the constituents of their chosen index, do not have a role in allocation in the way active managers do; their role is typically focused on oversight. While active managers do play a role in both allocation and oversight, a large proportion of active managers' stewardship activity is focused on oversight.

The IA proposed definition:

- Respects asset owners' and asset managers' fiduciary duty whilst recognising the interdependence between good stewardship and benefits to society and the economy over the long term.

- Recognises the role of stewardship in terms of the allocation of assets (for some actors) without neglecting the importance of active oversight of assets, which leads to sustainable value creation.
- Underpins the varying roles of stewardship across the investment chain, including asset owners and different types of asset managers, including both index strategies and active investors.

2. Activities and Outcomes

The Code should be focused on how to improve effective disclosure and reporting on outcomes; this is the key shift in approach recommended by the Kingman Review and that the IA has been advocating for some time. It has not yet achieved this – the Code is still too focused on prescriptive guidance on policies and processes.

Disclosures ought to be underpinned by the definition of stewardship and should clearly articulate how stewardship is generating sustainable value for beneficiaries.

The IA's Stewardship Reporting Framework contains recommendations for how asset managers' can make public disclosures on the outcomes of stewardship and is informed by market best practice. Disclosures ought to be underpinned by the definition of stewardship and should clearly articulate how stewardship is generating sustainable value for the beneficiary.

3. Stewardship for active managers and index strategies

Stewardship is an invaluable tool which helps asset managers generate sustainable value for beneficiaries, irrespective of their investment strategy. Active and index strategies use stewardship at different points in the investment process. For example, while index strategies do not use stewardship to inform buy and sell decisions, as long-term holders of companies in the constructed index they use oversight, engagement and the exercise of voting rights where relevant to ensure the long-term quality and performance of the assets held.

In a number of places the Code appears to implicitly assume that an active management model is the only way to deliver stewardship. The emphasis on investment *decision making* assumes an option to buy or sell. The Code should instead to refer to the investment *process*, to reflect the important role that stewardship plays in generating sustainable value in different investment strategies.

4. Differentiation of the roles and responsibilities of asset owners and asset managers.

A key mark of success for the new Code is whether it encourages asset owners to generate better demand for and distinguish excellence in stewardship. However, certain Provisions conflate the roles and responsibilities of asset managers and asset owners, resulting in expectations for asset owners to carry out stewardship activities that are typically delegated to their asset manager. This may deter asset owners from becoming signatories to the Code.

2. INTRODUCTION

Asset managers help their clients – whether individuals or institutions – achieve their investment objectives. These objectives can be financial, for instance to retire with enough money to live on, and can also be non-financial, such as to invest in companies, governments or projects that have a specific social or environmental benefit. Different clients have different investment objectives according to the investment needs of their beneficiaries. Stewardship plays a central role in generating sustainable value for these beneficiaries through responsible allocation and the active oversight of client assets. It can also play an important role in meeting other investment objectives as per the client mandate.

A good market for stewardship

Our members consider a good market for stewardship to have a number of critical features.

Good stewardship is underpinned by a clear objective to generate sustainable value for beneficiaries. This can be achieved by integration of stewardship across the relevant stages of the investment process. For index strategies, this involves oversight of the assets held to improve their performance and quality and using ownership rights such as voting to ensure that the interests of company management and beneficiaries are aligned. For active managers, this will also involve researching and selecting assets and making decisions to sell. For asset owners this ranges from identifying their investment beliefs and asset allocation strategy, to researching, identifying and selecting asset managers, to monitoring the performance and quality of those managers in terms of both financial returns and the outcomes of their stewardship activities.

To generate sustainable value for beneficiaries, stewardship involves oversight and engagement on the *material* issues that will impact on sustainable value of the asset. This can include issues like strategy and financial performance, audit and accounting, capital management and remuneration as well as environmental, social and governance issues such as climate change, human capital and diversity. This is not a definitive list - investors will focus on the relevant and material issues for the asset under consideration at that time. Different investors may take a different view on which material issues should be focused on for the particular asset, and may take a fund-specific approach. Some will determine this on a sector-specific basis; others will have minimum standards for certain issues for different assets, and others will determine which issues pose the greatest risk to the company.

Asset managers will also decide which particular stewardship activities will be most effective for the asset under consideration and at which time. These activities may include monitoring, engagement, escalation of engagement, exercising of rights and responsibilities, and in the case of active managers, making buy or sell decisions.

In a good market for stewardship, asset managers actively demonstrate the outcomes of their stewardship activities by demonstrating how it has helped to generate sustainable value for beneficiaries. They are transparent about these activities and held accountable by their clients as well as the general public in recognition of their responsibilities as market participants. There also needs to be clear demand from asset owners. This demand directs asset managers to dedicate sufficient resource to stewardship activities and ultimately drives up standards across the industry as asset managers compete to differentiate themselves from their peers. Asset owners help generate this demand by making stewardship an explicit part of their expectations of asset managers in their selection process and contractual arrangements.

Current barriers

While the UK has one of the world's most advanced stewardship markets, we believe that there is more that can be done to develop this market and ensure it is working harder to generate sustainable value for savers. The IA has been advocating for some time for

developments in the UK stewardship market to raise standards and help create a better market for stewardship[1]. In particular, we have recommended that there needs to be:

- Better and more consistent public disclosure of stewardship activities by asset managers. By being more open about how they conduct stewardship, investors can help to create awareness of the value of stewardship and allow clients to identify the different approaches of different asset managers.

- A clearer shift in focus away from policies and towards activities and outcomes. The expectation that the Stewardship Code would help to facilitate this shift was set out clearly by Sir John Kingman in his independent review of the FRC.

