

# **Building a regulatory framework for effective stewardship**

Feedback to DP19/1

**Feedback Statement**

FS19/7

October 2019

## This relates to

This relates to Discussion Paper 19/1 which is available on our website at [www.fca.org.uk/publications](http://www.fca.org.uk/publications)

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# 1 Summary

- 1.1** Stewardship by asset owners and asset managers involves making informed decisions about where to invest, and proactive oversight of assets once invested. Consistent with the FCA's objective to make relevant markets function well, these activities improve market quality and integrity, and help create sustainable, long-term value for clients and beneficiaries. Effective stewardship is also expected to have wider economic, environmental and societal benefits.
- 1.2** Through our regulation, we aim to ensure that firms, such as asset managers and life insurers, are delivering good outcomes for their customers. For many firms, the exercise of stewardship will be integral to this, for example, when an asset manager invests on behalf of asset owners over the long term.
- 1.3** In January 2019, jointly with the Financial Reporting Council (FRC), we published a Discussion Paper, Building a Regulatory Framework for Stewardship (DP19/1). This Feedback Statement (FS) responds to the rich feedback we received, within the scope of the FCA's regulatory responsibilities.
- 1.4** Since DP19/1 was a joint Discussion Paper, we have coordinated closely with the FRC in framing our future work and will continue to do so. The FRC has separately used this feedback in its work to revise the UK Stewardship Code, on which it consulted in parallel. The UK Stewardship Code 2020 has been published today.
- 1.5** We have considered stakeholders' views carefully. We agree with the view of most respondents that we should not impose further stewardship-related requirements on life insurers and asset managers now. We agree that we should let firms first adapt to our new rules on shareholder engagement (implementing the revised Shareholder Rights Directive (SRD II)), which took effect in June, and other related measures.
- 1.6** There is also evidence that some firms are already investing significantly to improve their stewardship capabilities. With a stronger focus on environmental, social and governance (ESG) matters, we are told that institutional investors increasingly look for asset managers that offer higher standards of stewardship.
- 1.7** However, we have identified several things we should do, working with industry, the FRC, Government and other regulators, to help address some remaining barriers to effective stewardship, including those summarised in paragraph 1.17. Our actions build on existing initiatives, including those announced in the recently published, Climate change and green finance: Summary of responses and next steps (FS19/6). In particular:
- We will examine how asset owners set and communicate their stewardship objectives and we will take actions to promote arrangements between asset owners, asset managers and service providers that support these objectives
  - We will help to address regulatory, informational and structural barriers to effective stewardship practices, including by consulting on rule changes to enhance issuers' climate change disclosures
  - We will consider further the role of firms' culture, governance and leadership in both the management of climate risks and the exercise of stewardship

- We will pursue a number of actions to promote better disclosure of firms' stewardship practices and outcomes

**1.8** We will continue to work with the FRC as the UK Stewardship Code 2020 is introduced. An important area of focus in DP19/1 was the balance between the regulatory baseline for effective stewardship and promoting higher standards through the UK Stewardship Code 2020. Continued close engagement and coordination will therefore be important. We will take steps to put appropriate arrangements in place with the FRC – and its successor – to support this.

**1.9** We will consider the need for any further actions as the new Code takes effect, so that the regulatory framework continues to support effective stewardship.

## Who this affects

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**1.10** This FS will be of interest to those directly engaged in stewardship or with an interest in the outcomes of these activities. These include:

- FCA-regulated asset management firms and life insurers
- pension providers, pension scheme operators and pension scheme trustees
- current and future signatories to the UK Stewardship Code
- proxy advisors, investment consultants and other service providers
- public companies, issuers of debt and their advisors
- policy-makers and regulatory bodies
- industry groups, trade bodies, consumer groups, individual consumers, charities and civil society groups, industry experts and commentators, academics and think tanks

## Our Discussion Paper

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**1.11** DP19/1 asked for views on how best to encourage the institutional investment community to engage more actively in stewardship. Within UK capital markets' existing structures, we examined what effective stewardship should look like, what the minimum expectations should be for financial services firms that invest for clients and beneficiaries, the standards the UK should aspire to, and how to achieve them.

**1.12** We received 48 written responses and engaged extensively with stakeholders in meetings, roundtables and other events. In parallel, supervisors have met with asset management firms to gather insights on stewardship practices.

## Summary of feedback to DP19/1

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**1.13** Overall, DP19/1 was well received. Stakeholders generally agreed with our view of the role stewardship can play in helping to make relevant markets function well. There were, however, mixed views on the definition of stewardship included in DP19/1. In particular, some questioned whether it was appropriate to include the interests of wider society and the economy as stewardship objectives.

- 1.14** Most stakeholders agreed with the key attributes of effective stewardship proposed in DP19/1, with some small refinements. They agreed it was important that asset owners set a clear purpose and communicate this effectively to promote consistent stewardship actions across the institutional investment community.
- 1.15** Stakeholders also agreed that we should take a system-wide approach to stewardship. That is, the effectiveness of stewardship depends on asset owners, asset managers and service providers all working together in a mutually supportive way across the institutional investment community.
- 1.16** Most respondents were against introducing further stewardship requirements for asset managers or life insurers now, especially as new rules in this area have yet to be in. More generally, stakeholders opposed prescriptive rules, noting the wide variety of stewardship objectives and practices.
- 1.17** However, they broadly agreed with our assessment of potential cost, incentive and informational barriers to stewardship. They highlighted the following:
- investment mandates, voting guidelines and other arrangements between asset owners and asset managers may not be fully aligned with asset owners' and beneficiaries' investment and stewardship objectives
  - the information that securities issuers disclose on climate change and other long-term factors may not adequately support investors' long-term decisions
  - regulatory uncertainties in Market Abuse Regulation (MAR) and competition law may discourage engagement between issuers and investors
  - the information firms disclose on their stewardship may not be detailed enough for investors to distinguish between firms based on the quality of their stewardship – this may weaken market discipline
  - service providers (including proxy advisors and investment consultants) may not adequately support investors' stewardship
  - firms' governance arrangements may not put enough emphasis on the value of effective stewardship
- 1.18** We give a more detailed summary of the feedback we received in Section 3.

## **Our response**

- 1.19** We have considered the feedback from stakeholders carefully, and agree we should not introduce new regulatory measures now that prescribe how asset owners and asset managers should exercise stewardship.
- 1.20** However, there are further actions we should take, together with industry and other regulators, to address some of the most significant barriers to effective stewardship. These actions will complement the regulatory measures we have already taken as well as implementation of the UK Stewardship Code 2020 and other forthcoming initiatives. By helping to remove these barriers, we aim to create the conditions in which progress towards effective stewardship can accelerate.
- 1.21** Firms are guided by the interests of their clients and beneficiaries, and so have different priorities, different strategies and allocate different resources to stewardship. This does not give us cause for concern.

**1.22** We expect firms to be clear whether acting in the best interests of their clients and beneficiaries requires them to undertake stewardship and other activities designed to improve the corporate governance of their investee companies and promote sustainable long-term value creation. Firms should then disclose to their customers, in ways that are fair, clear and not misleading, how they approach these activities. If they do not undertake stewardship, firms should make this clear, so that clients and beneficiaries can choose those firms that are most likely to meet their objectives.

**1.23** Our next steps are set out in Section 4. They build on other ongoing initiatives, including actions announced in FS19/6. We will keep progress under review, including as the UK Stewardship Code 2020 is introduced. We will also continue to focus on stewardship in our supervision and research. We summarise our actions below, organised by the key attributes of effective stewardship.

### **A clear purpose**

**1.24** We note stakeholders' comments about the importance of establishing mutually supportive arrangements for effective stewardship across the institutional investment community. Consistent with this, we will examine further the arrangements between asset owners, asset managers and service providers.

**1.25** As part of this, we will consider asset managers' voting policies, noting concerns raised about their recognition of pension scheme trustees' voting guidelines.

**1.26** We will take three actions:

- *An industry workshop on setting a clear purpose for stewardship.* As a first step, in the first quarter of 2020, we will hold an industry workshop, jointly with other regulators. We will use this event to discuss how asset owners set and communicate their stewardship objectives and how effectively these are adopted by asset managers and service providers. Reflecting other concerns raised, we will also use this as an opportunity to gather initial input on how best to extend the scope of our current rules on stewardship and shareholder engagement to SIPP operators.
- *Engagement with relevant work in the asset management industry.* We will engage with ongoing industry work, led by the Investment Association (IA), that is considering how to promote a longer-term perspective in investment mandates and asset owners' other arrangements with asset managers.
- *Investment consultants.* The Competition and Markets Authority (CMA) has recommended that investment consultants be brought under FCA regulation. The Treasury is considering this recommendation and will consult in due course. Pending the outcome of this consultation, we will consider the issue of stewardship as part of our work with the Treasury to design an appropriate regulatory regime for investment consultants.

## **Constructive oversight, engagement and challenge**

### **Regulatory issues**

**1.27** We have said previously that we think investors can comply fully with MAR and competition law while engaging individually and collectively with issuers, as long as they consider how to do this carefully and make appropriate adjustments.

- 1.28** We will continue to work with industry to identify areas of concern and provide appropriate clarity so that investors and issuers can engage effectively within the bounds of the regulation. In relation to MAR, we are happy to discuss specific examples of problems that investors or issuers have found and will consider if it is appropriate to provide further guidance.

### **Issuers' disclosures**

- 1.29** We announced in FS19/6 that we will consult in early 2020 on proposals for new 'comply or explain' rules requiring climate change-related disclosures by certain listed issuers aligned with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). This will be a first step to improving information flow from securities issuers on long-term factors, while also providing securities issuers with clarity about our expectations.

