

12 February 2015

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Stephen Hadrill  
C/O Carol Liuzzi  
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Dear Stephen

## **CONSULTATION RESPONSE: FRC DRAFT STRATEGY 2016/17**

Please find below, the Pensions and Lifetime Savings Association's response to the FRC's draft strategy 2016/17. As you know, the Association is an important stakeholder in the debates around corporate governance, stewardship and reporting, representing over 1,000 pension schemes managing nearly £1 trillion of assets on behalf of UK savers, much of it invested in UK companies. Our comments on the relevant consultation questions are as follows:

### **1 Do you have any comments on the regulatory approach we are proposing for our new three year strategy?**

We commend the FRC's Effectiveness review and support its recommendation of increased investor involvement in the FRC's work. The Pensions and Lifetime Savings Association represents more than 1,000 pension schemes investing on behalf of UK savers, with assets under management of nearly £1 trillion. We look forward to continuing our strong working relationship with the FRC.

We also support the FRC's objective of reducing regulatory burdens on business, and the intention to 'seek opportunities to reduce or remove burdens.' But while recognising that additional regulation can increase costs to investors or provoke perverse incentives, we see reducing regulation as a means rather than an end in itself. As such, we are also supportive of the FRC's assurances that the removal of regulations will be subject to the FRC's need to fulfil its wider remit and serve the public interest in maintaining and improving standards of corporate governance.



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Registered office: Cheapside House, 138 Cheapside, London, EC2V 6AE

**2 Are there areas of our work where we could reduce the regulatory costs we impose without compromising the quality of corporate governance and reporting in the UK?**

N/A

**3 Do you have any comments on the FRC's proposed projects and activities in 2016/17?**

**Corporate Governance and reporting:** We are glad to see the FRC focusing on corporate culture and board effectiveness. We also welcome the specific work on succession planning, which we also being relevant to the ongoing debate around directors' remuneration. A company with effective succession planning need not be overly-reliant on individuals, rendering the need for provocative pay packages to retain or attract candidates ought to be less pressing. As such, we think that executive pay levels play a useful role in analysing the effectiveness of corporate succession planning

We would like to highlight the importance of 'human capital' to culture and advise the FRC to monitor practices and reporting in relation to companies and the people who work for them. We produced a [report](#) last year highlighting how factors such as the composition; stability; skills and capabilities; and engagement levels of the workforce are critical determinants of an organisation's long-term success. Human capital represents an asset with an estimated worth of billions to companies, while at the same time, industrial disputes, employee misconduct or poor customer experience, for example, are all major strategic risks, the likelihood of which can differ from company-to-company, even within the same sector, depending on their relationship with their workforce. As such, it would be impossible for the FRC to fulfil its aim 'to promote corporate governance and corporate cultures that support the long-term success of companies' without taking a close interest in human capital developments across corporate Britain

We will produce recommendations on how investors can monitor investee companies' performance in terms of their human capital later this year.

**Investor Stewardship:** We support the FRC's focus on three key constituencies of the investment sector – asset owners; asset managers; and proxy advisers – but at the same time, hope that differences in stewardship capacity across these constituencies will be acknowledged. Many pension funds, particularly the smaller funds, lack the resource to dedicate significant time to stewardship issues. This is part of the reason why asset managers and proxy advisers are contracted in the first place. These industries should hold some responsibility to highlight the importance of stewardship to their clients, even if the pension funds do not raise it themselves. Only 29 per cent of respondents to our [2015 stewardship survey](#) said that their investment consultants had raised stewardship issues in discussions with them. While 81 per cent said they

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were satisfied with their asset manager's reporting of stewardship activities, only 9 per cent said they were very satisfied. So the FRC is right to focus on these areas.

We also wish to highlight the increased recognition of the materiality of Environmental, Social and Governance (ESG) factors to investment. A meta-study from Oxford University and Arabesque Asset Management found that 88 per cent of studies analysed indicated a positive relationship between an organisation's sustainability record and its operational performance. ESG should now be considered as an integral part of investment, not just an additional consideration driven by reputational concerns. We hope, therefore, that the FRC's work improving engagement and scrutinising reporting will encompass engagement and reporting on ESG factors.

**Corporate reporting:** As above, we support the FRC's approach, but would like to see better reporting in terms of the issues of human capital and ESG performance, in particular.

#### **4 Are the proposed indicators helpful in assessing progress towards the FRC's objectives; and are there other indicators that should also be taken into account?**

We think the indicators chosen by the FRC are well-judged, however we would reiterate our concerns outlined above regarding the capacity of asset-owners to scrutinise their asset managers.

In addition to levels of pension funds' satisfaction with reporting from their asset managers, our annual stewardship survey also highlights factors including:

- ▶ The number of pension funds who reported investment consultants raising stewardship issues with them as part of their advisory services
- ▶ Levels of collaboration between different fund managers
- ▶ Exercise of voting rights by investors
- ▶ Extent to which ESG/Stewardship criteria are included in mandates for asset managers

Our survey and others provide some documentation to this effect, while discussion of these issues as part of the FRC's individual engagements with stakeholders could further explore/refine headline survey findings.

This would perhaps add to the understanding of stewardship practices provided by the FRC's three priority indicators (the planned review of levels of asset owner satisfaction; the corporate view of engagement; and the impact of FRC scrutiny on Stewardship Code signatories).

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**5 Do you have any comments on our proposed budget for 2016/17?**

N/A

**6 Do you have any comments on our proposed funding requirement for 2016/17?**

N/A

**7 Do you agree with our proposed levy rates for 2016/17?**

N/A

We very much appreciate our ongoing dialogue with the FRC and value our regular meetings with your corporate governance team. We look forward to continuing to work together on these important issues to deliver our mutual objectives of rigorous investment stewardship and high standards of corporate governance, serving the interest of ordinary savers and the wider UK economy.

Yours sincerely



**Luke Hildyard**

**Policy Lead: Corporate Governance and Stewardship**

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