PENSIONS AND LIFETIME SAVINGS ASSOCIATION

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PLSA Consultation response: FRC UK Stewardship Code Consultation

We welcome the opportunity to respond to the FRC's consultation on the UK Stewardship Code. The Pensions and Lifetime Savings Association (PLSA) is the voice of workplace pensions and savings. We represent pension schemes that together provide a retirement income to more than 30 million savers in the UK and invest more than £1.3 trillion in the UK and abroad. Our members also include asset managers, consultants, law firms, fintechs, and others who play an influential role in people's financial futures. We aim to help everyone achieve a better income in retirement.

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Summary

Throughout the last year, the PLSA and our members have engaged extensively with the FRC on its proposals for the revised Stewardship Code. We are grateful to the FRC for the opportunities to engage and the openness with which proposals have been communicated and our concerns listened to. We hope this will continue as the consultation responses are considered and the new Code is subsequently implemented.

At an overarching level, we remain concerned with the direction of travel in relation to the shareholder rights of UK investors. We acknowledge and accept that the Government is increasingly looking for the regulators to play an active role in stimulating growth. But as we have stated before, notably in our response[1] to the FCA Primary Markets Effectiveness Review, Consultation Paper 23/31, we do not see economic growth and effective stewardship as mutually exclusive. It is vital that robust stewardship standards are maintained. Our response to the FCA made clear that we feel diluting effective corporate governance and stewardship standards does not guarantee growth and could actually inhibit it.

Before we provide specific answers to the consultation questions, there are a number of key points that we would like to make:

[1] PLSA, 2024, PLSA Consultation response: Primary Markets Effectiveness Review: Feedback to CP23/10 and detailed proposals for listing rules reforms, https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2024/Consultation-Paper-CP23-31-Primary-Markets-Effectiveness-Review-Mar-2024.pdf

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1. The Stewardship Code is a voluntary code. Signatories do not need to adhere to it, but they do in recognition of the importance of effective stewardship. Signatories to the Stewardship Code recognise the vital importance of the role of investors in being able to hold companies to account. For that reason, our response focuses on how the Stewardship Code must continue to be a beacon of best practice.
2. From an asset owner perspective, the 2020 Stewardship Code results in what are the most useful firm-level stewardship reports both as users and preparers. It is vital that comparability between firms is retained.
3. At face value, we welcome the proposals to combine principles to streamline reporting requirements, however it should be noted that our members perceive the change in reporting frequencies and removal of the standalone principle of escalation as indicative of a shift in the balance of power between asset owners and company management. It is vital that steps to reduce the reporting burden do not impact the robustness of the Code.
4. It should be noted that all regulatory changes take time to bed in. Whilst we acknowledge that conducting this review five years after the last is reasonable, our members have raised concerns that the Stewardship Code underwent significant changes in 2020. It is likely that only now will we be seeing signatories fully incorporating those developments in their daily practice. Care should therefore be taken in introducing further significant changes.
5. The accompanying guidance is vital and must be consulted on. Asset owners must be prioritised in this consultation process.

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Question 1: Do you support the revised definition of stewardship?

PLSA response

The revised definition of Stewardship proposed by the FRC is the area that has generated the greatest strength of feeling among our membership. The new definition is notable in its omission of specific references to ‘environment’ and ‘society’. In its place, the FRC has opted to refer to the creation of ‘long term sustainable value’.

It is important to outline that we have heard, and understand, the FRC’s rationale behind this change. The idea being that the new definition is sufficiently broad that it does not prevent code signatories from considering issues such as the environment or society. Whilst we understand this, we do not agree with the approach. As outlined up front in our response, the Stewardship Code is voluntary, and signatories should sign up to it in recognition that it represents the beacon of best practice when it comes to effective stewardship practices.

The new Government has made its commitment to the green transition clear with announcements at the Chancellor’s Mansion House Speech[2] setting out a clear plan for delivering the foundations of a world-leading sustainable finance framework. In addition,

[2] HM Treasury, Collection – Mansion House 2024, 2024, https://www.gov.uk/government/collections/mansion-house-2024

the work of the Department for Work and Pensions Independent Taskforce on Social Factors[3] last year shone a light on the importance of assessing social risks and opportunities in investments.

Whilst the new definition does indeed provide the scope to consider issues such as environment and society, the view of our members is that this change risks a dilution in standards at a time where consideration to the environment and society is front of mind for the Government and must also be front of mind for investee companies. The significant risk posed by climate change remains and is arguably more pressing than ever. Given our concerns, we do believe the proposed definition should be revised. The PLSA has engaged across the industry and our membership to consider what an appropriate alternative could be that strikes the right balance. This proposal for an alternative definition is supported by UKSIF and a number of the PLSA's members.

