LCP's response to the FRC's UK Stewardship Code consultation

30 January 2025

This document provides LCP's response to the Financial Reporting Council's consultation, published on 11 November 2024, which sets out proposals for changes to the UK Stewardship Code.

Thank you for the opportunity to provide our feedback on the proposed revised UK Stewardship Code. We have provided our responses to the specific questions asked below and have provided some other comments and concerns at the end of the response with reference to the current and revised Principles to which they relate.

In summary we are broadly supportive of the revisions to streamline and restructure the Principles, and to provide guidance to signatories; however, we have some concerns which we raise below.

Who we are

LCP is a firm of financial, actuarial, and business consultants, specialising in pensions, investment, insurance, energy, health and business analytics. We have around 1,100 people in the UK, including over 170 partners and over 300 qualified actuaries.

Our core business is the provision of actuarial, investment, covenant, governance, pensions administration, benefits advice and directly related services. About 80% of our work is advising trustees and employers on all aspects of their pension arrangements, including investment strategy and selection of investment managers. The remaining 20% relates to insurance consulting, energy, health and business analytics.

Response to questions

Question 1:

Do you support the revised definition of stewardship?

We have some concerns with the revised definition and supporting statements as they appear to weaken stewardship ambitions. Whilst we can understand that the inclusion of "*leading to sustainable benefit for the economy, the environment and society" in the 2020 Code definition* may have been problematic and created confusion for some signatories, the change in wording weakens the definition of stewardship. Our preference would be for the definition to be clarified in a way that retains the link to the economy, the environment and society.

Our view is that creating long-term sustainable value for clients and beneficiaries requires any stewardship actions undertaken to be consistent with delivering benefits to the economy, the environment and society. If they are not, the value "added" is unlikely to be either long-term or sustainable. We therefore regard supporting the continued functioning of these systems as a vital part of stewardship.

We would like to see this reflected in the definition of stewardship and as a minimum, we would like the supporting statements to be explicit on the point.

Furthermore, many of our clients are universal owners, and therefore derive the greatest benefits from stewardship activities that do lead to wider benefits for the economy, the environment and society. This reflects the knock-on positive impacts on their other portfolio holdings from such activities. This is a further reason for why we would like to see those stewardship activities strongly encouraged by the supporting statements.

As consultants we have considered how the change in definition may impact us and our clients as consumers of asset managers' reports. It is important for us to understand the factors that managers are considering when determining whether their stewardship activities promote "long-term sustainable value". Therefore, we are pleased to see that signatories will be expected to provide insights on how they interpret the definition and the range of factors they deem material to delivering long-term sustainable value for clients and beneficiaries. This additional information may provide useful insights to help clients determine whether their managers' views are aligned with their own.

In practice we don't expect the proposed change in the definition of stewardship will have an impact on how we report on our own stewardship activities.

We acknowledge that some change to the definition may be beneficial for our asset owner clients who are signatories themselves as, in some instances, their lawyers have raised concerns about difficulties in demonstrating the benefits for the economy, environment and society of their stewardship activities. However as noted above, the revised definition could be drafted to retain the linkage to the economy, environment and society without creating an issue for our clients.

Question 2:

Do you support the proposed approach to have disclosure related to policies and contextual information reported less frequently than annually? If yes, do you support the approach set out above?

Yes, on balance we believe that the proposed approach of distinguishing between the "Policy and Context Disclosure" and the "Activities and Outcomes Report" is sensible. We agree that the process of updating the policy and context disclosures every three years (or more frequently if there are substantial changes) is also reasonable. This should avoid some of the repetition in reports and so may slightly reduce the reporting burden. It may also mean that reports are easier to digest and allow users to focus on any significant changes to policies, and to stewardship activities and outcomes in signatories' respective reports. However, in practice the time saving for signatories in adopting this structure is likely to be small as the internal review and sign-off process for annual submission of the Policy and Context Disclosure, including identification of whether any "significant" changes are needed, is likely to be substantial.

Question 3:

Do you agree that the Code should offer 'how to report' prompts, supported by further guidance?

