

UK Stewardship Code rewritten

December 2019

*The 2020 Code sets higher expectations for
stewardship practices*

At a glance

In October 2019, the Financial Reporting Council (FRC) issued a substantially revised version of its UK [Stewardship Code](#). This voluntary code defines stewardship best practice for asset owners, asset managers and service providers such as investment consultants and proxy voting advisers. The new code is much broader in scope than the current one (it covers all assets, not just UK listed equities), it shifts the emphasis from policies and procedures to activities and outcomes, and it requires more frequent and extensive reporting. It comes into force on 1 January 2020. The first group of signatories will be publicised in Summer 2021.

Suggested actions for asset owners

- Familiarise yourselves with the 2020 Code
- Encourage your investment managers to sign the Code
- Review your stewardship approach and consider how to incorporate the Code's principles in an appropriate and proportionate manner

The Code is voluntary but endorsed by the FRC, FCA and TPR.

The Detail

Background

The FRC published the first UK Stewardship Code in 2010 and revised it in 2012. This voluntary Code set stewardship expectations for investors through seven "comply or explain" principles. Although its official scope was limited to UK listed equities, it was widely adopted and influenced the development of other stewardship codes around the world. To become a signatory, investors just needed to publish a statement of commitment outlining their approach for each principle. In 2016, the FRC began to formally assess these statements, with signatories classified as Tier 1 or Tier 2 depending on the quality of the statements, and some organisations were delisted.

On 30 January 2019, the FRC and Financial Conduct Authority (FCA) launched a consultation into an overhaul of the UK stewardship regime. The FRC consulted on a new version of the UK Stewardship Code, the FCA consulted on new rules to implement certain elements of the revised EU Shareholder Rights Directive and a joint FRC-FCA discussion paper called for input on how best to encourage institutional investors to engage more actively in stewardship of their assets. The new FCA rules took effect in June 2019, introducing certain minimum stewardship requirements for investment managers and insurers.

The FCA sets minimum stewardship standards for investment managers, while the UK Stewardship Code sets voluntary best practice principles.

On 24 October 2019, the FRC published the final version of the UK Stewardship Code 2020. Still voluntary in nature, it sets best practice principles for investors which go substantially beyond the legal and regulatory minimum. Alongside the new Code, the FCA confirmed that it would not impose further stewardship-related requirements now, although it intends to help address some remaining barriers to effective stewardship.

Although the Code is voluntary, FCA-regulated investment managers are required to disclose publicly the nature of their commitment to the Code or their alternative approach. The Pensions Regulator's guidance says *"trustees are encouraged to sign up [to the UK Stewardship Code]. We would like trustees to adhere to the code in their stewardship activities with a view to improving long-term returns and reducing the risk of poor outcomes due to poor strategic decisions."*¹

TPR encourages pension trustees to sign the UK Stewardship Code.

Stewardship: a new definition

The centrepiece of the January 2019 consultation documents was a broader definition of stewardship. The 2020 Code opens with this new definition:

"Stewardship is the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society."

Our viewpoint

The 2012 Code does not include an explicit definition of stewardship, so it is welcome that the new definition provides a degree of clarity.

Until now, stewardship has tended to be viewed in terms of micro-level actions such as voting at company AGMs and engaging with company management, whereas the new definition is more holistic. The 2020 Code emphasises that asset owners who delegate day-to-day management of their assets to others have an important

¹ [DB investment](#) and [DC investment governance](#) guidance

role in allocating capital and overseeing the broad range of investment activities carried out on their behalf.

Broader applicability

Consistent with the more holistic definition of stewardship, the 2020 Code applies much more broadly. It applies to all assets, whereas strictly speaking the 2012 Code only applies to UK listed equities.

The 2020 Code applies to all assets.

There has been no change in the types of organisations that can become signatories: the Code is intended for asset owners, asset managers and service providers such as investment consultants and proxy voting advisers. However, whereas the 2012 Code set the same expectations for all types of signatories, the 2020 Code recognises their differing roles in the investment chain.

Our viewpoint

Traditionally, stewardship was primarily seen as relevant to equity investors since they are the ones with explicit ownership rights such as voting rights. It is now increasingly recognised that other types of investor can also exercise stewardship, for example through engaging with company management, regulators and policymakers on matters relevant to the long-term performance of their assets. Moreover, the Code's new stewardship definition includes the allocation of capital which requires a strategic approach rather than a focus on a single asset class. We therefore strongly support the extension of the Code to all assets.

The principles

The 2020 Code has twelve principles for asset owners and asset managers. They are “apply and explain”, ie signatories must implement all of the principles and explain how they have done so. They no longer have the option of explaining why they have not complied with a certain principle.

Signatories must implement all the principles and explain how they have done so.

