ICGN
International Corporate Governance Network

Mr. Richard Moriarty
CEO
UK Financial Reporting Council
125 London Wall
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11 February 2025

Dear Mr. Moriarty,

Subject: Response to UK Stewardship Code consultation

The International Corporate Governance Network (ICGN) appreciates the opportunity to comment on the UK Financial Reporting Council's (FRC) consultation on the UK Stewardship Code ("the Code").

Led by investors responsible for assets under management of >US$90 trillion, ICGN is an authority on global standards of corporate governance and investor stewardship. Headquartered in London, our membership is based in more than 40 countries. ICGN's *Global Governance Principles* and *Global Stewardship Principles*, written from an investor perspective, are widely used by our members in their company assessments and voting decisions, and by regulators when developing corporate governance rules.

Key messages

- **We would like the Code to explicitly recognise stewardship as a core aspect of an investor's fiduciary duty.** Including such a reference in the definition's explanatory note, or elsewhere in the Code, would underscore the critical role stewardship plays in protecting the interests of clients and beneficiaries.
- **The proposed definition of stewardship aligns well with ICGN's definition** and accommodates diverse investment models and objectives and recognises that long-term sustainable value creation can take different forms depending on different investment approaches. While a range of views exist within ICGN's membership, there is broad support for the definition, recognising that it seeks to strike a balance of pragmatic flexibility with promoting the high standards of stewardship that the Code has been a key contributor to driving.
- **Some members would prefer if there was no supporting paragraph following the definition,** allowing signatories to disclose their own interpretation. **Others believe that the paragraph could be strengthened** with regards to its reference to the connection between stewardship and broader outcomes, such as societal and environmental.
- **We recommend that the Code specifically highlights public policy advocacy within Principle 2.** It is important that the Code recognises that not all stewardship activities are specifically focused on individual portfolio companies, and that activities focused on system wide issues, such as regulation, public policy and standard setting, are also a critical part of signatories' role as stewards on behalf of their clients and beneficiaries.

- We support efforts to streamline reporting, splitting dynamic and static reporting. **We suggest that the Policy and Context Disclosure should only be required to be submitted every third year.**
- **We support the streamlined, more tailored Principles.** This reflects the interconnection of these activities and allows signatories flexibility in reporting on their individual approaches. We believe it is important that the FRC continues to recognise best practices in stewardship and that although not mandatory, escalation and collaboration are important tools in an investors' toolkit and should be used where appropriate.
- We support the inclusion of clear reporting prompts and the development of guidance. **The guidance should be clear about what is a mandatory disclosure or minimum requirement to maintain signatory status and what is a suggested prompt for consideration.** We also believe it is important that the guidance is focused on disclosure quality rather than quantity, and **that that the FRC ensures that industry practitioner experience and input is a core part of the process it will undertake to create and maintain this guidance**, particularly given the fast pace of change in stewardship best practices.
- **We support the inclusion of differentiated Principles for proxy advisors and investment consultants.** We recommend including reference to systemic risks in the proxy advisors' Principles and that **the FRC consider adding a Principle for data providers to recognise the critical importance of high-quality data.**
- **We recommend retaining references to optional assurance.**

<u>Response to consultation questions</u>

1. ***Do you support the revised definition of stewardship?***

The revised definition closely aligns with ICGN's definition of stewardship, which is stewardship is "*the responsible allocation, management, and oversight of capital, to protect and enhance long-term value for beneficiaries and clients. This contributes to capital market efficiency, integrity, and resilience, and to sustainable economic growth*."[1]

We believe it is important that the revised UK Stewardship Code's definition accommodates diverse investment models and objectives and recognises that long-term sustainable value creation can take different forms depending on different investment approaches.

While a range of views exist within ICGN's membership, there is broad support for the definition, recognising that it seeks to strike a balance of pragmatic flexibility with promoting the high standards of stewardship that the Code has been a key contributor to driving. It is important that the revised Code continues to maintain these high standards as this supports the Code's leading role in the stewardship ecosystem.

