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TheCityUK Response to the FRC Stewardship Code Review Consultation 2024

TheCityUK is the industry-led body representing UK-based financial and related professional services. We champion and support the success of the ecosystem, and thereby our members, promoting policies in the UK and internationally that drive competitiveness, support job creation and enable long-term economic growth. The industry contributes 12% of the UK's total economic output and employs over 2.4 million people – with two thirds of these jobs outside London across the country's regions and nations. It pays more corporation tax than any other sector and is the largest net exporting industry. The industry plays a significant role in enabling the transition to net zero and driving economic growth across the wider economy through its provision of capital, investment, professional advice, and insurance. It also makes a real difference to people in their daily lives, helping them save for the future, buy a home, invest in a business, and manage risk.

Introduction

The United Kingdom is a global leader in corporate governance, with numerous countries worldwide adopting its practices as a benchmark. A sound governance framework is fundamental to the long-term success and reputation of UK financial and related professional services. It reinforces the UK's status as a reliable investment destination, thereby contributing to economic growth and enhancing global competitiveness. Stewardship practices facilitate improved access to capital markets, promote greater accountability and transparency, support informed decision-making, and mitigate potential risks, all of which help to build trust and confidence in businesses.

In recent years there has been a concern that the UK's Code has not evolved to suit the UK's position in the global economy and the rapidly changing capital markets landscape. We therefore welcome the Financial Reporting Council (FRC) Stewardship Code Review Consultation 2024. Working to maintain and enhance the competitiveness of the UK's Stewardship Code, while upholding high standards of corporate governance and responsible investment, will be key to the review. We support the FRC's focus on clients and beneficiaries (as savers, pensioners, investors and providers of productive capital) in the review. If the UK is to encourage capital, in particular retail capital, to be invested in companies, and if the UK is concerned with the ability of savers and pensioners to fund themselves, then their interest and their returns should rightly be the focus of the Code.

We believe the changes proposed will be important in boosting UK capital markets and ensuring long-term value for UK savers and pensioners. The revised Code demonstrates a considerable commitment by the FRC to modernise its approach to stewardship and to pursue policies that are effective in supporting the attractiveness of the UK and UK assets to all investors.

Our response addresses key aspects of the proposed revisions and provide recommendations that we believe will further enhance the effectiveness of the Code.

Definition and scope

We support the FRC's intention to amend the definition of stewardship. The pivot of the focus from 'sustainable benefits for the economy, the environment and society' to 'long-term sustainable value for clients and beneficiaries' aligns with the growing recognition that the Code needs to be flexible enough to suit the range of signatories to it. It will encourage reporting that aligns with firms' investment strategies, the values of the steward, their time horizons, their role in the investment chain, and the type of asset they invest in.

We recommend that the FRC provide clarity in the accompanying text on the meaning of 'sustainable'. The FRC should work with the government and other financial services regulators to ensure that the definition of 'sustainable' is consistent across all frameworks. We also recommend the FRC ensure that they achieve consistency between rules that apply to different market participants, such as the stewardship code, company law and fiduciary duty. Alongside a focus on specific definitions and rules, the FRC should work with a range of policymakers in this area – notably the Department for Work and Pensions (DWP) – to ensure that the entire regulatory framework around stewardship is internally consistent. Together, these changes should help address concerns that have been raised around the potential for greenwashing and varied interpretations with the new definition.

Autonomy and flexibility

The Code has been reformulated and restructured to emphasise more strongly that it is a principles-based, flexible framework designed to give signatories significant autonomy and discretion in how best to apply the Code. We recommend the FRC use their public engagement to continue to emphasise and remind signatories that the Code is principles-based, as this can often get lost in the practice of reporting and lead to an overly prescriptive approach.

We support the FRC's proposal to reduce and restructure the principles to allow investors to better align their practices with the Code. Merging and restructuring the principles will both reduce the reporting burden, allowing signatories to focus on practices that have a substantial impact on their activities, and provide clarity for specific stakeholders on how they report. The value of the revised Code comes in large part from its ability to be tailored for a range of signatories.

Clarifying which principles apply to which market participants sets clear expectations for a range of signatories on the application of the code. Alongside the 'how to report' prompts and further guidance, this will encourage autonomy for market participants and give them the flexibility to focus on the considerations that they believe are most material to both reporting and their broader stewardship role. On the issue of guidance, we note that only one example of the associated guidance has been published with the consultation and that guidance for the remaining principles will not be consulted on. We recommend that the FRC collaborate with signatories to develop further guidance and consider forming a consultative committee to support the development of the remaining guidance to ensure that it sets the right tone for reporting.