> ***Proposed alternative:***
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> *"Stewardship is the responsible allocation, management and oversight of capital, having regard to dependencies and impacts on the economy, the environment and society, to create long-term sustainable value for clients and beneficiaries".*

This definition represents a relatively small tweak to the proposed definition that the FRC has consulted on. Notably, it includes direct references to 'society' and the 'environment' which had been removed from the proposed definition. Some of the language here would mirror the UK Companies Act (whereby directors are required to conduct their duties having regard to the impact of the company's operations on the community and the environment) and recognise the importance of investor stewardship activities – as appropriate – and considering sustainability-related impacts and dependencies.

We think these changes are vitally important, but our members also have concerns with the way that the term 'sustainable value' could be interpreted within the new definition. Whether changes to the definition are accepted, or not, action should be taken to provide clarity over the use of 'sustainable value' in the definition. FRC representatives have stated that the definition of sustainable value has been left open to interpretation by signatories to allow them to reflect their specific investment objectives and strategies. Whilst we accept that the definition does allow for consideration of issues, like the environment and society, our concern is the fact that because 'sustainable value' is not clearly defined, it could lead to varied interpretations and potential greenwashing.

If this term is to remain in the revised definition, we would urge the FRC to ensure that each signatory outlines the definition of sustainable value that they are adhering to, this will be vital to ensure transparency and accountability. In addition, supporting guidance that gives strong steers to demonstrating climate change actions will be crucial if we are to maintain effective standards of stewardship.

[3] Department for Work and Pensions, Independent Taskforce on Social Factors, 2024, https://www.gov.uk/government/publications/considering-social-factors-in-pension-scheme-investments-a-guide-from-the-taskforce-on-social-factors

We would urge the FRC to recognise the strong views of the industry and note our collaborative efforts to identify a definition which builds on the proposed FRC position but also retains references to society and the environment.

Combined response to question 2 (Do you support the proposed approach to have disclosures related to policies and contextual information reported less frequently than annually? If yes, do you support the approach set out above?) and question 3 (Do you agree that the Code should offer 'how to report' prompts, supported by further guidance?)

PLSA response

Our members welcome the efforts of the FRC to reduce reporting requirements whilst seeking to uphold the rigor and timeliness of stewardship reporting. However, we do have a couple of concerns:

- The proposal for less frequent reporting on policy (every three years) could well go too far in reducing the rigor and timeliness of stewardship reporting. Our concerns are primarily that the additional flexibility that signatories have to determine what is or is not a fundamental or significant change could well be misused.
- There is also a risk of an increased variance in reporting standards because of the increased flexibility for signatories. Increased variance in both the quality and content of stewardship reports, will make it harder to compare and assess them. Comparability is a key feature for asset owners.
- The FRC have made clear that the intent of these changes is not to lower standards but to encourage more meaningful and tailored disclosures. 'How-to-report' prompts will be vital in ensuring a structured framework to ensure comparability. Guidance will offer examples and outline best practice to assist in the maintenance of high standards and to allow for reports to be assessed for consistency and quality.
- At present, it is not proposed that guidance will be consulted on. The issue around a lack of consultation on guidance is of significant concern to the PLSA and our members. We would expect responsible managers to consider and comply with guidance. However, almost all would also expect that they would have an ability to comment on what that guidance is. A failure to consult on accompanying guidance could result in practical challenges and a lack of industry buy-in which will have a detrimental impact on use of the guidance and, as a result, the quality of reporting.
    - In our engagement with the FRC, our concerns have been acknowledged, but it has been stated that this approach is designed to ensure flexibility and adaptability. The intent would be that guidance would be a living document that is regularly updated based on practical experience and feedback. We do not think this goes far enough.
    - We would call on the FRC to implement a process of consultation on any guidance that they develop. This can take many forms, possibly a written consultation process – as with the Code – it could also entail other means of

bringing leading industry practitioners together to input into the guidance. For example, a working group that ensures guidance is practical and effective.

Question 4: Do you agree that the updated Code for Asset Owners and Asset Managers should have some Principles that are applied only by those who manage assets directly, and some that are only applied by those who invest through external managers?

In having some principles that are applied only by those who manage assets directly and some that are only applied by those who invest through external managers, the intent of the FRC seems to be ensuring that the Code remains relevant and effective for different types of asset owners and managers. Our members are comfortable with this approach as a means to drive enhanced clarity, reduce reporting burdens and ensure the Code is more practical and beneficial for different asset owner and asset manager needs.

We would however urge the FRC to be mindful of the potential complexity that arises from having principles that apply differently to those managing assets vs those investing through external managers which could include:

- Inconsistencies in how stewardship activities are reported making it challenging to assess stewardship practices holistically.
- A reduced reporting burden being replaced by an increased resource allocation burden. Tailored principles may require specialised staff or systems to manage the compliance requirements. Additionally, it may lead to increased stakeholder communication needs as the rationale of specific stewardship practices will need to be effectively communicated.