Fiduciary duty

ICGN members generally agree that it would be helpful for the FRC to explicitly recognise stewardship as a core aspect of an investor's fiduciary duty. This is currently absent from the Code. For example, the FRC could draw on the ICGN *Global Stewardship Principles*, which affirm that "*Stewardship is a fundamental aspect of an investor's fiduciary duty*."[2] Including such a reference in the definition's explanatory note, or elsewhere in the Code, would

[1] ICGN *Global Stewardship Principles* (2024), p.3
[2] ICGN, ibid, p.3

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underscore the critical role stewardship plays in protecting the interests of clients and beneficiaries.

Broader outcomes

However, there are a range of views and suggestions on how the definition might be further developed in some areas, or more focused in others.

While some members would prefer if there was no supporting paragraph following the definition, allowing signatories to disclose their own interpretation, others believe that the paragraph could be strengthened with regards to its reference to the connection between stewardship and broader outcomes, such as societal and environmental.

Some possible ways to address this are:

- Seeking to echo the intentions of Section 172 of the UK Companies Act 2006 within the definition of stewardship. Section 172 states that directors must consider factors such as "*the impact of the company's operations on the community and the environment*".[3] Drawing some comparisons would help to acknowledge that stewardship can and should consider all material factors, including the economic, environmental and societal impacts.
- Drawing on the UN Principles for Responsible Investment's (PRI) definition of stewardship: "*Stewardship is the use of investor rights and influence to protect and enhance overall long-term value for clients and beneficiaries, including the common economic, social and environmental assets on which their interests depend*."[4] This could help to acknowledge the value protection that can come from good stewardship in avoiding adverse impacts.
- Replacing "may lead to" with "can" in the paragraph following the definition, to strike a more positive tone.

Defining 'sustainable'

Additionally, there is concern from some members that the term 'sustainable' has become a restricted term under various regulations, for example the Financial Conduct Authority (FCA) Sustainable Disclosure Regulation (SDR) and the EU Sustainable Finance Disclosure Regulation (SFDR). This creates challenges for signatories, as they navigate legal and compliance issues around its use. As such, the FRC should clarify how it defines 'sustainable' and reference this within the Code or guidance.

2. ***Do you agree with the proposed approach to have disclosures related to policies and contextual information reported less frequently than annually? If yes, do you support the approach set out above?***

Yes. Less frequent reporting would alleviate the reporting burden and streamline administrative efforts for signatories without compromising the quality or transparency of their disclosures. However, to achieve these benefits, we believe it will be necessary for the Policy and Context Disclosure to only be required to be submitted every third year, unless there is a material change. This will avoid the need for signatories to go through the various legal, compliance and sign-off processes on an annual basis to resubmit their disclosures.

In the event that the FRC does require the Policy and Context Disclosure to be submitted each year, it will be important to clarify the expectations of the required approvals of

[3] UK Companies Act 2006, S 172 "Duty to promote the success of the company"
[4] UN PRI, "Definitions for responsible investment approaches" (1 November 2023)

documents resubmitted without changes, for example if the FRC expects that the governing body which approved the initial disclosure needs to reapprove the resubmission each year.

We would appreciate the FRC including some clarity or examples of what might be considered a material change in the guidance to the Code, to allow signatories to make their own assessments in the context of that guidance. We suggest clarifying how material changes in the Policy and Context Disclosure outside the reporting cycle might be handled if they are flagged. There is a need to ensure that this process does not inadvertently expose signatories to unnecessary scrutiny.

Finally, to support the range of approaches to stewardship and reporting, we recommend allowing signatories to report according to the former model on a combined one-report basis, if they wish, particularly in the first reporting year as a transitional arrangement. This flexibility ensures that signatories can maintain consistency in their reporting while gradually aligning with the updated requirements.

3. ***Do you agree that the Code should offer 'how to report' prompts, supported by further guidance?***

Yes. The 'how to report' prompts and supporting guidance can help ensure clarity and consistency in reporting and will enable signatories to understand not only what is required but also how best to present their stewardship activities and outcomes. We encourage the FRC to clearly state that the guidance is voluntary and not prescriptive.

The guidance should be clear about what is a mandatory disclosure or minimum requirement and what is a suggested prompt for consideration. It is also important for the guidance to be focused on disclosure quality rather than quantity, and that it reflects a range of reporting best practices. For example, the approach taken by the FRC in previous reporting reviews of highlighting common approaches or "better reporting" could be helpful.