The FRC should clarify its expectations as to the application of the principles to market-wide and systemic risks. As currently read, the principles state that effective stewardship takes market-wide and systemic risks and 'seeks to address them'. Alongside the requirement for signatories to report on engagement with 'other relevant stakeholders' this creates an expectation that signatories, in collaboration with policymakers should address these risks. While we acknowledge that all parts of the supply chain have a part to play in avoiding systemic risk, setting public policy to address systemic risk is the ultimate responsibility of governments and policymakers. We also recommend that the FRC change their approach to the principles from apply and explain to comply or explain to ensure a complete move away from a "one-size fits-all" exercise.

Finally, we support the removal of escalation as a standalone principle. Escalation should be used only when resolution cannot be achieved through engagement. A standalone principle for escalation alongside a prescriptive approach to reporting leads to its use simply to demonstrate compliance. This should not be the purpose of escalation. There has been some concern that the 'wherever necessary' could lead some signatories to feel that it is never necessary. The FRC should address this by clarifying this point. The proposed approach of the incorporation of escalation activities within the engagement activities, alongside the emphasis that it should only be used when necessary, and more clarity on what necessary means, will lead to more effective use of the tool.

Reporting and sustainability

The right reporting and disclosure requirements are essential for fostering transparency and accountability in stewardship practices. We support the FRC's proposal for a two-part reporting structure, setting out separate policy and activity disclosures to reduce reporting burdens on signatories. The annual reporting for activities and outcomes versus the three yearly *(unless material changes)* for policies, processes and approach to stewardship will allow signatories to focus their reporting on matters that are most important to their strategies. However, we suggest the policy report is *submitted* three yearly to align with when it is updated. This will avoid any annual submission triggering legal and compliance issues for firms. While we support the annual reporting for activities and outcomes, stewardship outcomes do not always fit neatly into a 365-day timeline. The FRC should, therefore, clarify that signatories should take a common-sense approach to the timeframes which suits their place in a supply chain.

In the future there is likely to be a greater convergence between companies' business models and financial performance and societal and environmental issues. Therefore, although the revised Code has removed the explicit reference to ESG in the definition, it should not lose sight of the importance of these issues in creating value.

Engagement

Positive engagement between an issuer and investors is critical to ensure healthy businesses and long-term value for owners. To facilitate this, we recommend that the FRC provides more detailed guidance on best practices for collaborative engagement, including examples of successful case studies for coordination among investors. Some of our members have raised a concern that the merging of the engagement and collaborative engagement principles could suggest a dilution in the importance of engagement – a vital component of effective stewardship. To address this, the FRC should ensure that the final Code emphasises the importance of engagement as a central feature of good stewardship.

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On the issue of engagement, we would like to commend the FRC for its ongoing and extensive engagement with stakeholders as it has been developing its approach. Collaboration between the government, regulators, industry and stakeholders such as the Investor and Issuer Forum (IIF) will be crucial to ensure the Code plays its part in ensuring the UK's approach to corporate governance supports economic growth. Given the dynamic nature of the investment landscape, we recommend that the FRC set out a clear plan to review the Code in coordination with market participants to ensure the adopted proposals are effective in practice.

Conclusion

TheCityUK supports the FRC's efforts to modernise the UK Stewardship Code. Alongside other initiatives such as framing of directors' duty of care in UK company legislation and the simplification of the UK's non-financial reporting framework, the review must advocate for a greater emphasis on growth and the interests of those providing the productive capital necessary to drive growth, without losing sight of social and environmental concerns.

We believe the principles-based approach is right. The proposed revisions achieve the right balance between comprehensive and adaptable in such a way as to further enhance the UK's competitiveness and support economic growth. The commitment to ongoing engagement with signatories and stakeholders, and proposals for streamlined reporting, create a framework that will promote the responsible allocation, management, and oversight of capital to create long-term value for clients and beneficiaries.

Since its adoption, the UK Stewardship Code has been influential globally, serving as a model for other national stewardship codes. With continued review, adaptation and monitoring, the UK's Stewardship Code will continue to be a respected framework internationally. We would be happy to answer any questions you have on our response.