

FRC Review Secretariat
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Sent by email to FRCReview@BEIS.gov.uk

Dear Sir or Madam,

6 August 2018

Independent Review of the Financial Reporting Council

I am writing to respond to the call for evidence on the Independent Review of the Financial Reporting Council (FRC) on behalf of ShareAction, a registered charity established to promote transparency and responsible investment 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.

Q23: How effective has the Stewardship Code been in driving more and higher quality engagement by institutional investors? If not, why? How might quality of engagement be further strengthened?

How effective has the Stewardship Code been?

- We work with institutional investors to promote stewardship and engagement, and we also conduct annual industry-wide surveys to rank them on these activities. Our experience of this 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 believe where stewardship is part of an investor's agenda, the Stewardship Code does not inhibit it being done well. However, it is ShareAction's view that the Code is not substantively changing the stewardship behaviour of those who are less committed.
- We are pleased that the FRC intends to consult on changes to the Stewardship Code later this year and recommend that a robust approach is taken to improving its focus on long-termism, compliance and enforcement.

Reasons why the Stewardship Code may not be as effective as it could be

Reasons include:

1. Content of the Code.

- 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.
- In addition, while stewardship is inherently about risk management and about ensuring sustainable, long term returns, 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). 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.

- 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. The majority of respondents to the FRC’s recent consultation on corporate governance agreed that it would be helpful to have clearer expectations of the stewardship roles and responsibilities of those at different points in the investment chain.¹
- There is a concerning lack of transparency and agency in the relationship between asset owners and their managers, which is unlikely to benefit the beneficiary’s long-term interests. 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. In addition, voting records and disclosures often fail to include enough detail to be meaningful for an external reader. For example, many records list 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 have found that meaningful reporting on voting is still uncommon.

2. **Accountability and enforcement.**

- 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.
- 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.

3. **Lack of regulator powers.** The FRC does not currently have the necessary resources or powers to be able to monitor and enforce compliance with the Code. While the Financial Conduct Authority (FCA) has greater powers and dedicated resources, stewardship is not currently seen to be a key part of its regulatory role.

How to strengthen engagement

Addressing the points above, we suggest the following solutions:

1. **Content of the Code.**

- 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.

¹ FRC (2018). *Feedback Statement: Consulting on a revised UK Corporate Governance Code*, p24. Available online at: <https://www.frc.org.uk/getattachment/90797f4b-37a1-463e-937f-5cfb14dbdcc4/2018-UK-Corporate-Governance-Code-Feedback-Statement-July-2018.pdf> [accessed 30 July 2018].

- The Stewardship Code should also reflect stewardship codes in other jurisdictions by including explicit reference to environmental and social considerations.
- The Stewardship Code should clarify applicability for each type of sector actor by including 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.
- The Stewardship Code could go further and encourage asset managers to allow asset owners to direct voting in pooled funds. Explicitly including this point within the Code should help asset owners make their case for directed voting. We would also suggest that BEIS encourages the FRC to require disclosure of voting positions by large institutional investors, which many asset owners supported in the FRC's recent consultation on corporate governance, and provide guideline templates to ensure high-quality disclosure.

2. **Accountability and enforcement.**

- 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. This could also be achieved through extension of the FCA's role. For example, the soon-to-be-established Senior Manager and Certification Regime (SM&CR) for the asset management sector could potentially be used to ensure that individual senior figures in asset management firms become responsible for their firm's application of the Stewardship Code, where their firm is a signatory to the Code.
- We would recommend that BEIS encourages the FRC to incorporate 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 FCA.

3. **Lack of regulator powers.** We believe that the FRC needs (1) greater resources to dedicate to monitoring compliance with the Code, including being able to select signatories each year for in-depth interviews and reviews and (2) greater powers for taking action for non-compliance, including vague compliance statements. Given the various financial regulators with their intersecting remits, it would be constructive to create a coherent strategy that applies across them all. Alternatively, it may be better to create a new regulator in the form of a new 'stewardship' council that is responsible for oversight and regulation of the Code.

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.

Q43: What skills are needed for the FRC to be most effective? Does the FRC have the people, skills and resources it needs, of the quality it needs?

As stated above, we have concerns that the FRC has insufficient budget and resources to undertake meaningful oversight and enforcement of the Stewardship Code. While the team tasked with working on stewardship are highly knowledgeable and dedicated to their role, we feel that they are not sufficiently well resourced.

As we commented in our response to the FRC's consultation on its 2018-2021 Strategy and Draft Budget for 2018/19, there is no budget line at all for FRC work on stewardship. We understand that stewardship is allocated a portion of the corporate governance budget. However, we were concerned to see this shrink from £1.1m in 2017/18 to £0.8 in 2018/19. We feel it may be a false economy not to invest more in the FRC's role as owner of stewardship standards in the UK. Greater dedication to raising standards of stewardship in the UK would pay off in the long term, as it should reduce the need for post-hoc regulatory sanctions.

We would be happy to meet to discuss these recommendations in more detail.

Yours sincerely,

Rachel Haworth

Policy Manager