However, we believe that it is important that the FRC considers the process it will undertake to create and maintain this guidance, particularly given the fast pace of change in stewardship best practices.

For example, the FRC might consider a public consultation on the guidance to incorporate stakeholder feedback. If a public consultation is not feasible, we recommend that a practitioner working group is formed to help develop and maintain the guidance. Such a group should be composed of investors with diverse investment approaches and roles in the investment chain, to ensure that the guidance is industry informed and has sufficient clarity and applicability for a wide range of signatories.

This is crucial as the draft guidance as written in the consultation document raises a number of potential concerns and possible unintended consequences. For example, we recommend that the FRC remove or clarify the 10% threshold for determining which engagement reporting expectations apply based on assets under management. Given the range of stewardship approaches across different investment strategies, this threshold may not fully reflect the diverse ways in which signatories engage in stewardship. By allowing signatories more flexibility, the FRC can better support reporting that aligns with each signatory's business model and practices, encouraging a more inclusive and adaptable approach to stewardship.

We encourage the FRC to consolidate the final guidance into a single resource to ensure that signatories can easily access all the information available.

Beyond the 'how to report' prompts and guidance, we recommend that the FRC considers increasing its support to signatories at risk of losing their status. For instance, providing a "shortcomings guide" and individual feedback, outlining the specific steps and improvements required to retain their status.

4. ***Do you agree that the updated Code for Asset Owners and Asset Managers should have some Principles that are applied only by those who manage assets directly, and some that are only applied by those who invest through external managers?***

5. ***Do the Principles of the updated Code better reflect the different ways that stewardship is exercised between those who invest directly, and those who invest through third parties?***

We are answering questions 4 and 5 together, as we consider them closely related.

We broadly agree with the goals of these proposals. Differentiating Principles supports asset owners and asset managers in applying relevant stewardship practices based on their specific objectives. It can also alleviate reporting burden by ensuring each group only reports on aspects relevant to their role.

However, it is important to note that there are a range of approaches and models, all of which can be accommodated with sufficient flexibility. For example, many asset owners who primarily or wholly invest via third-party asset managers also do significant stewardship activities directly, including engaging with companies, policy related engagement or voting on their underlying holdings. Similarly, many asset managers have both directly managed and fund of fund structures that rely on the work of third-party managers in some way.

As such, retaining appropriate flexibility and clarity that reporting should follow the specific circumstances of the signatory is key.

It is also important to promote alignment across the investment chain and recognise that all parties - asset owners, asset managers, and others - are shareholders working toward shared goals of long-term sustainable value creation. As such, reporting to clients to support that client's own stewardship reporting is also important and should be encouraged in a pragmatic and efficient manner.

Finally, it would be helpful for the FRC to recognise the need for applying different approaches across asset classes to ensure that the Code recognises nuances in stewardship practices.

6. ***Do you agree that the updated Service Providers' Code should have some Principles that are applied only by proxy advisors, and some that are only applied by investment consultants?***

Yes. Differentiated Principles for allow each group to be held accountable for activities relevant to their specific responsibilities.

We recommend that the FRC includes the reference to identifying and responding to systemic risks for proxy advisors as well as investment consultants.

We recommend placing stronger emphasis on the critical importance of high-quality data provided by service providers. ICGN's *Global Stewardship Principles* highlight that high quality data, research, and analysis, is important to inform investors decision-making processes.[5] The FRC may consider adding a Principle for data providers, or make reference to data providers *in addition to* proxy advisors and investment consultants in the title of the

[5] ICGN, ibid. "5. Stewardship Commitment", p.5

Service Providers' Code, to address this need. We also recommend expanding the expectation on undertaking external or internal assurance to service providers.

7. ***Do the streamlined Principles capture relevant activities for effective stewardship for all signatories to the Code?***

Yes, to a large extent. The streamlined Principles will help ensure that stewardship practices are aligned with the evolving landscape, clarify expectations for all signatories, and provide a more efficient reporting framework.

We welcome the merging of Principles 9. *Engagement* and 10. *Collaboration* into one Principle, *Engagement*. We also welcome the absorption of Principle 11. *Escalation* into the Code's broader Principles. This reflects the interconnection of these activities and allows signatories flexibility in reporting on their individual approaches.

