RESPONSE TO THE FINANCIAL REPORTING COUNCIL CONSULTATION ON REVISIONS TO THE UK CORPORATE GOVERNANCE CODE

INTRODUCTION

The United Nations-supported Principles for Responsible Investment (PRI) is the world’s leading initiative on responsible investment. The PRI has over 1900 signatories (pension funds, insurers, investment managers and service providers) globally with approximately US $70 trillion in assets under management. Over 250 of these signatories are based in the UK.\(^1\)

 Responsible investment explicitly acknowledges the relevance to investors of environmental, social and governance (ESG) factors in investment decision making for the long-term health and stability of financial markets. The PRI welcomes the opportunity to contribute evidence to the FRC consultation on revisions to the UK Corporate Governance Code.

ABOUT THE CONSULTATION

In February 2017 the FRC announced plans for a comprehensive review of the UK Corporate Governance Code. In December 2017, a public consultation was launched including a draft revised Code that was opened for comment until the end of February 2018. It was launched to explore views on proposed amendments for a revised UK Corporate Governance Code, which among other areas focuses on; the importance of companies’ sustainability and long-term success, as well as asking questions on the future direction of the UK Stewardship Code.

SUMMARY OF THE PRI’S POSITION

The central recommendation of the PRI’s response is that the FRC should pay more attention to ESG issues throughout the UK Corporate Governance and the UK Stewardship Code. In particular, the UK Stewardship Code should explicitly state that environmental and social issues are important drivers of long-term investment value, and are part of the fiduciary duty that investors owe to their clients and beneficiaries.\(^2\) Our more detailed answers below are in response to specially selected questions from the consultation that draw on specific expertise and evidence from the PRI’s work.

\(^1\)See [https://www.unpri.org/signatory-directory/](https://www.unpri.org/signatory-directory/)

\(^2\) See response to consultation question number 22
CONSULTATION QUESTION RESPONSES

UK Corporate Governance Code and Guidance on Board Effectiveness Questions

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

The proposed methods for establishing the views of a company’s workforce as proposed in Provision 3 are all sensible proposals to helpfully address the government's emphasis on workforce representation, as set forth in the UK corporate governance reform green paper. Companies should be allowed flexibility to select one of the proposed methods depending on the board size and structure, and this flexibility is reflected in Provision 3 and the Revised Guidance on Board Effectiveness.

Additional ideas for engagement with the workforce outlined in the guidance may be equally beneficial to wider stakeholder engagement. We recommend that that the FRC amend wording of Provision 3 to also to include stakeholders and not just the workforce. This could include customers, suppliers, communities, government, trade unions and so forth. We note and support that in the Revised UK Corporate Governance Code consultation document, the FRC states reference will be made to the Companies Act 2006, section 172. Section 172 does not focus only on the workforce as stakeholders to whom directors must pay regard. Expanding Provision 3 will read more coherently with section 172 of the Companies Act 2006, and Provision 4 regarding the board’s explanation of how it has engaged with the workforce and other stakeholders. Therefore it provides a clearer instruction for directors to understand their duties and for companies to implement.

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

The PRI recommends the FRC amends explicitly references the SDGs under ‘Leadership and Purpose’ in the Code guidance, as follows:

‘The board should articulate how it has considered the SDGs as part of the company strategy, value and sustainability over the long term.’

The executive and non-executive members of the board should play a key role in implementing, overseeing and reporting on its application of this guidance. In addition to disclosing how the SDGs are considered to contribute towards the company’s long-term success, the PRI further

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3 We welcome reference to the ‘workforce’ and its intended purpose to extend consideration beyond those with formal employee contracts.

4 Including: appointing a director from the workforce, a formal workforce advisory council, or a designated non-executive director as well as means for the workforce to raise concerns in confidence and anonymously.

5 UK corporate governance reform green paper

6 FRC consultation documents Appendix B - Revised Guidance on Board Effectiveness

7 FRC consultation documents Appendix A – Revised UK Corporate Governance Code

8 Companies Act 2006, section 172

9 The Code guidance might also reference the UN Global Compact 10 Principles. The UN Global Compact White Paper: The UN Global Compact and the Sustainable Development Goals illustrates that the 10 principles are a necessary foundation to advance progress on the SDGs.
recommends that boards should increasingly consider and disclose how company activity meaningfully contributes to achieving the SDGs.\(^{10}\)

The integration of the SDGs into the Code guidance is an important signal for companies worldwide, and important for the UK to maintain its status as a leader and standard bearer in international corporate governance regulation, particularly in the context of increasing investor support for the SDGs, further outlined below.

