HIGH PAY CENTRE

High Pay Centre Stewardship Code consultation

About the High Pay Centre: The High Pay Centre (HPC) is a think tank focused on economic equality, worker voice and responsible business practice. We publish research and analysis, make policy recommendations, issue good practice guidance and host events. We work with stakeholders from across business, the investment industry, government, academia, trade unions and civil society to identify pathways to a fairer, more democratic, prosperous business and employment culture aligned with the interests of wider society.

Given the critical role of the investment industry overseeing the practices of their investee companies, they are critical socio-economic actors with enormous influence over our lives as workers, citizens and consumers. Therefore, we take a keen interest in policy and practice relating to the industry, particularly its stewardship practices.

Recent HPC publications include our Charter for Fair Pay making recommendations in relation to investor accountability to beneficiaries, and guidance for asset managers and asset owners on how they can engage with investee companies over issues including executive pay, employment practices and worker voice at boardroom level. For more information visit https://highpaycentre.org

Consultation response

Q1. Do you support the revised definition of stewardship?

We do not support the proposal to remove the direct reference to benefits for the economy, environment and society. The removal of this clause implies that good stewardship may lead to neutral or negative economic, environmental or social outcomes, potentially encouraging practices that have this effect. We believe that the code should continue to emphasise the responsibility of signatories to wider society, encouraging socially, economically and environmentally responsible behaviour.

As a regulator with a public service function, the remit of the Financial Reporting Council (FRC) should be to ensure outcomes that are in the public interest. To publish a code of practice that only “may” produce beneficial outcomes for the economy, environment and society seems at best pointless for a public service institution, and at worse actively perverse.

It is important to keep in mind that a definition based on the socio-economic and environmental impact of stewardship does not mean that every stewardship activity needs to save a kitten. Generating a return for a beneficiary represents a positive socio-economic outcome. If there is not a corresponding negative effect of greater value, then the activity can be said to have fulfilled the original definition of stewardship, prior to the diluting of the association with economic, environmental and social benefits. In cases where there would be a net negative outcome, this is surely exactly the kind of practice that the Stewardship Code and the FRC itself exist to prevent.

It is valid to think that the Government should either prohibit or penalise socio-economically or environmentally harmful activities, and that the role of addressing them should not be outsourced to the investment industry. However, this argument ignores the realities of a fast-changing world where it is difficult for Governments to produce sufficiently timely, targeted and subtle policies to regulate economic actors into socially responsible activity with no unintended consequences. In the real world, mechanisms that direct these actors to behave in a generally responsible way encourage a business and investment culture aligned with the economic, environmental and societal interest. The previous definition of stewardship reflected this sensible, sophisticated and modern approach to regulation, and supported better outcomes in line with the public service remit of the FRC. The new definition, treating the wider economy, environment and society as an afterthought, will have the opposite effect.

Q7. Do the streamlined Principles capture relevant activities for effective stewardship for all signatories to the Code?

