

29 March 2019

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Financial Reporting Council
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Dear team,

PLSA CONSULTATION RESPONSE: PROPOSED REVISION TO THE UK STEWARDSHIP CODE

About the PLSA

We're the Pensions and Lifetime Savings Association; we bring together the pensions industry and other parties to raise standards, share best practice, and support our members. We represent over 1,300 pension schemes with just over £1 trillion in assets under management and over 400 supporting businesses, including asset managers, investment consultants and other service providers. Our mission is to help everyone achieve a better income in retirement.

Please note that our response below considers the perspectives of asset owners both as signatories in their own right, and as clients who have an interest in ensuring their asset managers undertake best practice on stewardship issues.

Introduction/Summary

We welcome the opportunity to feed in to the revised Stewardship Code. Pension schemes, as long-term investors, have a duty to act as good stewards of scheme members' assets, investing in a way which achieves better outcomes for scheme beneficiaries. Pension schemes also have a unique role to play in drawing up good stewardship practices through the investment chain.

As such, the PLSA has been a strong supporter of the Stewardship Code. We believe that the Code has helped build the UK's reputation as a world leader on stewardship issues. However, the market has evolved since the Code's creation in 2012 – with responsible investment approaches becoming more embedded across the market – and we think the time is right to revise and refresh the Code. We support the general shift in approach in the revised Stewardship Code and in particular the following:

- The explicit reference to environmental, social and governance (ESG) factors

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- The expansion of the Code to cover asset classes beyond equity
- The differentiated guidance for different parts of the investment chain (including for service providers)

We agree that it is sensible to pitch the Stewardship Code at a more stretching level, given the need to support signatories on their stewardship journey against a background where the Shareholder Rights Directive II (SRD II) is now being implemented and in the more mature market for responsible investment. However, we believe there may be a tension between raising the bar in this way and the objective of the FRC to encourage more asset owners to become signatories.

We have encouraged our asset owner members to sign up to the Code. We also produce a range of guidance, including our Stewardship Disclosure Framework, to help asset owners hold their managers to account on their stewardship and engagement activities. Many non-signatory PLSA members have told us that they support and apply most of the Code's provisions, for instance through manager oversight and mandate design.

However, many schemes are reluctant to become a Code signatory given the resource implications of full compliance. We believe that a way should be found to encourage asset owners to express their support for, and commitment to, the aims of the Stewardship Code which also allows for the resource constraints of many schemes and acknowledges that schemes often delegate activity on stewardship issues to their managers.

We would like to express our thanks to the FRC for its extensive engagement with us and our members over the course of the debate on the future of the Stewardship Code. Our full response is below and draws upon discussions with both signatory and non-signatory members as well as our previous responses to the Kingman Review of the FRC and the 2017 consultation on proposed changes to the UK Corporate Governance Code.

Our response

Q1. Do the proposed Sections cover the core areas of stewardship responsibility? Please indicate what, if any, core stewardship responsibilities should be added or strengthened in the proposed Principles and Provisions.

We think that the proposed approach is broadly sensible and support the general direction of travel on the areas outlined above.

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Definition of stewardship

We support the definition of the primary purpose of stewardship as “looking after the assets of beneficiaries that have been entrusted to the care of others”; we believe this better encapsulates the role of fiduciaries – including schemes, with their duty to protect and grow the value of individuals’ savings. In line with this approach, we believe that the term fiduciary duty should be explicitly used throughout the new iteration of the Code, as the notion of fiduciary duty is fundamental to stewardship for both asset managers and owners.

The role of collective (or collaborative) engagement

We do not think that it is right that collective (or collaborative) engagement, which was a Principle in the previous Code, no longer has the same prominence under the proposed revisions.

Working together with other investors towards a common goal is a vital part of the stewardship toolkit, and one that is particularly relevant to those schemes (and other investors) which by themselves would not have sufficient resources or influence to maximise the effectiveness of their engagement. In an era where policymakers and industry are trying to encourage schemes of all sizes to become good stewards of their assets, we think that the role of collective (or collaborative) engagement should be made much more visible in the new Code.

