



Association of Member
Nominated Trustees

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Corporate Governance and Stewardship
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Dear Stewardship team,

The Association of Member Nominated Trustees is grateful for the opportunity to respond to the consultation document issued in January 2019 entitled *Proposed Revision to the UK Stewardship Code*. AMNT was established in 2010 as an organisation run by and for member-nominated trustees, directors and representatives of private sector and public sector pension schemes. We now have approximately 575 members from over 415 pension schemes that have collective assets of more than £775-billion.

In summary, we are supportive of the FRC revision of the UK Stewardship Code (SC) and particularly commend the updated definition of stewardship - 'Stewardship is the responsible allocation and management of capital across the institutional investment community to create sustainable value for beneficiaries, the economy and society.' It encompasses a wide range of stewardship models, applies globally to all asset classes (not just UK equities), and does not limit accountability solely to fund managers, but extends also to asset owners and service providers. We also commend the alignment with the Shareholder Rights Directive (SRD) with regard to the explicit mention of beneficiaries to whom we are accountable. We also welcome the explicit recognition of environmental, social and governance (ESG) factors, including climate change.

However, whilst we agree with the spirit of the revised UK SC, the new code will be a massive improvement but also represent an increased administrative burden. This elevates to an even greater degree the importance of the supporting guidance, which should highlight the different models that can be used to exercise stewardship responsibilities as well as how they can advance their stewardship approach over time. It is crucial that the FRC proactively engage with the trustee community to support asset owners in adhering to these new obligations; AMNT would be pleased to help FRC in this effort within the scope of our resources.

To ensure alignment across the stewardship chain we are keen to see the UK SC and good standard of compliance promoted and reinforced by other policy makers and regulators in the UK, including but not limited to, Department of Work and Pensions, MHCLG, Financial Conduct

Authority, Prudential Regulation Authority and The Pensions Regulator.

Along with its partner the UK Sustainable Investment & Finance Association we have produced guidance for trustees on holding consultants to account for the quality of their environmental, social and governance (ESG) (including stewardship) advice. We believe that consultants should form an important part of FRC's proactive engagement with trustees, given their reliance on advisors. We are also keen to see that the guidance for Section 3 on Active Monitoring, and Service 5 on Service Providers reflects the importance of this relationship. AMNT along with UKSIF offers its services to FRC in the development of a Code of Conduct for investment consultants (or similar guidance).

We wish to bring to your attention one particular barrier to effective stewardship which will have a negative impact on the effective implementation of the Code. As per our letter to FRC in October 2017, fund managers are still refusing to accept client voting policies as part of their pooled fund arrangements. If UK regulators are expecting asset owners to raise their game with respect to the development of robust stewardship policies, it is impossible for them to achieve this regulatory requirement if they cannot implement their policies through their external managers. As you are already aware AMNT, along with UKSIF and the PRI, have commissioned research on barriers to split voting in pooled fund arrangements, the findings from which will be available in due course. Whilst we commend the FRC for its inclusion of the fund manager requirement to disclose its policy on split voting in pooled funds, given your discussion document on stewardship in conjunction with the FCA, we believe this is an issue that requires the attention of both government departments.

We would be happy to discuss our response in further detail should you wish. To arrange a meeting, please contact our Campaign Manager for Red Line Voting, Leanne Clements, at leanne.clements@amnt.org

Regards

Janice Turner, Co-Chair
AMNT

Leanne Clements
Campaign Manager, AMNT

UK Stewardship Consultation Questions

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.

Yes. The draft does indeed cover the core areas of stewardship responsibility and includes many of the areas championed by your response to your consultation in February 2018, such as:

- Expanding the scope beyond the UK, listed equities and fund managers to include asset owners and service providers
- Ensuring the SC is aligned with the UK Corporate Governance Code, as evidenced by signatories having to report on purpose, values and culture
- The inclusion of “ESG factors including climate change” as aligned with upcoming DWP regulations (note: we would recommend that climate change be added to all “ESG” references to ensure consistency – e.g., Provision 11)
- The inclusion of whether fund managers accept split voting in pooled fund arrangements

However, we do believe that the guidance section of the SC needs more work, especially with regard to asset owners. We recognise that the service provider section may need more work, but since this will need to be revisited when final details have been published of the transposition of SRD II into UK law and FCA rules, we will focus our response from the perspective of the asset owner in our feedback.