### **Service providers**

- 1.30** We will look at various service providers and how they impact stewardship:
- We will consider outcomes as new regulations for proxy advisors bed in
  - We will consider the role played by specialist providers of ESG data services; as a first step, we are looking at the nature and quality of these services, how investors use them and how much reliance they place on them.
  - We will support the Law Commission's scoping study on intermediated securities and in particular on the implications of holding securities via nominees for the exercise of shareholder rights.

### **Culture and institutional structures that support effective stewardship**

- 1.31** In FS19/6, we said we will consider further the role of firms' culture, governance and leadership in ensuring they take appropriate action to manage their climate change risks and support the transition to net-zero emissions. We want to ensure our regulatory framework promotes transparency and accountability on climate change issues. This work could consider wider senior management accountability for stewardship. Proposed new rules for IGCs will also be an important addition to the governance of stewardship for workplace personal pension schemes.

### **Disclosure and transparency of stewardship activities**

- 1.32** We will pursue a number of actions to promote better disclosure of firms' stewardship practices and outcomes. These include steps announced in FS19/6 to support clients and beneficiaries in assessing whether firms' operations, products and services meet their sustainability objectives.
- *UK Stewardship Code 2020.* We will continue to engage with the FRC as it implements its proposed activities and outcomes reporting under the new Code.
  - *Supervision.* More generally, we will continue to engage with firms on stewardship through our supervisory work. As part of this, we may consider evidence from firms' disclosures under our rules on shareholder engagement and their reporting under the UK Stewardship Code 2020.
  - *Regulated firms' climate change disclosures.* Working with others, we will consider how best to enhance climate change disclosures by regulated firms, such as asset managers and life insurers, so that they provide transparency on how their activities

align with clients' sustainability objectives. As part of this, we will consider the most effective way to implement TCFD-aligned disclosures.

- *Expectations around green financial products and services.* In FS19/6, we noted that we will do further work to promote consumers' access to genuinely green products and services, including to:
  - challenge firms where we see potential evidence of misleading marketing (so called "greenwashing"), clarify our expectations, and take appropriate actions to prevent consumers being misled
  - carry out further policy analysis on greenwashing and act (e.g. publish new guidance), as appropriate
  - engage in relevant ongoing EU initiatives, particularly around common standards and product disclosures

## Outcome we are seeking

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**1.33** We want to see effective stewardship. This will contribute to our strategic objective to ensure that relevant markets function well, and to our 3 operational objectives:

- it will support market integrity by improving the quality of markets and the effectiveness of capital allocation
- it will help to deliver good outcomes for consumers by encouraging firms to actively seek value that meets consumers' preferences
- good disclosure of stewardship outcomes by firms will encourage them to compete on the quality of their stewardship in the interests of consumers

## Measuring success

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**1.34** The key attributes of stewardship are our success criteria for effective stewardship. We will seek evidence of progress through our supervision of regulated firms and our ongoing engagement with industry participants.

## Equality and diversity considerations

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**1.35** We have considered potential equality and diversity issues from the proposals in this Feedback Statement. Overall, we do not consider that the proposals materially impact any of the groups with protected characteristics under the Equality Act 2010.



## 2 The wider context to this Feedback Statement

- 2.1** Our work on stewardship is closely related to other regulatory initiatives to promote a long-term perspective in investment activity and create sustainable value for clients and beneficiaries.

### Other related initiatives on long-term investment

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- 2.2** We published DP19/1 alongside a consultation paper (CP 19/7) on measures to implement the SRD II provisions for FCA-regulated life insurers and asset managers, and for issuers of shares in respect of related party transactions.
- 2.3** Our new rules on shareholder engagement were finalised in our Policy Statement, PS 19/13, Proposals to promote shareholder engagement: Feedback to CP19/7 and final rules, published in May 2019. These rules establish an important regulatory baseline. They require life insurers and asset managers to disclose their stewardship approaches, enabling clients and beneficiaries to make informed decisions.
- 2.4** Several Government departments and regulators have an interest in promoting effective stewardship. Our work is therefore coordinated across the FRC, the Department for Business, Energy and Industrial Strategy (BEIS), the Treasury, the Department for Work and Pensions (DWP) and the Pensions Regulator (tPR).
- 2.5** DWP's implementation of SRD II measures for trust-based pension schemes built on new Investment Regulations introduced in 2018 to help clarify and strengthen trustees' investment duties. This includes their policies on the stewardship of investments and their consideration of ESG opportunities and risks.
- 2.6** The Treasury made the Proxy Advisors (Shareholder Rights) Regulations 2019. This requires proxy advisors to disclose their conflicts management policies, information on their research methods, voting policies and staffing, as well as whether they adhere to a voluntary Code of Conduct. The Regulations give us a limited role in overseeing how far proxy advisors are meeting these disclosure requirements.
- 2.7** In a separate consultation paper, also issued alongside DP19/1, the FRC set out proposed revisions to the UK Stewardship Code. The FRC considered carefully the responses received and has published the UK Stewardship Code 2020. The new Code aims to promote higher standards of stewardship beyond our regulatory baseline and maintain the UK's strong international reputation for stewardship. DP19/1 considered the appropriate balance between our regulatory rules and the Code.
- 2.8** We are also carrying out other work to promote a long-term perspective in investment activity:
- Independent Governance Committees (IGCs) were introduced in 2015 to assess the ongoing value for money of providers' workplace personal pension schemes

(and pathway investments). In April 2019, we consulted (in CP19/15) on extending the remit of IGCs and proposed new duties for them. These include that IGCs must consider and report on the adequacy and quality of the stewardship policies of the firms they oversee, and on how these firms take account of ESG risks and member concerns in their investment strategies.

- At the end of 2018 we launched a consultation paper, CP18/40, proposing changes to permitted links rules to allow retail investors greater access, with an appropriate degree of protection, to long-term patient capital investment opportunities in unit-linked funds. Alongside this, we also published a discussion paper, DP18/10, seeking input on potential barriers to UK authorised funds' investment in patient capital under existing rules. We are considering the feedback we received and will publish our responses in due course.

## Link to initiatives on sustainable finance and investment

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- 2.9** This work is, of course, also linked to growing interest in how companies and investment firms manage climate change and other ESG risks and opportunities.
- 2.10** The UK Government has made a legally binding commitment to achieving net zero greenhouse gas emissions by 2050. To meet this challenge the Government published its Green Finance Strategy in July 2019, emphasising the vital role that financial services play in financing the 'greening' of the economy.
- 2.11** There are a number of international industry and regulatory initiatives in this area. Most notably, the European Commission is pursuing a wide-ranging and ambitious Sustainable Finance Action Plan. This includes work on sustainable finance disclosures, sustainable benchmarks, and a taxonomy to promote a common understanding of what constitutes sustainable activity.
- 2.12** In its Green Finance Strategy, the Government committed to at least matching the ambition of the objectives of the EU's plan in relation to green finance, irrespective of the outcome of the UK's withdrawal from the EU. The European Commission is also examining short-termism in financial markets and gathering technical advice on this from the European Supervisory Authorities.
- 2.13** Through our work in this area, including as set out both in this paper and in our recent FS19/6, we are considering how well our rules support and encourage asset owners and asset managers to take a long-term perspective, where this is appropriate. As part of this, we are also considering how companies address climate and other ESG risks in their business, risk and investment decisions.
- 2.14** This is consistent with the joint declaration we made in response to the Green Finance Strategy, alongside the Prudential Regulation Authority (PRA), FRC and tPR. This declaration set out our shared understanding of the financial risks and opportunities of climate change and our commitment to working together on this issue. With the PRA, we have established a Climate Financial Risk Forum, as a means of bringing together representatives across the financial sector to share best practice and develop practical tools and approaches to address climate-related financial risks.

## 3 Summary of feedback and our response

- 3.1** This section summarises the feedback we received to DP19/1, and our response. Section 4 gives more details on our next steps.
- 3.2** We received 48 written responses and engaged extensively with stakeholders via a series of one-to-one meetings, roundtables and other events. Stewardship was also a key theme of a conference that we co-hosted in March with the London School of Economics. We are grateful to all respondents for their valuable input.
- 3.3** Almost half of the written responses received were from trade associations. We also received written responses from a range of other stakeholders, including academics, asset managers, asset owners, large consultancy firms, special interest and civil society groups and an exchange. Our statutory and advisory panels also contributed feedback.
- 3.4** We have organised this summary of feedback into the key themes raised by stakeholders.

### The definition and objectives of stewardship

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- 3.5** DP19/1 asked for views on the definition of stewardship. The definition presented in the joint FCA FRC Discussion Paper was aligned with that proposed in the FRC's consultation on revisions to the Stewardship Code. It was designed to capture the wider economic role of stewardship, rather than specifically to provide a basis for regulation. DP19/1 defined stewardship as: 'The responsible allocation and management of capital across the institutional investment community to create sustainable value for beneficiaries, the economy and society'.

### Feedback received

- 3.6** We received mixed feedback on this definition. Most stakeholders who responded agreed that stewardship should focus on capital allocation and oversight. Many respondents also agreed with including wider economic and social considerations in the definition.
- 3.7** However, many asset managers and some asset owners were concerned that the definition gave equal prominence to the interests of beneficiaries and to those of the wider economy and society. They emphasised that their fiduciary responsibilities are to their clients. They considered that any expectation that they act to the same extent in the wider interests of the economy and society would conflict with that primary duty. They pointed out that firms could not prioritise economic or societal objectives unless their clients explicitly mandated them to do so.