Yes, we believe that the 'how to report' prompts and guidance would be helpful in ensuring higher quality and greater consistency of reporting information. We support guidance over prescriptive reporting expectations and for that guidance to support reporting across asset classes. However, the detail of the guidance will be important in determining its effectiveness and in ensuring the ambition of the 2020 Code is retained.

One specific area where we would welcome further guidance is the reporting expectations for firms which offer both investment and non-investment products and services – such as consulting firms like ours that provide investment services and non-investment services (eg health and energy analytics). In particular, we would like to understand the extent to which reporting expectations apply to investment consulting-specific policies and activities versus firmwide ones.

The example guidance provided in Appendix D mostly looks reasonable to us. We would like the guidance to encourage signatories to provide summary information on engagement activities that gives an overall sense of how much activity has taken place and how effective it has been. In addition, the guidance would benefit from further detail on expectations for engagement beyond listed equities.

The guidance may enable greater comparability between reports; however, there is a risk that it will be followed too dogmatically and hence discourage wider reporting about uncommon and/or innovative approaches which are not covered explicitly by the guidance. Therefore, it is important that the FRC makes clear that it encourages wider reporting that may be above and beyond what is covered in the guidance.

We note that the guidance will not be subject to a formal consultation process and may be updated over time. Given the importance of the guidance, we believe the FRC should consult the industry while developing the guidance, encourage feedback on the final draft guidance, and explain the rationale for any subsequent updates to the finalised guidance.

In addition, we would like the FRC to provide a formal mechanism through which signatories can seek feedback on their draft reports or get help with any particular challenges they encounter when drafting their reports

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 which are only applied by those who invest through external managers?

Yes, we agree with the proposals for applying the Principles, and the thresholds distinguishing those who manage assets directly and those who use external managers.

Question 5:

Do the Principles of the updated Code better reflect the different ways that stewardship is exercised between those who invest directly, and those who invest through third parties?

Yes, the updated Code better reflects the different ways that stewardship is exercised between those who invest directly, and those who invest through third parties. We believe that it would be useful to provide clarification of the FRC's expectations for cases where the asset owner and in-house manager are separate legal entities, in particular whether they should be separate or joint signatories.

Question 6:

Do you agree that the updated Service Providers' Code should have some Principles that are applied only by proxy advisors, and some that are only applied by investment consultants?

Yes, we agree it is helpful to distinguish between proxy advisors and investment consultants. We agree that Principle 2 should only apply to proxy advisors and Principle 3 should only apply to investment consultants. However, we believe that Principle 4 should be applicable to both consultants and proxy advisors. Given the importance of systemic stewardship and the significant influence that proxy advisors have, we believe that proxy advisors should be expected to consider market wide and systemic risks in the recommendations and research they provide to clients and to carry out their own systemic stewardship activities.

Question 7:

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

Yes, we are comfortable that the streamlined Principles capture many relevant activities for effective stewardship for asset owners and asset managers. However, the supporting guidance will be critical to ensure that signatories give appropriate consideration to the full range of activities which are no longer captured in separate principles. We provide more detail on this in our "other comments" below.

With regards to service providers, in our view, the 'how to report' section of Principle 3 is too narrowly focussed. We would like to see this section expanded to cover the wider range of stewardship services that investment consultants provide to clients including support on development of voting and engagement policies, stewardship reporting, engaging with asset managers and selection of stewardship providers.

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?

We are broadly comfortable with signatories being able to reference publicly available external information subject to it being clearly signposted (in particular, highlighting the specific pages/sections in that referenced material which are relevant so the reader is clear what they should read) and only if it is limited and structured in a way that ensures that the stewardship report remains readable as a standalone document as much as possible. Otherwise, there is a danger that stewardship reports are written for the convenience of the author rather than the needs of the reader. On balance though, done well, we believe that cross-referencing other reports could make the stewardship code reports shorter and easier for the reader to consume unless there are too many hyperlinks to external information. Whilst there is a downside of the reports no longer being standalone documents, we can see the benefits of avoiding duplication and so reducing the reporting burden, thereby freeing up time for stewardship itself and potentially encouraging more entities to become signatories.

