

Who we are

We are tomorrow's company, a not-for-profit think tank, which aims to shape the way organisations of tomorrow think, work and act, inspiring and enabling business to be a force for good. As such, we produce research pieces and organise collaborative events with the aim of providing leaders with far-sighted and relevant insight about difficult issues.

We welcome the opportunity to respond to the FRC's consultation on the Stewardship Code. Our responses are drawn from our work on Stewardship, most notably our 2018 report 'Better Stewardship' - published in collaboration with a number of major Investors - and our 2018 roundtables. These were held through 2018 with 75 participants including asset managers, asset owners, investment consultants, pensions funds, investment institutions, businesses and advisory and representative groups.

Response to the consultation

Overall we welcome the changes outlined in the Stewardship Code. Many of the changes reflect work that Tomorrow's Company and the Stewardship Alliance have called for, and we feel they represent a significant step forward.

Our full response to the questions is below. As an overall response we would highlight the following:

- The recognition of different kinds of asset classes and for stewardship to apply to all entities - this came through in our roundtables and it is good to see this reflected in the Code;
- A need for differing guidance and expectations for different entities in the investment chain, including investment consultants and proxy advisors - as above, this was a key finding of our research and is a vital part of the future of the Stewardship Code. We are pleased to see it included in the Code here;
- The issue of long vs. short termism. This was raised considerably at our roundtables and the FRC has noted this in the consultation document too. It is not totally clear from the changes to the Code as they stand if this is going to address short term isms in the market, and, indeed, whether the code could be used to press for long term focus. This may not be an issue that can be addressed by the Code alone, but it bears noting that this may still be a key issue going forward.
- Overall we feel that the success of the Code now will rest a lot on two factors - the reviewing/monitoring process, and the extent to which signatories feel able to sign up and are encouraged to see it as an opportunity, rather than as a transparency or reporting exercise.

It is understandable that the new Code includes more rigorous reporting requirements - the principle of transparency leading to better practice underpins a great deal of policy around business. We would suggest that the monitoring going forward needs to ensure that the increase in reporting requirements is not a burden and that companies are sufficiently resourced to do it well, and to ensure that the reporting is of sufficient quality and clarity that it demonstrates changing practices, and avoids boilerplating. This should be an explicit part of the ongoing review (of both the Stewardship Code and the UK Corporate Governance Code). Given the recent expansion of the requirements of the FRC (now AGA) it will be important for this to be reviewed. (aka need to be clear that the expanded powers promised are appropriate and allow the AGA to fulfill their role, and that this explicitly focuses on the, at times, difficult balance between encouraging detailed reporting, while also ensuring that it is succinct, relevant, and - most importantly - represents changing practice.

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, we feel the proposed sections cover the core stewardship responsibilities.

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

Yes, we feel the Principles set sufficiently high expectations of effective stewardship for signatories of the Code.

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

Broadly speaking, yes. However we are concerned that the combination of Apply and Explain AND comply or explain makes the reporting more complicated - the language of application is different to the language of compliance, and could risk creating a confused message in signatories reporting. As noted above in our general feedback, we are concerned generally that the reporting be meaningful both to the reader and the reviewer, and the apply and comply combination could make this complicated both for reports preparers and for those reviewing them.

We do not think that the combination of comply and apply in the same code should be taken away, only that the first few years of reports monitoring (and guidance) be very clear on how these two perspectives will need to be reported on differently. The emphasis should be on supporting signatories to develop simple, readable and meaningful reporting that encourages better practice. Could more guidance be developed by the AGA in collaboration with reports preparers, to navigate through the practicalities of how to report against the Principles and Provisions. (It should be noted that, while the governance code in theory has historically included a requirement to report against the principles, companies have rarely done so and have instead focused on the compliance aspect - complying with the individual principles rather than embracing the spirit of the code.

It is also unclear if the combination of compliance and appliance will be easy for stakeholders to review.

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

We believe the guidance as it stands is a great first step to supporting the Principles and Provisions. We agree that the AGA should be able to update the guidance more frequently than the code, and indeed should be encouraged to do so as part of their reviewing and monitoring, updating the guidance as and when they see areas of good or bad practice. Guidance could be added when it is most needed, rather than waiting for a review or for other guidance (i.e. the FRC Labs) to be produced.

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 broadly support the proposed approach to reporting.

The expectation as to what needs to be included in the Activities and Outcomes report is more difficult, and will likely divide signatories. As with annual reporting for companies there will be those who do this well and invest a great deal of time in it, and those that do less. We would urge the review of this to assess activities and how they are specific to the signatory, so as to avoid a market for reams of reporting that is not relevant to the reader.

Our roundtables highlighted areas that could be beneficial to highlight in reporting. This is not exhaustive, but could give an initial roadmap or guidance on what could or should be included.

