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Dear Mauro,

Re: AMEC draft stewardship code

Thank you for the opportunity to respond to the consultation on AMEC's draft stewardship code.

PRI welcomes the development of the Stewardship Code (hereafter "the code"), which covers both stewardship and ESG incorporation practices. Effective ESG incorporation and stewardship are in the interests of all market participants, contributing to better risk-adjusted returns and ESG outcomes¹.

The code is framed as a set of actions which enable institutional investors to fulfil their fiduciary duty. PRI agrees that failing to consider ESG issues in stewardship and investment decision-making is a failure of fiduciary duty. Asset owners outsourcing investment management and stewardship activities must pass this requirement on to their agents, and monitor implementation.

This is increasingly important against the backdrop of the Sustainable Development Goals, and growing recognition that investors have a responsibility to support sustainable value creation, and in doing so, contribute to the resilience and stability of the financial system as a whole.

The PRI policy team has followed the development, implementation and impact of a number of international stewardship codes. This information, combined with analysis of the activities of PRI signatories, form the basis for our overarching recommendations, which focus on:

- Ensuring the code achieves real, measurable impact in Brazil, and
- Encouraging international alignment between stewardship codes.

Since 2006, PRI has worked with signatories to implement ESG incorporation and stewardship activities. We offer our support as you develop the implementation guidance for the code.

Yours sincerely,

Nathan Fabian

Director of Policy & Research

Principles for Responsible Investment

¹ Selected papers are shared here, for further details please contact PRI. Papers: Clark, Gordon L. and Feiner, Andreas and Viehs, Michael (2015), [From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance](#). Dimson, Elroy and Karakaş, Oğuzhan and Li, Xi (2015), [Active Ownership](#). Florida State Board of Administration (2015): [Valuing the Vote: The Impact of Proxy Voting on SBA Portfolio Holdings](#).

SUMMARY OF RECOMMENDATIONS

PROCESS RECOMMENDATIONS

Phase	Recommendation
Sign up	<ul style="list-style-type: none"> ■ Establish a clear expectation that institutional investors investing in Brazil should implement the code, or explain the alternative strategies in place to achieve the same outcomes ■ Publish a list of signatories to the code
Supervision	<ul style="list-style-type: none"> ■ Publish a plan for phasing in monitoring of application of the Code
Review	<ul style="list-style-type: none"> ■ Review the impact of the code on a regular basis, using signatory disclosures as a basis (see further recommendations on transparency below).

RECOMMENDATIONS ON CONTENT OF CODE

We provide further, detailed commentary on the language and recommendations of the code in our response to question 6 (*terms, definitions and recommendations in the code*). These are summarised below:

Principle	Recommendation
Principle 1	<ul style="list-style-type: none"> ■ Add to guidance: a requirement for asset owners to encourage investment managers to sign the code, and to continuously monitor adherence. This guidance should be aligned with PRI's recent recommendations in "<i>Beliefs to Mandates</i>". These recommendations are listed in our response to question 6.
Principle 2	<ul style="list-style-type: none"> ■ Add to guidance: requirement to disclose a policy on conflicts of interest in the investment process
Principle 3	<ul style="list-style-type: none"> ■ For international consistency, use the term "ESG incorporation" rather than "ESG integration"
Principle 4	<ul style="list-style-type: none"> ■ Add to guidance: recommendation on escalation of engagement
Principle 5	<p>We agree that investors should disclose why votes were not cast, in a cost effective manner. In addition to this, we recommend:</p> <ul style="list-style-type: none"> ■ Add to guidance: Recommendation on informing companies of the rationale when voting against management

Principle 6	We support the code's emphasis on collaboration.
Principle 7	<ul style="list-style-type: none"> ■ Add to guidance: Require signatories to provide a link to their stewardship policies and ongoing disclosure of actions against the code ■ Add to guidance: specify how frequently signatories should report against the code ■ Add to guidance: Reference the PRI Reporting Framework as an internationally consistent way of complying with the transparency requirements of the code

RESPONSE TO QUESTIONS

(1) THE MODEL FOR ADHERENCE TO THE CODE AND FOR THE REPORTING OF STEWARDSHIP ACTIVITIES, AND

(3) SUGGESTIONS ON A SUPERVISION STRUCTURE FOR ADHERENCE TO THE CODE;

Establishing stewardship is in the long-term interests of all market participants. International experience demonstrates that uptake and adherence to the code vary, depending on the level of expectation set, quality of reporting and supervision. We suggest several actions as a self-reinforcing model to encourage compliance with the Code. These are grouped by sign up, reporting, supervision and review.

a) Sign up

As noted in AMEC's consultation documents, the UK Stewardship Code has the highest uptake of all stewardship codes. This may reflect the code's age, but also the supportive regulatory environment - the UK's Financial Services Authority rules require any firm authorised to manage funds to disclose the 'nature of its commitment' to the code, or the alternative strategy in place². A similar model is adopted by the Hong Kong Securities and Futures Commission, although the code is too new to assess impact yet.