Notwithstanding SRD II developments, given the importance of investment consultants to externally managed asset owners (which constitute the majority of UK pension schemes), the relationship between them as it relates to ensuring stewardship obligations are met should not be underestimated. AMNT, along with its partner UKSIF, recently produced a guidance document for trustees on holding consultants to account for the quality of ESG (and stewardship) advice: <https://amnt.org/wp-content/uploads/2018/12/FINAL-investment-consultant-December-2018-report.pdf>. Given our continuing collaboration with the sixteen investment consultants forming part of the aforementioned guidance document (which represent more than 85% of total UK market share), AMNT would like to take this opportunity to extend our services to the FRC, in so much as resources allow, in helping with the creation of minimum stewardship requirements for investment consultants.

We wish to bring to your attention one particular barrier to effective stewardship which will have a negative impact on the effective implementation of the Code. As per our letter to FRC in October 2017, fund managers are still refusing to accept client voting policies as part of their pooled fund arrangements. If UK regulators are expecting asset owners to raise their game with respect to the development of robust stewardship policies, it is impossible for them to achieve this regulatory requirement if they cannot implement their policies through their external managers. Given your discussion document on stewardship in conjunction with the FCA, we believe this is an issue that requires the attention of both government departments.

Based on the research we have provided in this area, another area of concern for us is that we believe that fund managers are insufficiently publicly accountable in their voting policies about how they will vote across these key issues. Some fund managers did not publicly disclose their voting policy. With regard to voting record disclosure, the quality and accessibility is quite varied, with again some fund managers not disclosing their records at all.

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

Yes, however we wish to make the following comment regarding the substantive changes that the new Code reflects.

Whilst these changes have, in our view, improved the SC tremendously from its predecessor, we do not wish the vast improvement to be undermined by inaction from asset owners due to a lack of adequate support from their investment consultants. Therefore, if not already being organised, we would recommend that the FRC proactively engage with UK pension trustees to make clear their new obligations under the new Code requirements. AMNT would be happy to serve as a conduit to such engagement.

We also wish to re-emphasise the role of investment consultants for externally managed schemes in this regard, and therefore FRC may wish to include them as part of their proactive asset owner engagement to ensure that investment consultants are giving their asset owner clients the quality of advice required in this area. Given our engagement with the 16 consultants forming part of our AMNT-UKSIF initiative, we believe that this type of policy signaling is vital.

With regard to reporting, we strongly support the idea of reporting against the delivery of stewardship objectives, however considerable guidance and support for asset owners is needed in this area. We would ask the FRC to consider a working group of a few current signatories to develop guidance for reporting, especially for asset owners. More detail on reporting is provided later in this submission.

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

Yes, the principles appear to have broad applicability to allow for a “apply or explain” structure. The Provisions, conversely, may not be applicable to all signatories and thus a “comply or explain” structure seems more appropriate.

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

In general, the guidance needs substantially more work to provide more support on the ‘how to’. In some cases, the guidance does not offer much more than is already in the provision text. e.g. Provision 5, Provision 10, and Provision 11. A salient example of a Provision in which there is currently insufficient guidance available for asset owners is Provision 22: “Signatories should describe how they take account of beneficiaries’ needs and the extent to which they seek to engage with beneficiaries to understand their views”. The FRC, perhaps along with TPR, should develop guidance to help trustees (particularly those of DC schemes) navigate this complicated area of beneficiary engagement. Provisions such as these, where guidance is lacking in the market, should be prioritised and industry working groups created to develop such guidance.

Another pertinent example is Provision 23 under Exercise Rights and Responsibilities (Page 10): “Signatories should explain how they exercise ownership rights across different markets and asset classes” – without sufficient guidance, an asset owner could report in a paragraph (too little detail) or over 30 pages long (which would be overkill) given the amount of mandates that they manage. This again demonstrates the necessity that investment consultants step up to the plate to support asset owners in their stewardship obligations

More signposts to existing initiatives that drive best practice stewardship disclosure would be

beneficial, such as the following:

- ICGN Model Mandate Initiative¹ – which highlights suggested contractual language for ESG and stewardship obligations between asset owners and their fund managers
- PRI’s guidance for asset owners on fund manager selection, appointment and monitoring² - which helps asset owners to set ESG and stewardship expectations of fund managers
- Task Force on Climate Change Related Disclosures

The area which we believe asset owners need the most support is fund manager monitoring (Section 3). Examples of areas in which asset owners could use more guidance on fund manager monitoring are:

- Which stewardship factors could be considered in their decision making process
- Decision making processes that determine how these factors may be weighted in the overall evaluation process
- How to construct a suitable fund manager engagement programme should they not initially meet expectations (including a suitable escalation programme);
- Best practice case studies of how asset owners have succeeded in getting their fund manager(s) to meet their expectations over time (e.g., through collaboration, setting deadlines, etc).
- How they can report on their fund manager engagement programme as part of their reporting obligations

We also support more guidance on other asset classes such as bonds and private markets. We would encourage references to best practice guidance produced by the BVCA³ and PRI⁴.

