

20 March 2019

Corporate Governance and Stewardship
Financial Reporting Council
8th Floor, 125 London Wall
London EC2Y 5AS

To the members of the Financial Reporting Council,

On behalf of FCLTGlobal, we would like to express our appreciation for the opportunity to provide comments on the Financial Reporting Council's *Proposed Revision to the UK Stewardship Code*. Please find below a short background on our organization and its research and several comments that we hope will assist in your consultation.

Background on FCLTGlobal and its research

FCLTGlobal is a not-for-profit organization that works to encourage a longer-term focus in business and investment decision-making by developing practical tools and approaches to support long-term behaviours across the investment value chain.

Started as the Focusing Capital on the Long Term initiative in 2013, our organization was founded in July 2016 by the CEOs of the Canada Pension Plan Investment Board and McKinsey & Company, together with BlackRock, The Dow Chemical Company, and Tata Sons. In addition to our Founders, today we involve 51 Members from across the investment value chain, including asset owners, asset managers and corporations. While we do not speak on behalf of our members, our Members are broadly committed to accomplishing long-term tangible actions to lengthen the timeframe of capital allocation decisions.

We work closely with our Member organizations to conduct research, including a thorough investigation of the predictors of long-term value creation. For institutional investors, this includes higher employee ownership of firm and greater portfolio manager retention. For corporates, it includes appropriate capital allocation, including higher fixed investment, greater board gender diversity, greater presence of long-term investors, and the absence of ESG controversies.

Also with our Members, we develop practical research and accessible tools to facilitate long-term behaviours, such as approaches for structuring long-term mandates between asset owners and asset managers, a framework to facilitate long-term investor-corporate dialogue, and strategies for building boards with long-term perspectives. We have also conducted extensive research into stewardship codes globally. Later this year, we will publish this research, including a tool that allows investors and regulators to easily compare these codes. We provide additional detail on this research in our comments, and the complete reports are available on our website at www.fcltglobal.org.

Comments on the Proposed Revision to the UK Stewardship Code

Overall, our comments on the drafting of the 2019 Code are centred on our view of the importance of clearly reinforcing the principle that investors take a long-term approach in their stewardship of their beneficiaries' assets. We will elaborate further on this below in comments on questions 4 and 7 specifically.

Regarding question 4, we recommend an explicit focus on the long-term implications for businesses and other stakeholders.

Regarding question 7, we support the focus on outcomes and effectiveness, not only on policy statements, consistent with the Kingman Review Recommendation 42. We share evidence from our research to support four of the proposed changes to the code.

Question 4. How could the Guidance best support the Principles and Provisions? What else should be included?

Considering stakeholder perspectives

Many respondents to the FRC's consultation favor introducing a duty for investors that matches Section 172 of the Companies Act for directors, including deliberate attention to the long-term consequences of their decisions.¹ FCLTGlobal's research emphasizes the value of considering the long-term responsibilities of all relevant stakeholders and focusing attention on long-term business implications. Incorporating language that addresses stakeholders' long-term responsibilities would make the guidance better support the principles and provisions. We are in the process of drafting Optimal Long-Term Ownership Principles, which will be published shortly on our website.

Q7. Do the proposed revisions to the Code and reporting requirements address the Kingman Review recommendations? Does the FRC require further powers to make the Code effective and, if so, what should those be?

As previously noted, Recommendation 42 in the Kingman Review articulates that stewardship should focus on outcomes and effectiveness, not on policy statements. Given this recommended focus, we seek to share evidence from our research that supports four specific proposed changes to the code: (i) asking signatories to establish an organizational purpose, strategy, values and culture that enable them to fulfil their stewardship objectives; (ii) integrating stewardship and investment approach; (iii) recognizing the importance of environmental, social, and governance issues; and (iv) ensuring alignment of incentives with investment strategy and stewardship.

¹ In which directors are required to consider: (i) the likely consequences of any decision in the long term; (ii) the interests of the company's employees; (iii) the need to foster the company's business relationships with suppliers, customers and others; (iv) the impact of the company's operations on the community and the environment; (v) the desirability of the company maintaining a reputation for high standards of business conduct; and (vi) the need to act fairly as between members of the company

Purpose, values and culture

We were encouraged to read that signatories will be asked to establish an organizational purpose, strategy, values and culture that enable them to fulfil their stewardship objectives.

In our work to identify and measure the predictors of long-term value creation; we spent the past year reviewing over 320 pieces of academic and investment research, consulting with over 120 experts, and analyzing approximately 20 million data points. This research highlighted the importance of long-term governance and culture as a positive predictor of greater long-term value creation for asset managers and asset owners alike.

Integration of stewardship and investment approach

We were similarly encouraged to read that the draft 2019 code sets higher standards for asset owners and asset managers regarding how they integrate their stewardship responsibilities into their investment processes, including investment decision-making, mandate design, and other activities. Likewise, we agree that asset owners have a central role to play in promoting effective stewardship practice, as well as in the selection, monitoring and evaluation of the performance of asset managers who act on their behalf.

In our white paper, [*Institutional Investment Mandates: Anchors for Long-Term Performance*](#), we note that “[a]ctive ownership or engagement with investee companies is important to many long-term investors. As part of the mandate process, owners can ask managers to detail their current practices for engaging with portfolio companies and for casting proxy votes. In doing so, they can ensure these policies are long-term in nature and match their own long-term goals.”

Recognizing the importance of environmental, social and governance (ESG) issues

We support the code’s expectation of signatories to consider material ESG factors’ impact on long-term returns when fulfilling their stewardship responsibilities. Lack of ESG controversies is a statistically significant predictor of cumulative five-year return on invested capital in our research.

Aligning incentives with investment strategy and stewardship objectives

We were encouraged that the code asks signatories to ensure how incentives align with investment strategy and stewardship objectives. Both academic research and our own analysis to identify and measure the predictors of long-term value creation for asset managers reflect the importance of alignment of interests. In addition, our white paper, [*Institutional Investment Mandates: Anchors for Long-Term Performance*](#) emphasizes the centrality of incorporating long-term incentives to guide asset owners and asset managers toward long-term objectives.

Homing in on proven predictors of long-term value creation

Rather than focusing on the voting and reporting provisions in the code, we have limited our comments to the components of stewardship that are predictive of higher long-term value creation, according to our research. We were encouraged by the degree to which respondents to the consultation incorporated long-term value creation into their responses.

We thank the FRC for providing FCLTGlobal with the opportunity to comment on the Proposed Revision to the UK Stewardship Code. We are keen to assist the FRC in honing its principles and guidance for stewardship in the United Kingdom, and are happy to answer any questions or provide further information at any time.

Sincerely,

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