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Sent by email to  
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Dear Mr Bannister

## **Insolvency and corporate governance**

I am writing to respond to the BEIS consultation on Insolvency and corporate governance on behalf of ShareAction, a registered charity established to promote transparency and responsible investment (“RI”) practices by pension funds and other institutional investors. We are a member organisation and count amongst our members well-known NGOs and charitable foundations, as well as over 26,000 individual supporters. We work with institutional investors to promote stewardship and engagement, and we also conduct annual industry-wide surveys to rank them on these activities. We have extensive experience of research and policy development on barriers to long-termism, and fed into the 2012 Kay Review, the related BIS Select Committee, the Law Commission’s review of trustees’ fiduciary duty and the recent BEIS Select Committee on corporate governance.

**Q12. What more could be done through a revised Stewardship Code or other means to promote more engaged stewardship of UK companies by their investors, including the active monitoring of risk? Could existing investor initiatives to hold companies to account be strengthened (e.g. through developing the role of the Investor Forum)? Could better arrangements be made to ensure that lessons are learned from large company failings and controversies?**

We agree that it is right to ask whether a larger proportion of institutional investors could be more active and engaged stewards, and whether more could be done to ensure that company directors and their investors engage constructively. Our experience of conducting investor research and engagement has indicated that while some institutional investors operate conscientiously as stewards of companies, many are absentee landlords, lacking incentives to take the trouble to steward large companies with care and diligence.

We responded to the FRC’s initial scoping consultation questions in March on the future direction of the Stewardship Code. Our recommendations are summarised below:

1. The Stewardship Code as it stands does not necessarily drive best practice and can be complied with without much substantive effort. For example, Principle 5 can be complied with by expressing willingness to collaborate, while not taking action. The Code should mirror the proposed revisions to the Corporate Governance Code in terms of setting out more specific Principles, guiding Provisions and full guidance. This is particularly important because there is no one in the current system who oversees and questions compliance with the Stewardship Code in an equivalent role to investors overseeing the Corporate Governance Code.

2. There is currently a lack of clarity for different types of signatories (i.e. asset manager, asset owner or service provider) on how the Stewardship Code applies in practice to their specific roles. BEIS should encourage the FRC to clarify applicability for each type of sector actor by providing guidance on how the principles apply to them. This could be in the form of more tailored guidance to provide context for how each principle of the Stewardship Code applies to each actor and the role they play in stewardship. For example, asset managers should ensure they understand their client’s

investment objectives and purpose, and should report their stewardship activities and overall impact achieved.

3. The tiering exercise recently carried out by the FRC seems to have provided a valuable driver for improving quality of reporting. However, our impression is that some of the institutions in Tier 1 are not fully integrating these stewardship principles and more could be done in future to distinguish between them. The Stewardship Code can technically be complied with by stating that the investor has a particular policy without offering evidence that it has been followed and/or what the outcomes were. Our engagement with industry participants has indicated that some signatories who are taking stewardship seriously would like to see finer distinctions made on the quality of compliance within Tier 1. We would recommend that BEIS encourages the FRC to incorporate these clearer distinctions within its tiering exercise. This could include publishing more detailed information on the expectations for each tier, including criteria for assessment, introducing an additional tier for institutions showing integrated application of Stewardship Code in practice, and referring serious breaches of the Stewardship Code by asset managers to the Financial Conduct Authority.

4. Our experience of supporting pension scheme members to engage with their scheme and request information about how their money is managed indicates that institutional investors' reporting to beneficiaries is generally poor. We understand from the Association of Member-Nominated Trustees that fund manager reporting for their clients is often similarly poor. This suggests there is an investment chain issue with poor reporting that needs to be addressed.

The EU Shareholder Rights Directive will require fund managers and asset owners to better report to their respective clients that their approach is in their long-term best interests. The Stewardship Code should support this aim by promoting better client reporting. This will be important for the UK to retain equivalence with the EU post-Brexit. Signatories should be given more direction and detail on what is expected in reporting. This could be done by mirroring the format of the revised Corporate Governance Code (with Principles, Provisions and Guidance of the Corporate Governance Code). Best practice expectations and model templates for voting disclosures should be set out and the FRC should champion best practice.

5. There is no real risk for signatories if they fail to comply with the Stewardship Code or give poor explanations. Statements of compliance with the Stewardship Code do not necessarily reflect everyday practice across the wider organisation. This could be addressed by creating greater accountability and enforcement in relation to the Code, so that it is seen a high priority for the board of a signatory rather than the province of the compliance department. We would recommend requiring signatories to carry out a process of annual review and sign-off, by a signatory's board or specified director. If the FRC does not have the appropriate powers to make this mandatory, BEIS should consider extending these.

6. Stewardship is inherently about risk management and about ensuring sustainable, long term returns. It is intrinsically linked with financially material environmental, social and governance (ESG) risks. However, the guidelines to Principle 1 lack reference to the long term and do not explicitly mention social ("S") or environmental ("E") considerations. This means that the Stewardship Code is not visibly concerned about S and E factors (which are only mentioned in passing in Principle 4). Analysis of a number of recent international stewardship codes has found that these codes include explicit reference to environmental and social considerations. Our past surveys of asset managers have found that there is significantly less focus on S and E factors than on governance among UK asset managers.<sup>1</sup>

7. The Stewardship Code could go further and encourage asset managers to allow asset owners to direct voting in pooled funds. We have spoken with asset owners who have received a flat refusal when they ask if they can play a more active role in voting. Explicitly including this point within the Code should help asset owners make their case for directed voting.

More generally, there is a concerning lack of transparency and agency in this relationship, which is unlikely to benefit the beneficiary's long-term interests. Voting records and disclosures often fail to include enough detail to be meaningful for an external reader. For example, many records list

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<sup>1</sup> ShareAction (2017). *Lifting the Lid: Responsible Investment Performance of European Asset Managers*. Available online at: <https://shareaction.org/wp-content/uploads/2017/03/Survey-LiftingTheLid.pdf> [accessed 11 June 2018]; ShareAction (2015). *Responsible Investment Performance of UK Asset Managers*. Available online at: <https://shareaction.org/wp-content/uploads/2016/01/AssetManagerSurvey2015.pdf> [accessed 11 June 2018].

resolutions by number and do not refer back to the text of the actual resolution. They often do not give rationales even for controversial votes. In addition, our experience of undertaking surveys suggests there can also be a significant time-lag between the votes happening and disclosures being made. Our past reports on asset manager practices<sup>2</sup> have found that meaningful reporting on voting is still uncommon. We would suggest that BEIS encourages the FRC to require disclosure of voting positions by large institutional investors, and provide guideline templates to ensure high-quality disclosure.

In summary, if the Stewardship Code were clearer, had better guidance and focused more explicitly on ESG factors, it would help drive better stewardship. Furthermore, if it had substantive regulatory bite and had to be taken seriously at board level, signatories would have to think carefully about compliance and this should raise the overall standard of reporting. It would also mean that those signatories who do take it seriously could use it as a competitive advantage to distinguish them from their peers, and it seems right that they should be able to do so.

In terms of more general arrangements that could be made to learn lessons from large company failures and controversies, we would suggest that Parliamentary inquiries always ensure they focus on the role of shareholders as well as the board of directors. For example, they could consider what information shareholders were privy to, and their history of engagement with the company in question (including voting on significant shareholder resolutions). For example, we understand that the current BEIS Committee oral evidence session (Corporate governance: delivering on fair pay inquiry) will include several investors and investor groups.

Yours sincerely

Rachel Haworth

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<sup>2</sup> Ibid.