UK Corporate Governance Code, Guidance on Board Effectiveness, and Stewardship Code

A public consultation issued by the Financial Reporting Council

Response submitted by Cass Business School, Frank Bold and Sheffield Institute of Corporate and Commercial Law

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The Sheffield Institute of Corporate and Commercial Law (SICCL) is a research centre based at the University of Sheffield which focuses on corporate, commercial and financial law, combining practical and theoretical insights. An integral part of City, University of London, Sir John Cass Business School ("Cass") is consistently ranked amongst the best business schools in the UK and the world. Frank Bold is a European purpose-driven law firm committed to helping companies to fulfill and develop their vision, improving the environment for business, and solving the most pressing of society's problems.

Between 2014 and 2017, Frank Bold and the Modern Corporation Project at Cass Business School hosted a global series of roundtables on corporate governance. Prof. Andrew Johnston contributed his expertise to the roundtables. The outcomes of the Roundtables are summarized in the Corporate Governance for a Changing World report, which is available at http://www.purposeofcorporation.org/corporate-governance-for-a-changing-world_report.pdf .

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Overall comments

We support the aim of the FRC to simplify the Corporate Governance Code and elaborate further details in the Guidance. We also welcome the increased focus on desired outcomes, rather than on superficial compliance. We believe that this approach allows for a more effective use of comply-or-explain and apply-and-explain principles with respect to key provisions. In our response, we highlight a number of areas where these options are currently underutilised.

We particularly welcome the proposal to recognise, in a revised Code, the role and contribution of employees in achieving corporate success and to encourage their involvement in corporate governance. We agree with the increased emphasis on corporate purpose and the relationship of the company with wider society. On the other hand, our view is that the Code and the Guidance do not provide sufficient advice on how boards should engage with the concerns of their stakeholders and those of society as a whole.

This is particularly relevant in relation to the issues of environmental sustainability and human rights risks in a company's value chains. Given the complexity of these issues and the difficulties associated with developing binding international and transnational regulations, more guidance for boards would be highly desirable. Unfortunately, neither the Code, nor the Guidance include a single reference to environmental sustainability, natural capital, climate issues, planetary boundaries, or human rights.

Finally, we think that the Code would benefit from using the multiple-capitals model advocated by the International Integrated Reporting Framework and South African King IV Report because it provides a clearer definition of what success of the company means.

With respect to the Stewardship Code, we recommend that it should adopt as its focal point the interest of the dispersed shareholder with a long-term perspective. Correspondingly, we recommend that the Corporate Governance Code and the Stewardship Code should start to differentiate between types of shareholder and control positions in order to develop more specific mandates for different categories of investors. We also recommend that the Code specifies in clear terms an expectation that investors obtain feedback from their end beneficiaries on key elements of the stewardship policy.

Corporate Governance Code and Guidance on Board Effectiveness

Q1. Do you have any concerns in relation to the proposed Code application date?

No.

Q2. Do you have any comments on the revised Guidance?

We have included comments on the Guidance in our responses to particular questions below.

In addition, we welcome that the Guidance addresses the question of directors' duties. As s172 of the Companies Act 2006 states, the core of directors' duties is to promote the success of the company, from which the benefit to shareholders is subsequently derived.

However, we think that paras 10 and 11 provide insufficient and potentially misleading guidance to directors by taking out the success of the company and placing the main emphasis on shareholder value. These two paras currently read: "*10. At the heart of a director's duties (see Figure One) lies a focus on generating and preserving value for shareholders for the long-term, taking account of the interests of the company's workforce and the impact on other stakeholders such as customers, suppliers, the community and the environment. … 11. An effective board will have a clear understanding of how that value is dependent on relationships with its stakeholders, and will be able to explain how these relationships help deliver the company's purpose. …*"

Such reframing of directors duties does not accord with the formulation of Principles A and D of the Code. Equating the success of the company with shareholder value in the context of directors' duties ignores the fact that the immediate interests of current shareholders may not always be aligned with the long-term prospects and success of the company (and thus the interests of future shareholders), as noted, for example, in De Larosière report[1], and documented in numerous high profile cases of corporate failure[2]. By obscuring what the directors are responsible for, namely promoting the success of the company, this part of the guidance further muddies the waters.

