AustralianSuper

UK Stewardship Code Review
Financial Reporting Council
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By email to: stewardshipcode@frc.org.uk

Dear UK Stewardship Code Review Team

UK Stewardship Code Consultation

AustralianSuper welcomes the opportunity to respond to the consultation on the UK Stewardship Code (the 'Code') being undertaken by the Financial Reporting Council (FRC).

Background to AustralianSuper

AustralianSuper is Australia's largest superannuation fund, with over 3.4 million members, and have more than A$356 billion (£184billion) in member assets under management. Our purpose is to help members achieve their best financial position in retirement.

Understanding the impact of environmental, social and governance (ESG) factors on long-term asset value is a material component in managing investment risk and opportunity. As such, consideration of ESG and stewardship issues is integral to our investment process. As a long-term owner, we understand that the quality of the corporate governance, sustainability and corporate social responsibility policies and practices of our assets influences their long-term value. Companies with good ESG management are likely to provide better long-term returns.

AustralianSuper invests in order to maximise the financial outcomes at retirement of AustralianSuper's beneficiaries. We are an active investor and steward on ESG issues, with the aim of creating better long-term financial outcomes for members. Stewardship involves exercising the rights and responsibilities as asset owners to seek positive management of ESG issues that we believe can impact members' investment returns. Our approach varies by asset class and investment characteristics, including whether we are investing directly or through external managers or whether our investment is actively or directly held.

We comment on the proposed changes to the UK Stewardship Code from the context of being a global asset owner and signatory to the Australian Asset Owner Stewardship Code, created in 2018 to increase transparency and accountability of stewardship activities in Australia.

In general, stewardship codes benefit institutional asset owners by improving transparency and accountability in the market, driving efficiency in capital allocation and allowing better management of ESG risks and opportunities in our portfolios. AustralianSuper therefore has an interest in ensuring the UK Stewardship Code maintains the high standards of stewardship that it has established.

AustralianSuper's view on the proposed changes to the UK Stewardship Code

The current UK Stewardship Code, introduced in 2020 following extensive consultation, has set a high standard and has influenced the development of stewardship codes globally. Any changes to the UK Code should be made with consideration of the influence these changes are likely to have in other markets. Investment stewardship practices continue to mature, and, under the influence of the Code, are evolving to optimise the realisation of long-term value. We consider that introducing significant changes to the Code at this stage risks undermining this development.

We are also concerned that the proposed changes to the Code represent a weakening of stewardship standards compared to the current 2020 Code. The primary purpose of the current Code is to set out 'more rigorous requirements for reporting, focusing on how stewardship activities deliver outcomes against objectives.'[1] This focus on outcomes is necessary to ensure that the Code most effectively meets the needs of asset owners to deliver for beneficiaries. We are concerned that the proposed change to the objective to 'provide transparency around the different approaches and activities that investors and their service providers undertake to steward assets in their care'[2] weakens obligations under the Code. This, in turn, reduces the effectiveness of the Code in assisting asset owners, including in how they understand and manage risks in the stewardship chain.

It is against this backdrop that we offer more detailed views on the suggested changes as set out the consultation:

The Origins of the UK Stewardship Code

It is worth reiterating why a code for stewardship came into existence and remains necessary today. The 1992 Cadbury Report[3] referenced the statement by the Institutional Shareholders' Committee on the Responsibilities of Institutional Shareholders in the UK. This was the first statement of responsibilities for UK shareholders and formed the basis for the first Stewardship Code released in July 2010. This followed recommendations in Sir David Walker's 2009 review of the corporate governance of banks and financial institutions after the global financial crisis of 2007-2008[4]. This report suggested the concept of codified investor stewardship under the auspices of the FRC amidst concerns about the role of shareholders, auditors and regulators in the performance and accountability of companies in the lead up to the financial crisis.[5] The view was that 'by acting as responsible stewards of capital, and by dealing with company underperformance, institutional investors (including asset owners and asset managers) can check and curb excessive risk-taking and short-termism behaviours.'[6] In addition, the Stewardship Code's origins in the original Cadbury Code of Corporate Governance also emphasises that 'stewardship codes are counterparts to corporate governance codes'.[7]

In his 2012 report into long termism in UK equity markets[8], Professor John Kay sought to put stewardship at the heart of investment management. The Kay Review stated that 'stewardship should be key to the equity investment chain' and recommended an 'extended concept of stewardship' requiring that 'the skills and knowledge of the asset manager be integrated with the supervisory role of those employed in corporate governance; it looks forward to an engagement which is most commonly positive and supportive, and not merely critical.'[9] Its first recommendation was that the UK Stewardship Code be 'developed to incorporate a more expansive form of stewardship, focussing on strategic issues as well as questions of corporate governance.'[10] This imagining of the Stewardship Code sought to establish high standards of stewardship, beyond transparency of stewardship activities alone.

[1] *'FRC strengthens Stewardship Code'*, FRC website, 30 January 2019
[2] *UK Stewardship Code Consultation*, FRC website, 11 November 2024
[3] *The Report of the Committee on the Financial Aspects of Corporate Governance*, 1 December 1992
[4] *The Walker Review - A review of corporate governance in UK banks and other financial industry entities – Final Recommendations*, November 2009
[5] *'Myners lashes out at landlord shareholders',* Financial Times, 21 April 2009
[6] *Stewardship 2.0: Awareness, Effectiveness, and Progression of Stewardship Codes in Asia Pacific*, CFA Institute, 2020
[7] Ibid.
[8] *The Kay Review of UK Equity Markets and Long-Term Decision Making - Final Report*, July 2012.
[9] Ibid.
[10] Ibid.