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 are supportive of the proposal to introduce an annual Activities and Outcomes Report. As previously stated, we would ask the FRC to consider a working group of a few current signatories to develop guidance, especially for asset owners, on reporting. Some initial thoughts on the state of play on stewardship reporting within the fund manager and asset owner communities are provided below.

In a perfect scenario, it would not be recommended that the FRC provide prescriptive templates as this may lead to unintended negative consequences of “ticking a box” and not provide the necessary encouragement for signatories to individually explore what reporting requirements would suit their particular stakeholder base. However, having said that, we are not dealing with a perfect scenario in our view. The quality of stewardship reporting within the fund management industry could be substantially improved across the board, both at an aggregate level (public reporting at an aggregate firm level) and at a client, mandate level (more detailed, private reporting as highlighted in ICGN’s Global Stewardship Principles). Indeed it was in recognition of the issue of substandard client-specific reporting that 16 asset owners developed the Guide to

¹https://d3n8a8pro7vhm.cloudfront.net/intentionalendowments/pages/27/attachments/original/1420777456/ICGN_Model_Mandate_Initiative.pdf?1420777456

² <https://www.unpri.org/asset-owners/aligning-expectations-guidance-for-asset-owners-on-incorporating-esg-factors-into-manager-selection-appointment-and-monitoring/416.article>

³ <https://www.bvca.co.uk/Our-Industry/Responsible-Investment/Responsible-Investment-Toolkit>

⁴ Example: <https://www.unpri.org/investor-tools/infrastructure>. Other PRI tools for bonds, real estate, private equity also can be found on their website.

Responsible Investment Reporting in Public Equity in 2015⁵. The asset owner stewardship reporting cannot improve if the fund managers themselves do not improve or indeed provide mandate-specific stewardship reporting to their asset owner clients – it is an interconnected system. We recognise that there would be some details within the client-specific reporting that cannot be made public, but this is a discussion that can be had with the fund manager, and set up as part of their contractual obligations upon contract award/renewal. However it is set up, we believe beneficiaries should be able to expect reporting that is directly applicable to their fund, not culminations of various fund manager aggregate reports that has some unknown degree of overlap between their own fund and other clients the fund manager has (exceptions to this of course would be passive investments). With regard to asset owner reporting to their beneficiary base, it is absolutely crucial that further guidance is provided as there are very few examples of this type of reporting being done currently that asset owners can use as a resource to develop their own reporting template.

Therefore, we believe the new SC could provide an opportunity for FRC to explore the quality of stewardship reporting to determine the degree to which it needs to “step in” and assist, whether it be through the development of minimum standards (e.g. to help asset owners hold their fund managers to account for the quality of their reporting), a “lighter touch” approach of simply highlighting best practice across the piece, or perhaps both to show a trajectory of possible reporting improvement over time that an asset owner can choose is the most appropriate for them. Either way, as previously highlighted, the creation of a working group for stewardship reporting to explore this matter further would be strongly recommended.

In general, the report should provide assurance that the signatory has delivered across all its stewardship obligations – ie needs to be comprehensive in coverage but need not contain unnecessary detail. We would recommend such detail can be signposted in other available documents e.g. individual voting decisions, detailed technical guidelines and other supporting policies.

We would also recommend the FRC are clearer that matters need only be reported once, even if the matter in question supports several principles or provisions. One example is securities lending, which is referred to in number of areas. The other is fund manager selection, appointment and monitoring, a key area for asset owners.

We welcome the emphasis on voting reports that are accessible and informative, as well as the inclusion in the guidance that rationale for votes against management be provided. However, we would also recommend that managers be urged to identify those contentious votes in which management was supported and explain their decision to do so. One could argue that these rationales are more material to an asset owner holding a fund manager to account for their stewardship approach than rationales for votes *against* management. It is important that fund managers invest in their voting infrastructure so that they provide voting records that are easy to access, such as the use of online databases.

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, but have recommended a working group to develop more detailed supporting guidance.

⁵ <https://www.plsa.co.uk/Policy-and-Research/Document-library/Guide-to-Responsible-Investment-reporting-in-Public-Equity-Published>

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?