- **The PRI's Blueprint for responsible investment and The SDG investment case**

In May 2017, the PRI published its 10 year strategy, the PRI Blueprint for responsible investment.\(^{11}\) Developed in formal consultation with PRI signatories, the SDGs are firmly embedded within the strategy as one of the nine pillars that will define the PRI’s work over the next decade.

Many PRI signatories believe that their investments in companies and other entities will only be profitable over the long term if societies and the financial system develop in an environmentally sustainable, equitable way. This is explored in the PRI’s publication, *The SDG Investment Case*\(^{12}\) which outlines why there is an expectation that investors will contribute to the SDGs and – crucially – why investors should want to contribute to them.

- To the SDGs represent the globally-agreed most pressing environmental, social and economic issues in the world, and as such serve as a list of the material environmental, social and governance (ESG) factors that should be considered as part of an investor’s fiduciary duty.
- Large institutional investors – which can be considered as universal owners – with their portfolios exposed to growing and widespread economic risks, can protect their long-term financial performance by encouraging sustainable economies and markets.
- Achieving the SDGs will be a fundamental driver of economic growth which, in the long term, will boost corporate revenues and earnings and, in turn, equities and other assets.
- Providing solutions to sustainability challenges offers attractive investment opportunities. Investors can implement strategies that target SDG themes and sectors, with opportunities available in most asset classes.

Furthermore, ultimate beneficiaries (of pension funds, clients of insurance companies, etc.) increasingly demand that all parties in the investment chain (markets, asset holders and managers) take into account their broader long-term interests and those of future generations. The SDGs offer clear direction to meet these needs.

For companies, the ‘SDG Investment Case’ notes that environmental damage, social dislocation and economic inequality may have significant associated costs forced into companies’ accounts in the future. The SDGs provide a clear risk framework for companies to mitigate these costs, as well as to consider and report against in the broader context of sustainable development. As one example, the Global Reporting Initiative (GRI)\(^{13}\) offers guidance for companies to report against the SDGs, and therefore can practically support companies’ implementation of any such Code guidance.

In summary there is significant support from, and benefit for, investors and companies alike to include specific reference to the SDGs in the Code guidance. Achieving the SDGs through corporate responsibility and responsible investment will require a more dedicated approach from multiple actors, and the FRC has an opportunity to bring the UK into a leadership role by making this reference explicit.

\(^{10}\) Examples might include; labour practices, job creation, energy and resource consumption etc. Many more examples can be found in the GRI’s *SDG Compass - linking the SDGs and the GRI*.

\(^{11}\) See the **PRI Blueprint for responsible investment**

\(^{12}\) The **SDG Investment Case**

\(^{13}\) *SDG Compass - linking the SDGs and the GRI*
• *Growing a Culture of Social Impact Investing in the UK (recommendations on the SDGs)*

In November 2017, at the request of UK government, an independent advisory published its report, ‘Growing a Culture of Social Impact Investing in the UK’.\(^{14}\) It made a number of recommendations, which the PRI endorses, to help develop a competitive environment for responsible investment, aligned with the SDGs. These include that:

1. The FRC should include the development of mechanisms for wider corporate reporting by companies, including reporting on social impact in the context of the SDGs, in its consultation of its strategic plan for 2018/21.

2. The FRC should ensure its review of the Corporate Governance Code encourages more companies to be purposeful, engaged with wider stakeholders and committed to assessing and communicating their social impact in the context of the SDGs.\(^{15}\)

3. The Department for Business, Energy and Industrial Strategy (BEIS) should explore, with the FRC, how best to encourage UK business to increase transparency on the contribution business makes towards the achievement of the SDGs. Separately, in regard to the FRC consultation on companies’ strategic report, the FRC should explore ways in which material information, useful to wider stakeholders, can be reported in the context of the SDGs.

By implementing these recommendations we believe that the FRC can play it’s a key role in accelerating companies’ much needed consideration of, and reporting on, the SDGs.