Several stewardship codes, including Japan's *Principles for Responsible Institutional Investors*, also publish a list of signatories to the code. This gives visibility to stakeholders over the level of sign-up to the code.

PRI Recommends that AMEC:

- **Establish a clear expectation that institutional investors investing in Brazil should**

² UK Financial Services Authority - Conduct of Business Rule 2.2.31. Covers funds managed for professional clients. Venture capital funds are excluded.

implement the code, or explain the alternative strategies in place to achieve the same outcomes

- **Publish a list of signatories to the code**

b) Reporting

Disclosure against Stewardship Codes typically incorporates disclosure of a stewardship policy and ongoing disclosure of activities towards the code, such as voting records or engagement examples. Both are important to ensure that signatories to the code are clear about the commitment they have made, and accountable for their progress. In some cases (eg. Japan) stewardship codes require signatories to provide URLs to where such disclosures have been made. This allows for a centralised overview of the progress and impact of the code.

As a Principles-based voluntary code, the PRI itself recognises the need to be transparent and accountable about the impact of its activities. The PRI's Principles codify a requirement to be transparent about progress towards implementing the Principles³.

As part of this commitment, the PRI has been requiring Signatories to report on ESG incorporation and stewardship activities since 2013. As of 2016, over 1,000 investors globally reported using the PRI Reporting Framework, of whom 37 are in Brazil – all public responses can be viewed at: <https://www.unpri.org/signatory-directory>.

The Reporting Framework is also recognised by the *Code for Responsible Investing in South Africa* as a way to comply with the transparency requirements⁴, and meets the level of disclosure mandated by several other codes. Consistent reporting requirements will reduce the burden on investors seeking to comply with multiple codes.

PRI recommends that AMEC:

- **Require signatories to provide a link to their stewardship policies and ongoing disclosure of actions against the code**
- **Specify how frequently signatories should report against the code**
- **Reference the PRI Reporting Framework as an internationally consistent way of complying with the transparency requirements of the code**

c) Supervision

There are two important sources of supervision for the code: the party responsible for the code, and asset owners who expect investment managers to comply with the code.

Asset owners can play a key role in promoting uptake of the code. They can do this by signing the code themselves, selecting investment managers with the skills necessary to enact their strategy, encouraging their investment managers to sign the code, and continuously monitoring how external managers perform on these issues. We discuss these issues further in response to

³ Principle 6: We will each report on our activities and progress towards implementing the Principles

⁴ CRISA Reporting practice note: https://www.iodsa.co.za/resource/collection/58CA7BC8-8C67-4CF7-A644-0EDB06165C8B/Guidance_on_disclosure_of_application_of_CRISA.pdf

question (6), below.

AMEC should also play a role in monitoring. It is appropriate to give the market time to adapt to the code, especially given the historically challenging conditions for shareholder engagement and proxy voting in Brazil. However, without formal monitoring, the code risks failing to achieve meaningful change. Principles-based codes offer flexibility, but by contrast to rules-based systems, they require sophisticated and involved monitoring to ensure outcomes are met⁵. The UK's FRC has recently announced an in-depth review into the quality of disclosures from signatories, to increase the UK code's accountability.

PRI recommends that AMEC:

- **Publish a plan for phasing in monitoring of application of the Code**

Review

To follow international best practice, **PRI recommends that AMEC commit to reviewing the impact of the code on a regular basis**. Disclosures from signatories will be a crucial input into this analysis.

(2) DEFINITION AND TRANSLATION OF STEWARDSHIP, AND

(4) THE INSPIRATIONAL APPROACH OF THE CODE TO ENCOURAGE INSTITUTIONAL INVESTORS TO ACT AS THE 'OWNERS' OF THEIR INVESTEES.

The term "stewardship" is often interpreted to refer to engagement and voting (active ownership) alone. However, this code is framed as a set of actions which enable institutional investors to fulfil their fiduciary duty. In 2015, PRI, UNEP and UNGC produced a comprehensive review of law and policy regarding fiduciary duty, which found that fiduciary duty requires investors to take account of ESG issues in their investment processes, in their active ownership activities, and in their public policy engagement⁶. We therefore agree with the inclusion of Principle 3 – "Take ESG factors into account in investment processes and stewardship activities".

This follows international good practice. Both the South African and the Japanese stewardship codes include a requirement to consider ESG factors. This is addressed in the naming of the codes – the Code for Responsible Investment in South Africa (CRISA) and the Principles for Responsible Institutional Investors (Japan).