Investment approach

We strongly support Section 2 on *Investment Approach* and the shift from an approach which requires merely a description of the arrangements for integrating stewardship within the wider investment process to Principles E and F. We think it is important that the new Code instead places the focus on active demonstration of how investments align with the stewardship approach of the signatory and how stewardship is integrated throughout. We believe that this will be of significant help to schemes in assessing how well their asset managers are undertaking stewardship.

Although investment mandates are clearly key to helping define asset owners’ expectations of, and relationship with, their asset managers on a range of issues – and we support the specific references in Provision 11, we believe this could be broadened out to better reflect the range of ways in which this takes place. The investment mandate is only one approach, other avenues for

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setting out expectations include at manager selection or throughout the oversight process. Most schemes will not yet have reached the stage where they incorporate their expectations of asset managers on integration of stewardship in a legal way (although we hope that as the market develops, more and more will do so).

We also believe that the Provisions in this Section should include further explicit references in the asset owner guidance which link the importance of taking the time to consider a scheme's investment beliefs to how that feeds through to the stewardship strategy. An expansion of Provision 12 may work in this respect.

References to non-equity asset classes

We welcome the FRC's commitment to encouraging good stewardship across all asset classes in the new Code. This is increasingly pertinent as schemes continue to reduce their allocation to listed equities and to increase their allocation to fixed income, infrastructure, private equity and beyond. However, we think that this approach could be better and more explicitly integrated throughout the Code. At present, it is mentioned only once at the beginning.

As the new regulatory requirements¹ for schemes on stewardship across all their asset classes bed in, it is important that the new Code and guidance is clear as to how investors can undertake good stewardship beyond equity. Examples of such stewardship activities across non-listed equity asset classes for scheme signatories include:

- Engagement at issuance and other key stages of the issuance cycle (fixed income)
- Undertaking extensive due diligence on relevant issues before a co-investment (e.g. infrastructure)
- Engagement with credit rating agencies to ensure ESG issues are appropriately captured in credit assessment and ratings
- Engagement with tenants and communities and agencies on sustainability (real estate)
- Engagement with regulatory exchanges to facilitate better practice and transparency (for instance in commodity markets)

Member views

We think that it is important that the FRC's approach to the salience of member views to a scheme's investment decisions (and their fiduciary duty to invest in members' best interests) is consistent with that taken elsewhere by the UK government and regulators. We note that DWP, in their latest changes to the *Occupational Pension Schemes (Investment) Regulations*, decided

¹ The 2018 changes to the *Occupational Pension Schemes (Investment) Regulations*.

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against requiring “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.” We would urge the FRC to explore some of the feedback received by DWP in this respect.

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

Yes. We think it is right that the requirements are set at a more stretching level now that the SRD II is likely to be implemented in the UK.

However, as mentioned above, we believe there may be a tension between raising the bar in this way and the objective of the FRC to encourage more asset owners to become signatories. Schemes, as long-term investors, understand the importance of stewardship in helping grow and protect the value of scheme members’ savings. In our January 2019 stewardship survey, 86% of respondents agreed that ESG considerations are financially material to their investments, with 71% saying they take stewardship factors into consideration when selecting their asset manager, selecting managers with a clear commitment to stewardship.

Although there will be schemes with the means to comply with the new Code requirements, many schemes – despite supporting the aims of the Stewardship Code and using signatory status as a factor in their manager selection – are reluctant to become signatories themselves even to the old Code, given the resource implications of full compliance. We believe that further steps should be taken to encourage asset owners to engage with the Stewardship Code but which allows for the resource constraints of many schemes and acknowledges that schemes often delegate activity on engagement to their managers.