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

The PRI recommends that the FRC amend the proposed Provision 40 of the Code to refer to how the remuneration committee has addressed sustainability, including ESG issues, to complement and in addition to how it has addressed the alignment of executive remuneration with culture and strategy.

The PRI’s report ‘Integrating ESG issues into executive pay’\(^{16}\) makes further recommendations about how remuneration committees can

- adopt a process to identify relevant ESG metrics and ensure they constitute a meaningful component of the overall remuneration framework as appropriate for the company; and

- disclose information about the rationale, method and challenges faced in the process of identifying and incorporating ESG metrics into executive pay.

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\(^{14}\) *Growing a Culture of Social Impact Investing in the UK*

\(^{15}\) *Growing a Culture of Social Impact Investing in the UK*, p30. This report was published in November 2017. One month later, HM Treasury also signalled its support for the recommendations, as follows: “The government will be giving full consideration to its report, ‘Growing a culture of social impact investing in the UK’, …and will continue to work with the regulators to build capability and increase transparency in this form of investing to further encourage growth of the impact investing market.” *The UK Investment Management Strategy*, p25, paragraph 7.11

\(^{16}\) *Integrating ESG issues into executive pay: a review of global extractive and utility companies*
UK Stewardship Code Questions

General comments regarding this initial consultation on the future direction of the UK Stewardship Code

The PRI welcomes this initial consultation on the future direction of the UK Stewardship Code and its forthcoming revision. The UK Stewardship Code is a leading example for markets worldwide, and as such, it should incorporate explicit reference to ESG issues into the Code. We believe that the implementation of the EU Shareholder Rights Directive offers a clear opportunity to do this.

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?

The Code should be more explicit about expectations on Stewardship duties undertaken by investors investing directly, indirectly and those advising them. To strengthen investor stewardship and expectations on different parts of the investment chain, the PRI recommends that the following areas should be addressed:

1. UK asset owners should sign the UK Stewardship Code. The PRI recommends that the FRC explicitly encourage UK asset owners to sign the UK Stewardship Code, including corporate pension funds. As signatories to the Code, the FRC should encourage asset owners to make public commitments to responsible investment and incorporate expectations on stewardship duties into their mandates with their asset managers.

2. The FRC should work with BEIS and the Department for Work and Pensions (DWP) to update the Investment Regulations and FCA codes to establish clear expectations of a stewardship duty for UK investors. This could be reinforced through greater scrutiny of pension fund trustee practices by The Pensions Regulator (TPR). The government should also clearly signal that international investors in the UK should act in accordance with the UK’s Stewardship Code, a practice adopted by other stewardship codes around the world.17 The FRC should support the call for these changes and engage as necessary with relevant bodies.

3. Stewardship activity and ESG integration should be incorporated into both mandates and performance review processes that institutional investors have with investment managers and investment consultants.18

Finally, we note that high standards of corporate governance reinforce high standards of pension fund governance and stewardship. The actions the PRI recommends the FRC undertake across these areas are complementary and reinforcing to encourage consistency of higher standards of governance and stewardship throughout the investment chain.19

17 Especially important, noting that over half the UK stock market is owned by overseas investors, on whom such a duty would not be binding.

18 Given their major role on advising pension investments, ESG must be a core part of investment advice to reflect ESG as a core part of investors’ fiduciary duties. We see market structure, market practice and regulatory reasons why ESG is not currently a core part of investment advice. Addressing these reasons is a necessary step for a more sustainable financial system. See PRI’s publication: Working towards a sustainable financial system: investment consultant services review

19 For further recommendations on pension fund governance and stewardship see the PRI’s publication: How asset owners can drive responsible investment
Q19. Are there alternative ways in which the FRC could highlight best practice reporting?

Stewardship practices should be a source of competitive differentiation, particularly among investment managers. It is important that signing the Code is a meaningful activity, and that high quality reporting against it enables stewardship practices to be assessed. We commend the FRC for the work it has undertaken to tier signatories of the UK Stewardship Code in 2016. This has proven to be a valuable exercise in improving practice and reporting standards for signatories.