The current code is a significant step forward from the previous version and the FRC is to be commended for its efforts. However, there are some areas to be considered as it relates to the Kingman Review. Below you will find the Kingman Review recommendations pertaining to the SC, with AMNT commentary as to the degree to which the proposed revisions address the Kingman recommendations provided in italics:

- The SC should focus on outcomes and effectiveness, not on policy statements.
The majority of the principles and provisions are policy and process-based, however, the Activities and Outcomes report could satisfy the Kingman Review recommendations, as long as the following occurs:
 - *The creation of a working group for reporting for the purpose of assessing the need to develop minimum reporting standards, highlighting best practice reporting or a combination of both in order to support fund managers' and asset owners' ability to meet the reporting requirement.*
 - *The FRC monitors the quality of stewardship reporting for both fund managers and asset owners.*
- The Government should also consider whether any further powers are needed to assess and promote compliance with the Code. If the Code remains simply a driver of boilerplate reporting, serious consideration should be given to its abolition.
The only reference to assessment that is made within the Code itself is the following: "The FRC will continue to monitor and assess stewardship disclosures against the Code", which we feel provides insufficient detail as to how this will be done in practice. AMNT does agree with the Kingman Review in that without appropriate oversight from the FRC regarding the quality of stewardship across the investment chain, it will not serve the SC's intended purpose. Some form of tiering exercise on reporting, as was done in the past, may be necessary. AMNT is not prescriptive as to what form of assessment and compliance promotion is required, simply that it is necessary to avoid the boilerplate reporting of the past. The FRC's assessment and enforcement approach to the SC should be made clear within the Code itself, not only within the consultation document.

We are keen to see the UK SC and good standard of compliance promoted and reinforced by other policy makers and regulators in the UK, including but not limited to, Department of Work and Pensions, MHCLG, Financial Conduct Authority, Prudential Regulation Authority and The Pensions Regulator. The well-being of beneficiaries can only be served by alignment of interests across the investment chain. We recognise that the development of further guidance across the stewardship piece will be an administrative burden to the FRC, and thus it may be wise to call upon other governmental departments to support where applicable (e.g TPR– fund manager monitoring guidance, for example).

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

Yes. This is helpful particularly for beneficiaries so they can assess if there is any gap between 'organisational purpose, values, strategy and culture' and the organisation's stewardship activities.

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?

Yes. We would propose the FRC, drawing on the work of the PRI, UKSIF, IIGCC, PLSA, BVCA and other such organisations, draws up a list of guidance documents that is held on the FRC website as a separate document that can be regularly updated. The FRC has advisory groups which would be well placed to support the development and maintenance of such guidance.

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?

Yes and Yes, so long as the focus is on material areas of difference in the approach. The guidance is key here so that asset owners understand what “material areas of difference” might mean in practice.

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?

Yes and Yes.

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

Yes, however as previously mentioned, this Section represents one of the most important areas in which asset owners need support. Therefore, more detailed guidance is needed on fund manager monitoring for asset owners. More details on this are provided under Q4.

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

Yes. We are happy with the use of ‘collaborative engagement’ as it implies a level of consensus in the engagement objectives. Collective does not have the same meaning.

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

In principle the ability to report concerns to a regulator could provide a useful escalation mechanism for investors. However, the regulator would need to give careful consideration to what it does with the information once received and what expectations that might create. Given the FRC’s collaboration with the FCA on matters of stewardship, it is also important to consider the mechanism by which asset owners can escalate concerns regarding their fund managers.

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

Yes, see our response to question 9.

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?

No but as previously stated, we believe that these principles and provisions should be updated to reflect the transposition of SRD II into UK law and FCA rules. Therefore, we believe that the service provider module should be revisited when details of this transposition become known. Given the importance of investment consultants to asset owners, however, we do believe that in the interim further guidance is required to be used as a tool for asset owners to hold consultants to account for the quality of the stewardship advice they are receiving. We refer to the work of AMNT and UKSIF as previously referenced which will support the FRC in their efforts in this regard: <https://amnt.org/wp-content/uploads/2018/12/FINAL-investment-consultant-December-2018-report.pdf>.

Overall, it is important to note that a balance needs to be struck between:

- Ensuring service providers provide good stewardship products and services with strong internal governance mechanisms that are aligned with clients' best interests, and
- The responsibility of asset owners and fund managers as the procurers of this service, as it is they that hold the fiduciary responsibility as stewards.

