

Clients & Friends Memo

2020 Update to the UK Stewardship Code

November 5, 2019

Introduction

In March 2019, we reported that the UK's Financial Reporting Council ("**FRC**") was consulting on proposed changes to the UK's Stewardship Code (the "**Stewardship Code**") (see our previous memo [here](#)). Those consultations have led to an updated 2020 edition of the Stewardship Code, which will come into effect from January 1, 2020.

The reshaped 2020 Stewardship Code is a voluntary code which asset owners (like pension schemes and insurers) as well as asset managers and investment-related service providers (like proxy advisers and investment consultants) may choose to adhere to. It sets higher standards than the legal requirements that signatories may be subject to¹, though signatories may choose to use their Stewardship Report (which is not required to be in any particular form) under the Code to meet their legal, regulatory and other voluntary stewardship reporting requirements. UK authorised asset managers are required to report on whether or not they apply the Stewardship Code.

Organizations which pride themselves on their stewardship credentials will welcome the Code as a benchmark against which they can publicly measure their performance.

Background

The FRC is the UK's regulator of auditors, accountants and actuaries². In addition to this portfolio the FRC is also the body that sets and oversees the UK's Corporate Governance Code (setting out good practice for corporate governance for companies, this is binding on a

¹ For example, occupational pension schemes have stewardship-related disclosure obligations under the pension regulations, insurers and reinsurers under the Senior Management Arrangements, Systems and Controls sourcebook from the FCA, asset managers under the Conduct of Business Sourcebook from the FCA and proxy advisors under the Proxy Advisors (Shareholders Rights) Regulations 2019.

² The FRC is in a process of transition into a new form, it will become the Audit, Reporting and Governance Authority in the coming year, with stronger powers and greater resources supporting its mandate to improve audit quality, corporate governance and investor stewardship.

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comply-or-explain basis for companies with a premium listing on the London Stock Exchange) as well as the Stewardship Code.

The UK was a leader in recognizing the important role that investors play in governance of their investee companies, and in 2010 created the first version of the Stewardship Code, with the aim of making investors' stewardship efforts more transparent, thereby making them more accountable for such action to their clients and beneficiaries.

In the decade since the first version of the Stewardship Code was published, the academic, regulatory and public debate on the role of investors in stewardship of their investee companies has moved on. Despite a revision in 2012, the Stewardship Code was no longer viewed as setting the best practice standard for stewardship activities. Accordingly, the FRC launched a consultation in early 2019 with a view to re-establishing the Stewardship Code's primacy for investors seeking to demonstrate excellence in their stewardship of their portfolio.

What Does Stewardship Require Under the Code?

The new Stewardship Code defines stewardship as “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.”

In a change from the consultation version (which had a less streamlined set of principles, provisions and guidance), the final 2020 Code is made up of 12 “Principles” with which asset owners and managers who sign up must comply.

The 12 Principles are:

- Principle 1 - signatories' purpose, investment beliefs, strategy and culture enable stewardship that creates long-term value for clients and beneficiaries leading to sustainable beliefs for the economy, the environment and society.
- Principle 2 – signatories' governance, resources and incentives support stewardship.
- Principle 3 – signatories manage conflicts of interest to put the best interests of clients and beneficiaries first.
- Principle 4 – signatories identify and respond to market-wide and systematic risks to promote a well-functioning financial system.
- Principle 5 – signatories review their policies, assure their processes and assess the effectiveness of their activities.
- Principle 6 – signatories take account of client and beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them.

- Principle 7 – signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities.
- Principle 8 – signatories monitor and hold to account managers and/or service providers.
- Principle 9 – signatories engage with issuers to maintain or enhance the value of assets.
- Principle 10 – signatories, where necessary, participate in collaborative engagement to influence issuers.
- Principle 11 – signatories, where necessary, escalate stewardship activities to influence issuers.
- Principle 12 – signatories actively exercise their rights and responsibilities.

Notable Themes

Stewardship Beyond Equity. Per the consultation version of the 2020 Code, signatories are required to exercise their stewardship not just in respect of UK-listed equity (as was the case under the 2012 Code) but to use the resources, rights and influence available to them to exercise stewardship, however capital is invested.

Investor Primacy, with ESG Focus. A key element of the consultation on changes to the Stewardship Code was in relation to how “stewardship” itself should be defined. The consultation version of the definition set the purpose of stewardship as creation of sustainable value “for beneficiaries, the economy and society”. Following very mixed feedback, where half respondents believed the primary purpose of stewardship is the creation of financial returns for clients, while a third believed that regard to the economy and society was a necessary element of the steward’s duty, the final definition is a compromise of sorts - the purpose of the steward is “to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.”

In fulfilling this purpose, while governance issues have always been a mainstay of investment stewardship, this version of the Stewardship Code also places environmental issues (including climate change), social issues and the economy on a par with governance as a focus of good stewardship. The introduction emphasizes the role of asset managers and owners as “guardians of market integrity” and working to “minimize systemic risk”.

Collaboration and Escalating Engagement. In what may be a reflection of a more general trend towards active shareholder engagement, the Stewardship Code requires its signatories both to collaborate with other stakeholders in their stewardship efforts (Principle 10) and to “escalate” their activities (Principle 11) by using the full range of rights available to influence issuers.

Clear Reporting. Each Principle is accompanied in the Code by reporting expectations. In a change from the consultation version, the Stewardship Code no longer requires a “statement of

policy”, but signatories must produce a report at the end of the year explaining how they have complied with the Code principles, describing, in a “fair, balanced and understandable” way the concrete actions they have taken and the outcomes of those actions (both successful and unsuccessful).

How to Sign Up

Organizations that wish to become signatories to the 2020 version of the Stewardship Code should begin to track their relevant activities and outcomes to allow them to submit their first “Stewardship Report” describing their compliance with the Code over the prior 12 months by March 31, 2021. The FRC will review the adequacy of the reporting (though not the actual stewardship) and those that meet expectations will be accepted, and the applicant listed as an original signatory to the revised Stewardship Code in the summer of 2021.

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