We further recommend that the FRC work with the TPR and the FCA respectively to provide clear guidance for:

1. Asset owners that outsource investment management (and associated activities) about effective oversight and review of asset managers’ stewardship duty and how they are expected to deliver on their stewardship obligations; and

2. Asset managers about the standards required to discharge their stewardship duties for any assets under their management, and strengthen Conduct of Business Rule 2.2.3 from requiring an investor to state the nature of its commitment to the UK Stewardship Code to a comply or explain requirement.20

Guidance which sets expectation on stewardship duties and meaningful reporting is a necessary basis to establish best practise reporting.

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 PRI recommends that ESG issues are explicitly referenced in a Principle of the UK Stewardship Code.21 This should be a major area of focus for the FRC resulting from this consultation.

In reference to ESG issues, the Code should state that it requires investors to:

“demonstrate how they promote the long-term performance and sustainability of companies, including their integration of material environmental, social and governance (ESG) factors in stewardship activities”

Stewardship is one of the central tools that investors can use to manage investment risk and return, and considering ESG issues in stewardship activities and investment decision making is core to the fiduciary duty that investors owe to beneficiaries. Explicit reference to ESG issues in the UK Stewardship Code provides clear direction to investors on the need to include ESG issues in stewardship activities, and therefore helps to ensure that investor’s duties are properly fulfilled through this investment governance channel.

Explicit reference to ESG issues in a Principle of the UK Stewardship Code will also align it with a strong and clear trajectory taking place both in the UK and internationally, as evidenced by a

20 COBS 2.2.3 states: A firm, other than a venture capital firm, which is managing investments for a professional client that is not a natural person must disclose clearly on its website, or if it does not have a website in another accessible form: (1) the nature of its commitment to the Financial Reporting Council’s Stewardship Code; or (2) where it does not commit to the Code, its alternative investment strategy.

21 Currently the UK Stewardship Code only references “social and environmental matters” as examples of issues that may warrant escalation of stewardship activities. See the UK Stewardship Code (issued in September 2012).
series of developments since the Code's last review which should be reflected in any updated Code, further outlined below.

- The EU Shareholder Rights Directive specifically references ESG issues throughout, and places a positive duty on all investors to consider stewardship and long-term factors. The PRI has previously demonstrated that the majority of European PRI signatories already comply with, or exceed, the disclosure requirements of the directive. The directive will address many of the weaknesses identified by the PRI's 'Global Guide to Responsible Investment Regulation', which should also be supported by the UK Stewardship Code.

- This is already being called for through the final report of the EU High-Level Expert Group on Sustainable Finance (HLEG). The European Commission has indicated "we will propose to integrate sustainability factors into investment mandates. This means these criteria will be reflected in the duties that asset managers and institutional investors have towards those whose money they manage. This would clarify their legal obligation to factor sustainability risks into capital allocation decisions."

- Developments of the EU HLEG follow previous work by the PRI and UNEP FI supported by The Generation Foundation on the definition of fiduciary duty in the 21st century and the launch of a UK roadmap which set outs recommendations to fully embed the consideration of Environmental, Social and Governance (ESG) factors in the fiduciary duties of investors in the UK capital markets.

- Explicit reference to ESG issues are now being included as Stewardship Codes are developed across the world (for more detail, please see response to question 25). The UK Stewardship Code is an instrument that governments and investors around the world refer to and is used as a model for the development of other codes. In this international context, it is particularly important that the UK Stewardship Code embodies best practice.

The UK Stewardship Code will be incomplete without explicit reference to ESG issues and clarification on stewardship duties, trailing behind these international developments to recognise ESG factors as core to investors' legal obligations as fiduciaries.

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?

The PRI has recently produced ‘A practical guide to active ownership in listed equity’ which encourages PRI signatories to incorporate ESG issues into their ownership policies and practices,
including engagement with companies and exercise of voting rights. It demonstrates how stewardship and focus on ESG issues is an effective tool to support long-term value creation in listed equity investing and provides examples of what may be considered as best practise disclosure which may serve as a useful reference for the FRC to encourage this reporting. In addition the PRI recommends:

1. Disclosure of voting records: in 2017 the corporate governance green paper asked whether shareholders need greater powers to help them hold companies to account. It also provides compelling evidence that many investors do not use their existing powers. Therefore, the PRI recommends that the FRC works with BEIS and others to encourage greater disclosure of fund managers’ voting records to their asset owner signatories to the Code. This is in line with market practice; of the PRI’s UK fund manager signatories, 58% already provide public disclosure of their voting activities. In addition, institutional investors and fund managers should be encouraged to disclose rationale for voting decisions and in-house guidance. As well as supporting stronger implementation of the UK Stewardship Code, this is also in line with recent developments in the EU’s Shareholder Rights Directive (see the PRI’s briefing here).