One unintended consequence of having service providers adhere to strict stewardship provisions may be that it allows asset owners and managers to place undue regulatory reliance on service providers to fulfill fiduciary responsibilities. Therefore, we believe the most powerful mechanism to improve stewardship is to develop provisions and guidance which send a signal to fund managers and asset owners that, while they can outsource some of the administrative elements of stewardship, asset owners and managers remain responsible for the effective exercise of shareholders' rights. We don't wish to release service providers of their professional responsibilities in this regard and we believe that they should have their own SC obligations. However, we believe that the most powerful way to effect change and improvement in these areas is to give the lever to the people that are providing the advice, as opposed to the regulators themselves. Therefore we do not recommend the level of prescription of principles and provisions to be the same as that for fund managers and asset owners. However, there should be differentiated guidance for each type of service provider, and perhaps guidance to help fund managers and/or asset owners:

- Hold their service providers to account for the quality of their advice; and,
- Through the reporting mechanism, demonstrate to their client base that the service provider in question helps fulfil their stewardship objectives, and that they are using the service appropriately.

There has been considerable criticism of proxy advisors, especially in the US, specifically that they "wield too much power." We are also mindful of the feedback the FRC has received with regard to greater scrutiny on proxy advisors and it is partially with that feedback in mind that we make the following observations:

- The AGM season presents significant logistical challenges. Proxy advisors/voting agencies fulfill important information and transaction processing functions in much the same way as the sell side community supports the stock selection function. Proxy advisors are, however, not stewards. Just as it would be unacceptable for an asset manager to automatically defer to the broker's research and trading recommendations, auto-pilot voting demonstrates a compliance mentality and not an integrated stewardship mentality

- The "power" that proxy advisors allegedly wield is therefore directly proportional to the degree to which asset owners and/or fund managers allow them to wield it.
- If a fund manager does not allocate sufficient resource to voting its clients' shares and outsources responsibility, then that is the fault of the fund manager, not the proxy voting agency.
- It is the role of asset owners to hold fund managers to account for their actions and for asset managers to demonstrate to their clients that they are using service providers appropriately.
- We share the concerns expressed in the FCA/FRC Discussion Paper 19/1 that there appear to be structural problems in the market for stewardship services which is dominated by two providers⁶. This lack of diversity may be a contributing factor to the perceived failings of the SC and bears a more detailed separate investigation.

It is with this perspective in mind that we feel that the SC should reflect that the onus is on the procurer of services to demonstrate that their service provider procurement and oversight is aligned with client interests rather than a box-ticking compliance approach predicated on outsourcing to the cheapest provider. Therefore, we believe that the FRC should make clear that the responsibility for service provider oversight lies with the asset owners and fund managers, and provide guidance as to how this oversight should operate in practice.

Notwithstanding the above, we do believe however that those proxy voting agencies that do generate in-house voting policies should publicly disclose those policies and their voting records, to the same standard being placed upon asset owners and fund managers.

⁶ <https://www.pwc.co.uk/services/human-resource-services/insights/demystifying-executive-pay/iss-friend-or-foe-to-stewardship.html>

Detailed feedback

Consultation document, p13: paragraph 60 could be edited and inserted into the Code p5
Consultation document, p17: question 9 – we would wish to see in the Guidance links to good practice developed by other organisations, e.g. BVCA RI Advisory Group and PRI PE monitoring guidelines.

Code (Annex A), p1: reference to ESG factors should say “including climate change”.

Code (Annex A), p3: we should wish it made clear that the annual Activities and Outcomes Report need not be the exclusive reporting route (e.g., voting records, quarterly voting/engagement reports, etc).

Code (Annex A), p3: this definition for asset owners is preferable to the one on p20. The definition should be same to be consistent.

Code (Annex A), p4-5: should include here details of the FRC checking your Policy and Practices Statement and of the assessment of the Outcomes Reports.

Section 1:

Code (Annex A), p12: Provision 2, there should be guidance on what stakeholder means.

Code (Annex A), p6: Provision 3 – not sure how this expands on to Principle C. It should explicitly link to the risk framework. This helps to interweave stewardship and the TPR governance framework.

Section 2:

Code (Annex A), p14: Provision 10 – the guidance needs to note that there could be a variety of timeframes relating to different aspects of investment beliefs and stewardship.

Code (Annex A), p7: Provision 11 should say “ESG factors including climate change” for consistency with Principle E.

Code (Annex A), p14: Provision 12 could have guidance that links to TPR because this guidance for asset owners on investment beliefs includes example beliefs relating specifically to climate change.

Section 3:

Code (Annex A), p15: Provision 14 – the guidance needs to note that there could be a variety of timeframes relating to different aspects of investment beliefs and stewardship.

Code (Annex A), p8: Provision 15 – This needs to allow for various implementation models, whilst accepting the principles that stewardship responsibility cannot be delegated.

Section 4:

Code (Annex A), p9: Provision 21 (Asset managers) – should explicitly include a requirement to report back to clients on what they have done and how (as opposed to the term “proactively communicate, which could mean various things).

Section 5:

Code (Annex A), p10: Provision 27 feels like it should belong in Section 4.