The principles are:


1. Signatories' **purpose, investment beliefs, strategy, and culture** enable stewardship that creates long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.
2. Signatories' **governance, resources and incentives** support stewardship.
3. Signatories **manage conflicts** of interest to put the best interests of clients and beneficiaries first.

4. Signatories identify and respond to **market-wide and systemic risks** to promote a well-functioning financial system.
5. Signatories **review** their policies, **assure** their processes and **assess** the effectiveness of their activities.
6. Signatories take account of **client and beneficiary needs** and **communicate** the activities and outcomes of their stewardship and investment to them.
7. Signatories **systematically integrate** stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities.
8. Signatories **monitor and hold to account** managers and/or service providers.
9. Signatories **engage with issuers** to maintain or enhance the value of assets.
10. Signatories, where necessary, participate in **collaborative engagement** to influence issuers.
11. Signatories, where necessary, **escalate** stewardship activities to influence issuers.
12. Signatories actively **exercise their rights** and responsibilities.

There is a separate set of six “apply and explain” principles for service providers.

Our viewpoint

The new principles are more comprehensive than the current ones, reflecting the broader definition of stewardship. The significant changes include:

- *The systematic integration of stewardship and investment (Principle 7). This requires a joined-up approach, whereas previously the two activities could have been viewed as quite separate.*
 - *An explicit requirement to oversee third parties such as investment managers and consultants (Principle 8). This recognises that asset owners cannot delegate their responsibility for effective stewardship to others and can encourage better practices throughout the investment chain.*
 - *Inclusion of market-wide and systemic risks such as geopolitical issues and climate change (Principle 4). These can have more significant impacts on investment returns – not to mention wider society – than issues at specific companies but are sometimes seen as matters for regulators and policymakers rather than individual investors.*
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Reporting requirements and expectations

Signatories no longer need to produce a statement of commitment to the Code. Instead they must report publicly each year on how they have applied the Code. The reports must be reviewed and approved by the organisation's governing body, and signed by the chair, chief executive or chief investment officer. The report is submitted to the FRC for approval and, provided it meets the FRC's quality standards, the organisation is confirmed as a signatory.

The 2020 Code includes an extensive set of reporting expectations underneath each principle, grouped under the headings of "activity", "outcome" and sometimes "context". The FRC states that reports should be fair, balanced and understandable. For example, reporting should acknowledge setbacks experienced and lessons learned, as well as successes.

Although the same principles apply to both asset owners and asset managers, the reporting expectations do differentiate between their roles where appropriate. For example, for some principles, signatories can state the expectations they have set for the asset managers that implement the principle on their behalf. For Principle 12, there are different reporting expectations for listed equity and fixed income assets.

Signatories must publish annual stewardship reports that have been approved by their governing body.

Some reporting expectations differ between asset owners and asset managers.

Our viewpoint

Reporting will be significantly more onerous under the 2020 Code, both because it is annual and because the expectations are extensive. However, it is the transparency that this reporting will bring – along with the expectation of continuous improvement embedded in Principle 5 – that is intended to drive improvements in stewardship practice. The requirement that the governing body takes responsibility for the reports is also significant: senior level buy-in is vital in achieving effective implementation of stewardship throughout the organisation.

Asset owners seeking to oversee their asset managers and service providers should find the stewardship reports produced by signatories help them in this task. They may therefore want to encourage these parties to sign the Code (even if they conclude they do not have sufficient resource to do so themselves).

Next steps

Organisations wishing to become signatories to the UK Stewardship Code can sign up to the 2012 Code until the end of 2019, after which there will be a hiatus during which new signatories will not be accepted.

The 2020 Code takes effect for reporting years beginning on or after 1 January 2020, but potential signatories do not need to submit their first stewardship report until 31 March 2021. Prior to this deadline, the FRC will reach out to the investment community to communicate its expectations for the quality and content of the reports. In Summer 2021, it will publish the first list of signatories, consisting of those organisations whose reports are deemed to meet the required standard. Initially at least, signatories will not be tiered according to the quality of their report.

The deadline for signatories' first stewardship report is 31 March 2021.

In the meantime, we suggest that asset owners:

- familiarise themselves with the 2020 Code;
- encourage their investment managers and service providers to sign the Code; and
- review their stewardship approach and consider how to incorporate the Code's principles in an appropriate and proportionate manner.

Pension scheme trustees should also ensure they are complying with the stewardship sections of TPR's investment guidance.

This briefing note does not constitute advice, nor should it be taken as an authoritative statement of the law. If you would like any assistance or further information on the contents of this briefing note, please contact the partner who normally advises you at LCP or contact us on +44 (0)20 7439 2266 or by email enquiries@lcp.uk.com.

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