One idea which has received support from many PLSA scheme members is the concept of an asset owner ‘supporter’ status or similar. This could require schemes to make a number of commitments e.g. to the aims of the Stewardship Code, to assess how well an asset manager or service provider integrates the Code’s Principles into their investment process as a significant factor in manager selection and monitoring, or to communicate their supporter status of the Code to beneficiaries. The FRC could then encourage supporters to consider moving to full signatory status over time as the stewardship, investment and pensions markets develop in ways which may enable more schemes to achieve the capacity to do so.

To be clear, we do not support the concept of different Codes for different types of signatory. We believe that the current approach in the new Code with separate guidance for assets owners and managers within the same document works well. We also support the direction of travel of the new Code. However, we would encourage consideration of a pragmatic approach which recognises that not all schemes will be able to fulfil the new reporting requirements and commitments of the Code, but encourages more schemes to engage with it.

This must include discussion of how to structure any such supporter status so that it encourages more schemes to interact with the Code and become better stewards, without deterring those schemes which have the resources to become full Code signatories from doing so. The FRC would also need to explore what kind of reporting [and enforcement] requirements would be appropriate and proportionate for 'supporters'.

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

We do. We believe that the current approach sets the right level of stretching expectations for the different levels of the Code. The use of 'comply or explain' is important in allowing asset owners the flexibility in cases where the specific Provision is not appropriate.

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

In general, we believe that one of the strengths of the Code is its lack of prescriptiveness. It is important to ensure that it does not simply become a long list where investors 'tick off' certain activities, and continues to encourage a meaningful approach.

However, we do think there is a need to strengthen the references to non listed equity classes throughout the document, for instance in guidance on 2.13, which currently only mentions equity and fixed income.

On members' views, please also see our response to Question 2 above.

We support the decision to tailor the Principles, Provisions and Guidance across different categories of signatory. We think that the specific way in which most Provisions have been applied to asset owners and asset managers does recognise that good stewardship on the part of assets owners often involves delegating engagement activities to external managers, and scrutinising and holding their asset managers to account.

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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 support the approach to more outcomes-based reporting: this development is in line with current market best practice and should help pension schemes better understand whether their managers are living up to their commitments under the Code. We particularly support moves to encourage signatories to produce case studies, outlining how they have undertaken engagement, on key issues, how such activity aligns with their investment beliefs (and those of their clients) and the outcome. As well as helping schemes assess managers' stewardship efforts, such case studies can serve a broader purpose in demonstrating the value of good stewardship practices to clients.

However, some schemes which are currently signatories of the Stewardship Code have expressed slight concerns to us about the level of reporting required under the new Code. We recognise and appreciate that the FRC is seeking to avoid duplication with other reporting frameworks to minimise the burden on investors. We hope that the FRC will continue to be mindful of the need for a balanced approach in this respect.

We supported the previous move to a tiered Code; in principle, tiering is helpful to schemes in assessing and differentiating between asset managers on stewardship issues. However, in practice the tiers have been drawn so broadly that even within Tier 1, there remains a wide range in terms of the quality of 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?

Yes.

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

We believe that the proposed changes will make the Code more outcomes-focused and raise the standards of stewardship of Code signatories, in line with the Kingman Review recommendations. We believe that the FRC has not had the resources necessary to be as

effective as possible within its remit. We think there may be merit in stronger investigative powers to ensure asset manager practice is in line with their policy statements.

We also believe that a key step to building an effective framework for corporate governance and stewardship must also include greater balance in the backgrounds of FRC staff. At present, there remains a significant and dominant proportion of FRC employees drawn from the accountancy and audit professions, as opposed to those with investor practitioner expertise and experience. We recognise that the two are not mutually exclusive, but would welcome greater representation of the investor viewpoint at every level of the FRC; such a move would boost the FRC's 'soft' power in terms of its credibility amongst investors, ensuring it can develop different and senior-level relationships and it would also enable a more informed approach to upholding the future regulatory framework.

