POLICY FRAMEWORK FOR CORPORATE GOVERNANCE AND STEWARDSHIP

WHAT IS CORPORATE GOVERNANCE?

Corporate governance is about ensuring that appropriate structures and individuals are in place to enable effective, entrepreneurial and prudent management, in turn delivering sustainable business success. It is not a matter of box ticking or mechanistic compliance; in fact, a compliance mind-set can undermine good corporate governance.

The PLSA believes that the underlying principles of all good corporate governance are accountability, alignment, transparency and integrity.

Truly effective corporate governance is, in the UK context, reliant upon a company's willingness to engage with the spirit of the Corporate Governance Code[1], rather than simply about compliance with the Code's "Principles". In parallel, it is equally important that all institutional investors play their part and take their responsibilities seriously.

WHAT IS STEWARDSHIP?

Pension schemes are entrusted by savers to protect and enhance the value of their retirement savings. This requires them to take an active role – either directly or through their asset managers and other advisers – to monitor, engage and (where necessary) intervene on matters which may affect the long-term value of investee companies.

Although the term "stewardship" is often used interchangeably with Environmental, Social, and Governance, or "ESG," the issues upon which schemes should act as good stewards encompass anything potentially financially material, from strategy, performance and treatment of "traditional" financial risks to topics such as climate change, human rights or board and workforce diversity.

Stewardship must sit alongside the integration of long-term factors in investment decision-making. Where a pension scheme hires a fund manager, even the most active stewardship programme cannot substitute for poor investment decisions.

CORPORATE GOVERNANCE VS STEWARDSHIP: TWO SIDES OF THE SAME COIN

A strong UK corporate governance regime relies significantly upon investors. This includes pension schemes, even if not directly engaging with companies themselves, recognising and assuming their own stewardship responsibilities. The PLSA therefore supports the 2020 Stewardship Code[2] and the mind-set that underlies it, which is that companies with engaged shareholders will perform better over the long run and that this should have a positive impact on pension scheme members' savings. We also welcome the recommendations of the

[1] Financial Reporting Council, 'The UK Corporate Governance Code' Financial Reporting Council (2018) <https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF>.

[2] Financial Reporting Council, 'The UK Stewardship Code 2020' Financial Reporting Council (2020) <https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf>.

Taskforce on Pension Scheme Voting Implementation (TPSVI) to government, regulators, and industry,[3] published in 2021, which recommended:

- Trustees should either set their own voting policy or acknowledge responsibility for the voting policies that asset managers implement on their behalf
- Trustees should make an assessment of the efficiency of the implementation of voting policies
- Where possible, trustees should set out an expression of wish on voting across all pension investment structures
- Industry should promote a vote disclosure template.

The Vote Reporting Group, established by the FCA in November 2022 to address the recommendations of the TPSVI, published a consultation and discussion paper.[4] in June 2023 proposing a voluntary, standardised and comprehensive 'vote reporting template' for asset managers to communicate to asset owner clients on their voting activity. The consultation closed in September and the FCA, acting as Secretariat, will be reviewing responses and submitting a summary to the Vote Reporting Group.

In 2022, alongside the Investment Association, the PLSA published a report[5] setting out several recommendations across the entire investment chain on how effective stewardship can ensure long term value creation. Those recommendations are set out in this document, as we believe this forms the blueprint for effective stewardship practices for asset owners.

REGULATORY AND STATUTORY BUILDING BLOCKS OF STEWARDSHIP AND CORPORATE GOVERNANCE

We believe that shareholders have a responsibility to work to ensure good governance at the companies in which they invest, going beyond the latest trends or shifts in policy and regulatory thinking. However, it is clear that developments in the policy environment can fundamentally alter the framework within which pension schemes and other investors exercise their stewardship responsibilities.

The following sections go through some of the most fundamental 'building blocks' of the legal, regulatory and policy frameworks for corporate behaviour and investor stewardship. It is vital that schemes – even if they outsource their stewardship and voting activities – have a good understanding of the parameters within which they operate. We would encourage all schemes and asset managers to consider becoming a signatory to the Financial Reporting Council (FRC) Stewardship Code.

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[3] Department for Work and Pensions, 'Taskforce on Pension Scheme Voting Implementation: recommendations to government, regulators and industry' Department for Work and Pensions (2021) <https://www.gov.uk/government/publications/taskforce-on-pension-scheme-voting-implementation-recommendations-to-government-regulators-and-industry>.

[4] Vote Reporting Group 'Vote Reporting: A consultation and discussion paper from the Vote Reporting Group', Vote Reporting Group (2023) <https://www.fca.org.uk/publication/consultation/vote-reporting-consultation-discussion-paper.pdf>.

[5] Pensions and Lifetime Savings Association & The Investment Association, 'Investment Relationships for Sustainable Value Creation: Alignment Between Asset Owners and Investment Managers' Pensions and Lifetime Savings Association & The Investment Association (2022) <https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2022/Investment-relationships-for-sustainable-value-creation-July-2022.pdf>.

A. THE COMPANIES ACT 2006

A Directors' duties, as set out in the Companies Act 2006,[6] are the foundation of corporate governance. They include the duty to promote the success of the company, while having regard to:

- The likely consequences of any decision in the long-term
- The interests of its employees
- Its need to foster the business relationships with customers and suppliers
- The impact of its operations on communities and the environment
- Its desire to maintain a reputation for high standards of business conduct.

