The FRC's Consultation on Proposed Revisions to the UK Corporate Governance and Stewardship Code

We are supportive of the FRC's move to simplify the Corporate Governance Code and its emphasis on "stakeholders, integrity and corporate culture, diversity and how the overall governance of the company contributes to its long-term success".

We advocate for the link between the two Codes to be strengthened. The Corporate Governance Code should drive businesses to think about the impact of the company on society and wider stakeholders and the Stewardship Code should encourage this too, otherwise shareholders and boards will not be well-aligned.

In terms of responses to individual questions:

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

The FRC may wish to explicitly mention trade unions in this provision. There are nearly 6 million trade union members and trade unions remain the most common mechanism for structured engagement between employers and workforces. Their involvement in the engagement process would mean that it includes a well-resourced and experienced body.

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?

Principles A and C in the revised Code reflect the SDGs but they do not capture the full intention and depth of the SDGs. The SDGs do provide a helpful framework for considering long-term sustainable success and impact on wider society. We encourage the FRC to explicitly refer to the SDGs and/or to the key themes.

This could also be done in a high level manner in the Code itself and expanded in the guidance. Another relevant framework is the TCFD recommendations, which, for most companies to which the Code applies, will be relevant to the question of long-term success.

Overall, it is concerning that the environment is not mentioned explicitly in the revised Code.

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?

We welcome the intention to increase diversity and the focus on the executive pipeline and beyond. We welcome the reference to diversity on 'gender, social and ethnic backgrounds, cognitive and personal strengths (Principle J).

The proposed Principles themselves should include reference to the pipeline and developing diversity in the wider workforce.

The Provisions could be clearer on the types of policies and practices which should be in place at the lower ranks of the company. Action is needed here to build the 'pipeline', but the term 'pipeline' suggests people ranked more closely with the board.

Fair policies relating to parental leave, outreach and apprenticeships, flexible working, fair pay and investment in training should be in place at the lowest levels of the company in order to grow talent. It should be noted whether implementation of these policies is undermined by high levels of short-term contracts and outsourcing.

Q.11 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.

We support reporting in order to build up data on this, in the same way that data is available on gender balance and this has helped to drive changes.

The assumption should be that it apply to all companies, as the Code is ‘comply or explain’, so companies can explain if they cannot report on this area.

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

We agree that the remuneration committee should have a role in respect of oversight of the wider workforce policies on remuneration, as this ties the company’s pay policies together and sets them in the context of top and bottom pay levels. It is good that they will be required to report on this element.

It is important that this wider remit not cut across established mechanisms for collective bargaining within the workplace. This point should be made explicitly in the Code and/or guidance.

The workforce and their representatives, such as trade unions, should be involved in the discharge of this responsibility.

Q.15 Can you suggest other ways in which the Code could support executive remuneration that drives long-term sustainable performance?

Senior management should have a significant portion of their pension contribution from the employer in the same scheme as the rest of the workforce, to motivate them to show interest in the scheme.

Executive pay/reward should not be linked to unsustainable business practices over the long-term e.g. bonuses for increased exploitation of fossil fuel reserves by oil companies.

Q. 16 Do you think the changes proposed will give meaningful impetus to boards exercising discretion?

‘Workforce policies and practices’ in Principle O is too broad and should be clarified to cover issues like practices around e.g. use of zero-hour contracts, freedom of association and collective bargaining coverage, out-sourcing, paying of Living Wage, pay ratios, training, flexible working etc.

The bullet in Provision 41 covering reporting on ‘an explanation of the company’s approach to investing in, developing and rewarding the workforce…’ could be elevated to be a Principle.

In general, we encourage the use of the term ‘workforce’ throughout. We agree with the FRC’s logic at para 33: ‘By using the term ‘workforce’ we are encouraging companies to consider how their actions impact on all, not only those with formal contracts of employment’.

Points on specific questions – Future direction of the UK Stewardship Code:

Q.17 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?

The Stewardship Code needs to be more explicit about the obligations of different types of investors, but we do not think that separate codes are necessary. Overall, the same principles for stewardship apply to all members of the investment chain and so the same Code should apply

There should be clearer, enhanced explanations within the Code (within each Principle and/or in more detailed guidance) about how each element applies to the different types of signatories.

Q.18 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?

Yes, the Stewardship Code as it stands does not necessarily drive best practice and can be complied with without much substantive effort. For example, Principle 5 can be complied with by expressing willingness to collaborate, but never actually doing this.

