



## PROPOSED REVISION TO THE UK STEWARDSHIP CODE

Issued 5 April 2019

ICAEW welcomes the opportunity to comment on the Proposed Revision to the UK Stewardship Code published by Financial Reporting Council on 30 January 2019, a copy of which is available from this [link](#).

Revising the Stewardship Code is an opportunity to reassert the importance of active and responsible stewardship in UK corporate governance. It is a chance to alter the perception of stewards as overstretched and reluctant watchdogs. Stewardship will be integral to the new regulatory architecture if the Code encourages stewards to take a holistic, consistent and persistent interest in their investee companies.

This ICAEW response of 5 April 2019 reflects consultation with the Corporate Governance Committee whose members are drawn from the business and investment communities. The Committee informs our thought leadership and policy work on corporate governance issues and related submissions to regulators and other external bodies.

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## KEY POINTS

1. An 8 week consultation period is inadequate. The consultation period for the revised Corporate Governance Code was 12 weeks.
2. Having said that, our overall impression of the Code and Guidance is positive. The length and level of detail are appropriate. We agree with the separate treatment of asset owners and asset managers as owners pull the strings.
3. The division of the Code into five sections is logical and easy to follow. However, we are unsure about the semi-inclusion of service providers. As the Revised EU Shareholder Rights Directive (SRD II) introduces compulsory requirements for proxy advisers a voluntary code and 'comply or explain' Provisions will be insufficient unless the FCA strengthens implementation through new rules.<sup>1</sup>
4. One of the most significant and positive changes to the Code is the higher standard for the integration of stewardship with investment decision-making, and quite rightly this has been linked with stewards governance policies and structures. Bringing stewardship into the mainstream is absolutely critical. Stewardship must not be confined to departments which are detached from the main business and under-resourced.
5. The FRC could consider rotation of internal and external assurance. This could mirror Provision 21 of the Corporate Governance Code which says that FTSE 350 companies should have an external board evaluation at least every three years. A statement that assurance has been undertaken is insufficient. A meaningful statement will say how assurance has been undertaken, ie, scope, whether internal or external assurance has been used and which international standards have been followed. The Guidance to Provision 8 should refer to assurance of activities (rather than stewardship processes) as well as outcomes. Stewards may benefit from their service providers being assured.
6. We support a new and reinvigorated attempt at differentiating code signatories based on the quality of their reporting, policies, objectives, activities, and particularly outcomes. Provided the FRC's evaluation, scoring and assessment of Activities & Outcomes reports (A&O reports) is meaningful it will discourage boilerplate reporting and incentivise low-performing stewards to do better, eg, by discouraging stewards from free-riding on the stewardship of others.
7. On balance, we support the encouragement of stewardship of other asset classes. However, we are uncomfortable with allocating extra attention to particular subject areas, eg, ESG in Provision 11.

## ANSWERS TO SPECIFIC QUESTIONS

### **Question 1**

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

Yes. The nature of stewards' responsibilities when deciding to exit and exiting investments could also be covered.

### **Question 2**

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

Yes. However, if the intention is for the Code to apply to stewards' overseas holdings then this must be made clear, especially if the FRC decides to encourage stewardship of other asset classes. The

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<sup>1</sup> Rules for proxy advisers were not proposed in FCA CP19/7: Consultation on proposals to improve shareholder engagement.

FCA and FRC joint discussion paper<sup>2</sup> invites comment on the position of overseas investors, and the Code must reflect the decision reached.

### **Question 3**

***Do you support ‘apply and explain’ for the Principles and ‘comply or explain’ for the Provisions?***

Yes. This approach fits nicely with achieving outcomes. It is also logical that the same approach is taken to Principles and Provisions in the Stewardship Code and the Corporate Governance Code.

### **Question 4**

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

The status of the Guidance must be made clear, ie, whether Guidance is merely encouragement or more than that. The application of ‘comply or explain’ to Provisions makes them difficult to differentiate from Guidance.

The introduction to the current Stewardship Code says that [investee companies’] explanations must not be evaluated in a mechanistic way. This important point must be included in the new Code. The Guidance for Provision 17 may be an appropriate place to repeat this important point.

### **Question 5**

***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?***

Yes. We support A&O reports as activities and outcomes are far more important than policies, and activities and outcomes should be reported simultaneously using both quantitative and qualitative information. A&O reports will provide the FRC and stewards with valuable insights.

Relevant entries on the Investment Association’s public register of shareholder opposition votes should be disclosed alongside voting records.

### **Question 6**

***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. Signatories of the 2012 Code should not automatically be grandfathered over to the 2019 Code as the new version is significantly different.

### **Question 7**

***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?***

Yes. The proposals reflect Kingman’s desire to differentiate excellence in stewardship. They also reflect the outcomes-focused approach to stewardship articulated in the Kingman Review and in the Government’s response to the BEIS consultation on Insolvency and Corporate Governance. The methodology used by ARGA to evaluate, score and assess A&O reports should underline the importance of outcomes.

ARGA’s powers must reflect its statutory responsibilities which will be defined in future legislation.

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<sup>2</sup>FCA and FRC DP 19/1: Building a regulatory framework for effective stewardship.