2. Reporting on engagement activity: the PRI supports the BEIS Inquiry on Corporate Governance recommendation that the FRC provide guidelines for companies on what high quality engagement entails. The PRI recommends that the FRC also encourage high quality reporting on engagement activity from investors through application of the Stewardship Code, and the Listed Equity Active Ownership module of the PRI Reporting and Assessment Framework provides a model of how investors could increase and further improve the quality of information provided. This includes; tracking number of engagements, the method of engagement, investor’s role in the engagement, their level of intensity and so forth.

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

The focus of the UK Stewardship Code is on the role of shareholders in publicly listed companies. However, investors implement responsible investment across a range of asset classes, as evidenced by over 1900 members of the PRI. To better recognise how investors exercise their stewardship duties in different ways, the FRC could consider:

- Referencing the PRI Reporting Framework. This is the world’s most comprehensive dataset on responsible investment. It is structured to collect data on investors' implementation of responsible investment across listed equity, fixed income, infrastructure, commodities, hedge funds and others.

- Encouraging asset owners and asset managers to publicly state their commitment to responsible investment and active ownership in their Statement of Investment Principles (SIPs) and their investment beliefs respectively. This will help to clarify how investors view their stewardship duty across a range of investments.

29 The UK corporate governance reform green paper, p25, states that 28% of shareholders do not make use of their voting rights. On average, FTSE 250 remuneration policies achieved 94% support over the 2013-16 period.

30 BEIS Inquiry on Corporate Governance

31 The PRI welcomes the retention of Provisions from section E in the previous UK Corporate Governance Code within the Principles of the revised code, noting that Principle C and Provision 5 of the revised UK Corporate Governance Code underlines the importance of shareholder engagement and disclosure on the annual report.

32 https://www.unpri.org/report
Lastly, while the PRI’s most recent report on active ownership has a focus on practices related to listed equity holdings, several insights and recommendations on policy development, execution and disclosure can be equally applied to other asset classes such as corporate fixed income and private equity. Further in-depth analysis of the differences and engagement implications in fixed income is included in the forthcoming PRI publication, ‘ESG engagement for fixed income investors: managing risks, enhancing returns.’ The PRI would welcome an opportunity to discuss how to better take account of investors’ wider view of responsible investment in the UK Stewardship Code with the FRC.

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

There has been notable growth in stewardship codes in recent years, particularly in Asia, with Japan, Hong Kong, Malaysia, Singapore and South Korea implementing codes since 2014. While all stewardship codes are voluntary, some governments promote ESG issues in the Code more explicitly than others. In particular, the Australian, Brazilian and South African codes include explicit reference to ESG issues within their principles,33 and we recommend that the FRC amend the UK Stewardship Code similarly (see response to consultation question 22 for suggested wording).

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?

The PRI recommends that guidance is developed on the broader application of existing assurance standards to processes including engagement and voting. Through the PRI Reporting Framework, we examine how information reported to the PRI by our signatories has been verified in assurance reports. Our data reflects that there is limited understanding and application of assurance on responsible investment and stewardship processes within the assurance industry to be addressed, and we suggest guidance for as a necessary first step to address this need.

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

The PRI recommends that any changes to the UK Stewardship Code regarding signatories approach to directed voting in pooled funds:

1. Supports asset owners’ disclosure of their approach to how they direct managers to vote on their behalf in pooled funds, in conjunction with supporting asset managers’ disclosure on their investments in pooled funds, and their approach to voting on behalf of their clients. Without a clear line of sight between asset owners and their investments, there will be inadequate accountability in asset manager voting decisions, even with asset owners’ disclosing their approach to how they direct managers to vote in pooled funds.

2. Aligns with existing guidance from TPR34 which encourages pension schemes to ‘become familiar with [your] managers’ stewardship policies and where you consider it appropriate, seek to influence them.’

33 See Appendix B for excerpts from global stewardship codes that explicitly reference ESG issues within their principles. Many more reference ESG issues in accompanying guidance. See the PRI’s Global guide to responsible investment regulation for more.