- Clearer alignment of incentives across the investment chain to focus on long-term value creation. In particular, a more demanding and discerning client base and better inclusion of stewardship in asset owners' expectations of asset managers. This will help increase competition in the industry and drive forward best practice in stewardship.

- A clearer focus on long-termism in line with the investment horizons of beneficiaries – this will help to ensure that stewardship is focused on the issues that will impact on assets' ability to generate sustainable value over the short and long term.

The Stewardship Code plays an important role in realising these changes. In recent years, it has become clear that the Code could be improved to ensure that it keeps up with evolving standards of best practice and actively contributes to creating an effective market for stewardship. Our annual Stewardship Survey and recent assessment of signatories' disclosures against our Stewardship Reporting Framework indicate that asset managers in the UK are not limiting their stewardship activities to the requirements set out in the current Code. Ways in which these managers are going further in their stewardship activities include:

- Conducting stewardship across a range of asset classes, not only listed equities;
- Integrating stewardship across the investment process; and
- Dedicating resource to collective engagement and escalation with companies, i.e. not just voting and associated policies.

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[1] Please see:

- Recommendations relating to stewardship in our Productivity Action Plan.
- Our Response to BEIS' consultation on the Corporate Governance Code.
- Our Response to BEIS' consultation on Insolvency and Corporate Governance.

3. RESPONSES TO QUESTIONS

Q1: DO THE PROPOSED SECTIONS COVER THE CORE AREAS OF STEWARDSHIP RESPONSIBILITY? PLEASE INDICIATE WHAT, IF ANY, CORE STEWARDSHIP RESPONSIBILITIES SHOULD BE ADDED OR STRENGTHENED IN THE PROPOSED PRINCIPLES AND PROVISIONS.

The IA agrees that the sections of the Code set out below reflect essential aspects of stewardship:

- Purpose, Governance and Objectives
- Investment Approach
- Active Monitoring
- Constructive Engagement and Clear Communication
- Exercises Rights and Responsibilities.

However, we are not supportive of the definition of stewardship that these Principles are built upon. We set out why we think the proposed definition will hinder the development of an effective market for stewardship and propose an alternative definition below.

We have also made a number of recommendations for how the Principles and Provisions could be strengthened or amended. In summary, we think the Principles and Provisions can be strengthened to:

- Provide a greater focus on transparent disclosure to reflect reporting on outcomes and activities rather than on policies.
- Ensure that compliance with the Code allows for a focus on material issues rather than encouraging a compliance driven, tick box approach to stewardship, in particular with regard to material ESG issues and the reflection of an organisation's purpose, governance and objectives.
- Make a clear distinction between the roles and responsibilities of asset owners and asset managers.
- Better reflect the important role of oversight and escalation in stewardship activities.
- Make the use of key terms and definitions clearer and more consistent.

Definition of Stewardship

We propose amending the definition of stewardship set out in the draft Code to read as follows.

"Stewardship involves the responsible allocation and active oversight of assets by different actors across the investment chain to generate sustainable value for beneficiaries. Effective stewardship should lead to long-term benefits for society and the economy."

The FRC needs to make a clear statement accompanying the definition that different actors in the investment chain have differing roles and responsibilities when it comes to stewardship – they are not all expected to play a role in both oversight and allocation. For example, asset owners should not necessarily be expected to provide active oversight of individual companies, as that role is typically delegated to their asset managers. Asset owners typically focus on allocation. Index strategies, where asset allocation is driven by the constituents of their chosen index, do not have a role in allocation in the way active managers do; their role is typically focused on oversight. While active managers do play a role in both allocation and oversight, a large proportion of active managers' stewardship activity is focused on oversight.

This definition builds on the existing definition of stewardship in terms of reflecting the roles and responsibilities of stewardship across the investment chain, and:

- Respects asset owners' and asset managers' fiduciary duty whilst recognising the interdependence between good stewardship and benefits to society and the economy over the long term.
- Recognises the role of stewardship in terms of the allocation of assets (for some actors) without neglecting the importance of active oversight of assets, which leads to sustainable value creation.
- Underpins the varying roles of stewardship across the investment chain, including asset owners and different types of asset managers, including both index strategies and active investors.

Conflict with fiduciary duty

The definition of stewardship in the 2012 Stewardship Code assumes the primacy of beneficiaries - that is, that the ultimate purpose of stewardship is to benefit beneficiaries. The new definition however puts the benefit of society and the economy on an *equal footing* with the benefit of beneficiaries. This is in conflict with asset managers' fiduciary responsibilities towards their clients. Whether this is consistent with other asset owners duties toward their beneficiaries will depend on their particular investment objectives. For example, some sovereign wealth funds or charities may have particular environmental and social investment objectives; pension fund trustees have a fiduciary duty to their scheme beneficiaries. Either way, the asset manager's mandate is driven by the particular investment objectives of their client, which will reflect the investment objectives of the asset owners' beneficiaries. This will be articulated in the contract between the asset owner and asset manager.

Nevertheless, to generate long-term value for beneficiaries, it is important for asset managers to have regard to the impact of their investment activities on the society, environment and economy and to factor this impact into the investment process Asset managers may incorporate these factors into their investment processes by assessing the material Environmental, Social and Governance risks and opportunities that an asset presents. This may inform their selection of assets if they are an active manager and their approach to engagement with and oversight of these assets according to their investment strategy. This is essential to generating sustainable value for their clients and their beneficiaries. As a result, in the long term, we expect stewardship to have a positive impact on the society and the economy, regardless of whether this is a particular investment objective of beneficiaries. Our members also recognise the interdependence of these factors - over the long-term, a healthy society and economy will contribute to the financial wealth of beneficiaries. Different asset managers and asset owners will draw on this interdependence to varying degrees in their investment beliefs and objectives. Increasingly asset owners are formally reflecting in their investment beliefs on the world that beneficiaries retire into.