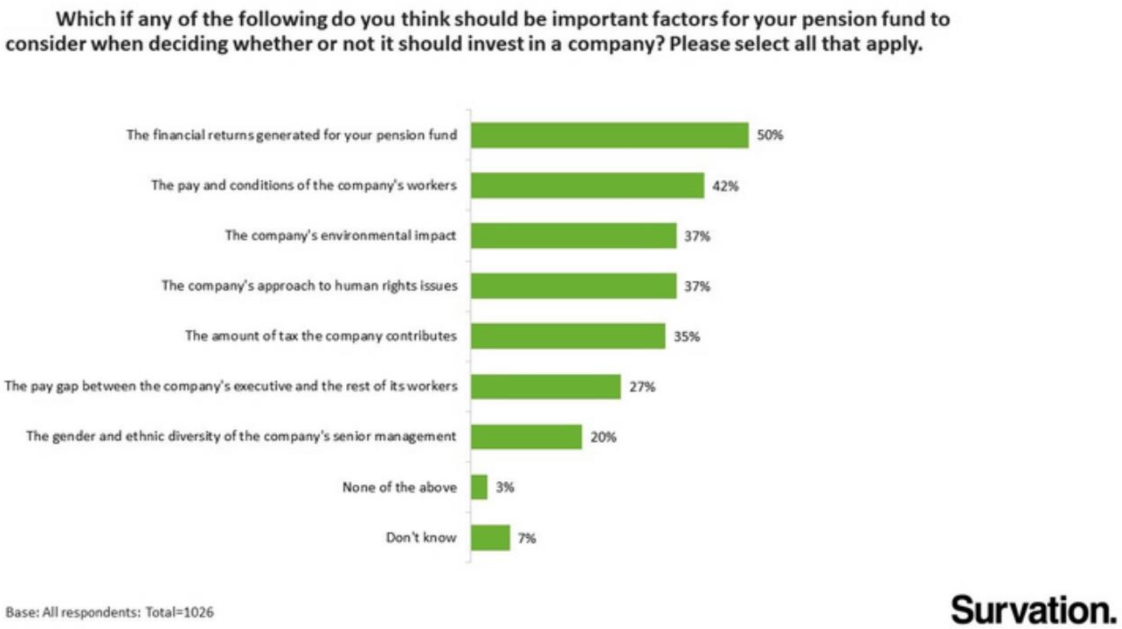
Principle E: The requirement to maintain dialogue with clients and beneficiaries outlined in Principle E is welcome, but should go further, emphasising the responsibility of asset owners to consider the holistic (ie non financial) interests of their beneficiaries and how these are affected by the asset owner's investment and stewardship practices, and to explain how they do so.

It is vitally important that asset owners understand and incorporate the views of their clients into investment and stewardship practices, and that asset owners incorporate the views of their beneficiaries. In the case of the latter group however, it is also important to be realistic about the level of financial literacy of ordinary savers, or their capacity to engage with and feed into the investment stewardship strategy of the fund charged with investing their savings. This is why investment intermediaries have a responsibility to act in the long-term interest of beneficiaries - this should not just be taken to mean the return generated by their investment.

Pension savers have to live in a world that is shaped by the companies and industries that they invest in. Achieving an adequate return on their investment is critical to their standard of living in later life - but so too are factors such as the prevailing labour standards of the day; the tax contribution of major corporations; environmental change; or societal inequality. Therefore, pension funds need to consider the potential of their investment and stewardship activities to shape these factors and what that means for their beneficiaries. This is not an easy thing to discern, but it is also not a responsibility that investment intermediaries responsible for billions of pounds worth of investment with huge influence over economic life should abdicate, particularly given the previously noted point about the difficulty delivering sufficiently timely, targeted and nuanced policies to address such factors through regulation.