34 The Pensions Regulator guidance on managing DC benefits, chapter 4, investment governance (investment stewardship). ‘For most pension schemes, stewardship activities, including engagement, are likely to be undertaken by the investment manager on the trustee board’s behalf. This especially applies where investments are made via pooled funds. We would encourage you to become familiar with your managers’ stewardship policies and where you consider it appropriate, seek to influence them. For some schemes, a formal scheme stewardship...
We further recommend that asset owners incorporate their requirements on engagement and voting into their agreements with investment managers, which can inform their selection, appointment and monitoring of investment managers.

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

Board and executive pipeline diversity should be included as key considerations for investors to raise with companies, and investors should continue to have flexibility around how they prioritise topics of engagement and the frequency with which issues are raised.

An effective board is that which has the right mix of skills, expertise, diversity and competencies. Every board should carefully consider what they deem to be a suitable structure, through continuous evaluation of the current composition, the company’s strategic direction, key challenges and the risks and opportunities in the external environment.

Investors increasingly recognise the role of diversity in improving company performance and shareholder value. This is demonstrated by investor initiatives and engagements targeting gender and other forms of diversity. Just as ‘progress on gender balanced boards… should be assessed [by investors] as a key corporate governance issue when considering their responsibilities under the UK Stewardship Code’ engagement on executive pipeline diversity in all of its forms must be an explicit expectation of investor engagement, as suitable for the company being engaged.

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

The PRI recommends that the UK Stewardship Code explicitly requests that investors consider how companies are assessing and managing their exposure to climate risk. There is a strong basis of support outlined below which lend weight to the need for this action.

- PRI Baker McKenzie climate disclosure country reviews

The ‘PRI Baker McKenzie climate disclosure country reviews’ demonstrate that UK Corporate Governance Code requires disclosure of material risks in financial reporting. Because of the medium to long term financial risk that climate change presents, company reporting on climate change risk and adaptation is therefore essential to achieving compliance with the UK Corporate Governance Code. Similarly, to properly uphold their stewardship duty, investors need to give consideration to company performance and reporting on adapting to climate change. Neither the Governance Code nor the UK Stewardship Code expressly address climate or other ESG risks in any detail. Both codes would benefit from explicitly referencing ESG issues including climate change to make this clarification.

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approach may be appropriate (e.g. by following the principles set out in the UK Stewardship Code), particularly where your scheme holds a significant amount of assets. For wholly insured schemes, it is unlikely to be possible to engage directly with your provider’s fund managers, but you may wish to ask your provider for information about the fund manager’s stewardship policies. “Good stewardship includes the exercising of rights attaching to investment, such as the voting rights attached to shares. Where practicable you may wish to agree specific voting criteria with your investment managers. Services that provide analysis and voting recommendations are available and can assist you in setting criteria.”

35 https://www.30percentcoalition.org/


37 Note this includes transition risk, physical (adaptation) risk and liability risk.

38 PRI Baker McKenzie Climate Disclosure Country Reviews
For companies and investors, reporting on climate issues should be aligned with international good practice such as provided by the Taskforce for Climate-related Financial Disclosures’ (TCFD) recommendations. This would:

- clarify that institutional investors and companies are aware of this issue and establishing management systems to reduce exposure from related financial risks;
- minimise the risk of future litigation against UK directors. Financial institutions and companies’ directors may face legal liability exposure by failing to assess and manage climate risk. The TCFD framework outlines information that is required for disclosure, and thereby will help UK directors reduce the likelihood of future climate-related litigation;
- align institutional investors and companies with the Paris Climate Agreement and the UK government’s Clean Growth Strategy;
- contribute towards longer term financial stability. Climate-related disclosure will facilitate an orderly transition to a low-carbon economy and support an efficient market response to climate change.  

The TCFD recommendations are supported by over 237 companies with a combined market capitalisation of over US$6.3 trillion, including 150 financial institutions responsible for assets of over US$81 trillion. The UK Stewardship Code should request that investors give consideration to company performance and reporting on adapting to climate change, and the TCFD framework provides the means by which this request would be implemented.