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1 The De Larosière report notes that, in the build up to the financial crisis, 'shareholders' pressure on management to deliver higher share prices and dividends for investors meant that exceeding expected quarterly earnings became the benchmark for many companies' performance'. Report of the High-Level Group on Financial Supervision in the EU chaired by Jacques de Larosiere, Brussels, 25th February 2009, para 24.

2 For example, in case of Enron, the institutional investors failed to hold Enron executives to account, as they invested on the basis of 'market hyperbole rather than fundamental value'. See WW Bratton, 'Enron and the Dark Side of Shareholder Value' (2002) 76 Tulane L Rev 1275 at 1339-40

It would be more useful if the Guidance recognized the conflict between the perspectives and timeframes of different types of shareholders (and that of the company) and offered suggestions to boards as to how to address it. For example, the Guidance could provide a definition of what the success of the company means, what is typically required to achieve this over the long-term, and explain the importance of ensuring proper capitalization of the company across human, social, intellectual, and other relevant capitals. In this regard, the Guidance can draw inspiration from the International Integrated Reporting Framework[3] and the King IV Report[4].

The Guidance should emphasize more clearly that the duty of the directors to have regard to the matters listed in s172 requires directors to consider them from the perspective of the sustained success of the company - that is, their contribution to the creation of added value now and in the future - rather than from the proxy perspective of shareholder value.

In addition, the Guidance should clarify how boards should approach the issue of natural capital. Many natural resources are essential to life, and have no substitutes, and therefore should not be depleted or converted as freely as other types of capital. The Guidance could in this respect refer to the concept of planetary boundaries[5] and - in order to meet the expectations expressed in Principle A of the Code - encourage directors to steer their company's business model towards environmental sustainability as an essential aspect of promoting the long-term success of the company.

These clarifications would provide boards with clearer benchmarks, as well as provide better guidance on how to engage with ESG-related risks which are beyond the time horizons typically considered by capital markets.

3 The International Integrated Reporting Council, The International <IR> Framework (13 December 2013), available at http://integratedreporting.org/resource/international-ir-framework/

4 Institute of Directors Southern Africa, King IV Report on Corporate Governance for South Africa 2016, Fundamental Concepts, p. 24, available at https://c.ymcdn.com/sites/www.iodsa.co.za/resource/resmgr/king_iv/King_IV_Report/IoDSA_King_IV_Report_-_WebVe.pdf

5 Rockström, J; Steffen, WL; Noone, K; Persson, Å; Chapin III, FS; Lambin, EF; Lenton, TM; Scheffer, M; et al. (2009), "Planetary Boundaries: Exploring the Safe Operating Space for Humanity" (PDF), *Ecology and Society*, 14 (2): 32, available at http://www.stockholmresilience.org/download/18.8615c78125078c8d3380002197/ES-2009-3180.pdf

Q3. Do you agree that the propose methods in Provision 3 are sufficient to achieve meaningful engagement?

Engagement of workforce

We welcome the greater emphasis on 'the needs and views of a wider range of stakeholders'. We also welcome recognition that the workforce is a key stakeholder in the business. We agree that the Corporate Governance Code and Guidance should encourage stakeholder advisory panels and appointment of workers to company boards as best practice, in line with the support expressed for this in the UK Government's Green Paper consultation[6], the Recommendation from BEIS[7] and Theresa May, both before and after she became Prime Minister[8].

Our view is that designating a non-executive director to gather the views of the workforce is not an adequate substitute for a director appointed from the workforce or a formal workforce advisory panel. These two mechanisms would provide unmediated information from this key stakeholder group to the board, and the board would be expected to respond to this information. Using a non-executive director would weaken the accountability produced by this process because it will be unclear to the workforce what information has been passed to the board, and the workforce will have no means of ensuring that the non-executive director represents their views effectively or adequately. We would also be concerned about whether the designated NED has the appropriate expertise, experience, understanding of the issues involved and time commitment adequately to perform this function, and this might undermine their credibility in the eyes of the workforce.