We encourage constructive and substantive engagement between investors and companies, and full exercise of rights due to shareholders. However, a recent review of the legal framework in Brazil by Harvard Business School⁷ concluded that the Board of a company has a duty to

⁵ Ref: [OECD \(2010\): Policy Frameworks for Efficient and Effective Financial Regulation](#). See also the UK FRC's [development of public compliance tiers](#).

⁶ <http://fiduciaryduty21.org/>

⁷ Robert G. Eccles and Tim Youmans (2015): [Materiality in Corporate Governance: The Statement of Significant Audiences and Materiality](#)

consider the needs of a wide range of stakeholders, including, but not limited to, shareholders.

(5) THE IDEAL APPROACH TO THE JUSTIFIED WAIVERS TO THE EXERCISE OF VOTING RIGHTS. SPECIFICALLY, SHOULD INVESTORS DISCLOSE THE JUSTIFICATION OF NON-EXERCISE OF VOTING RIGHTS?

PRI considers it good practice to disclose why votes have not been cast. Signatories to the PRI are required to report annually on their progress in implementing the Principles – for investors with substantive listed equity portfolios, this includes the number of, and rationale for, voting abstentions⁸. PRI also collects data on why votes were not cast.

Historically, voting in Brazil has been challenging compared to other markets, requiring physical presence at AGMs or a sometimes complicated and expensive proxy process. To facilitate a stewardship culture, it is important to understand impediments to voting – this data is also important to monitor the effectiveness of reforms, such as the impact of Comissão de Valores Mobiliários Instruction No. 561 (CVM Instr. 561/2015), due for implementation from 1 Jan 2017.

Given the historic challenges associated with voting, disclosure should be made as simple and cost-effective as possible for investors.

(6) TERMS, DEFINITIONS AND RECOMMENDATIONS IN THE CODE

Below, we suggest some amendments or additional guidance in the Code:

- *Principle 1: Establish a Stewardship Programme:* As noted in our response to questions (1) and (3), we recommend that the guidance be amended to include guidance on implementation by asset owners both directly and through external managers. PRI's recent report *Beliefs to mandates – How asset owners can drive responsible investment* – recommends that asset owners;
 - Publish investment beliefs, with commitments to take account of ESG issues in investment decision-making and in engagement with companies and issuers⁹.
 - Implement investment beliefs throughout the organisation, including Board/Trustees, CEO/CIO, portfolio managers, research analysts and legal counsel.
 - Engage public policy makers on issues relevant to sustainable development finance.
 - Integrate sustainability factors in the selection process for asset consultants and other advisers.
 - Integrate sustainability factors in the selection process for investment managers, and
 - Integrate sustainability factors in the monitoring process for investment managers and

⁸ Reference: [PRI Reporting Framework: Listed Equity Active Ownership module](#).

⁹ We take the term “investment beliefs” to mean codified principles and policies that the board of trustees use to make decisions about the fund's assets. This terminology was chosen to be internationally relevant.

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- *Principle 2: Implement mechanisms to manage conflicts of interest.* PRI considers it good practice to disclose a policy on managing conflicts of interest in the investment process – we encourage AMEC to include this in the guidance under principle 2.
- *Principle 3: Take ESG factors into account in their investment processes and stewardship activities.* This is further clarified to mean: “*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*”. We recommend replacing the word “integrate” with “incorporate”. The term “incorporate” encompasses screening and thematic investment approaches, alongside integration of ESG factors into fundamental analysis. This would offer a wider range of techniques to investors wishing to comply with the code, and adopt terminology consistent with international initiatives such as PRI and the Sustainable Investment Forums.

As noted above, we agree with the code that ESG factors are necessary for the fulfilment of fiduciary duty.

- *Principle 4: Monitor the issuers of securities.* We propose that the code include guidance on escalation activities.
- *Principle 5: Be active and diligent in the exercise of voting rights.* In our response to question (5) above, we agree that investors should disclose why votes were not cast, but given the challenges associated with proxy voting, this should be done in the most cost effective manner. In addition, where an investor votes against management, we consider it good practice to inform company of the rationale.
- *Principle 6: Establish collective engagement criteria.* We agree with the recommendations regarding collaborative engagement. Analysis of data reported to the PRI by our signatories suggests that collaborative engagements are considerably more likely to result in action by companies¹⁰. Collaborative engagements also offer an opportunity for resource constrained investors to participate in engagement activities. PRI’s [Collaboration Platform](#) has seen over 700 collaboration proposals launched since 2006.
- *Principle 7: Be transparent as to their stewardship activities.* Transparency is necessary to ensure that signatories to the code are accountable to stakeholders, that asset owners have the information needed to hold managers to account, and to allow ongoing evaluation of the progress and impact of the code. As noted in our responses to questions (1) and (3), PRI recommends that AMEC centrally collect statements of commitment to the Code, specify how frequently investors should report and reference the PRI Reporting Framework as a compliance tool.

¹⁰ Reference: PRI Annual Report 2016 (due August 2016).