- **UK Committee on Climate Change (2017 report)**

The PRI supports the recommendation made in the ‘Progress in Preparing for Climate Change’ report from the UK Committee on Climate Change, that the UK Stewardship Code should be amended to ask investors to consider company performance and reporting on adapting to climate change.

- **UK Green Finance Taskforce (2018 report)**

The PRI recommends that the FRC should work with the UK Green Finance Task Force and the follow up to the endorsement of the UK Government of the TCFD on climate change reporting, and adapt the UK Stewardship Code accordingly to ask how investors take into account company performance and reporting on adapting to climate change.

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?

The PRI recommends that signatories to the UK Stewardship Code are required to state the purpose of stewardship with respect to the role of their organisation and specific investment or other activities. This means that signatories would be required to state their commitment to

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39 The Bank’s response to climate change, quarterly bulletin, 2017, Q2.

40 TCFD Secretariat press release 12th December 2017.

41 UK Committee on Climate Change, Progress in Preparing for Climate Change. It also noted that investors are increasingly attuned to the effects of climate change on risk adjusted returns, and the Committee recommended that government promote voluntary disclosure of climate change risks by both large and small companies, including the risks in relation to supply chain.

42 Forthcoming for Spring 2018.
responsible investment and active ownership in their SIPS and investment beliefs and further clarify how this is supported by their stewardship activities.\textsuperscript{43}

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 be achieved?

For pension funds, the UK Stewardship Code should require the disclosure of a fund purpose and this should be highlighted in the implementation of the Institutions for Occupational Retirement Provision (IORP2) directive. When transposed it will require affected pension schemes to consider ESG factors, and report on their approach on where there have been integrated.

Funds may also, where appropriate, disclose the fund’s purpose and approach to stewardship in the fund prospectus, which may include how it incorporates ESG factors into voting, engagement and investment decision making. This provides clarity for any investor in the fund about how money is being managed in a manner that aligns with beneficiary preferences, which could also serve to differentiate and promote ESG credentials of the fund.

APPENDIX A

Full list of consultation questions:

LIST OF CONSULTATION QUESTIONS
If you wish to make general comments not relating to the following questions, please state clearly the Principle or Provision the comment relates to, so that these can be more effectively captured as part of the post-consultation review.

UK Corporate Governance Code and Guidance on Board Effectiveness Questions
Q1. Do you have any concerns in relation to the proposed Code application date?
Q2. Do you have any comments on the revised Guidance?
Q3. Do you agree that the proposed methods in Provision 3 are sufficient to achieve meaningful engagement?
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?
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?
Q6. Do you agree with the removal 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.
Q7. Do you agree that nine years, as applied to non-executive directors and chairs, is an appropriate time period to be considered independent?
Q8. Do you agree that it is not necessary to provide for a maximum period of tenure?
Q9. Do you agree that the overall changes proposed in Section 3 of revised Code will lead to more action to build diversity in the boardroom, in the executive pipeline and in the company as a whole?

\textsuperscript{43} Also recommended in response to consultation question 24.
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.

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.

Q12. 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?

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

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?

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

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

**UK Stewardship Code Questions**

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?

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?

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

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

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

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?

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?

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

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

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

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

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

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?

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 be achieved?

APPENDIX B

Excerpts from global stewardship codes that explicitly reference ESG issues.

Australia

FSC Standard 23: Principles of Internal Governance and Asset Stewardship July 2017

'Disclosure should include the Asset Manager’s approach where relevant to the following stewardship activities and the governance and oversight associated with each one… approach to considering Environmental, Social and Governance factors (risks and opportunities) and whether these considerations influence investment decision-making and company engagement.'

Brazil

AMEC Stewardship Code

'Principle 3: Take ESG factors into account in their investment processes and stewardship activities Institutional investors should integrate environmental, social and governance factors into their investment process, evaluating both their impact on risks and returns and their contribution to the sustainable development of the issuers of securities.'

South Africa

CRISA Code

An institutional investor should incorporate sustainability considerations, including environmental, social and governance, into its investment analysis and investment activities as part of the delivery of superior risk-adjusted returns to the ultimate beneficiaries.

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44 https://www.fsc.org.au/_entity/annotation/82bbc3f8-316c-e711-8103-c4346bc5977c

45 https://www.amecbrasil.org.br/stewardship/codigo/

46 http://www.iodsa.co.za/?page=CRISACode