It is important to note that in some circumstances there may be a conflict between the investment benefits for beneficiaries and the impact on society and the economy of a particular investment. It is important to draw from the learnings of the Law Commission's investigation into this area for pension funds, when considering the implications for the definition of stewardship.

Asset managers' duties are towards their clients – they take account of material Environmental, Social and Governance issues to help generate sustainable value for beneficiaries. They cannot prioritise sustainable value for society or the economy over beneficiaries, unless their clients explicitly mandate them to. This means that where a conflict between these areas arises, the impact on client and/or beneficiaries has to take priority. This is not reflected in the proposed definition, which introduces a conflict with

fiduciary duty. Careful consideration should be given to the legal ramifications of imposing additional duties on financial market participants. The FRC and FCA would need to initiate a much broader and transparent conversation to understand whether this would be appropriate or practical.

Our proposed definition avoids this conflict by maintaining the primacy of beneficiaries, whilst recognising the importance of the longer-term impact of stewardship on the economy and society and the interdependence between these factors.

The importance of active oversight

The new definition neglects the important role of the active oversight of assets by asset managers in stewardship. One of the fundamental roles of asset managers is to hold companies to account and promote their ability to create sustainable value over the long term. This often means engaging with companies to reform practices which are inherently short term. The second sentence of the proposed definition alludes to this role in terms of the kinds of activities that constitute stewardship - "Stewardship activities include monitoring assets and service providers, engaging issuers and holding them to account on material issues, and publicly reporting on the outcomes of these activities."

However, by not pointing to this important role in the first sentence, setting out what stewardship *is,* we are concerned that the resulting definition is misleading, implying that capital allocation is more important than oversight, when in fact both are critical to generating sustainable value for beneficiaries. It also implies that the role of stewardship is limited to those actors that are actively involved in the selection of assets – this excludes index strategies whose emphasis in stewardship is necessarily on oversight.

We recognise that this emphasis on allocation may have resulted from an attempt to incorporate the role of asset owners in the new definition. We agree that the existing definition should be broadened to recognise the important role of asset owners in the investment chain. However, the new definition should recognise the roles and responsibilities of both asset owners and asset managers in terms of both capital allocation and oversight.

IA proposed definition

A new definition needs to be developed to address both these concerns. The combined effect of conflicts with fiduciary duty and neglecting the importance of oversight is to encourage disclosures that are potentially misleading about the actual role that stewardship plays; this is at odds with the desire to encourage accurate disclosure about the actual outcomes achieved, which will drive differentiation in excellence in stewardship.

Our proposed definition addresses these concerns and we believe will better promote an effective market for stewardship.

"Stewardship involves the responsible allocation and active oversight of assets by different actors across the investment chain to generate sustainable value for beneficiaries. Effective stewardship should lead to long-term benefits for society and the economy."

To clarify the kinds of activities that could be designated stewardship, it is helpful, but not essential, to add "Stewardship activities include oversight of assets and service providers, engaging issuers and holding them to account on material issues, and publicly reporting on the outcomes of these activities" as per the consultation's proposed definition.

Section 1 - Purpose, Governance and Objectives

It is important that the Principles and Provisions underpinning this section support meaningful disclosures, rather than a tick-box, compliance driven approach to stewardship.

We are supportive of the expectation that institutional investors coordinate their approach to stewardship with the overarching objectives and governance of their firms.

However, we have some concerns with how this will be implemented in practice. While this presents a helpful opportunity for asset managers and owners to set out how their approach to stewardship ties in with their overall organisational approach, which should be encouraged, these should not be 'developed' solely for the purpose of becoming signatories to the Code. Organisations should be disclosing their purpose, objectives and governance arrangements independently of the Code, which should focus on how these relate to stewardship. It would be helpful for organisations to set out how this process informs (and where relevant is informed by) their approach to stewardship – this will help both asset owners and asset managers to identify who they want to work with during the selection process.

Principle A therefore should read:

"Signatories should *disclose* how their organisational purpose, strategy, values and culture, enable them to fulfil their stewardship objectives"

Omitting the reference to the 'development of organisational purpose'. Similarly, 'develop' should be omitted from Principle B. It would also be helpful for Principle B to have a greater emphasis on the relevant time horizon of clients and beneficiaries, as this is of considerable importance in determining the appropriate stewardship approach. This should be reflected in the accompanying Provisions.

Finally, regarding Provision 1, it would be helpful for this to read:

"Signatories should clearly disclose if, and how, stewardship approaches differ across…"

For both the asset owner and asset manager Provisions. The current focus develops an undue focus on 'policies', rather than the development of the right approach, which may include the development of policies for particular asset classes. This amendment also gives more room for the asset owner to describe the expectation of the asset manager's approach in different asset classes, rather than their own implementation of the approach per se.

Section 2 - Investment Approach

We agree that it is important for signatories to the Stewardship Code to disclose their investment approach. Asset managers with different investment strategies will adopt different approaches to stewardship, and it is important that disclosures allow asset managers and asset owners to reflect how these approaches relate to their investment strategy and overarching purpose. We have concerns that the Provisions in this section:

- assume an active approach to investment management, whereas stewardship approaches are adopted across a variety of investment strategies;
- portray an inconsistent treatment of the materiality of ESG factors; and
- Confuse the roles and responsibilities of asset owners and asset managers.

Stewardship across different investment strategies

Provision 9 gives a misleading account of how stewardship is integrated across the investment process.

- First, it assumes that all asset management investment strategies will use information gleaned from stewardship to make active investment decisions – the emphasis on investment decision-making assumes an option to buy or sell on the

basis of an asset managers' stewardship activities. However, index strategy funds do not have this option. As long-term holders of assets, index strategies use stewardship activities not to make buy and sell decisions but instead to improve the value of assets held through oversight, engagement and the exercise of their rights and responsibilities.