- 3.8** Those who supported the definition saw no conflict between these objectives. Some stressed that pursuing economic and societal objectives did not necessarily lead to lower investment returns, particularly over a longer period. One asset manager observed that any action to manage medium to long-term risks to clients and beneficiaries would be consistent with being 'a good steward and a good fiduciary'. Respondents cited climate change as one example of this type of risk.
- 3.9** One asset owner respondent said the proposed definition was consistent with its own perspective, which was to assess ESG risks through the lens of 'the world our beneficiaries will retire into'.
- 3.10** Some respondents who supported the definition also suggested some amendments and refinements. Among these, there were requests for us to add an explicit reference to the pursuit of environmental objectives.
- 3.11** Some respondents encouraged us to think carefully about the roles and responsibilities of the different agents in the institutional investment community, and how these influence their stewardship practices. For instance, many asset owners will not engage actively with investee companies. They may restrict their focus to setting objectives for asset managers and monitoring if these are met.
- 3.12** Alongside responses to DP19/1, the FRC directly received extensive feedback on the definition of stewardship in response to its consultation on revisions to the UK Stewardship Code. Much of this feedback was consistent with the views expressed in responses to DP19/1, though some asset owners and other stakeholders more strongly supported the definition proposed in the consultation. The FRC has considered this feedback and published a revised definition of stewardship for the purposes of the UK Stewardship Code 2020 as part of the revised Code.
- 3.13** Respondents also asked that we continue to work closely with the FRC to ensure a coordinated and consistent approach to stewardship.

### Our response

We have considered this feedback carefully and discussed these matters further with the FRC as it completed its work to revise the UK Stewardship Code. Continued coordination on these matters is important, to support both our regulatory activities in this area and the FRC's encouragement of higher standards through the UK Stewardship Code 2020.

We note some stakeholders' reservations about the potential conflicts for firms from giving equal weight in their stewardship objectives to beneficiaries, the economy and society.

We think it is important to acknowledge the role that effective stewardship can play in promoting better economic, environmental and societal outcomes. However, we recognise these outcomes may be indirect, flowing from pursuing sustainable financial returns for clients and beneficiaries.

A focus on clients' and beneficiaries' interests provides a more consistent basis for regulation. As a regulator, we want to ensure that firms carry out stewardship effectively where this is integral to delivering good value for their customers. However, this should not prevent an asset owner from promoting a wider purpose in its investment beliefs and in the investment mandates it sets for its asset managers, if it considers that this would be consistent with beneficiaries' preferences.

For instance, as part of the new Investment Regulations for trust-based pension schemes, a trustee may set out how members' preferences have been considered in developing its Statement of Investment Principles. Similarly, our proposed new rules for IGCs require, among other things, that they report on how their firms consider ESG factors and member concerns in their investment decisions and strategies.

In Section 4, we describe the further work we will do to examine how asset owners set their investment and stewardship objectives and how these are reflected in asset owners' arrangements with asset managers.

We also note that the direction of travel in both public policy and industry practice is towards a wider view of corporate purpose. Related work on sustainable and green finance increasingly emphasises the role of the institutional investment community – and finance more broadly – in promoting positive and sustainable economic, environmental and societal outcomes.

The EU's Sustainable Finance Action Plan explicitly pursues these sustainability objectives. For instance, an asset owner may set a sustainable benchmark, or seek disclosures, to confirm that an asset manager is managing investments in a way that is consistent with its desired sustainability impact. We will continue to engage with relevant EU initiatives and assess their impact in the UK.

Stewardship has an important role to play where investors set these types of objectives. The Government's Green Finance Strategy explicitly references the work of its Asset Management Taskforce, which recently established a sub-group to promote sustainable stewardship.

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## The focus of stewardship activities

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**3.14** DP19/1 asked for views on whether there are particular areas that stewardship should focus on when pursuing value for beneficiaries, the economy and society.

### Feedback received

**3.15** Stakeholders' responses to this question included some recurring themes. They often cited climate change and the environment as important areas of focus for stewardship. They also frequently mentioned governance issues, such as diversity and executive

pay. Several responses highlighted social considerations, noting that among the ESG factors, social issues had so far received the least attention.

**3.16** However, some asset managers emphasised the importance of flexibility in setting stewardship priorities, since these will naturally change over time. An industry body commented that: 'effective stewardship cannot be boiled down to a checklist of issues to engage on – this would turn stewardship into a compliance exercise and prevent asset managers from differentiating themselves from their competitors based on their stewardship approach.'

**3.17** In prioritising issues, one pension fund said that stewardship should focus on material issues that will impact the long-term value of investments. This was echoed by others. An academic respondent commented that 'the best type of stewardship grows the pie, creating more value for both investors and stakeholders alike'.

### Our response

In line with much of the feedback, we consider that for many firms stewardship will be an integral part of their strategy to deliver long-term sustainable value creation, in the best interests of their clients and beneficiaries. The focus of stewardship will then be determined by this long-term objective. It will therefore typically include careful consideration of ESG factors, consistent with the UK Stewardship Code 2020.

We acknowledge, however, that stewardship priorities will differ both between institutions and over time. So, we do not want to be prescriptive about areas of focus.

We also agree that it is important stewardship does not become a compliance exercise. Hence our focus in Section 4 is on actions that we consider will help address barriers to effective stewardship and create the conditions in which market-led incentives can drive improvements in stewardship.

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## The key attributes of effective stewardship

**3.18** DP19/1 asked for input on a set of key attributes of effective stewardship. The DP proposed 4 key attributes and suggested some example behaviours that would be consistent with each of these. The attributes were:

- clear purpose
- constructive oversight, engagement and challenge
- culture and institutional structures that support effective stewardship
- disclosure and transparency of stewardship activities

## Feedback received

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- 3.19** Respondents broadly agreed with the proposed key attributes. Some suggested small amendments. These included, for example, drawing out the different roles played by different agents in the institutional investment community and emphasising the importance of an 'outcomes' focus for investor stewardship.
- 3.20** Some respondents said that, when considering behaviours consistent with these attributes, we should allow for a variety of stewardship approaches. They also suggested that we emphasise the important role of collective engagement as a way of increasing the influence of individual asset owners and asset managers.
- 3.21** A number of respondents, including asset managers, asset owners, trade bodies and interest groups, emphasised the importance of integrating stewardship into investment processes. They felt that stewardship should be central to investment processes, rather than a siloed activity carried out in a separate governance or engagement team. Their view was that this would give stewardship real purpose and impact, and enhance firms' credibility in their engagement with companies.
- 3.22** Stakeholders again encouraged us to ensure that both we and the FRC apply the key attributes consistently to underpin our respective stewardship work.

### Our response

Given the general support for the key attributes identified in DP19/1 we have adopted them – with some amendments in response to feedback – to help guide our policy thinking and to describe the outcomes we seek to achieve (Figure 1). We use these to organise our actions and next steps in Section 4.

We agree with respondents that the key attributes should make a stronger reference to outcomes. The value of stewardship – and asset owners' demand for it – will depend on the contribution stewardship makes to creating sustainable long-term value for clients and beneficiaries.

Consistent with this, we note that the UK Stewardship Code 2020 includes reporting on activities and outcomes. We are engaging with the FRC's ongoing work on this. We anticipate that this reporting will bring transparency to the value of stewardship. By better distinguishing the outcomes achieved by different firms, it should support the development of a competitive market for effective stewardship.

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**Figure 1. Key attributes of effective stewardship**

<p><b>A clear purpose</b></p> <p>A clear understanding of the scope, role and purpose of stewardship. Contractual and other arrangements that reflect clients' and beneficiaries' investment and stewardship objectives</p>	<p><b>Constructive oversight, engagement and challenge</b></p> <p>Active and effective monitoring of assets, constructive dialogue with issuers, and exercise of ownership rights. Integration of stewardship and investment processes to achieve outcomes consistent with clients' and beneficiaries' investment and stewardship objectives</p>
<p><b>Culture and institutional structures that support effective stewardship</b></p> <p>Culture and institutional structures to promote and support investment strategies and stewardship activities consistent with clients' and beneficiaries' investment and stewardship objectives</p>	<p><b>Disclosure and transparency of stewardship activities and outcomes</b></p> <p>Reporting and disclosures across the institutional investment community to demonstrate that stewardship activities and outcomes reflect clients' and beneficiaries' investment and stewardship objectives</p>

## The institutional, asset class and geographical scope of stewardship

**3.23** DP19/1 asked for views on the appropriate scope of stewardship across institutions, asset classes and geographies.

### Feedback received

**3.24** Respondents generally agreed that, given the complexity of the institutional investment community, it is important that stewardship activities are mutually supportive across the institutional investment community – ie, across asset owners, asset managers, investee companies and service providers. There was also general support for the idea that stewardship should be engaged across all asset classes and geographies, notwithstanding some challenges in achieving this.

### Institutional scope

**3.25** Stakeholders generally agreed with the DP's system-wide perspective on stewardship. Many respondents shared the view that asset owners set the tone for stewardship, including through the mandates they set for asset managers. They also agreed that these arrangements should reflect the interests of beneficiaries over their relevant time horizons. They acknowledged this was not always done systematically.

**3.26** One advisor suggested we examine the institutional investment community in more detail, mapping the different interactions, information flows and incentives. For instance, we should acknowledge that different types of asset owner – e.g. trust-based pension schemes, contract-based pension schemes, master trusts, life insurers – may have different resources, incentives and constraints.



**3.27** Stakeholders also said service providers need to provide effective support for stewardship. We discuss some potential barriers to this later in this section.

### ***Asset class scope***

**3.28** Most stakeholders felt that firms should exercise stewardship beyond listed equities. While they recognised that stewardship may be easier to achieve in listed equities, which carry voting rights, they argued that bondholders can still exercise influence. Some respondents emphasised bondholders' 'important position in the capital structure'. Accordingly, it was noted that bondholders can exert pressure before an investment is made – e.g. when setting covenants and disclosure expectations – and when debt is being rolled over.