- A clear sense of the responsibility each signatory takes for Stewardship and how this is demonstrated in their activities. We note the ‘blame game’ that occurs at every stage of the investment chain, and this can only be rectified if there is a sense of shared responsibility and accountability.
- The issue of short-termism came up often in the roundtables. We would suggest that an emphasis on long termism should be expected, or encouraged, from reporting against the Code.
- Engagement with and regard to wider stakeholders. Given the wider expectations being placed on boards to engage with their wider stakeholders, questions were raised about how the voice of the ‘every-day person/ultimate beneficiary is being heard, and whose responsibility this is. Wider engagement - particularly with the ‘ultimate beneficiary’ - should be considered as part of stewardship activities.
- Activities beyond engagement. Conversations around what constitutes effective stewardship often start and end at engagement; this leads to the ‘dialogue of the deaf’ where boards and investors blame each other for not engaging enough. Activities should be about more than engagement (and engagement needs to be about more than pay...)
- Incentives and Pay. Many companies expressed frustration that investors were focused intently on the subject of executive pay but there was little transparency regarding how other parts of the Stewardship Chain are incentivised. How signatories are remunerated/incentivised, as well as how much focus they place on remuneration of executives, could be part of the reporting.
- Following on from this point - many felt that remuneration took too much of the time of investors and companies and there was no space for discussion about other areas such as culture, purpose etc. Good reporting in this area could include how they are engaging and focused on issues other than remuneration.
- In conversations with our members there has been some concern that the definition of Stewardship as outlined, is that it does not sufficiently emphasise shareholder primacy. This is a politically charged issue and one that came up a great deal in the roundtables and with the discussion around Section 172 of the Companies Act. Some had recommended that the definition of Stewardship be adjusted to make clear that shareholder primacy is not at threat, but that reporting on how they engage or consider wider stakeholders could be beneficial.

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?

- It is essential to the success of the changes to the Code that the FRC/AGA are given sufficient powers and resources to monitor, encourage and champion better stewardship and governance. A lack of resources and power has prevented the FRC having the impact they should, and has been to their detriment and those the Code applies to.
- We believe that this monitoring and oversight role will need to be stronger and more imaginative than simply writing to companies or signatories who are providing insufficient reports. We would note, for instance, the disappointment felt both internally and externally with the Tiering process and whether it had led to better outcomes. We don’t believe that this is the fault of the FRC, rather the set up of the organisation and its powers.
- The suggestions outlined in the consultation (best practice highlights, reviewing reports, a Lab-esque mechanisms, and highlighting those who are high standard or lagging) are a good start. We would hope that thematic reviews, best practice and others should be aspirational, focused on outcomes and activities. An over-focus on best practice reporting leads only to better reporting or, at worst, boiler plating, rather than an imaginative commitment to better practice. We strongly echo the Kingman review findings that the

FRC/AGA work needs to focus on outcomes and effectiveness, not policy statements, and that if it only drives boilerplate responses it is not delivering on its potential.

- At the same time, given the significant increase in reporting requirements for signatories, it is vitally important that the reviewing and monitoring is supportive to new signatories, and reflects the very different stages signatories are likely to be at when coming to the reporting to ensure the reporting isn't intimidating. It would be a great shame if the Code requirements put people off becoming signatories completely.
- Overall, we believe that the AGA should be a driver for standards in Stewardship practices, and using transparency and reporting requirements as a way to drive best practice behaviours, rather than the other way around. While a focus on disclosures is a natural first step, overall, the emphasis should be on what is disclosed rather than how it is disclosed.

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

Yes.

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?

Expanding to other Asset classes is something that was raised throughout our roundtables and was a key concern for many of our members. We do not think it needs to be expanded further at this stage, but we think this should be a key part of the review going forward - to address if it needs to be updated at a later stage.

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. We would hope that investment beliefs would provide insight to readers and could be a significant indicator of their culture, aims and purpose. As with all disclosure requirements the test will come when we see how seriously it is taken.

One concern - again as with many areas - will be ensuring the balance is struck between making the Code aspirational without being intimidating.

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

Yes.

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

Yes.

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

Although we can see how this may be valuable for addressing very serious issues, it is unclear how it would work in practice or this is something that would actually promote better practice. The question posed in the BEIS response - that they would need to establish if the current mechanisms for escalation are sufficient - has not yet been addressed.

Given plans to expand the remit and powers of the FRC/AGA, escalation through highlighting to the FRC may be one way to achieve this, but again this will depend on what powers the FRC/AGA have to do anything about it, should the situation arise.

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

Yes.

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 agree that the focus on service providers needs to emphasise their role in Stewardship, and we too found that in roundtable discussions participants were quick to blame proxy advisors in particular for exacerbating issues that make effective stewardship difficult.