Signing up for stewardship

Financial Reporting Council (FRC) head of stewardship, Claudia Chapman, speaks to Jack Gray about the organisation's UK Stewardship Code and why it is important for pension schemes to sign up

Can you please give a brief overview of the code?
It's a set of best practice principles about the way in which those who look after the assets in their care undertake their responsibilities and how they do that. Those that are captured by the code or choose to sign the code are quite a varied bunch; you have the likes of small local government authority pension funds, and you have big insurers and multi-trillion pound global index-linked investors. What's great about the code is that everyone is brought together under those common set of principles. When we redid the code, we were thinking about how to connect it to the end user, being a UK pension saver. Everyone who is fulfilling those principles should be thinking about that stakeholder as the ultimate beneficiary of the code. We introduced some principles around purpose and governance because we think that is central to effective stewardship. That underpins the ways in which you integrate stewardship, investment and ESG factors, the way you undertake your engagement and escalation, and how you exercise your rights and responsibilities. You need a conscious decision around resourcing, purpose and governance to be able to fulfil those things. We've moved away from those policy statements we had 12 years ago when the code was first introduced.

How did you find a stringency balance within the code?
I think it works because it is principles based and regulation lends itself better to that. We try to be proportionate; essentially everybody has to do the same thing, but the resourcing put into it or the extent to which they achieve that can be different. It works broadly for most applicants. Putting reporting expectations in for asset classes other than listed equity and fixed income, now everybody's got used to that idea, people are going 'what do you expect from us in real estate where we own the assets?' or 'what is expected of private equity investments?'. Where we go next is to start to put more of a framework around what is expected in other asset classes other than listed equity and fixed income.

Why is it important for pension schemes to become signatories?
Its important for pension funds to be demonstrating what they are doing on behalf of their members/beneficiaries and how they are being responsible investors. Its not about prescribing a value-based approach necessarily, or having some altruistic reason for investing their money, but being very clear about what they are doing to look after those assets and how they are going to fulfil their responsibility to pay their pensions. Increasingly, members might not just be satisfied with the money, but they'd also say: 'What is the side effect of that investment?' The profile of people's members' views and expectations is changing.

How does one become a successful applicant?
We ask them to apply the principles, but they have to demonstrate their application of the principles by evidencing how they have applied them. They do that through responding to several reporting expectations. What we are looking for from pension funds, particularly if they are investing indirectly, is much more emphasis on how they are selecting those third parties as their agents, how they are holding their agents to account and what those agents are doing on their behalf. A lot of the evidence may not be evidence of direct engagement between the pension

fund and their holdings, but of how your asset manager demonstrated what they have done to invest on your behalf or how have they engaged, escalated or exercised rights with your assets. One of the shifts I observed is that the code has almost given greater levels of permission or a wake-up call to say that we are expecting asset owners to have these conversations and it's ok for you to ask your investment consultant and manager about this stuff. You are not a passenger in this, they are your assets and your members' assets. It shouldn't just be that they are advising on the investment and the return, it should be connected and integrated to the role of stewardship in maintaining the value of that asset.

Why might some applications be unsuccessful?

Currently, we are not making a judgement on people's choices of stewardship activity. For example, we ask that people integrate material ESG, we are not saying that they must have a particular ethical stance or a particular impact perspective, so we are just asking them to demonstrate what it is they consider. If someone has been unsuccessful, they haven't sufficiently demonstrated their application of the principles. For example, they haven't effectively provided enough evidence of how they select their asset managers, how they hold to account the third parties they work with, they haven't demonstrated what others are doing on their behalf with their assets, or they have not perhaps been clear. There are a few principles that people don't tend to do well across the board. That's conflicts of interest, and talking about how they review policies, procedures and processes, and who provides assurance on those. Perhaps they are not having those discussions at a high enough level in the organisation and reflecting on what they can do differently, and perhaps not being clear about how they set expectations of others that operate on their behalf.

How well have applicants generally been performing?

We've had some reapplications this time and people have taken on board our feedback quite well, and in many instances they will have done a wholesale review of what they submitted previously and produced a very different report, and taken what we said quite seriously and understood that. I do feel that people are engaging with the spirit of it, but I think there are areas across the board that we expect improvement in. What I've been particularly impressed with is, considering purpose and governance was a new inclusion in the code, people are doing quite well to explain their thinking about who they serve and why they are there. Pension funds do quite a good job of that. They tend to be able to describe their purpose quite well. Maybe you can say that, compared to a commercial organisation, there is usually a good clarity of purpose with a pension fund. Everybody in the room is probably clear what they are there to do, which can maybe differ if you are in the big engine of a multi-national business.

What are the FRC's future plans for the code?

We want to look at trying to align reporting where possible between us and the requirements of other regulators like the FCA, DWP and TPR. We also want to look at the usefulness of reporting. We are going to do a project with asset owners and investment consultants to understand how they use the stewardship reporting of asset managers, and what is useful and what is not useful, what they want more of and what they want less of, so that can feed into any future changes of the code when we do a review in 2023.

We are doing quite a lot of work with the Occupational Pension Scheme Council. I think that is a really useful output of the recommendations from the *Investing with Purpose* report that the Treasury did, and that seems to be providing quite a useful network for pension funds to get involved in. We would like to have more master trusts on board because the liability lies with the individual saver, and because we think there is a little bit more work for master trusts to do in terms of their responsible investment policies.

Written by Jack Gray