**3.29** Respondents acknowledged that exercising stewardship across asset classes can introduce complexities. One asset management trade body, for instance, said it may require specific governance arrangements – for instance, to promote consistent messaging and to manage any conflicts from owning assets of the same company with different seniority and different rights.

**3.30** Other respondents commented on the role of stewardship in alternative investments. For instance, a trade body for the private equity and venture capital industry emphasised the natural incentives for stewardship in this asset class from long-term holdings and from having 'skin in the game'.

**3.31** Another respondent, representing mutual companies, commented that ownership of a mutual by its customers inherently aligns the interests of owners and customers. They argued that this ownership structure helps to guard against short-termism since there is no quarterly reporting cycle or pressure from sell-side analysts. They also cited this as one driver of recent growth in the market share of mutual companies.

### ***Geographical scope***

**3.32** Stakeholders generally agreed that effective stewardship requires coordinated action, not only across the institutional investment community, but also across borders. However, they also pointed out challenges to achieving this. These challenges include different legal and regulatory requirements, different local market conditions, and the need to use local agents. Some stakeholders also mentioned 'home bias' in engagement activity, which we defined in DP19/1 as the tendency for investors to engage more actively with investee companies in their home jurisdiction.

## **Our response**

There is broad support for taking a system-wide perspective on stewardship, as suggested in DP19/1. Accordingly, several of the actions and next steps described in Section 4 aim to tackle barriers to achieving a mutually supportive environment for stewardship across the institutional investment community.

We also agree with those respondents who favoured a broad asset class and geographical scope for stewardship.

So, we support the application of the UK Stewardship Code 2020 beyond listed equity and the inclusion of Principles for service providers within the Code. We recognise, however, some of the potential challenges

that respondents identified. We will work with the FRC to consider any practical evidence of these challenges.

On geographical scope, our implementation of SRD II explicitly extended the scope of rules on shareholder engagement to firms' entire share portfolios, including shares traded on markets outside the UK.

Additionally, many of the signatories to the UK Stewardship Code 2012 are asset owners, asset managers and service providers that are headquartered overseas. We expect this also to be the case for 2020 Code. Furthermore, to the extent that the UK Stewardship Code 2020 starts to raise the bar for best practice in stewardship, other jurisdictions may choose to adopt similar standards. The original Code was adopted as a basis for the Codes introduced in some other countries, and other jurisdictions have already expressed an interest in the changes that the FRC is making.

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## Examples of stewardship approaches

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**3.33** We asked for input on how firms with different objectives and investment strategies approach stewardship. We asked for feedback on matters such as prioritisation, resourcing, and integrating stewardship with investment decisions.

### Feedback received

**3.34** Most of the feedback to this question came from asset managers. Respondents described their approaches to stewardship, including prioritisation, organisation and resourcing, influence and escalation. An asset management trade body also referenced some of the findings in its 2018 survey, *Stewardship in Practice*.

- *Prioritising engagements.* Respondents identified a number of key factors that determined how they prioritised stewardship engagements. These included the size of the firm's holding, the time since the firm's last engagement, individual company-specific issues, and a company's performance on a particular theme of interest.
- *Organisation and resourcing.* Some firms said they were expanding their stewardship teams and strengthening their stewardship capabilities. They described varying degrees of integration with investment teams. One stakeholder discussed how firms were increasingly finding that they needed technical expertise on topics such as climate change, cyber security and worker health and safety. Some firms described their data strategies to support stewardship as a 'work in progress'.
- *Influence and escalation.* One asset management trade body said stewardship actions typically followed the following sequence: 'voice; escalate; vote; exit.' Other respondents described variations on this stylised approach. One academic stressed the importance of including divestment strategies as part of an active stewardship strategy. Some respondents pointed out that transparency over escalation and exit thresholds can be an important discipline on investee companies.
- *Stewardship in different investment strategies.* In DP19/1, our view was that index strategies might be more likely to take a more centralised, top-down thematic approach to stewardship, compared to active funds. While some respondents agreed, some index managers strongly challenged this characterisation. Index

managers emphasised that they use their scale and influence to set strong expectations for investee companies on issues such as board diversity or climate change. These firms said their thematic campaigns could be a catalyst for market-wide change.

**3.35** Several respondents stressed the value of collective engagement to tackle thematic or company-specific issues of common interest across firms, especially where individual engagement is not delivering results. One respondent noted: 'Collective engagement is crucial to overcome obstacles caused by fragmented ownership, which is a particularly acute issue for UK-listed companies...' Stakeholders also said that collective engagement could be an important way of sharing expertise and sharing the cost of otherwise expensive engagements.

**3.36** We also gathered information on firms' stewardship activities through our supervision of asset managers. Alongside firms acting as good agents and as good market participants, stewardship is one of the three roles of an asset manager that we focus on. We summarise our findings in Box 1.

#### **Box 1. Supervisory findings on asset managers' stewardship practices**

Although asset managers have different priorities and there is no one-size-fits-all approach to stewardship, we observed a number of examples of good practice, consistent with the attributes of effective stewardship in DP19/1. Some of these examples are presented below:

##### *A clear purpose*

- key stakeholders in the firm understand the role of stewardship
- senior stakeholders agree clear, documented objectives and priorities for stewardship activities as part of a formal governance process, and regularly review them
- the firm seeks clients' and beneficiaries' views
- the firm considers how to be a good steward across asset classes

##### *Constructive oversight, engagement and challenge*

- systematic ability to track engagements and outcomes, as well as to effectively incorporate ESG data into capital allocation decisions
- the firm considers how best to use available ESG data, with specialised personnel
- the firm works with proxy advisors on tailored voting requirements or principles
- the firm identifies and manages conflicts of interest involving stewardship
- the firm integrates effective stewardship into the investment process, both through engagement of investment teams and integration with front office systems.

##### *Institutional culture and structures*

- the stewardship team is sufficiently resourced and backed by senior leadership
- the firm reflects stewardship activities and outcomes in its remuneration of investment teams

##### *Disclosure and transparency of stewardship activities*

- the firm clearly explains its approach to existing and potential clients
- stewardship objectives and/or priorities are transparent and accessible to investors
- the firm discloses outcomes, both at a granular level, such as case studies of investee companies' engagements, and at a broader level, against engagement priorities

## Our response

We note that there are a variety of approaches to stewardship and that stewardship practices continue to evolve.

In our consideration of responses and our supervisory engagement with firms we have identified practices that would be consistent with the key attributes that we set out in DP19/1. We also observed some practices that seem to be less consistent. There is evidence of a sharper focus in this area among firms and increasing investment in stewardship capabilities. Supervisors will continue to engage with firms on these issues.

Based on what we have learned, we anticipate that firms will make further investments in stewardship in response to recent (and forthcoming) regulatory developments, the introduction of the UK Stewardship Code 2020, and increasing client demand.

We have also considered stewardship practices across different investment strategies in our research work. We are currently undertaking research on the implications of index strategies for market quality. As part of this, our researchers are leading a cross-regulator project on the topic for the International Organisation of Securities Commissions. One initial conclusion of our research so far is that a diverse ecosystem of institutions and strategies can improve market quality and corporate performance.

Collective engagement may help achieve this mutually positive relationship. More generally, we agree with stakeholders that collective engagement can be an important vehicle for investors to exercise effective stewardship. This is particularly the case where ownership is highly fragmented and individual investors may not have sufficient influence.

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## Barriers to effective stewardship

- 3.37** In DP19/1, we set out the barriers to stewardship, including from investment in stewardship, misaligned incentives and problems with information flow. We asked respondents for their views on these barriers and the most significant challenges to achieving effective stewardship. We also asked for views on the interactions of these barriers with other aspects of the regulatory framework.
- 3.38** DP19/1 also asked for input on any potential issues from the role of proxy advisors, and whether new measures introduced under SRD II and proposed under the revised UK Stewardship Code would address them sufficiently.

## Feedback received

**3.39** Stakeholders generally agreed with our description of the barriers to effective stewardship. They also gave more detail and colour on the implications of these barriers. We summarise some of the key emerging themes below.

### *Investment in stewardship*

**3.40** There was widespread agreement that stewardship can be expensive, particularly for smaller firms and investors. Respondents underlined the investment needed to build and upskill teams, develop data capabilities and resource meaningful engagements with investee companies. Firms pointed out that they manage costs down by targeting and prioritising stewardship activities or by participating in collective engagements.

### *Arrangements between asset owners and asset managers*

**3.41** Some respondents were concerned that asset owners' investment and stewardship objectives may not systematically consider beneficiaries' long-term preferences, including on ESG matters. We received feedback that it was difficult to gather representative information from beneficiaries. However, we were also given evidence of where this had been done. For instance, there are examples of Dutch pension funds gathering inputs from members to inform their sustainability objectives.

**3.42** Stakeholders also had some concerns that contractual and other arrangements between asset owners and asset managers may not sufficiently promote effective stewardship. For example, respondents agreed that there could be incentive problems if short-term financial performance is a key driver in selecting and assessing asset managers. The IA advised that it has a programme of work underway to examine how a longer-term perspective can be incorporated into investment mandates and asset owners' other arrangements with asset managers.

**3.43** One asset owner trade body representing pension scheme trustees raised a concern about asset managers' voting policies. They felt asset owners did not have the ability to influence these policies, especially when investing via pooled vehicles. Citing recent survey evidence, this respondent said that many asset managers do not support best-practice voting policies and guidelines, including on matters such as climate change, and gender and ethnic diversity on boards. They argued that this would make it difficult for trustees to meet their stewardship obligations under the new Investment Regulations. They asked us, as regulator of asset managers, to act on this problem.