Any support that the FRC can provide on how signatories might manage these potential challenges would be welcomed.

Question 7: Do the streamlined Principles capture relevant activities for effective stewardship for all signatories to the Code?

PLSA response

As outlined at the start of our response, the PLSA and our members are broadly supportive of the efforts of the FRC to streamline the Stewardship Code Principles to reduce the reporting requirements on signatories whilst also capturing key activities for stewardship reporting. We have however identified several areas of concern on which we would welcome further clarity from the FRC.

- **The removal of a standalone escalation principle.**
    - The FRC has proposed removing the standalone escalation principle and replacing it with a duty to focus on escalation, 'wherever necessary'.
    - In principle, we understand that the FRC's intent here is for escalation to be reported on under each relevant principle to facilitate a more holistic approach to the way in which escalation activities are reported.

    - If it is the case that escalation activities are reported under each relevant principle, this could well be an effective change, particularly given the FRC argument that the principle was largely redundant, unnecessarily burdensome and that this approach will provide greater flexibility.
    - Whilst we understand what the FRC hopes to be the intended outcome of this proposal, we are concerned that ‘wherever necessary’ provides too much flexibility and is too open to interpretation.
    - Rather than embedding reporting of escalation activities throughout reporting on all the Stewardship Code principles, the changes and the additional flexibility that they provide, could mean that some do not deem it necessary in important aspects of their stewardship reporting.
    - Our view is that a standalone principle in relation to the reporting of escalation activities is more impactful and we would urge the FRC to re-consider their approach here.
    - Whilst the sample guidance outlines how to develop effective case studies highlighting how signatories have escalated their engagement, we would also welcome case studies provided by the FRC that demonstrate the types of issues where they may expect escalation activity to occur.
- **The merging of principles of engagement and collaborative engagement.**
    - At face value, this change could well be viewed as effective streamlining.
    - However, we would offer a note of caution and flag that engagement is a vital component of stewardship activities.
    - By merging the principles of engagement and collaborative engagement, there is a perception that the importance of engagement has been diluted.
    - We would welcome further feedback from the FRC around the importance of engagement and the intent of these changes.
    - In addition, we feel there is also a need for better recognition of the influence of engagement. Sometimes, it is difficult to understand from Stewardship reporting what has been achieved through engagement. A specific ‘engagement outcomes’ section could be highly effective in allowing investors to clearly summarise the impact of their important engagement work.
- Impact on smaller institutions.
    - Although not directly related, we would urge the FRC to clarify the impact on smaller institutions. The threshold for reporting (10% of AUM) might imply that smaller institutions do not need to engage in stewardship activities, which could have unintended consequences.

Question 8: Should signatories be able to reference publicly available external information as part of their Stewardship Code reporting, recognising this means Stewardship Code reports will no longer operate as a standalone source of information?

PLSA response

As with other FRC proposals, we welcome measures aimed at reducing the reporting burden on Stewardship Code signatories. We support allowing signatories to reference publicly available external information as part of a wider package to reduce the reporting burden. These changes should also have a positive impact in ensuring effective stewardship reporting through reducing unnecessary duplication. It will allow signatories to leverage existing disclosures and manage their stewardship reporting more effectively from a content consistency and resource perspective.

We would expect that signatories will leverage information from a range of sources such as their annual reports, company sustainability or ESG reports, proxy statements, regulatory filings and press or public announcements. The FRC stated in the consultation document that any use of cross-referencing would be supported by a clear policy from the FRC on its appropriate use and we would welcome further detail on this as part of the FRC's response to the consultation feedback.

Question 9: Do you agree with the proposed schedule for implementation of the updated Code?

PLSA response

The proposed timeline for the implementation of the updated Stewardship Code is ambitious. We note the coming into force date of the new Code as 1st January 2026 and this prompts a few comments and questions where clarity would be welcomed:

- To allow sufficient time for signatories to get up to speed with the new Code ahead of its implementation in 2026, it is important that as much lead in time as possible is given. It is vital therefore that the updated Code is published as committed to in the first half of 2025. Our members are comfortable that this is a sufficient lead in time providing this occurs.
- A key concern with the speed of the rollout relates to the development and publication of guidance. We would expect guidance to be made available at the same time as the updated Code is published. It will be challenging to ensure guidance is developed, consulted on (as we deem necessary), and published within the first six months of 2025. Any further clarity that the FRC can provide on these timelines would be welcomed.
- Finally, can the FRC confirm that when the new Code is published and before it is implemented in January 2026, any application to be a new signatory would be subject to the 2026 Code?

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We have appreciated the extensive engagement on the Stewardship Code over the course of the last year and thank the FRC for the opportunity to respond to this consultation. We look forward to seeing the outcome of it and stand ready to support the FRC as the next iteration of the Code is finalised and implemented.

Kind regards,

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