

PRI RESPONSE TO THE FCA CONSULTATION ON THE IMPLEMENTATION OF THE REVISED SHAREHOLDER RIGHTS DIRECTIVE

ABOUT THE PRI

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. Originally set up by the UN in 2005, the PRI is now a not-for-profit company with over 2,300 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles globally with approximately US \$83 trillion in assets under management.

339 of these signatories, representing \$7 trillion, are based in the United Kingdom.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that ESG factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

SUMMARY OF THE PRI'S POSITION

The PRI strongly supports active, engaged ownership of companies over the long-term. This is in line with the six Principles, especially Principle 2: "*We will be active owners and incorporate ESG issues into our ownership policies and practices*". Recent academic research¹ shows the value of active ownership: when done well, engagement and proxy voting activities bring higher financial returns, enhanced communication, improved knowledge, stronger internal relationships and more integrated strategies.

¹ See: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2154724

By placing a positive duty on all investors to consider stewardship and long-term factors, the Directive will address many of the weaknesses identified by PRI's *Global Guide to Responsible Investment Regulation*². The Directive will provide an effective minimum baseline for stewardship in the UK, complemented by higher standards set out under the UK Stewardship Code.

RECOMMENDATIONS FOR THE FCA

The PRI has two key recommendations regarding the implementation of this directive:

- 1) **Require the disclosure of an engagement policy and the exercise of shareholder votes.**
The FCA should make the requirements under Article 3g of the Directive mandatory, rather than proceeding on a comply or explain basis.
- 2) **Define “insignificant” votes.** The FCA should provide guidance on which votes are outside the scope of the reporting requirements of the Directive. A failure to do so risks this term being interpreted too expansively.

RESPONSE TO DETAILED QUESTIONS

The PRI will be responding to questions 1 and 2.

Q1: Do you agree that the territorial scope of the rules framework should extend beyond that envisaged by the Directive?

Yes, the PRI supports expanding the scope of the Directive to include non-EEA investment firms authorised by the FCA and non-EEA investee companies listed on a comparable market outside the EEA.

Information relating to firms' engagement policies and voting records is important to allow asset owners to hold their investment firm accountable and should form an important part of asset owners' selection processes³, irrespective of where the investment firm is formally headquartered. Information relating to the stewardship of companies without an EEA listing is also important, given evidence that performance on corporate social responsibility tends to be poorer the further investors are located from investee companies.⁴

² See: <https://www.unpri.org/sustainable-markets/global-guide-to-responsible-investment-regulation/207.article>

³ See: <https://www.unpri.org/listed-equity/a-practical-guide-to-active-ownership-in-listed-equity/2717.article>

⁴ See: https://www.researchgate.net/publication/303197029_Institutional_Ownership_and_Corporate_Social_Responsibility_The_Moderating_Effect_of_Geographic_Proximity

Q2: Do you agree with our proposed amendments to the Handbook to implement the Directive requirements around engagement policies? If not, please explain what alternative approach you would like us to take.

The PRI recommends:

- The requirements on disclosure of an engagement policy and voting records should apply on a mandatory rather than a comply or explain basis; and
- The FCA should clarify what votes might be considered “insignificant” and unnecessary to disclose.

(i) *Mandatory v comply or explain*

The PRI recommends that the minimum requirements set out in article 3g of the Directive for life insurers and asset managers - to develop and disclose a policy on shareholder engagement and to explain how they have cast votes at general meetings - should be mandatory, rather than “comply or explain”.

In their joint discussion paper *Building a regulatory framework for effective stewardship*⁵, the FCA and FRC articulate their vision that the implemented Directive will serve as a minimum regulatory baseline whereas the revised Stewardship Code will promote higher standards beyond this. A mandatory disclosure requirement is more consistent with this framework, and is crucial to confirm that asset owners have the relevant information to ensure that firms’ engagement with investee companies and their voting practices are in line with the interests of their beneficiaries.

The requirements under the revised Directive are also unlikely to represent a significant additional reporting requirement, as many asset managers are already meeting or exceeding the Directive’s requirements. For example, 77% of PRI’s asset manager signatories headquartered in the UK disclosed that they had a formal engagement policy during the 2017/18 reporting year⁶.

(ii) *Insignificant votes*

The PRI recommends that the FCA provide guidance on what constitutes an “insignificant vote” which firms will not be required to disclose.

Voting is an important aspect of stewardship; engagement and voting practices are interlinked and feed into each other. The voting policies and practices of asset managers are a key part of asset owners’ selection process, and should be sufficiently clear for asset owners to determine how aligned

⁵ See: <https://www.fca.org.uk/publications/discussion-papers/dp19-1-building-a-regulatory-framework-effective-stewardship>

⁶ Data from responses to the 2018 PRI Reporting Framework.

these are with their beneficiaries' interests. At a minimum, asset owners and beneficiaries should be able to understand how votes are being taken on their behalf

A lack of clarity around which votes are outside of the scope of this reporting requirement risks an uneven availability of this information across the market, with some firms taking an expansive view of what constitutes an insignificant vote. This risks undermining the FCA's efforts to strengthen information flow along the investment chain.

Any questions or comments can be sent to policy@unpri.org .