**3.44** Respondents also commented on the role of investment consultants. They said that investment consultants are highly influential in decisions on manager selection and strategic asset allocation, and many – especially smaller – asset owners rely on their advice heavily. This means investment consultants' approach to this issue may have important system-wide implications.

**3.45** Based on a recent review, one public interest body said that many consultants still do not consider ESG issues as a core part of the service they offer asset owners. Accordingly, investment consultants may not adequately support asset owners in making decisions aligned with their investment and stewardship objectives, including in relation to ESG and other long-term factors.

**3.46** In further stakeholder engagement, we learned that, although investment consultants are now more active in this area, many asset managers feel that ESG is still a secondary consideration in consultants' advice on selecting asset managers.

### ***Asset managers' disclosures on stewardship activities and outcomes***

- 3.47** Respondents recognised that firms' disclosures may not provide enough information on outcomes of stewardship to be able to demonstrate the value of their activities. They said this may make it difficult for asset owners to identify asset managers that offer a service aligned with their interests and objectives. In turn, this may weaken competition between firms based on stewardship performance. However, they noted that good outcomes reporting was challenging.
- 3.48** One stakeholder cautioned about the risk of 'boilerplate' reporting, which 'doesn't necessarily reflect the quality of the engagement between investors and companies'. A trade body recommended 'better and more consistent public disclosure of stewardship activities by asset managers.'
- 3.49** Stakeholders said that disclosure is already improving. There have also been some industry efforts to collate and assess firms' disclosures to give an overview of practices in this area. Respondents expected the FRC's proposed activities and outcomes reporting to enhance the quality of stewardship disclosure.
- 3.50** They also said that improved disclosures of how firms' investment portfolios were positioned in respect of climate change and other ESG factors would help asset owners and beneficiaries to make informed choices, aligned with their investment and stewardship objectives. They thought that adopting consistent frameworks for such disclosures, such as TCFD for climate change, could help this.
- 3.51** Reflecting the link between stewardship and sustainable investing, consumer-focused respondents raised concerns about the quality, consistency and reliability of the information on sustainable products that firms give investors. A particular concern was greenwashing.
- ### ***Regulatory barriers***
- 3.52** Some stakeholders, including asset managers and trade bodies, raised concerns that regulatory uncertainties may be a barrier to exercising effective stewardship.
- 3.53** One concern, raised frequently in meetings with stakeholders, was uncertainty about how MAR applies where investors and issuers engage on strategic matters in the context of stewardship.
- 3.54** Some respondents had concerns that companies may be reluctant to engage on particular matters if they are concerned that they may inadvertently reveal inside information. For example, an asset management trade body observed that 'issuers often cite these issues as a reason not to engage with shareholders individually or collectively'.
- 3.55** Equally, some respondents said that a lack of clarity about the application of insider rules was making some, particularly overseas, investors cautious about engaging with issuers, or otherwise receiving non-public information from issuers to support their stewardship.
- 3.56** Some respondents also said there was a lack of clarity about competition rules when investors engage collectively. They asked for further guidance on how firms' coordination and information-sharing in these cases interacts with rules around 'acting in concert'. An investor body noted: 'For collective engagement to work effectively,

participants need to be clear about the objectives, the boundaries of engagement, and to feel assured that they are acting in a safe and secure environment.'

**3.57** We understand that ESMA's Public Statement, Information on shareholder cooperation and acting in concert under the Takeover Bids Directive, may have provided some comfort, at least in the context of takeover rules. ESMA's Statement identifies a 'White List' of engagement activities in which shareholders may engage to exercise good corporate governance.

**3.58** Nevertheless, respondents sought reassurance from us on both issues.

### ***Information on ESG and other long-term factors from investee companies***

**3.59** Several stakeholders said there was a need for better disclosures on ESG and other long-term factors from securities issuers, with some suggesting that this was one of the main barriers to effective stewardship.

**3.60** However, respondents representing both issuers and investors cautioned that a balance needs to be struck between providing investors with high-quality information that can help in decision-making, and imposing a proportionate burden on issuers.

**3.61** Some stakeholders, including a trade body representing issuers, commented on the need to ensure that financial reports contain all relevant information, while remaining succinct and user-friendly. Another stakeholder pointed out that companies may be reluctant to disclose long-term strategies to avoid revealing commercially sensitive information.

**3.62** Some respondents said that the 'information gap' between corporate issuers and investors could be improved by applying standardised disclosure and reporting frameworks. They said that adopting consistent frameworks would give issuers clarity on what information was required. It would also reduce the volume of ad hoc information requests from investors.

**3.63** An asset management trade body said that it had developed long-term reporting guidelines for investee companies. Several respondents specifically recommended that securities issuers adopt TCFD for their climate change disclosures. The work of the Sustainability Accounting Standards Board was also mentioned, as were ESG disclosure frameworks developed by some stock exchanges.

### ***Specialist data providers***

**3.64** Some respondents pointed out that, without good disclosures from issuers, the data and metrics that investors source from specialist ESG data services may not be based on complete and reliable information. They noted that these data providers typically rely on estimation models to fill data gaps.

**3.65** They also said that, to date, there has been little transparency over the methodologies some of these providers use to produce their company-level ESG metrics and ratings. We were directed to evidence of considerable variability in ESG ratings of individual companies by different data providers which could not be explained easily.

**3.66** One asset manager said that access to reliable, high-quality data on long-term factors from data providers may be a particular problem for smaller companies who might otherwise lack the resources to source and analyse this data.

**3.67** In follow-up discussions, stakeholders pointed out that the ESG data industry was evolving rapidly. They observed that rating agencies and other large firms are expanding their products and making acquisitions, and investors are scrutinising data more closely and expecting greater transparency.

### ***Proxy advisors***

**3.68** DP19/1 was published before the Treasury implemented new Regulations for proxy advisors aligned with the measures in SRD II.

**3.69** There were over 20 responses to our question on proxy advisors. Investors were generally content with the service provided by proxy advisors. Issuers were more critical, particularly about proxy advisors' engagement with companies. Around half of respondents felt the new requirements under SRD II and the new measures proposed for service providers in the revised Stewardship Code would not be sufficient to address perceived problems with proxy advisors.

**3.70** Some stakeholders were concerned about the quality of proxy advisors' research and voting advice, and how they manage conflicts of interest. They also called for more transparency around how proxy advisors support voting in accordance with investors' investment and stewardship objectives, including in relation to ESG and other long-term factors. One stakeholder said that proxy advisors 'should set out their approach on key thematic areas such as remuneration, climate change, modern slavery, plastic pollution etc. and on how they are addressed.'

**3.71** Issuers and their advisors also pointed out what they saw as a lack of engagement by proxy advisor firms with issuer companies. One stakeholder said this engagement was often only done at the last minute, giving no time for issuers to respond to any proposed recommendations or the accuracy of the proxy's findings. One stakeholder pointed out the potential problem that proxy votes based on inaccurate information might outweigh votes by informed investors.

**3.72** There were mixed views about the degree of reliance by asset managers on proxy advisors' research and voting recommendations. Respondents said that large asset managers gather a wide range of research inputs to support their voting activity. These asset managers typically use more than one proxy advisor, although many do rely primarily on the voting infrastructure supplied by one of the large proxy advisors. A few respondents highlighted the risk that smaller asset management firms may rely more heavily on a single proxy advisor's research and recommendations.

### ***Governance***

**3.73** Some stakeholders raised concerns that asset managers' governance arrangements may not put enough emphasis on the value of effective stewardship.

**3.74** One trade body recommended that asset managers disclose their governance of stewardship. Another stakeholder said that a lack of buy-in from a firm's leadership can be a significant barrier to stewardship.



## Our response

We appreciate the feedback received on the range of barriers to effective stewardship. These elaborate on the key cost, incentive, informational and coordination issues highlighted in DP19/1.

We have examined these barriers and agree that many of these could have a material impact on both the demand for effective stewardship and its supply. They could impede progress towards a mutually supportive environment for effective stewardship. Therefore, where we can contribute to removing such barriers, we think it is important that we do so.

In Section 4 we set out actions that we can take, working with industry, the FRC, Government and other regulators, to help address the most significant barriers. By helping to remove these, we aim to create the conditions in which market-led incentives can encourage a culture of good stewardship across the institutional investment community.

## Stewardship by retail investors

- 3.75** The main focus of DP19/1 was stewardship by institutional investors. However, some of the matters raised were relevant to how different firms, such as investment advisors, nominee companies and SIPP operators, might support stewardship by retail investors.
- 3.76** We asked specifically whether we should consider bringing Self-Investment Pension Plan (SIPP) operators within the scope of the rules on shareholder engagement we recently introduced as part of our implementation of SRD II for asset managers and life insurers. SIPP operators are firms that receive, hold and administer the underlying assets held in SIPPs, on behalf of their clients.

## Feedback received

### *Investment advice to retail investors*

- 3.77** One trade association representing wealth managers and financial advisors said that existing frameworks for stewardship, including the UK Stewardship Code, were designed to apply to institutional investors. They recommended that regulators launch a separate project to decide on an appropriate regulatory framework for effective stewardship for firms providing investment services and advice to retail clients. They noted that a direct read-across from the regulatory framework for institutional investors would be unlikely to produce a sensible or proportionate outcome.

### *SIPP operators*

- 3.78** Eleven respondents commented on the question of whether SRD II obligations should be extended to SIPP operators. Around half of these supported bringing SIPP operators within the scope of the new rules to implement SRD II. One respondent said that there could be a vast source of empty votes if SIPP operators were not brought within scope. Other stakeholders noted that, since SIPP operators provide a variety

of services, an extension would only be appropriate for those SIPP operators that influence investment choices or facilitate voting.