Beyond this reservation, we would suggest that, in an event, the comply-or-explain principle should apply in relation to the three methods of strengthening employee voice mentioned in paragraph 3 of the proposed revised code. It should be made clear that companies adopting none of these mechanisms must offer an explanation of why they have not done so, and identify the measures they have adopted to ensure information flow from the workforce to the board. This would go some way towards preventing companies from simply adopting cosmetic workforce participation measures. In addition, we would also suggest that, even where they

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6 Around 40% of respondents supported the appointment of individual stakeholder representatives to company boards: see UK Government response to Green Paper Consultation, para 2.17

7 BEIS paras 54 and 146

8 Theresa May, 'We can make Britain a country that works for everyone', speech given in Birmingham on 11th July 2016, in which she stated that 'if I'm Prime Minister… we're going to have not just consumers represented on company boards, but employees as well' (http://press.conservatives.com/post/147947450370/we-can-make-britain-a-country-that-works-for); Theresa May, Prime Minister, U.K., Keynote Speech at Conservative Party Conference (Oct. 5 2016) stating that plans to put both consumer and worker representatives on boards would be published before the end of the year.

adopt one of the mechanisms suggested, companies should be required to explain why they have selected that particular mechanism, and how it operates in practice to ensure an adequate flow of information to the board.

These proposed changes are in keeping with the Government's approach to this issue, which is to 'ensure that good practice is adopted more widely and more consistently'[9], and with the BEIS recommendation that the Code be revised 'to require a section in annual reports detailing how companies are conducting engagement with stakeholders'[10]. We submit that, as drafted, the proposed revisions do not do enough to encourage companies to adopt best practice.

The Guidance notes that the notion of workforce extends beyond the employees, and that agency workers and contractors should be included in any engagement mechanisms (31, also consultation at paras 32-3). We welcome this recommendation, but note that the Guidance offers no further indication as to how this might occur beyond a list of examples of workforce engagement activities (box following para 35) which are not well suited for engagement with the workforce when it is understood in this extended way.

Consideration of stakeholders' interests

The Guidance formulates a number of expectations on how the boards should consider stakeholders interests (11, 19, 27) and in para 30 it states: '*Directors should be accountable by explaining their decisions and how they have taken account of the interests of different stakeholders. This will include being able to explain how the benefits in terms of the long-term success of the company outweigh any negative impacts, and any action the company plans to take to mitigate those impacts.'*

This statement does not explain to whom directors should explain their decisions, nor to whom they should give an account of the benefits and impacts of decisions or mitigation actions. We would recommend a specification that the board should provide this explanation in form of a statement in the annual report. The statement should identify which issues and stakeholder interests the board considers material, why, and how they were identified and addressed.

Furthermore, *The Stakeholder Voice in Board Decision Making* document referred to in para 29 notes that 'The board should provide feedback to those stakeholders with whom it has engaged, which should be tailored to the different stakeholder groups.'[11] It would be appropriate to include this obligation in the Code or the Guidance, clarifying that accountability

9 Green Paper response, para 2.41

10 BEIS at para 54

11Stakeholder Voice at 27

requires reporting to both shareholders and stakeholders, and that, as the *Stakeholder Voice* points out, this obligation requires more than simply disclosing in the annual report how the directors have complied with their s172 obligation[12].

We would also strongly recommend that the relevant section of the Guidance (paras 26-30) specifies that boards of companies which are exposed to risks of being connected to serious environmental and human rights violations through their business relationships should put in place appropriate procedures to ensure screening of their operations, business relationships and value chains and to allow relevant stakeholders' opinions to be conveyed to the company. This is in line with the UN Guiding Principles on Business and Human Rights, which have been endorsed by the Government[13]. The Code and the Guidance could strengthen this expectation by recommending that the company's environmental and human rights due diligence be subject to independent verification.

In addition, companies could be encouraged to hold regular stakeholder forums which are open to those who consider themselves 'affected' by the company's operations, and which give them an opportunity to express their views. The stakeholder forum could be chaired by a non-executive director who could report back on the forum to the full board. This will give the board greater knowledge of the expectations of, and impacts on, stakeholders, and provide an opportunity for 'effective engagement' and a limited degree of participation by a wider range of stakeholders, which is what the revised code seeks to ensure.