- Secondly, it is clear from the guidance that the Provision is intended to encapsulate asset managers' approach to the integration of stewardship across the investment process; however this is not clear from the wording of the Provision itself, which ignores the role that stewardship plays across the investment process, including monitoring, engagement and voting.
- Finally, by applying equally to asset owners and asset managers this Provision assumes that asset owners have a direct role in investment decision-making. Depending on the particular arrangement an asset owner has with their manager, this may or may not be the case. In general, these functions are delegated to the asset manager.

We recommend this Provision is amended to say:

"Signatories should disclose how their stewardship approach is integrated throughout their investment process".

This will give more flexibility for signatories with different investment strategies and client bases to differentiate their approach and disclose which aspects of the investment process their stewardship approach covers.

The FRC should differentiate the guidance for this Provision for asset owners and asset managers. At present this guidance is targeted only at asset managers, despite also applying to asset owners.

Materiality of ESG issues

There is inconsistent use of the word 'material' and 'climate change' throughout the Principle, Provision and Guidance. It is important for the Code to emphasise the materiality of ESG issues throughout the Code, in order to ensure an accurate reflection of how stewardship works in practice. ESG issues, including systemic issues such as climate change, have an important impact on the short- and long-term value of assets.

The topics on which investors engage with companies are wide-ranging. They will depend on the investment in question and also the investment approach of the investor. For the purposes of the Code, the focus should be on how asset managers take material issues, including ESG issues, into account. This will encourage reporting on how signatories have identified material issues, rather than reporting against a generic list of issues, which may not be relevant to the asset (or company) in question. Having a set list of issues turns stewardship into a compliance exercise: this will not move the Code towards a more outcomes-based focus.

Provision 11 should therefore be amended to read "takes material issues, including ESG issues into account".

In addition, it is not clear whether Provision 10 is needed given the important emphasis in Provision 11 on how asset managers reflect their clients' time horizon and asset owners their beneficiaries'. The investment time horizon of the asset manager makes most sense in the context of their delivering on their client's objectives, and this will vary from one client to the next.

Clear differentiation of the roles and responsibilities of asset owners and asset managers

We strongly welcome the emphasis on how asset owners should reflect the value of stewardship in their relationship with their asset managers. As identified in our introduction, it is essential to improve the quality of the demand from asset owners on stewardship in order to help develop a better market for stewardship. However, Provision 11 currently focuses too narrowly on the investment mandate – the formal legal documentation between the asset owner and the asset manager. We think it would be helpful for the scope of this Provision to be expanded to reflect the broader relationship between the asset owner and asset manager.

It is currently relatively rare for investment mandates to incorporate expectations on stewardship and material ESG integration. It is important to recognise that the mandate is one aspect of the expression of the relationship between asset owners and asset managers, where asset owners give legal form to what they expect from their managers. Many asset owners are only at the beginning of a process to understand how they expect their asset managers to incorporate stewardship and the integration of material ESG issues into their investment activities. For many pension funds this has been catalysed by the recent clarifying legislation from the DWP[2]. However, many asset owners have still not considered how this translates into the legal relationship with their asset manager. Those asset owners that are most advanced at incorporating stewardship into their mandates consider this to be only one aspect of how they ensure their asset manager is incorporating stewardship into the investment process. Generally, asset owners consider it more important to establish a relationship which focuses on the long term delivery of the investment objectives. The mandate is only one legal expression of this relationship.

Recognising that there is still some way to go to make progress in this area, it would be more helpful at this stage for Provision 11 to be amended to reflect the asset owner's *expectations* of their asset manager's approach to stewardship and the incorporation of issues aligned with the investment time horizon of their beneficiaries, including material ESG issues. In the guidance to this Provision, examples of how this can be accomplished can include reference to the inclusion of expectations in the contractual relationship between the asset owner and asset manager, which may be underpinned by a variety of legal documentation. While we consider this legal expression to be the pinnacle of best practice, setting expectations too high here, may deter overall engagement with stewardship from asset owners.

In addition, we recommend that the FRC consults with the Pension's Regulator and the Department for Work and Pensions to ensure the expectations of the Code are consistent with the legal obligations of pension fund trustees, and in particular in terms of how trustees set out their Investment Beliefs and Statement of Investment Principles.

Provision 13 also conflates the different roles and responsibilities of asset owners and asset managers. When asset owners delegate asset management activities to an asset manager, they are generally delegating the responsibility to make asset selection, management and oversight decisions. This will of course vary according to the particular contractual arrangement asset owners have with their asset managers. It is not appropriate therefore for the asset owner to develop a 'list' of criteria that asset managers must assess assets

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[2] https://www.gov.uk/government/consultations/pension-trustees-clarifying-and-strengthening-investment-duties

against. Instead, asset owners are responsible for developing their Investment Beliefs, and will set these out in their Statement of Investment Principles alongside their investment objectives. They will then select managers on the basis of their ability to manage assets in line with these objectives and beliefs. Some asset owners may go into some detail about how these beliefs relate to the expected approach that the asset manager should take in assessing assets – this would be agreed in the selection process.

In addition, Provision 13 assumes an active approach to investment management, by assuming that an active buy or sell decision is being made.

Provision 13 should therefore be omitted for asset owners. It should be amended for asset managers to reflect the variety of investment strategies that facilitate stewardship (including both index and active) and to reflect that asset managers should conduct their stewardship activities in line with the client's expected approach to generate sustainable value for beneficiaries.

These two examples of the conflation of the different roles and responsibilities of asset owners and asset managers may deter asset owners from becoming signatories to the Code. They set overly onerous expectations of asset owners in areas which are typically delegated to the asset manager. Deterring this critical part of the investment chain from becoming signatories will not help to facilitate an effective market for stewardship.