**3.79** Respondents who did not support an extension primarily represented wealth managers. They pointed out that an extension to SIPP operators could be impractical and involve disproportionate cost. For instance, they noted that some SIPP operators handle investments via hundreds of asset managers, investing in many thousands of companies.

### ***Voting in nominee structures***

**3.80** DP19/1 noted that questions have been raised about how retail shareholders exercise their rights where they have a direct investment and hold shares on the share register via a nominee company.

**3.81** A small number of respondents had concerns that, in these circumstances, nominee companies may not adequately support voting in line with beneficiaries' preferences. In this case, beneficial owners cannot vote unless nominees vote on their behalf or a special arrangement is made for them to do so.

**3.82** One stakeholder said there should be 'a greater public awareness of difficulties related to voting where there is a pooled nominee somewhere in the chain'. Another stakeholder representing shareholders commented that providing for shareholders who hold their shares in nominee accounts to vote their shares easily and at no additional cost is critical to shareholder rights and shareholder democracy.

## **Our response**

We note the feedback on retail issues and will continue to engage with the industry and other regulators on stewardship by firms advising retail investors. We will consider this matter in the context of ongoing EU initiatives on how investment advisors should consider sustainability when assessing the suitability of investments for their clients.

We note the practical challenges to extending stewardship requirements to SIPP operators, including the diversity in SIPP operators' business models.

However, we also understand the concerns of some stakeholders that, where SIPP operators have business models that allow them to influence investors' choice of asset managers and/or funds, failure to set clearer expectations around their exercise of stewardship could give rise to harm.

Given this, we will consider further how we can extend the scope of our current rules on stewardship and shareholder engagement to SIPP operators in a way that meets our objectives while taking appropriate account of firms' different business models.

In the meantime, we would encourage SIPP operators to exercise stewardship where relevant to their business models and service offerings. Some SIPP operators may consider becoming signatories to the UK Stewardship Code 2020.

We also note the problems stakeholders have raised about exercising retail shareholder rights where shares are held by a nominee company. We will support the Law Commission's scoping study on intermediated securities, providing input on the implications of holding securities via nominees for the exercise of shareholder rights.

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## Regulation of stewardship and the UK Stewardship Code

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- 3.83** In DP19/1, we asked for views on the appropriate balance between regulatory rules and the UK Stewardship Code in promoting effective stewardship. We also sought feedback on how to deal with some specific issues in the design of the regulatory framework.
- Feedback received**
- 3.84** A clear majority of respondents did not favour further regulation on stewardship at this time. They argued that there had been significant regulatory intervention recently and that our new rules, the UK Stewardship Code 2020, and other related measures on sustainable finance, should be allowed to bed in before we consider further measures.
- 3.85** One stakeholder noted the interaction between the revision of the Code and our COBS 2.2.3 rule that references the Code. They said that competitive pressures, combined with the COBS 2.2.3 requirements, should lead to widespread adoption of the Code, and so higher stewardship standards.
- 3.86** A number of stakeholders explicitly supported the proposed balance between regulation – a 'minimum bar which has been raised' – and the UK Stewardship Code as a means of promoting higher standards.
- 3.87** One stakeholder noted, however, that the proposed framework should recognise the reduced ability of smaller asset owners to undertake extensive stewardship activities. Another stakeholder commented that there should be a clear 'carrot and stick' approach. One stakeholder commented that it was important to promote best practice and suggested that there should be a gold standard, or 'kite mark', for signatories to the Code.
- 3.88** Respondents generally considered that a 'comply or explain' approach was appropriate for the shareholder engagement rules we introduced recently to implement SRD II. They favoured a principles-based approach, allowing for a range of approaches to stewardship. However, a small number of respondents, primarily representing interest groups, asked us to strengthen our approach, for example, to make voting and engagement disclosures mandatory.
- 3.89** Stakeholders said it was important that the FCA and the FRC continue to work together closely to ensure coherence between the UK Stewardship Code 2020 and the wider regulatory framework for stewardship.

## Our response

We have considered this feedback and agree with the majority of respondents that we should not introduce further regulation in this area now. As we have noted, however, there are some actions that we can take to help address some of the remaining barriers to effective stewardship. We discuss these further in Section 4.

We agree with feedback that a comply or explain approach should allow for a range of stewardship approaches to emerge. As long as there is high-quality and accurate disclosure of activities and outcomes, clients and beneficiaries will be able to exercise choice and apply market discipline.

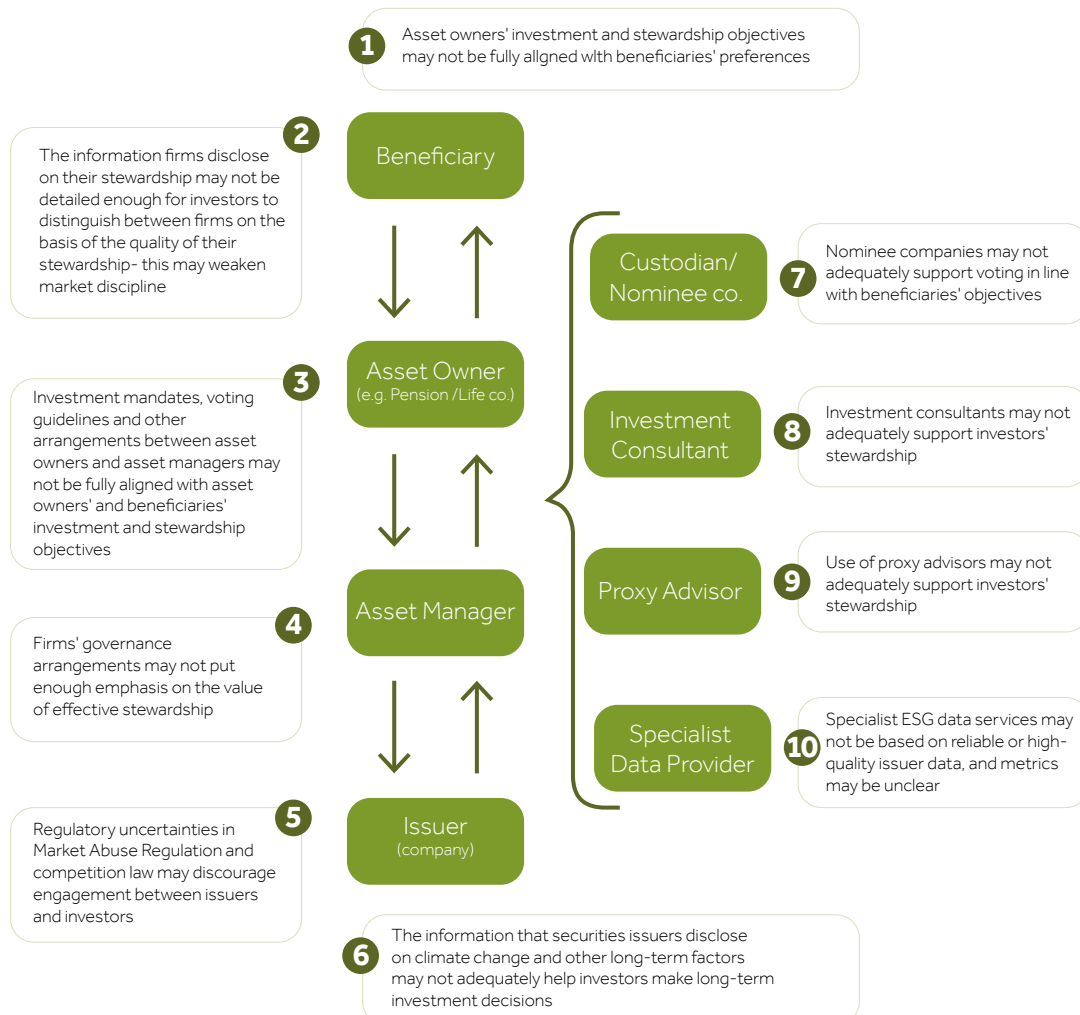
We also agree with stakeholders that close coordination between the FCA and FRC on stewardship is necessary to ensure the balance between our regulatory baseline and the UK Stewardship Code 2020 delivers a framework for effective stewardship. We will continue to engage with the FRC as the UK Stewardship Code 2020 is introduced. We will take steps to put appropriate arrangements in place with the FRC – and its successor – to support effective coordination. We will consider the need for any further actions as the new Code takes effect.

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## 4 Actions and next steps

- 4.1** Our new rules on shareholder engagement have only recently come into effect. We agree that the industry should be given time to embed these new rules, as well as the UK Stewardship Code 2020 and other related initiatives on sustainable finance, before we consider further regulation.
- 4.2** The feedback we received to DP19/1 did, however, reveal some remaining barriers to effective stewardship across the institutional investment community. Drawing on this feedback, we have examined some of the potential informational, incentive and coordination issues across the institutional investment community (Figure 2).
- 4.3** Within the scope of our regulatory responsibilities, we want to help address these barriers. If these can be removed, market-led incentives are likely to be a more effective mechanism than further regulation to encourage investors to engage more actively in stewardship, complementing existing measures and the UK Stewardship Code 2020. As some stakeholders have pointed out, there is a danger that extensive, prescriptive rules would encourage a box-ticking compliance-based approach to stewardship. This could be costly and counter-productive.

**Figure 2: Barriers to effective stewardship across the institutional investment community**



**4.4** Against this backdrop, this section sets out some actions that we can take, working with industry, the FRC, Government and other regulators, to help address some of the most significant barriers and create a supportive environment in which progress towards effective stewardship can accelerate.

## Actions to address identified barriers to effective stewardship

**4.5** Below we set out our actions to help address the barriers identified in Figure 2.

**4.6** Respondents were generally supportive of the key attributes of effective stewardship that we identified in DP19/1. We have therefore used these as a basis for prioritising our further policy work in this area and mapped our actions against these attributes (Figure 3).