### **Question 8**

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

No. There must be sufficient disclosure to make clear that stewardship centres on 'do as we do' not 'do as we say', and the importance of alignment should be emphasised and explained. However, there may unnecessary duplication and repetition between purpose, values and culture (and beliefs).

### **Question 9**

***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?***

No. The new Code rightly encourages the application of stewardship to other asset classes, but it is too soon to say if the Provisions and Guidance need to be further expanded as that depends upon the statutory responsibilities ascribed to ARGA.

### **Question 10**

***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 to all funds?***

Yes. The proposed Provision 1 does provide sufficient transparency. Signatories should be expected to disclose funds which are not subject to their usual stewardship approach, and explain why an alternative approach is necessary or preferable.

No. Listing the extent to which the stewardship approach applies to all funds should only be considered if Provision 1 proves to be unsatisfactory.

### **Question 11**

***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?***

No. Stewards may wish to disclose their beliefs if there is more to say after purpose, values, strategy and culture have been disclosed. However, disclosure of beliefs should not be subject to 'comply or explain.'

### **Question 12**

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

Yes. However, monitoring by signatories must not overlap with monitoring by ARGAs, ie, agents must not be pulled in different directions by their clients and regulator.

### **Question 13**

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

Yes. Collaborative engagement should be used as it is an internationally recognised term.

The Guidance to Provision 20 makes clear that 'collaborative engagement' means engagement with other investors and other market participants. The rest of Section 4 seems to relate to constructive engagement between investors and investee companies, but the correct position needs to be made plain in the Code.

The application of Provision 20 to pension trustees' collaborative engagement with members should be added to the Guidance for this Provision.

### **Question 14**

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

Yes. This reflects the spirit of the age, ie, Kingman’s recommendation for a mechanism for auditors to report viability and other serious concerns to ARGAs.

Escalating concerns will help investors meet public expectations of responsible corporate citizenship. Provided there are sufficient powers and resources to act on information received, early intelligence and intervention could reap significant public interest benefits, eg, improved security for investors, employees, suppliers and creditors. Jurisdictional variations would need to be considered although they are not insurmountable, eg, there may be overlap with the compensation scheme administered by the Office for the Whistleblower in the US.

The matter of confidentiality (and perhaps anonymity) for reporters depends upon whether reports will be made by individuals or by organisations (which perhaps include a contact name). Individuals are more likely to seek assurances about confidentiality or anonymity.

### **Question 15**

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

No. More specificity may imply a requirement or expectation, rather than encouragement.

The Guidance for Provision 1 says that the scope of signatories’ stewardship should be disclosed. As part of this stewards should disclose whether their expectations of investee companies is consistent, or why their expectations vary between companies.

### **Question 16**

#### ***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?***

No. In order to implement article 3j of the SRD II for proxy advisers much more detail is needed. Expectations must also be transformed into requirements through new FCA rules. The Code is only voluntary for proxy advisers, and this weakness is compounded by the application of ‘comply or explain’ to Provisions.

Article 3j requires proxy advisers to make annual public reports which include: the essential features of the methodologies and models they apply; the main information sources they use; the procedures in place to ensure quality of the research, advice and voting recommendations and qualifications of the staff involved; whether and, if so, how they take market, legal, regulatory and company-specific conditions into account; the essential features of the voting policies they apply for each market; whether they have dialogues with the companies which are the subject of their research, advice or voting recommendations and with the stakeholders of the company and, if so, the extent and nature thereof; and their policy regarding the prevention and management of potential conflicts of interests.

The Principles and Provisions for service providers skirt some of these issues but the material is incomplete, eg, Provision 2 refers to providing information about how products and services are prepared which is reminiscent of the article 3j requirement to disclose methodologies, models and main information sources; Provision 4 refers to ensuring that the workforce has appropriate experience and qualifications but article 3j requires the disclosure of the procedures in place to ensure [the quality] of qualifications of staff; and Provision 5 refers to the disclosure of a conflicts of interest policy and how it has been applied whereas article 3j requires disclosure of a policy regarding the prevention and management of potential conflicts of interest.

Provision 6 says that signatories should establish a code, whereas article 3j requires proxy advisers to publicly disclose which code of conduct they follow, or give a clear and reasoned

explanation as to why they do not follow a code. Article 3j also requires proxy advisers to disclose any deviations from their chosen code, the reasons for deviation, and, where appropriate, to disclose any alternative measures applied.

The Best Practice Principles for Shareholder Voting Research and Analysis (BPP) are currently being revised. The revised BPP may delve into areas such as the effect of the application of managers' house-styles on proxy advisers, and whether advisors roles and responsibilities vary as investments mature. We also hope that the revised BPP will encourage proxy advisers to treat the companies they are researching fairly and with respect. The transparency required by article 3j will support this professionalism but more may be needed, eg, an articulated duty of care to companies.

Adding direct references to investment consultants and proxy advisers to the Code and Guidance is a simple way to raise awareness of the Stewardship Code as it will improve the ranking in internet searches. The FCA's definition of proxy advisers<sup>3</sup> should be included as part of the definition of service providers. One of the reasons why this definition is attractive is because it does not refer to the lack of a direct fiduciary duty for service providers.

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<sup>3</sup> See footnote 1.