We would propose a comply or explain obligation in the Code that companies should provide a clear disclosure of their stakeholder consultation and reporting processes. This would comply with the BEIS recommendation[14], and allow for dissemination of best practice. In addition, the Guidance could provide examples of possible stakeholder consultations which companies could adopt or adapt to their particular circumstances.

Q4. Do you consider that we should include more specific reference to the UN SDGs or other NGO principles, either in the Code or in the Guidance?

The Code or the Guidance could encourage boards to pay attention to the UN SDGs in order to raise awareness of this important framework. However due to the broad scope and general

12 Stakeholder Voice at 30-1

13 "Good Business: Implementing the UN Guiding Principles on Business and Human Rights" available at https://www.gov.uk/government/publications/bhr-action-plan

14 BEIS para 54

nature of the SDGs, it is difficult to develop specific recommendations for how corporate governance practice can be aligned with them.

We recommend that the Code and the Guidance should refer to more specific principles that have been developed in two concrete areas covered by the SDGs (business and human rights, and climate matters), reminding companies of their importance, international nature and ongoing relevance to the success of the company.

The UN Guiding Principles on Business and Human Rights (UNGPs)[15], that were supported and endorsed by the Government, set out the scope of corporate responsibility to respect human rights and propose human rights due diligence as the principal tool for meeting this responsibility. This extends to situations where the company is connected to human rights risks through its international business relationships.

With respect to climate matters, a reference could be made to the Recommendations of the Financial Stability Board's Task Force on Climate-related Disclosures (TFCD)[16]. They recommend that companies should consider, model and disclose the potential impact of climate-related risks (both physical and regulatory) on their business model under different scenarios.

The Code and the Guidance could refer to both UNGPs and TFCD in Section 1 (in particular in connection with provision 1 of the Code) and in Section 4 where they refer to risk analysis and external reporting. The human rights due diligence outlined in the UNGPs includes a strong element of stakeholder engagement and thus is relevant also in the context of the provision 3 of the Code and related paragraphs in the Guidance.

Q5. Do you agree that 20 per cent is 'significant' and that an update should be published no later than six months after the vote?

The 20 per cent threshold would capture situations in which a number of institutional investors have voted against a resolution. We further submit that the 20 per cent threshold could be supplemented by a requirement to indicate the categories of shareholders voting for the specific resolution. The reason for this is that a 20% vote by dispersed shareholders is qualitatively different from, for instance, a 20% vote by a coalition of a limited number of institutional investors.

Subject to further analysis the categories of shareholders could include, e.g., dispersed shareholders (with shareholdings <1%); shareholders with potential engagement capacity

15 Available at http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf

16 Available at https://www.fsb-tcfd.org/

(approx. 2% to 5%); shareholders meeting the threshold to propose resolutions at AGM (5%); shareholders with sufficient shares to block special resolutions (25%); and shareholders with a director nomination.

Implementing these categories could be used to give different weight to proposals brought forward by different categories of shareholders. They could also be developed further to enable dispersed shareholders to provide resolutions by combining their voices.

Q6. Do you agree with the reoval of the exemption for companies below the FTSE 350 to have an independent board evaluation every three years? If not, please provide information relating to the potential costs and other burdens involved.

Rather than remove these exemptions altogether, a different type of cut-off point could be used. The Dutch Corporate Governance Code provides a clear distinction between types of companies included and exempt from the provisions in the Code, based on a number of specific criteria. We would be happy to provide further details if this would be helpful.

Q7. Do you agree that nine years, as applied to non-executive directors and chairs, is an appropriate time period to be considered independent?

An NED can remain on the board after this period but will no longer be considered independent. This seems sensible, as the company may wish to retain their expertise.

Q8. Do you agree that it is not necessary to provide for a maximum period of tenure?

Yes, as the company may wish to retain expertise.