**Figure 3: Actions to address identified barriers to effective stewardship**

		Our actions
Key Attributes of Effective Stewardship	<p><b>Clear purpose</b></p> <p>A clear understanding of the scope, role and purpose of stewardship. Contractual and other arrangements that reflect clients' and beneficiaries' investment and stewardship objectives</p>	<p>We will look further at the arrangements between asset owners, asset managers and service providers and how these support stewardship objectives:</p> <p><b>An industry workshop</b> In the first quarter of 2020, we will hold an industry workshop, jointly with other regulators, to discuss how asset owners set and communicate their stewardship objectives and how well these are adopted by asset managers and service providers</p> <p><b>Engagement with relevant industry work</b> We will engage with ongoing industry work led by the IA that is considering how to promote an appropriate long-term perspective in investment mandates and in asset owners' other arrangements with asset managers</p> <p><b>Investment consultants</b> The Treasury is considering the CMA's recommendation to bring investment consultants under FCA regulation and will consult in due course. Pending the outcome of this consultation, we will consider the issue of stewardship as part of our work with the Treasury to design an appropriate regulatory regime</p>
	<p><b>Constructive oversight, engagement and challenge</b></p> <p>Active and effective monitoring of assets, constructive dialogue with issuers, and exercise of ownership rights. Integration of stewardship and investment processes to achieve outcomes consistent with clients' and beneficiaries' investment and stewardship objectives</p>	<p><b>Regulatory issues</b> We will continue to work with industry to identify areas of concern in relation to MAR and competition law and provide clarity so that issuers and investors can engage effectively within the bounds of the regulation</p> <p><b>Issuer disclosures</b> We will consult in early 2020 on proposals to introduce new 'comply or explain' climate change disclosure rules for certain listed issuers aligned with the TCFD's recommendations; we will also clarify existing disclosure obligations</p> <p><b>Intermediated securities/voting practices</b> We will support the Law Commission's scoping study on intermediated securities</p> <p><b>Service providers</b> We will consider outcomes as the new regulatory regime for proxy advisors, introduced in the context of SRD II, beds in  We will consider the role played by specialist providers of ESG data services; as a first step, we are looking at the nature and quality of these services, how investors use them and how much they rely on them</p>

<b>Key Attributes of Effective Stewardship</b>	<b>Culture and institutional structures that support effective stewardship</b>	<p><b>Culture and governance</b></p> <p>We will consider further the role of firms' culture, governance and leadership in ensuring that firms take appropriate action to manage their risks of climate change and support the wider transition to net-zero emissions</p> <p>We want to ensure our regulatory framework promotes transparency and accountability around climate change issues; this work could consider wider senior management accountability for stewardship</p> <p>Our proposed new rules for IGCs will also be an important addition to the governance of stewardship in workplace personal pension schemes</p>
	<b>Disclosure and transparency of stewardship activities and outcomes</b>	<p><b>Stewardship and sustainability disclosures</b></p> <p>We will continue to engage with the FRC as it implements its proposed activities and outcomes reporting under the UK Stewardship Code 2020</p> <p>We will continue to engage with firms on stewardship as part of our supervisory work</p> <p>We will consider how best to enhance climate change disclosures by regulated firms, such as asset managers and life insurers; the approach we take will need to be coordinated with and informed by other ongoing initiatives</p> <p>We will challenge firms where we see evidence of potential greenwashing, clarify our expectations, carry out further policy analysis and take further actions as appropriate</p>

## A clear purpose

- 4.7** We consider that a clear purpose is a key ingredient of effective stewardship. A clearly communicated purpose can set the tone for mutually supportive stewardship activities across the institutional investment community. A clear purpose would reflect asset owners' and beneficiaries' investment and stewardship objectives.
- 4.8** Under the UK Stewardship Code 2020, signatories will have to establish an organisational purpose, strategy, values and culture that supports their stewardship objectives. Their stewardship objectives should enable them to fulfil their obligations to their clients or beneficiaries.
- 4.9** We learned from stakeholders that firms may not always communicate a clear purpose. This can potentially happen due to the following issues, as identified in Figure 2:
- asset owners' investment and stewardship objectives may not be fully aligned with beneficiaries' preferences (Barrier 1 in Figure 1)
  - investment mandates, voting guidelines and other arrangements between asset owners and asset managers may not be fully aligned with asset owners' and beneficiaries' investment objectives (Barrier 3)
  - investment consultants may not adequately support investors' stewardship (Barrier 8).
- 4.10** We will look further at the arrangements between asset owners and asset managers and how these support effective stewardship, taking the following actions.

## An industry workshop

- 4.11** As a first step, in the first quarter of 2020, working with other regulators with an interest in this area, we will hold a workshop on setting a clear purpose for stewardship.

We will bring together representatives from across the institutional investment community to consider how asset owners set and communicate their stewardship objectives, and how well these are adopted by asset managers and service providers.

- 4.12** Reflecting other concerns raised, we will also use this as an opportunity to gather initial input on how best to extend the scope of our current rules on stewardship and shareholder engagement to SIPP operators. Depending on the inputs received, we would expect to consult on rule changes later in 2020.

### **Investment mandates**

- 4.13** We will engage with ongoing industry work in this area, led by the IA. This work is considering how to promote an appropriate long-term perspective in investment mandates and in asset owners' other arrangements with asset managers.

- 4.14** The objective of the IA's work is to consider the governance of the relationship between asset owners and asset managers and the incentives established by contractual and other arrangements. The work aims to provide guidance on how to inject a long-term focus in these arrangements, including:

- at the point that an asset manager is selected and appointed
- through the contractual basis established in the investment mandate
- on an ongoing basis in monitoring, due diligence and performance evaluation arrangements

- 4.15** The IA is planning to establish a cross-industry steering group to oversee this work.

### **Investment consultants**

- 4.16** We note some stakeholders' concerns about how well investment consultants support stewardship in the advice they give asset owners.

- 4.17** Following its market investigation in 2018, the CMA recommended that investment consultants be brought under FCA regulation. The Treasury is considering this recommendation and will consult in due course. Pending the outcome of this consultation, we will consider the issue of stewardship as part of our work with the Treasury to design an appropriate regulatory regime for investment consultants.

## **Constructive oversight, engagement and challenge**

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### **Regulatory issues**

- 4.18** Some stakeholders identified regulatory uncertainty as an obstacle to individual and collective engagement with investee companies (Barrier 5). They were particularly concerned about a lack of clarity on how MAR and competition rules apply. We note these concerns and have engaged with many stakeholders about them.

- 4.19** We consider constructive engagement with issuers to be an important vehicle for asset owners and asset managers to exercise effective stewardship. We have said previously that we think investors can comply fully with MAR and competition law while



engaging individually and collectively with issuers, as long as they consider how to do this carefully, and adjust their approach if needed.

**4.20** We note, for example, the detailed work that the Investor Forum has done to develop its Collective Engagement Framework. The Investor Forum has just launched a revision of its Framework, which aims to provide a 'safe and secure environment' in which its members can conduct collective engagement.

**4.21** We will continue to work with industry to identify areas of concern and provide clarity so that issuers and investors can engage effectively within the bounds of the regulation. In relation to MAR, we are happy to discuss specific examples of problems that investors or issuers have found and will consider if it is appropriate to provide further guidance.

### **Issuers' disclosures**

**4.22** The coverage, quality and consistency of information on ESG and other long-term factors in securities issuers' disclosures have also been identified as potential barriers to effective stewardship (Barrier 6).

**4.23** Some respondents said that the flow of information to investors could be improved by applying standardised disclosure and reporting frameworks. This would clarify what information was required and reduce the volume of ad hoc information requests from investors. We received similar feedback to our DP18/8 on climate change and green finance.

**4.24** We announced in FS19/6 that we will consult in early 2020 on proposals to introduce new rules requiring certain listed issuers to make climate-related disclosures aligned with the TCFD's recommendations. We will propose that these rules be introduced, at least initially, on a 'comply or explain' basis. This recognises the challenges that such disclosures may pose for some issuers. This will be a first step to improving information flow from investee companies on long-term factors, while also providing issuers with clarity about our expectations.

**4.25** We will also clarify our view that existing disclosure obligations already capture the reporting of the implications of climate change for a business where these are financially material to the company's prospects.

**4.26** Looking ahead, we will continue to consider whether issuer disclosures on other sustainability factors, beyond climate change, are adequate to support investors' business, risk and investment decisions. As frameworks emerge for such disclosures, there may be a need to take further actions to promote consistency and comparability.

### **Proxy advisors**

**4.27** A number of concerns were raised about proxy advisors' support for stewardship (Barrier 9). Some stakeholders voiced concerns about the quality of proxy advisors' research and voting advice, how they manage conflicts of interest, and how they support voting in accordance with investors' investment and stewardship objectives. Issuers and their advisors also pointed out what they saw as a lack of engagement by proxy advisors with issuers.

- 4.28** New Regulations for proxy advisors were introduced in June 2019, aligned with the measures in SRD II. The Regulations introduce a number of disclosure requirements, spanning conflicts management policies, research methods, voting policies and staffing, as well as any adherence to a voluntary Code of Conduct.
- 4.29** These Regulations give us a limited role in overseeing how far proxy advisors are meeting these disclosure requirements. Under the Regulations, proxy advisors must notify us that they are operating in the market by 1 April 2020. Proxy advisors have also recently launched a new Code of Conduct through the Best Practice Principles Group and the FRC has introduced Principles for Service Providers Code as part of the UK Stewardship Code 2020.
- 4.30** The new Regulations do not directly address some of the issues raised by respondents. However, we expect that the new regime will provide some additional transparency to the market. We will consider outcomes as the new regulatory regime for proxy advisors beds in.