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At the time of the major revamp of the UK Stewardship Code in 2019, there was concern that the UK was losing its leadership in stewardship because codes in other markets were moving beyond the UK Code's recommendations and this had implications for the UK's ability to attract public companies and investment.[11] In addition, the 2018 Kingman Review noted that 'a fundamental shift in approach is needed to ensure that the revised Stewardship Code more clearly differentiates excellence in stewardship. It should focus on outcomes and effectiveness, not on policy statements.'[12] In 2019, the Financial Conduct Authority worked with industry and other regulators, including the FRC, to build a regulatory framework for 'effective stewardship'[13]. The benefits of effective stewardship would drive well-functioning markets, support market integrity - including in the effectiveness of capital allocation - and deliver good outcomes for consumers.

Across the period 1991 to 2019, 41 stewardship codes were implemented globally.[14] A major review of the effectiveness of stewardship codes by the CFA Institute in 2020[15] identified emerging trends across global stewardship codes, namely:

(i) Inclusion of sustainability and ESG factors
(ii) Coverage beyond listed equities
(iii) Explicit reference to service providers
(iv) Increased transparency and better reporting

Many jurisdictions have a similar Stewardship Code now in place. It signals the gold standard, not the minimum standard. Many asset owners and their representative bodies recognise this, including the Australian Council of Superannuation Investors, of which AustralianSuper is a founding member.[16] The Code is voluntary and adopts an 'apply and explain' system. Investors are not compelled to become signatories.

The Code has heightened the focus on stewardship internally within investing organisations. A robust stewardship framework tested with veracity through a regulatory body has many positive wider externalities to the market as a whole and to investing as a discipline.

Definition of Stewardship

AustralianSuper is not supportive of the proposed change to the definition of stewardship. The definition included in the 2020 Stewardship Code was fit for purpose and was widely consulted on at the time of its introduction.

The proposed new definition represents a reduction in clarity in the value focus and wider outcomes of stewardship activity. As noted above, investment stewardship practices continue to mature and evolve to optimise the realisation of long-term value and we consider that it is pre-emptive to introduce significant changes at this stage.

We are concerned that the insertion of 'sustainable value' has the potential to be interpreted in a wide manner, leading to inconsistency across the market on what a high standard of stewardship means. If 'sustainable value' is to be retained, the FRC should consider providing some guardrails around its interpretation to ensure consistency is preserved and expectations of Code signatories are made clear.

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[11] '*Beacon of British stewardship needs a brighter flame*', Financial Times, 27 January 2019
[12] *Independent Review of the Financial Reporting Council*, Sir John Kingman, December 2018
[13] *Building a regulatory framework for effective stewardship, Feedback Statement FS19/7*, Financial Conduct Authority, October 2019
[14] *The Global Diffusion of Stewardship Codes*, Dionysia Katelouzou and Mathias Siems, European Corporate Governance Institute, June 2020
[15] *Stewardship 2.0: Awareness, Effectiveness, and Progression of Stewardship Codes in Asia Pacific*, CFA Institute
[16] '*Stewardship code gains supporters*', Financial Times, 26 September 2010

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Removal of reference to material ESG risks and opportunities, climate and social factors

The 2020 Stewardship Code notes in its preamble that:

Environmental, particularly climate change, and social factors, in addition to governance, have become material issues for investors to consider when making investment decisions and undertaking stewardship.

One of the many ways in which the 2020 Code sought to enhance and uplift stewardship practices was the inclusion of the consideration of ESG factors. Therefore, it is concerning that the proposed new Code does not reference ESG, climate, environmental or social factors at all. This could be considered as a weakening of the purpose and role of stewardship and counteracts one of the main proposed changes brought in through the 2020 Code, namely recognising the importance of ESG factors to delivering long-term value.

Another major area of improvement enacted through the 2020 Stewardship Code was Principle 1 on purpose, values and culture within investing institutions. It is concerning that this has been reduced to reporting requirements on the investing organisation, its clients and its investment beliefs. This area should have a related Principle to elevate the importance of culture and values within investing organisations in the enactment of stewardship.

Removal of Principles on Collaboration and Escalation

It is significant that the new Code would remove explicit principles on 'Collaboration' and 'Escalation' and that these will be reported under the retained Principle on 'Engagement'. At the very least, we suggest that the new Principle 3 be named 'Stewardship Activities' as stewardship is not just engagement, it is exercising the full spectrum the rights and responsibilities that flow to providers of capital.

Without individual Principles on escalation and collaboration and their demotion to 'How to report' prompts, there is a risk that the Code is seen to promote a basic level of stewardship. This would not meet the needs and expectations of a voluntary Code that sets out high standards of stewardship.

One standalone Stewardship Code report

We note that a possible consequence of signatories being able to reference publicly available information as part of their Stewardship Code reporting is that it may lead to Stewardship Code reports no longer operating as a standalone source of information. There have been tangible benefits to asset owners through the standalone Stewardship Code report that is subject to a robust assessment process by the FRC, with this process being independently verified to 'ensure consistency, fairness, integrity and rigour'.[17] In addition, it would be more appropriate that the UK Stewardship Code report remains the definitive document to which other reporting and external information can reference, not the other way around.

Consultation on guidance

It is noted that the FRC proposes to launch guidance for the entirety of the revised Code. Given this guidance will shape how and what Code signatories report, this should be consulted on.

We trust our feedback is helpful. We would be pleased to provide additional information or to discuss our feedback in further detail.

[17] *UK Stewardship Code 2020 Application and Assessment*, FRC, March 2021

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Yours sincerely

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