We note that the FRC is proposing to provide a clear policy on cross-referencing which should help ensure the potential pitfalls associated with it are addressed.

We would like any cross-referencing to be limited to disclosures that have received senior management or board-level sign-off to maintain the quality of reporting.

We note there is a risk that, if signatories subsequently update their other reporting, their stewardship code report may no longer refer to the intended material.

Question 9:

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

Yes, the proposed schedule for implementation appears reasonable, allowing sufficient time for consultation and for guidance to be drafted and provided to signatories. We would like more clarity around when applications under the updated code will be able to be submitted, as the timeline is not clear on that point. Our understanding is that the current submission timetable will continue.

Other comments

There are several points in the 2020 Code which we consider important but which are no longer included in the revised Code. Our expectation is that these will be covered in the guidance; however, we have listed the main ones below and request that the FRC ensures they are not omitted (references to the asset owner/asset manager ("AO/AM") and service provider ("SP") principles in the 2020 code are provided in square brackets []; where square brackets [] are not used, a Principle or disclosure refers to the revised Code):

- "Reports must be reviewed and approved by the applicant's governing body, and signed by the chair, chief executive or chief investment officer" [How to report] is not mentioned in the revised Code. It is important that this is maintained to ensure the appropriate level of oversight and senior commitment to stewardship.

- The reporting expectation "Explain how performance management or reward programmes have incentivised the workforce to integrate stewardship and investment decision making" [AO/AM Principle 2] is not covered explicitly in AO/AM Policy and Context Disclosure B.

- The purpose of responding to market-wide and systemic risks "to promote a well-functioning financial system" [AO/AM Principle 4] has been replaced in Principle 2 with "in the interest of clients and beneficiaries". We believe it is important to spell out that promoting well-functioning markets is likely to be in client and beneficiaries' interests to avoid the interpretation of the new phrase being too narrow.

- AO/AM Principle 3 omits the guidance that "[Engagement] Examples should be balanced and include instances where the desired outcome has not been achieved or is yet to be achieved" [AO/AM Principle 10]. We believe it is helpful to see where engagement has been unsuccessful and including such examples will help avoid cherry picking.

- AO/AM "how to report" Principle 3 omits "where necessary" [AO/AM Principle 11] when describing escalation. This appears to make escalation seem more optional than before; however, our expectation is that some form of escalation is likely to be required over a 12-month period by almost all signatories. It may be worth highlighting that escalation does not necessarily need to be confrontational (eg possible actions include additional meetings with management), particularly in the initial stages.

- AO/AM "how to report" Principle 4 omits a number of important details which were included in [AO/AM Principle 12] including: stock lending, ability of clients to override house voting policy, ability of clients to direct voting in segregated and pooled accounts, monitoring what shares and voting rights they have, the extent to which voting decisions were executed by another entity and how signatories have monitored any voting on their behalf, and the outcomes of voting decisions. It is important that the guidance is clear on these points. We would also like to the guidance to encourage signatories to report on the next steps following their exercise of rights and responsibilities. We also note that the "how to report" wording about exercising rights and responsibilities in other asset classes makes this sound more optional than before, whereas we would regard this as fundamental to good stewardship practice.

- AO/AM "how to report" Principle 6 omits "action they have taken where signatories' expectations of their service providers have not been met" [AO/AM Principle 8]. We are unclear on why this has been removed as it is important to understand how signatories have escalated any material shortfalls in service standards.

We also note that aspects relating to collaboration appear to be weaker and less prominent in the revised code. In particular, [AO/AM Principle 10] states that "Signatories should disclose what collaborative engagement they have participated in and why" and "describe the outcomes" whereas AO/AM Principle 3 of the revised code positions collaboration as an optional approach to engagement. We believe that collaboration is necessary to tackle system level risks such as climate change, and therefore we would like to see the FRC encourage collaborative action.

Similarly, the collaborative expectation for SPs also appears to have been weakened with the removal of "how they have worked with other stakeholders to promote continued improvement of the functioning of financial markets" [SP Principle 4]. The new wording in SP Principle 4 "where you have chosen to participate in initiatives" appears to remove the expectation to participate.

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