Q9. Do you agree that the overall changes proposed in Section 3 of the revised Code will lead to more action to build diversity in the boardroom, in the executive pipeline and in the company as a whole?

These are, in principle, the right steps to take to bring more diversity into the boardroom setting.

Q10. Do you agree with extending the Hampton-Alexander recommendation beyond the FTSE 350? If not, please provide information relating to the potential costs and other burdens involved.

Yes. We don't think that the implementation of the recommendation would be costly.

Q11. What are your views on encouraging companies to report on levels of ethnicity in executive pipelines? Please provide information relating to the practical implications, potential costs and other burdens involved, and to which companies it should apply.

No opinion.

Q13. Do you agree with retaining the requirements included in the current Code, even though there is some duplication with the Listing Rules, the Disclosure and Transparency Rules or Companies Act?

Yes.

Q13. Do you support the removal to the Guidance of the requirements currently retained in C.3.3 of the current Code? If not, please give reasons.

No opinion.

Q14. Do you agree with the wider remit for the remuneration committee and what are your views on the most effective way to discharge this new responsibility, and how might this operate in practice?

The FRC was invited by the Government to consult on how 'to give remuneration committees greater responsibility for demonstrating how pay and incentives align across the company, and to explain to the workforce each year how decisions on executive pay reflect wider pay policy'.

We welcome the change to recommend that the remuneration committee should oversee remuneration and workforce policies and practices, and to take these into account when setting policy for director remuneration (Code provision 33).

However, we would suggest that the Code or the Guidance should require remuneration committees to offer a justification of executive remuneration schemes and practices to the workforce. This could occur through the workforce voice mechanism established in the individual company. If an employee representative is invited onto the remuneration committee, they could act as a conduit for information to the wider workforce.

We do not agree with the proposal (para 85 of consultation) that the remuneration committee should be permitted to delegate oversight of workforce policies to other committees. We believe that such delegation would blur the lines of responsibility and accountability on this important issue. We think that alignment and balance between executive and workforce remuneration should be addressed by the remuneration committee and that that committee should give a public account to the relevant stakeholders of the outcomes for which it is responsible. We also note that the UK Government's Green Paper consultation on *Corporate Governance Reform* elicited strong support for such a wider role for the remuneration committee on the grounds of motivation, fairness and company purpose[17]; we believe that allowing delegation of this function would undermine these aims. In addition, concerns expressed about the remuneration committee's workload has centred on bilateral discussions with shareholders, rather than on the proposed stakeholder aspects of its role[18].

Q15. Can you suggest other ways in which the Code could support executive remuneration that drives long-term sustainable performance?

The Code should discourage the use of complex long-term incentive plans (LTIPs) and share options, which often operate to incentivise short-term decision-making and financial engineering. The effect of LTIPs in encouraging a focus on 'share price growth and short-term returns to shareholders' was recognised by a 'large majority' of respondents to the UK Government's Green Paper Consultation on *Corporate Governance Reform*[19]. Most recently, the short-term incentives given to executives in Carillion may well have contributed to the company's aggressive accounting, high levels of dividend payouts and growing reliance on debt, despite the fact that the company's pension scheme was in significant deficit[20]. The collapse of the company will occasion significant social costs, whether in the form of a public bail out or in the form of defaults on contractual and pension obligations.

17 UK Government Response to Green Paper Consultation, para 1.22

18 UK Government Response to Green Paper Consultation, para 1.26

19 UK Government Response to Green Paper Consultation, para 1.41

20 F Mor, L Conway, D Thurley and L Booth, 'The Collapse of Carillion', House of Commons Library Briefing Paper Number 08206, 30 January 2018

In light of this, the Code should provide stronger encouragement to companies to adopt different performance metrics. For example, the Code might recommend the use of performance metrics such as metrics based on ESG factors, systemic risks, or stakeholder satisfaction. In this respect, the Code and the Guidance should encourage companies to develop strategic objectives and metrics informed by the concept of multiple capitals that is described in the International Integrated Reporting Framework[21] and advocated by the South African King IV Report[22]. In this concept, the capitals are stocks of value that the company uses or affects and depends on for its success. As such, this approach would support the underlying obligation of the directors to promote the success of the company.