For all of the Principles and Provisions the FRC should identify where there are clear stewardship expectations for:

- Just the asset owner
- Just the asset manager and, or
- Both the asset manager and asset owner.

This will help to avoid this conflation of roles and responsibilities where there should only be an obligation on one signatory and not the other.

Section 3 - Active Monitoring

Asset managers do not just monitor the performance of their assets as a part of their stewardship process. They also consider the *quality* of assets in terms of a wide range of material issues, which informs an assessment of the assets ability to deliver sustainable value for beneficiaries over the relevant time horizon.

Principle G should therefore be amended to say "monitor the performance *and quality* of assets". This wording should be reflected in Provision 14 and the accompanying guidance.

Again, Provision 14 conflates the roles and responsibilities of asset owners and asset managers – usually the asset owner will delegate responsibility to asset managers to actively monitor the issues that may impact on the sustainable value of assets. This Provision should be amended to reflect the different roles for asset owners and asset managers. Asset owners should identify, in their investment beliefs and Statement of Investment Principles, whether there are any particular issues that they consider to be essential to consider in the manager's assessment; this expectation should be covered under Section 2.

Section 4 - Constructive Engagement and Clear Communication

In addition to setting expectations, monitoring, engagement and exercising rights and responsibilities, a critical way in which asset managers hold companies to account is by escalating their engagement with companies on issues where there is significant concern.

While it might be argued that these activities are included in the definition of 'constructive engagement and clear communication', given the important role that escalation plays in the stewardship process, we would find it helpful for this to be made more explicit.

The FCA's Discussion Paper on building an effective regulatory framework for stewardship refers to the essential expectations outlined in sections 3 and 4 in terms of 'constructive oversight, engagement and challenge', which includes the 'active monitoring of assets, constructive dialogue with issuers, exercise of ownership rights and the integration of stewardship and investment decisions'. We would find it helpful for sections 3 and 4 to better reflect this terminology as it more accurately depicts the stewardship process and gives better emphasis to the importance of escalation through the use of the word challenge. The FRC should consider including a particular Principle relating to the role of challenge and escalation in active monitoring.

In addition, Principle I should read "signatories must communicate clearly with clients, beneficiaries and issuers".

This will allow for signatories to disclose their approach to communication with all relevant parts of the investment chain. This should include the clear communication of expectations of asset managers by asset owners and issuer behaviour by asset managers and should be reflected in the accompanying Provisions.

Provision 22 is an important Provision in terms of clarifying the extent to which beneficiaries' views inform the stewardship and investment approach taken. In the context of allocating capital to social and environmental impact, these views form an important part of the Law Commission's 'two stage test' on fiduciary duty. We would note however that in response to their consultation on clarifying pension fund trustees' legal duties[3], the DWP decided not to introduce a requirement for "trustees to consider and prepare a statement on how they will take account of the views which they consider scheme members to hold in the preparation or revision of the Statement of Investment Principles…. (Including) members' views on both financial and non-financial matters that may be relevant to the trustees' investment and stewardship decisions" in light of a number of concerns being raised with this suggestion. It would be helpful for the FRC to reflect on the feedback to this in the consultation in the context of this Provision.

Section 5 - Exercises Rights and Responsibilities

It is important that institutional investors exercise the rights and responsibilities attached to the ownership structures of different asset classes.

We have identified a number of Provisions that should be strengthened or amended in this section.

We welcome Provision 24 on the disclosure of the use of proxy advisors. It is not clear, however, why there are no corresponding Provisions with respects to asset owner's use of

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3 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/739331/response-clarifying-and-strengthening-trustees-investment-duties.pdf

investment consultants in respect of their services relating to stewardship activities. Investment consultants are highly influential in supporting asset owners to develop their investment strategies, and ultimately play a huge role in directing the flow of assets to different managers and strategies, including the extent to which stewardship is integrated into the investment process.

The FRC should include an additional Provision to encourage disclosure with regards to asset owners' use of investment consultants.

It is important that Provision 25 is phrased in such a way that encourages asset owners to take into consideration the various rights and responsibilities associated with delegating management to different investment structures such as segregated or pooled mandates. For example, when asset owners opt to enter into pooled funds rather than a segregated mandate, this typically limits the capacity for asset owners to exercise voting rights with respect to the funds' underlying shares – though this will vary according to the particular contractual arrangement.

Clients have a choice to use pooled funds or segregated mandates. Those clients who choose to use a pooled fund are usually informed that their shares will be voted in accordance with the institution's voting policy. If a client wishes to have a more bespoke service that includes directed voting then they have the option to use a segregated mandate. Ultimately asset owners need to ensure the form of arrangement they choose is consistent with their overall approach to stewardship as a part of their selection process.

Provision 23 already requires asset managers and owners to explain how they exercise ownership rights across different markets and asset classes. It is therefore not clear why bond issuance has been singled out for explanation in Provision 27. This Provision should be omitted, and the guidance should instead set out recommendations for how Provision 23 can be applied across distinct asset classes with different characteristics.

Q2: DO THE PRINCIPLES SET SUFFICIENTLY HIGH EXPECTATIONS OF STEWARDSHIP FOR ALL SIGNATORIES TO THE CODE?

The Code sets high expectations for actors in the UK stewardship market, at a significant level over and above the minimum requirements set out under SRD II. This in an important step in creating a better market for stewardship.

We have identified above how these expectations are overly prescriptive in places and not sufficiently flexible to allow for signatories to articulate different approaches to stewardship in line with their particular investment strategy, client base and strategic objectives. If these concerns are not addressed, the Code will fall short of the aspiration to shift towards a focus on outcomes instead of policies and processes - this will drive counterproductive, compliance-led behaviour.