We believe it is important that the FRC continues to recognise best practices in stewardship and clarify that although not mandatory, escalation and collaboration are important tools in an investors' toolkit and should be used where appropriate. It may be helpful for signatories if the FRC provides examples of escalation tools within the guidance, while emphasising that these are suggestions. ICGN *Global Stewardship Principles* references a list of potential escalation tools, for example.[6] We also recommend that the FRC add shareholder/securities litigation to its list of escalation tools as outlined in the consultation document.

Finally, it would be helpful that the definition of engagement in the context of the Code and its associated reporting be clear. There are many activities that may be considered engagement, and to ensure that reporting is useful to the reader, the specific definition used by the signatory is important. For example, the removal of the Principle on monitoring means that it will be important to understand which interactions with investee companies are conducted for research purposes or seeking information only, and which are engagements aimed at driving some form of change, for example strategic or operational improvements, new disclosures or to respond to the investor's governance expectations.

8. ***Should signatories be able to reference publicly available external information as part of their Stewardship Code reporting, recognising this means Stewardship Code reports will no longer operate as a standalone source of information?***

Yes. This can further alleviate the reporting burden by reducing duplication, which is particularly valuable for signatories reporting against similar frameworks in other jurisdictions. We encourage the FRC to develop guidance on the types of external information deemed appropriate or approved for this purpose, and their appropriate use within the report. This would help signatories navigate what can be referenced.

9. ***Do you agree with the proposed schedule for implementation of the updated Code?***

Yes. We reiterate our recommendation to allow signatories to report according to the former Code model, if they wish, particularly in the first reporting year as a transitional arrangement.

<u>Other comments</u>

We wish to share some additional observations on the revised Code.

Strengthening the role of public policy advocacy in Principle 2. Systemic risks

[6] ICGN, ibid. "3.6. Escalation", p. 7

We recommend that the Code specifically highlight public policy advocacy within Principle 2. It is important that the Code recognises that not all stewardship activities are specifically focused on individual portfolio companies, and that activities targeting system-wide issues, such as regulation, public policy and standard-setting, can also be a critical part of signatories' role as stewards on behalf of their clients and beneficiaries. These activities are fundamental to the effective functioning of the wider ecosystem of the capital markets and are important to ensure that the investor voice is heard.

ICGN has introduced a Principle on public policy advocacy in its *Global Stewardship Principles*. It encourages investors to "*Consider public policy advocacy to mitigate market-wide issues or systemic risks, thereby protecting and enhancing value for beneficiaries and clients, and safeguarding capital market efficiency, integrity, and resilience*."[7]

In the 'how to report' section, we recommend:

- Adding a prompt to "Explain how your chosen approach to addressing market-wide issues or systemic risks aligns with your long-term value creation goals for clients and beneficiaries". This helps to acknowledge the strategic importance of systemic risks in contributing to or detracting from sustainable financial performance over time.
- Highlighting the role of collaboration: ICGN *Global Stewardship Principles* encourages investors to consider collaborative advocacy, as appropriate.[8] For example by including a reference in the Code to encourage collaboration with other investors, industry groups, or similar stakeholders.
- Referencing examples of relevant stakeholders: For example, adding a sentence to bullet point three under "How to report" (starting "Explain how you have engaged with…") referencing examples of "other relevant stakeholders". Such as, standard-setters, regulatory authorities, or policymakers, where appropriate.[9]

Retaining references to audit and internal assurance

We recommend retaining references to optional assurance under C. *Stewardship policies and review* (former Principle 5. *Review and assurance*) in the Code or in the guidance. These mechanisms can be helpful for maintaining transparency and accountability.

Thank you again for the opportunity to share our perspective. If you would like to follow up with questions or comments, please contact our CEO, Jen Sisson (jen.sisson@icgn.org) or Policy Executive, Wendela Rang (wendela.rang@icgn.org).

Yours faithfully,

Jen Sisson

Jen Sisson

Chief Executive Officer, ICGN

Co-signatories

Aotearoa New Zealand Stewardship Code, Jackson Rowland, Director

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[7] ICGN, ibid. "5. Public policy advocacy", p.9
[8] ICGN, ibid. "5.4 Collaborative advocacy", p.10
[9] ICGN, ibid. "5. Public policy advocacy", p.9