Encouragement for companies to use a wider range of metrics would go some way towards overcoming the key problem identified in the Green Paper consultation, namely that shareholders and their advisors would not support divergence from current market practice. It would also, as the BEIS report recognised, 'send a clear signal to investors and employees that a company took seriously its corporate governance responsibilities'. BEIS recommended that 'companies make it their policy to align bonuses with broader corporate responsibilities and company objectives and take steps to ensure that they are genuinely stretching'[23]. The role of the Code should be to steer market practice towards remuneration practices that better align with the long-term interests of the company, its current as well as future shareholders, and its stakeholders. Hence, the proposals' silence on the use of broader performance metrics is regrettable.

Going further, and in order to generate new ideas and a better alignment with the long-term success of the company, the workforce could be consulted on remuneration design. This could occur through the 'employee voice' mechanism set up under the Code, and using the documentation produced under existing company law processes (such as the remuneration policy and report). Alternatively, an employee representative could be invited to sit on the remuneration committee in an advisory capacity.

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21 The International Integrated Reporting Council, The International <IR> Framework (13 December 2013), available at http://integratedreporting.org/resource/international-ir-framework/

22 Institute of Directors Southern Africa, King IV Report on Corporate Governance for South Africa 2016, Fundamental Concepts, p. 24, available at https://c.ymcdn.com/sites/www.iodsa.co.za/resource/resmgr/king_iv/King_IV_Report/IoDSA_King_IV_Report_-_WebVe.pdf

23 House of Commons Business, Energy and Industrial Strategy Committee, *Corporate Governance*, Third Report of Sessions 2016-17, para 86

Q16. Do you think the changes proposed will give meaningful impetus to boards in exercising discretion?

The proposed new Guidance states that remuneration committees should ‘avoid designing pay structures based solely on benchmarking to the market or the advice of remuneration consultants’ (108).

In order for this to occur, there is a need for clearer guidance on appropriate metrics, including references to multiple capitals, coupled with input from a wider range of stakeholders into the remuneration process, as discussed in the answer to the previous question. These changes could be complemented by requiring the remuneration committee to give a public explanation of the reasons behind their decisions. This last point is reflected in para 113 of the Guidance, which requires the remuneration committee to ‘engage with the workforce to explain how executive remuneration aligns with wider company pay policy and promotes long-term value generation. This may involve using pay ratios to help explain the approach where appropriate. It may also involve explaining the rationale behind the structure and metrics chosen, any principles that have been applied to remuneration, factors that have been considered in setting executive remuneration and the circumstances in which discretion will need to be when determining pay outcomes.’ We welcome this guidance because it highlights the importance of alignment of incentives with the success of the company. However, we would point out that its potential is weakened by the flexibility surrounding employee voice mechanisms.

Finally, remuneration consultants have not been adequately addressed: para 35 of the proposed new code merely requires that they be identified, that their appointment should be the responsibility of the remuneration committee and that the committee should exercise independent judgement. As Professor John Kay noted in his 2012 *Review of Equity Markets* at para 11.9, the ‘interests of remuneration consultants are more closely aligned with the interests of the members of the boards who select them than the interests of shareholders.’ It would be desirable more explicitly to discourage the use of remuneration consultants in the Code.

Stewardship Code

Q17. Should the Stewardship Code be more explicit about the expectations of those investing directly or indirectly and those advising them? Would separate codes or enhanced separate guidance for different categories of the investment chain help drive best practice?

We recommend that both the Corporate Governance Code and the Stewardship Code follow the approach of the SEC in the US, where the interest of the 'retail investor' is more developed. From this starting position we recommend a further differentiation between types of shareholder and control positions. With a variety of shareholding and control positions identified and differentiated, there could be general guidance aimed at all categories, followed by guidance addressed to specific categories of investor. This would, for example, allow the SC to establish a clearer link between the activity of asset management and the consultation of shareholders and end beneficiaries on their stated goals. It would also encourage asset owners: to focus more clearly on the mandates they give to asset managers; to consider how far those mandates alignment with their strategic goals; and to explain how those mandates reflect their approach to stewardship.