It is particularly important for the concerns regarding the clear differentiation of the roles and responsibilities of asset owners and asset managers identified above to be addressed. If not, this will result in a Code that may be too onerous for many asset owners – many of the expectations set out in the current draft would require extensive resources to fulfil. These responsibilities are typically delegated to asset managers. This will not help to stimulate a better market for stewardship. The Provisions in the Code that apply uniquely to asset owners need to be developed in such a way as to encourage a better demand for stewardship from asset owners as well a more discerning approach to manager selection and performance assessment. This will not be achieved if the expectations of asset owners are conflated with the expectations of asset managers. The FRC needs to carefully

scrutinise which of the expectations apply solely to asset owners and which apply solely to asset managers in recognition of the fact that they are conducting stewardship at different junctures of the investment chain, rather than assuming that all expectations apply to both actors.

Q3: DO YOU SUPPORT 'APPLY AND EXPLAIN' FOR THE PRINCIPLES AND 'COMPLY OR EXPLAIN' FOR THE PROVISIONS?

It is essential that the Code maintains its high-level Principles approach and does not prescribe specific activities or topics that investors must comply with. As discussed in the introduction to this consultation, good stewardship relies on investors choosing the right approach and material issues to engage on. These will change dependent on the individual circumstances of their investments.

With this in mind, we are supportive of the 'apply and explain' approach for the Principles, providing the specific concerns with the Principles that we have outlined above have been addressed. 'Comply or explain' is appropriate for the Provisions as this gives flexibility for asset managers to explain where particular Provisions may not be appropriate in their circumstances.

Q4: HOW COULD THE GUIDANCE BEST SUPPORT THE PRINCIPLES AND PROVISIONS? WHAT ELSE SHOULD BE INCLUDED?

Building on the concerns outlined in response to question 1, we have a number of concerns with the proposed guidance. Suggested changes to the Principles and Provisions should be reflected appropriately in the accompanying guidance.

The current approach to addressing where aspects of the Code meet the requirements of SRD II is confusing. The Code needs to be clearly set out how SRD II reporting requirements and signatories disclosures interact - that SRD II sets out minimum standards for all market participants while the Code seeks to set a higher level of best practice.

To achieve this it would be helpful to more clearly indicate in one location which of the Principles and the Provisions are designed to satisfy the minimum requirements expected under SRD II. At present the guidance takes a haphazard approach to doing this and it is not clear which aspects of the guidance for any particular Provision are designed to meet the relevant articles of SRD II. For example, there are differences between the list of issues that should be monitored in Article 3g of SRD II and the guidance to Provision 14. The list of issues presented in the Code is more comprehensive than that required by SRD II. It would be helpful to articulate which issues to monitor are particular to SRD II and which are particular to the Code.

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?

We welcome the addition of an annual Activities and Outcomes report. Signatories can help to create awareness of and demand for the value of stewardship by clearly articulating how they have helped to create sustainable value for beneficiaries. This will allow clients to identify the different approaches of different asset managers and assess their stewardship capabilities by considering the outcomes achieved. We are therefore supportive of this new recommendation as it will help improve transparency and accountability.

As such, we are pleased that the Activities and Outcomes report provides an evaluation of how well stewardship objectives have been met and the outcomes achieved.

As the key aspect of the new Code that will shift the emphasis of disclosures away from policies and practices towards outcomes, the quality of these reports and the extent to which they are used to shift behaviour will therefore be a critical test for the new Code.

We note that the FRC has made no specific recommendations on what the Activities and Outcomes Report should include. We have set out a number of suggestions as to how these reports will work best in practice below.

- Disclosures ought to be underpinned by the definition of stewardship and have the end client – the beneficiary of the investment process – in mind. Disclosures should clearly articulate how stewardship is generating sustainable value for the beneficiary.

- Client-specific disclosures should be driven by the expectations set by the client and may vary from client to client. With this in mind, we do not think it is helpful for the Stewardship Code to prescribe client-related disclosures. In particular, Provision 21 should be reframed, so that signatories are not expected to make disclosures about client-specific disclosures.

- The Activities and Outcomes Report should allow for reporting that reflects the relevant time horizon of investors' stewardship activity. For example, many of the stewardship activities carried out by asset managers involve engagement and escalation that is expected to have an impact over the longer term. It is important that a yearly report allows for asset managers to communicate this approach and doesn't reduce reporting to commentary on the (more limited) range of activities that appear to have had a 'tangible' impact in any one year.

- It is also important that the Report does not encourage stewardship to become a marketing exercise. Soundbites such as 'We wrote 100 letters to company chairs on a thematic area' may not necessarily amount to effective stewardship if the thematic area was not relevant to the companies in question or if sending the letter didn't result in any meaningful engagement or change. Signatories should be encouraged to demonstrate how their activities have resulted in particular outcomes.

- Disclosures should avoid 'greenwashing' – signatories should be encouraged to reflect on successes as well as learnings, for example when engagements did not meet the intended outcome. Reflections on how more challenging cases were resolved should be encouraged.

- Signatories should take a proportionate approach to reporting on outcomes, by being mindful of the amount of resource that is being dedicated to reporting on stewardship outcomes, as opposed to actually achieving those outcomes through stewardship.

- This report should take a proportionate approach to ongoing engagement where there may be sensitivities around disclosure. For example, it may not be possible to name certain companies where there is ongoing engagement and where doing so may impact on the company's value, which will not be in the best interest of beneficiaries. It should be possible to report some cases on an anonymised basis and to defer reporting until after the engagement has concluded.

We do not think it would be helpful at this stage for the FRC to produce explicit guidance or templates for these reports. We think it would be more helpful to monitor developments in this area as the first year of reports are developed. Guidance based on best practice could be developed at a later stage if there is a need for it.