As such, a proactive and effective board should provide the framework for discussing, managing and driving the long-term sustainability of the company by supporting the Director in carrying out these statutory responsibilities.

B. THE UK CORPORATE GOVERNANCE CODE 2018

The UK Corporate Governance Code establishes good practice (according to the Principles set out in the Code) that board Directors should apply to promote the purpose, values and future success of the company. In July 2018, the FRC published a significantly amended version of its UK Corporate Governance Code. The Code is structured into five sections:

- Board Leadership and Company Purpose
- Division of Responsibilities
- Composition, Succession and Evaluation
- Audit, Risk and Internal Control
- Remuneration.

Following a consultation in 2023 with a focus on directors' responsibilities for internal control, risk, audit and corporate reporting, the FRC took forward a small number of these proposals[7] and published its revision[8] to the Code on 22 January 2024.

The changes made have been limited with the focus on promoting smarter regulation and better governance through revisions to the Code in Internal Controls. The comply or explain regime means companies do not have to adhere strictly to the rules if they can provide a rationale as to why. The new 2024 Code will apply to financial years beginning on or after 1 January 2025. Until then the 2018 Code will apply.

We believe that how well a company applies the Principles of the Code – and the quality of its explanations – must be used as a benchmark by investors in their scrutiny of firms' corporate governance approaches.

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[6] Companies Act 2006, The Stationery Office <https://www.legislation.gov.uk/ukpga/2006/46/contents>.
[7] Richard Moriarty 'Statement: FRC policy update', Financial Reporting Council (2023) < https://www.frc.org.uk/news-and-events/news/2023/11/statement-frc-policy-update/>.
[8] Financial Reporting Council 'UK Corporate Governance Code', Financial Reporting Council (2024) <https://media.frc.org.uk/documents/UK_Corporate_Governance_Code_2024_FF6VFzi.pdf>.

Our Voting Guidelines on pages 26-73 mirror the five sections as laid out in the Code, but we also cover additional issues which we believe are particularly material to investors such as climate change, workforce, and capital structure and allocation.

C. THE UK 2020 STEWARDSHIP CODE

The Stewardship Code[9] is a voluntary comply or explain initiative run by the FRC which "aims to enhance the quality of engagement between investors and companies to help improve long-term risk-adjusted returns to shareholders." Updated in 2020, the most recent Code includes a broader definition of stewardship which expects that in creating long-term value for clients and beneficiaries, stewardship will lead to sustainable benefits for the economy, the environment and society. The PLSA supports these changes, which include:

An explicit reference to ESG factors
A focus on stewardship beyond UK listed equities, into asset classes such as fixed income and infrastructure and assets invested globally
A shift towards more outcome-focused reporting
A new set of six Principles for service providers.

Since 2010, all UK-authorised asset managers are required by the Financial Conduct Authority (FCA) Conduct of Business Sourcebook (COBS)[10] to produce a statement of commitment to the UK Stewardship Code or explain why it is not appropriate to their business model.

D. OTHER RELEVANT CHANGES IN THE PENSIONS INVESTMENT REGULATORY LANDSCAPE

The last few years have brought about new responsibilities for pension schemes when communicating how they have undertaken their stewardship responsibilities, including for climate change risk investment.

Changes to Occupational Pension Scheme Investment Regulations

- As of 1 October 2019, the 2018 changes[11] to the Occupational Pension Scheme Investment Regulations (2005)[12] required pension schemes to set out in their Statement of Investment Principles (SIP) their policies on stewardship, including engagement and voting, and how they consider financially material ESG factors.
- 2020 brought the first implementation deadlines of the 2018 changes, which abide by the directive brought about by the European Union's Shareholder Rights Directive II (SRD II). These require further detail on trustee stewardship policies to be added to pension scheme SIP and the publication of annual Implementation Statements.

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9 Financial Reporting Council, 'The UK Stewardship Code 2020' Financial Reporting Council (2020) <https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf>.
10 Financial Conduct Authority, 'FCA Handbook' COBS 1.1 General application, Financial Conduct Authority <https://www.handbook.fca.org.uk/handbook/COBS/1/?view=chapter>.
11 The Pension Protection Fund (Pensionable Service) and Occupational Pension Schemes (Investment and Disclosure) (Amendment and Modification) Regulations 2018, The Stationery Office <https://www.legislation.gov.uk/uksi/2018/988/regulation/4>.
12 The Occupational Pension Schemes (Investment) Regulations 2005, The Stationary Office <https://www.legislation.gov.uk/uksi/2005/3378/contents/made>.

- While DC schemes are already required to publish information online, 2018 changes mean DB schemes also need to publicly disclose their policies – and what they are doing – on their stewardship, ESG and shareholder engagement activities.

Changes to Climate Related Regulations

- All schemes with Assets Under Management (AUM) of more than £1 billion, plus all authorised Master Trusts, are now required to produce an annual TCFD report, according to regulations set out by the Department for Work and Pensions (DWP). A review of extending the requirements to smaller schemes should have taken place in 2023, but it has been delayed. All Local Government Pension Scheme (LGPS) funds will fall into the scope of new legislation to comply with TCFD reporting after a consultation was published in 2022. However, the date of implementation of the new rules has been delayed. LGPS pools fall within new FCA requirements that came into force in 2022.
- In 2021 the Government announced a plan for mandatory 'Net Zero Transition Plans.' In October 2023, the Transition Plan Taskforce published the final Disclosure Framework and a suite of Implementation Guidance, with the latter open for public consultation until the end of 2023.