As noted in our response to Q5, the categories of shareholders and their respective responsibilities could include:

- dispersed shareholders (<1%): No specific responsibilities, but focus on strengthening the position and rights of shareholders in this category.
- shareholders with potential engagement capacity (perhaps 2% to 5%): Disclosure of engagement strategy mandatory.
- shareholders meeting the threshold to propose resolutions at AGM (5%): As above plus disclosure of their endorsement of the strategic direction of the company becomes mandatory.
- shareholders with sufficient shares to block special resolutions (25%) and shareholders with director nomination: As above plus disclosure of their long-term plans for the company

Q18. Should the Stewardship Code focus on best practice expectations using a more traditional 'comply or explain' format? If so, are there any areas in which this would not be appropriate? How might we go about determining what best practice is?

A comply-or-explain approach would strengthen the SC if drafting and publishing a stewardship policy is reframed as an obligation. This arrangement would extend the reach of the SC beyond signatories to all relevant actors. Hence all institutional investors would be required to draft and publicly disclose a policy on how they discharge their stewardship responsibilities. If investors do not disclose a stewardship policy, they should explain why they have not done so, and confirm whether they have drafted one.

It would still be possible to leave a great deal of discretion to individual addressees, but to impose explicit comply-or-explain obligations in relation to specific policy areas. For example, as part of Principle 1, it would be desirable to require all institutional investors to draft and disclose their policy in relation to the ESG risks and social impacts associated with investments, or to explain why they have not done so. The same applies to action taken to press companies to consider adaptation to climate change and to comply with the Recommendations on CRFD. This would not force investors to have a policy in these areas, but would push them to consider having one, and to provide explanations where they decide not to have one, or have decided not to disclose it.

As part of Principle 7, there should be a comply-or-explain obligation for investors not only to report to, but also to obtain feedback from, their end beneficiaries on key elements of the stewardship policy. These key elements should include a list of engagement points with ESG matters as specified in our response to Q22 below.

Furthermore, the requirement to consult end beneficiaries must reflect the need for such communication to be conducted in a clear and easily accessible way. It would be useful if the SC included more specific guidance in this respect, including best practice examples, and - where appropriate - mandatory elements.

Q19. Are there alternative ways in which the FRC could highlight best practice reporting other than the tiering exercising as it was undertaken in 2016?

No opinion.

Q20. Are there elements of the revised UK Corporate Governance Code that we should mirror in the Stewardship Code?

Principle C of the Corporate Governance Code and the relevant provisions of the Code and the Guidance could be mirrored in a requirement for institutional investors to report on and consult with their end beneficiaries on their investment and engagement strategies.

Q21. How could an investor's role in building a company's long-term success be further encouraged through the Stewardship Code?

As part of Principle 3, the SC could encourage investors to analyse the long-term success of investee companies from the perspective of salient ESG issues and of integrated governance, that is, considering the capitalisation of the company across all relevant capitals.

As discussed above in relation to Q18, a comply-or-explain obligation in relation to the investor's policy on ESG issues and social impacts of investments - with particular reference to the systemic risks associated with them - would encourage more institutional investors to pay attention to these issues, and, as a consequence, would be likely to lead to more engagement and strategic thinking.

Q22. Would it be appropriate to incorporate 'wider stakeholders' into the areas of suggested focus for monitoring and engagement by investors? Should the Stewardship Code more explicitly refer to ESG factors and broader social impact? If so, how should these be integrated and are there any specific areas of focus that should be addressed?

The SC should refer more explicitly to these issues. If a comply-or-explain obligation were introduced in relation to ESG issues and social impacts, this would be likely to result in more investors paying more attention to these issues. Explanations should be required to explain why investors do not consider these issues material to their beneficiaries.

The SC should require investors to draft and publish an assessment of ESG and social impact issues from the perspective of their materiality for end beneficiaries' interests, as well as any other reasons (e.g. ethical) why they consider them important. This should include a description of their policies and objectives in respect of these issues.