It is important recognise that the enhanced reporting requirements will create additional obligations for asset managers, many of which report in line with a number of Stewardship Codes for different markets. We would expect the soon-to-be-created ARGA and the FCA to play a role in helping to shape international standards and driving excellence in global stewardship.

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?

Our own assessment of our members' disclosures against our Stewardship Reporting Framework indicates that a large number of asset managers are already making stewardship disclosures above the level set out by the 2012 Stewardship Code. Many are well-placed to make disclosures in line with the new Code, as they have already developed their operational processes to report extensively on some of the new additions to the Code, including their approach to ESG integration, considering stewardship across multiple asset classes and innovative public disclosures. However, there are varying practices amongst the industry - it may be more challenging for some firms to meet the proposed timeframe as significant changes in the operational processes that drive their reporting practices will be required, particularly in terms of the approach to stewardship across different asset classes. Asset managers will also be developing their reporting practices to meet the requirements of SRD II.

We do not think that it would be appropriate for the FRC to focus on the quality of outcomes achieved when assessing the content of signatories' disclosures as part of any tiering exercise. The assessment of outcomes should be left to asset owners in their scrutiny of prospective managers and beneficiaries in their scrutiny of asset owners. This would help facilitate a good market for stewardship. Instead, the FRC should focus on assessing how consistently signatories are reporting their outcomes in line with their policies and processes. There may also be a role for the FRC in terms of identifying misleading disclosures or so called greenwashing, however this would require new skills and expertise.

This assessment will be more challenging than the current assessment being undertaken by the FRC. Investors will need to be confident that the body that replaces the FRC has sufficient expertise and resource to carry this work out effectively. Given the significant changes in reporting required it would be helpful for the FRC to give private feedback on the quality of reporting in the first instance, before making their tiering assessment public.

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 THOSE SHOULD BE?

The new Code is a step in the right direction towards the outcomes-based approach recommended by Kingman. The key distinguishing feature in this respect between the old and the new Code is the Activities and Outcomes report. However, as identified in a number of places in response to Question 1, we are concerned that the Code is too focused on

prescriptive guidance on policies and processes, which will not encourage a more outcomes based approach, while saying very little about how signatories should assess and disclose the impact of their stewardship activity.

The implementation of SRD II and the new approach to signatories' reporting will result in a significant shift in the stewardship market. This will result in much clearer differentiation by asset owners of excellence in stewardship and, as a result, a better functioning market. At this point in time, it would not be appropriate for the FRC to be granted additional powers, to enforce the Code until we can see how these reforms work in practice.

Q8: DO YOU AGREE THAT SIGNATORIES SHOULD BE REQUIRED TO DISCLOSE THEIR ORGANISATIONAL PURPOSE, VALUES, STRATEGY AND CULTURE?

As set out in our response to Question 1, we are supportive of the expectation that institutional investors coordinate their approach to stewardship with their firms' overarching objectives and governance. We have recommended where the supporting Principles and Provisions can be strengthened. It is particularly important that these kinds of disclosures, which are aimed towards more explicitly outlining asset managers' policies and processes, don't distract from meaningful and effective stewardship activities.

Q9: THE DRAFT 2019 CODE INCORPORATE STEWARSDHIP BEYOND LISTED EQUITY. SHOULD THE PROVISIONS AND GUIDANCE BE FURTHER EXPANDED TO BETTER REFLECT OTHER ASSET CLASSES? IS SO, PLEASE INDICATE HOW?

We agree that stewardship should not be limited to listed equities. Stewardship can help to play an important role in creating sustainable value across all asset classes. Many asset managers will have holdings in a particular company through different asset classes – for example, they may own shares in the company as well as the company's bonds. In these cases it is helpful for the manager to ensure consistent messaging to companies across these different asset classes. Where conflicts of interest arise as a result of owning assets of the same company in different structures, asset managers should have an appropriate governance process in place to manage these conflicts.

The Stewardship Code originates in relation to equity, as a result of this asset class having significant voting rights and therefore increased opportunities to engage with investee companies and escalate any concerns. An important driver of stewardship activity for other asset classes, therefore, is the extent to which ownership of the underlying asset comes with rights and responsibilities. Where these are more limited there may be greater emphasis on pre-selection engagement than post – selection oversight.

It is important to reflect this in the Stewardship Code by asking signatories to explain the approach they take to stewardship in different asset classes, rather than being prescriptive about what form these activities should take. It is also important that this reflects on the particular agreement between asset owners and asset managers regarding the asset owners' expectations.

This flexible approach that allows signatories to explain the approach they take for different asset classes has not been adopted consistently throughout the Code. For example, this is not reflected in Provision 27which is prescriptive about the activities of bondholders, despite their being no equivalent expectation in terms of equities. We would recommend omitting Provision 27 so that signatories can explain the approach that they take.

Q10: DOES 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 ACROSS ALL FUNDS?

There are variety of ways in which asset managers adopt stewardship across their institutions:

- Many asset managers adopt an institution-level approach to stewardship, which relates to their strategic objectives. There may however be some variation between different approaches across funds and asset classes.
- Other asset managers adopt a fund-level approach, which may or may not translate to a wider institution-level approach.
- Some institutions will segment their stewardship approach according to the type of clients they act on behalf of, for example, whether their clients are institutional investors, retail investors, or 'execution only' clients.

It is important that signatories are able to adapt their approach to reporting depending on how they adopt stewardship across their institution.

For those that adopt an institution-level approach it is important that group level disclosure doesn't result in misleading statements about the extent to which different stewardship approaches are applied across different funds or asset classes. The Code should encourage asset managers to disclose their institutional approach or fund-level approach, and then highlight where this might deviate by exception while setting out the rationale for this. This should also be made clear in client-specific documentation.