We also welcome the decision of the FRC to proceed with its proposed changes to the Stewardship Code even while the precise remit and powers of its successor body are yet to be determined. There has been, in recent years, a significant level of regulatory, policymaker and industry activity on stewardship and long-term investment practices both in the UK and globally and it is important to capitalise on this momentum at this time in order to shape future developments.

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

We do. There has been a public policy shift towards greater recognition of the importance of organisational culture in the UK, including through the FRC's previous work on this issue and the new UK Corporate Governance Code. Best practice in stewardship requires this to be fully integrated throughout an organisation, with clear links to its broader strategy and purpose. Such information from asset managers will be helpful to asset owners in differentiation on engagement and stewardship issues.

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

Although the leading stewardship practitioners already apply the Code across all their asset classes, we believe that others will need more explicit encouragement and support in doing so. We therefore believe that an expansion of the Provisions and Guidance would be helpful in this regard. Please also see our response to Question 1 above.

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Q10. Does the proposed Provision 1 provide sufficient transparency to clients and beneficiaries as to how stewardship practices may differ across funds? Should signatories be expected to list the extent to which the stewardship approach applies against all funds?

We do. We think it strikes the right balance between helping asset owners understand how stewardship differs across a given asset manager's products, funds and asset classes and ensuring that signatories do not face too onerous a burden. We think that there could be benefit in encouraging asset managers to explain how the overarching approach to stewardship is tailored for different investment strategies, including consideration and application of headline themes and principles.

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?

It is important for both schemes and managers to have a clearly articulated and considered set of investment beliefs, to provide a robust framework for investment strategy and decisions. The purpose of the Code is to ensure that stewardship is fully integrated through the investment approach of each signatory and we believe that requiring owners and managers to disclose their investment beliefs will be helpful.

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

It is vital that asset owners undertake effective scrutiny and monitoring of managers and other service providers, including on stewardship issues. We therefore support Section 3 in the level of expectations that it sets.

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

Both of these terms are used by investors and are useful ways of describing a particular approach which involves working together with other shareholders and stakeholders to engage on themes and issues of common concern.

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

There are already a number of mechanisms through which investors can escalate concerns about an investee company. This includes collaborating or undertaking collective action with other investors with similar concerns, including through industry forums like those of the PLSA and the Investor Forum.

We can see that there would be benefits in escalating concerns about a company to a regulator which had the power to act on these concerns. However, the remit and specific powers of the successor body to the FRC is at present uncertain, so we think that this *specific* issue should be considered once there is greater clarity. It is also the case that it takes time for any regulated community to have trust in a new regulator. Being able to trust that the new regulator will take appropriate action on information given in confidence will be important and we consider this a further argument for delaying specific consideration of such a mechanism to a later date.

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

Yes. Please see our responses to previous Questions.

Q16. Do the Service Provider Principles and Provisions set sufficiently high expectations of practice and reporting? How else could the Code encourage accurate and high-quality service provision where issues currently exist?

We support the setting of service provider standards. Although service providers do not have fiduciary or stewardship responsibilities, advisers on investment services to schemes can wield significant influence in the investment decision-making process. Efforts should therefore be made to encourage investment and service providers to engage with the Code so they can better support their clients' stewardship activities.

We agree that the Service Provider Principles and Provisions necessarily need to take a broad approach. We also agree that the emphasis needs to be on promoting and enabling effective stewardship across the investment chain and with their clients. Currently the language feels tailored to voting services and less so to investment consultants. Given the reliance of many schemes on investment consultants on range of issues, we believe this is an area which needs to be addressed in the final Code. We think that more could be done to emphasise that service providers must work with clients to develop policies on issues – including ESG issues – which are important and tailored to the client's investment beliefs, principles and objectives.

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We also believe that, where possible, specific areas of focus for the Service Provider Principles and Provisions should be aligned with those for other signatories and elsewhere in legislation. This could include explicit reference to consideration of "environmental, social and governance issues, including climate change."

We trust that this is helpful. We would be happy to discuss any of these issues further.

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