The SC should also recommend that the stewardship policy should include engagement profiles in relation to ESG issues[24]. End beneficiaries should be consulted on these engagement points, and they should be explained in a clear and easily accessible way. Disclosure of the use of voting rights and engagement capacity in accordance with such explicit engagement points would enable prospective shareholders and end beneficiaries to choose funds according to their positions on such matters and/or to hold asset managers accountable. A good example is provided by Mirova, which has an explicit voting policy in relation to a list of concrete engagement points, and which publicly reports on its engagement in relation to this policy[25].

Q23. How can the Stewardship Code encourage reporting on the way in which stewardship activities have been carried out? Are there ways in which the FRC or others could encourage this reporting, even if the encouragement falls outside of the Stewardship Code?

A clearer framework will drive better reporting practice. The SC can achieve this by introducing more specific expectations regarding stewardship policy and its implementation.

At present, 2.2.3R of COBS requires a firm which manages investments for professional clients to disclose on its website 'the nature of its commitment to the Financial Reporting Council's Stewardship Code' or 'where it does not commit to the Code, its alternative investment strategy'.

It would be desirable to encourage consultation with beneficiaries on this by means of a comply-or-explain obligation, coupled with more extensive reporting to them. This consultation with beneficiaries is desirable in the case of funds, as it will give greater weight to the voice of end beneficiaries over that of intermediaries in investment chains.

Q24. How could the Stewardship Code take account of some investors' wider view of responsible investment?

It is desirable to bring responsible investment into the mainstream of stewardship, since the two concepts are inseparable. Both bear heavily on the medium and long-term financial outcomes for end beneficiaries and are therefore arguably required by investors' fiduciary

24 See http://www.stern.nyu.edu/experience-stern/global/putting-s-esg-measuring-human-rights-performance-investors

25 See http://www.mirova.com/en-INT/voting-and-engagement

duties to their beneficiaries. The SC can encourage convergence of these concepts by encouraging investors to carry out and disclose their assessment of ESG issues from the perspective of materiality. Furthermore, as part of the obligation to disclose stewardship policy, investors could be required to state whether they follow a policy of responsible investment, how they determine whether an investment is responsible and how they respond where they determine that an investment is no longer responsible.

Q25. Are there elements of international stewardship codes that should be included in the Stewardship Code?

Principle 6 of the ICGN requires investors to 'promote the long-term performance and sustainable success of companies and should integrate material environmental, social and governance (ESG) factors in stewardship activities', This provides a good starting point for the SC. However, we think that investors should be encouraged to integrate these activities into their policies and should disclose actions taken in these areas to their beneficiaries.

Q26. What role should independent assurance play in revisions to the Stewardship Code? Are there ways in which independent assurance could be made more useful and effective?

No opinion.

Q27. Would it be appropriate for the Stewardship Code to support disclosure of the approach to directed voting in pooled funds?

No opinion.

Q28. Should board and executive pipelines diversity be included as an explicit expectation of investor engagement?

No opinion.

Q29. Should the Stewardship Code explicitly request that investors give considerations to company performance and reporting on adapting to climate change?

In relation to the disclosure of material ESG-related risks, disclosure of climate change risk and the investor's adaptation to it should be considered a minimum requirement. The comply-or-explain obligation to draft and publish an engagement policy should include the investor's approach to encouraging investee companies to disclose their adaptation to climate change risks, as well as their ESG and social impacts. Such a rule could give impetus to adoption of the Recommendations on Climate-Related Financial Disclosures. In order to promote the CRFD, it would be helpful to mention explicitly the importance of investors encouraging companies to produce and disclose a variety of scenario analyses in line with the CRFD Recommendations.

Similarly, the Stewardship Code could explicitly request that investors give consideration to company performance and reporting on human rights risks, taking into account the UN Guiding Principles on Business and Human Rights and the OECD general and sectoral human rights due diligence standards.

Q30. Should signatories to the Stewardship Code define the purpose of stewardship with respect to the role of their organisation and specific investment or other activities?

See the answer to Q24.

Q31. Should the Stewardship Code require asset managers to disclose a fund's purpose and its specific approach to stewardship, and report against these approaches at a fund level? How might this best achieved?

See the answer to Q24.