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 Principle, it is helpful for signatories to state their investment beliefs. However, it is not clear how this is expected to relate to Principles A and B on signatories' disclosures about their organisational purpose, strategy values, stewardship approach and objectives. There is a clear precedent for pension funds to articulate their investment beliefs in the context of their statement of investment Principles. For asset managers it may be important to differentiate overarching group level beliefs and the beliefs adopted by individual funds.

The Pensions Regulator Guidance on Defined Benefit Investments says that "you may find it helpful to develop and maintain a set of beliefs about how investment markets function and which factors lead to good investment outcomes. Investment beliefs, supported by research and experience, can help focus your investment decision-making and make it more effective. If you do this, your investment strategy should then reflect those beliefs".

This is clearly an important exercise for asset owners to undertake. In particular, it is important for them to articulate how the particular views about the role that stewardship plays and their expectations of stewardship in leading to good investment outcomes.

As a part of their selection process asset owners should then use these beliefs to inform their assessment of funds' ability to deliver good investment outcomes.

Q12: DOES SECTION 2 SET A SUFFICIENTLY HIGH EXPECTATION ON SIGNATORIES TO MONITOR THE AGENTS THAT OPERATE ON THEIR BEHALF?

It is important for signatories to have oversight of the agents that operate on their behalf, whether that is asset owners' oversight of their asset managers or asset managers' oversight of services delegated to proxy advisers. This is an important aspect of ensuring that delegated activities are consistent with the owner or manager's approach to stewardship and helping them to achieve their investment objectives.

However, it is important that the emphasis is not just on monitoring, but how this monitoring informs particular actions – the term 'oversight' may be more appropriate in this context. This is more helpfully articulated in the corresponding guidance to this section. Again, this would help strengthen the Code in terms of moving the emphasis away from policies and towards activities and outcomes.

We also think it would be helpful for this Provision to reflect the relevant time horizon of beneficiaries. We are concerned that guidance may support a more short-term approach by asking signatories to disclose "how, and with what regularity, they appraise their appointed managers and service providers". The regularity of appraisals should reflect the long-term objectives of the investments and should not be conducted more frequently for the sake of trying to demonstrate compliance with the Code.

Q13: DO YOU SUPPORT THE CODE'S USE OF 'COLLABORATIVE ENGAGEMENT' RATHER THAN THE TERM 'COLLECTIVE ENGAGEMENT'. IF NOT, PLEASE EXPLAIN YOUR REASONS.

Our members consider collective engagement and escalation an important component of their stewardship activities. Our Stewardship Survey illustrated that 75% of respondents engaged with other investors mainly via direct communication or through representative bodies such as the IA or Investor Forum.

Contrary to the arguments set out in this consultation, we understand the term "collective engagement" to be more widely understood, more commonly used globally and to signify a more constructive form of engagement. While this traditionally reflects on the collective role of shareholders with similar interests in a company, the term is sufficiently flexible to be extended to reflect other asset classes and engagement with other stakeholders.

Q14: SHOULD THERE BE A MECHANISM FOR INVESTORS TO ESCALATE CONCERNS ABOUT INVESTEE COMPANIES IN CONFIDENCE? WHAT MIGHT THE BENEFITS BE?

In a number of high-profile cases where businesses have collapsed or gone through significant financial strain, the Boards had ignored investors' concerns in the run up to these events. In light of this, it is appropriate to question whether asset managers can play a more proactive role in publicly or privately reporting their concerns over company behaviour, if they feel their engagement activity is not producing the desired results.

Shareholders do have powers to pursue legal action against Directors if they are not complying with their duties. This has seldom been pursued however, as it is generally not in the asset manager's interest to engage in protracted legal battles with a company, where this will not deliver any value to clients.

In our response to BEIS' consultation on Insolvency and Corporate Governance we argued the need for the opportunity for investors to privately raise concerns to a regulatory authority regarding a company's corporate governance, risk management or other material issues such as fulfilment of Directors duties. Such a mechanism could be used where shareholders have escalated and exhausted the limits of their engagement activity with a

particular company. This authority could then take a decision on whether to investigate a company or individual Directors based on the information received through this reporting mechanism and other intelligence. It would be likely that the authority would focus on those companies where similar concerns are received from a number of shareholders. While this opportunity would go beyond the asset manager's responsibilities to their clients where they have decided to exit their holdings in that company, it would help to promote market integrity. This would benefit all actors in the market.

For this to work in practice, and for individual asset managers to have the confidence to provide information to the regulator, the regulator will need to have the confidence of investors. Therefore, we believe that the new regulator, ARGA, will need to more fully consider and take account of the views of investors and build the confidence of the investor community to take on this responsibility in the future. Specifically, it will be important for investors to have confidence that if they were to channel concerns to the new body, these concerns would be approached with the necessary expertise and sensitivity. It would be important for this to be provided as a mechanism rather than a duty on investors.

Q15: SHOULD SECTION 5 BE MORE SEPCIFIC ABOUT HOW SIGNATORIES MAY DEMONSTRATE EFFECTIVE STEWARDHIP IN ASSET CLASSES OTHER THAN LISTED EQUITY?

Please see our response to question 9.

Q16: DO THE SERVICE PROVIDE PRINCIPLES AND PROVISIONS SET SUFFICIENTLY HIGH EXPECTATIONS OF PRACTICE AND REPORTING? HOW ELSE COULD THE CODE ENCOURAGE ACCURATE AND HIGH-QUALITY SERVICE PROVISIONS WHERE ISSUES CURRENTLY EXIST?

We agree that the service provider Principles and Provisions set sufficiently high expectations of practice and reporting for proxy advisers. However, as set out in response to question 1, we think these need to be updated to reflect the important role that investment consultants play in advising asset owners on stewardship. We also have concerns with Provision 3 as per our response to Question 1.