### **ESG data providers**

- 4.31** Stakeholders have highlighted that specialist data service providers play an important role in collating, assessing and providing ESG metrics, ratings and indices but raised concerns around the transparency of the methodologies used by some of these providers to produce their metrics and ratings (Barrier 10).
- 4.32** This will be another future area of focus. As a first step, we are looking at the nature and quality of the services that data providers offer, how investors use these and how much they rely on them. As far as we have a role to play in this area, we will consider our next steps based on the outcome of this factfinding work.

### **Intermediated securities**

- 4.33** Respondents also identified the role of nominee companies as a barrier to stewardship by retail investors (Barrier 7). For example, there have been questions about how retail shareholders can exercise their rights where they have a direct investment and hold shares on the share register via a nominee company.
- 4.34** BEIS has asked the Law Commission to produce a scoping study. This will provide an accessible account of the law and identify issues in the current system of intermediation of securities. As part of this process the Law Commission has published a call for evidence. This runs until 5 November 2019. We will support the Law Commission's scoping study, providing input on the implications of holding securities via nominees for the exercise of shareholder rights.

## **Culture and institutional structures that support effective stewardship**

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- 4.35** Some stakeholders also raised a concern about whether firms' governance arrangements adequately support stewardship (Barrier 4). In FS19/6, we noted that we will consider further the role of firms' culture, governance and leadership in ensuring that firms take appropriate action to manage their risks of climate change and support the wider transition to net-zero emissions.

**4.36** We want to ensure our regulatory framework promotes transparency and accountability around climate change issues. This work could consider wider senior management accountability for stewardship. We note that signatories to the UK Stewardship Code 2020 will have to disclose their governance structures and accountability for stewardship.

**4.37** Our proposed new rules for IGCs will also be an important addition to the governance of stewardship in workplace personal pension schemes, by providing a vehicle for independent oversight of providers' stewardship arrangements. The proposed new arrangements will supplement institutional structures that support effective stewardship, by creating an additional level of scrutiny on behalf of beneficiaries.

## Disclosure and transparency of stewardship activities and outcomes

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**4.38** We heard that firms' disclosures may not provide enough information on outcomes of stewardship to be able to demonstrate the value of their activities. Respondents said this may make it difficult for asset owners to identify asset managers that offer a service aligned with their requirements. If disclosures do not adequately distinguish between firms' stewardship outcomes, market discipline may be weaker (Barrier 2).

**4.39** Since we published DP19/1, we have introduced new rules for life insurers and asset managers that implement relevant provisions of SRD II. These rules require these firms, among other things, to disclose their shareholder engagement policies and how the main elements of their investment strategies contribute to long-term performance of their assets (or explain why they have chosen not to do so). Our proposed rule changes for IGCs also require reporting on the adequacy and quality of workplace personal pension providers' ESG and stewardship policies.

**4.40** We will pursue a number of actions to promote further improvements in the disclosure of firms' stewardship practices and outcomes.

- *UK Stewardship Code 2020.* The FRC has made improvements to signatories' reporting under the UK Stewardship Code 2020. These include activities and outcomes reporting. We will work closely with the FRC as it introduces these new reporting expectations and the assessment methodology to support its oversight of signatories' reports.
- *Supervision.* We will also continue to engage with firms on stewardship as part of our supervisory work. As part of this, we may consider evidence from firms' disclosures under our rules on shareholder engagement and their reporting under the UK Stewardship Code 2020.

**4.41** We will take further actions, announced in FS19/6, to support clients and beneficiaries in their assessments of whether firms' operations and their products and services meet their sustainability objectives:

- *Regulated firms' climate change disclosures.* Building on our work on climate change-related disclosures by certain listed issuers, we will consider how best to enhance climate change disclosures by regulated firms, such as asset managers and life insurers. The approach we take will need to be coordinated with and informed by other ongoing initiatives. These include the work of a cross-regulator taskforce established under the Government's Green Finance Strategy to examine the

most effective way to implement TCFD-aligned disclosures, and the Climate Financial Risk Forum we established with the PRA earlier this year. We consider that improvements to issuers' disclosures, as discussed above, are an important foundation for further measures to improve climate-related disclosures by regulated firms.

- *Expectations around green financial products and services.* We will do further work to promote consumers' access to genuinely green products and services, including to:
  - challenge firms where we see potential evidence of greenwashing, clarify our expectations, and take appropriate actions to prevent consumers being misled
  - carry out further policy analysis on greenwashing and act (e.g. publish new guidance) to address concerns, if appropriate
  - engage in relevant ongoing EU initiatives, particularly around common standards and product disclosures

## Annex 1

### Questions from DP19/1

- Q1:** Do you agree with the definition of stewardship set out here? If not, what alternative definition would you suggest?
- Q2:** Are there any particular areas which you consider that investors' effective stewardship should focus on to help improve outcomes for the benefit of beneficiaries, the economy and society (e.g. ESG outcomes, innovative R&D, sustainability in operations, executive pay)?
- Q3:** To what extent do the proposed key attributes capture what constitutes effective stewardship? Which attributes do you consider to be most important? Are there other attributes that we should consider? If so, please describe.
- Q4:** What do you think is the appropriate institutional, geographical and asset class scope of stewardship? How can challenges associated with issues such as the coordination of stewardship activities across asset classes, or the exercise of effective stewardship across borders, be overcome?
- Q5:** We welcome examples of how firms with different objectives and investment strategies approach stewardship. In particular, we welcome input on how stewardship practices differ across active and index-tracker funds, in the following areas:
- i:** how firms prioritise and conduct stewardship engagements
  - ii:** what investments firms have made in stewardship resources
  - ii:** how stewardship activity is integrated with investment decisions.
- Q6:** To what extent do you agree with the key barriers to achieving effective stewardship identified in this DP? What do you believe are the most significant challenges in achieving effective stewardship? We would particularly welcome views on the investment required to embed effective stewardship in investment decision-making.

- Q7:** To what extent do you consider that the proposed balance between regulatory rules and the Stewardship Code will raise stewardship standards and encourage a market for effective stewardship?
- Q8:** To what extent are there are issues with proxy advisers that are not adequately addressed by SRD II and proposed revisions to the Stewardship Code?
- Q9:** We welcome feedback on other specific aspects of the regulatory framework described above. In particular, we are interested in views on:
- i:** Whether and to what extent the FCA's proposed rules for asset owners should be extended to SIPP operators?
  - ii:** The case for regulatory rules to expand the reach of stewardship beyond listed equity
  - iii:** Whether there is a role for UK regulators in encouraging overseas investors to engage in stewardship for their asset holdings in the UK
  - iv:** The extent to which additional rules might be necessary either to improve stewardship quality or prevent behaviours that might not be conducive to effective stewardship
  - v:** For differences between active and index-tracker strategies in the practice of stewardship, whether there are particular regulatory actions we should consider to address any perceived harms.
  - vi:** Whether the FCA's proposed rules to implement certain provisions of SRD II should apply on a mandatory, rather than 'comply or explain', basis.
- Q10:** We welcome feedback on whether, to support effective stewardship, we should consider amendments to other aspects of the regulatory framework that affect how investors and issuers interact (such as the LRs, PRs and DTRs)?

## Annex 2

# List of non-confidential respondents

A J Bell

Alex Edmans

Allianz GI

Anna Tilba

Association of Financial Mutuals (AFM)

Association of Investment Companies

Association of Pension Lawyers (APL)

Australian Institute of Performance Studies (AIPS)

Blackrock

Brunel Pension Partnership

BVCA

Castlefield Investment Partners

Certified Financial Analyst Society (CFA)

Charles Stanley

Client Earth

City of London Law Society (CLLS)

Ernst and Young

Financial Services Consumer Panel

GC100

Green Finance Initiative (City of London)

Hermes

Institute of Chartered Secretaries Association (ICSA)

Institution of Occupational Safety and Health (IOSH)

Institutional Shareholder Services

International Corporate Governance Network (ICGN)

Invesco

Investment Association (IA)

Investor Forum

International Property Securities Exchange (IPSX)

Iris Chui

Cass Business School

Listings Authority Advisory Panel

Lane Clark and Peacock

M&G Prudential

New City Initiative

Pensions and Lifetime Savings Association (PLSA)

Personal Investment Management and Financial Advice Association (PIMFA)

Principles for Responsible Investment (PRI)

Price Waterhouse and Coopers (PWC)

Quoted Companies Alliance (QCA)

RPMI Railpen

Securities Industry and Financial Markets Association (SIFMA)

Share Society and UK Shareholder's Association (UKSA)

ShareAction

Small Business Practitioner Panel (SBPP)

Vanguard

Vigeo Eiris



## Annex 3

### Abbreviations used in this paper

<b>CMA</b>	Competition and Markets Authority
<b>COBS</b>	Conduct of Business Sourcebook. The section of the FCA's Handbook that deals with business standards.
<b>CP</b>	Consultation Paper
<b>DP</b>	Discussion Paper
<b>DWP</b>	Department for Work and Pensions
<b>ESG</b>	Environmental, Social and Governance
<b>FCA</b>	Financial Conduct Authority
<b>FRC</b>	Financial Reporting Council
<b>FS</b>	Feedback Statement
<b>IA</b>	Investment Association
<b>IGCs</b>	Independent Governance Committees
<b>MAR</b>	Market Abuse Regulation
<b>SIPP</b>	Self-Invested Personal Pension scheme
<b>SRD II</b>	Shareholder Rights Directive
<b>TCFD</b>	Taskforce on Climate-related Financial Disclosures
<b>tPR</b>	The Pensions Regulator

We have developed this Feedback Statement in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

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