The Code should mirror the Corporate Governance Code in terms of setting out more specific Principles, guiding Provisions and full guidance.

This is particularly important because there is no one in the current system who oversees and questions compliance with the Stewardship Code in an equivalent role to investors overseeing the Corporate Governance Code.

The FRC could determine best practice through: (1) its experience from the tiering process; (2) work with industry and wider stakeholders; and (3) setting its own expectations which are more stretching.

There are no areas in which this would be inappropriate as the 'explain' element allows signatories to explain non-compliance.

Q.19 Are there alternative ways in which the FRC could highlight best practice reporting other than the tiering exercise as it was undertaking in 2016?

The FRC states in the consultation document that the tiering process has been valuable: 'The tiering exercise improved reporting against the Stewardship Code and was successful in encouraging more disclosure about stewardship approaches to allow clients to make more informed choices' (para. 24).

Moving away from tiering risks moving backwards, which will be frustrating for those who are really taking stewardship seriously and should be distinguished for this.

The FRC should make a clear proposal on how the Stewardship Code can be monitored going forward. We encourage more money to be put into this element of the FRC's work so that the tiering is a permanent feature of its role.

Q. 20 Are there elements of the revised Corporate Governance Code that we should mirror in the Stewardship Code?

Yes. Stewardship should be set within the same context as the Corporate Governance Code in order to align the expectations of shareholders with the duties of boards.

The Stewardship Code should therefore reflect: (1) the emphasis on long-term success, culture and benefit to society; (2) alignment with s.172 Companies Act duties; and (3) references to ESG (whether in the form of references to SDGs, TCFD or otherwise. Both Codes should refer to social and environmental issues).

Principle 1 of the Stewardship Code should fully set out the purpose of stewardship.

Q. 21 How could an investor's role in building a company's long-term success be further encouraged through the Stewardship Code?
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Q.22 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 current Stewardship Code undervalues engagement on environmental and social factors and the impact of companies on wider stakeholders.

This is at odds with the move in the Corporate Governance Code review to look at workforce issues, long-term success and s.172 obligations. The obligations on boards should align with investors' stewardship expectations otherwise there will be a tension.

Environmental and social issues are currently mentioned only in guidance to Principle 4. They are not mentioned in the context of the Principle 1 statement on stewardship. Principle 1 should explicitly refer to ESG risks.

There should be guidance on the relevance of environmental and social factors. Environmental and social factors should feature under all the Principles (possibly with the exception of Principle 2 on conflict policies).

Alternatively there could be a separate Principle which emphasises that stewardship on environmental and social factors is important. This could mirror the language of s.172.

Q.23 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?

Signatories should be given more direction and detail on what is expected. This could be done by mirroring the format of the revised Corporate Governance Code (with Principles, Provisions and Guidance of the Corporate Governance Code).

Best practice expectations and model templates for voting disclosures should be set out and the FRC should champion best practice.

There is an outstanding issue that there is no real risk for signatories' non-compliance with the Stewardship Code or giving poor explanations. This could be tackled by requiring annual high level sign off on the Code within the signatory.

Q. 24 How could the Stewardship Code take account of some investors' wider view of responsible investment?

It could encourage this to be part of their policies, by setting out in the Code that stewardship is linked to a wider approach to investment.

Q.25 Are there elements of international stewardship codes that should be included in the Stewardship Code?

Yes, e.g. explicit reference to ESG (Australia, Japan and the Netherlands) and including model policies and detailed guidance on voting (Australia).

Q.27 Would it be appropriate for the Stewardship Code to support disclosure of the approach to directed voting in pooled funds?

Yes, such disclosure would be a low bar to meet in the context of a comply or explain code.
The Stewardship Code could go further and encourage asset managers to allow asset owners to direct voting in pooled funds.

Q.28 Should board and executive pipeline diversity be included as an explicit expectation of investor engagement?

Yes, in line with the desire to drive this change expressed in the revised Corporate Governance Code.

Q.29 Should the Stewardship Code explicitly request that investors give consideration to company performance and reporting on adapting to climate change?

Yes, in the context of a clearer focus on environmental issues as key to long-term success for companies. Climate change should be referenced as an example, but the wider reference should be environmental issues more broadly, to allow flexibility.

Q. 30 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?

Yes, to encourage integration of stewardship into their broader investment philosophy.