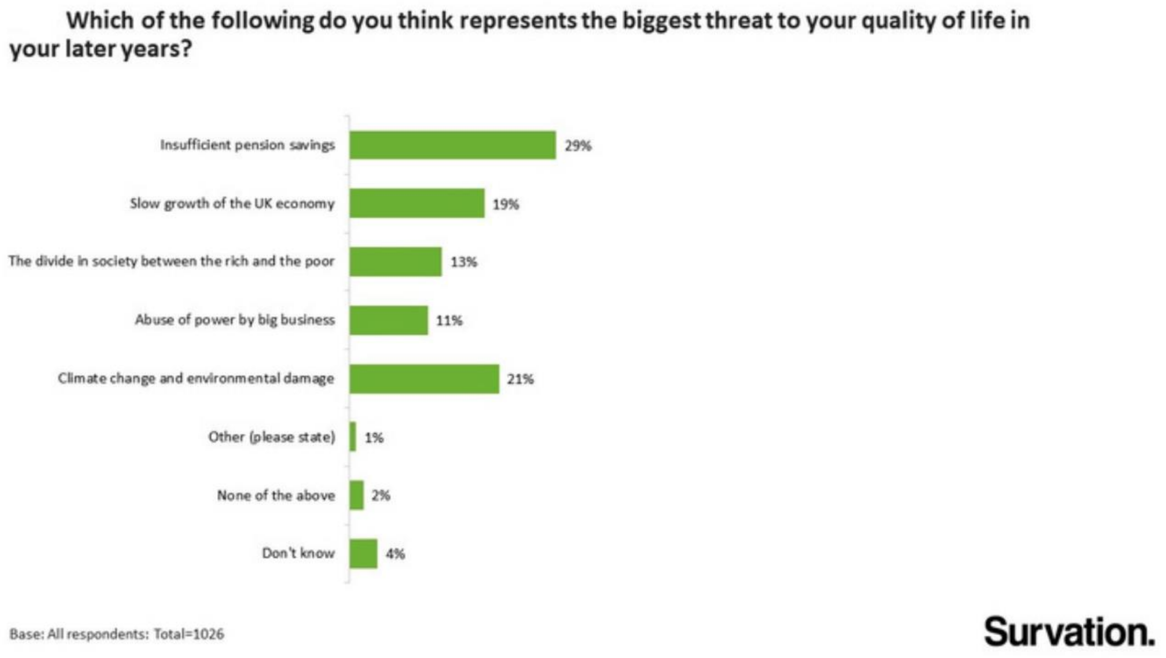
HPC research on pension savers' views of the determinants of their standard of living in later life emphasise this point. Half of respondents said that generating financial returns is an important priority pension funds should consider when investing in companies (50%), but almost as many people said the same of the pay and conditions of a company's workers (42%), the company's environmental impact (37%), and the company's approach to human rights issues (37%).

Figure 1: Pension savers views on factors relevant to pension funds' investment decisions



Similarly, almost a third of people consider insufficient pension savings as the biggest threat to their quality of life in their later years (29%), but considerable numbers of people see factors such as climate change (21%), the slow growth of the UK economy (19%) or the divide in society between the rich and the poor (13%) as bigger threats.

Figure 2: Pension savers views on threats to their long-term standard of living



The code could recognise this indirect or holistic impact of investments on beneficiaries by amending the text of Principle E to say "Describe how you maintain a dialogue with clients and/or beneficiaries and understand how they will be affected by your stewardship practices." The 'How to report' section could explicitly state that as well as 'maintaining a dialogue' with beneficiaries, signatories should seek to understand the holistic or indirect impact of investment and stewardship practices on beneficiaries, and report on how they do so and how this informs stewardship practices

Principle 1: While the concept of 'Environmental, Social and Governance (ESG)' investing has become increasingly politicised (though far more in the US than in the UK), the fundamental principle of aligning investment and stewardship activities with the long-term interests of society and the environment remains vitally important, for reasons already outlined.

Whether or not the precise term 'ESG' remains in the code, it seems a backward step to dilute the reminder to code signatories of their social and environmental responsibilities, implying that these are now less important considerations. It would be naïve to think that the change to the wording of Principle 1 (Principle 7 in the 2020 Code) will be taken any other way.

We therefore believe that Principle 1 should commit signatories to deliver long-term sustainable value for their clients and beneficiaries while also delivering benefits to the economy, environment and society. The guidance should recommend that signatories report on how they understand the economic, environmental and social impact of their investments, and how their stewardship practices support positive outcomes for the economy, environment and society.

Q9. Do you agree with the proposed schedule for implementation of the updated Code?

We are slightly concerned at the (apparent) lack of engagement in or oversight of the changes to the Stewardship Code from anyone with democratic accountability. The Code is a technical document that is never likely to command major public interest, but it has a huge impact in the UK's economic life in terms of shaping the behaviour of economic actors governing trillions of pounds of investments in the biggest and most powerful companies in Britain and the world. Whether or not deliberate, the timing of the publication of the draft Code in the almost immediate aftermath of the election of a new Government, with Ministers newly in post, seems likely to have reduced the potential political interest in its content. This is not necessarily a good thing – the strong views that some of the proposed changes to the code have animated demonstrate that many of the related issues are inherently political, relating to competing values or visions of how we achieve good socio-economic outcomes. Involvement in these decisions from people who are democratically accountable would be appropriate.